

January 20, 2021



Nigeria Strategy Report

H1 2021

Domestic Economy and Policy Environment

Nigerian Fiscal: Bullish estimates amidst uncertainties

Executive Summary

The initially approved 2020 budget of ₦10.59trillion in December 2019 was adjusted upwards to ₦10.81trillion in June 2020 to make provision for the intervention needed to cushion the effect of the covid-19 pandemic on the economy. However, following the crash in crude oil prices to historic low levels during the year, the expected revenue available to the Federal Government for the execution of the budget was reduced to ₦5.37trillion (vs ₦7.87trillion in the initial budget), thus, widening the fiscal deficit (including GOEs) from ₦2.18trillion to ₦4.98trillion. Despite the downward review of revenue expectations, Federal retained revenues underperformed the FY20 budgeted estimates by 27%, printing at ₦3.94trillion. The shortfall in revenue generation was driven by lower non-oil receipt and subdued realized revenue inflow from other independent sources. On the expenditure leg, the FG disbursed 109% of its budgeted spend over the period. The bulk of this was driven by higher than budgeted spend on debt service (+11% to ₦3.27trillion) and c.100% implementation of its non-debt recurrent expenditure. However, capex spend was 11% lower than the FY20 estimate of ₦1.96trillion.

Going into 2021, we are quite comfortable on the realization of FG's oil revenue estimate. The expected recovery in global growth and its attendant impact on crude oil demand and prices should support the actualization of the assumptions made in the computation of crude oil revenue numbers. Thus, we project crude oil production and prices to average 1.90mbpd and \$52.47/barrel respectively in 2021. Similarly, we project an 89% performance in non-oil revenue budgeted estimates in 2021 which is better than the 5-year average performance rate of 75%. Elsewhere on expenditure, we assume a 100% implementation rate of the budgeted recurrent spending in 2021 for our base case scenario. Similarly, we forecast a maximum implementation rate on the Debt Service and Transfer budgeted spend for 2021. However, we project capex implementation rate in 2021 to print at 60%. This implies an estimated capex spend of ₦1.85trillion, 6% higher than FY20 (₦1.74trillion). That said, we expect FY21E fiscal deficit to print at ₦5.74trillion (vs budgeted ₦4.89 trillion, excluding GOE) which translates to a funding gap of ₦847billion.

In this report, we focus on developments in the fiscal space over H2 20 and delineate our view on the FG's 2021 Budget.

2021 Budget: Bullish estimates amidst uncertainties¹

Following its passage by the National Assembly on the 21st of December 2020, the 2021 Nigeria budget was finally signed into law by President Muhammadu Buhari on the 31st December 2020. The initial estimates of the 2021 budget, which has been tagged the budget of recovery and resilience, was adjusted upwards by ₦506billion to ₦13.58trillion (vs ₦13.08trillion presented to the National Assembly) translating to a 26% increase compared to 2020 budget estimates of ₦10.81 trillion. This is largely driven by increased provision for capex (+63% to ₦4.37trillion), higher non-debt recurrent expenditure (+14% to ₦5.64trillion) and a rise in debt service (+13% to ₦3.32 trillion).

Excluding GOEs, non-debt recurrent expenditure was relatively unchanged in 2021 (-0.12% YoY to ₦4.28trillion) as increases in personnel cost was neutered by reduction in other service wide votes and provision for pension and retirees' benefits. Also, the absence of the ₦214billion covid-19 intervention funds provisioned for in 2020 largely supported the slight moderation in non-debt recurrent expenditure (excluding GOE) estimate for the year. On the increase in the provision for debt service for the year, we are of the view that this points to legacy problems of consistent underperformance in the nation's actual revenue numbers which has increased the country's indebtedness overtime. For context, Federal Government total debt increased by over \$3billion from the start of year 2020 up until H1 2020. Also, we suspect the increased budgeted estimates for capex may be overly optimistic bearing in mind that revenue generation may remain weak. Historically low implementation rates (average of 48% over the last 5 years) further gives reasons to suggest we may not see any material turnaround in 2021. On a sectorial basis, Federal Ministry of Works and Housing (₦404.64 billion), Federal ministry of Finance, Budget and National Planning (₦382.63 billion) and Federal Ministry of Transportation (₦256.09 billion) had the highest capital allocation in the 2021 budget.

¹ All amounts are projections unless specified

Table 1: Top 10 capital allocations in the 2021 budget

SECTORS	2020 Revised Budget Estimate (₦'bn)	2021 Budget Estimate (₦'bn)
Federal Ministry of Aviation	44.27	89.97
Federal Ministry of Agriculture & Rural Development	102.49	110.24
Ministry of Defence	115.87	121.24
Federal Ministry of Water Resources	80.7	152.77
Federal Ministry of Education	75.17	197.41
Federal Ministry of Power	128.01	198.28
Federal Ministry of Health	51.4	211.96
Federal Ministry of Transportation	109.35	256.09
Federal Ministry of Finance, Budget and National Planning	3.61	382.63
Federal Ministry of Works and Housing	265.87	404.64

Source: Budget Office, ARM Research

On the revenue side, the National Assembly approved a projected sum of ₦7.99trillion for 2021, 37% higher than 2020 estimate and ₦100billion above the ₦7.86trillion proposed by the executive. The additional ₦100billion was derived from higher projected revenue numbers from independent sources to ₦1.06trillion (initially ₦961billion). Net of GOE, Federal Government revenue in 2021 is estimated to rise by 29% YoY to ₦6.63trillion. This is expected to be driven by higher oil revenues (+98% to ₦2.01trillion), upbeat revenue expectations from independent sources (14% to ₦1.06 trillion) as well as anticipated increase in revenue generation from Signature bonuses (+93% to ₦677.02billion), Stamp duty (+150% to ₦500.00billion) and Grant and donor funding (+731% to ₦354.85billion). Recovery in global growth is expected to support higher crude oil demand and prices in 2021 relative to their 2020 levels. This largely accounts for the expected jump in budgeted oil revenue numbers in 2021. However, the lagged impact of the virus on economic performance may have informed the lower expected revenue generation from the non-oil sector (-8% to ₦1.49trillion). We also think government may have taken a cue from actual revenue performance in the FY20, where we saw non-oil revenue underperformed its budgeted estimates by 21% despite its 10% downward revision in the 2020 revised budget. For instance, revenues from CIT and VAT are projected to decline by 17% and 16% to ₦681.72billion and ₦238.43billion respectively in 2021 compared to 2020, which more than outweighs the expected 13% increase in customs revenue to ₦508.27billion over the same

period. To give more clarity on the non-oil leg, we observed that implementation rate printed at 79% of the FY20 budgeted estimates. This is lower than the 81% and 88% recorded in 2018 and 2019 respectively, especially bearing in mind that the budgeted non-oil revenue estimates for FY20 were revised downwards over the course of the year. Following through from the above, the projected revenue and expenditure estimates for 2021 implies a fiscal deficit of ₦5.60trillion which translates to a deficit to GDP ratio of 3.93% (higher than the 2020 deficit to GDP ratio of 3.57%).

Table 1: Key highlights of the 2021 approved budget

	Approved 2021 budget	2020 budget	2020 actual
Oil Production (mbpd)	1.86	1.80	1.79
Oil Price (\$/bbl)	40.00	28.00	43.02
Exchange Rate (₦/\$)	379.00	360.00	379.00
FGN Share of oil revenue (₦billion)	2,011.02	1,013.77	1,521.44
Total Non-oil revenue (₦billion)	4,626.56	4,351.66	2,415.90
FGN Total revenue (₦billion)	6,637.58	5,365.43	3,937.34
FGN Expenditure (₦billion)	11,529.49	9,973.65	10,083.17
Fiscal Deficit (₦billion)	4,891.93	4,608.24	6,145.83

Source: Budget Office, ARM Research

FY 2020 budget implementation: Full revenue implementation still a pipe dream

The initially approved 2020 budget of ₦10.59trillion in December 2019 was adjusted upwards to ₦10.81trillion in June 2020 in order to make provision for the intervention needed to cushion the effect of the covid-19 pandemic on the economy. However, following the crash in crude oil prices to historic low levels during the course of the year, the expected revenue available to the Federal Government for the execution of the budget was reduced to ₦5.37trillion (vs ₦7.87trillion in the initial budget), thus, widening the fiscal deficit (including GOEs) from ₦2.18trillion to ₦4.98trillion.

Despite the downward review of revenue expectations, Federal retained revenues underperformed the FY20 budgeted estimates by 27%, printing at ₦3.94trillion. The shortfall in revenue generation was driven by lower non-oil receipt and subdued realized revenue inflow from other independent sources. For more clarity, all sub-components of the non-oil receipt fell short of the FY20 projected estimates over the course of the year. The decline in CIT (-18% to ₦673.22billion) reflects the weakness in corporate performance. Furthermore, we saw lower revenue from VAT (-32% to ₦192.66billion) mirroring weak consumption and pressure on consumer wallet. Also, reduced

customs revenues (-12% to ₦396.37billion) is a consequence of the shrinkage in global trade as countries continue to tighten on border control.

However, oil revenues outperformed its revised FY20 budgeted estimates by 50%. This was largely supported by higher average crude oil prices (\$43.02/barrel vs \$28/barrel in the budget) which more than offset the slightly reduced crude oil production than provisioned for in the budget (1.79mbpd vs 1.80mbpd in the 2020 budget). We also note the impact of the exchange rate devaluation as supportive of the higher than budgeted oil revenue numbers over the period.

On the expenditure leg, the FG disbursed 109% of its budgeted spend over the period. The bulk of this was driven by higher than budgeted spend on debt service (+11% to ₦3.27trillion) and c.100% implementation of its non-debt recurrent expenditure. However, capex spend was 11% lower than the FY20 estimate of ₦1.96trillion. Nonetheless, FY20 capex spend came in the highest since 2015 with an implementation rate of 89%, higher than the 5-year average of 48%. Going forward, we expect FY20 capex implementation rate to print at 60% which translates into a total capex spend of ₦1.85trillion by year end.

	2020 Revised Budget	Actuals (Jan-Dec 20)	Actuals (Jan-Dec 19)
Retained Revenue	5,365.42	3,937.34	4,120.09
Oil Revenue	1,013.77	1,521.44	1,373.18
Non-Oil Revenue	1,624.93	1,276.09	1,582.58
FGN Independent Revenue	932.84	519.36	557.34
Others	1,793.88	620.45	606.99
Expenditure	9,973.67	10,083.17	8,916.96
Recurrent	7,585.57	7,910.68	6,822.01
Capital	1,960.07	1,744.46	2,094.95
Surplus (+)/Deficit (-)	- 4,608.25	-6,145.83	-4,796.87
Borrowings	4,849.50	3,281.54	912.82

Source: Budget Office, ARM Research

2021 budget performance rate to be dampened by Other Revenue sources

Going into 2021, we are quite comfortable on the realization of FG's oil revenue estimate. The expected recovery in global growth and its attendant impact on crude oil demand and prices should support the actualization of the assumptions made in the computation of crude oil revenue numbers. Thus, we project crude oil production and prices to average 1.90mbpd

and \$52.47/barrel respectively in 2021. This compares favorably with the 1.86mbpd and \$40/barrel used in the calculation of oil revenue in the budget.

Similarly, we project an 89% performance in non-oil revenue budgeted estimates in 2021 which is better than the 5-year average performance rate of 75%. We note that in FY20, the Federal Government recorded a 79% performance rate on its 2020 non-oil revenue forecast. Our view of a higher performance rate in 2021 relative to 2020 is reflective of the lower projected non-oil revenue numbers in the 2021 budget by the government (₦1.48trillion in 2021 vs ₦1.62trillion in 2020) and expected recovery in economic performance which should support higher actual non-oil revenue numbers in 2021. On a sub-component basis, we think revenue from CIT would increase by 5% YoY to ₦704.32billion in 2021 (FY20: ₦673.22billion), 3% higher than the budgeted estimate of ₦681.72billion. Our view is premised on the expected recovery in economic performance which should bode well for corporate performance and support higher taxes.

Bearing in mind that activities were almost muted owing to the covid-19 impact on the economy in 2020, we are of the view that this line item of the budget should perform better in 2021. Furthermore, we project an 85% and 81% performance rate on the forecasted VAT (₦238.43billion) and Custom's (₦508.26billion) revenue estimate in the 2021 budget. Compared to 2020, we expect revenue from VAT to increase by 5% to ₦202billion, which should be supported by a rebound in domestic spending. Similarly, we believe the rebound in global growth in 2020 should improve trading activities, which should support an improvement in Custom's revenue.

However, we remain bearish on FG's estimates on revenue from other sources, which contributes 47% of the overall revenue expectations. We are particularly concerned with the revenue projections on signature bonuses and independent revenues. To begin with, the expected sum of ₦677.02billion from signature bonuses appears far-fetched bearing in mind how this revenue line item has performed historically. In the 2020 revised budget, a sum of ₦350.52billion was projected with only ₦78.72billion being realized. Except for 2019 when ₦348.67billion was realized (vs ₦84.20 billion budgeted), no revenue was generated from this line item from 2016 through to 2018. We do not have any pointer to assume a turnaround in revenue performance in 2021 not to mention the 93% increment in revenue expectations by the government on this line item. Furthermore, Federal Government expectations of ₦1.06trillion from independent revenue sources looks very ambitious. Similar to our argument for signature bonuses, over the past years, this revenue line has underperformed its budgeted estimates largely due to leakages in government parastatals. Over the past 5-years, performance rate on this revenue line item has averaged 49%. Also, in 2020, ₦932.84billion was expected from this revenue source, out of which ₦519.36billion was realized.

Elsewhere on expenditure, we assume a 100% implementation rate of the budgeted recurrent spending in 2021 for our base case scenario. Just as we have seen in past years, government implementation of non-debt recurrent spending has always been high, averaging around 96.1% from 2016 through to 2020.

In 2020, implementation rate on this line item printed at 100%, higher than historical average. This reflects the need to boost consumption through government spending and thus, may continue into 2021. Similarly, we forecast a maximum implementation rate on the Debt Service and Transfer budgeted spend for 2021. We note that actual debt service spent in 2020 was 10.6% higher than the budgeted estimate. However, we project capex implementation rate in 2021 to print at 60% (exclusive of GOEs, project tied loans and statutory transfer). This implies an estimated capex spend of ₦1.85trillion, 6% higher than FY20 (₦1.74trillion). Although higher than 2020 levels in absolute terms, we expect implementation rate to be lower than FY20 capex implementation rate of 89% largely due to the 57% increase in budgeted capex spend to ₦3.08 trillion (excluding GOE, project tied loans and statutory transfer). This said, we expect FY21E fiscal deficit to print at ₦5.74trillion (vs budgeted ₦4.89 trillion, excluding GOE) which translates to a funding gap of ₦847billion.

To plug the revenue gap for 2021, the Federal government has planned to source ₦2.34trillion each from local and foreign sources, ₦709.7billion from Multilateral/Bilateral loan and ₦205.1billion from proceeds from privatization. Critically examining these plans, we think the Federal Government may likely revisit the Eurobond market this year. In our view, the fiscal deficit has continued to widen which simultaneously coincides with the need to support the FX space. While the recovery in crude oil prices is positive for the FX reserves and the Naira, subdued crude oil production numbers, which could likely rebound slowly in 2021, continues to moderate its benefits. This combined with our yet uninspiring inflow from foreign portfolio investors suggest the need to explore alternative sources. However, investors' uncertainty on the FX front, backlogs of FX demand yet to be cleared and obligations to settle maturing Eurobond of \$500m in January 2021 may lead to demand for premium on FGN Eurobond issuances in 2021. To this end, we see the likelihood for the government to delay the issuances of Eurobond to H221 to allow for a stronger recovery in crude oil prices which may improve its ratings and reduce cost of borrowing in the foreign market. On the local scene, we suspect the government may be less aggressive in the domestic market in 2021. Thus, the possibility for government to raise less than it budgeted in the local market persist. Our view is hinged on the various sources available to the government to fund its deficit. For instance, the Finance Act 2020 signed into law provides that the government can borrow

from the unclaimed dividends and dormant account balances. Also, as we have observed in past years, the government has continued to explore back door lending from the CBN. Over the past 5 years, fiscal deficits funded through CBN's support has averaged 57.20%, which gives a pointer that it has overtime been preferred by the government.

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