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Nigeria Strategy Report

H2 2020

Domestic Economy and Policy Environment

Nigerian Fiscal: New budget, same old problems

Executive Summary

The early passing of the 2020 budget last December created hope that this year would see the FG make a real concerted effort to meet its revenue and capital expenditure targets. But before the first quarter of the year was done, all hopes dissipated as the outbreak of covid-19 left a big hole in the budget. The tussle in the oil market and lockdown measures necessitated a revision to the projected FG revenue. Despite reduced revenue (-37%), expenditure remained relatively stable, driving a 150% increase in the 2020 fiscal deficit to ₦5.45 trillion. To fund this deficit, the FG announced a raft of borrowing measures including ₦2.19 trillion of domestic borrowings and ₦1.98 trillion of foreign borrowings.

Implementation data for the first 5 months of the year showed that, once again, the FG is only meeting a fraction (56%) of its total revenue projections. And this was despite oil revenue coming in 44% higher than the expected pro-rata amount for the period. The largest discrepancy came from other revenue which reported an actual figure that was just 36% of the projected amount. Expenditure, meanwhile, was 84% of the expected amount led by a strong showing from debt service and non-debt recurrent expenditure. Only a small fraction of capital expenditure (~27%) had been released by the end of May which FG blamed on the budget revision exercise. This meant that the deficit over the period was 23% higher than projected at ₦2.3 trillion

Over the full year, we expect the fiscal deficit to print 3.4% higher than the FG's estimate at ₦5.63 trillion. Our forecast is hinged on revenue coming in 42% lower than the FG's projections at ₦3.08 trillion (implementation rate: 58%) and this is despite oil revenue printing 8% higher at ₦1.09 trillion. Expenses, meanwhile, we see printing 20% lower at ₦8.71 trillion (implementation rate: 80%) driven largely by a more conservative implementation rate of 35% for capital expenditure.

In this report, we focus on developments in the fiscal space over H1 20 and delineate our view on the FG's 2020 Budget.

2020 Budget Revision: A new budget for a new reality¹

The early passage of the 2020 budget led to some optimism with regards to FG's fiscal cycle and its deficit financing but by the end of Q1 20, global events had made the budget moot. As countries enforced one form of lockdown or the other with the global economy grounded to a near halt, the demand for oil plummeted and with it the price of oil. From \$66.25 p/b at the start of the year, oil prices dropped as much as 70% to \$19.33 in April, thus necessitating a rethink of the budget projections. To start with, the projected oil production volume was decreased from 2.18mbpd to 1.80mbpd reflecting the need to comply with the OPEC cuts put in place to stabilize oil prices. Additionally, the benchmark oil price was slashed from \$57 p/b to \$28 p/b while the average exchange rate was moved to ₦360/\$ from ₦305/\$. The outcome of this was a 62% crash in the projected net oil revenue from ₦2.64 trillion to ₦1.01 trillion. On the non-oil side; understandably, customs revenue experienced the largest projection cut by 27% to ₦450.7 billion due to the impact of reduced economic activities on the back of covid-19 pandemic. Meanwhile, CIT was lowered by 2.1% to ₦821.67 billion while VAT was down by 2.9% to ₦284.1 billion. Overall, non-oil revenue is now projected to print at ₦1.62 trillion, 10% lower than the original estimate of ₦1.81 trillion. Finally, other revenue was cut by 20% to ₦2.73 trillion despite a 10% increase in independent revenue to ₦932.8 billion. Instead, what drove the lower estimate was a 56% cut in stamp duty to ₦200 billion, a 62% reduction in signature bonus to ₦350.5 billion and a 100% cut in exchange rate differentials. Cumulatively, total revenue² is now forecasted to print at ₦5.37 trillion which represents a 36% decrease from the ₦8.42 trillion projection in the initial budget.

Elsewhere, total expenditure³ was increased by 2% to ₦10.81 trillion reflecting ₦185.9 billion Federation intervention, ₦4bn hazard allowance for health workers, ₦3bn for social housing and other adjustments amounting to ₦70bn. Accordingly, we saw capital expenditure and recurrent expenditure increase 0.9% and 0.2% respectively. Coalescing the higher expenditure with the lower revenue translates to a 150% increase in fiscal deficit to ₦5.45 trillion.

¹ All amounts are projections unless specified

² Including GOEs

³ Excluding GOEs & project-tied loans

Table 1: Key highlights of the revised 2020 budget (Including GOEs)

(₦ billion)	Initial 2020 budget	Revised 2020 Budget	ARM estimate
Oil-Revenue	2,637.61	1,013.77	1,094.99
Non-oil Revenue	1,805.12	1,624.93	927.24
FG Independent Revenue	849.97	932.84	205.22
Other Revenue	2,573.29	1,793.88	1,057.02
FG Retained Revenue	8,419.16	5,365.42	3,079.26
Recurrent non-debt	4,842.97	4,942.27	4,596.06
Debt Service	2,725.50	2,951.71	2,833.92
Capital Expenditure	2,465.42	2,488.79	871.15
Total Expenditure	10,594.36	10,810.80	8,707.73
Deficit (-)	2,175.20	5,445.38	5,628.47

Source: Budget Office, ARM Research

5M 2020 budget implementation: Full revenue implementation still a pipe dream

Despite taking the opportunity to revise the budget to be more reflective of our current reality, there still lies a sizable discrepancy between the FG’s budgeted figures and actual figures, most notably when it comes to revenue. In the first 5 months of the year, the FG’s total realized revenue of ₦1.48 trillion was 44% lower than the budgeted pro rata amount of ₦2.62 trillion stemming from lower than expected non-oil revenue and other-revenue. Precisely, non-oil revenue totaled ₦439.3 billion over the 5-month period, 35% lower than the ₦677.1 billion expected. This differential came from lower collections of CIT (-38%), VAT (-42%) and customs revenue (-21%) leading to a combined discrepancy of ₦217 billion. Meanwhile, Oil revenue printed at ₦701.6 billion, 44% higher than the projected pro rata amount of ₦422.4 billion hinged on higher realized oil price and production. Specifically, average oil price over the period printed at \$38.64 p/b (projection: \$28 p/b) while crude production printed at 1.88mbpd (projection: 1.80mbpd). The final revenue line, other revenue, came in at ₦339.5 billion which was 69% lower than the pro rata budget figure of ₦1.1 trillion.

Driving this differential are independent revenue which printed at ₦80.2 billion (Projection: ₦388.7 billion), signature bonuses at ₦70 billion (Projection: ₦146.1 billion) while nothing was received on domestic recoveries and stamp duty over the review period.

Meanwhile, actual expenditure for the 5 months ending in May was ₦3.52 trillion, which translated to 85% implementation rate. This stemmed largely from lower CAPEX implementation rate at ~27% (₦253.3 billion). However, debt service was fully implemented, printing at ₦1.25 trillion (12% higher than budget). Despite lower expenditure over the period, the shortfall in revenue resulted into an actual deficit of ₦2.04 trillion vs projected amount of ₦1.88 trillion, a 23% increase.

Table 2: Implementation of the revised 2020 budget approved between Jan – May

(₦ billion)	Pro rata (Jan – May)	Actual (Jan – May)	Variance
Oil-Revenue	422.40	701.60	279.20
Non-oil Revenue	677.06	439.32	-237.73
Independent Revenue	388.68	80.22	-308.47
Other Revenue	713.17	259.29	-453.88
Total Revenue	2,622.00	1,481.28	-1,140.72
Total Expenditure	4,504.50	3,800.00	-640.00
Deficit (-)	1,882.50	2,318.72	436.22

Source: Budget Office, ARM Research

FG looks inwards to fund higher deficit

The borrowing plan under the initial budget entailed ₦744.9 billion in domestic borrowing and ₦850 billion in foreign borrowings that was to come via a new Eurobond issuance. However, following the crash in oil prices, which dampened the economic outlook of the country and precipitated a downgrade by Fitch⁵, Eurobonds were no longer a viable or attractive option. In its proposal for the new budget, the FG detailed how it would be funding the higher deficit and it included converting the planned ₦850 billion foreign borrowing into domestic borrowings. In addition, the FG increased the total domestic borrowings by another ₦594 billion to meet up with the increased deficit bringing total domestic borrowing to ₦2.19 trillion. On the foreign leg, the FG is looking to borrow a total of \$5.5 billion which translates to ₦1.98 trillion based on an assumed exchange rate of ₦360/\$.

⁵ Nigeria's long-term foreign-currency Issuer Default Rating was lowered to 'B' with a negative outlook

The sources of these foreign borrowings are concessionary loans from multilaterals: \$3.4 billion from the IMF, \$1.5 billion from the World Bank, \$500 million from AfDB and \$113 million from IDB⁶, of which only the IMF loan has been received. This takes total borrowings to ₦4.17 trillion, a 162% increase from the initial borrowing schedule. Additional financing for the deficit comes in the form of privatization proceeds of ₦126.04 billion (a 50% decline from the initial budget), from the sale of power assets such as the Yola DisCo. Supplementing these are new borrowings from special accounts in the amount of ₦263.6 billion and multi-lateral project-tied loans of ₦387.3 billion (an 18% increase compared to the initial budget). These all sum to ₦4.95 trillion which covers the deficit in the appropriation revision⁷ but is less than the deficit in the budget signed into law by president Buhari. Hence, we expect the FG to account for the missing ₦494 billion when the full details of the passed budget are released. We expect this to come in the form of higher domestic borrowings.

Table 3: Financing plans (Including GOEs)

(₦ billion)	Initial 2020 budget	Revised 2020 Budget
FG Retained Revenue	8,419.16	5,365.42
Total Expenditure	10,594.36	10,810.80
Deficit	2,175.20	5,445.38
Additional Financing (based on appropriation revision)		
Privatization proceeds	252.08	126.04
Multi-lateral Project-tied Loans	328.13	387.30
Borrowing from Special Accounts	-	263.63
New Borrowings	1,594.99	4,173.56
Domestic Borrowing	744.99	2,188.88
Foreign Borrowing	850.00	1,984.68
Sub-Total	2,175.20	4,950.53
Unfunded Deficit	-	494.85

⁶ Islamic Development Bank

⁷ Budget revision proposed by the house

Our view: Deficit to tick higher despite more optimistic oil revenue estimate

Reflecting the change in macro reality, we have also made amendments to our projections for the year. To start with, we are slightly more optimistic with regards to the average oil price for the year – we have \$40.50 p/b (budget: \$28 p/b) as the base case. This coupled with a slightly higher oil production estimate of 1.82mbpd (budget: 1.80 mbpd) means that we see total oil revenue printing at ₦1.09 trillion for the year, 8% higher than the FG’s estimate. On the non-oil revenue side, still comparing with the FG’s revised estimate, we project lower VAT (-45%), CIT (-37%) and customs (-59%) of ₦156 billion, ₦515 billion and ₦256 billion respectively. For us, while VAT has been extended to online transactions, we believe the closure of hotel and restaurants since March - a major chunk of VAT receipts – will leave actual receipts lower. With the WTO¹⁰ expecting world trade to fall between 13% and 32% in 2020 as a direct result of the pandemic, we believe customs revenue will print lower. In total, our non-oil revenue is lower by 43% at ₦930.6 billion. Using the 5-year average implementation rate of 47% and adjusting for the current situation we arrived at an independent revenue of ₦251.9 billion (22% implementation rate). Combining the independent revenue estimate with planned transfers and grants, as well as our estimates of stamp duty and domestic recoveries, total ‘other revenue’ comes in at ₦1.06 trillion – 61% less than the FG’s forecast. Putting this all together gives a total revenue figure of ₦3.08 trillion which is 43% less than the FG’s estimate.

Given our expectation of reduced FG receipts, we foresee lower CAPEX of ₦871.15 billion, which translates to an implementation rate of 35% (5-year average of 60%). On the other expenditure lines, we have ₦4.6 trillion for non-debt recurrent expenditure (93% implementation), ₦2.83 trillion for debt service (96% implementation) and ₦407 billion for statutory transfers (95% implementation). This works out to a total expenditure of ₦8.71 trillion (budget: ₦10.81 trillion). On balance, our base case fiscal deficit comes in 3.4% higher than the revised FG’s at ₦5.63 trillion. Our bear case deficit is at ₦5.86 trillion while the bull case is ₦5.32 trillion.

On the financing leg, we expect the FG to meet both its foreign and domestic borrowing targets for the year. As of writing, loans from the IMF and AfDB have been approved and we expect the IDB¹¹ and World Bank to follow suit in approving the requested loans. On the domestic leg, as of end of June, the FG had issued ₦1.66 trillion of new/net borrowings with majority (88.6%) coming in from bond issuances and sukuk. This represents 75% of the planned domestic borrowing and 50% of the year left, we foresee a smooth sail in ramping up its target borrowings over the rest of the year.

¹⁰ World Trade Organisation

¹¹ Islamic Development Bank

But as we mentioned earlier, based on the borrowing figures in the appropriation revision, there is still an unfunded ₦494.85 billion which we expect the FG to plug via domestic borrowings. Lastly, we think the FG might be overly optimistic in its estimation of proceeds from privatization. Based on historical averages and current global economic climate, we estimate that only 20% of that target will be met. This leaves an unfunded ₦100 billion deficit which we feel the FG will plug by increasing its domestic borrowing even further or by tapping the CBN for backdoor financing – something they have done regularly over the last couple years. Combining this with our expectation for a higher deficit, we strongly expect the FG to turn to one or both of these additional measures to fully fund the deficit.

Table 4: ARM budget scenario analysis

(₦ billion)	ARM bear case	ARM base case	ARM bull case
Oil-Revenue	792.21	1,094.99	1,312.74
Non-oil Revenue	844.07	927.24	1,150.10
FG Independent Revenue	139.92	205.22	373.12
Other Revenue	736.93	1,057.02	1,335.72
FG Total Revenue	2,373.20	3,079.26	3,798.56
Recurrent non-debt	4,447.80	4,596.06	4,694.90
Debt Service	2,656.80	2,833.92	2,952.00
Capital Expenditure	746.70	871.15	1,057.83
Total Expenditure	8,236.50	8,707.73	9,119.89
Deficit (-)	5,863.30	5,628.47	5,321.32

Source: Budget Office, ARM Research

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