

Nigeria

Economic Alert

X-raying the 2020 FGN budget proposal



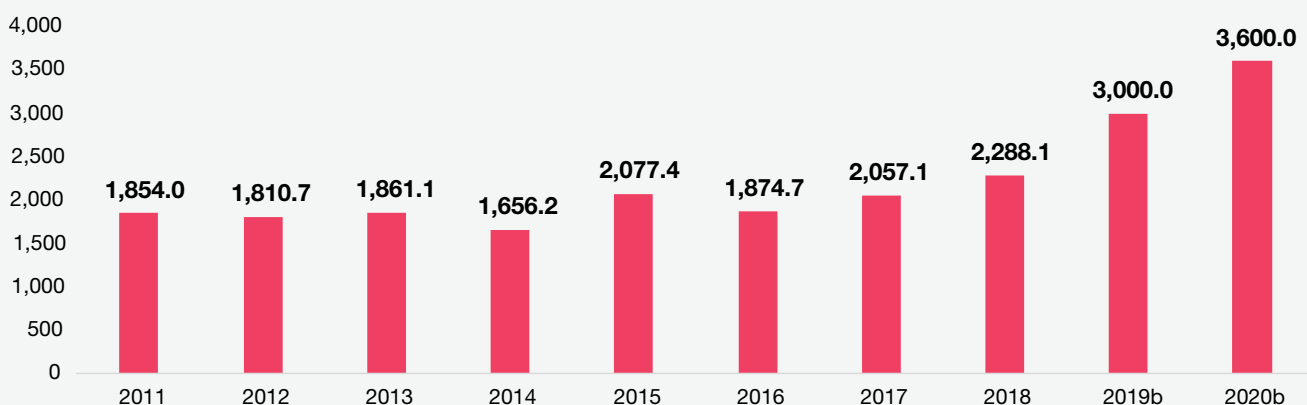
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The proposed FGN budget of N10.3 trillion for the 2020 fiscal year was presented to the National Assembly on Tuesday, October 8, 2019. The budget represents an increase of 11% from the approved N9.1 trillion FGN budget for 2019. Of the total proposed 2020 budget, non-debt recurrent expenses accounts for 47.6% (N4.9 trillion), while capital outlay represents 20.7% (N2.1 trillion).

The cost of governance remains a cause for concern, as recurrent expenditure continues to grow annually. By 2020, cumulative FG personnel costs, pensions and gratuities (from 2011 to 2020) will be over N20 trillion. As at 2018, the federal government's workforce was reported to be about 400,000 in total, signifying that about 0.2% of the country's population consumed about one-third (33%) of the national budget. This figure is expected to expand further in coming years, especially given the low staff turnover in the federal civil service and the new minimum wage.

The proposed 2020 budget is anchored on two policy frameworks – the Finance Bill, and the Deep Offshore and Inland Basin Production Sharing Contract (Amendment) Bill 2018. The former intends to amend the existing VAT regimes and make it more dynamic. The latter, which was previously rejected by the National Assembly, has been returned for reconsideration. These Bills have the potential of generating substantial revenue stream from tax and crude oil.

Personnel costs, pension and gratuities of FG workforce (N'bn)



Source: Budget Office of the Federation, PwC analysis

Despite this substantial revenue generation potential, the achievement of the proposed 2020 FGN fiscal plan remains in doubt, as the Federal Government's actual revenue has fallen short of the budgeted revenue in eight years (2011 – 2018). The continued shortfall in budgeted revenue has resulted in a widening budget deficit which is proposed at N2.8 trillion in 2020, fuelling the debate of the growing debt burden of the government. This debate continues, with the Federal government's plans to spend N2.5 trillion on debt servicing in 2020 – approximately 23% of the total proposed budget.

FG's revenue profile still vulnerable to oil price shocks

Nigeria's fiscal revenue profile remains highly susceptible to oil price shocks in the global energy market, as the oil sector contributes more than 60% of the annual budgetary income. In 2016, the global oil crisis resulted in an economic recession. As a result, fiscal revenue generated from oil sales decreased to about N0.70 trillion (representing 46% of total fiscal revenue) in 2016, the lowest in eight years (2011 – 2018). In 2018, actual oil revenue grew to N1.96 trillion, representing 64% of total fiscal revenue.

Non-oil revenues, on the other hand, continued to grow in the same period. Consequently, in terms of contribution to fiscal revenue, the non-oil sector contributed 54% in 2016.



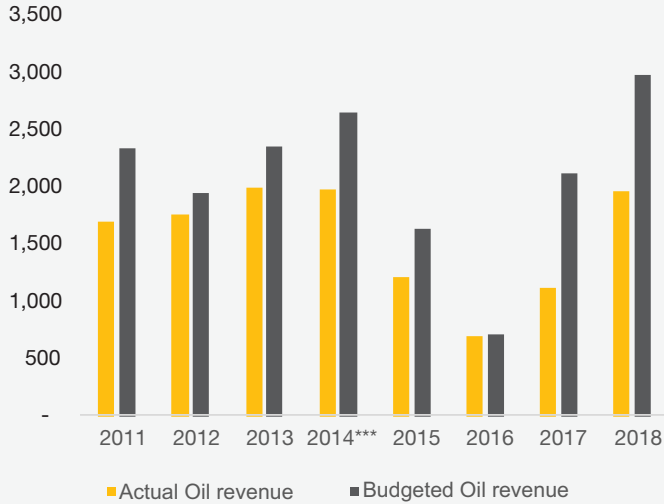
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This was the first time in the history of the country that non-oil revenue outpaced oil revenue. Despite this significant trend in 2016, the proportion of actual non-oil revenue slowed marginally to 36% in 2018.

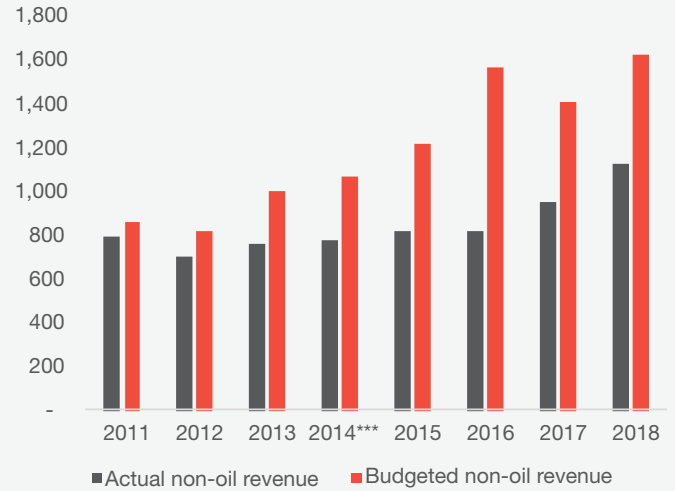
From 2011 to 2018, actual oil revenue generated remained below budgeted oil revenue. In 2018, the gap between the actual and the budgeted oil revenue reached a peak of N1.02 trillion, due to contraction in oil sector GDP.

Actual vs Budgeted Share of Oil Revenue to FG (N' billions)



Source: PwC, Budget Office of the Federation

Actual vs Budgeted Share of Non-oil Revenue to FG (N'billions)



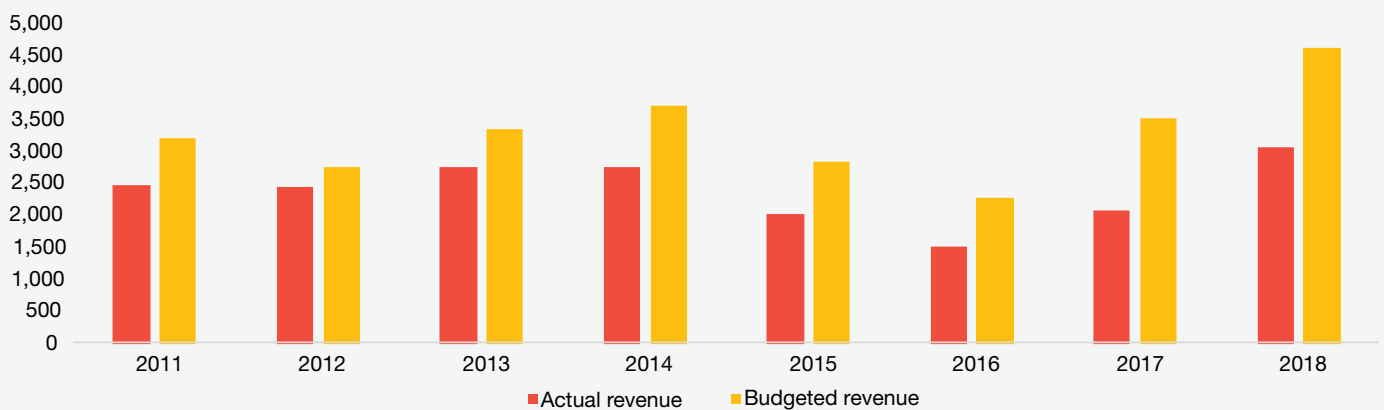
Source: PwC, Budget Office of the Federation

*** represents an estimation of revenue breakdown using an average of 70% of budget revenue as share of oil revenue budget to FG

Appraisal of previous budget documents

In the period under review (2011 – 2018), the Federal Government did not achieve the revenue projections for both oil and non-oil revenue. As the gap between projected oil revenue and the actual revenue inflow widens, so also the increasing need to borrow to close the growing deficit.

Actual and budgeted federal government revenue (N'billions)



Source: Budget Office of the Federation, PwC analysis

Implementation of the recurrent expenditure portion of the budget continues to outperform capital spending. In 2018, budgeted recurrent expenses stood at N3.52 trillion but actual recurrent expenses incurred for the year was N3.24 trillion representing 92% implementation rate. In contrast, capital budget implementation was slightly above half (58%) of the over N2.8 trillion budgeted in the same year. Since 2010 (except for 2015), the FG has not been able to implement up to three-quarters of its capital spending plan.

How realistic are the assumptions of the 2020 budget?

Assumptions of the 2020 budget	Historical trend	Explanation
<ul style="list-style-type: none"> Oil price benchmark - US\$57 	On average, daily crude oil price has been higher than the benchmark of US\$57 since February 2019.	The assumption of US\$57 appears realistic based on historical trends. Except there are major events that may precipitate a shock, US\$57 is achievable.
<ul style="list-style-type: none"> Oil production - 2.18 million barrels per day 	Since January 2018, daily oil production has been below the projection of 2.18 mbpd. The peak was 2.02 mbpd in March 2019.	If there is no major rehabilitation of existing domestic refineries and OPEC maintains the current state of oil caps, the assumed 2.18 mbpd in oil production may not be met.
<ul style="list-style-type: none"> Official exchange rate - N305/US\$ 	Based on historical trend, the official exchange rate has been diverging from a base rate of N305 since January 2018.	The CBN will only achieve the assumed official exchange rate by supplying U.S. Dollars to the market. This is at the expense of reserve depletion. Without deliberate action from the CBN, N305/US\$ may not be achievable.
<ul style="list-style-type: none"> Real GDP growth rate - 2.9% 	Since Q1 2018, quarterly real GDP growth rate has been below 2.9%. The highest growth rate was 2.38% in Q4 2018.	In the absence of major economic policies that will stimulate domestic production, achieving a real GDP growth of 2.9% in 2020 may not be attainable.
<ul style="list-style-type: none"> Inflation rate - slightly above single digit. 	Inflation rate since January 2018 assumed double digits.	There is a slight chance that inflation will be slightly above single digit, except there is a significant growth in domestic production, exchange rate appreciation and effective counter - cyclical policies.

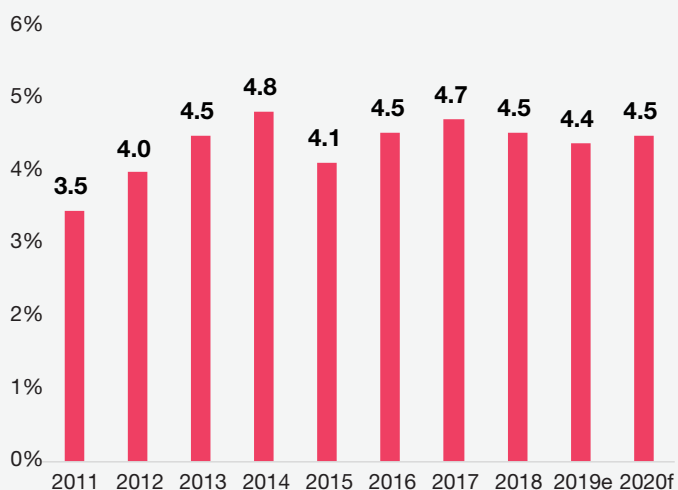
Raising VAT: To what extent will it fund the budget?

The proposed 2020 budget is premised on the increase in VAT rate from 5% to 7.5%. Between 2013 and 2018, when the VAT rate was pegged at 5%, VAT revenues only financed an average of 3% to 5% of recurrent expenditure. Therefore, it is expected that the increase in VAT will cover a small fraction of the proposed recurrent expenditure in 2020.

In relation to non-oil revenues, VAT contribution was between 11% to 14% from 2011 to 2018. The all-time high contribution of VAT to non-oil revenue was 14.1% in 2013.

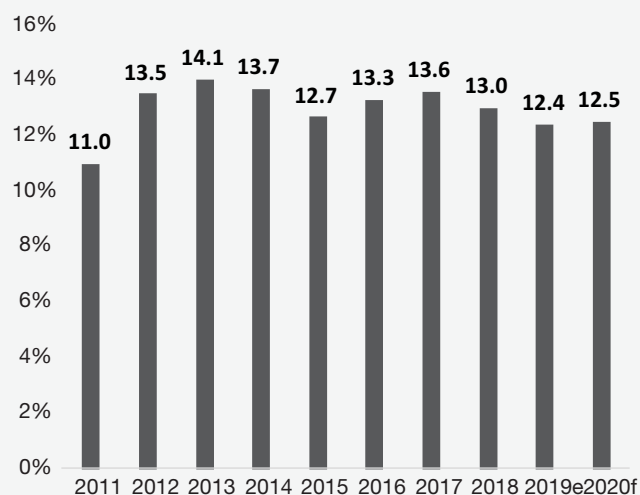
PwC forecasts VAT contribution of 12.5% to non-oil revenue in 2020. Therefore, the rise in VAT rate from 5% to 7.5% is insufficient to boost non-oil revenues, especially with the low collection rate. Consequently, PwC estimates that the increase in VAT to 7.5% will cover about 4.5% of recurrent expenditure in 2020.

VAT to recurrent expenditure (%)



Source: NBS, CBN Bulletin

VAT to non-oil revenue (%)



Source: NBS, CBN Bulletin

Evaluating the budget in line with the ERGP

The 2020 budget is short of the ERGP with respect to several key variables. The table below shows some of the divergence between the 2020 budget and the ERGP.

	2020 Budget Benchmarks	ERGP Projections	Remarks
Inflation	Slightly above 10%	9.9%	Proposed Inflation benchmark in 2020 is short of the ERGP's target
Real GDP growth	2.93%	7%	Nigeria will not meet up with the ERGP's growth projection
Oil price benchmark	US\$57	US\$52	Oil prices will be higher than the ERGP's target
Oil production	2.18mbpd	2.5mbpd	There will be a production gap of 0.32mbpd in 2020
Annual increase in fiscal revenue	N 1.15 trillion	N 800 billion annually	Revenue in 2020 will increase more than is proposed in the ERGP
Oil revenue	N 2.64 trillion	N 2.76 trillion	Oil revenue will trail behind the ERGP's projection
Non -oil revenue	N 5.51 trillion	N 3.36 trillion	Non -oil revenue is expected to rise beyond projection
Non -debt recurrent expenditure	N 4.88 trillion	N 2.79 trillion	A negative trend – non -debt recurrent expenditure will be higher than projection
Interest payments	N 2.45 trillion	N 2.12 trillion	Interest payments will be higher than the ERGP's projection
Sinking fund	N 296 billion	N 350 billion	Provisions for principal retirement of debts will be lower than the projection in 2020
Capital expenditure	N 2.14 trillion – 21%	N 1.93 trillion –30%	Capital expenditure, though higher in absolute terms accounts for 21% of budget in 2020, compared to the ERGP's projection of 30%.

Source: ERGP document, PwC analysis

Assessing Nigeria's debt profile in the context of the 2020 budget

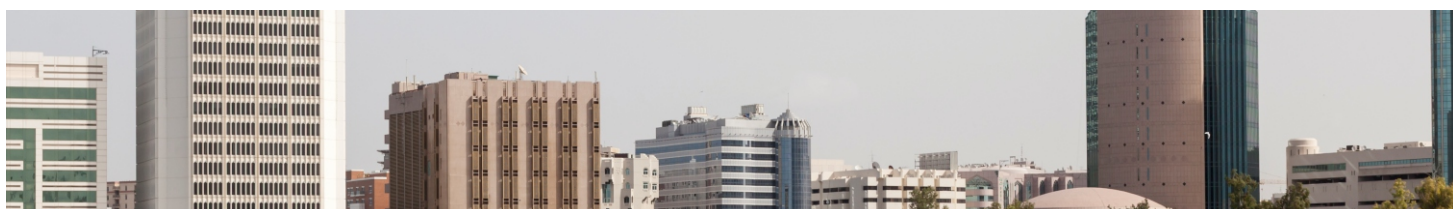
The growing debt profiles of the federal and sub-national governments continues to raise concerns among policymakers and analysts. The widening budget deficit necessitates government's resolve to borrow to cover its revenue shortfalls. The government has reiterated that the existing debt level has not breached the internationally acceptable threshold of 30% debt-to-GDP ratio.

As at 2018, the federal government's total debt stock stood at N20.5 trillion, a 12% increase from N18.4 billion in 2017. Consequently, debt-to-GDP rose to 29% from 27% recorded in the prior year. By H1 2019, the debt-to-GDP ratio surged to 61%.

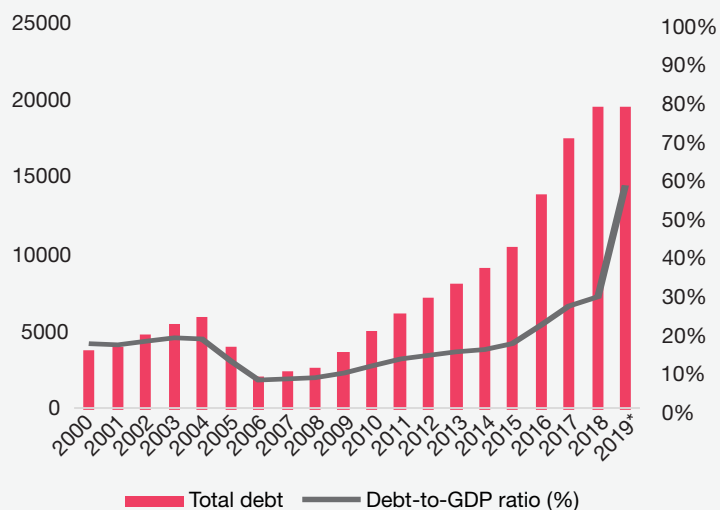
With a slowing economic growth rate and a spiraling debt growth rate, the debt-to-GDP ratio may pass the 30% threshold by year-end 2019.

However, the debt-to-GDP ratio paints just half of the picture. The issue bordering on debt sustainability is the ratio of debt service to government revenue on one hand, and the ratio of government debt to government revenue. Since 2011, debt service-to-revenue ratio rose consistently from 21.2% to 51.9% in 2015 peaking at 86.6% in 2016. It declined thereafter to 78.6% and 67.7% in 2017 and 2018 respectively. This significantly exceeds the international acceptable threshold of 20 – 25%.

The continuous decrease in debt service-to-revenue ratio over the last two years is underpinned on revenue growth which outpaced growth in debt servicing within the period under review.

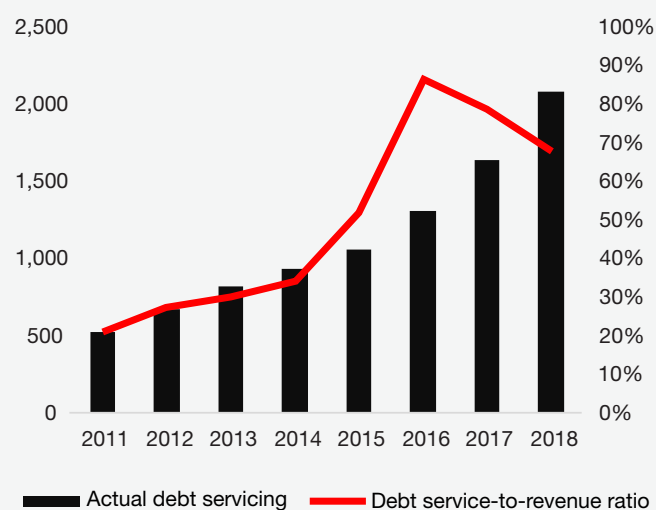


Nigeria's total debt (N'billions)



Source: CBN, Budget Office of the Federation, World Bank, PwC analysis

Total debt service payments (N'billions)



Source: CBN, Budget Office of the Federation, World Bank, PwC analysis

* As at first half 2019 ** total debt stock are aggregation of external and domestic debt stock respectively

Despite sluggish output growth recovery, low domestic revenue mobilization and the unsustainability of the current debt level, the government intends to borrow more to plug the revenue shortfall of N2.2 trillion in the proposed 2020 budget.

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