Nigeria Economic Alert

2018 budget: implementation hinges on revenue accretion

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Budget proposal reaches record high

The Federal Government of Nigeria (FGN) has announced a 2018 budget proposal which will put spending at a record high of NGN8.6 trillion. According to the budget speech, the aim is to consolidate on the improvement in economic growth in 2017 by sustaining the reflationary policies of the past two budgets. The budget assumes an oil price benchmark of USD45/bbl, oil production of 2.3 million barrels per day, and an exchange rate of NGN305/USD.

The budget is to be funded with revenues projected at NGN6.6 trillion (+30.1% y/y), with oil and non-oil accounting for 37.0% and 63.0% respectively. Given the delays in legislative approval of the 2017 budget, we expect that the operational period for its appropriation will be extended to 2018. This suggests that the implementation of the 2018 budget could be delayed, perhaps into Q2'18.

Underperforming non-oil revenues could result in higher fiscal deficit

The 2018 budget proposes an aggressive increase in non-oil revenues to NGN4.2 trillion. Relative to the 2017 budget, the target is 44.6% higher; this variance could be close to 100% when compared to our estimate of the actual non-oil revenue collected in 2017. Whilst the reduced reliance on oil revenues is plausible, the trend and reasons for revenue underperformance in prior years suggest that this target might be difficult to achieve. Nigeria's low tax to GDP ratio at around 6%[1] is a consequence of a poor and inefficient tax collection system. While the government has implemented specific measures to address this by expanding the tax base and increasing tax compliance using various incentives, the impact is yet to materialise. As a result, we estimate that the fiscal deficit could overshoot projections by as much as 67.7% to NGN3.4 trillion.

Increasing debt portends debt sustainability risks

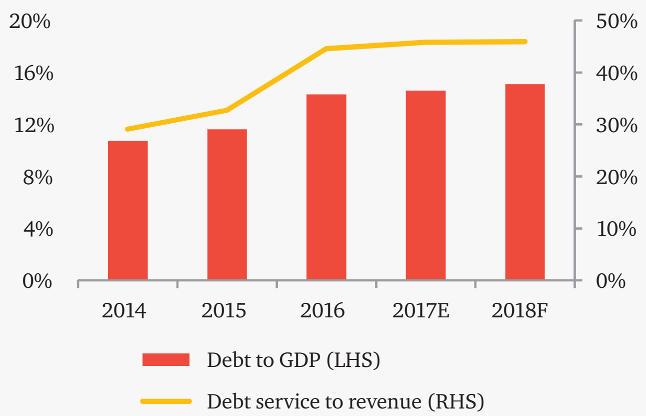
The FG's budget estimates the 2018 deficit at NGN 2.0 trillion. Given our outlook of revenue underperformance, we expect a higher-than-expected deficit, which could bring the FG's debt stock to NGN20.9 trillion in 2018 (2017E: NGN17.6 trillion).

1. PwC estimates
2. Debt Management Office (2016): Debt Sustainability Analysis

We believe the FGN would rely more on the domestic debt market to finance this deficit, given the availability of a stable domestic investor base, which includes the Pension Funds. Moreover, external financing could be tight in 2018 due to the uptrend in interest rates in advanced economies, particularly in the US and UK. Following this, we estimate that debt to GDP could rise marginally to 15.1% (2017E: 14.6%). This is closer to Nigeria's country-specific threshold of 19.4%, but still far below the IMF's recommended threshold of 56%[2].

Although the low debt-to-GDP ratio is reassuring, the debt service to revenue ratio which is often cited as a better measure of debt sustainability is projected at 30.1% in 2018 (threshold: 28%). Based on our estimates, this could rise to 45.9% in the event the budget deficit reaches 2.4% of GDP.

Debt Sustainability Indicators



Source: NBS, PwC analysis

Inflationary risks subdue scope for monetary easing

Given a reduction in core inflation to 12.1% y/y in September 2017, and our expectation of a continued moderation in inflation in the near term, we believe there is sufficient head-room for a rate cut in Q1'18. However, this reflationary budget which provides for a 12.0% increase in personnel costs raises inflation expectations. Likewise, history suggests that the commencement of the election cycle ahead of the 2019 general elections could portend significant inflationary risks, thus reducing the scope for monetary easing.

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