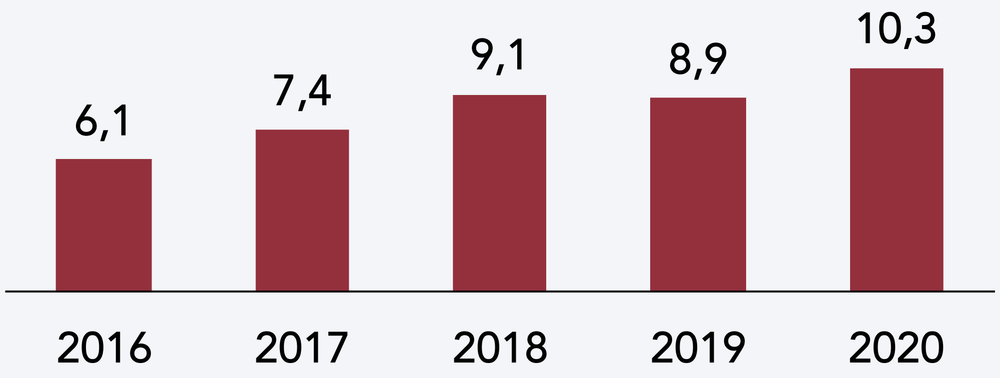
THE PROPOSED 2020 BUDGET AND THE ECONOMY

October 2019

FGN pursues fiscal expansion with N10.3 Trillion 2020 Budget

FGN Total Budget (Trillion Naira)



Key Budget Assumptions

- Crude oil production - 2.18 million barrels per day
- Estimated crude oil price - $57 per barrel
- Exchange rate - N305/$1
- Projected GDP growth rate – 2.93%
- Fiscal Deficit – N2.18 trillion

Data Source: Budget Office of the Federation

- The 2020 proposed budget was N10.3 trillion, 16% higher than the approved 2019 budget of N8.9 trillion. This represents the highest ever spending plan of the Federal Government.
- The government's spending plan of N10.3 trillion consist of Non Debt Recurrent expenditure of 47%, Debt Services of 27%, Capital Expenditure of 21% and Statutory Transfer of 5%.
- Proposed revenue totaled N8.1 trillion which consists of N2.64 trillion Oil Revenue (32%) and Non-Oil Revenue of N5.5 trillion (68%).
- Non-oil revenue will include income from the proposed VAT increase as well as other non-oil taxes and tariffs.
- Despite the proposed VAT increase, Revenue projection of N8.1 trillion is overly ambitious and likely to be unmet especially with possible shortfall in crude oil production and expected slow implementation in the collection of newly imposed VAT.
- Fiscal deficit is N2.18 trillion in 2020. The deficit will be funded largely by domestic and external borrowings.

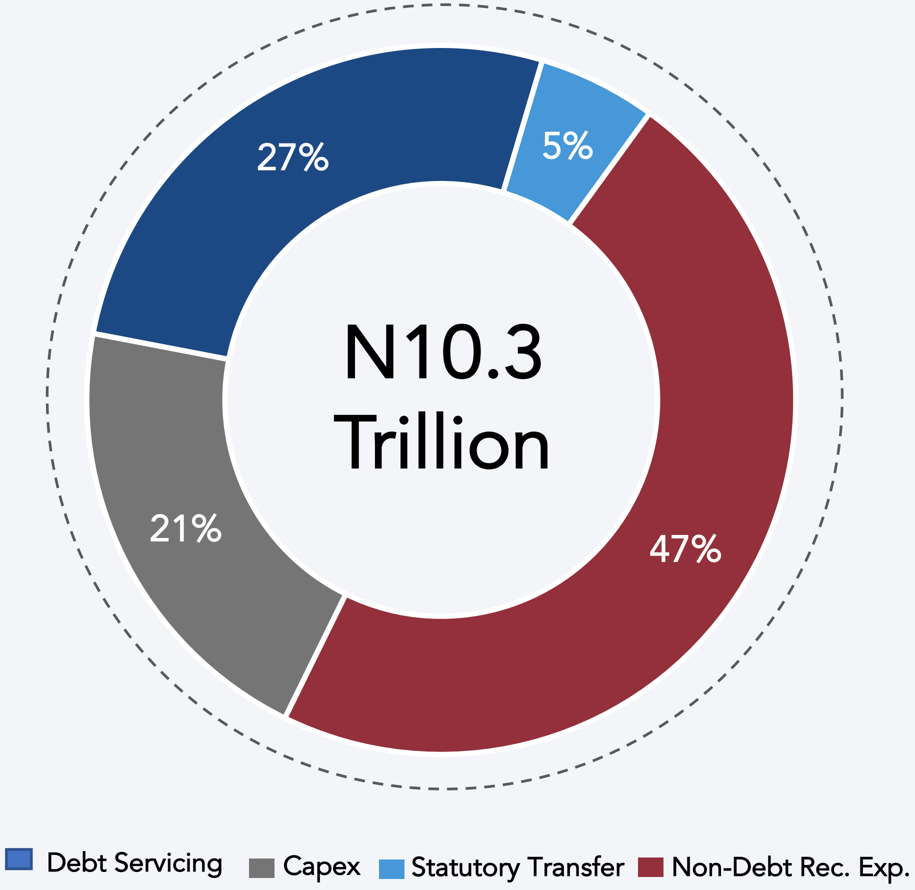
Recurrent Expenditure rises significantly, Capex remains stable

Debt Servicing
N2.7 trillion

Accounting for 27% of total expenditure, Debt Servicing is 22% higher than N2.3 trillion approved in 2019 budget. 74% of the N2.7 trillion will be used to service domestic debts

CAPEX
N2.7 trillion

Capital Expenditure increased marginally by 2% in the proposed 2020 budget. Capex accounts for 21% of total budget. Early budget passage could result in higher implementation rate of capex



Statutory Transfer
N557 billion

Statutory Transfer accounts for 5% of the proposed budget. It increased by 11% in the proposed budget to N557 billion

Non-Debt Recurrent
N4.9 trillion

Non-Debt Recurrent Expenditure accounted for 47% of total spending in the 2020 budget to reach 4.9 trillion. Personnel and pension costs stood at N3.6 trillion representing 74% of non-debt recurrent expenditure, arising from the agreed minimum wage

Data Source: Budget Office of the Federation

Key Sectoral Capital Allocations in the proposed 2020 Budget

Transportation
N123 billion

Power
N127 billion

Defence
N100 billion

Works and Housing
N262 billion

Agriculture
N83 billion

Capital allocation in the proposed 2020 Budget targets existing infrastructure project to ensure completion

The proposed 2020 Budget and the Economy

- Early presentation of the 2020 budget is a welcome development. If the budget is approved before the budget year begins, this could result in improved budget performance, particularly capital budget execution.

- The proposed 2020 budget is largely ambitious both in terms of spending plans and projected revenue.

- One major concern is meeting revenue targets to fund the budget. Oil only accounts for 32% of total budgeted revenue in 2020, suggesting that more pressures will be exerted on major non-oil revenue generating areas.

- To meet revenue projections, the federal government will implement an increase in VAT and other forms of taxes which could trigger inflation and reduce purchasing power of consumers.

- In addition, slow implementation/collection of newly imposed VAT and other taxes is expected to play out in 2020.

- Revenue drive should be implemented with caution to limit undue pressure on businesses and consumers, especially given the slow economic recovery with GDP growth below 2%.

The proposed 2020 Budget and the Economy

- We note the significant increase in recurrent expenditure from N6.8 trillion to N8.2 trillion. Personnel costs including overhead and pensions increased to N3.6 trillion and accounts for 74% of non-debt recurrent expenditure.

- The new minimum wage was partly responsible for this increase. This is expected to create inflationary pressures in the short to medium term from the year 2020.

- The marginal 5% increase in capital expenditure when compared with 2019 approved budget figures is a concern.

- Given the country's huge infrastructure deficit, it is crucial to prioritize capital spending to improve budget performance and ease of doing business in Nigeria.

- With the revenue target likely to be unmet as well as the challenges in the procurement system, only about 55% of capital budget will be implemented i.e. N1.2 trillion would be injected into the economy for capital projects in 2020.

The proposed 2020 Budget and the Economy

- Debt servicing as a percentage of budgeted revenue stood at 33% in the 2020 proposed budget.

- However, actual debt servicing as a share of actual revenue rose to 63% in the third quarter of 2018 and this trend of high debt servicing to revenue ratio is expected to continue, owing to anticipated revenue shortfall.

- The Budget deficit of N2.18 trillion is to be financed mainly by domestic and external borrowing. Deficit remains below the stipulated 3% to GDP limit in the Fiscal Responsibility Act. The increased borrowing is expected to shore up liquidity in the fixed income market.

Conclusion

- Economic recovery is slow but steady, inflation is falling, but external buffers are declining in the face of increased portfolio outflows.

- We share the view of the CBN that the fiscal authorities should build fiscal buffers to avert macroeconomic downturn in the event of a decline in oil prices and/or any other external shock.

- The continued unrealistic revenue targets and increasing dependence on central bank financing of the fiscal deficit is unsustainable.

- Federal Government interest payments continue to absorb more than half of revenues in 2019.

- Coordinated fiscal and monetary policies are urgently required that focus on fiscal consolidation and tighter monetary policy.