MERISTEM

Critiquing the Assumptions Underlying the 2023 FGN Budget

Introduction/ Background

Recently, President Muhammadu Buhari presented what would be the last budget of the current administration in Nigeria's capital city, Abuja. Dubbed the "Budget of Fiscal Sustainability and Transition", the 2023 Federal Government of Nigeria (FGN) Budget has a total planned expenditure of NGN20.51trn. In coming up with the budget, a couple of assumptions were made which raised some questions about whether the overall budget is achievable. In this note, we briefly review the implementation of the 2022 budget so far, dimension the 2023 budget, and evaluate the underlying assumptions of the 2023 budget.

Review of 2022 Budget Implementation

In the past four full fiscal years (2018 – 2021), Nigeria's actual expenditure performance has averaged c. 91% of budgeted. For revenue however, the actual realised amount is c. 68% of budgeted. The sub-par revenue performance reflects the optimistic assumptions that are adopted in preparation of the budget and the overreliance on oil for government revenue. As of August 2022, Nigeria's budget implementation has only been c. 64% for revenue, and c. 83% for expenditure

Chart 1: 5 years Budgeted vs Actual Expenditure (NGN'tr)

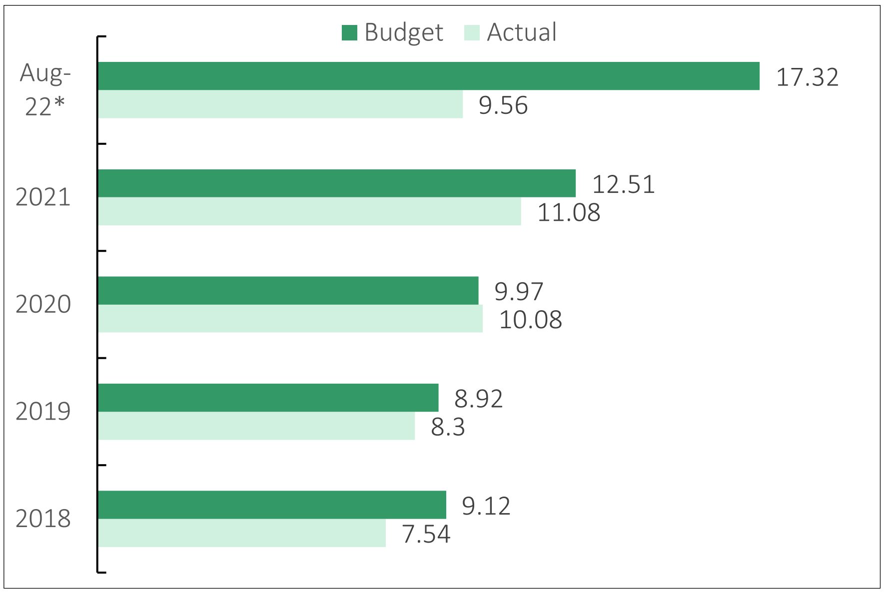
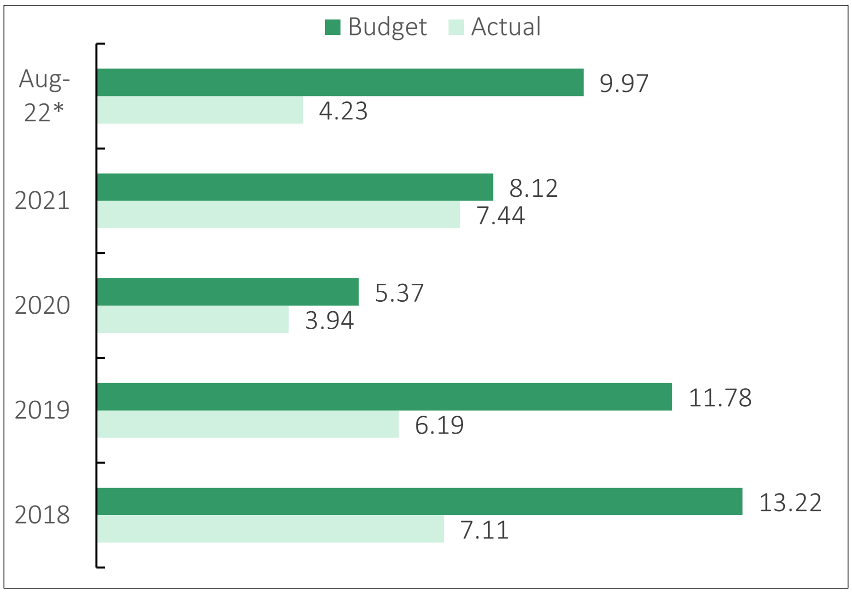


Chart 2: 5 years Budgeted vs Actual Total Revenue (NGN'tr)



Source: Federal Ministry of Finance (FMoF), Budget Office of the Federation (BOF), Meristem Research

**August budgeted figure is prorated on a linear basis.*

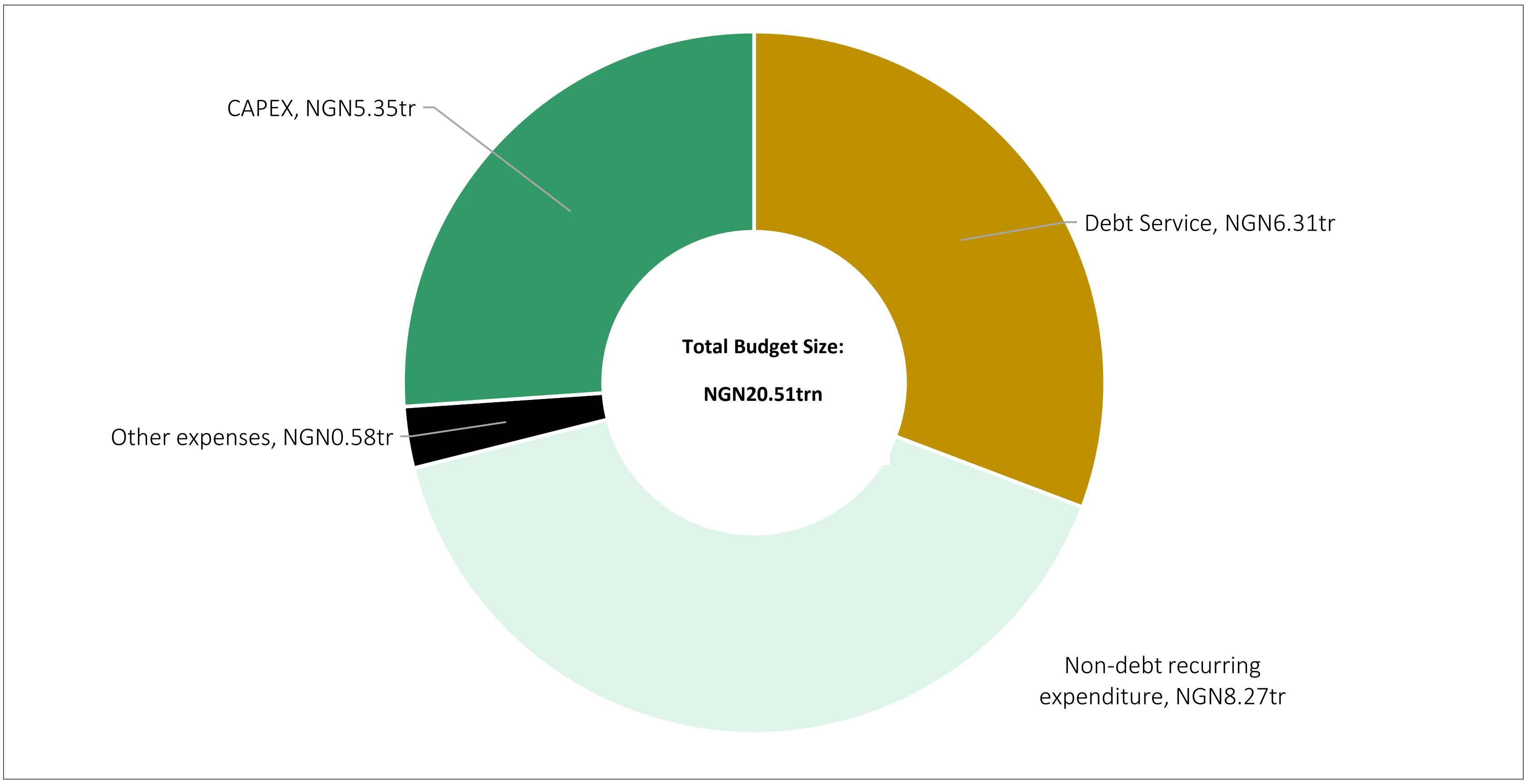
Despite higher oil prices, only a paltry c.27% of budgeted oil revenue has been achieved as of August 2022, reflecting the myriad of challenges with oil production volumes. On the bright side however, revenue from non-oil sources outperformed its budgeted amount (102.94% of budgeted, esp. Company Income taxes).

Unsurprisingly, debt service has taken up the lion share of recurrent expenditures (c.49%) so far, and is 32.88% above the pro-rated budget target for the period as the mounting debt stock needs to be serviced. On the other hand, capital expenditure takes up a measly portion (c.19%). This performance buttresses the opinion that most often than not, the budget assumptions are typically "over- optimistic"

Dimensioning the 2023 Budget

The total budgeted expenditure for 2023 is NGN20.51trn, translating to an increment of 18.42% from NGN17.32trn in 2022. The planned expenditure is expected to be funded by an expected revenue of NGN 9.73trn, with the balance of NGN10.78trn (or 52.56% of total budget) earmarked as deficit.

Chart 3: Breakdown of 2023 Budget



Source: FMoF, BOF, Meristem Research

Representing 26.08% of the total budget size and as indicated in the chart above, NGN5.35tr has been allocated for capital expenditure (CAPEX) in 2023. This amount is 8.77% lower than the NGN5.86tr provided for in the 2022 budget.

On the other hand, non-debt recurrent expenditure, which includes personnel and other overhead costs represent 40.32% of the total budget, increasing by 16.36% compared to the 2022 number of NGN7.11tr. Also, debt service is expected to gulp 30.77% of the total 2023 budget (higher than CAPEX: 26.08%). **It is important to highlight that a subsidy of NGN3.36tr (16.38% of total budget size) has been budgeted for in 2023, which is a provision made for only the first 6 months of the year.** This means that a full year subsidy would equal committing public funds of up to NGN6.72trn to an unproductive activity. We note that this is a very substantial amount and therefore, emphasize the importance of phasing out the subsidy regime especially considering the controversy around its genuineness.

The Underlying Assumptions: Myriad of Mirages

As any other budget, the 2023 projections have been prepared based on certain assumptions. Outlined below, the assumptions underlying the 2023 budget can, at best, be described as a fantasy in the making.

Table 1: Breakdown of 2023 Budget

Parameters	
Oil Price	USD70pb
Oil Production	1.69mbpd
Inflation Rate	17.16%
GDP Growth Rate	3.75%
Exchange Rate	NGN435.57/USD

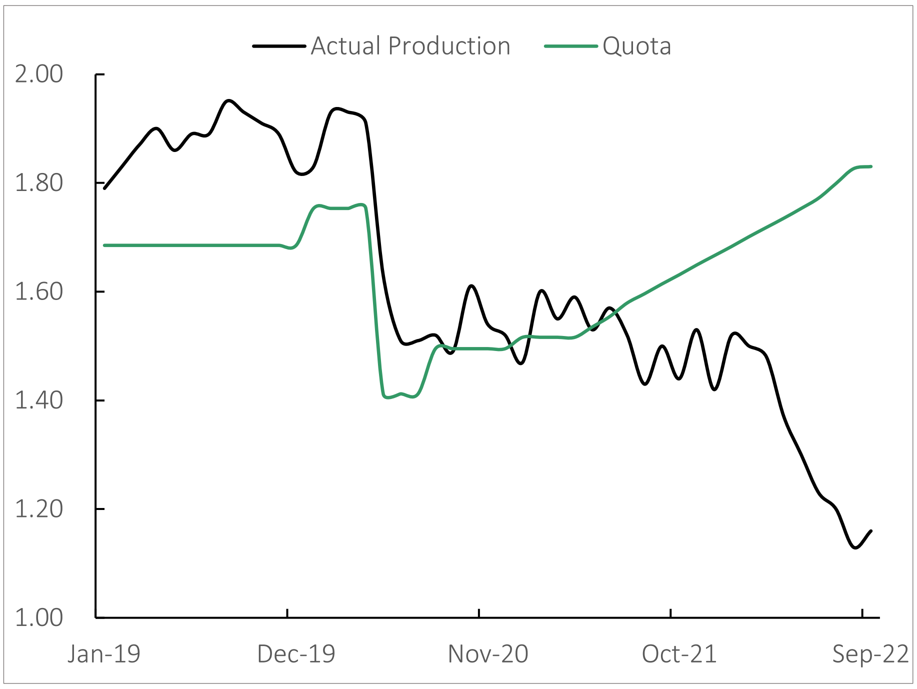
Source: FMoF, BOF, Meristem Research

Of the total expected revenue of NGN9.73tr, NGN1.92tr (or 19.73%) is expected to come from oil, while the balance is expected from non-oil sources. The expected oil revenue is based on an assumed price of USD70pb and a production volume of 1.69mpbd. Nigeria currently has a rig count of 11, the same number that achieved an average production of 1.66mbpd in 2020. However, the average production since the start of the year has been 1.32mbpd, raising the question of whether the 1.69mbpd assumed for next year is likely to be actualised. Moreover, the country's crude oil production has been on a free fall since the beginning of the year, declining from an average of 1.52mbpd in January to only 1.16mbpd as of September. Issues including crude oil theft, pipeline vandalism, and a downturn in investment flows into the oil and gas sector have been responsible for the sub-par production in the year. Furthermore, the growing fear of recession globally might limit the global demand for oil and reduce the OPEC production quota in the coming year. Recall that OPEC recently reduced its members' production quota by 2 million barrels per day (Nigeria's production quota currently stands at 1.74mbpd).

On the other hand, the assumed price of USD70pb is conservative and realistic in our view, especially considering that the price of brent crude oil is currently around USD90pb, and the outlook is tilted towards the upside. The indication from OPEC+ to support the price of crude oil around current levels further backs the outlook for a high oil price in 2023.

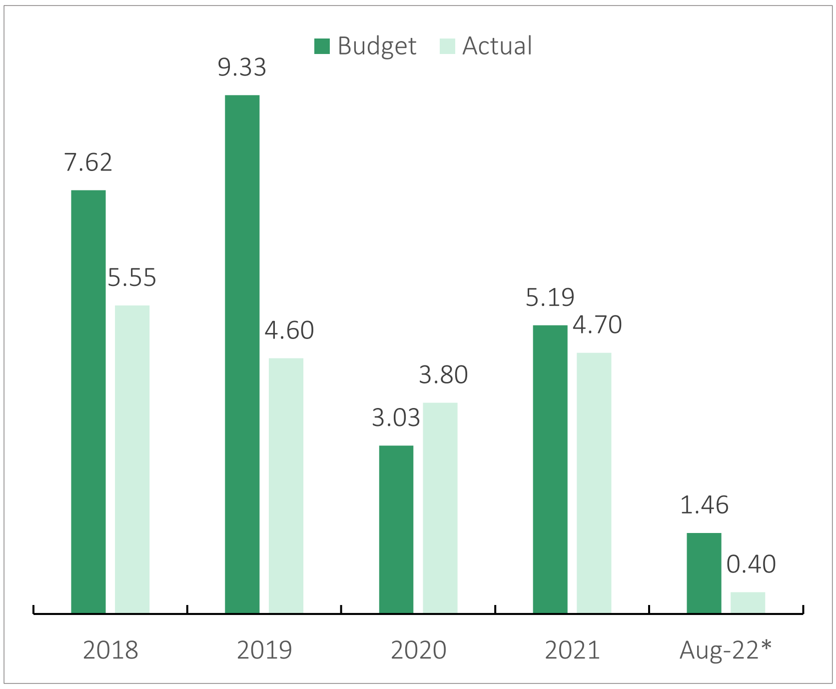
Juxtaposing historical budgeted oil revenue with actual shows that Nigeria has been underperforming. As of August, Nigeria's realised oil receipt has only been NGN0.40tr vs. NGN1.46tr prorated (full year expected oil revenue is NGN2.19tr). This means that the 2022 budgeted oil revenue is on the path of an unprecedently sub-performance and 2023 might not be different.

Chart 4: **Nigeria's Oil Quota vs. Actual Production (mbpd)**



Source: Bloomberg, OPEC, Meristem Research

Chart 5: **Nigeria's Budgeted vs. Realised Oil Revenue (NGN'tr)**



Source: FMoF, BOF, Meristem Research

**August budgeted figure is prorated on a linear basis.*

On inflation, the budget assumption is 17.16% respectively. Without mincing words, our view is that this assumption is rather unrealistic. Firstly, Nigeria's latest inflation data from the National Bureau of Statistics (NBS) shows that inflation rate is currently 20.77% as at October 2022.

We have identified some factors that might keep inflation elevated in 2023:

- The effect of the recent flooding in some parts of the country as well as the upcoming festive period might filter into the coming year to keep food prices high;
- The likely removal of fuel subsidy upon the inauguration of a new administration post-general elections also means that energy cost, transportation cost, and food prices might also trend upwards;
- The liquidity injection that comes with electioneering campaign which is expected to intensify next year also has the potential of keeping prices high.

Nonetheless, the aggressiveness of the Monetary Policy Committee (MPC) to rein in inflation by the recent series of hike in the Monetary Policy Rate (MPR) and the 500bps increase in the Cash Reserve Ratio (CRR) to 32.50% might be helpful in limiting the pace of jump in price level. The implication is that some budgeted costs that are indexed to inflation would be higher in 2023, potentially leading to a wider deficit than anticipated.

However, the hawkish monetary stance might limit the level of output growth in Nigeria, raising the question of whether the GDP growth assumption of 3.75% in 2023 is achievable. In our assessment, it is likely that Nigeria's GDP growth slows in the remaining quarters of 2022 leading into 2023. It is also unlikely that the MPC will reverse course on its hawkish stance until inflation starts to abate, which is unlikely in the near term as highlighted above. Lending support to our view, the Purchasing Managers' Index (PMI) readings shows that manufacturing PMI has been declining since July 2022, subsiding below the 50pts mark at 47.20pts in August according to data from the Central Bank of Nigeria (CBN). This indicates that production activities are slowing, and we do not expect a reversal to this trend in going into 2023 given the tightening monetary stance.

For the assumed exchange rate of NGN435.57/USD, our view is that it is a conservative choice. Notably, the assumed exchange rate is the conversion rate for all inflows in dollars including the oil receipts shared by the Federal Account Allocation Committee (FAAC). Nonetheless, the pressure on Nigeria's FX reserves, which is not likely to ease in the near term, means that the Naira might be further pressured. As of October 21st 2022, the exchange rate in the I&E window is NGN441.67/USD and this is unlikely to reduce in the near term.

Summarily, achieving the 2023 budget is likely to be another tale of the past budget implementation experiences. Moreover, the transition from one government to another might slow down decision taking of some aspects of the budget, and therefore affect the overall budget implementation.

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