
WALKING ON EGGSHELLS

H2-2019 Macro-economic Outlook



Executive Summary

- Against the backdrop of a pessimistic global outlook for 2019, we maintain our growth forecast for the Nigerian economy at 2.1% y/y in 2019. We expect growth from the non-oil sectors, led by the information and communication sector as the adoption of information and communication technology (ICT) by the country's teeming population continues. However, we believe growth in the real sectors will remain subdued due to structural problems.
- Despite increased uncertainty in the oil market, we raise our oil price forecast to average US\$68/bbl in 2019 from US\$60/bbl at the start of the year. For the rest of the year, we anticipate that crude supply in the global market will continue to remain tight on the back of OPEC+ production cuts and continued supply disruptions from the shaky-five (Iran, Venezuela, Libya, Angola and Nigeria).
- Through H1-2019, the naira remained relatively stable at both the parallel market and I&E window at c.N360/US\$. The accommodative monetary policy stance adopted by the US Fed limited the outflow of capital from emerging markets and eased pressure on local currencies, the Naira inclusive. In addition, higher oil prices and the negligible growth in imports which reduced demand for the dollar, fuelled accretion in reserves to support the Naira. Looking ahead, we expect the Naira to remain stable at c.N360/US\$ for the rest of the year, supported by our optimism around global oil prices and portfolio flows for the rest of the year.
- On account of expectations of a stable Naira exchange rate, we expect the inflation to average 11.1% in 2019 (2018: 12.1%) supported by a slackening in price pressure on both the food and core sub-indices, compared to 2018.
- With respect to monetary policy, we anticipate a further rate cut of no more than 50bps before the end of the year. Though the decision by the MPC to lower the MPR in March, signals the adoption of a pro-growth approach, we see a need for the MPC to loosen cautiously to sustain portfolio flows to the economy.
- In the last few years, the country's fiscal profile has been characterised by colossal expenditure plans, optimistic revenue assumptions and substantial shortfalls in revenue which have had to be financed by both local and foreign borrowings. We note that with the factors that pose a downside risk to the country's fiscal profile still in place (over-reliance on oil revenue, inefficient tax system, inadequate investment in the oil sector and a volatile Niger-Delta region) a shortfall in government revenue estimate for 2019 is almost unavoidable. In addition, high cost of subsidies as well as the implementation of the new minimum wage, will further stretch the government's purse and could cause fixed income investors to demand a higher yield for their investments thereby worsening the government's fiscal profile.

Indicators

Macros			
	2017	2018	2019f
Real GDP growth	0.83%	-1.58%	2.1%
CPI (y/y Dec)	15.4%	11.44%	11.1%
N/US\$ (end-year)	360.00	363.00	360.00
MPR	14.00%	14.00%	13.00%
Interest rates			
MPR			13.50%
Open buy back			3.86%
NIBOR			
O/N			4.57%
30-day			5.50%
90-day			6.75%
180-day			8.00%
*T-bill			
3-month			10.6%
6-month			12.4%
12-month			13.4%
FGN bond			
5-year			14.3%
10-year			14.2%
15-year			14.3%

*As at 05 July 2019

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Macroeconomic data and forecasts

	2018 (Actual)	2019 Approved Budget	2019 CSL Forecast
Recurrent Spending, NGN trn	3.5	4.7	4.0
Capital spending, NGN trn	2.9	2.9	1.0
Debt service, NGN trn	2.0	2.1	2.5
Other, NGN trn	1.1	1.0	1.0
Total spending, NGN trn	9.1	8.8	8.5
Oil Revenue, NGN trn	3.0	3.7	3.0
Non-oil revenue, NGN trn	4.2	3.3	2.5
Total revenue, NGN trn	7.2	7.0	5.5
Deficit, NGN trn	-2.0	-1.9	-3.0
Oil price, USD/bbl (Average)	71.3	60.0	68.0
Oil production, mbpd	1.96	2.3	2.0
Real GDP growth	1.9%	3.0%	2.1%
External Debt Stock, USD'bn	25.3	n/a	26.5
Domestic Debt, NGN'trn	16.6	n/a	18
Inflation (Average)	12.1%	9.98%	11.1%
MPR (year-end)	14.00%	n/a	13.0%
Three-month treasury bill	14.3%	n/a	10.0%
Current account balance, USD'bn	1.1	n/a	1.5
Naira/USD (I&E window; year-end)	364.0	n/a	360.0

Source(s): FMBNP; CSL Research

Global Economic Outlook

In the first half of the year, downside risks to global growth continued to build and fuelled a loss in momentum for global expansion. The escalation of US–China trade tensions and further tightening of trade policies, uncertainties around Brexit, macroeconomic stress in Argentina and Turkey, looming crisis in Germany’s car industry, China’s credit crisis and already tight financial conditions continue to cloud global economic prospects. As international trade and investment soften, trade tensions remain elevated and emerging markets continue to experience financial market pressures. Against this less favourable backdrop, multilaterals have reviewed their global growth forecast for 2019 downwards as downside risks have become more severe. Also, this has dampened the economic growth prospects for Sub-Saharan Africa. Being a commodity export-dependent region, the region is bound to feel the adverse impact of restrictive trade policies, which can put downward pressure on commodity prices and create financial system imbalances in domestic economies that will not only constrain growth in individual countries but also have a spill over effect on the region’s aggregate output.

Outlook for Global Growth and Sub-Saharan Africa’s growth

	Global Growth (Previous)	Global Growth (New)	SSA Growth (Previous)	SSA Growth (New)
IMF	3.5%	3.3%	3.8%	3.5%
World Bank	3.0%	2.9%	3.3%	2.8%
OECD	3.3%	3.2%	-	-
AfDB	-	-	4.1%	4.0%

Source(s): IMF, World Bank, OECD, AfDB

Economic activities appear to have picked up and caused unemployment rates to moderate in the first half of the year across some developed economies. Most leading economic indicators have come in line, or even above expectations. In the US for instance, the economy expanded by 3.1% y/y in Q1-2019, despite a partial government shut down that took up 25 days in 2019, against a growth of 2.2% y/y recorded in Q4-2018. The expansion in the US economy had an attendant impact on its unemployment level as it dropped marginally to 3.6% in May from 4.0% in January.

However, many developing economies- particularly commodity exporters- continued a gradual growth recovery process with the Q1-2019 growth estimates for Nigeria coming in at 2.0% y/y while South Africa showed no y/y growth in the quarter (-3.2% q/q decline for the quarter). In addition to being sluggish, growth in developing economies have been uneven as the real sectors have lagged in acceleration. This has caused unemployment to reach uncomfortable levels and, in addition to the already high inflation levels, resulted in a worsening of the misery indices for developing countries, fuelling widespread poverty. Based on Hanke’s Misery Index, the countries likely to be the most miserable in 2019 are mainly developing, commodity-export-dependent economies with Venezuela topping the list amid its hyperinflation crisis. Many of the developing economies that are lagging in growth depend heavily on commodities for both export revenue and financing fiscal expenditure.

Global Oil Outlook

Crude oil prices have been on a rollercoaster over the past 9 months with the price of Brent crude oil peaking at US\$85/bbl in October 2018, dropping to a low of US\$50/bbl in December, and recovering to US\$75/bbl in April 2019. Since the start of the year, oil prices have rallied on disruptions to global supply in a few countries as well as the non-renewal of US waivers on Iranian oil. Although some investors have shown concern for the increased domestic production of crude oil in the US as well as China's slowing growth and how it could impact the global demand for oil, the optimism on prices from supply disruptions have outweighed the underlying pessimism from oversupply and economic growth concerns. This has supported a c.21% year-to-date rise in oil prices.

The expiration of waivers given to key Iran oil importers to check a spike in oil prices was a major contributor to the oil price rally. The US had previously granted a six-month waiver in November 2018 to eight importers of Iranian oil (Italy, Greece, Turkey, China, India, Japan, South Korea, and Taiwan) when the US sanctions on Iran took effect. This was meant to limit a further rise in oil prices as Brent was already trading above US\$80/bbl. Prior to the expiration of the waiver in May 2019, market players had priced in the impact of the non-renewal of US waivers on Iranian oil which supported a recovery in oil prices to sub US\$70/bbl from the US\$50/bbl levels where it traded towards the end of last year. This is because major oil importers like China and India, who are big buyers of Iranian oil, were being compelled to look for alternative sources.

Venezuela suffers a fate like Iran's in the face of sanctions on its oil sector by the US. Although the tension between the US and Venezuela has lasted for over a decade, the country took a big hit on its oil exports when the US government literally moved to halt the purchase of Venezuelan crude by US refineries- Venezuela's top clients. The US Treasury sanctioned Venezuela's Central Bank in order to cut off its access to the dollar and limit its ability to conduct international financial transactions by enforcing that proceeds of Venezuela's oil sales in the US be put in a blocked account. This is aimed at severely limiting Venezuelan oil exports to other countries and further widening the supply gap to be filled by the existing producers. In response to the sanctions, global oil flows are already being re-ordered as the demand by US refineries for oil from Iraq, Nigeria, Angola and Brazil increased post-sanction in April while Venezuela has increased oil supplies to Cuba (an ally) in May by four-fold.

Aside from the sanction-induced supply gaps in the oil market, supply disruptions have also emanated from OPEC and non-OPEC countries. In Russia, the dirty oil crisis remains a drag on the country's oil exports as some 5 million tonnes of contaminated crude is blocking the 1mbpd Druzhba pipeline that has been shut since April. The Druzhba pipeline is the world's longest oil pipeline (c.4,000km) and one of the biggest oil pipeline networks in the world that extends from Russia to points in Ukraine, Belarus, Poland, Hungary, Slovakia, the Czech Republic and Germany. Similarly, Saudi Arabia also suffered disruptions to its oil export as its oil assets were targets of sabotage attacks that are being linked to Iran or its proxies. Two of the kingdom's oil vessels suffered damages in an explosion at the UAE's Fujairah port while one of the kingdom's oil pipeline pumping stations was the target of a drone attack that has been claimed by Iran's allies- the Houthi rebels in Yemen. In the Persian Gulf region, a total of six oil tankers have been attacked since May while the US has continuously put the blame for the attacks on Iran. The attacks have raised anxiety about the security of global oil supplies and fuelled a rise in oil prices.

In Africa, disruption to global oil supplies have emanated from Libya and Nigeria. In Nigeria, three of the country's oil pipelines (Nembe Creek, Amenam and Trans Forcados trunk lines) were shut down due to fire outbreaks and explosions on the pipelines.

However, oil export through these pipelines have since resumed. In Libya, attacks on Libya's capital (Tripoli) by a militia called the Libyan National Army (LNA) threatened to cut off- or at least disrupt- the nation's oil supply and raised supply concerns in the global market. Although Libya has the largest proven reserves of oil in Africa, its 8-year old civil war has caused its production to drop from about 1.6mbpd in 2011 to 300kbpd and rising tensions have continued to threaten oil supplies and caused oil prices to increase. In Angola, oil production continued to topple due to aging fields and a lack of interest from foreign investors to invest in new projects while the political unrest in Algeria posed a threat to just over 1mbpd of light, sweet crude.

For the rest of the year, we anticipate that crude supply in the global market will continue to remain tight on the back of OPEC+ production cuts and continued supply disruptions from the shaky-five (Iran, Venezuela, Libya, Angola and Nigeria). In Libya for instance, the leader of the militia (General Khalifa Haftar) has stated that offensive on Tripoli will continue as he vies for power and control of Libyan oil. Also, an escalation in Persian Gulf tensions could pose a threat to global oil supplies and support a higher pricing on oil in the global market. We also anticipate that the Russian oil contamination situation will last for months. Over the past ten weeks, the crisis is proving bigger, longer and costlier than anyone had expected. Although extraction of the contaminated oil has commenced, no concrete deals have been reached between the Russian government and the affected parties. A prolonging of the crisis will limit Russia's oil exports, further tighten global oil supply and provide support for higher pricing of oil in the global market.

However, we note that trade tensions play a crucial role in the oil market and can be used by the US President to fulfil his desire for lower oil prices amid a deliberate effort by OPEC+ to keep prices elevated. This played out in May on President Trump's trip to Japan where he seemed to have softened his stance on Iran as he clearly stated that he is not seeking a regime change but rather a halt of its nuclear weapons program. Although no concrete agreements have been made thus far towards hosting a US-Iran summit to enable both leaders engage in a dialogue, a continuous effort by President Trump to douse the tension with Iran could successfully draw Iran to dialogue.

A successful summit could see sanctions being lifted on Iranian oil and ratchet up the supply of oil in the global market while softening oil prices. An example of deploying trade tension as a tool to regulate pricing in the oil market played out when the US threatened to impose a 5% tariff on Mexican imports and was due to increase monthly (up to 25% in October) until the surge of undocumented immigrants across the border subsides. This raised concerns about trade between both countries as Mexico is the world's biggest buyer of US energy products (more than 1mbpd). The possibility of retaliatory tariffs from Mexico increased fears about an oversupply in the oil market and pressured prices to c.US\$60/bbl. Although the US and Mexico reached a truce before the tariffs could take effect as Mexico was already working on the conditions President Trump had given, the pronouncement of the proposed tariffs sent panic to the oil market and weighed on the price of oil in the global market.

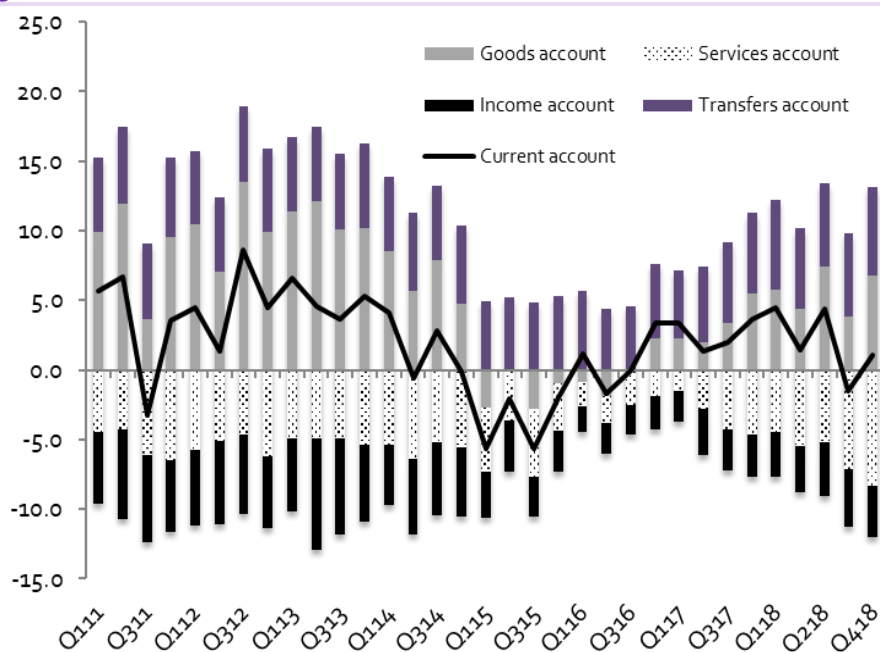
Although, trade tensions continue to spook fears of a slowdown in global oil demand, we believe demand will be healthy in 2019 as more countries work towards complying with the International Maritime Organization's (IMO) MARPOL environmental conventions ahead of the 2020 deadlines. Therefore, we expect Brent- the leading global price benchmark for Atlantic basin crude oils- to average US\$68/bbl in 2019 as supply disruptions offset concerns that trade tensions will curb demand. This is an upward revision to our earlier forecast of US\$60/bbl.

Nigeria's Economic Outlook

External Sector Outlook

Nigeria's external sector remained resilient in the first half of the year supported by oil trading at sub US\$60/bbl levels, stable oil production (1.96mbpd) and a not-so-significant growth in imports relative to exports. This has culminated in favourable terms of trade, eased pressures on the country's current account & external reserves and supported a relatively stable exchange rate through the period. The most recent update on the current account position revealed that Nigeria's current account position recovered in Q4-2018 and swung into a US\$1.1bn surplus. This was due to a 79% increase in the balance in the goods account as well as a narrowing in the deficit in the income account. The balance in the goods account increased as a result of a more aggressive drop in the imports (-14% q/q) than exports (-8% q/q) which caused the trade balance to rise by 28% q/q in Q4-2018. However, the deficit in the services account deepened to US\$8.3bn.

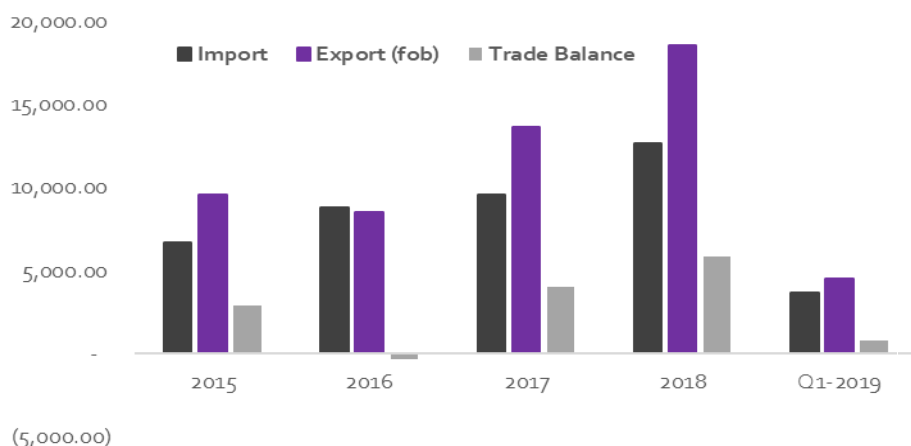
Nigeria's Current Account Position



Source(s): CBN, CSL Research

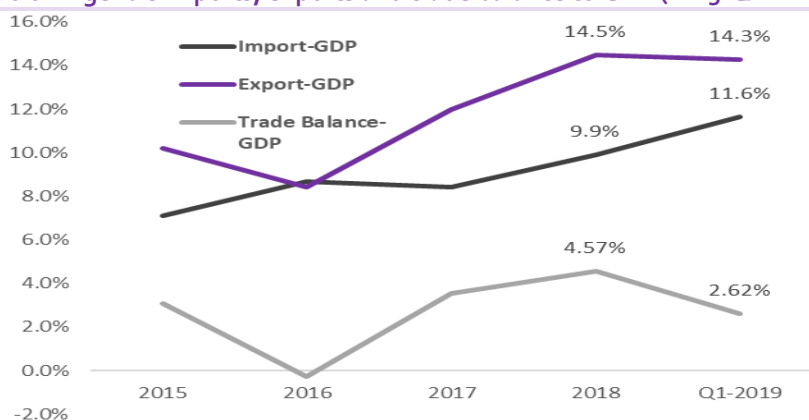
In the first quarter of the year, Nigeria's imports grew faster than its exports, fuelling a drop in its trade balance albeit, the trade balance remained positive. While the country's exports grew by 1.8% q/q, its imports were higher by 3% q/q causing a 5% drop in its trade balance to N832bn and a narrowing of the trade balance-GDP ratio to 2.6% from 4.6% in 2018.

Nigeria's International Trade in goods (2015-Q1'2019; N' billion)



Source(s): NBS, CSL Research

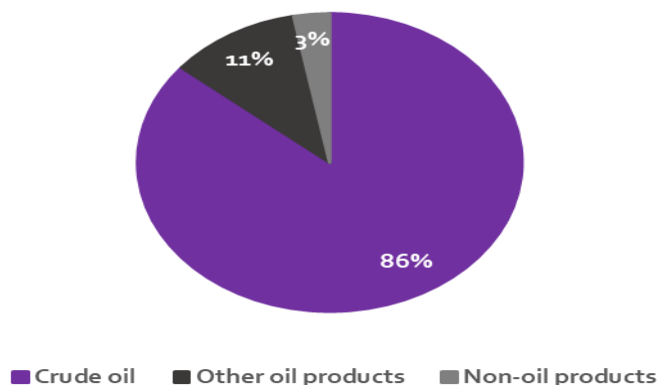
Ratio of Nigeria's imports, exports and trade balance to GDP (2015-Q1'2019)



Source(s): NBS, CSL Research

Exports in the period was still crude oil dependent as crude oil exports accounted for 86% of total exports while other oil products and non-oil products accounted for 11% and 3% respectively of total exports in the quarter under review.

Composition of Nigeria's exports (% , Q1-2019)

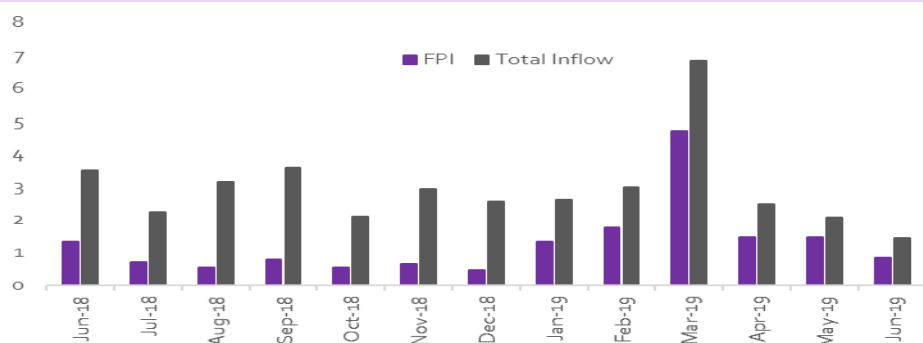


Source(s): NBS, CSL Research

Foreign portfolio flows into the Nigerian economy increased in the first half of the year relative to the corresponding period in 2018 despite the political and policy uncertainties that clouded the economy. Uncertainties increased on the back of the general elections as well as speculation of a possible change in leadership at the Central Bank. Also, threats by disgruntled candidates- in the February/March general polls- to contend election results in court increased uncertainty around economic policies and weighed on foreign investor sentiment, especially in the equities market.

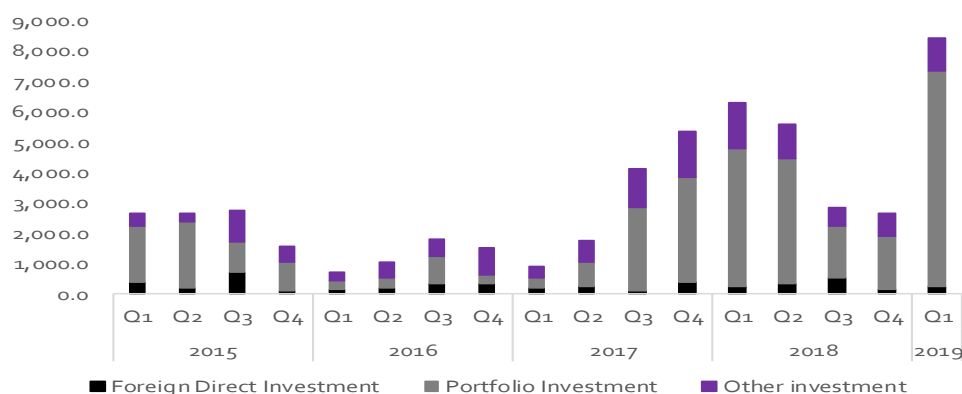
However, according to FMDQ report, FPIs inflows into the economy through the Investors and Exporters' (I&E) window stood at US\$11.3 billion in H1-2019 relative to US\$8.7 billion in H1-2018. Nevertheless, the bulk of the inflows were channelled towards the money market given the lethargic performance of the equities market. Capital Importation data for Q1 2019 revealed a 35% y/y growth in foreign capital inflows to US\$8.5bn with 84% of the inflows directed towards Foreign Portfolio Investments (FPIs). Further breakdown of the data shows that 83% of total FPI inflows were directed towards money market instruments reinforcing our earlier standpoint.

Investors' and Exporters' FX Inflow Report



Source(s): FMDQ, CSL Research

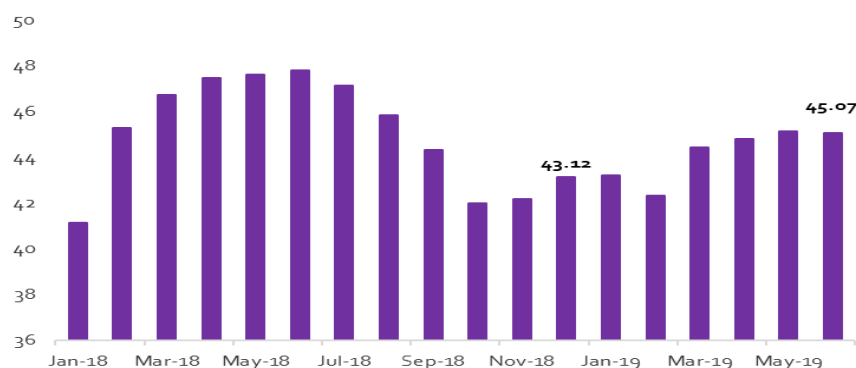
Foreign Direct Investment, Portfolio Investment, Other Investment (US\$'bn)



Source(s): NBS; CSL Research

The improvement in portfolio flows as well as the rise in the global price of oil had an attendant impact on accretion in external reserves. In H1 2019, the nation's external reserves rose by c.5% to US\$45.07bn. The bulk of the accretion was in Q1-2019 (3%) as the growth in the foreign reserves in the second quarter was subdued by a fall in the price of oil in the global market from a year high of US\$75/bbl in April 2019 to the sub US\$60/bbl during Q2 2019.

Gross External Reserves (US\$'bn)



Source(s): CBN, CSL Research

In 2018, the country’s external debt rose by 33% to US\$25.2bn from US\$18.9bn in 2017. This caused the cost of debt service to triple (to US\$1.4bn) from US\$464m in 2017 while the external debt- GDP ratio worsened to c.6% (2017: c.5%). For the current year, we expect external debt to rise further in 2019 by c.5% to US\$26.5bn as the Minister of Budget and National Planning has already hinted about the likelihood of increasing the level of borrowing in order to fully fund the 2019 budget. The rise in external debt could come from an increase in concessionary loans as the Director-General of the DMO noted through a separate medium, that the Federal Government wants to tap concessionary long-term loans to finance its 2019 budget in addition to local borrowing and plans are not underway to return to the Eurobond market this year.

Exchange rate outlook

Through H1-2019, the Naira remained relatively stable at both the parallel market and I&E window at c.N360.00/US\$. The accommodative monetary policy stance adopted by the US Fed limited the outflow of capital from emerging markets and eased pressure on local currencies (safe for countries like Turkey and Argentina due to country-specific risk factors), the Naira inclusive. In addition, higher oil prices sustained the inflow of foreign exchange into the economy while the negligible growth in imports resulted in moderate demand for the dollar. Looking ahead, we are optimistic on our outlook for oil prices in the global market and expect it to be positive for the country. Also, the return of Godwin Emefiele as the CBN Governor for a second term provides fixed income investors with some confidence of continuity in monetary policy and suggests that the CBN will still be biased towards sustaining foreign flows by adopting a data driven approach in setting the MPR. Hence, we anticipate sustained portfolio flows for the rest of the year. Against this backdrop, we expect the CBN to continue its intervention in the foreign exchange market and support a stable naira exchange rate at N360.00/\$ for the rest of the year.

Monetary Policy & Inflation Outlook

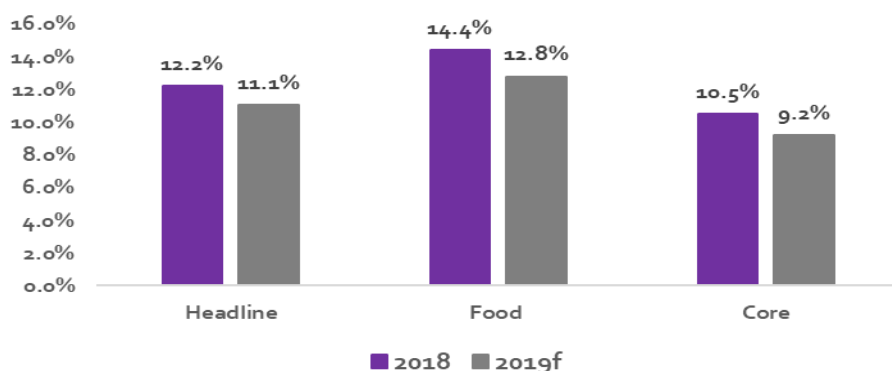
At its March meeting, the Monetary Policy Committee (MPC) appeared to be shifting its policy stance to pro-growth to boost domestic demand and stimulate growth. Thus, Monetary Policy Rate (MPR) was reduced by 50bps to 13.5% from 14.0% (a position it had maintained for 32 months), although inflation remained above the Central Bank of Nigeria’s 6.0% -9.0% target range. The decision to lower the MPR was hinged on the premise that inflation had moderated from a high of 18.7% in January 2017 to 11.3% in March 2019 (when the MPC decided to reduce the MPR) and the need to boost economic growth.

Additionally, pressure on external reserves and the country’s current account position had eased on account of export growth outpacing growth in imports. This enabled the

Central Bank (CBN) sustain its intervention in the FX markets, causing the exchange rate to be stable at around N360/US\$. With the macroeconomic indicators faring much better, despite increased global uncertainty, the arguments swung in favour of a rate cut.

Looking ahead, we see the need for the MPC to continue maintaining a tight monetary policy environment to sustain portfolio flows to the economy. This, however, needs to be balanced with the need to ensure that growth is not completely stifled. On a balance of factors, we anticipate a further rate cut of no more than 50bps for the rest of the year. Also, we expect inflation to moderate to 11.1% y/y (12-month average) from 12.2% y/y (12-month average in 2018). This will be driven by a subdued price pressure on both the food and core sub-indices, relative to 2018. In 2019, we expect food inflation to moderate further to 12.8% y/y (12-month average) from 14.4% y/y in 2018 while the core inflation is projected to ease to 9.2% y/y (12-month average) from 10.5% y/y in 2018.

Inflation (12-month average): 2018 vs. 2019f



Source(s): NBS; CSL Research

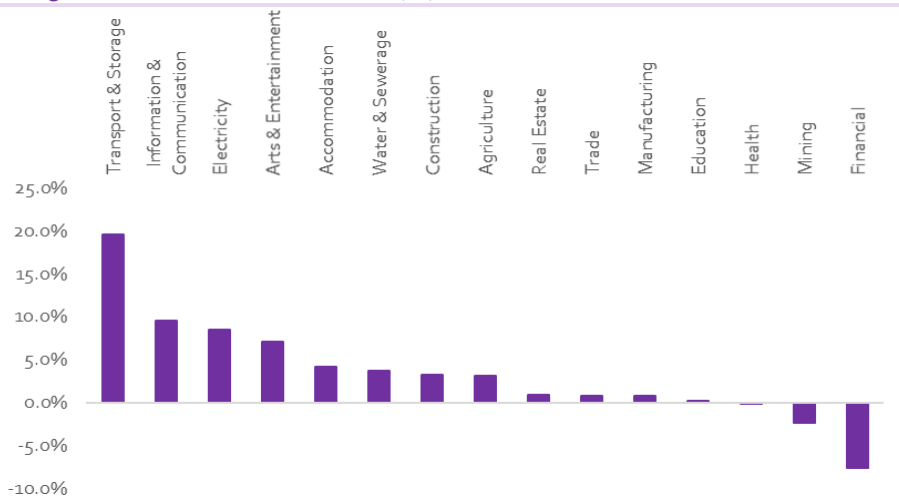
Real GDP Outlook

Against the backdrop of a pessimistic global outlook for 2019, we expect growth in the Nigerian economy to remain steady at 2.1% y/y in 2019. In 2018, the economy had sustained the growth momentum, growing by 1.9% y/y compared to a growth rate of 0.82% recorded in 2017. The growth in 2018 was largely propelled by improvement in the non-oil sector, which grew at 2.0% compared to that of the oil sector which grew by 1.14%. Growth in the real sectors of the economy (agriculture, mining, and construction, manufacturing and trade sectors) remained sluggish, resulting in an adverse impact on employment generation and by extension, income generation and poverty reduction as the real sector accounted for 63% of national output in 2018.

In Q1-2019, the Nigerian economy grew by 2.0% y/y, although, the pace of growth was slower than the 2.4% y/y growth recorded in Q4-2018. Performance was mixed across economic sectors and the utilities sector continued to outperform the real sector. The sluggish growth in the real sector extended to the first quarter of 2019 as growth in the real sector- which captures agriculture, mining, manufacturing and construction was sluggish, as it recorded a slower growth of 1.5% y/y (vs. 4.8% y/y in Q1-2018) while the utilities sector expanded further by 18% y/y in the review period. The growth in the real sector was held back by a further contraction in the mining sector (-2% y/y) as well as the slower growth recorded in the manufacturing sector (0.8% y/y). Both sectors constituted 9.2% and 9.8% respectively of real GDP in the review period (Q1 2018: 9.6% and 9.9% respectively). In addition, the sub 3% y/y growth rates recorded in the agriculture and construction sectors was not enough to accelerate growth in the real sectors of the economy.

However, the utilities sector- which captures transport & storage, information & communication, electricity and water & sewerage- sustained its growth momentum and posted double-digit growth of 18% y/y in Q1 2019. This was led by the transport sector which grew by c.20% y/y propelled by a strong expansion in road transport (21% y/y). We note that investors' apathy for Nigerian risk assets in the first quarter of the year resulted in a deeper contraction in the financial services sector as output from the sector shrunk further for the third consecutive quarter by c.8% y/y. On the bright side, the real estate sector posted a modest growth of 0.9% y/y, representing the first growth in 13 quarters.

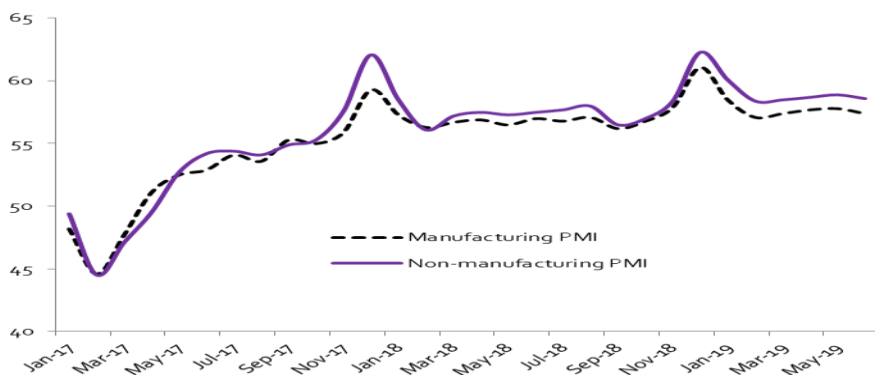
Q1-2019 Growth in Economic Sectors (%)



Source(s): NBS, CSL Research

For the rest of the year, we believe growth in the real sectors will remain subdued. We expect growth in the agriculture and construction sectors to stagnate at 2.1% y/y and 2.3% y/y respectively while we anticipate a 2.1% y/y contraction in the mining sector (2018: +1.3% y/y). Also, growth in the manufacturing sector is expected to slow to 1.4% y/y (2018: 2.1% y/y). We note that Purchasing Managers' Indices (PMI) readings have softened since December, although they have remained above the neutral 50.0 points level, pointing to a possible slowdown in the pace of expansion in the manufacturing sector.

PMI: Manufacturing vs Non-manufacturing



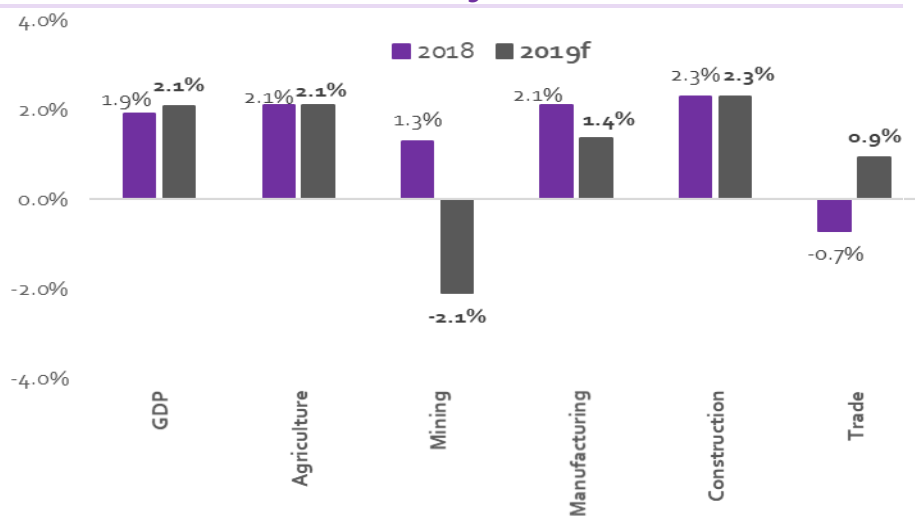
Source(s): CBN

Furthermore, we expect growth in the construction sector to stagnate due to weak implementation of the CAPEX side of the budget, further delaying the current

administration’s infrastructure development mandate. We anticipate an improvement in trade (0.9% y/y vs -0.7% y/y in 2018) on account of higher pricing of oil in the international market.

In the mining and quarrying sector, we may see some pressure on output in 2019 on account of wear and tear in oil infrastructure as well as vandalism of pipeline due to theft and civil unrest. Already, the operator of OML 29 (Aiteo) had declared a force majeure on the Nembe Creek Trunk Line (NCTL) due to a fire incident that is suspected to have been triggered by an illegitimate, third-party breach of the functionality of the pipeline. The NCTL has the capacity to produce 150k barrels of oil per day. Also, Total declared a closure on its Amenam field trunk- whose exports are typically around 100k bpd while the Forcados trunk line (with a 250k bpd capacity) was also closed briefly due to an alleged inferno. In addition, there have been reported cases of kidnapping of oil workers in the Niger-Delta region which if not checked promptly could escalate, resulting in further production disruptions. Against this backdrop, we expect output from the sector to contract by about -2.1% y/y.

Real Sector GDP Growth Rate: 2018 vs. 2019f



Source(s): NBS, CSL Research

Despite our weak expectation from the real economy, we are optimistic about growth in some non-oil sectors- particularly the information and communication sector. We expect the information and communication sector to grow by 15.8% in 2019 against a growth rate of 9.7% recorded in 2018, driven by the continued adoption of information & communication technology (ICT) by the country’s teeming population and aggressive engagement of capital expenditure on continued 4G LTE rollout.

Fiscal Outlook

In the last few years, the country’s fiscal profile has been characterised by colossal expenditure plans, optimistic revenue assumptions and substantial shortfalls in revenue, all of which have resulted in huge fiscal deficits which has been financed by both local and foreign borrowings. In 2016 and 2017, actual revenues fell short of their targets by 32% and 48% respectively with preliminary data for 2018 showing a revenue shortfall of 45% of the target. These revenue shortfalls have been accentuated by disruptions to oil production against an unrealistic benchmark of 2.3mbpd in the budget and an inefficient tax collection system. Dearth of new investment in the oil sector have resulted in the wear and tear of the existing infrastructure, causing frequent breakdowns. Also, the Niger-Delta region is prone to civil unrest and security challenges- both of which have continually posed downside risks to the country’s crude oil producing capacity. Thus, the

government had resorted to borrowing to finance the deficits in order to implement its expansionary fiscal plans. Increase in borrowings has continued to put pressure on the government's fiscal position through the dual impact of rising borrowing costs and higher indebtedness- we believe this was responsible for the reduction in the budget size for 2019, albeit at the expense of capital expenditure.

In 2019 thus far, government revenue has been stable. Although, there have been reports of disruption to oil production in the Nembe Creek Trunk line (with a capacity of 150,000 bpd) and Amenam field trunk (with a capacity of 100,000 bpd), this has been offset by a higher pricing on oil in the international market as oil currently trades at a 5% premium (US\$63/bbl) to the oil price assumption of US\$60/bbl in the 2019 budget. As at April 2019, oil revenue constituted c.60% of total revenue to the government.

Government spending in the first half of the year has been predominantly recurrent (salaries, interest repayment and election funding) expenditure. Not much has been achieved with respect to capital expenditure owing to a shift in government focus to delivering a peaceful election, further exacerbated by the delay in the passage of the 2019 budget by the House of Assembly. Upon passage of the budget by the House, the Senate approved the sum of N8.92trn for 2019's expenditure plan, slightly higher than the initial proposal (N8.83trn) submitted by the President but lower than that of 2018 (N9.12 trillion). This increased the proposed budget deficit for 2019 by N58.83bn.

The details of the approved budget revealed that allocation to recurrent (non-debt) spending (i.e. personnel costs, funding for welfare schemes and amnesty programs, etc.) is significantly higher in the 2019 appropriation bill by c.34% at N4.7trn compared to N3.5trn in 2018. However, allocation to capital expenditure is the same as 2018 at N2.9trn. It is however unclear if the rise in recurrent (non-debt) expenditure has captured the implementation of the new minimum wage as public information shows that the notable changes made by the Senate were increased allocation to security and making provision for the severance benefits of outgoing lawmakers, their aides as well as the National Assembly orientation program- which were not captured in the initial proposal submitted by the Presidency.

Comparison of Budget Proposal versus Approved Budget

	May Approved Budget, NGNbn	December Budget Proposal, NGNbn	Change, %
Revenue	6998	6967	0.4%
Oil Revenue	3688	3688	0.0%
Non-Oil Revenue	3310	3278.71	1.0%
Aggregate Expenditure	8917	8827	1.0%
Statutory Transfers (incl capex)	502	492	2.0%
Recurrent Non-Debt	4735	4718	0.4%
Debt Service	2144	2144	0.0%
Sinking fund	110	120	-8.3%
Capital Expenditure	2873	2428	18.3%
Capex % of total expenditure	31	30	3.3%
Budget Deficit	-1918	-1860	3.1%

Source: FMBNP, CSL Research

This year, the government has been a little aggressive with its borrowing. So far, the government has raised a total of N602 billion via the sale of local bonds- about four times the total amount raised in 2018 (N134 billion) through bond sales. The government also opted to extend the term of its domestic borrowings, as we had anticipated, with the introduction of the 30-year maturity in April. This will reduce the

risk of redemption concentration in the short to intermediate term as the longest maturity on the FGN debt instrument was 2037, prior to the sale of the 2049 bond.

For the rest of the year, we expect oil prices to continue trading above the US\$60/bbl budget benchmark amid deliberate efforts by OPEC+ to continue supporting the price of oil through the production cuts. Hence our expectation of a US\$68/bbl average price for 2019. This is particularly positive for the government's purse, in addition to stable production in the Niger-Delta. We also expect the country's actual production to come in at 2.0mbpd, against a benchmark of 2.3mbpd in the 2019 budget proposal. With respect to non-oil revenue, we agree that tax revenue could come under pressure due to the halt of the voluntary tax amnesty schemes and narrow profit margins to companies. However, we expect the recent increase in Value Added Tax (VAT) to provide some support to government revenue. Also, the tax agency has been consistently making deliberate efforts to expand the tax net and we believe this tax drive will continue through the year.

On the other hand, we do not anticipate an aggressive rise in government spending for the rest of the year as we envisage the President will be focused on re-structuring his cabinet for his second term. In his first term, it took about five months for the full government cabinet to be sworn in. On the back of this, we believe the implementation of the 2019 budget will spill over to 2020.

We highlight that with the factors that pose a downside risk to the country's fiscal profile still in place (over-reliance on oil revenue, inefficient tax system, inadequate investment in the oil sector and a volatile Niger-Delta region) a shortfall in government revenue estimate for 2019 is almost unavoidable. In addition, high cost of subsidies and the Niger Delta amnesty program as well as the implementation of the new minimum wage will further stretch the government's purse and could cause fixed income investors to demand a higher yield for their investments, thereby worsening the government's fiscal profile.

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