The 2018 Budget and the Fear of Secular Stagnation

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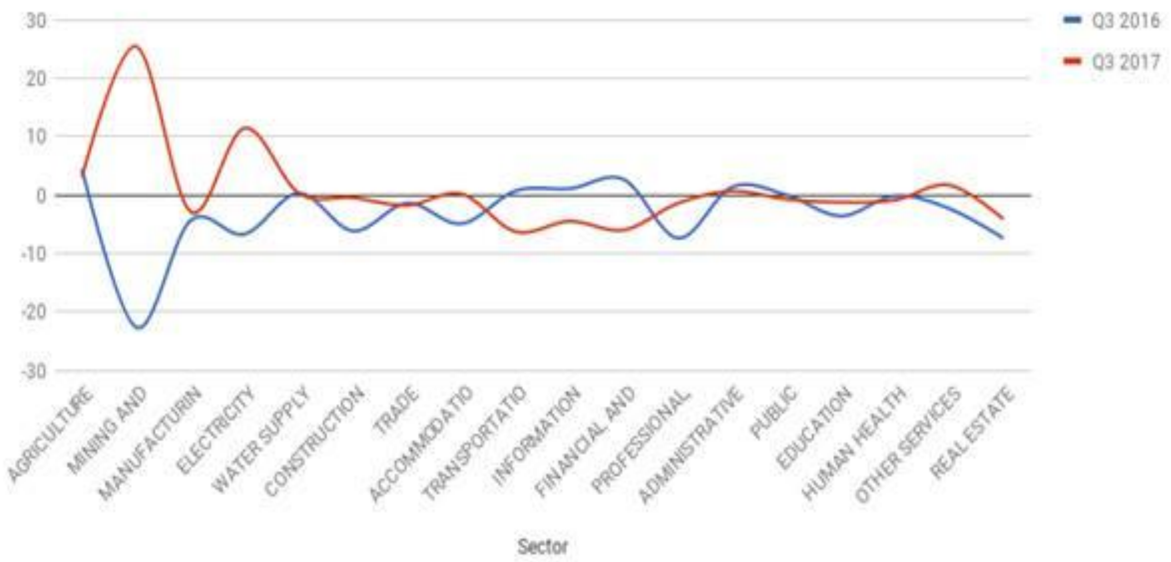
The Importance of 2018 Budget

A budget is a country's most important document as it provides the needed hindsight on the policy objective of the movement coupled with the tools available. Beyond the importance that characterise every budget as mentioned earlier, the 2018 budget does enjoy an overriding importance and why?

1. It is cheery to note that Nigeria grew by 1.4% in the Q3 2017 , regardless most sectors of the economy is still in negative territory. Especially the non-oil sectors, in fact sectors like finance and ICT which were resilient during the recession are already experiencing missing output. Therefore, growths remain largely fragile, the possibility of lingering fragile growth could lead to stagnation.

Fig 1: 2017 Third Quarter GDP



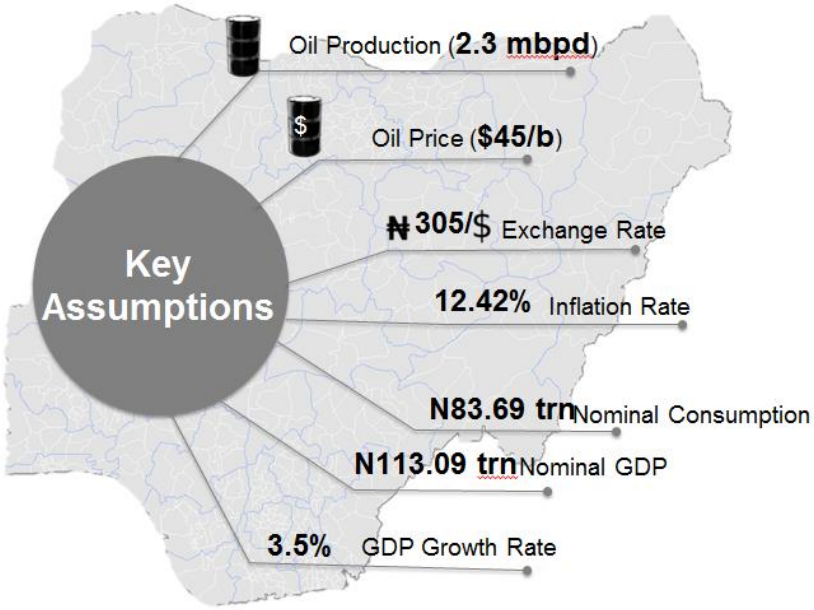
Source: NBS

2. The 2018 budget usher in another mid-term, which is significant. As it is, the 2018 budget does not just hint on a one year plan but a larger picture of a 3 year plan. It is the first leg of 3-year mid-term plan.
3. Certainly, it is the penultimate budget prior to the election year. Politics tend to have the front row while economics take the back seat.

Therefore, the importance of the 2018 budget to further foster economic activity, also salvage a largely depressed human index's cannot be underemphasized at this point.

Projected Macro Assumptions

Fig 2: Assumptions in the 2018 budget



Source: Budget Office of the Federation

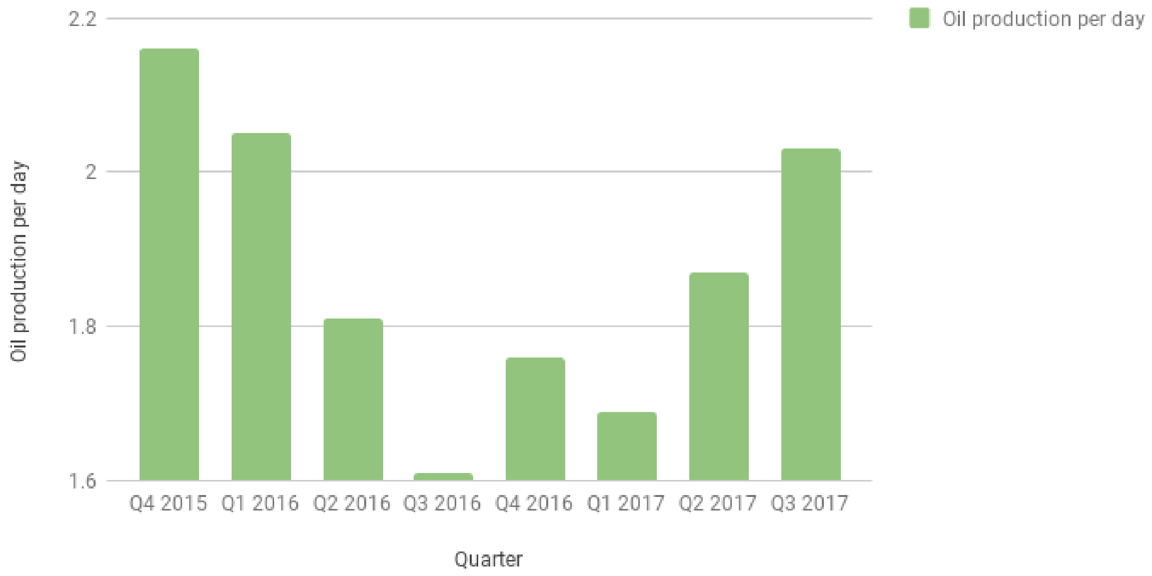
The Assumptions are largely in line with the Economic recovery and growth plan (ERGP), as most projection remains in tandem with the ERGP. The 2018 budget also signals substantial policy continuity, clearly pointing out that the ERGP is the over-arching plan.

Shelving through the Assumptions

Oil Production

At the end of the 3rd quarter of 2017, oil production had rose to 2.03 million barrels per day from 1.64 million and 1.87 million barrel per in the corresponding quarter of 2016 and previous quarter of 2017. The steady increase in oil production, has been primarily responsible for lifting the GDP out of recession.

Fig 3: Oil Production per day from Fourth Quarter 2015 to Third quarter of 2017



Source: NBS

The recent OPEC decision to cap Nigeria from 2.2 million barrels day to 1.8 million barrels per day puts the budget under threat. In the light of such decision, the budget is presently undercut by N530 billion. Therefore, leaves the budget with 2 options:

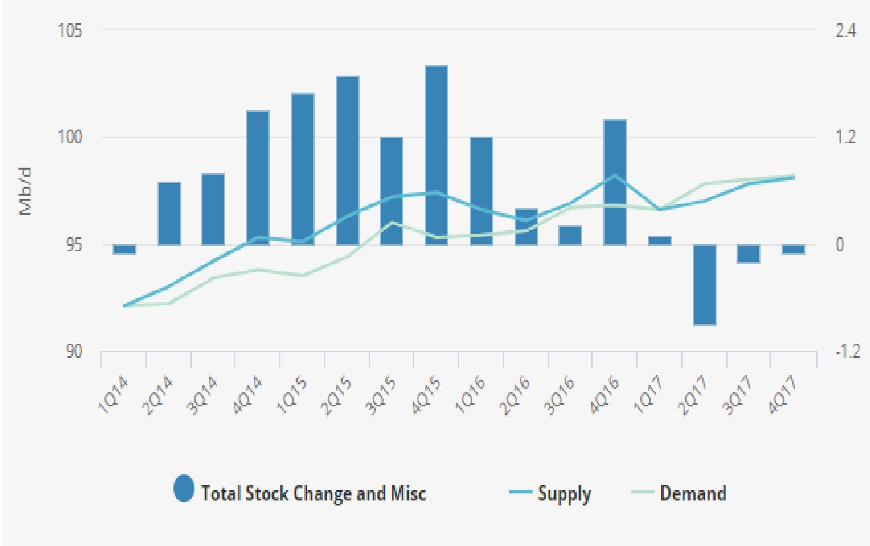
- Increase the price benchmark or
- Widen the deficit

Oil Price

There is a gradual reversal in the cycle as the earlier patterns of excess crude supply give way as it is replaced by marginal excess demand. In response, the global balance of crude stock has experienced backwardation. Thereby, the current price assumption of $45 per barrel is considered conservative enough.

A mark up in budget oil price is inevitable to cover the production cap. The inability to mark-up the price benchmark in the budget could widen the budget deficit.

Fig 4: Supply and Demand of Crude Oil



Source: IEA

Nominal Currency

The introduction of the Nigerian importers and exporter's window in June 2017 coupled with improves oil receipts restored calm to the exchange widow. Thus the exchange rate assumption of N305/$ hint on a few things

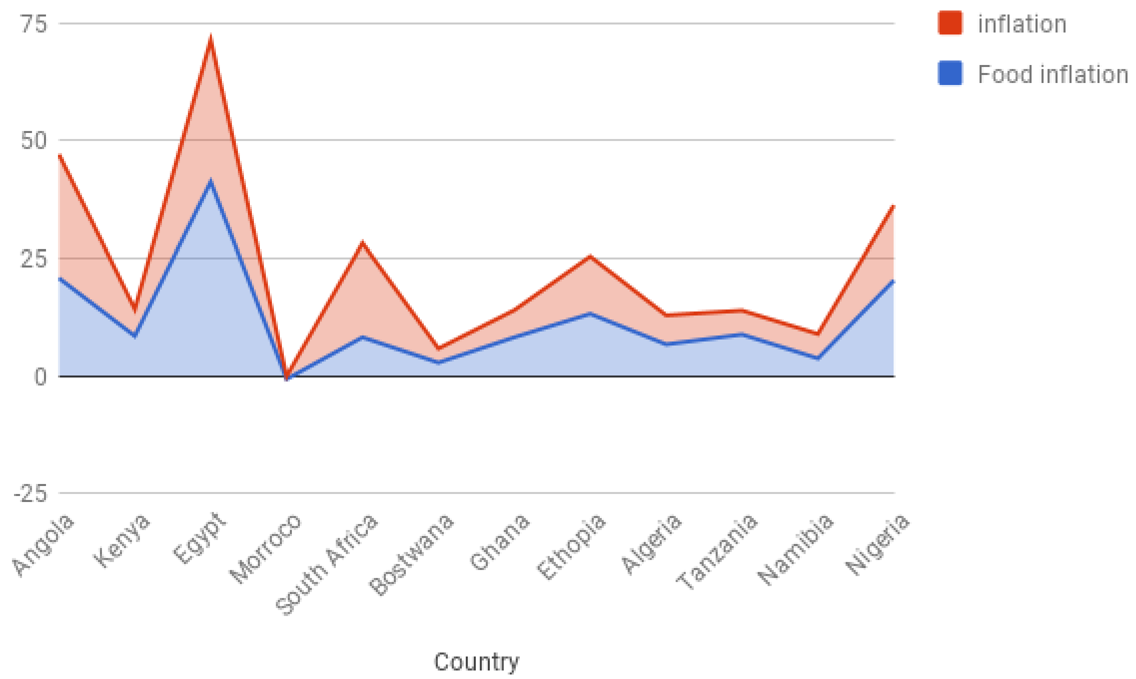
- The federal government will maintain the crawling peg exchange rate regime
- Rate fragmentation will still exists, thereby unification of rates won't occur
- The N305 to a Dollar is largely meant for oil subsidy in 2018

Price Stability and the Rate Channel

Inflation has slipped from 18.72% at the end of 2016 to 15.91%, factors largely responsible for inflation were

- Base effect
- Weaning core inflation
- Central Bank's dynamic sterilization, softened month-on-month inflation
- Delayed rains, weak harvest and rising cost of transportation have bolstered food inflation, making it an up risk to price stability.

Fig 5: Headline and Food Inflation across Selected African Nations



Source: Trading Economics

Budget assumptions on inflation are still in tad, as we are convinced food inflation will remain high in 2018 coupled with an already exhausted base effect.

Although, the Central Bank has made it clear that its numerical target for inflation is 15% and the bank won't cut its rate until it hits that target.

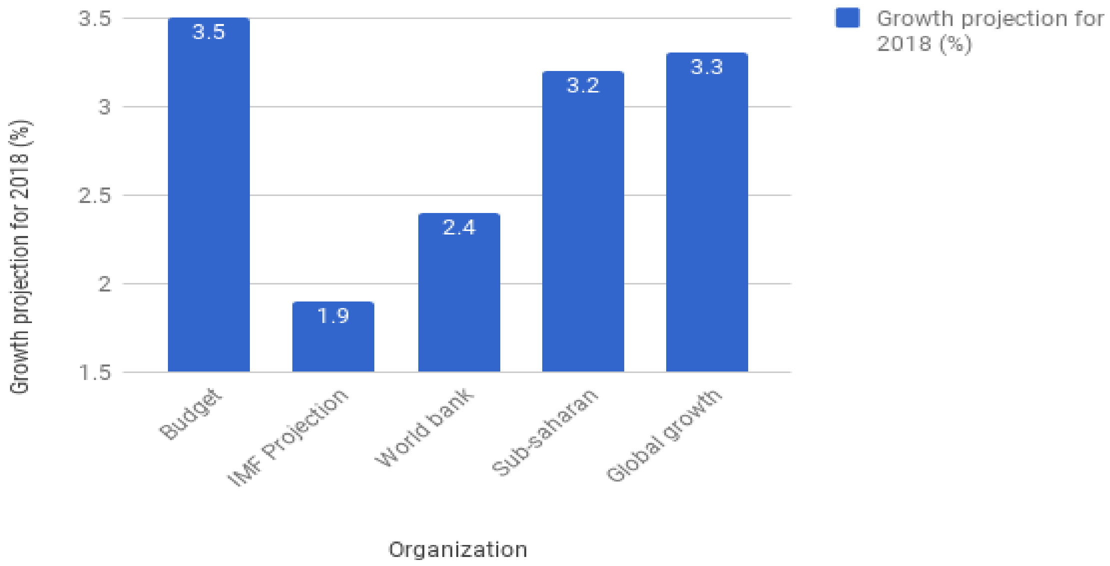
"Moving forward, the CBN must distinguish between when price alone maters and price do matter. In 2018 price do matter, just as other fundamentals such as growth and unemployment matter more". After all, the natural rate (MPR) is indexed as a baseline for government borrowing.

A research paper delivered by CBN on February 2016 in one of its monetary paper session, titled "Relevance of inflation targeting in the new normal for developing countries: Nigeria a case study.

The bank in its concluding remarks stated
"It appears that a full-fledged Inflation targeting framework may not be too relevant in the new normal as it may not address the exchange rate and foreign reserves variability, economic growth as well as employment objectives of the Nigerian economy. However, the alternative scenario of Nominal GDP targeting framework seems more plausible, as it generates higher economic growth, increment in foreign reserves, more stable exchange rate as well as lower inflation rate". I guess it couldn't be said better.

Growth

Fig 6: Growth Projections for 2018



Source: IMF, Budget Office of the Federation, World Bank

The 2018 budget projects a 3.5% growth for 2018, which is far ahead of the International monetary fund projection of 1.9%. At the same time the World Bank forecast a 2.4% growth in 2015, while the regional and global growth forecast stands at 3.2% and 3.3% respectively. The present missing output in the real sector put a 3.5% growth under threat. Certainly, there is a limitation to how far 1.8 million barrel coupled with possible mark up in the price benchmark can go as scaffold.

The ability to achieve growth above 3% hinges largely on how best to lift the real economy from negativity. In house projection for 2018 lie between 2.5% to 2.8%

Budget Projection and Economic Freedom: Priming the Pump

Policy objectives of 2018 budget;

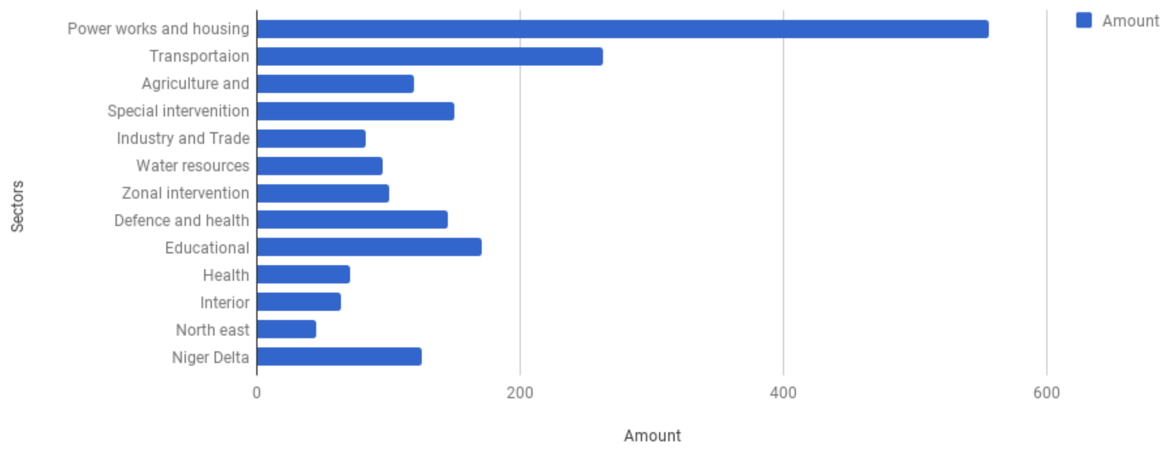
- Re-balancing the debt portfolio of government from 84:16 to 60:40
- Increase tax's to GDP from 6% to 15%
- Increase Value added tax's on luxury goods from 5% to 15%, such as champagne, Yachts
- CAPEX range between 30-35% of the total budget.
- Deficit to GDP should not go beyond 3%
- Maintain its expenditure switch policy
- Concession off some public infrastructure
- Sell off non- oil Assets, especially those the government consider to be dead wood

Table 1: Budget Projections for 2018 and 2017

Highlights	2018 Trillion (N)	2017 Trillion (N)	Change (%)	Ratio to GDP (%)
Oil revenue	2.442	1.985	23	2.16
Non- oil revenue	3.31	1.37	142	2.93
Independent	0.85	0.81	5	0.75
Aggregate revenue	6.61	5.08	30	5.85
Deficit	1.77	2.14	17	1.57
Capital expenditure	2.43	2.24	8.4	2.15
Non- interest Recurrent expenditure	3.494	2.9	20.4	3.1
Interest expenditure	2.041	1.66	22.95	1.81
Aggregate expenditure	8.612	7.44		7.62
External	0.84	1.07	21	0.74
Internal	0.84	1.25	33	0.74

Source: Budget office of the Federation

Fig 7: Allocation across Priority Sectors



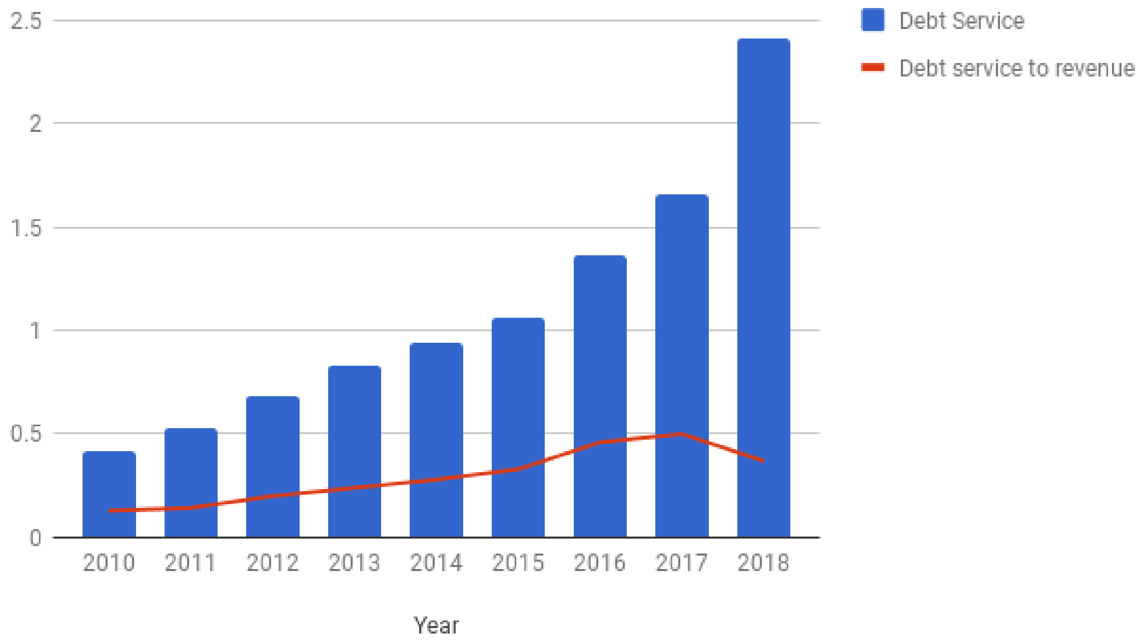
Source: Office of the Budget

Key Take Away

- The revenue pool, underlines government objective at diversifying its revenue base
- Given recent event that the budget will experience material change undercut envisaged from the current production cap, has to be resolved.
- Although measures such as increase in the VAT rate on luxury good, voluntary asset and income scheme (VAIS) and sale of non-oil asset will bolster non-oil revenue e.g. Argentina

- At the same time Projecting 142% increase in Non –oil revenue could be a distance off from reality and why? Non-oil revenue have been tepid so far, in the first half of 2017 alone, non-oil revenue fell by 53.3%, short of projection.
- Moreover the weakness in the real sector remains an headwind to company income tax's
- Although the relative stability in the Exchange rate corridor will support an improvement in custom revenue in 2018, compared to the past.
- The lack of a proper legal frame work and valuation structure could pose as a threat to maximising independent revenue.
- In line with policy objective, the budget deficit is below 3% but the deficit to GDP. Possible shortfalls to estimate could inflame the defect to GDP ratio.
- However debt servicing is 1.8% to GDP, 27.9% of total expenditure and 43.5% of recurrent expenditure.
- Debt servicing has risen from N 416 billion in 2010 to N2.041 trillion in 2018.

Fig 8: Debt servicing and Debt to revenue from 2010 to 2018



Source: CBN, Office of the Budget of the Federation

- By rebalancing the debt portfolio, the trajectory of debt servicing will grow at a slower pace.
- The rising chunk of foreign debt in the debt portfolio could trigger an astronomical increase in debt to asset ratio, if currency shocks are not managed properly
- The huge expenditure on infrastructure underlines the administration to maintain its expenditure switch policy.

How Does The 2018 Budget Fare With Regards To Economic Freedom?

Table 2: Economic Freedom

Freedom	2018 Budget	Verdict
Business	• Supporting private public partnership through concessions • Providing tax's credit for firms willing to build infrastructure • Mobilising revenue through the sale of non- oil asset, encourage private contribution to gross capital formation. • Tax incentives for Foreign Direct Investment • Slashing import and export requirement • Improving the ease of doing business	Positive
Financial/ Financial Deepening	Rebalancing debt portfolio will the crowding out effect experienced by firm Eventually enhancing financial freedom but possible shortfall in non-oil revenue threaten it.	Positively cautious
Monetary	Maintaining the crawling peg coupled with an expansionary monetary policy puts monetary freedom largely neutral	Neutral

Certainly, improved macro management such as institutional reforms and a more accommodative stance towards the private sector is responsible for bolstering of business freedom.

The incomplete assimilation of fiscal adjustment in the budget is responsible for the position of financial and monetary freedom respectively. Most importantly it underlines the short pits of an expenditure switch policy in the face of a revenue mismatch.

2018 Budget and the Household: What is the True Value Of the 2018 Budget? : Secular Stagnation

Budgets are people centred, while such centre is largely driven by forward looking policies. At the same time the policies are made up programmes and project. Over the years the Naira has lost its value both internally and externally, ascertaining the real value of the budget is inevitable. In order to determine the root of the expenditure, therefore what is?

1. The actual value of the 2018 Nigeria budget?
2. The actual cost of expenditure per person and government spending per person
3. The budget's contribution to per capital income and Purchasing Power Parity (PPP) per Individual.

Budgeting over the years have been quantitative driven, most circumstance comparison are most done base on the face value on the Naira. Even though given the nature of our economy as an export concentrated one, we are forced to readjust rate in order to calculate revenue appropriately and tap into external debt.

In most circumstances budget comparison has been base on face value of the naira whereby filtration either of exchange rate or inflation is not done. Just like we had earlier done in the previous section, we end up relying on the nominal value.

The inherent monetary illusion associated with the nominal value make it hard to determine the actual value of the budget. Therefore what is the real value of the Nigerian budget and how deep is the budget spending root on an ordinary Nigeria?

Table 3: The Value of Projected the 2018 Budget in Dollar Terms from 2000 to 2018

Year	Amount Billion ($)
2000	6.71
2001	7.98
2002	4.77
2003	5.40
2004	6.66
2005	10.29
2006	11.92
2007	15.09
2008	18.01
2010	26.42
2011	23.44
2012	25.3
2013	32.01
2014	28.43
2015	22.80
2016	19.92
2017	20
2018	23

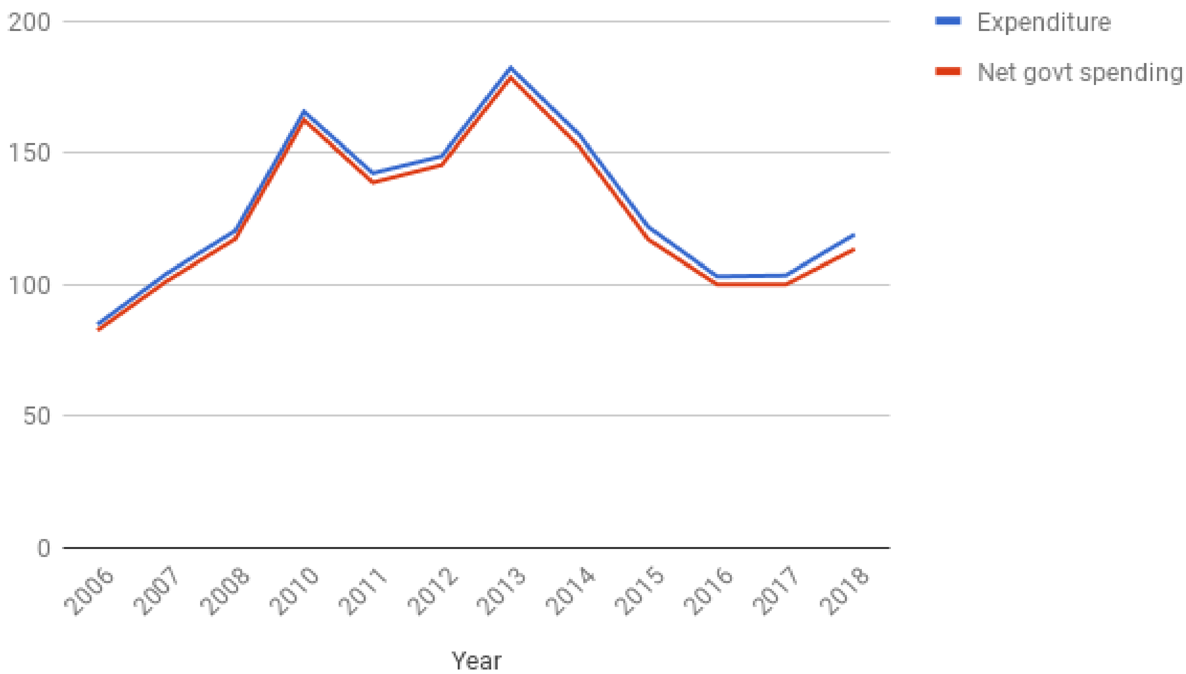
Source: CBN

*The end user value of exchange rate was used, it has as stronger correlation with inflation *

- Filtering face value of total budget from Naira depreciation and inflation, the actual value of the budget is $23 billion
- The 2018 budget is 15% and 13% higher than 2017 and 2018 but far less than budget year of 2010, 2011, 2012, 2013 and 2014.

- The budget in Dollar terms clearly point out government's objective to keep priming the pump, so as to shore up the fragile growth.
- At the same time intrinsic value of the budget is far less than what it was 5 years ago

Fig 9: Budget Expenditure Per person and Net Spending per Person from 2000 to 2018

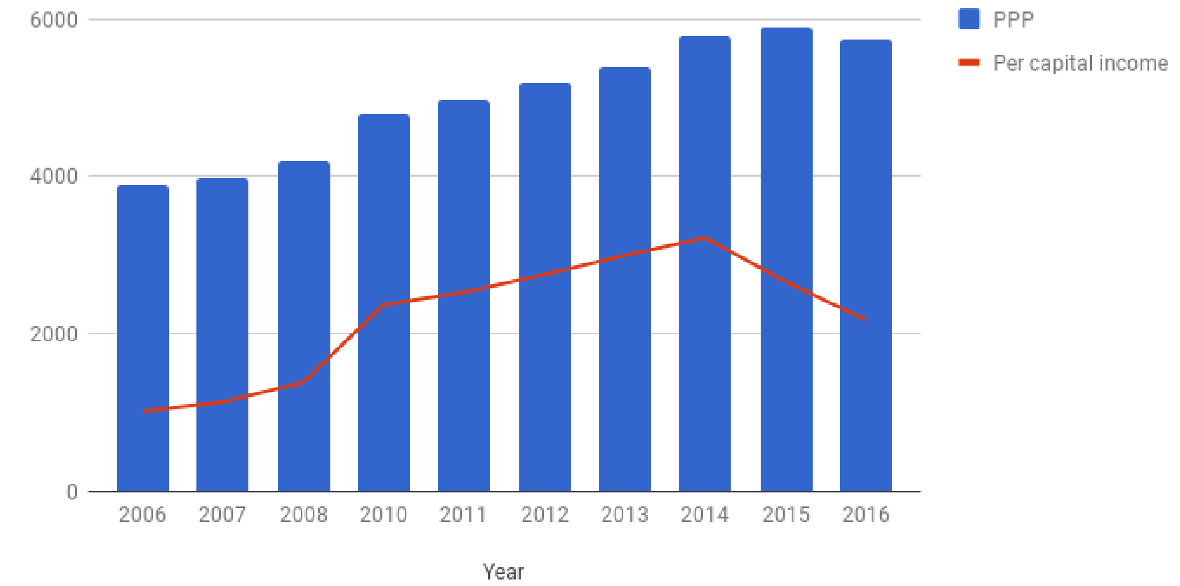


Source: CBN, National Population Commission

- According to the Nigerian population commission, Nigeria's population has risen from 140 million in 2006 to 196 million in 2016.
- Nigeria has been growing at an average population of 5million every year, which is higher than the total population of North Ireland. The population of north Ireland stands at 4.6 million.
- Budget expenditure and government net spending per person is $118 and $113 in 2018
- Even though, budget expenditure per person and net spending rose 15% compare to the previous year.
- Regardless, budget expenditure per person and Government net spending person has fallen far below levels of 2008

Even though government is spending more on each individual compared to 2018. On the other hand the combination of rising debt and population, concentrated revenue pool and successive currency shock has blunted net spending per person to levels compared to 2007.

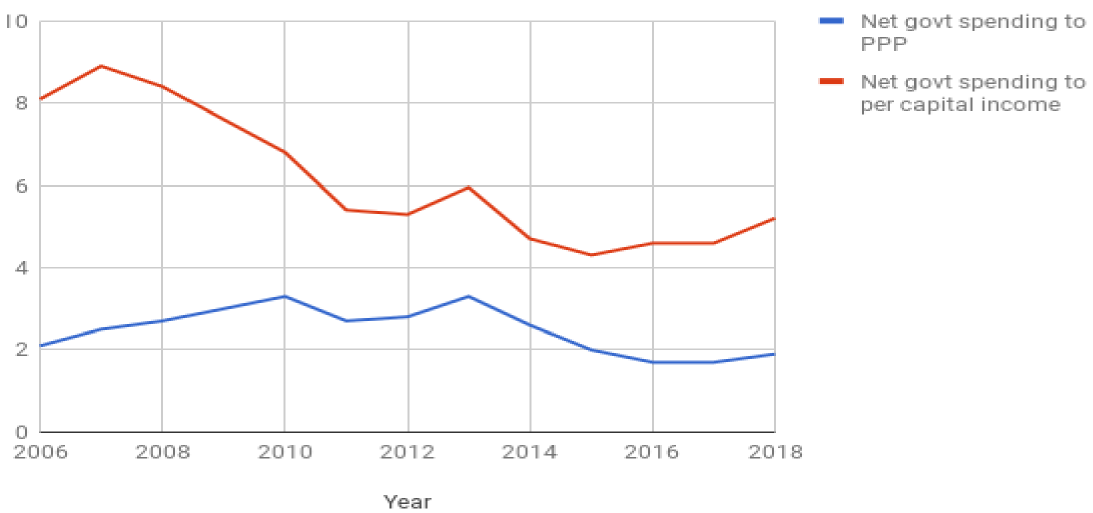
Fig 10: Purchasing Power Parity and Per Capital Income



Source: World Bank

- Presently, the per capital income of an ordinary Nigerian stands at $2,177. Per capital income has fallen from $2,665.16 and $3,221 compared to the previous and penultimate.
- Our present PPP stands $5,740, far less than the previous and penultimate which were $5,900 and $5,740 respectively
- Although it is expected that as growth pick up marginally at the end of 2017, PPP will move in the same tandem
- Regardless the growth is too little to provide a scaffold for per capital income to rise, validating the existence of a secular stagnation

Fig 11: Net Government Spending contribution to both per Capital Income and Purchasing Power Parity



- Net spending will only contribute 5.2% of net capital income, relatively lower than 2014
- Net government spending to PPP will be 1.9%, slightly higher than 2016 and 2017; which was 1.7% for those years.
- The effect of government spending as a contribution to net per capital at the end of 2018 will be largely flat.

Implying that growth levels at the end of 2018 might not have any substantial impact on income nor address the bloated level of misery. Therefore policies that support private capital formations can best address this dent in per capital income.

Deepening structural and institutional reforms that can attract more multinational enterprises (MNE) participation in the economy is of great importance.

The Effect of 2018 Budget on Sectors and Selected Economic Agents

Table 4: (Looser, Neutral and Winners 2017 and 2018)

Sector	2018	2017
Oil	Neutral • Oil prices have risen but the balance of stock crude is margin. Besides the cap to production will limit capital investment in the upstream	Neutral
Portfolio Investors	Neutral • On-going, rebalancing of debt portfolio by government will dent yield on their risk free asset. Therefore reduce the revenue mobilization	Winners
Agriculture	Winners/positive • Government increased intervention in the agriculture sector	Winners
Construction	Winners/ positive • Increased spending in capital expenditure will blister the construction sector	Winners
Banks	Neutral • In response to rebalancing government portfolio high, which were a major source of revenue for banks	winner
Accommodation	Neutral	Neutral
Mining	neutral • Increased attention in the solid sector remain a budding stage	Neutral
Real estate	Losers	Losers

	• Real estate have been a third feeble, due to the fact it is cramped behind road and energy	
Exporters	Winners • Slashing requirements for exporters coupled with the export promotion policy of the present admiration	Winners
Manufacturing	Neutral	Neutral
ICT	Positive cautious • Promoting e-government • Establishing ICT clusters	Neutral
Transport	Winner • Continuous investment in rail and road	Winner

End

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