RISK RADAR

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NIGERIA IN 2019: A GLIMPSE

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Overview

Finite Risk Advisors Limited looks at some selected issues for Nigeria in 2019. We connect them across the landscape and explain them around the threats and prospects for Nigeria's macroeconomic themes. We zero in on the Political happenings, Assumptions of 2019 National Budget and Regulatory actions across some key sectors for pointers.

Introduction

The year 2019 is an election year and this makes us to start from the Political Risk angle. The flow of political actions stems from the Federal Government's moves, because regional/state governments actions have less impact on the national polity generally. The federal government of Nigeria wields enormous power.

Political Outlook

- **New National Minimum Wage Bill**: This executive draft bill which pegs the national minimum wage at N30,000 is a potential political threat. The bill is yet to be transmitted by the President to the National Assembly. It can be heard among Nigerians that an improved wage compensation is required for workers but aside the Federal Government plus two or three other states which can foot their monthly wage bill with minimal hiccups; many Nigeria states find it difficult to pay their workers' salaries even at the present rate of N18,000 minimum wage. We therefore foresee a hard compromise between a very formidable labour union and the Federal Govt. There will be some serious fallouts for most states should the bill be signed into law.

- **A Polarised National Parliament**: There have been political tensions in the National Assembly following the exit from the ruling party of some high-ranking legislators, though some legislators equally moved in the opposite direction. The Senate President and the Speaker of the House of Representatives left the ruling All Progressive Congress (APC) for the main opposition party, the People Democratic Party (PDP). It is our view then that the tensed atmosphere poses a stern challenge for the ruling party to have the 2019 Appropriation Bill passed. A pointer to our assertion was the incident of 'jeering and cheering' of President Buhari on the floor of the Parliament during his

budget presentation speech earlier in December 2018. The Senate President and the Presidential candidate of PDP also derided the budget as unrealistic few days after its presentation.
A constructive bipartisan approach is needed now more than at any time for the Parliamentary approval. But we see a storm in this regard in 2019.

- **Who wins the presidential election?** The biggest upset for the political landscape will be a loss for the ruling APC in the February 2019 Presidential Election. The key contenders in the general elections are President Muhammadu Buhari of APC and Former Vice President Atiku Abubakar of PDP. A win for PDP may initially spook the potential investors' understanding of the macroeconomic directions. It may put in jeopardy the resources of those that have committed to the on-going reforms agenda of the ruling APC. A Buhari's win may however be a continuity push for his administration policies. His party further needs an absolute majority of core loyalists in the National Assembly for its plans to have favourable debates and approval.
  On the flip side, some investors may see an Atiku's win as a plus. Atiku has tried to present himself as pro-market by declaring in November 2018 that he could risk having higher inflation rates to have higher GDP growth rates if elected.

Key Assumptions of 2019 Budget: How Realistic?

- Oil price benchmark of $60 per barrel;
- Oil production estimate of 2.3 million barrels per day, including condensates;
- Exchange rate of N305/$1;
- Real GDP growth of 3.01 percent; and
- Inflation Rate of 9.98 percent.
- Budget Expenditure: N8.83 trillion
- Revenue: N6.97 trillion
- Deficit: N1.86 trillion

Nigeria has had six quarters of growth since it recovered from recession in the second quarter of 2017. The real GDP growth stood at 1.81% in the 3rd quarter of 2018. Inflation rate dropped from a peak of 18.72% in January 2017 to 11.28% in November 2018. So, the FG optimism is quite understandable.

But how realistic are these assumptions? Will they be met? Nigeria's heavy reliance on crude oil sale for foreign exchange earnings underscores the importance of these key assumptions. The table below shows the comparison between some key assumptions for both actual and estimates for 2018 and the estimates for 2019

Key Budget Assumptions (Estimate and Actual)

	2018 (est)	2018 (actual)	2019 (est)	2019 (actual)
Oil price benchmark[a]	$51	$74[b]	$60	??
Oil Production estimate	2.3 million bbl per day	1.95 million bbl per day	2.3 million bbl per day	??
Exchange rate (CBN Rate)	N305/$1	N305/$1	N305/$1	??
Real GDP growth	3.5%	0.82%	3.01 %	??
Inflation Rate	12.4%	11.28%	9.98%	??

Source: The President Budget Presentation Speech; National Bureau of Statistics

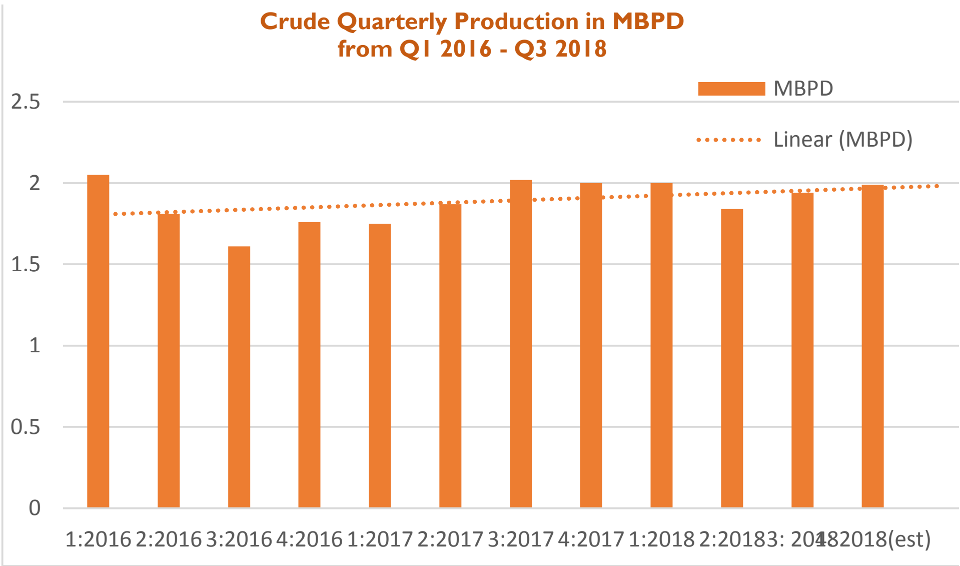
a: Bonny Light Crude

b: As at October 2018

The crude oil price towards the end of 2018 was not favourable for an oil producer like Nigeria. The highest price in 2018 was $88/bbl while the lowest price was around $50.2/bbl. Technically, oil price trend is bearish on a monthly chart, but supply concerns do not represent a challenge for now. The global energy demand for 2019 will rest squarely on the resilience of the key energy buyers from the rest of the world which makes an oil price consistently below $50/bbl throughout 2019 a threat to the budget implementation because oil had its worst quarterly decline in four years towards the end of 2018.

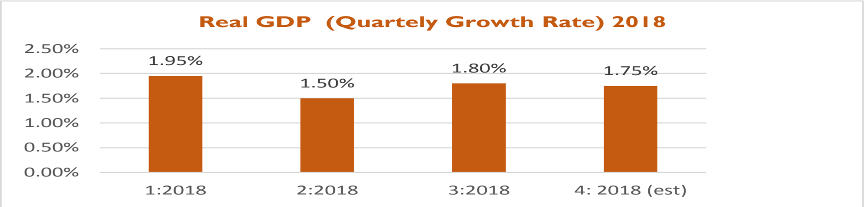
Oil Production (MBPD): The restiveness of the Niger Delta militants has considerably subsided due mainly to the Federal Government's effort and this has helped maintain the oil production. However, achieving a production of 2.3 Million Barrels Per Day (MBPD) appears difficult. In the last two years, the only periods that Nigeria exceeded the 2million mark was in Q1 2016 and Q3 2017. The data from National Bureau of Statistics (NBS) gave a 1.94 MBPD figure for Q3 2018. Using the data from NBS (from Q1 2016 to Q3 2018), we got an average of 1.88 MBPD per quarter. So, the FG needs to inch up her determination to achieve a 2.3MBPD target for 2019.

Quarter	MBPD
1:2016	2.05
2:2016	1.81
3:2016	1.61
4:2016	1.76
1:2017	1.75
2:2017	1.87
3:2017	2.02
4:2017	2
1:2018	2
2:2018	1.84
3: 2018	1.94
4: 2018(est)	1.99



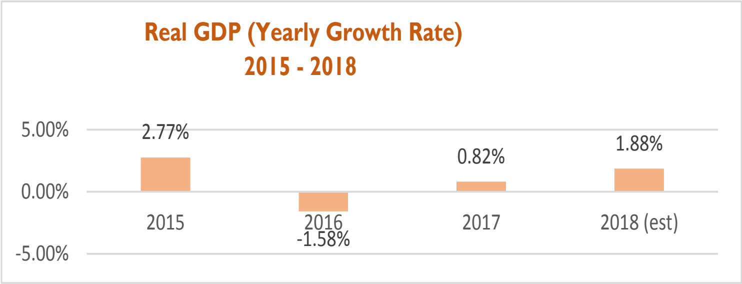
Source: National Bureau of Statistics ; Estimates from Author's Calculations

Quarter	RGDP
1:2018	1.95%
2:2018	1.50%
3:2018	1.80%
4: 2018 (est)	1.75%



Source: National Bureau of Statistics ; Estimates from Author's Calculations

Year	Real GDP Growth Rate
2015	2.77%
2016	-1.58%
2017	0.82%
2018 (est)	1.88%



Source: National Bureau of Statistics ; Estimate from Author's calculation

Contributions to Real GDP

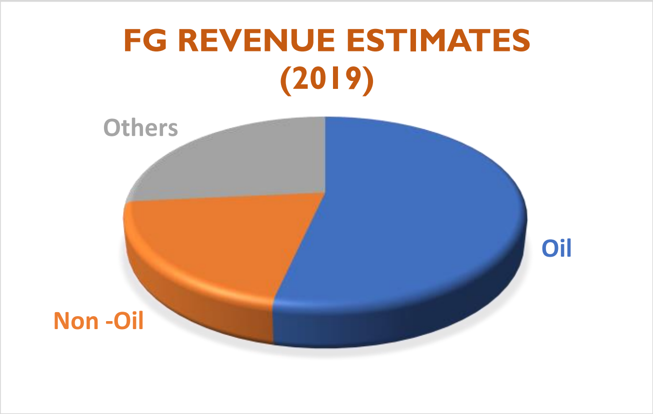
In Q3 2018, according to the data from the NBS, the contributions to the GDP from Agriculture, Industries and Services were 29.25%, 21.97% and 48.79% respectively. Using the data from the NBS for our calculations, their average contributions over the seven consecutive quarters from Q1 2017 – Q3 2018 were 24.61% ,22.63% and 52.59% respectively. Both industries and services contributions deviated slightly from their trend as measured since Nigeria's exit from the recession in the Q2 2017 while Agriculture witnessed a rebound. Nigeria must achieve strong and increased contributions from these sectors to achieve a meaningful budget implementation and her target for real GDP growth rate.

Share of Oil & Non-Oil Sectors of Real GDP

In Q3 2018, according to the data from the NBS, the share of Non-Oil sector of the real GDP was 90.62% and Oil Sector was 9.38% Their average contributions over the seven consecutive quarters from Q1 2017 – Q3 2018 from our calculations (using the data from NBS) were 91.1% and 8.9% respectively. Even though the share of oil sector appears small in the real GDP, its contributions are key sources of revenue for yearly budgets for federal, state and local governments. For instance, the federal government expects 72.9% of direct revenue to come from oil in 2019 and about 53.51% of the total revenue. Oil income constitutes more than 80% of the revenue source for a high number of local and state governments across the federation.

Federal Government Revenue Estimates in 2019

Source	Revenue	%
	(in Trillion)	
	=N=	
Oil	3.73	53.52%
Non -Oil	1.39	19.94%
Others	1.85	26.54%
Total	**6.97**	**100.00%**

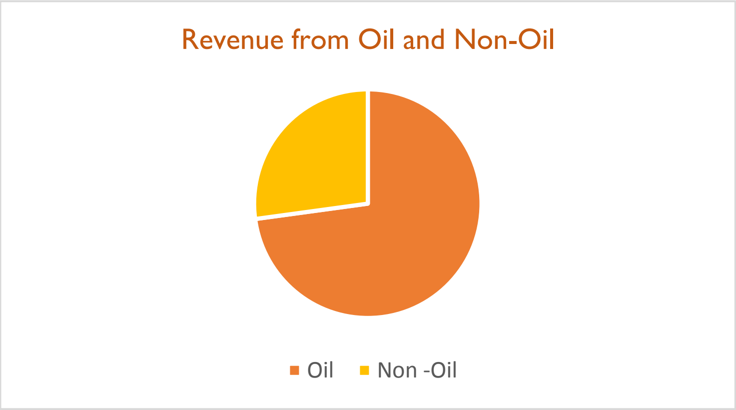


Source : Author's calculations ; President's Budget Speech

Federal Government Revenue Estimates in 2019

Direct Revenue (Oil and Non-Oil)

Source	Revenue	%
	(in Trillion)	
	=N=	
Oil	3.73	72.85%
Non -Oil	1.39	27.15%
Total	**5.12**	**100.00%**



Source: Author's Calculations ; President Budget's Speech

The federal government has placed a huge bet on an oil price of $60/bbl in 2019. Let us assume that achieving a 2.3 MBPD is within her control; but the oil price of $60/bbl is not in her control. Even if restiveness in the Niger-Delta were to cause oil price to rise, Nigeria would not benefit significantly from the oil price rise because it is difficult for a producer to benefit both from the oil price rise and increased production concurrently especially if the supply blockages emanate from the producer.

By our calculations, an average price of $50/bbl in 2019, holding the target production and other sources of revenue constant, will reduce the oil revenue by about 17% and the overall FG's revenue by about 10%. For sure, things are not that simple because there are interactions between the oil and non-oil sectors in the economy. So, the impact from an oil price fall might even be followed by a reduction /increase in the production target. If the revenue fall is real; then the revenue going to other tiers of government will be hit. Budget deficits will widen, and the impact of debt service on government's coffers will be severe.

A marked fall in the oil price will also affect the Central Bank's ability to support the naira at the official N305/$1; it will reduce the fund going to the excess crude account (an account opened primarily to smoothen the cyclical trend in oil earnings). It will also affect the under-recovery or subsidy on the pump price of petrol. The pump price is N145/liter at present. The federal government has budgeted $1bn for petrol subsidy in 2019.

On the other hand, a rise in the crude oil price above the budget assumption is a possibility. And it may facilitate a better than expected growth in the real GDP, even though we believe it will require a lot of spending and sustained revenue flow for Nigeria to achieve the target 3.01% in the real GDP for 2019. By our calculations, an average price of $80/bbl in 2019, holding the target production and other sources of revenue constant, will increase the oil revenue by about 33% and the overall FG's revenue by about 18%. That will be good news for Nigerians.

Regulatory Risks

Our focus will be on two financial sector regulators: The Central Bank of Nigeria (CBN) and National Insurance Commission (NAICOM)

CBN: The CBN upped its regulatory and supervisory actions in 2018. The CBN revoked the operating license of Skye Bank Plc and established a bridge bank - Polaris Bank Limited – which was capitalized by Asset Management Corporation of Nigeria (AMCON), a federal government establishment. AMCON will then source for investors to buy out its (AMCON's) investment in the bank. It was a move that calmed the financial system. The CBN also approved the merger between Access Bank Plc and Diamond Bank Plc. Their combination is expected to be the Nigeria's largest bank by retail/customer's base.

From the monetary policy angle, key users of fund in the economy will expect the CBN to slash its Monetary Policy Rate (MPR) that it had maintained at 14% for the 14th consecutive time in November 2018. We don't expect it to reduce the rate at its next meeting in January 2019 because of the impact of increased political spending will have on the inflation rate before the general elections in February 2019. Borrowers, especially manufacturers, will however be expecting a reduction in the MPR if the inflation rate sustains its downward trend especially after May 2019. The federal government expects inflation rate to fall to 9.98% in 2019.

CBN and MTN: There appears to be a seeming resolution of the row over the fine imposed by the CBN on MTN (a telecoms company) for its illegal capital repatriation. The initial fine of US$8.1billion was reduced to US$52.6million in an out-of-court settlement. This is a positive signal that Nigeria is not trying to foster a hostile economic environment. The news should be welcoming for the foreign investors. But the fine of N5.8billion imposed on the four Nigerian banks involved in the case is yet to be resolved.

Emefiele: Will he be re-appointed? The CBN governor, according to Section 8 (2) of the CBN Act 2007 as amended, is appointed by the president subject to the confirmation by the Senate. The governor is appointed for a term of five (5) years in the first instance and he/she is eligible for another term not exceeding five years. Mr. Godwin Emefiele, the present CBN governor was appointed in 2014 following the suspension/sack of Mr. Lamido Sanusi in the same year. Mr. Emefiele's first term will come to an end in June 2019. Markets would like to know whether he will be re-appointed or not. The position of the CBN governor is a key factor to consider for monetary policy risks and direction. No governor has been reappointed after their first term in office since

1999. We therefore believe the odds are slightly against Mr. Emefiele's reappointment 2019 notwithstanding whoever wins the February 2019 presidential election.

NAICOM: The regulatory environment in the insurance subsector of the Nigeria financial system in 2018 was mixed. The insurance sector has always been touted to have potentials for growth, but the sector is performing sub-optimally. Its combined capital is frustratingly low and is inadequate to underwrite big ticket transactions in the economy. And it contributes less than 1% to the GDP.

NAICOM, worried by the challenges of the industry, came up with operational directives/guidelines to develop the sector to contribute meaningfully to the national income. But the two policies it came up with in 2018: Tier-Based Minimum Solvency Capital (TBMSC) and State Insurance Producer (SIP) were both rejected by the industry and NAICOM had to suspend the policies. A Federal High Court stopped NAICOM from enforcing the TBMSC. The insurance companies opposed the TBMSC while insurance brokers opposed the SIP. The suspension of these policies is a risk to the resilience of the industry to withstand macro-shocks. TBMSC was meant to classify the insurers along their respective capital capacity to underwrite risks and to sustain the risk-based supervisory model. SIP on the other hand was meant to enhance and foster an alternative distribution channel for insurance products due to the present thinly spread of the insurance intermediaries.

It thus appears that NAICOM is entangled in what is known as "*Regulatory Capture*" a circumstance that makes the regulatory body to be influenced or even controlled by the industry that is being regulated. NAICOM may find it so difficult to come up with practical and global best practices for the industry. This is a big threat for the industry in 2019.

Conclusion

The year 2019 is an election year for Nigeria. We do not foresee any tension as the leading contenders in the presidential race are from the same part of the country. But the year presents both opportunities and threats. The war against the insurgency in the North East is not over. And there are still flashes of minor conflicts in some parts of the country. We believe there are prospects for growth if reforms are pursued with stronger commitment and the investment climate is friendlier. Positive events from the external sector will strengthen the growth themes at home.

About Finite Risk Advisors Limited

FRA is a risk advisory firm providing a broad range of risk solutions. We provide advisory services on Risk Transfer Audit, Alternative Risk Transfer, Tendering, IT Risk, Financial Management and Business Optimization/Transformation.

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