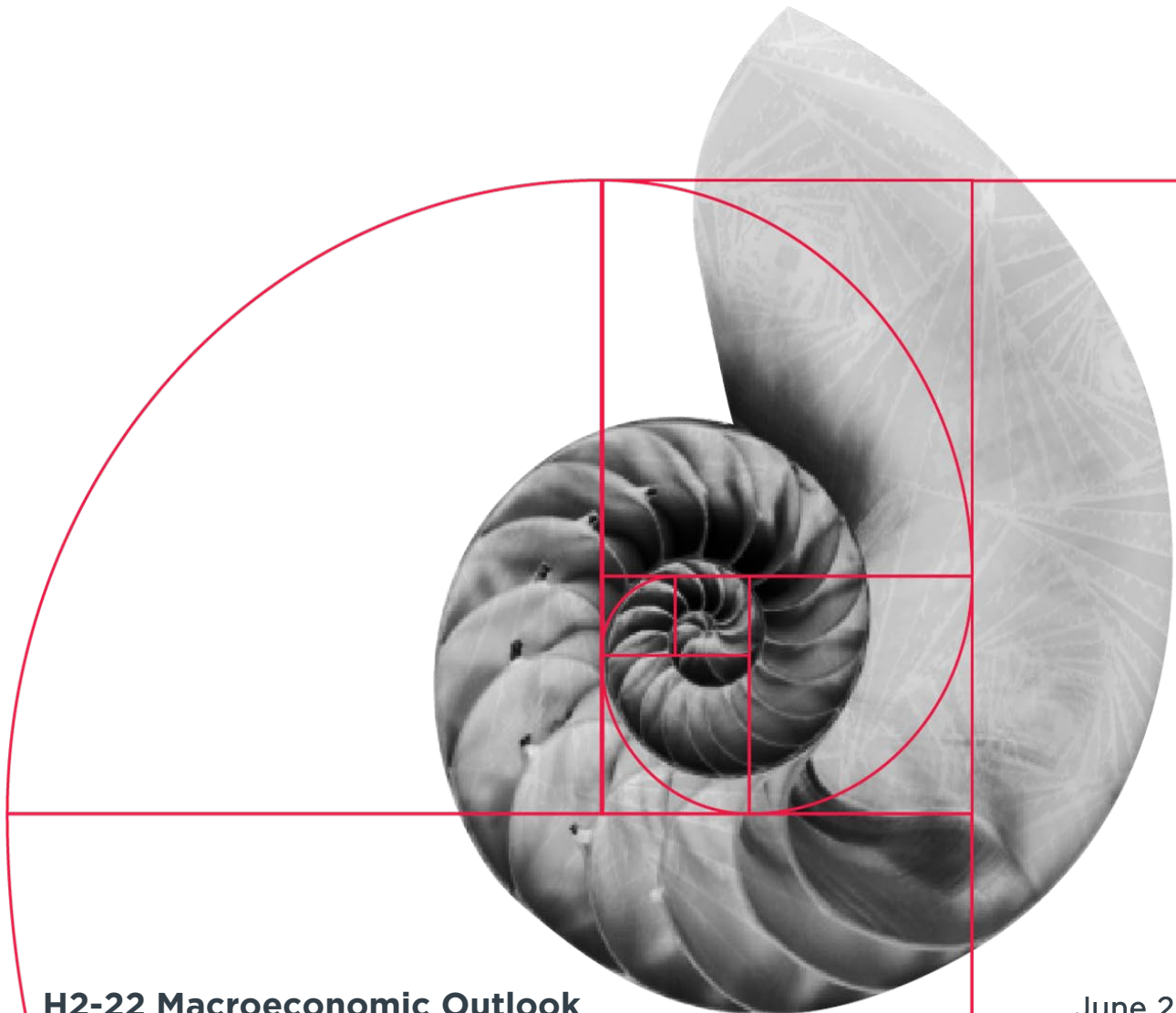


Heightened Uncertainties Amid Great Policy Unwind.



H2-22 Macroeconomic Outlook
Domestic Economy

June 2022

Executive Summary.

Domestic economic activities appear to be decoupling from the global economy even as the heightened uncertainties regarding the Russia-Ukraine conflict and low demand from China introduce new shocks to global growth outcomes amid the 'great policy unwind'. The government's sustained fiat-led interventions and a recovery in household consumption partly supported the real sector's resilient growth in Q1-22, despite elevated inflationary pressures. However, the macroeconomic narrative isn't wholly positive, which puts the Nigerian investment landscape in the same position. This, may likened to driving in torrential rain, racing fast to reach a destination – as the brake lights flash and exits back up, it is impossible to know whether to stay the course, change lanes, or pull over and wait it out.

Looking ahead, we firmly believe that domestic output will expand faster than population growth in the absence of any significant shock to the economy. Importantly, we see the non-oil sector remaining the overall growth engine, just as we expect sustained contraction in the oil sector.

Notwithstanding, we expect headline inflation to sustain its upward pressure given (1) higher gas and other energy prices, (2) elevated global food prices and (3) the spill over effect of higher transport costs amid pre-existing structural constraints. Moreover, we expect the FX liquidity conditions to remain pressured as foreign portfolio inflows remain low and accretion to the FX reserves from crude oil receipts remain weak. Hence, we reiterate that without further devaluation of the local currency at the IEW and improved FX flexibility, the CBN can comfortably sustain itself as the significant FX supplier to the various FX markets.

On monetary policy, despite the 150bps increase in the Monetary Policy Rate (MPR), we expect the Monetary Policy Committee (MPC) of the CBN to remain under pressure to further increase the key policy rate in H2-22. The primary factors responsible for this prognosis are hinged on a more aggressive path for interest rates in advanced economies and the unrelenting inflationary pressures in the domestic economy.

On fiscal policy, we envisage that the government's fiscal stance will align with historical trends where it meets its expenditure target while retained revenue performance remains sub-optimal. However, we are optimistic that higher corporate income tax (CIT) and value-added tax (VAT) collections will support non-oil revenue, even though this is unlikely to sufficient to salvage the overall revenue picture. Overall, we expect a record fiscal deficit in 2022E, pointing towards elevated borrowing in the domestic debt market.

Analysts

Jolomi Odonghanro
jolomi.odonghanro@cordros.com

Gbolahan Ologunro
gbolahan.ologunro@cordros.com

Opeoluwa Oluwa
opeoluwa.oluwa@cordros.com

Abdulazeez Kuranga
abdulazeez.kuranga@cordros.com

Jennifer Chiwetelu
jennifer.chiwetelu@cordros.com

Tesleemah Lateef
Tesleemah.lateef@cordros.com

Emmanuel Nwamaka
Emmanuel.nwamaka@cordros.com

Contents.

Executive Summary	1
Growth	3
Q1-22 GDP: Post Pandemic Recovery Remains in Good Shape	3
Inflation	11
Inflationary Pressures Persist on High Food and Energy Prices	11
Balance of Payments	14
CA Surplus Moderated on Lower Trade Balance Surplus	14
Currency	20
Pressure Lingers at the Currency Market Amidst Tepid Inflows	20
Monetary Policy	26
Stepping into the Realm of Known Knowns	26
Fiscal Policy	29
Fiscal Deficit Rose to a Record High on Higher Revenue Shortfall	29
Appendix. Nigeria - Key Economic Forecasts	35
Disclosures	36

Growth.

Q1-22 GDP: Post Pandemic Recovery Remains in Good Shape

Nigeria's economy maintained its growth momentum for the sixth consecutive quarter, growing by 3.11% y/y in Q1-22 (Q4-21: +3.98% y/y). The growth outturn was in line with Bloomberg's median consensus estimate (+3.10% y/y), albeit 30bps higher than Cordros' estimate (+2.81% y/y), with the deviation stemming from a better-than-expected performance in the Services sector. Our attribution analysis showed that the GDP growth in the quarter was primarily driven by the Services and Agriculture sectors, with absolute contributions of 4.02% and 0.71%, respectively, to the overall growth print. The growth in both sectors helped to neuter the negative contribution of the Industries (-1.62%) sector to the GDP growth rate.

Figure 1: Nigeria's real GDP growth

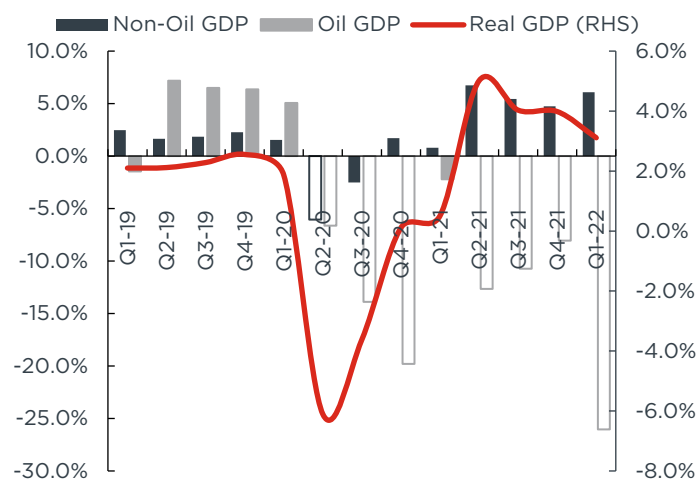
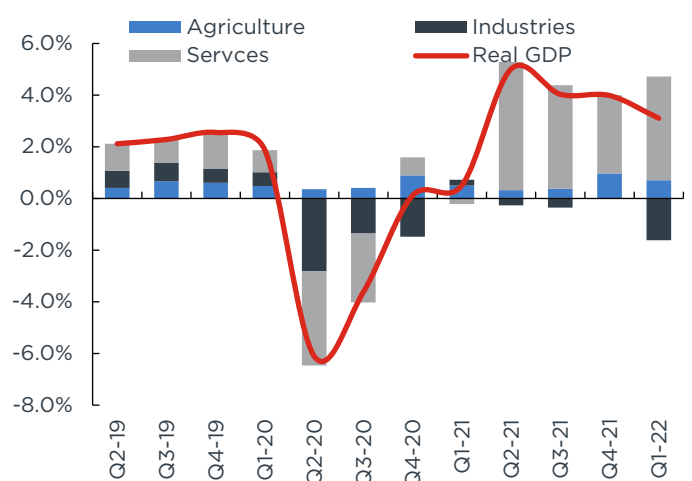


Figure 2: Contribution to real GDP growth



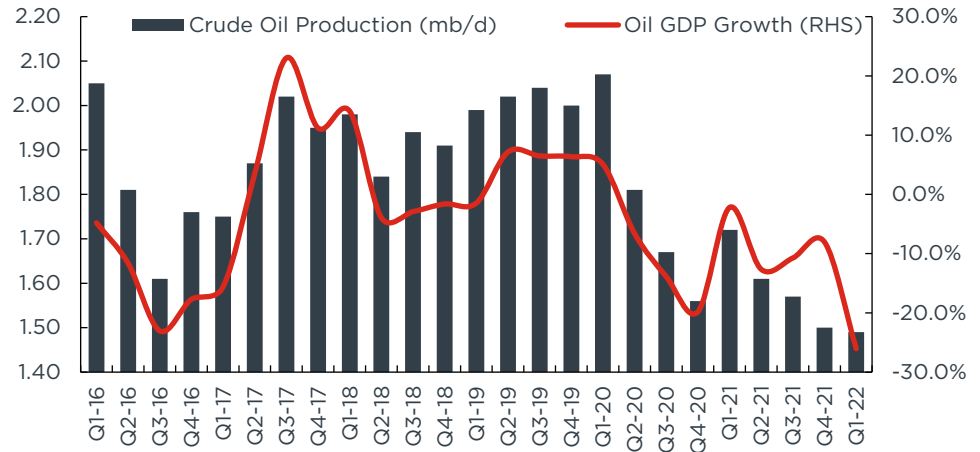
Source: NBS, Cordros Research

Oil Sector Still in the Woods

The growth of the oil sector remained negative for the eighth consecutive quarter, declining by 26.04% y/y (Q4-21: -8.06% y/y) - the worst performance since the NBS started keeping the current data series. The last time the oil sector recorded this level of decline was in Q3-16 (23.04% y/y), a period characterised by unabating vandalism of oil assets and incessant crude oil theft in the Niger Delta region. Notably, crude oil production (including condensates) declined to a new record low, averaging 1.49mb/d in Q1-22 (Q4-21: 1.50mb/d). We believe the continuous low crude oil production reflects the impact of (1) infrastructure decay, (2) massive theft and vandalism, and (3) divestments by IOCs, given the challenging business environment amidst the shift to cleaner energy sources. To shed more light, data from the Nigerian Upstream Petroleum Regulatory Commission (NUPRC) showed that crude oil production declined across the

Bonny (-49.0% y/y), Escravos (-18.9% y/y), Agbami (-13.8% y/y), Bonga (-7.3% y/y), and Forcados (-3.5% y/y) production terminals.

Figure 3: Crude production vs oil GDP growth

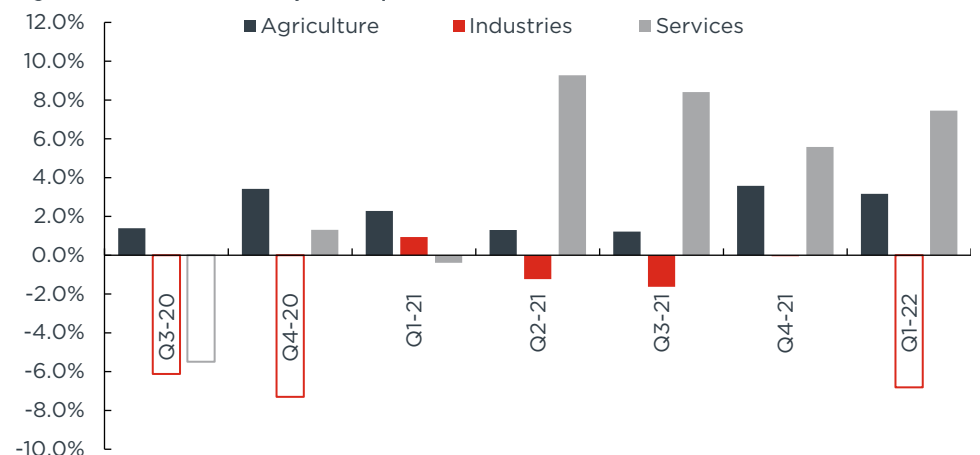


Source: NNPC, NBS, Cordros Research

Non-Oil Sector remains the Overall Growth Engine

Contrastingly, the non-oil sector grew by 6.08% y/y (Q4-21: +4.73% y/y) - the highest print in four quarters. We highlight that the ICT (+12.07% y/y vs Q4-21: +5.03% y/y) and Trade (+6.54% y/y vs Q4-21: +5.34% y/y) sub-sectors were the key drivers behind the sector's growth. Other sub-sectors that contributed to the non-oil sector's performance included the Finance & Insurance (+23.24% y/y vs Q4-21: +24.14% y/y), Agriculture (+3.16% y/y vs Q4-21: +3.58% y/y) and Manufacturing (+5.89% y/y vs Q4-21: +2.28% y/y) sub-sectors. Broadly, the Industries GDP (-6.81% y/y vs Q4-21: -0.05% y/y) declined to the lowest level since Q4-20 (-7.30% y/y). On the flip side, the Service sector grew stronger by 7.45% y/y (vs Q4-21: +5.58% y/y) while the Agriculture sector grew by 3.16% y/y (vs Q4-21: +3.58% y/y).

Figure 4: Non-oil GDP major components

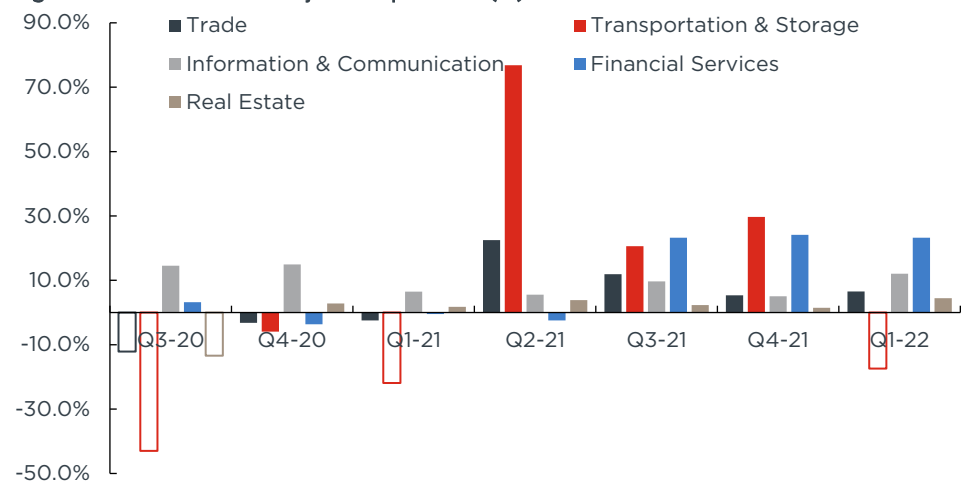


Source: NBS, Cordros Research

Increased Domestic Spending Supports Services GDP

A rebound in consumer spending, improved lending activities, and continued gains from the reopening of the economy underpinned the Services sector's growth, driven explicitly by the Trade, Finance & Insurance and ICT sub-sectors. The ICT sector's growth is consistent with the increased data and voice traffic during the review period. For instance, MTN Nigeria (c.38.0% market share) recorded 84.4% y/y and 69.8% y/y growth in data traffic and usage (MB per user), respectively, in Q1-22. Elsewhere, we imagine that the passthrough impact of increased consumer demand on activities in the Fast-Moving Consumer Goods (FMCG) space supported the Trade sector's growth besides from the favourable base effects from the prior year (Q1-21: -2.4% y/y).

Figure 5: Services GDP major components (%)

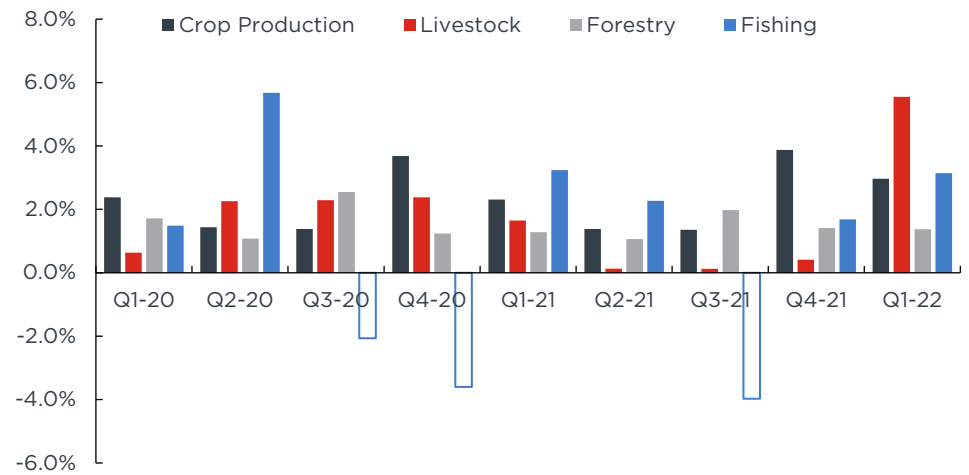


Source: NBS, Cordros Research

Government Interventions Support Agriculture Sector

Despite the persistent security challenges in the country, the Agriculture sector recorded positive growth in Q1-21, albeit weaker than the prior quarter. We believe this demonstrates the sector's resilience even as the Central Bank of Nigeria (CBN) sustained liquidity injections. However, considering that the impact of security issues, particularly in the Northern region and some parts of the South-West, remain pronounced, the growth in the sector slowed to 3.16% y/y relative to Q4-21 (+3.58% y/y). Across the sub-sectors, we highlight that growth moderated across the crop production (+2.97% y/y vs. Q4-21: +3.87% y/y) and forestry (+1.37% y/y vs. Q4-21: +1.41% y/y) sub-sectors. However, the livestock (+5.55% y/y vs Q4-21: +0.41% y/y) and fishing (+3.14% y/y vs Q4-21: +1.69% y/y) sub-sectors grew faster during the review period.

Figure 6: Agriculture GDP growth breakdown

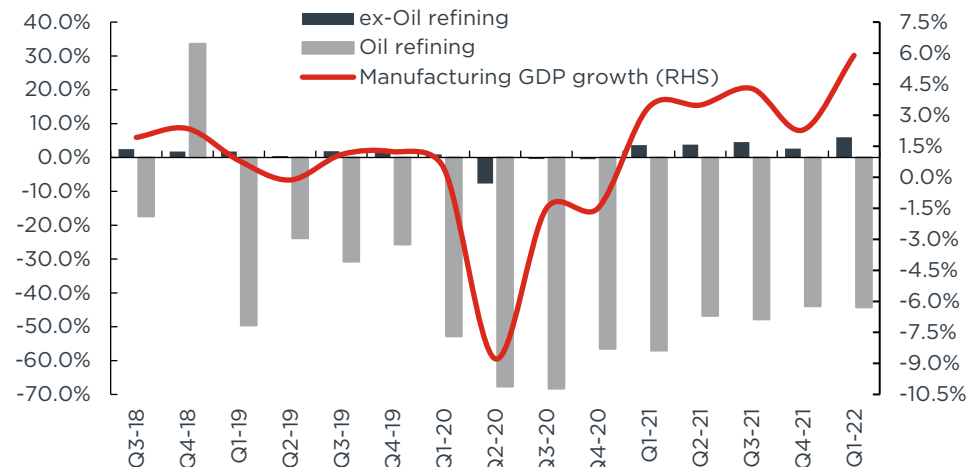


Source: NBS, Cordros Research

Manufacturing Sector Posts Highest Growth since Q1-14

The Manufacturing sector (+5.89% y/y vs Q4-21: +2.28% y/y) recorded its highest growth since Q4-14 (+13.47% y/y), which we believe reflects the impressive increase in turnover recorded by consumer and industrial goods producers, as evidenced by Q1-22 financial performances of listed companies. In addition, we highlight that the absence of restrictive measures relating to lockdowns, higher consumer demand and sustained CBN intervention also supported the sector amidst the lingering structural challenges plaguing the sector. Elsewhere, Oil refining (-44.26% y/y vs Q4-21: -43.94% y/y) contracted for the 13th consecutive quarter as the refineries remained non-operational due to poor maintenance.

Figure 7: Manufacturing GDP breakdown



Source: NBS, Cordros Research

Outlook: Non-Oil Sector to Support Overall Growth Again

We expect that the positive growth momentum recorded in Q1-22 will be sustained over the rest of the year, underpinned mainly by the non-oil sector. Notably, we expect the Services and Agriculture sectors to be the key growth drivers. Meanwhile, we expect crude oil production to remain pressured due to the nature of the sector’s challenges, most of which we believe are unlikely to be resolved over the short term. Accordingly, we expect the growth in the oil sector to remain in the negative territory, albeit better than the contraction in 2021FY. **Sequentially, we expect the economy to grow by 3.48% y/y in 2022E (2021FY: +3.40% y/y), primarily underpinned by the non-oil sector’s growth resilience.**

Figure 8: GDP growth projection

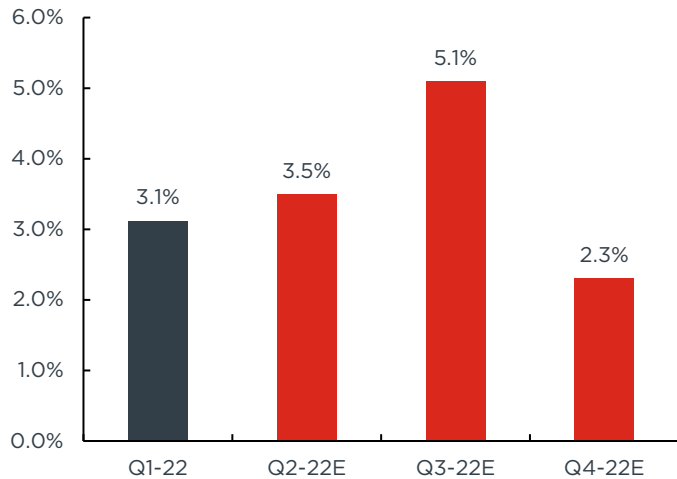
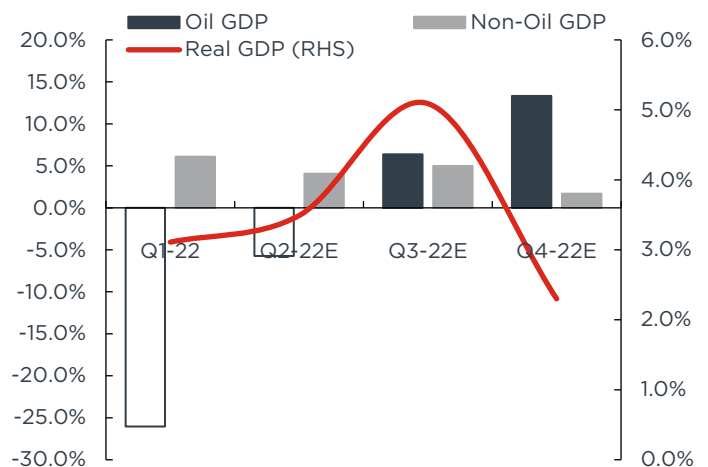


Figure 9: GDP growth by segments



Source: NBS, Cordros Research estimates

Lingering Challenges to Keep the Oil Sector in Negative Growth Terrain

As earlier discussed, the production challenges in the oil sector have persisted so far in 2022, with crude oil production (excluding condensates) declining for four consecutive months from 1.31 mb/d in April to 1.26 mb/d in May. While the current OPEC+ agreement allows Nigeria to produce 1.80 mb/d (excluding condensates), the country only managed to produce 1.38 mb/d in Q1-22, given the persistent shut-ins during the period. These could be adduced to (1) vandalism and theft, (2) divestments by IOCs, (3) COVID-19-related shut-ins, and (4) lagging impacts of age-long under-investments. Overall, we expect the oil sector’s woes to persist in the short to medium term. Accordingly, we estimate crude oil production (including condensates) will average 1.60 mb/d in 2022E. Consequently, we project the oil sector to record a decline of 4.24% y/y in 2022E (2021FY: -8.30% y/y).

Figure 10: Crude oil benchmark prices (USD/bbl.)

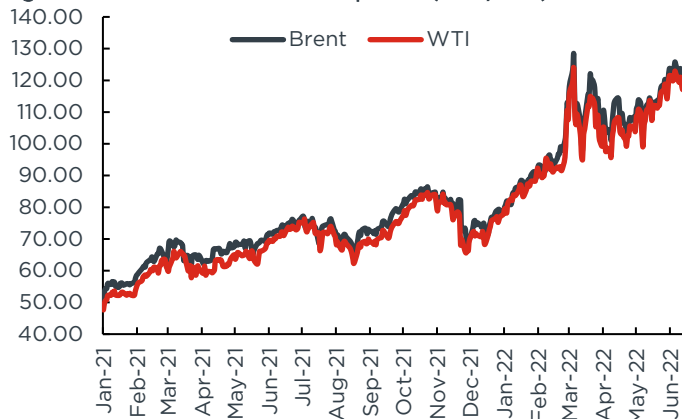
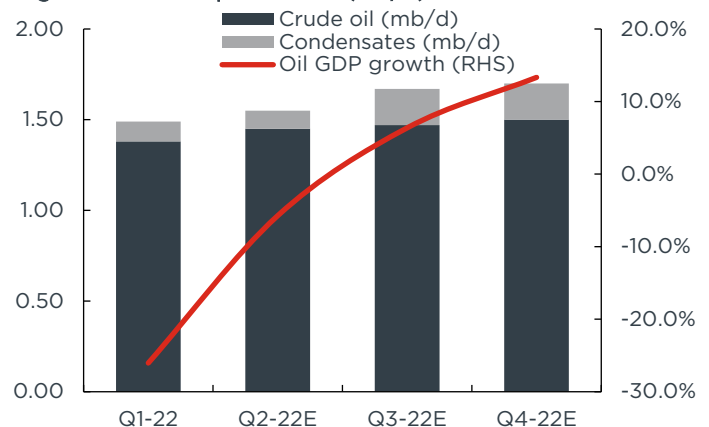


Figure 11: 2021 oil production (mb/d) vs oil GDP

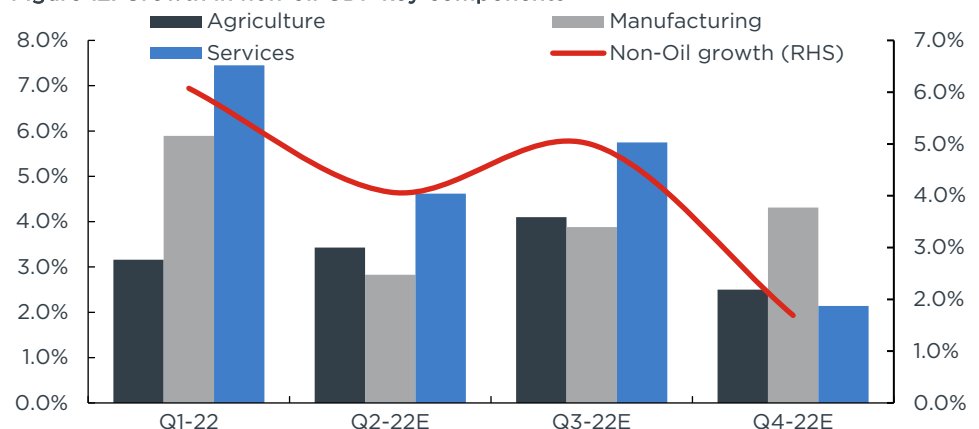


Source: Bloomberg, NBS, Cordros Research estimates

Increased Domestic Consumption to Buoy Non-oil Sector Growth

In line with our [2022FY outlook report](#), we still expect the non-oil sector to spearhead the growth in the broad economy. Specifically, we expect the Services sector to continue to benefit from the (1) rise of payment service banks; (2) gains from the reopening of additional land borders; (3) recovery in the telecommunications subscriber base due to the Nigerian Communications Commission's (NCC) relaxed ban on the issuance of new SIM cards amidst continued increase in voice and data traffic; and (4) improving banking sector credit to the economy. Thus, we expect the ICT, Trade, and Financial Services sub-sectors to spearhead the Services sector's growth. Meanwhile, we expect a continued improvement in consumer demand, the absence of pandemic-related restrictions and sustained government intervention to support the Manufacturing and Agriculture sector's growth despite the existential structural challenges. Therefore, on a balance of factors, we expect non-oil GDP to grow by 4.08% y/y in 2022E (2021FY: +4.44% y/y).

Figure 12: Growth in non-oil GDP key components



Source: NBS, Cordros Research estimates

Service Sector to Maintain Solid Growth Path, Albeit Slowly

We highlight that MTN Nigeria (MoMo PSB) and Airtel Africa (SmartCash PSB) have commenced the operations of their payment service banks (PSBs) businesses. We regard this as a positive development that will support the ICT sector, given that MTN and Airtel have vast networks of agents and large numbers of subscribers (MTNN: 76.20 million | AIRTEL: 56.24 million as of April 2022), which will aid the deployment of their services. Elsewhere, we expect the continued improvement in domestic macroeconomic conditions to spur banks to increase risk asset creation. Furthermore, we expect improved private sector credit to generate a positive spill over effect in the Real estate subsector. At the same time, the knock-on effect of increased activities in the FMCG space and the absence of pandemic-related restrictions should buoy the Trade sector's performance. However, the high statistical base from the prior year could moderate the Services sector's growth as the effect of the initial post-COVID-19 boosts fades. Overall, we now expect the Services GDP to grow by 4.84% y/y (vs +5.61% y/y in 2021FY).

Figure 13: ICT and Services GDP growth

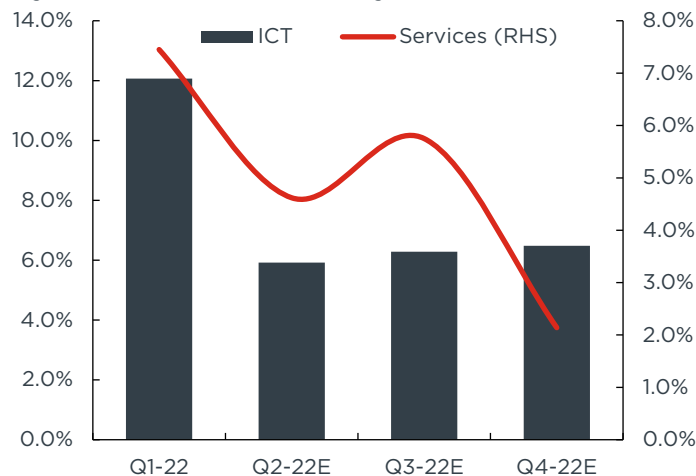
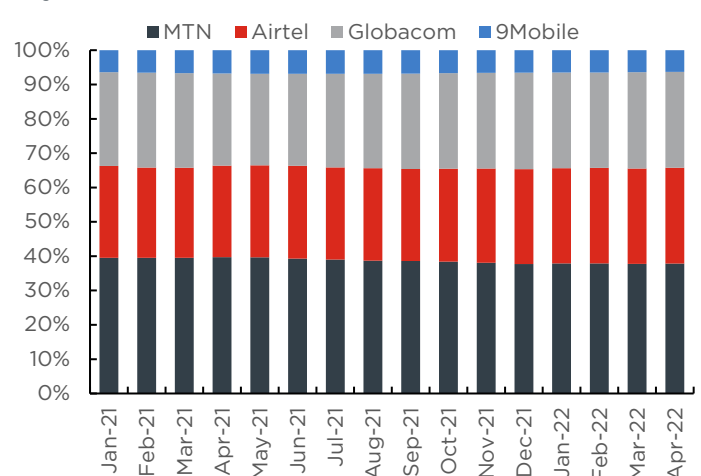


Figure 14: Market Share based on Telecoms Subscribers



Source: NCC, NBS, Cordros Research estimates

CBN's Interventions to Support Manufacturing GDP but Risks Abound

Suppose the Q1-22 financial performance of manufacturing companies is anything to go by. In that case, it suggests producers have been able to push out more volumes to cater for the increased demand even as consumer wallets remain pressured by elevated inflationary pressures. Besides from that, the monetary authority has maintained its targeted interventions in the real sectors of the economy. According to the CBN, the cumulative disbursement under the Real Sector Support Facility (RSSF) for financing 402 real sector projects across the country stands at NGN2.10 trillion as of May 2022. Accordingly, we expect the Manufacturing sector to maintain strong growth momentum. However, growth

outcomes remain susceptible to short-term risks, including rising energy costs exacerbated by the Russian-Ukraine conflict, FX challenges and increased tax burden on manufacturers. On a balance of factors, we estimate the sector will grow by 4.28% y/y in 2022E (2021FY: +3.35% y/y).

Figure 15: Manufacturing GDP growth

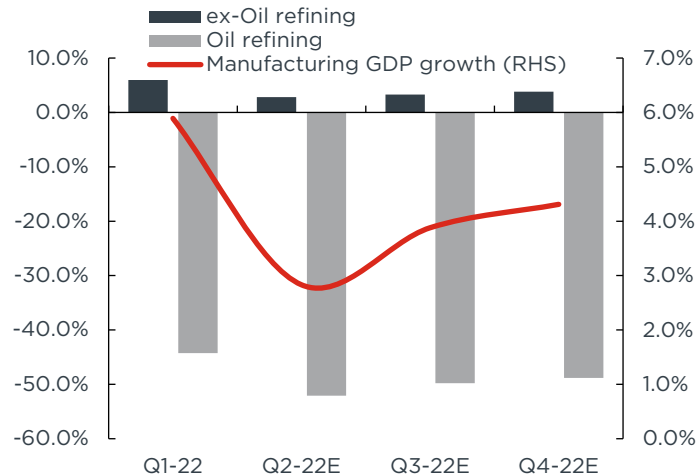
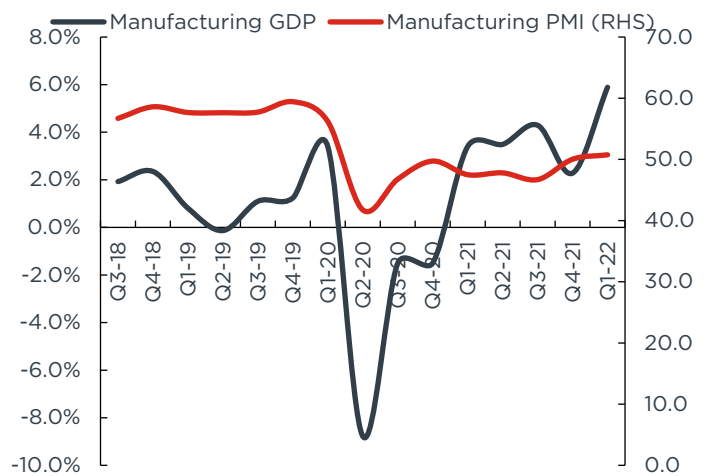


Figure 16: Manufacturing PMI vs manufacturing GDP

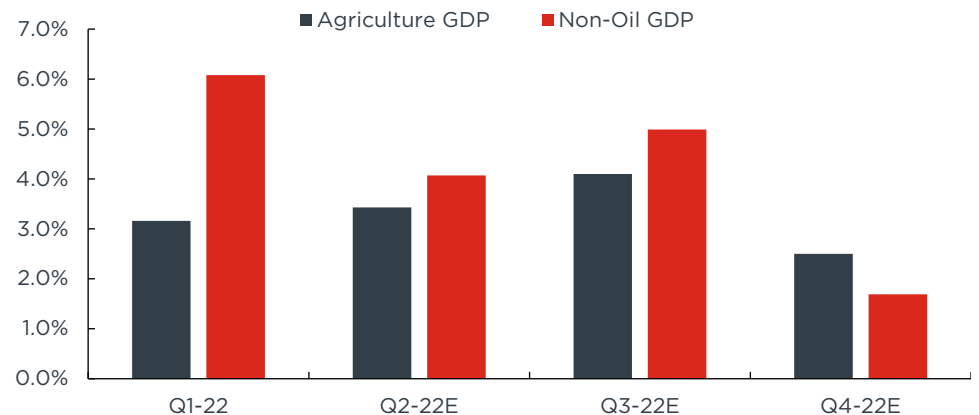


Source: NBS, CBN, Cordros Research estimates

FGN's Fiat-Led Interventions to Support the Agriculture Sector

Despite persistent security challenges across the country, we expect the government's sustained interventions to keep the agricultural sector afloat in 2022E. However, we highlight key downside risks to growth, including (1) increased fertiliser costs worsened by the Russia-Ukraine conflict, (2) poor weather conditions, (3) clashes between farmers and herders, and (4) disruptions to distribution network due to pre-election activities. On a balance of factors, we project the Agriculture sector will grow by 3.30% y/y in 2022E (2021FY: 2.13% y/y).

Figure 17: Agriculture and non-oil GDP growth



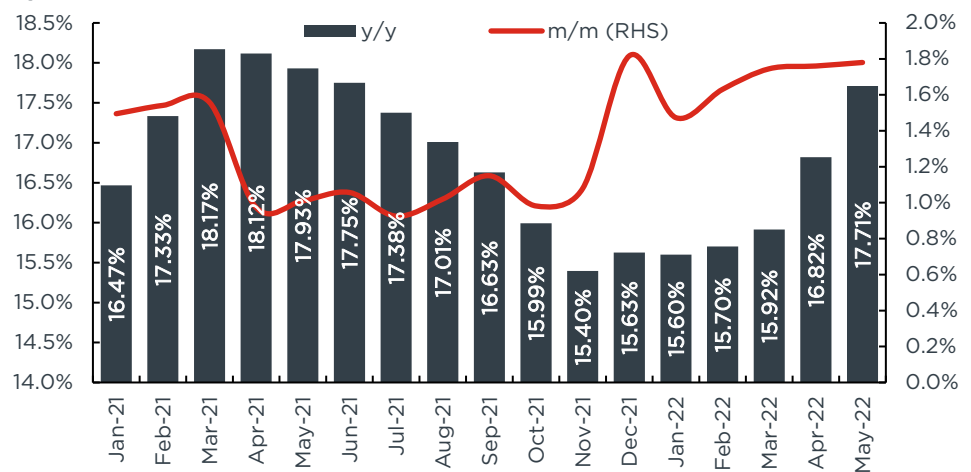
Source: Cordros Research estimates

Inflation.

Inflationary Pressures Persists on High Food and Energy Prices

Headline inflation maintained an uptrend in 5M-22 (+209bps vs 5M-21: +218bps) as prices increased across the food and non-food baskets. On the food basket, we attribute the increase to a plethora of factors, including (1) lingering security challenges, (2) onset of the planting season, (3) passthrough impact of increased transport costs, (4) increased demand associated with Ramadan and Easter seasons, and (5) high commodity prices worsened by the Russia-Ukraine conflict. Accordingly, we were not surprised that food prices remained elevated, rising by 213bps to 19.50% y/y in May.

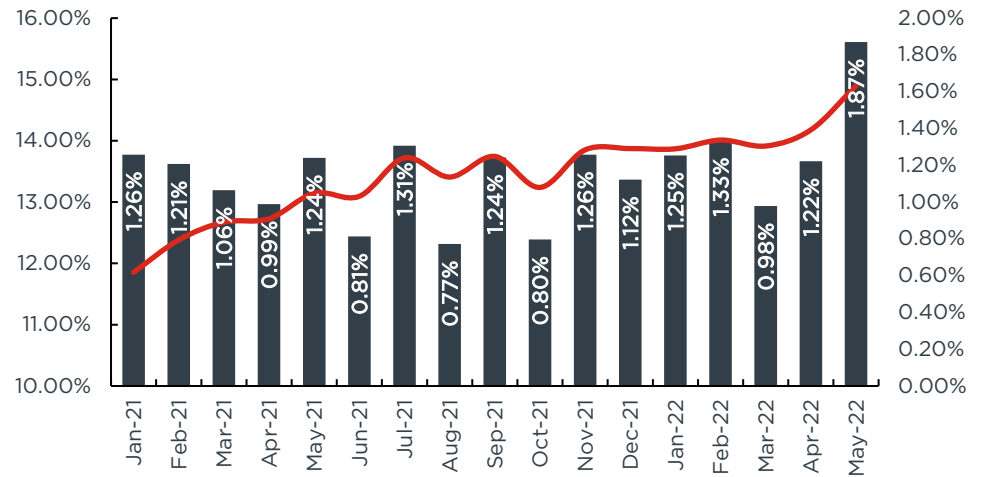
Figure 18: Historical food inflation



Source: NBS, Cordros Research

While the price of PMS was relatively stable given fuel subsidies, we highlight that cooking gas (+89.3% y/y to NGN784.20/KG in May) and diesel (+181.0% y/y to NGN671.08/litre in April) prices mirrored the global trend, given the fallout of the Russia-Ukraine conflict. The preceding was the primary factor responsible for the uptrend in core inflation in 5M-22 (+102bps). Besides from the increased gas and other fuel prices, we highlight that higher taxes also impacted the increase in core inflation in line with the 2021 Finance Act amid higher electricity tariffs. Moreover, currency pressures (23.5% y/y depreciation to an average of NGN600.65/USD in May) at the parallel market also contributed to the elevated price pressure in the core basket. Accordingly, the core inflation rose by 14.90% y/y as of May relative to 13.87% y/y recorded in December 2021. Across the core basket, we highlight that pressures were most significant in the prices of Utilities (+277bps to 13.85% y/y), Transport (+134bps to 16.39% y/y) and Education (+207bps to 14.96% y/y).

Figure 19: Historical core inflation

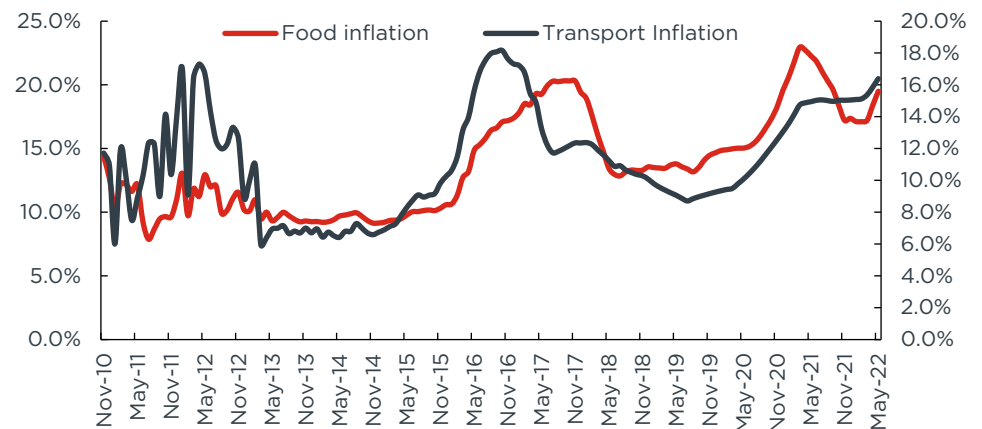


Source: NBS, Cordros Research

Inflationary Pressure to Remain Elevated in the Medium Term

In our [2022FY Outlook report](#), we posited that inflationary pressures would moderate due to stable PMS prices, improved FX supply and a steady rise in electricity tariffs. However, the emergence of the Russia-Ukraine conflict has made us shift ground given the knock-on effects of elevated energy prices on domestic prices. Beyond the impact of the conflict on energy prices, global food and commodities supply is significantly hampered (due to the critical roles Russia and Ukraine play in the supply of fertilisers, wheat, barley and corn). To mitigate rising prices, some countries have banned the exportation of essential products. Notably, India banned the exportation of sugar and wheat, Malaysia curbed chicken exports, and Indonesia limited palm oil exports. Meanwhile, persistent bandit attacks are limiting farmers' activities, undermining cultivation during the planting season. Moreover, higher transport costs are also expected to have a spill over effect on farm produce prices amid the high cost of farming inputs.

Figure 20: Trend in food and transport inflation

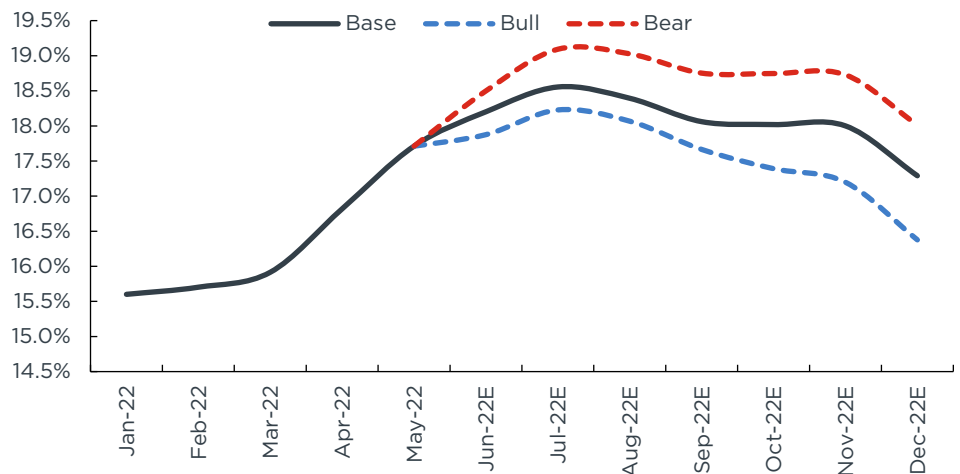


Source: NBS, Cordros Research

Meanwhile, we expect the higher gas and other energy prices to continue to pressure the core basket, given elevated energy prices induced by the Russia-Ukraine conflict, which has shown no signs of abating. Furthermore, we expect the lingering effects of increased taxes in the 2021 Finance Act to continue to pressure the core basket over the short term. Similarly, we believe the progressive hikes in electricity tariffs will continue to exert upward pressures on the energy sub-baskets. Accordingly, we expect the increase in core inflation to be spread across the utilities, household equipment, transportation, energy, education, and clothing & footwear sub-baskets.

On a balance of factors, we expect headline inflation to settle at an average of 17.36% y/y over 2022E (2021FY: 16.98% y/y) and 17.29% y/y by year-end (2021FY: 15.63% y/y) based on our base case.

Figure 21: Headline inflation (y/y) scenarios



Source: NBS, Cordros Research estimates

Bull case: In this scenario, If the Russia-Ukraine conflict ends in June, diesel prices hover between NGN550.00/litre and NGN600.00/litre, and the FX supply improves relative to 2021, we would expect the headline CPI to average 16.82% y/y over 2022E and settle at 16.03% y/y by year-end.

Bear case: If we assume the Russia-Ukraine conflict persists till year-end, diesel prices settle above NGN750.00/litre, and FX supply deterioration continues, we expect the headline inflation to average 18.23% y/y over 2022E and a year-end print of 18.01% y/y.

Balance of Payments.

CA Surplus Moderated on Lower Trade Balance Surplus

Nigeria's current account (CA) position maintained a surplus position for the third consecutive quarter, given high export receipts relative to the growth in imports. As of Q4-21, the CA surplus settled at USD2.43 billion (Q3-21: USD3.68 billion), representing a moderation of 33.9% q/q. The moderation was primarily driven by a lower trade surplus and decline in remittances which ensured current transfers also declined during the review quarter. The trade surplus fell by 45.8% q/q to USD960.00 million (Q3-21: USD1.77 billion) on account of higher imports (+8.9% q/q) relative to the growth in exports (+1.3% q/q). We highlight that the increased import bill was consistent with the higher domestic demand that accompanied the festivities in Q4-21. On the other hand, the surplus in the current transfers (also called the secondary income balance) declined by 4.8% q/q to USD6.15 billion, given lower workers' remittances arising from the spread and impact of the Omicron variant of the COVID-19 virus in advanced economies.

Figure 22: Trade balance (USD billion)

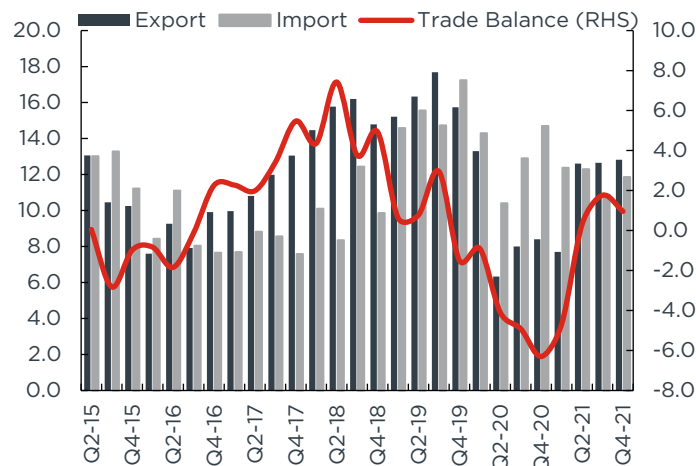
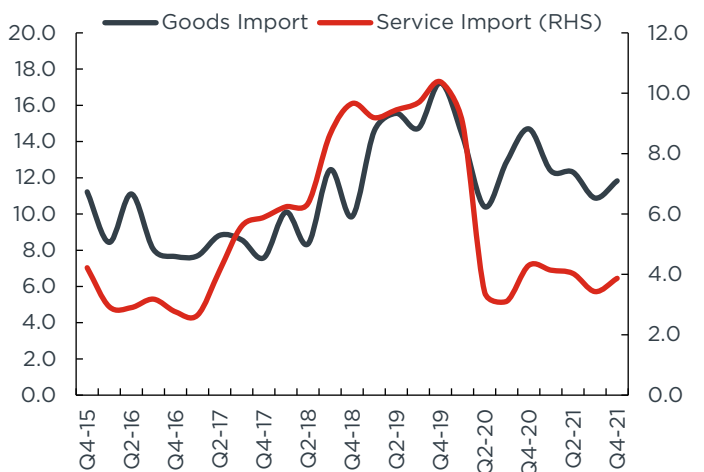


Figure 23: Goods vs Services imports (USD billion)



Source: CBN, Cordros Research

That said, the services account deficit, which historically prints a deficit position, widened by 14.3% q/q to USD2.87 billion due to the gradual global return to normalcy as vaccine access and administration improved worldwide. Nonetheless, we highlight that the services balance is still far from pre-COVID levels (c.USD8.44 billion). We believe this development is closely connected with the combined impact of (1) FX liquidity constraints and (2) persistent currency pressure. Elsewhere, the decline in the primary income balance (-11.0% q/q) mirrored foreign investors' lower repatriation of investment incomes amid the CBN's capital control measures. **Overall, the Q4-21 data puts the total CA**

surplus for 2021FY at USD4.25 billion (or 1.0% of GDP vs USD16.98 billion deficit in 2020FY).

Figure 24: Goods, Service, Income, Current transfer (USD billion)

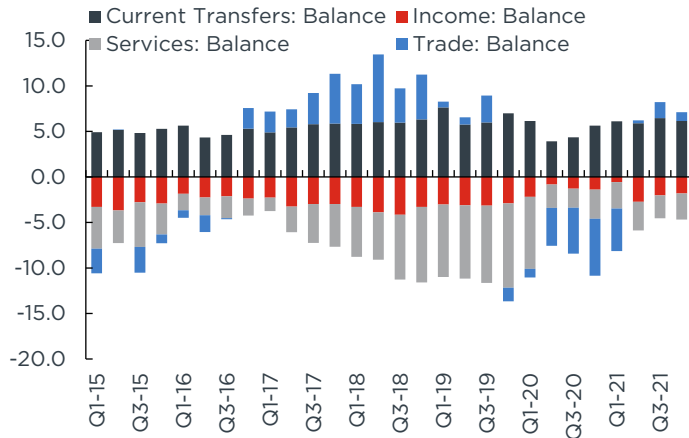
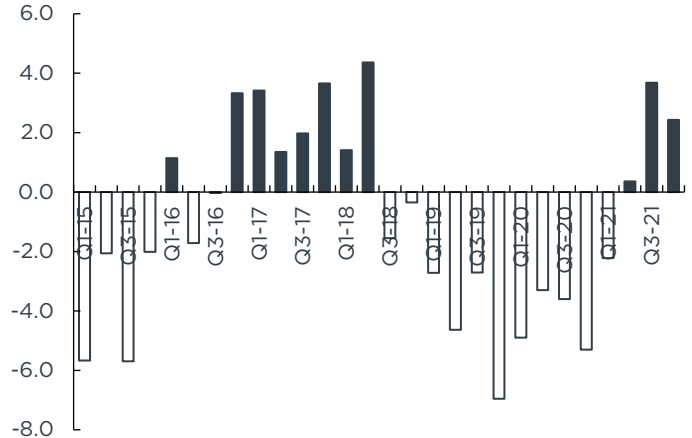


Figure 25: Current Account (USD billion)

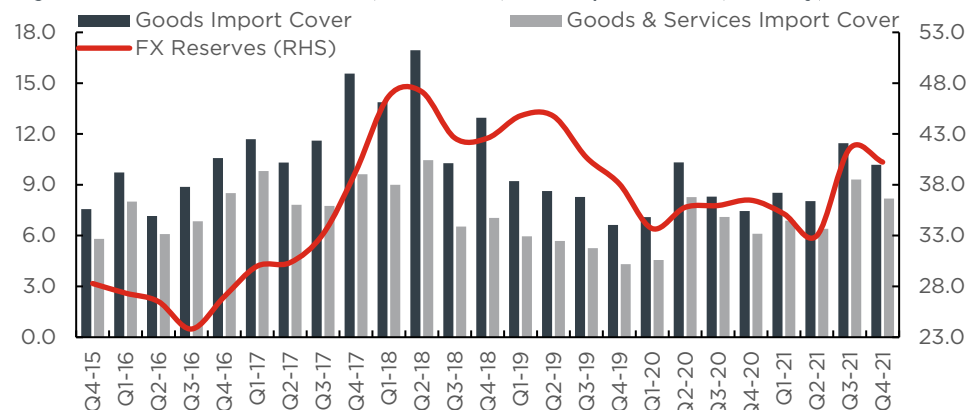


Source: CBN, Cordros Research

Despite the CA surplus, we highlight that the gross FX reserves declined by 3.2% q/q or USD1.34 billion to USD40.23 billion in Q4-21 (Q3-21: USD41.57 billion). We understand that the depletion was in line with the (1) increased FX supply at the Investors and Exporters Window (IEW), (2) public sector direct payments, (3) third-party Ministries, Departments & Agencies (MDA) transfers, and (4) Joint Venture cash call payments. Notably, we highlight that the CBN's FX sale at the IEW (USD1.93 billion vs Q3-21: USD795.75 million) in Q4-21 was 1.4x the amount sold to the window in Q3-21.

That said, we note that the gross FX reserves can cover approximately ten months of imports. However, when we account for services imports, FX reserves of USD40.23 billion as of December 2021 cover about eight months of imports (Q3-21: nine months), comfortably above the six-month cover recommended by the IMF for West African Monetary Zone (WAMZ) countries.

Figure 26: Trend in FX reserves (USD billion) and import cover (monthly)



Source: CBN, Cordros Research estimates

CA Surplus to Moderate on Higher Imports and Service Payments

For one, we expect total exports to increase above the 2021 level due to higher oil prices primarily driven by the Russia-Ukraine conflict amid crude oil production underperformance. We forecast crude oil prices to average c.USD106.00/bbl. in 2022E (2021FY average: USD70.68/bbl.). However, lower oil production volumes due to theft and infrastructure challenges mean that exports are unlikely to reach pre-COVID levels. For context, oil and gas exports account for c. 88.0% of total exports. Accordingly, our model suggests a 36.5% increase in total exports to USD62.49 billion in 2022E (2021FY: USD45.79 billion) – 3.8% below the 2019FY level.

Figure 27: Oil vs non-oil exports contribution (%)

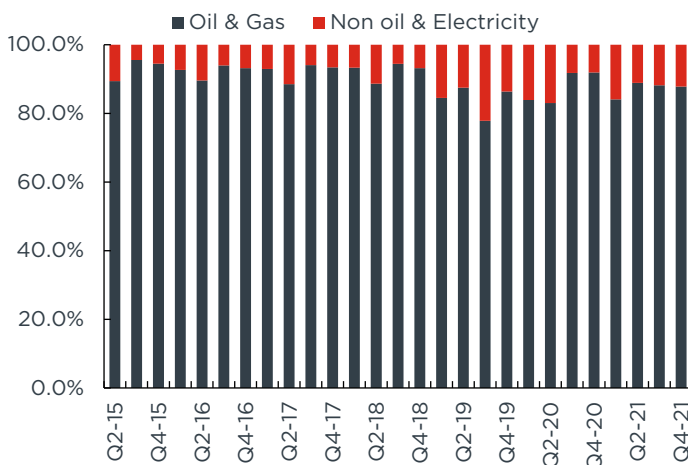
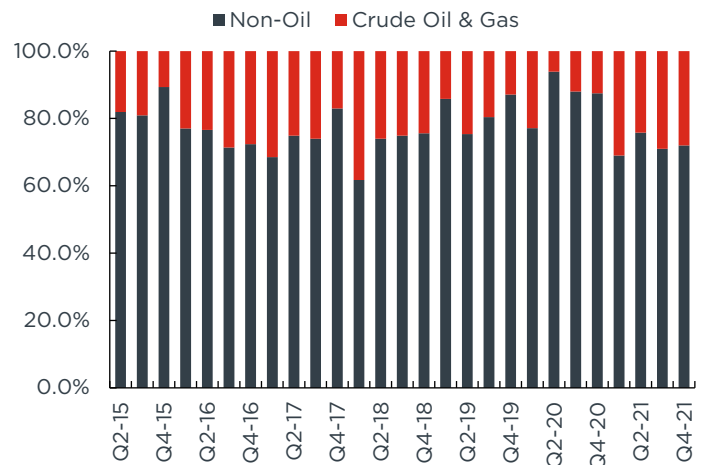


Figure 28: Oil vs non-oil imports contribution (%)

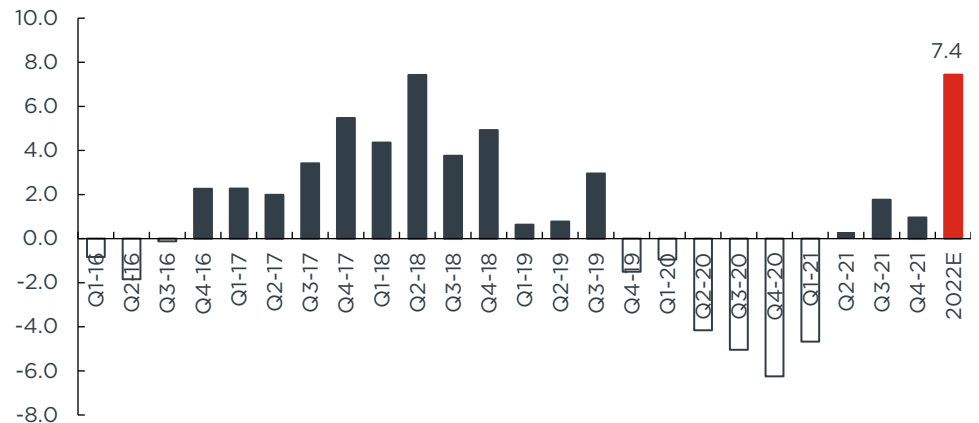


Source: CBN, Cordros Research Estimates

Asides from the domestic demand recovery, we expect imports to increase in line with the spill over effect of the Russia-Ukraine conflict on petroleum products and food import prices. Notably, refined petroleum and wheat imports contributed 34.9% of total imports in Q1-22. Simultaneously, 26.2% of Nigeria's wheat imports come from Russia and Ukraine combined. We also expect the increased imports to be supported by higher freight costs and currency pressure. Thus, we forecast a 16.1% y/y increase in imports.

Overall, given our estimate of faster growth in exports (+36.5% y/y) compared to imports (+16.1% y/y), we expect the 2022E trade surplus to settle at USD7.44 billion (2021FY: USD1.64 billion deficit).

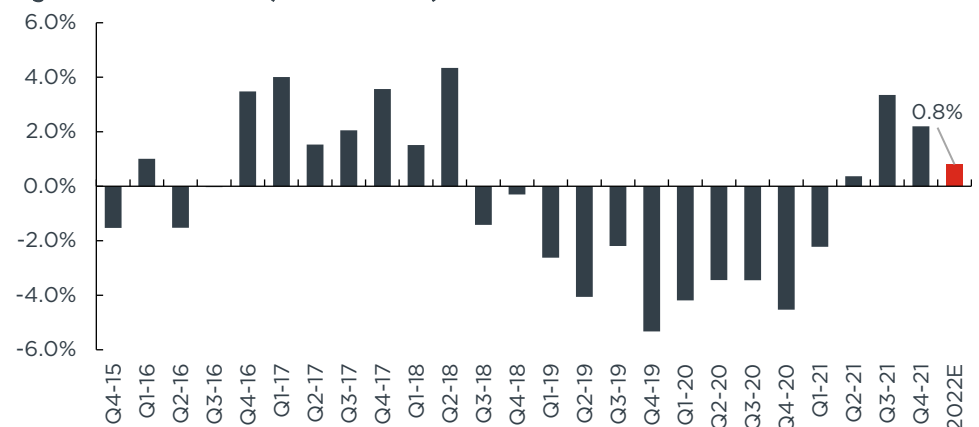
Figure 29: Trade balance (historical and forecast; USD billion)



Source: CBN, Cordros Research estimates

In line with our 2022FY outlook, we maintain our expectation of increased demand for foreign currencies for service-based transactions. Our prognosis is hinged on the slowdown in virus cases and the effective reopening of the global economy. However, we expect the FX liquidity constraints and currency pressure to limit the services account deficit relative to pre-COVID levels. Consequently, we expect the services account (net) to increase by 76.7% y/y to USD20.27 billion in 2022E (2021FY: USD11.47 billion) – 40.0% below 2019FY (USD33.76 billion). Similarly, our model suggests the primary income balance will widen by 49.8% y/y as foreigners repatriate investment income even as the CBN maintains its capital control measures. Meanwhile, we expect the surplus in the secondary income balance to increase by 6.6% y/y due to (1) the reopening of world economies and (2) lower unemployment rates in advanced economies, implying nationals residing overseas can now send funds home after regaining employment. **On a balance of factors, we now look for the CA surplus to settle at USD3.57 billion in 2022E (2021FY: USD4.03 billion or 1.0% of GDP), translating to 0.8% of GDP (nominal).**

Figure 30: CA balance (as a % of GDP)



Source: CBN, Cordros Research Estimates

Capital Importation: Foreign Interests in the Economy Remain Low

Capital importation, which used to be the bedrock of build-up in the reserves, has continued to dry up as foreign investors limit exposure to the Nigerian economy. According to the National Bureau of Statistics (NBS), capital importation into Nigeria fell to its lowest level in four quarters, declining by 17.5% y/y to USD1.57 billion in Q1-22 (Q4-21: USD2.19 billion). We believe the persistent slowdown in capital importation reflects foreign investors' lacklustre interest in the country given (1) the weak macro narrative, (2) relatively lower yields on fixed income instruments and OMO bills compared to historical trends, and (3) lingering FX liquidity constraints. Parsing through the breakdown provided, we highlight that the decline in other investments (-40.7% y/y to USD406.59 million) and foreign portfolio investments (-1.7% y/y to USD957.58 million) were enough to offset the slight increase in foreign direct investments (+0.1% y/y to USD154.97 million).

Over 2022FY, we expect portfolio inflows to remain significantly below pre-pandemic levels, given the lower yields on fixed income instruments and OMO bills compared to historical trends and CBN's capital control measures. On FDI, we do not expect any significant divergence from historical trends due to the (1) continued presence of structural rigidities, (2) socio-economic problems, (3) policy inconsistencies, and (4) election uncertainties.

Figure 31: Capital importation (USD billion)

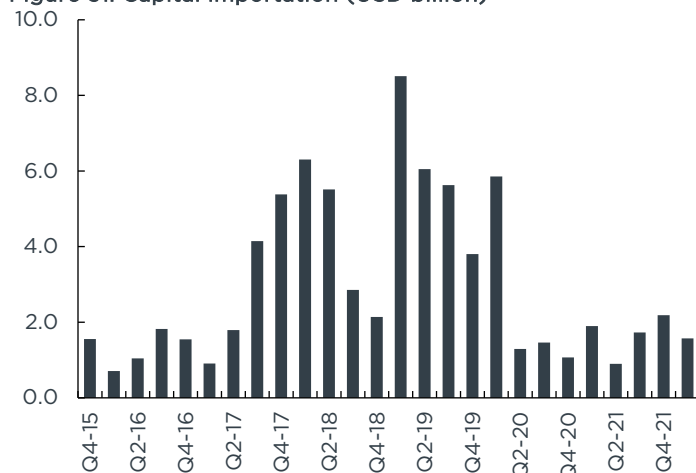
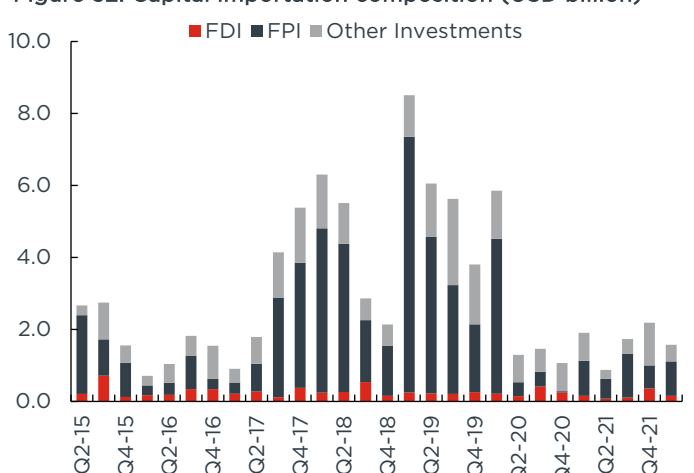


Figure 32: Capital importation composition (USD billion)



Source: NBS, CBN, Cordros Research

Figure 33: FPI contribution to total inflows (%)

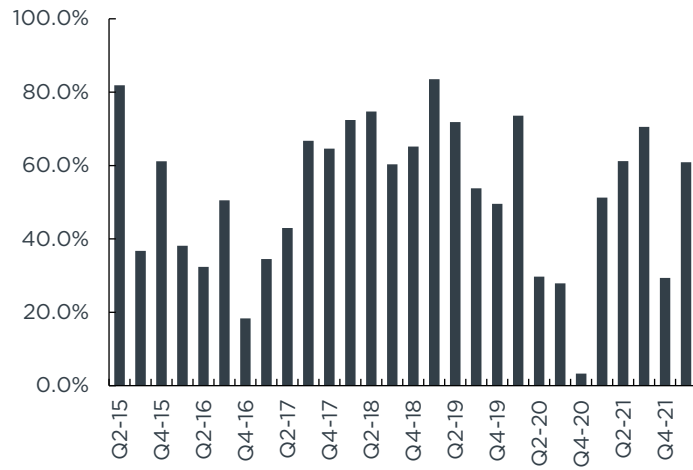
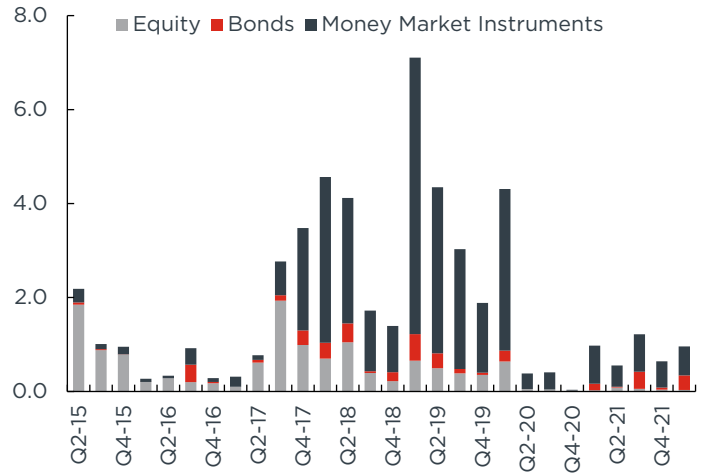


Figure 34: FPI composition (USD billion)



Source: NBS, CBN, Cordros Research

Currency.

Pressure Lingers at the Currency Market Amid Tepid Inflows

The naira remained pressured against the US Dollar in 6M-22, given the limited FX supply at the official channels amid increased FX demand, exacerbated by (1) pre-election activities, (2) high speculative demand, and (3) elevated import prices. Notably, available data from the CBN showed that official interventions through the various FX windows averaged USD1.82 billion monthly in 2021FY – 43.3% lower than its monthly average in 2019FY (USD3.21 billion). Besides, we understand that travellers and manufacturers have continued to utilise the parallel market as most of their FX needs are not met at the official windows. Accordingly, FX pressure persisted across the parallel market (the naira depreciated by 7.2% YTD to NGN609.00/USD) and IEW (the naira weakened by 1.0% YTD to NGN421.33/USD) as of the 17th of June.

That said, inflows to the Investors and Exporters Window (IEW) rose by 38.9% m/m to USD1.58 billion as of April. However, this was c.62.0% below the pre-pandemic level of USD4.14 billion (February 2020). We highlight that the increased inflows during the month reflect higher inflows across local (+39.9% m/m to USD1.24 billion) and foreign sources (+34.1% m/m to USD340.60 million). Notably, inflows from the exporters (+81.0% m/m to USD429.5 million) rose to their highest level since the CBN created the IEW, reflecting the initial impact of the CBN's non-oil export proceeds repatriation rebate scheme. We discussed the scheme extensively in our report titled '[Assessing the CBN's Attempts to Attract Non-Oil Exports](#)'. By May, we note that inflows to the IEW declined by 28.0% m/m given low FX inflows across local (-22.9% m/m to USD955.20 million) and foreign (-46.8% m/m to USD181.10 million) sources.

Moreover, despite proceeds from the USD1.25 billion Eurobond issued in March, the gross FX reserves have declined by 4.6% YTD (USD38.66 billion as of 17th June). The decline reflects that the country is yet to benefit from the rally in crude oil prices, given (1) low crude oil production volume and (2) elevated subsidy payments. Notwithstanding, we believe FX liquidity conditions will remain pressured given weak inflows from FPIs, which have historically supported the CBN's ability to supply FX through the various market segments. Accordingly, we think (1) further adjustments in the NGN/USD peg closer to its fair value and (2) flexibility in the exchange rate would be significant in attracting foreign inflows back to the market.

Figure 35: IEW vs parallel rates

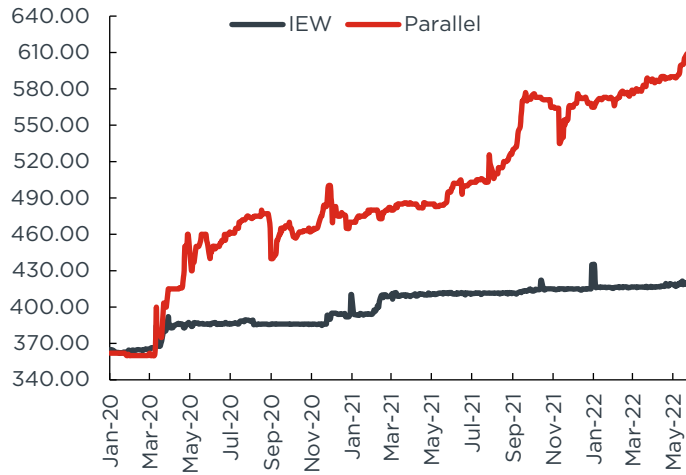
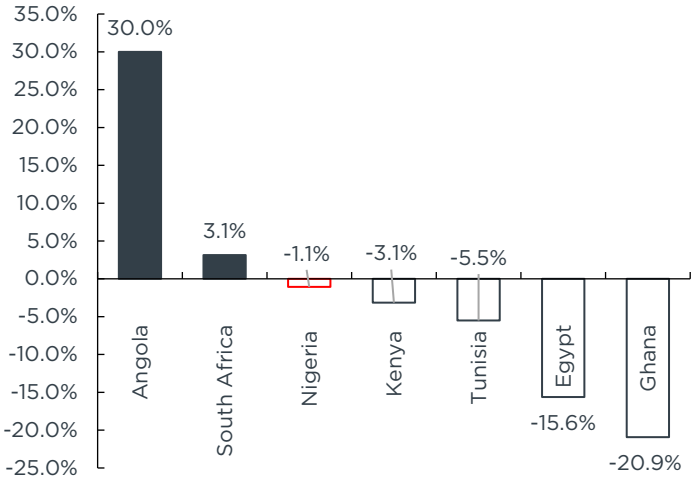


Figure 36: NGN vs comparable currencies (YTD)



Source: Bloomberg, AbokiFX, Cordros Research

CBN Attempts to Attract Non-Oil Exports

On 25th February, the Central Bank of Nigeria (CBN) released the operating guidelines for the non-oil export proceeds repatriation rebate scheme as introduced in the RT200 FX programme. Precisely, the guideline stipulates that exporters will be paid (1) NGN65.00 for every USD1.00 repatriated and sold at the IEW to Authorised Dealing Banks (ADB) for other third-party use and (2) NGN35.00 for every USD1.00 repatriated and sold at the IEW for own use on eligible transactions only. According to the CBN, the rebate scheme is designed to incentivise non-oil exporters to repatriate and sell FX proceeds in the official market. Although the rebate scheme is just one of the five key anchors of the RT200 FX programme, the CBN aims to raise USD200.00 billion in FX earnings from non-oil export proceeds over the next three to five years.

Figure 37: Cash inflows to the IEW (USD billion)

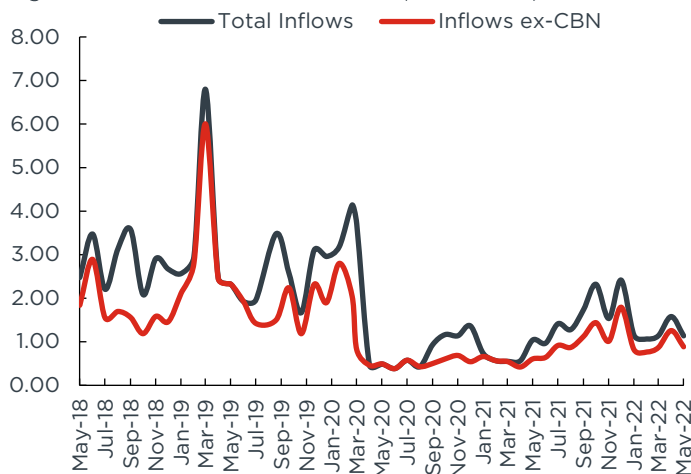
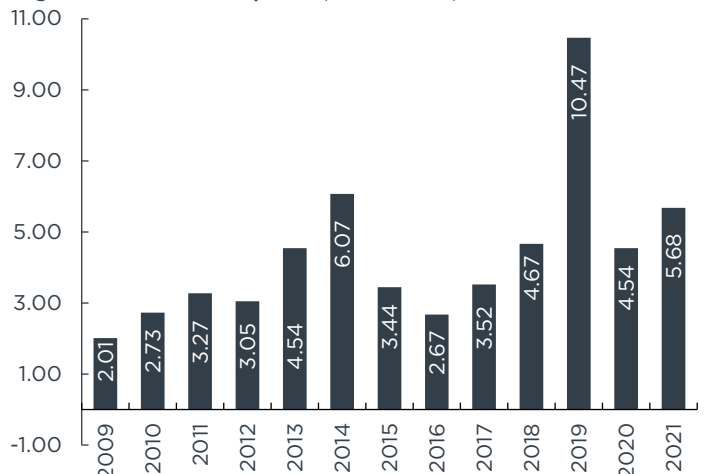


Figure 38: Non-Oil Exports (USD billion)



Source: FMDQ, CBN, Cordros Research

For us, we see the rebate scheme as a tacit devaluation of the naira to incentivise non-oil exporters to repatriate their proceeds into the FX market. That said, we believe the primary factors responsible for the low repatriation of non-oil export proceeds into the FX market are (1) low aggregate non-oil export earnings, and (2) lack of flexibility in the country's exchange rate framework, increasing the margin between the official and parallel market exchange rate.

Figure 39: CBN's FX Supply through Various Windows (USD billion)

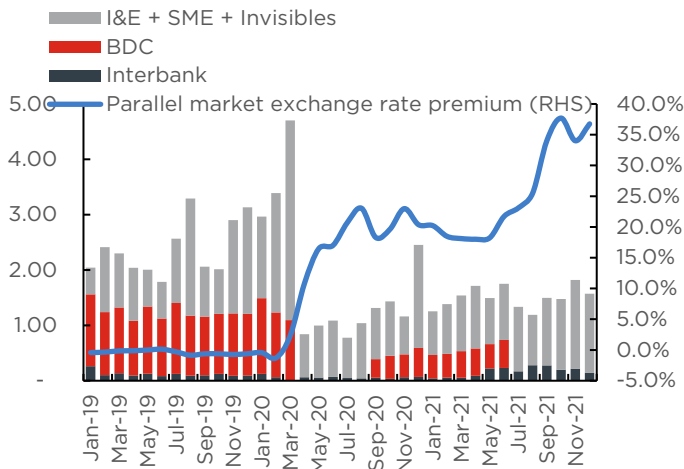
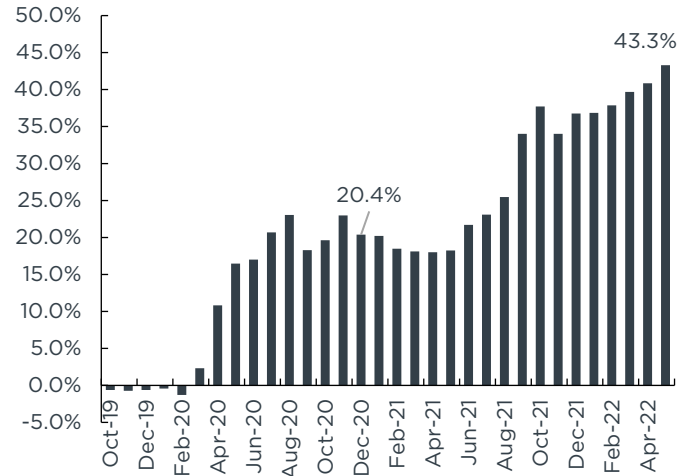


Figure 40: Trend in the Parallel Market Premium



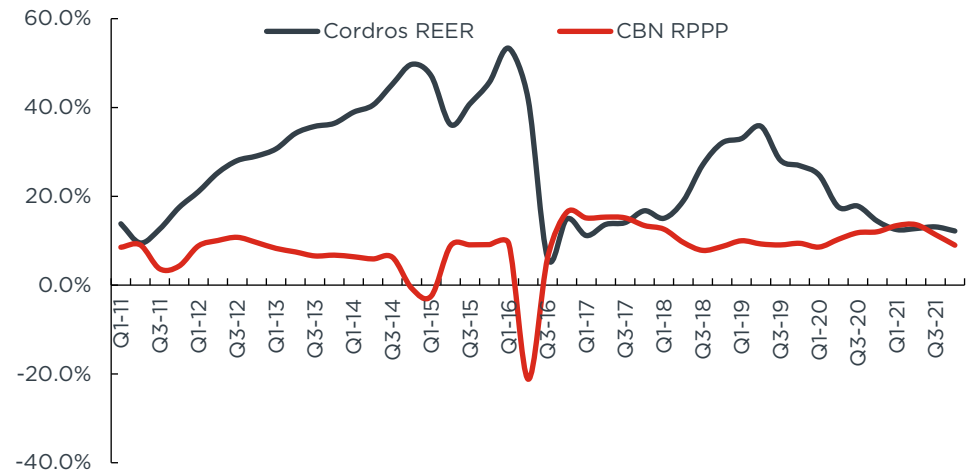
Source: FMDQ, Cordros Research

Lack of FX Flexibility is Ensuring the REER Gap Remains Wide

We used the CA model of the external sector assessment to determine how overvalued the naira is, providing a leading indicator of how much depreciation is needed to restore the external balance, other things being equal. After accounting for our expected GDP, inflation and Net Foreign Asset (NFA) benchmark for 2022, our model established a 0.1% CA norm as a percentage of GDP in 2022. Furthermore, our preliminary adjusted CA balance settled at -2.0% for 2022, leading to a corresponding CA gap of -2.15% of GDP. Based on the IMF's external sector assessment for Nigerian peers, we note that the current account elasticity to the real exchange rate is -0.2%. Adjusting the current account elasticity with the CA gap, we arrived at a REER overvaluation of 10.8%. The overvaluation is consistent with the CBN's Relative Purchasing Power Parity of 9.0% overvaluation as of December 2021.

Nonetheless, the estimates are subject to statistical uncertainties, including (1) balance of payment errors and omissions and (2) structural factors affecting the CA, which the model does not capture.

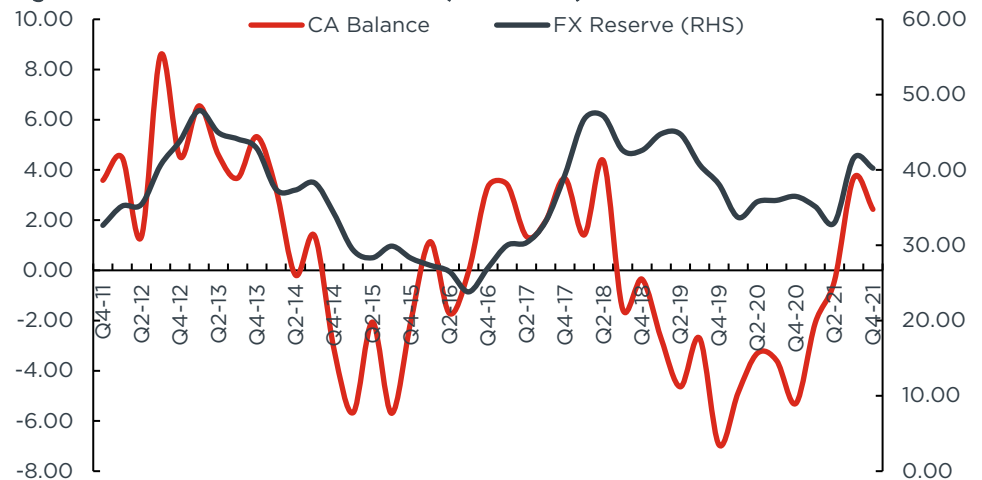
Figure 41: Fair Value of the Naira



Source: CBN, Cordros Research estimates

That said, since the CA balance positively correlates with the FX reserves, we believe the CBN would continue to limit its FX sales to the various official FX markets relative to pre-COVID levels. Our prognosis is hinged on the expected tepid accretion to the gross FX reserves amid low foreign inflows. Besides, Nigeria not accessing the Eurobond market again in 2022FY, given the rising global interest rates, further compounds the outlook on the gross FX reserves. Combined with the elevated FX demand, we expect that the pressure on the currency will be sustained over the rest of the year.

Figure 42: CA Balance vs FX Reserves (USD billion)



Source: CBN, Cordros Research

Covering All Bases

On the CBN's liquidity position, we estimate average monthly oil inflows of USD886.22 million over the second half of 2022. The preceding is based on our crude oil average price estimate (USD106.00/bbl.) and production (1.60mb/d) estimates after accounting for PMS subsidy costs (average USD712.85 million per

month using NGN415.00/USD). Furthermore, we project average monthly non-oil inflows to increase by 1.0% y/y to USD3.72 billion in H2-22. **Thus, we expect the total inflows into the CBN's coffers to average USD4.60 billion in H2-22 (H2-21: USD4.33 billion).**

Elsewhere, OMO maturities over H2-22 are relatively low (USD5.73 billion vs H2-21: USD8.39 billion), and we assume that FPIs own c.70.0% (pre-market segregation: c. 35.0%) of the maturities. We also believe that the CBN will clear a portion of the FX backlog (estimated as USD1.81 billion as of October 2021) as it tries to woo foreign investors to the market, even as the lack of FX flexibility and overvalued currency remain a concern. Overall, we assume that c.55.0% of this foreign portion will not be rolled over due to foreign investors' desire to repatriate funds given a combination of factors – including (1) persistent FX liquidity issues and (2) uncertainties surrounding the upcoming elections. Accordingly, we expect the CBN's monthly average spot sales at the IEW to increase by 43.4% y/y to USD651.07 million in H2-22 (H2-21: USD454.00 million).

Further on outflows, we expect the CBN's halt of FX sales to the BDCs to remain in place. At the same time, we expect an average of 40.0% of the allocation typically directed to that market to be channelled to the commercial banks for onward sales to the retail segment. **Overall, we expect the CBN's average monthly cash outflow to increase by 40.2% y/y to USD4.34 billion in H2-22 (H2-21: USD3.09 billion).**

On balance, our estimated monthly average net cash flow translates to a reserve accretion of USD1.60 billion over H2-22 (vs accretion of USD7.24 billion in H2-21). Consequently, we expect the reserves to settle at USD39.94 billion at the end of 2022, translating to import cover (goods and services) of 10.5 months.

Figure 43: CBN's Monthly Cashflows (USD billion)

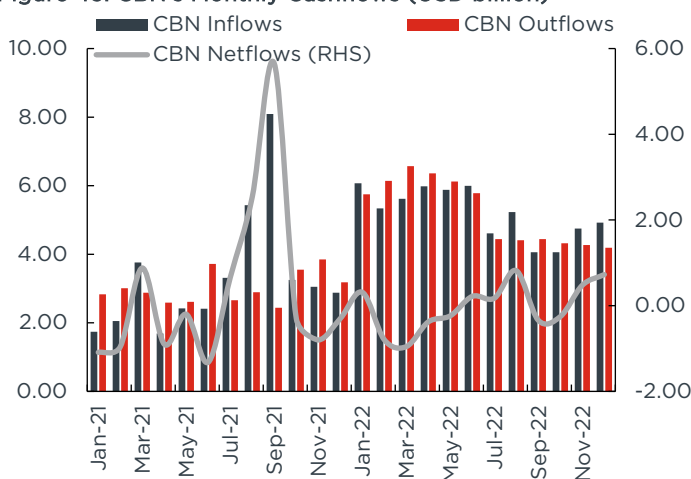
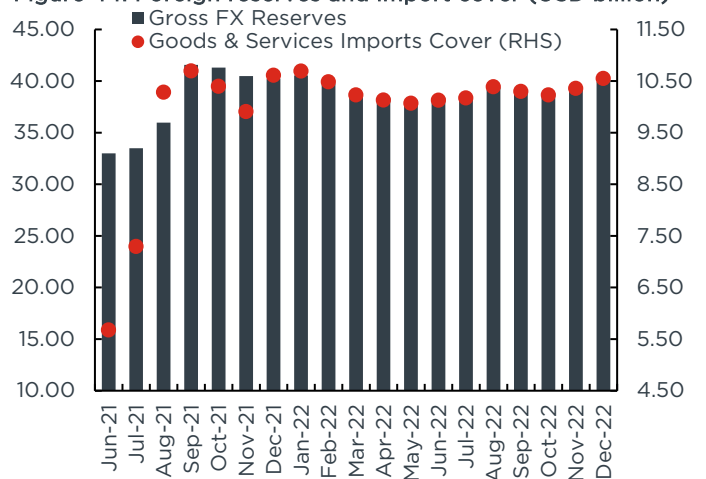


Figure 44: Foreign reserves and import cover (USD billion)



Source: CBN, Cordros Research

It is pertinent to note that our baseline expectation for the gross FX reserves in line with our analysis assumes that the CBN would not significantly intervene in the FX market with the required liquidity, as seen before the onset of the COVID-19 pandemic. The preceding surrounds the issues we mentioned earlier on lower foreign currency receipts from previously buoyant sources (FPI inflows and crude oil sale receipts). Against this backdrop, should the CBN decide to sell FX up to pre-COVID levels and clear all FX backlogs, which is unlikely in our opinion, we estimate that the gross FX reserves will settle at USD33.48 billion by 2022FY other things being equal.

That said, foreign investors continue to stay on the sidelines given the perception that the local currency is overvalued and there is a lack of flexibility in the IEW. In our view, the highlighted factors imply that the regularity of inflows from foreign investors to enhance accretion to the FX reserves is not certain. Therefore, without further devaluation of the local currency at the IEW and improved FX flexibility, we do not think the CBN can comfortably sustain itself as the significant FX supplier to the various FX markets. Besides, we believe the foreign investors remaining in the market would continue to explore creative means of exiting the domestic economy as global central banks sustain the switch to tightening cycles. Consequently, we think the exchange rate cannot be maintained at the current level over the long term. Accordingly, we believe (1) that further adjustments in the NGN/USD peg closer to its fair value and (2) flexibility in the exchange rate would be significant in attracting foreign inflows back to the market.

Monetary Policy.

Stepping into the Realm of Known Knowns

Monetary policy outcomes in H1-22 were in line with our expectations. To put things in proper context, we expected that the CBN would hold the key policy rate steady in the first half of the year but switch to a hawkish stance either at the May or July policy meeting. In line with our prognosis, the Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) unanimously voted to increase the Monetary Policy Rate (MPR) by 150bps to 13.0% at its May policy meeting. According to the CBN Governor, the increase was necessitated by the need to (1) moderate the inflationary pressures, (2) narrow the negative real interest rate gap, (3) moderate the impact of capital flow reversals triggered by rising global yields, and (4) mitigate inflationary pressures. Nonetheless, the Committee judged that the rates on the CBN's development finance initiatives should remain at 5.0% until March 2023 as a way of ensuring that the MPR increase does not derail the solid recovery process.

Figure 45: MPR & Inflation

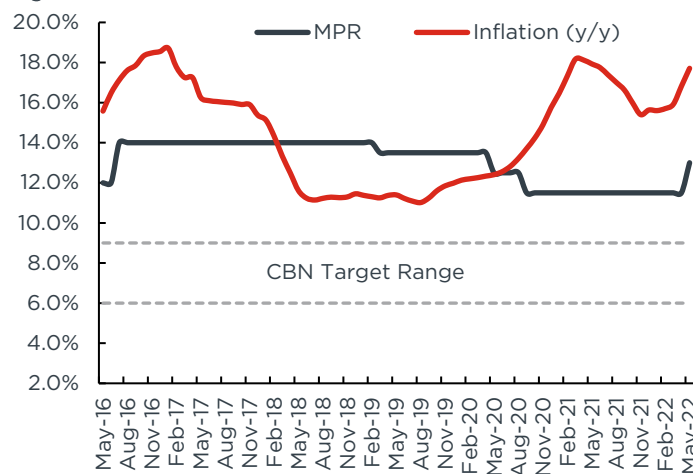
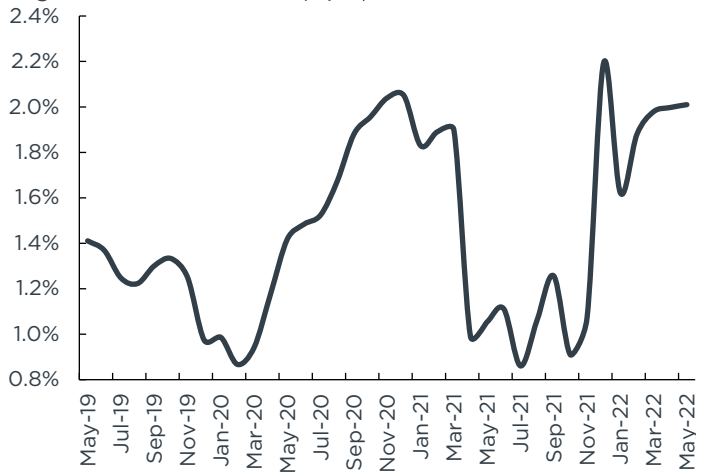


Figure 46: Food inflation (m/m)



Source: NBS, Cordros Research

MPC's Rate Hike Appears to be just Symbolic

With the hike in the MPR, we expected that the OMO yields would follow suit as a response to the increased rate. However, it appears that the 150bps hike could turn out to only be totemic without having much impact. For one, we highlight that the CBN kept the OMO stop rates flat at the PMA held on June 2nd - 7.0% at the short end, 8.5% at the mid-segment and 10.1% at the long end. Similarly, the CBN maintained a static position with the roll-over of the special bills at a flat rate of 0.5%. Again, increasing the MPR without adjusting the asymmetric corridor back to the previous level of the +200/-500 band or returning to a symmetric corridor suggests the CBN is comfortable with maintaining a wide negative real

return on savings, given that the interest rate on the SDF will remain low (6%; based on MPR - 700bps). Therefore, on a balance of factors, we believe that without allowing yields to trend upwards and adjusting the asymmetric corridor around the MPR, the intended effects of the 150bps hike would not materialise. Accordingly, we expect the currency and inflationary pressures to persist in the short-to-medium term.

That said, we believe the CBN could be compelled to increase the OMO rates if the increase in the United States Treasury yields persists, particularly after the July Federal Open Market Committee (FOMC) meeting. We believe this would be necessitated by the need to attract foreign investors by improving the attractiveness of a carry trade in the face of rising yields in advanced economies.

Figure 47: Average OMO net inflow (NGN billion)

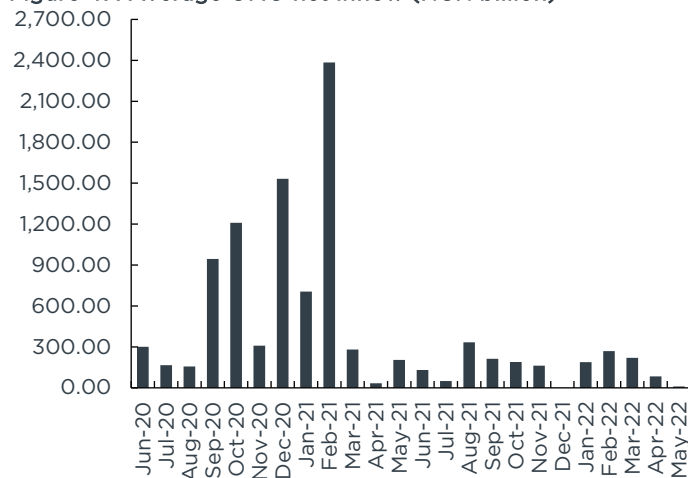
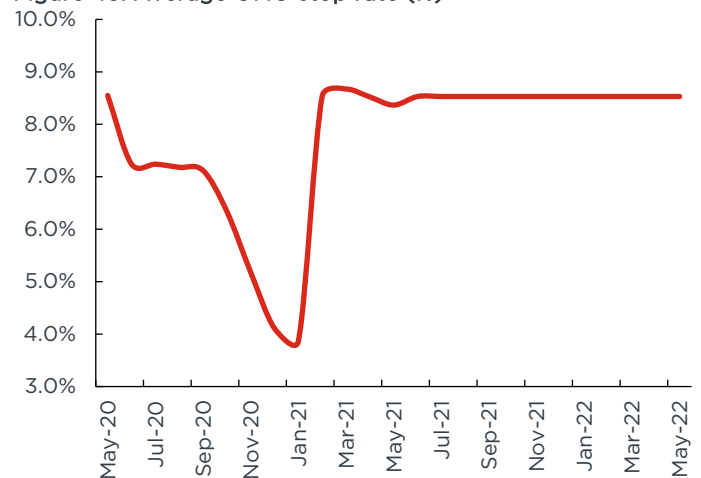


Figure 48: Average OMO stop rate (%)



Source: FMDQ, CBN, Cordros Research

MPC Likely to be More Hawkish by Year-end

For the rest of 2022FY, our outlook for the MPR is framed around our expectations for the economic growth trajectory, inflation rate and global interest rates. First, on growth, the MPC’s tone at the May policy meeting suggests the Committee is satisfied with the growth momentum, given that the Q1-22 GDP growth (+3.11% y/y) outperformed market expectations. Accordingly, growth is expected to remain positive over the rest of 2022, particularly as election-related spending in H2-22 is expected to buoy economic activities. Thus, we believe positive GDP readings from Q2-22 through Q4-22 will provide comfort to the Committee that growth has solidified and tightening of monetary policy will not dampen economic activities materially.

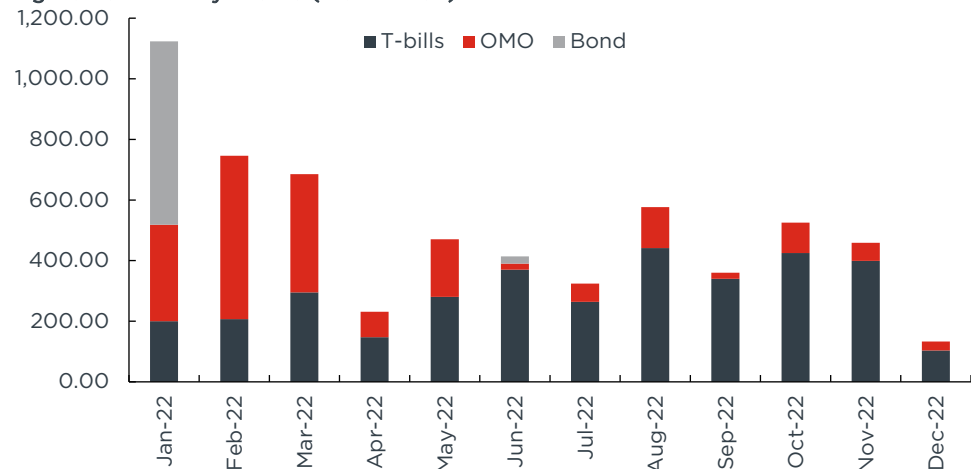
However, inflationary pressures remain elevated due to the confluence of (1) widening food demand-supply gap, (2) increased electricity tariffs, and (3) higher gas and other energy prices. Moreover, in historical periods, money demand pressure from election-related spending exerted increased pressures on inflation,

and we expect this trend to recur until the 2023 general elections. Moreover, gleaned from our inflation outlook, we expect the headline inflation to maintain its upward pressure before moderating slightly towards 17.29% y/y by the end of the year. The preceding points toward elevated domestic prices over the year, with the headline inflation expected to average 17.36% y/y in 2022E (2021FY: 16.98% y/y) in our base case scenario.

On the external front, global central banks are not showing signs of making a U-turn on hiking cycles, even as overall growth risks remain tilted to the downside. For instance, the Fed's "dot plot" now suggests a more aggressive path for interest rates after the July policy meeting, as the Fed expects the key policy rate to hit 3.4% by year-end. Consequently, we believe rising US yields will reduce the attractiveness of carry trade opportunities and mount pressure on the CBN to stem capital flow reversals. However, we think the decision to hike rates will be balanced against growth risks and impact on debt servicing costs to the government.

Overall, we believe concerns about the domestic economy's health and the need to ease the burden on government financing costs will make the Committee hold off on further rate hikes in the next two meetings in July and September. However, we have pencilled down a 100bps hike in the MPR at the last meeting in November. In the interim, we expect the CBN to sustain the use of its development finance initiatives to ensure the rate hike does not derail the fragile recovery.

Figure 49: Maturity Profile (NGN billion)



Source: FMDQ, CBN, Cordros Research

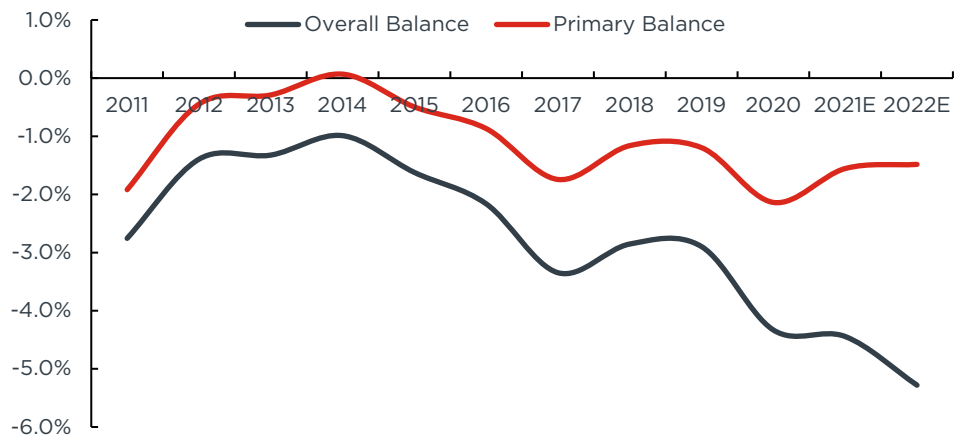
Fiscal Policy.

Fiscal Deficit Rose to a Record High on Higher Revenue Shortfall

In line with historical precedence, Nigeria’s fiscal policy position in 2021FY remained largely unimpressive as actual revenue underperformed the pro-rated budget while the government spent more than it budgeted. Although the FGN’s retained revenue (excluding GOEs¹) in 11M-21 (NGN4.31 trillion vs 2020FY: NGN3.42 trillion) rose to a record high, we highlight that it underperformed the pro-rate budget (NGN6.21 trillion) by 30.6%. The revenue underperformance was due to a 47.4% and 75.4% underperformance of oil revenue and FGN drawdowns from Special Accounts, respectively. Notwithstanding, non-oil revenue (NGN1.62 trillion) outperformed the pro-rated budget by 18.8%, in line with the recovery in domestic economic activities amid an improved tax collection from the collection agencies. If we include GOE’s retained revenue, we note that the aggregate revenue settled at NGN5.51 trillion – 26.0% below the pro-rated budget.

On the other hand, the FGN’s expenditure (excluding GOEs and project-tied loans) settled at NGN11.78 trillion in 11M-21 – 2.7% higher than the pro-rated budget (NGN11.47 trillion). Parsing through the breakdown provided by the Budget Office, we note that the overperformance stemmed from higher-than-expected spending on debt servicing (+37.9% higher than the pro-rated budget) and recurrent expenditure (+4.5% above the pro-rated budget) even as capital expenditure underperformed the pro-rated budget by 25.6%. Notably, the higher debt service was primarily due to the interest on Ways & Means (NGN1.12 trillion), which was not provided for in the budget. The aggregate expenditure (including GOEs and project-tied loans) settled at NGN12.56 trillion in 11M-21, representing a 5.9% underperformance compared to the pro-rated budget (NGN13.36 trillion).

Figure 50: Movements in the budget deficit (% of GDP)



Source: Budget Office, CBN, Cordros Research estimates

¹ Government Owned Enterprises

Overall, the fiscal deficit rose to a new record high of NGN7.05 trillion in 11M-21 (pro-rated budget: NGN5.91 trillion). Annualising the number, we estimate the fiscal deficit settled at NGN7.69 trillion – 2.4% higher than the FGN’s aggregate expenditure (excluding GOEs and project-tied loans) in 2018FY. The fiscal deficit was financed through domestic borrowing – CBN (NGN5.06 trillion), foreign borrowing (NGN1.62 trillion) and multilateral/bilateral project-tied loans (NGN369.93 billion).

Faster Growth in Expenditure to Offset Revenue Rebound in 2022FY

Although we expect the government’s revenue to be higher in 2022E compared to 2021FY, we believe the revenue would underperform the budget given the ambitious targets of the FGN. Our prognosis on increased revenue is hinged on the implementation of the 2021 Finance Act and the continued consolidation of economic growth amid strong corporate performances. However, we expect the increased expenditure over the year to outweigh the improvement in revenue, leading to a wider fiscal deficit above the budgetary estimates.

For context, although oil revenue remains underwhelming, given low crude oil production and elevated subsidy payments (+660.0% y/y to NGN676.66 billion as of Q1-22), we highlight that non-oil revenue is providing succour to the FGN’s revenue. Notably, Company Income Tax (CIT) collection increased by 35.6% y/y to NGN532.48 billion in Q1-22 (Q1-21: NGN392.65 billion) – the highest collection since Q2-15 (NGN621.50 billion). The increase was primarily due to broad-based growth across foreign CIT payments (+75.3% y/y to NGN323.35 billion) and local collections (+37.3% y/y to NGN209.13 billion). We attribute the substantial growth of the foreign CIT payment to the impact of the provision of the 2021 Finance Act, which includes a 6.0% tax on the turnover of e-commerce (including digital services) businesses by non-resident companies. At the same time, we think the growth in the local collection was underpinned by improved business activities consistent with the strong corporate earnings delivered by companies during the review period. Based on the preceding, we envisage that VAT collections also increased. Consequently, the average monthly FAAC distribution to the three tiers of government in 5M-22 settled at NGN649.44 billion (5M-21: NGN639.15 billion), despite the NNPC not remitting funds to the Federation Account as of Q1-22.

However, we envisage that aggregate expenditure increased more than expected in 5M-21, given increased borrowing during the review period amid the high PMS subsidy costs. In April, President Buhari requested that the National Assembly approve a request to borrow an additional NGN965.42 billion from the domestic debt market to cover a wider budget deficit in 2022FY. Accordingly, the government expects the 2022FY budget deficit (including GOEs and project-tied

loans) to rise to NGN7.35 trillion or 3.99% of GDP (previously: NGN6.39 trillion). According to the President, the wider deficit is necessitated given the (1) elevated subsidy costs given the decision to suspend the removal of PMS subsidy, and (2) the need to make adequate provisions for the recent enhancements of allowances for the Nigeria Police Force. On borrowings, preliminary estimates from the CBN showed that the outstanding Ways and Means to the FGN as of April was NGN19.01 trillion (December 2021: NGN17.46 trillion), implying actual Ways and Means of NGN1.55 trillion to the FGN in 4M-22. That said, the total borrowing in the domestic debt market in 6M-22 stood at NGN2.53 trillion (or 71.6% of planned domestic borrowing in 2022E), while the government also issued Eurobond (USD1.25 billion) in March. Given the substantial amounts of borrowings made by the FG in 6M-22, we imagine that growth in expenditure must be running ahead of the increase in revenue, leading to a widening fiscal deficit.

Figure 51: NNPC's gross sales receipts (NGN million)

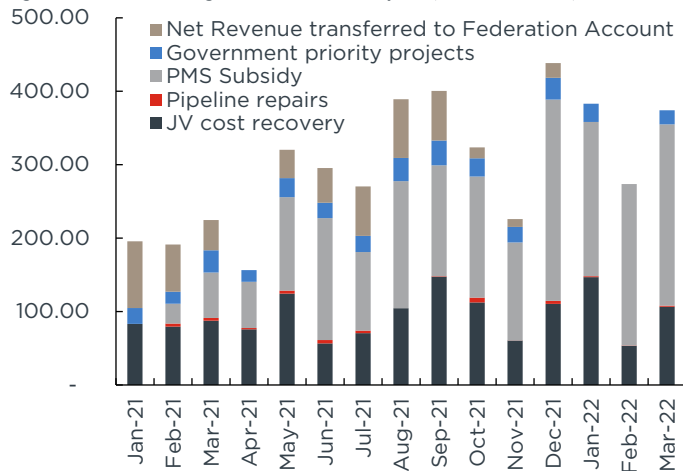
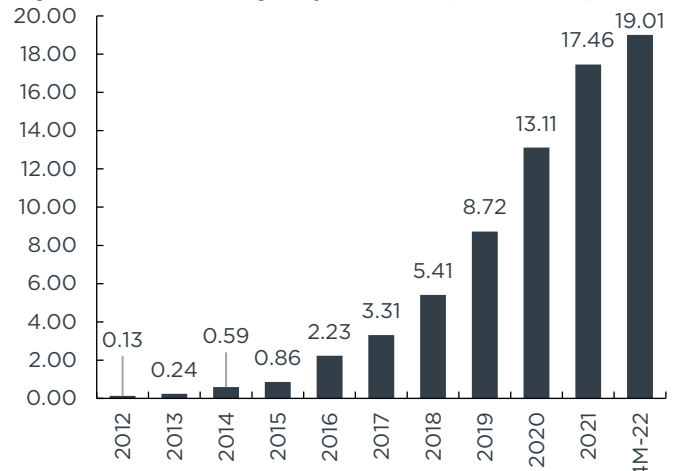


Figure 52: Outstanding Ways & Means (NGN trillion)



Source: NNPC, CBN, Cordros Research

FGN 2022 Budget: Fiscal Deficit to Widen More than Expected

FGN sustained its expansionary fiscal policy thrust in 2022 with a historic budgetary estimate of NGN16.39 trillion. However, the National Assembly approved a budget of NGN14.26 trillion (+13.9% y/y), split across recurrent non-debt (NGN5.49 trillion), debt service (NGN3.88 trillion), and CAPEX (NGN3.66 trillion). Meanwhile, projected retained revenue is set at NGN9.01 trillion, excluding GOEs revenue (net operating surplus). If we include the GOEs' finances, and the supplementary borrowing approved in April, the government expects the 2022FY budget deficit to rise to NGN7.35 trillion (or 3.99% of GDP). Accordingly, the FGN expects the deficit to be financed by domestic borrowing (NGN3.54

¹ 2022 approved budget including GOEs and project-tied loans amount to NGN17.13 trillion

trillion), foreign debt (NGN2.57 trillion), project-tied loans (NGN1.16 trillion) and privatisation proceed (NGN90.73 billion).

Table 1: Breakdown of 2022 approved budget (NGN trillion)

Fiscal items	2022 (Approved)	2021 (revised)
Assumptions		
Oil production volume (mb/d)	1.60	1.86
Benchmark oil price (USD/bbl.)	73.00	40.00
Average exchange rate (USD/NGN)	410.15	379.00
Revenue		
FGN retained revenue	10.74	8.12
Oil & related revenue	3.36	2.01
Non-oil tax revenue	2.13	1.49
Other revenue	5.25	4.62
Expenditure		
Gross FGN expenditure	17.13	14.57
Statutory transfers	0.87	0.50
Debt service	3.61	3.12
Sinking fund	0.27	0.20
Recurrent (non-debt) exp.	6.91	5.77
Aggregate capital expenditure	5.96	5.23
Fiscal deficit		
	7.35	6.45

Source: Budget Office, Cordros Research

Fiscal deficit to set a New Record High given Overambitious Budget

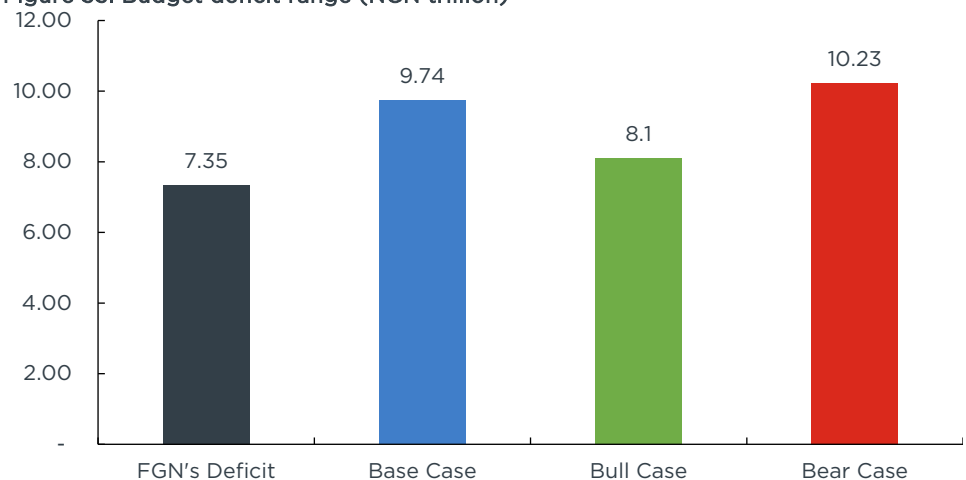
Relative to 2021FY, the FGN revised its crude oil production expectation to an average of 1.60mb/d (previously: 1.88mb/d). The downward revision is in line with the current production challenges, given infrastructure constraints, divestments and theft. Although the government's revised estimate aligns with our expectations, we expect the crude oil price to average USD106.00/USD. However, elevated PMS subsidy payments (estimated at an average of NGN295.83 billion monthly) suggest oil revenue will be underwhelming. The preceding informs our projected retained oil revenue of NGN2.08 trillion – 38.1% below the FGN's assumption of NGN3.36 trillion.

Elsewhere, we believe the proposed non-oil tax revenue of NGN2.13 trillion is aggressive as it represents a 43.2% increase compared to the 2021 budget. Although we expect non-oil revenue to increase compared to 2021 levels, we believe it will not meet the FGN's expectations given pre-existing macroeconomic challenges, particularly slacks in the job market and poor operating conditions for businesses. Therefore, we project the non-oil tax revenue will settle at NGN1.85 trillion. Meanwhile, we expect the other revenue lines to grossly underperform the

budget due to the ambitious targets, especially independent revenue (NGN2.22 trillion). The preceding is also in line with gross historical underperformance (2017 to 2020 average performance ratio: 58.5%), given the weak operational efficiencies in most state-owned enterprises (SOEs). **Overall, we project FGN's total retained revenue to settle at NGN6.25 trillion in 2022E (vs 11M-21: NGN4.31 trillion). Assuming 80.0% GOEs' revenue performance, the aggregate revenue would be NGN7.64 trillion (vs 11M-21: NGN5.51 trillion).**

On balance, assuming a budget implementation rate of 95.8% in addition to the supplementary budget (NGN965.42 billion), our scenario analysis indicates that the fiscal deficit (including GOEs' and project-tied loans) could range between NGN8.10 trillion and NGN10.23 trillion. Therefore, our baseline expectation is that the fiscal deficit will print NGN9.74 trillion in 2022E compared to NGN7.71 trillion in 2021E.

Figure 53: Budget deficit range (NGN trillion)



Source: Budget Office, Cordros Research estimates

FGN to Rely Heavily on the Domestic Debt Market to Plug the Deficit

Like in previous years, we believe the FGN's ability to mobilise debt is crucial to achieving a meaningful budget implementation rate. On foreign borrowing, we highlight that the FGN already borrowed USD1.25 billion or (NGN518.75 billion) through Eurobond issuance in March. The amount borrowed leaves a gap of NGN2.05 trillion in relation to the budgeted foreign borrowings (NGN2.74 trillion). In May, the finance minister stated that Nigeria is unlikely to patronise the Eurobond market again this year, given that external financing condition is no longer favourable given increases in global interest rates. Accordingly, we expect the gap to be channelled to the domestic debt market. Elsewhere, we are conservative with other financing sources as we assume that the government will meet its target from privatisation proceeds (NGN90.73 billion) and multilateral/bilateral project-tied loans (NGN1.16 trillion).

Consequently, we estimate the remaining borrowings required to balance the 2022E fiscal deficit to be NGN7.45 trillion when juxtaposed with our baseline fiscal deficit (NGN9.74 trillion). We expect a significant chunk of the balance will be borrowed in the domestic capital market while the rest is done through the CBN's Ways & Means advances. Indeed, actual CBN's Ways & Means to the FGN settled at NGN1.55 trillion in 4M-22. At the same time, total domestic borrowing as of 5M-22 (NGN2.53 trillion) was 71.6% of the planned government borrowing, suggesting that the FGN will borrow significantly higher than it budgeted in 2022E.

Figure 54: Debt Service to Revenue Ratio

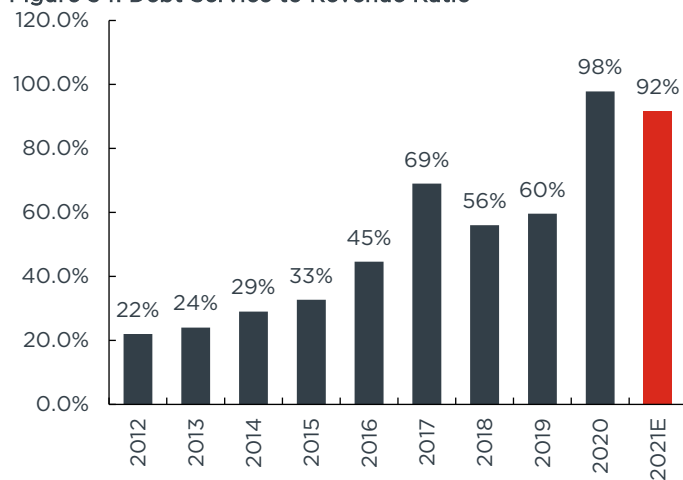
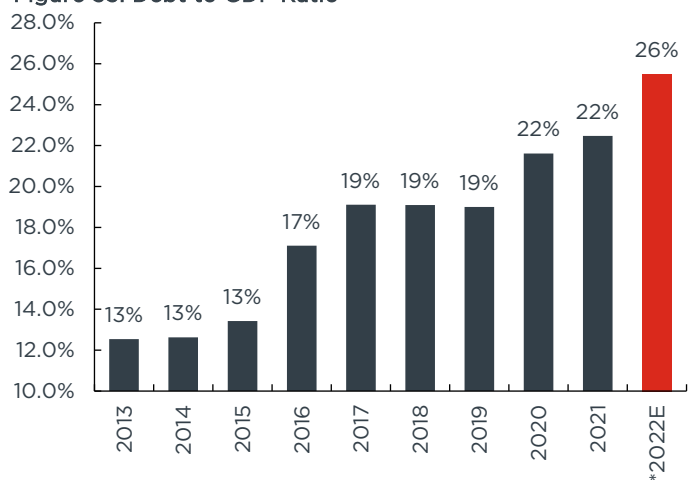


Figure 55: Debt to GDP Ratio



Source: Budget Office, CBN, Cordros Research Analysis | *Excluding CBN's Ways and Means to the FGN

Appendix. Nigeria – Key Economic Forecasts.

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022E
Activity													
Real GDP (% YoY)	9.5	5.3	4.2	5.5	6.2	2.8	(1.6)	0.8	1.9	2.3	(1.9)	2.9	3.5
Private consumption (% YoY)		(3.1)	0.3	21.2	0.6	1.5	(5.7)	(0.4)	4.6	(1.1)	(1.7)	25.7	10.2
Government consumption (% YoY)	17.8	4.6	(2.0)	(10.3)	(7.0)	(11.9)	(15.1)	(12.4)	39.9	8.8	61.6	(34.0)	5.3
Oil production (million b/d year-end)	2.4	2.4	2.0	2.2	2.2	2.1	1.6	1.9	1.9	2.0	1.8	1.6	1.6
Nominal GDP (NGN billion)	54,612	62,980	71,714	80,093	89,044	94,145	101,489	113,712	127,737	144,210	152,324	173,528	184,382
Nominal GDP (USD billion)	363	410	459	515	569	495	405	376	398	448	402	423	444
Real GDP (NGN billion)	54,612	57,511	59,930	63,219	67,153	69,024	67,931	68,491	69,800	71,388	70,014	72,394	74,910
Population (million)	160	165	170	176	181	187	193	199	205	211	218	224	231
GDP per capita (USD)	2,277	2,490	2,700	2,931	3,134	2,641	2,093	1,886	1,941	2,121	1,846	1,888	1,924
Gross national saving (% of GDP)	10.7	10.2	11.0	11.9	12.7	12.4	13.7	12.6	12.4	12.5	14.3	14.6	13.4
Stock of bank credit to the economy (NGN billion)	7,706	7,313	8,150	10,006	12,889	13,086	16,117	15,741	15,134	17,188	20,373	24,378	28,583
Stock of bank credit to the economy (% of GDP)	14.1	11.6	11.4	12.5	14.5	13.9	15.9	13.8	12.1	11.1	13.4	14.0	15.5
Loan to deposit ratio (%)	74.2	44.8	42.3	38.0	64.2	69.6	80.0	78.2	64.3	59.9	65.0	65.0	65.0
Fiscal balance (% of GDP)													
Federal government balance	(2.0)	(2.8)	(1.4)	(1.3)	(1.0)	(1.6)	(2.2)	(3.3)	(2.9)	(2.9)	(4.3)	(4.4)	(5.3)
Total public debt	9.6	17.6	17.7	18.6	17.5	20.3	23.4	25.3	28.4	19.9	21.6	22.5	25.5
Capital Expenditure	1.6	1.5	1.0	1.1	0.7	0.6	0.2	1.3	1.3	0.8	1.1	1.5	1.2
Debt Indicators													
Gross external debt (USD billion)	4.6	5.7	6.5	8.8	9.7	10.7	11.4	18.9	25.3	27.7	33.4	38.4	44.6
Gross external debt (% of GDP)	1.1	1.1	1.0	1.7	1.8	2.3	3.4	5.1	6.1	6.2	8.3	9.1	10.0
Gross external debt (% of exports)	5.7	5.7	6.7	9.0	11.7	23.3	32.9	41.3	41.3	42.6	92.8	83.6	71.3
Total debt service (USD billion)	2.8	3.4	4.3	5.3	5.9	5.5	5.6	6.0	7.1	8.0	8.9	10.4	11.0
Total debt service (% of GDP)	0.8	0.8	0.9	1.0	1.0	1.1	1.4	1.6	1.8	1.8	2.2	2.5	2.5
Total debt service (% of exports)	3.4	3.4	4.4	5.4	7.2	12.0	16.2	13.0	11.5	12.3	24.8	22.6	17.6
External Balance													
Exports (NGN billion)	13,010	19,036	22,446	14,245	16,304	9,593	8,527	13,598	18,532	19,192	12,523	18,908	25,734
Exports (USD billion)	80.6	99.9	97.0	97.8	82.6	45.9	34.7	45.8	61.2	65.0	35.9	45.9	62.5
Imports (NGN billion)	6,649	10,033	5,625	7,016	7,374	6,698	8,818	9,563	13,165	16,960	12,701	20,844	24,700
Imports (USD billion)	44.2	65.2	35.7	44.6	46.5	34.7	34.8	31.3	43.0	62.1	52.4	45.6	54.1
Trade balance (NGN billion)	6,361	9,003	16,821	7,229	8,930	2,895	(290)	4,036	5,367	2,232	(178)	(1,936)	1,033
Trade balance (% of GDP)	11.6	14.3	23.5	9.0	10.0	3.1	(0.3)	3.5	4.2	1.5	(0.1)	(1.1)	0.6
Current account balance (USD billion)	14.6	12.7	18.9	20.1	1.3	(15.4)	2.7	10.4	3.9	(16.7)	(17.0)	4.0	3.6
Current account balance (% of GDP)	4.0	3.1	4.1	3.9	0.2	(3.1)	0.7	2.8	1.0	(3.7)	(4.2)	1.0	0.8
Exports (% YoY, NGN value)	75.0	46.3	17.9	(36.5)	14.5	(41.2)	(11.1)	59.5	36.3	3.6	(34.8)	51.0	36.1
Imports (% YoY, NGN value)	31.7	50.9	(43.9)	24.7	5.1	(9.2)	31.6	8.5	37.7	28.8	(25.1)	64.1	18.5
Foreign exchange reserves (ex. gold, USD billion)	32.3	32.6	43.8	42.8	34.2	28.3	27.0	39.4	42.6	38.1	36.5	40.2	39.9
Foreign exchange reserves adequacy (average months of import cover)	9.0	6.1	8.6	10.0	7.4	7.0	9.1	12.0	13.8	7.9	7.7	10.6	10.5
Prices													
CPI (average % YoY)	13.8	10.9	12.2	8.5	8.0	9.0	15.6	16.5	12.1	11.4	13.2	17.0	17.4
CPI (year-end % YoY)	11.8	10.3	12.0	8.0	8.0	9.6	18.5	15.4	11.4	12.0	15.8	15.6	17.3
Interest & Exchange Rates													
Monetary policy rate (MPR), % year-end	6.3	12.0	12.0	12.0	13.0	11.0	14.0	14.0	14.0	13.5	11.5	11.5	14.5
Broad money supply (NGN billion)	11,526	13,303	15,481	15,681	18,886	20,030	23,592	24,141	27,069	28,783	37,829	43,818	48,375
Broad money supply (% YoY)	6.9	15.4	16.4	1.3	20.4	6.1	17.8	2.3	12.1	6.3	31.4	15.8	10.4
Credit to the private sector (NGN billion)	9,830	14,184	15,152	16,191	18,126	18,721	22,326	22,243	23,536	26,695	29,890	35,195	40,263
Credit to the private sector (% of GDP)	18.0	22.5	21.1	20.2	20.4	19.9	22.0	19.6	18.4	18.5	19.6	20.3	21.8
3-month interest rate (T-bill year-end %)	7.5	14.1	11.7	10.9	10.8	5.7	21.0	14.0	11.3	5.2	0.4	5.0	UR
5Y yield (% year-end)	12.0	11.2	12.0	13.3	15.3	11.0	11.4	14.0	15.2	10.3	6.3	12.3	UR
Official exchange rate, (NGN/USD) year-end	148.8	156.7	155.8	155.7	168.0	197.0	305.0	306.0	307.0	307.0	380.0	435.0	445.0
Official exchange rate (NGN/USD) annual average	150.3	153.9	157.5	157.3	158.6	193.3	253.5	305.8	306.1	306.9	x	410.4	434.4
BDC exchange rate (NGN/USD) annual average	153.1	159.3	160.9	162.4	171.5	222.7	372.9	395.4	361.5	359.5	435.3	515.8	NA
BDC exchange rate (NGN/USD) year end	156.0	165.0	159.0	172.0	191.5	267.0	490.0	363.0	361.0	362.0	475.0	565.0	NA
I & E exchange rate (NGN/USD) annual average								365.6	362.1	361.9	381.5	435.0	434.4
I & E exchange rate (NGN/USD) year end								360.3	364.0	364.5	394.7	410.4	445.0

Source: World Bank, CBN, NBS, Budget Office, DMO, FMDQ, Bloomberg, Cordros Research estimates

Disclosures.

Analyst's Certification and Disclaimer

The research analyst(s) whose name(s) appear(s) on the cover of this report are primarily responsible for this report and certifies (y) that:

- (1) all of the views expressed about the companies and their securities in this report are accurately expressed and reflect his or her personal views about any and all of the subject securities or issuers;
- (2) no part of any of the research analyst's remuneration or compensation (overall firm revenue) was, is, or will be directly or indirectly related to the specific recommendations, estimates, opinions or views expressed by the research analyst(s) in this report; and
- (3) all analysis made by the analyst(s) were in good faith based on public information regarding the companies, securities, industries or markets and the views expressed reflect the analyst's opinion, without undue influence or any intervention.

Conflict of Interest: It is the policy of Cordros Capital Limited and its subsidiaries and affiliates that research analysts may not be involved in activities that suggest that they are representing the interests of Cordros Capital in a way likely to appear to be inconsistent with providing independent investment research. In addition, research analysts' reporting lines are structured so as to avoid any conflict of interests. For example, research analysts are not subject to the supervision or control of anyone in Cordros' Investment Banking or Sales and Trading departments. However, such sales and trading departments may trade, as principal, on the basis of the research analyst's published research. Therefore, the proprietary interests of those Sales and Trading departments may conflict with your interests.

Important Disclosure

This document has been issued and approved by Cordros Capital (Cordros) and is based on information from various sources that we believe are reliable. However, no representation is made that it is accurate or complete. While reasonable care has been taken in preparing this document, no responsibility or liability is accepted for errors or fact or for any opinion expressed herein. This document is for information purposes only. It does not constitute any offer or solicitation to any person to enter into any trading transaction.

Investments discussed in this report may not be suitable for all investors. This report is provided solely for the information of Cordros clients who are then expected to make their own investment decisions. Cordros conducts designated investment business with market counter parties and customers and this document is directed only to such persons. Cordros accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report is for private circulation only and may not be reproduced, distributed or published by any recipient for any purpose without prior express consent of Cordros. Users of this report should bear in mind that investments can fluctuate in price and value. Past performance is not necessarily a guide to future performance.

Cordros and/or a connected company may or may not have a relationship with any of the entities mentioned in this document for which it has received or may receive in the future fees or other compensation. Cordros is regulated by the Securities and Exchange Commission to conduct investment business in Nigeria.