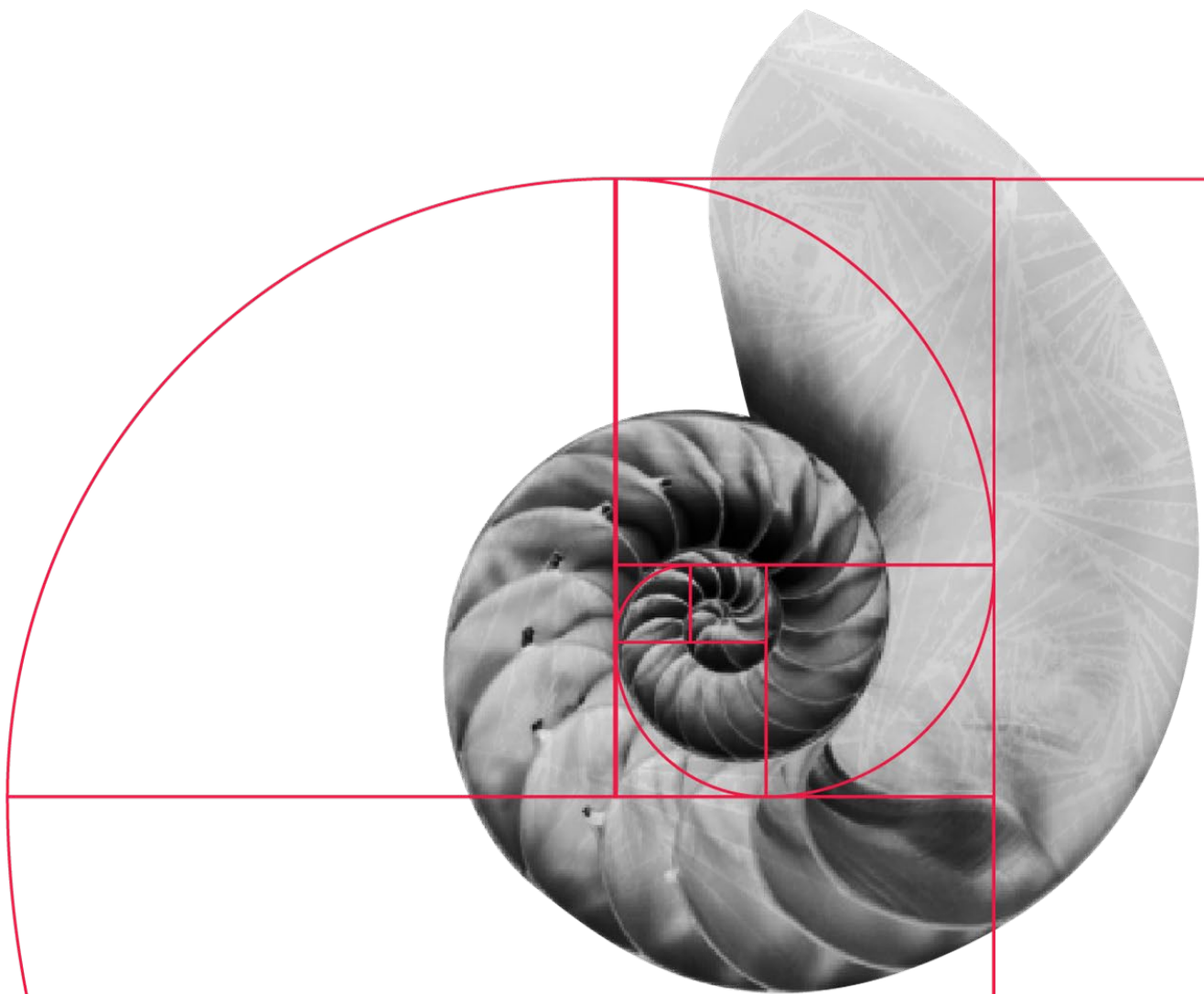


# Nigeria

## in 2023. *Charting Through a Pervasive Slowdown.*



## Executive Summary.

The domestic macroeconomic narrative did not change much in 2022, given the government's lack of will to institute the necessary reforms to propel the economy forward. While domestic economic activities appear more resilient than envisaged, inflationary pressures remain entrenched, pressuring consumer wallets. Similarly, FX pressures persisted, and foreign investments remained frail. In the words of the World Bank, "amid heightened risks, the government has kept a 'business-as-usual' policy stance that hinders prospects for economic growth and job creation". Amidst all these, the socio-economic conditions worsened, with 63.0% (or 113.00 million) of the population living in multidimensional poverty, according to the National Bureau of Statistics (NBS). At the same time, the unemployment rate remains high, exacerbated by an unfriendly business environment.

Although the Russia-Ukraine conflict compounded the domestic inflation woes, we highlight that price pressures were also self-inflicted in the form of policy distortions such as (1) trade restrictions, (2) lack of flexible FX framework, and (3) insincere monetary policy actions. On (3), the CBN continues to increase the key policy rate but maintains its monetary financing of the FGN's fiscal deficits and credit intervention programs.

The FGN's fiscal operations have been the same as in the last few years. On the one hand, the government continues to defer the decision on fuel subsidy removal and consistently increases its aggregate spending amidst a dwindling revenue profile. On the other hand, we like that the government continues to use the annual Finance Act to boost non-oil revenues. However, we think more efforts are needed to expand the current tax net so as not to 'over tax' the existing tax bracket, potentially reducing business flows and subsequent government revenues.

Going into the next year, we think a complete removal of the subsidy on PMS while consumer prices remain elevated could further aggressively stoke inflationary pressures, lead to massive protests, and ultimately compound economic woes. Indeed, Fitch ratings noted that the potential removal of fuel subsidies would reduce hard-currency demand but could fan inflation even higher, keeping the naira under pressure. Accordingly, we tilt towards a phased removal of PMS subsidies, similar to the phased increases of electricity tariffs. That said, the fiscal authorities need to come to terms with the fact that solving the lingering elevated price pressures rests more on them, given that supply constraints primarily drive the current consumer price increases.

Similarly, we do not see the current CBN management devaluing the currency, barring a new market-oriented fiscal administration. However, for credible policy

### Analysts

**Jolomi Odonghanro**  
[jolomi.odonghanro@cordros.com](mailto:jolomi.odonghanro@cordros.com)

**Opeoluwa Oluwa**  
[opeoluwa.oluwa@cordros.com](mailto:opeoluwa.oluwa@cordros.com)

**Abdulazeez Kuranga**  
[abdulazeez.kuranga@cordros.com](mailto:abdulazeez.kuranga@cordros.com)

**Jennifer Chiwetelu**  
[jennifer.chiwetelu@cordros.com](mailto:jennifer.chiwetelu@cordros.com)

**Tesleemah Lateef**  
[tesleemah.lateef@cordros.com](mailto:tesleemah.lateef@cordros.com)

**Emmanuel Nwamaka**  
[emmanuel.nwamaka@cordros.com](mailto:emmanuel.nwamaka@cordros.com)

framework and reform, we lean towards devaluing the currency at the official FX markets and improving flexibility and communication in the FX framework. Without flexibility, it is only a matter of time before the FX misalignments build back up, leading to more pressures to implement another outsized currency devaluation. Accordingly, we believe a currency devaluation followed by periodic communications allowing the local currency to depreciate in line with fundamentals will be tenable as power changes hands in 2023. On the fundamentals, the CBN can enable the currency to depreciate yearly based on the external balance assessment after considering inflation, net foreign assets, current account gap, and growth. Clear communication and commitment to this framework will be crucial to bringing back credibility and significantly reducing FX volatility.

For fiscal operations, we highlight that majority of the government spending is on personnel costs & overheads (29.7% of total expenditure) and debt servicing (30.8% of total spending), which are sticky, making it difficult to reduce the fiscal deficit amidst a low revenue profile. Also, rationalising the public workforce with no private sector absorption could compound the unemployment headaches in the country. Thus, while we believe most of the expense items are sticky, removing duplicated projects and cutting wasteful spending would go a long way in reducing the cost of governance and narrowing the fiscal deficit in the medium to long term. Moreover, freezing new employment in the public sector and creating an enabling business environment could help improve the country's employment situation while relieving the government of pressures to absorb unneeded labour into different parastatals.

Overall, we expect the growth momentum to be sustained in 2023FY, slightly higher than 2022E levels, primarily due to our expectation of the oil sector's performance turning positive after three consecutive years of negative performance. Our oil sector's positive outlook follows the low statistical base effects in 2022E and the government's efforts at tackling crude oil theft and pipeline vandalism. Elsewhere, we expect the non-oil sector to maintain its resilience, although growth is likely to come lower than 2022E levels given the trifecta impact of (1) tighter credit conditions, (2) flood-induced slower pace of Agriculture GDP growth in H1-23, and (3) higher inflationary pressures. On a balance of factors, we expect the oil and non-oil sector to grow by 12.40% y/y and 2.45% y/y, respectively, in 2023FY. Sequentially, we expect the Nigerian economy to grow by 3.02% y/y in 2023FY (2022E: +2.72% y/y).

Aside from looking at the GDP expectation using our estimates for performance across the different sectors of the economy, we think 2023FY growth will be undermined by the impact of some monetary and fiscal decisions undertaken in 2022. For one, should the CBN not extend the deadline for making the old

banknotes cease to become legal tender, we expect traders will be reluctant to accept old notes by the time the CBN starts rolling out the new banknotes on 15 December. As a result, the preceding could reduce trade flows, increase uncertainties, and negatively affect aggregate output. Elsewhere, high-interest rates in line with the CBN's tight monetary policy stance could suppress activities in interest rate-sensitive sectors, including the manufacturing, trade, construction, and agriculture sectors.

## Contents.

<b>Growth</b> .....	<b>5</b>
Domestic Economic Activities to Maintain its Resilience.....	5
<b>Inflation</b> .....	<b>13</b>
Inflationary Pressures to Remain Elevated.....	13
<b>Balance of Payments</b> .....	<b>17</b>
CA Surplus to Weaken on Account of Lower Trade Surplus.....	17
<b>Currency</b> .....	<b>21</b>
Naira Remains Mired in Persisting Illiquidity Situation.....	21
<b>Monetary Policy</b> .....	<b>26</b>
Monetary Policy Stance to Remain Tight Over 2023FY.....	26
<b>Fiscal Policy</b> .....	<b>30</b>
2023FY Budget: Ambitious Revenue Targets Support Widening Deficit.....	30
<b>Appendix. Nigeria - Key Economic Forecasts</b> .....	<b>35</b>
<b>Disclosures</b> .....	<b>36</b>

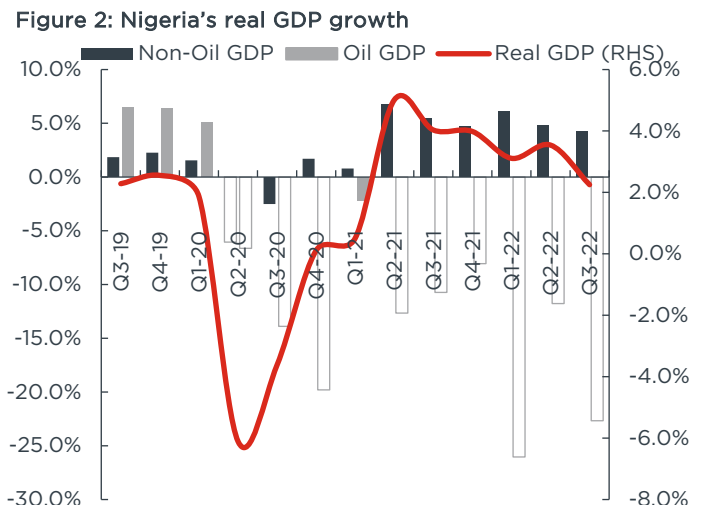
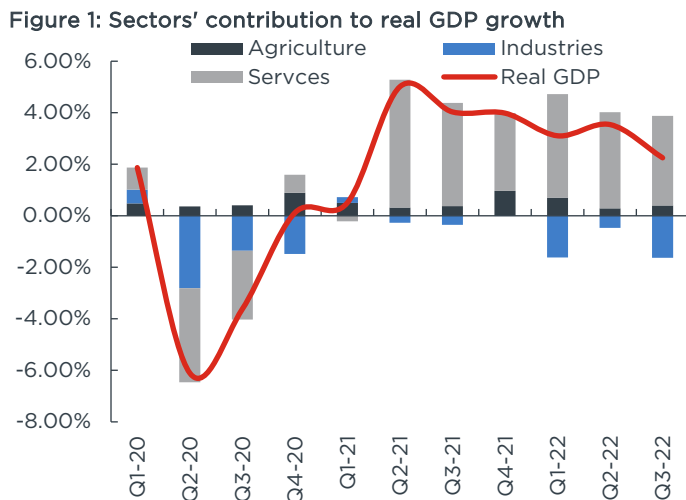
## Growth.

### Domestic Economic Activities to Maintain its Resilience

- Domestic economy to grow by 3.02% y/y in 2023FY (2022E: +2.72% y/y)
- The Oil sector to grow by 12.40% y/y in 2023FY (2022E: -18.54% y/y)
- Non-oil sector to expand by 2.45% y/y in 2023FY (2022E: +4.37% y/y)

After the 2021FY initial post-COVID boost, domestic economic activities normalised in 2022E despite the lingering challenges to factory and business activity. Pertinently, the non-oil sector remains the overall growth engine as the oil sector's performance remained marred by the trifecta impact of (1) massive theft and vandalism, (2) age-long infrastructure deficit and (3) IOC divestments, given the challenging business environment and the move to cleaner energy sources. Moreover, the non-oil sector's resilience was supported by sturdy growth across the Telecommunications, Trade, Real estate, and Finance & Insurance sub-sectors. In the midst of these, the Agriculture sector's performance remained underwhelming, while the Manufacturing sector contracted in Q3-22. **Overall, we anticipate the economy will grow by 2.72 y/y in 2022E.**

In 2023FY, we expect real GDP growth to be slightly higher than 2022E levels as we forecast the oil sector to return to a positive growth path in line with a moderate recovery in crude oil production, albeit significantly below pre-pandemic levels. However, we also expect the non-oil sector to maintain its growth trajectory albeit slowly, given several headwinds, including (1) tighter credit conditions, (2) the passthrough impact of events in the global space, (3) flood-induced slower pace of Agric GDP in H1-23, and (4) higher inflationary pressures. **Overall, we expect the oil sector to grow by 12.40% y/y and the non-oil sector to grow by 2.45% y/y. Consequently, we forecast a GDP growth of 3.02% y/y in 2023FY.**

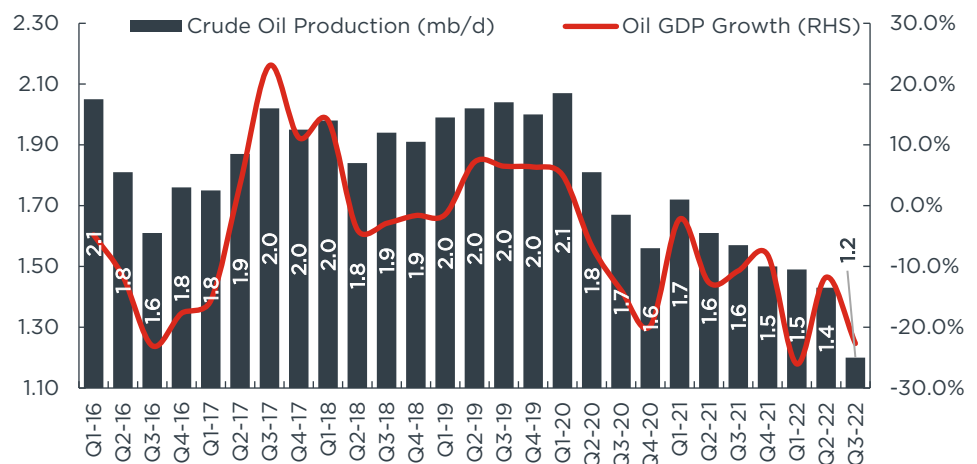


Source: NBS, Cordros Research

## Oil Sector Woes Continue as Lingering Challenges Remain Intact

Against our expectations of an increase in crude oil production relative to 2021FY levels amid favourable base effects, the oil sector’s woes continued in 2022FY, with crude oil production successively reaching new record lows in 9M-22. Pertinently, the persistent decline in crude oil production volume is in line with the trifecta effect of (1) age-long infrastructural deficit, (2) massive oil theft and pipeline sabotage, and (3) IOC divestments, given the challenging business environment and the move to cleaner energy sources. Importantly, our analysis of the data from the Nigerian Upstream Petroleum Regulatory Commission (NUPRC) showed that crude oil production declined significantly across the Bonny (-86.2% y/y), Forcados (-66.5% y/y), Agbami (-15.2% y/y), and Escravos (-3.3% y/y) production terminals in Q3-22. Consequently, the oil sector contracted by 22.67% y/y in Q3-22 (Q2-22: -11.77% y/y).

**Figure 3: Crude production (mb/d) vs oil GDP growth y/y**



Source: NNPC, NBS, Cordros Research

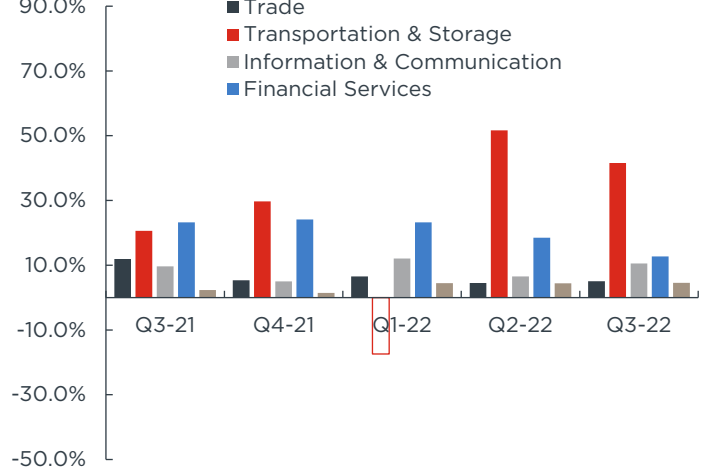
## Non-Oil Sector Remains Growth Engine but Momentum Slows

The non-oil sector remains the overall growth engine, maintaining its impressive run even as it slowed compared to the prior quarter. In our opinion, the sustained non-oil sector’s growth was underpinned by the (1) sustained growth in telecoms subscribers, (2) reopening of more land borders for trade, (3) sustained fiat-led interventions, and (4) commercial banks’ expansion of their loan books amid the sustained improvement in the economy. Accordingly, the non-oil sector grew by 4.77% y/y in Q2-22 (Q1-22: +6.08% y/y). However, by Q3-22, the non-oil sector’s growth (+4.27% y/y) slowed further. Nonetheless, the ICT (+10.53% y/y vs Q2-22: +6.55% y/y), Trade (+5.08% y/y vs Q2-22: +4.51% y/y), Real estate (+4.56% y/y vs Q2-22: +4.42% y/y) and Finance & Insurance (+12.70% y/y vs Q2-22: +18.48% y/y) sub-sectors were the primary drivers of the non-oil sector’s growth during the period.

**Figure 4: Non-oil GDP major components**



**Figure 5: Services GDP major components**

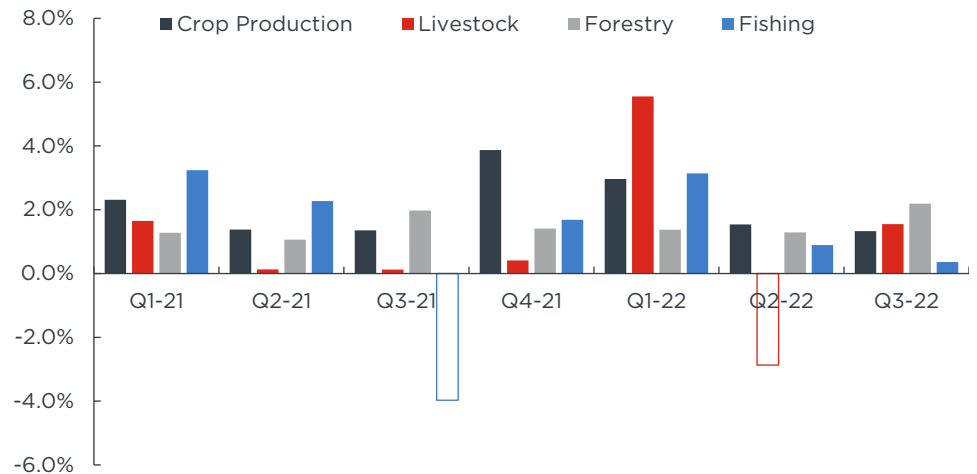


Source: NBS, Cordros Research

### Existing Challenges and Seasonality Capped Agriculture Growth

The Agriculture sector’s performance was underwhelming in Q2-22 given the impact of the (1) lean planting season and (2) lingering security challenges in the food-producing regions, both of which outweighed the impact of the government’s fiat-led stimulus in the sector. Thus, the sector grew by 1.20% y/y in Q2-22 (Q1-22: +3.16% y/y) – the lowest growth print since Q2-18. In Q3-22, the Agriculture sector grew by 1.34% y/y (Q2-22: +1.20% y/y) as higher input costs worsened by the Russia-Ukraine conflict continued to weigh down the government’s fiat-led interventions.

**Figure 6: Agriculture GDP growth breakdown**



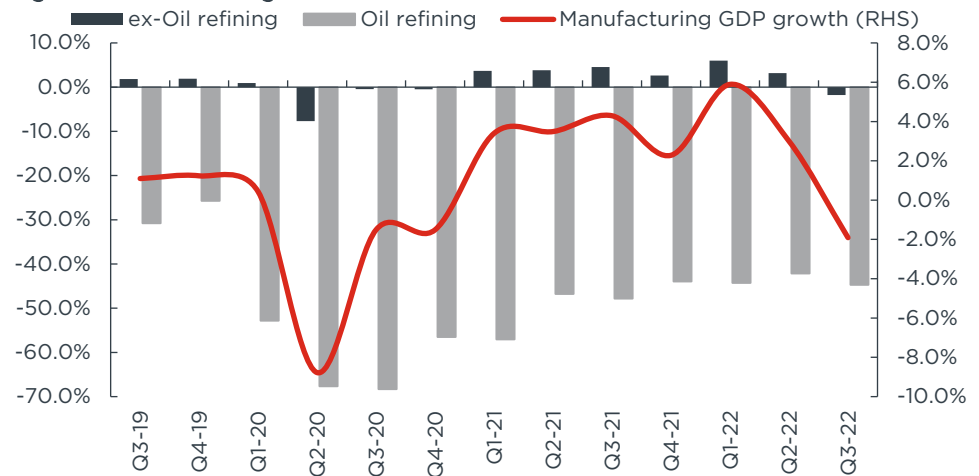
Source: NBS, Cordros Research

### Manufacturing Sector Contracted for the First Time Since Q4-20

The Manufacturing sector’s performance in the first half of the year was more resilient than the pre-pandemic level, given (1) the government’s sustained interventions to the real sectors of the economy and (2) resilient corporate

earnings by FMCGs and cement producers during the review period. However, by Q3-22, the sector recorded its first decline since Q4-20 (-1.51% y/y), contracting by 1.91% y/y (Q2-22: +3.00% y/y). In our view, the lacklustre performance was driven by the combination of (1) rising borrowing costs in line with higher interest rates, (2) persistent currency pressures, (3) elevated energy costs, and (4) depressed demand in line with rising inflation. Similarly, Oil refining (-44.70% y/y vs Q2-22: -42.12% y/y) remained in the woods as the country's major oil refineries remained inoperative.

**Figure 7: Manufacturing GDP breakdown**



Source: NBS, Cordros Research

### Positive Outlook Maintained for Q4-22

While we acknowledge the government's recent efforts at combating oil theft, we expect crude oil production to remain underwhelming in the short term, given that the existing production challenges linger. Accordingly, we expect crude oil production to settle at 1.35mb/d in Q4-22, translating to an oil GDP decline of 10.00% y/y. Elsewhere, we expect the lagging impact of the recent flooding incidents and high fertiliser prices to whittle the Agriculture sector's growth even as the sector continues to enjoy government interventions. Moreover, we expect the Service sector to maintain its growth, albeit slowly. The Manufacturing sector is also likely to grow modestly, given favourable base effects amidst the rising cost of production and pressured local demand. Accordingly, we forecast the non-oil sector to grow by 2.80% y/y in Q4-22. **Overall, we expect growth to settle at 2.14% y/y in Q4-22 and revise our 2022FY growth forecast to 2.72% y/y (Previously: 3.01% y/y).**

### 2023FY Outlook: Economy to Maintain Growth Trend

We expect the domestic economy to maintain its positive growth trajectory in 2023FY. However, economic activity is expected to be constrained by the impacts of (1) tighter credit conditions, (2) flood-induced slower pace of growth

in Agriculture GDP, (3) elevated inflationary pressures and (4) spillover impact of the pervasive global slowdown. For the non-oil sector, a primary growth driver remains the telecommunications sub-sector, given that telecommunications companies have begun the full rollout of their mobile banking operations. While we expect the higher crude oil production and favourable base effects to drive oil sector growth into the positive region, production volume is expected to remain below pre-pandemic levels as existing challenges remain intact. **Overall, we project that the oil and non-oil sectors will grow by 12.40% y/y and 2.45% y/y, respectively, in 2023FY.**

Figure 8: GDP growth projections

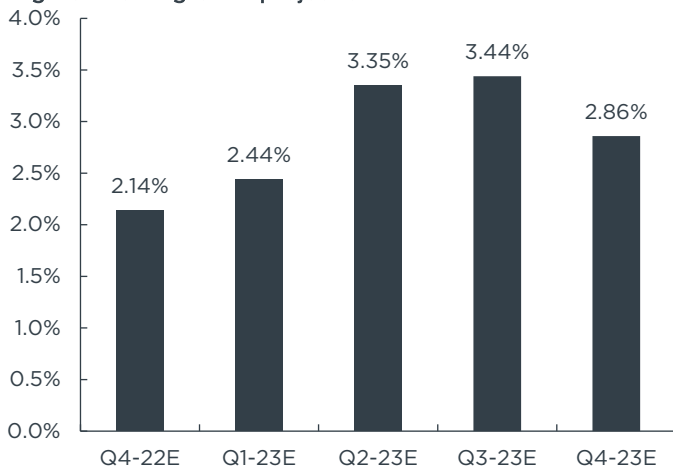
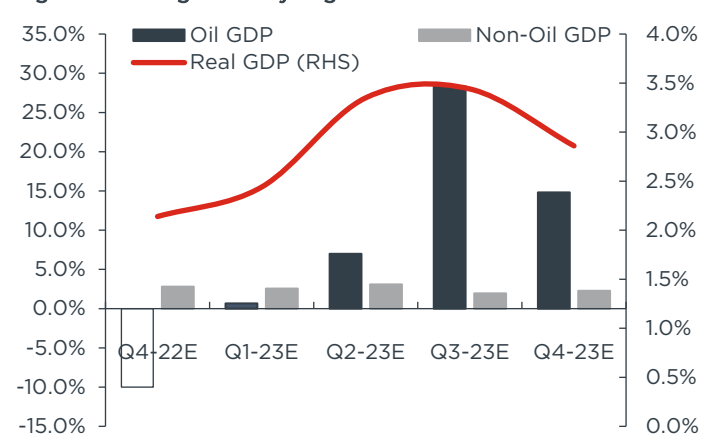


Figure 9: GDP growth by segments



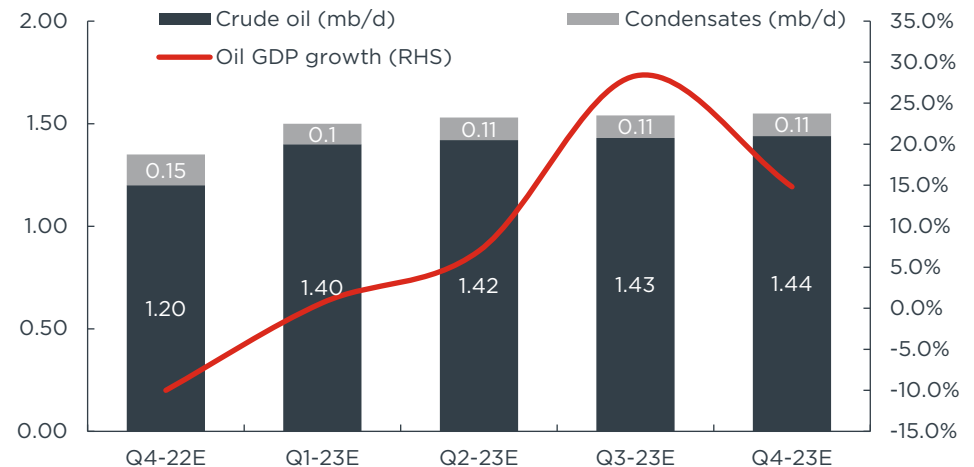
Source: NBS, Cordros Research estimates

## Oil Sector to Grow as Crude Oil Production Volume Rises Slowly

We forecast crude oil production to settle at an average of 1.53mb/d in 2023FY (2022E: 1.37mb/d) in line with the government's efforts to curb crude oil theft amidst other challenges inhibiting increased production volume. Importantly, it is pertinent to state that current crude oil production challenges are primarily due to the troika impact of (1) massive theft and pipeline vandalism, (2) age-long infrastructure deficit, and (3) International Oil Companies (IOCs) divestments away to cleaner energy amid challenging operating environment. Accordingly, we think the attention on theft and pipeline vandalism alone as a solution to the lingering production challenges is overblown by the government. For production levels to improve significantly, there is a need to pursue initiatives that result in long-lasting solutions to other critical challenges. Indeed, at a press briefing on 24 October, the CEO of the Nigerian Upstream Petroleum Regulatory Commission (NUPRC) stated that current statistics showed that the volume of oil lost to theft in Nigeria is about 100.00 kb/d, translating to an estimated 3.00 million barrels per month. That said, we recognise that the FGN issued letters of award to investors for crude oil production from 57 marginal oil fields. We estimate this could add 285.00 kb/d to the country's crude oil production based

on an estimated 5.00 kb/d output for each field. However, without incentivising investment in new production capacity and proper training of indigenous firms to handle the divested IOC's assets, we believe that Nigeria will be unable to meet its pre-pandemic average crude oil production peak (c. 2.50 mb/d). **Therefore, we expect the oil sector to grow by 12.40% y/y in 2023FY compared with an estimated decline of 18.54% y/y in 2022E.**

Figure 10: 2023 Oil production vs GDP

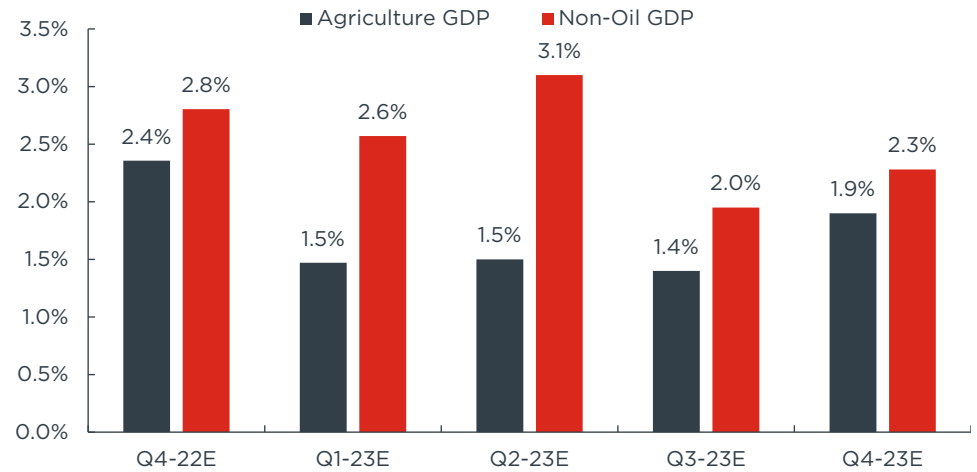


Source: NBS, Cordros Research estimates

### Unprecedented Extreme Weather Conditions to Dampen Agric GDP

Climatic factors have gained prominence, given how extreme weather conditions have disrupted the country's typical weather calendars, with regions experiencing extremely dry and rainy seasons. In addition, improper planning for the increased flooding situations witnessed across the country has further exacerbated the aftermath of extreme weather conditions. Indeed, the 2022 flooding incidents are seen to be the worst since 2012. Accordingly, we expect the impact of the preceding to spread until the off-season harvest in May 2023. Consequently, we expect the Agriculture sector output to remain under pressure over 2023FY. However, we believe that (1) sustained government fiat-led intervention in the sector and (2) the fight against banditry and kidnapping could tether the decline. Thus, in modelling our growth expectation for the sector in 2023FY, we discounted our expected output growth by several identified downside risk factors, including (1) flooding across the country, (2) poor farming practices and low-quality seedlings, (3) security challenges, and (4) disruptions to distribution channels due to election activities. **Sequentially, we forecast the Agriculture sector's growth will settle at +1.70% y/y in 2023FY (2022E: +1.97% y/y).**

Figure 11: Agriculture GDP growth



Source: NBS, Cordros Research estimates

### Service Sector's Growth to Slow as Downside Risks Mount

We expect the Service sector to maintain its growth pace, supported by the ICT, Finance & Insurance, Trade, Real estate, and Transportation sub-sectors. However, the sector's growth is likely to slow significantly compared to 2022E levels, given the impact of tighter monetary conditions and pressured consumer wallets. Notably, the commencement of operations of MoMo PSB (MTN Nigeria) and SmartCash PSB (Airtel Africa) will be positive for the ICT sector's growth, given MTN and Airtel's vast network of agents to deploy their services and both companies' large numbers of subscribers (MTN: 83.27 million | Airtel: 58.67 million as of October 2022). However, higher taxes pose a downside risk to the subsector's growth. Elsewhere, while the improved macroeconomic environment would spur banks to maintain the current quantum of risk assets, tighter monetary conditions are likely to limit the growth of credit creation, slowing the financial institution's growth in 2023E. We expect the preceding to also have a passthrough impact on the Real estate sub-sector.

Moreover, our model suggests a relatively high statistical base effect and increased interest rate could moderate the Trade sub-sector's growth even as the impact of further land border reopening is expected to linger in the year. Finally, we expect the Accommodation & Food Services and Arts & Entertainment sub-sectors to maintain their growth trend, albeit slowly, given the mix of continued normalisation of economic activities and reduced disposable income. **Thus, on a balance of factors, we expect the Service sector to grow by 3.36% y/y in 2023FY (2022E: +6.28% y/y).**

Figure 12: ICT and Services GDP growth

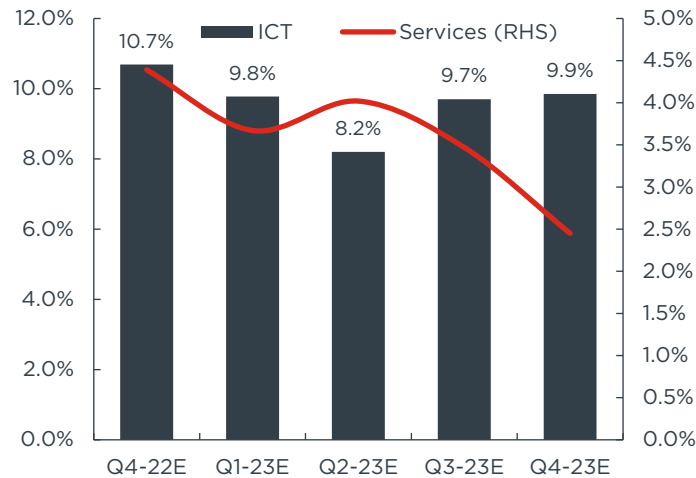
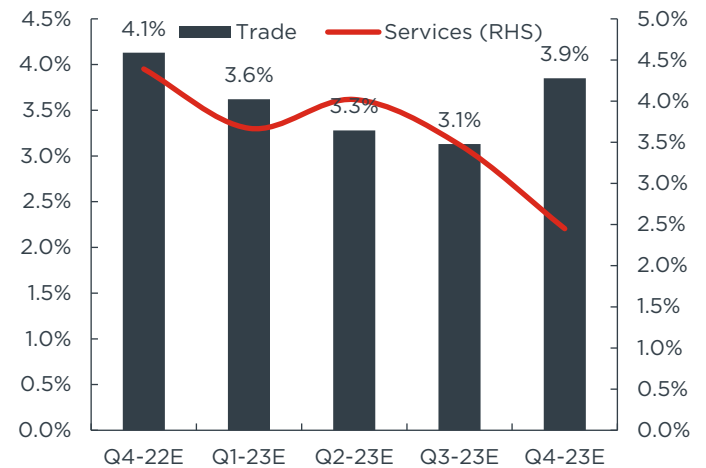


Figure 13: Trade and Services GDP growth



Source: NBS, Cordros Research estimates

### High-Interest Rate & Currency Pressures to Slow Manufacturing Growth

We expect interest rates domestically to remain high over 2023FY. At the same time, we expect currency pressures to persist in the absence of any positive signal that denotes an improvement in FX supply relative to the pre-pandemic levels. Accordingly, given the manufacturing sector's sensitivity to interest and exchange rates, we expect the sector's growth to slow in 2023FY relative to 2022E. Besides, the increased cost of production underpinned by high energy costs is expected to further pressure the sector's growth amid an inflation-induced slowdown in domestic demand. **Therefore, we project that growth in the Manufacturing sector will moderate to 1.94% y/y in 2023FY (2022E: +2.42% y/y).**

Figure 14: Manufacturing GDP growth

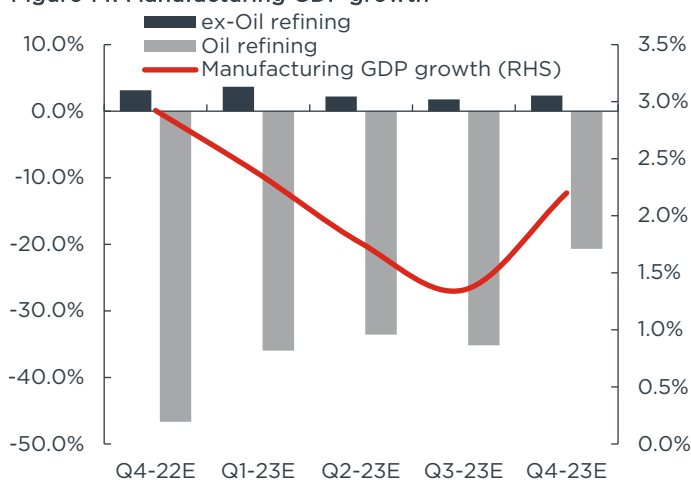
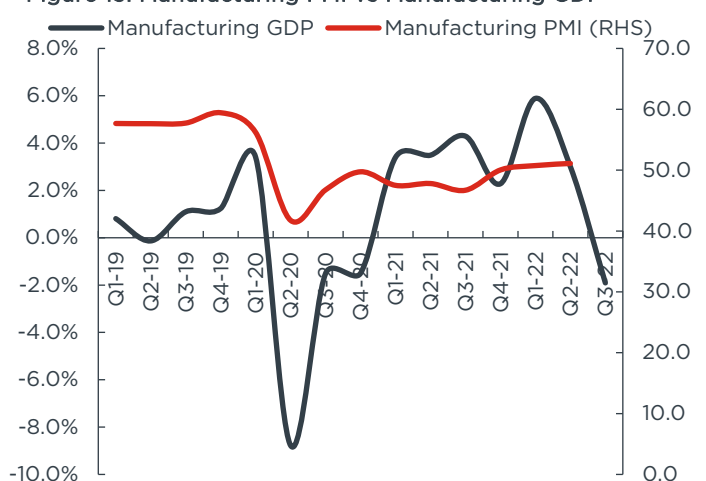


Figure 15: Manufacturing PMI vs Manufacturing GDP



Source: NBS, CBN, Cordros Research Estimates

Having modelled our expectations across the oil and non-oil sectors, we project full-year growth of 3.02% y/y in 2023FY (2022E: +2.72% y/y).

## Inflation.

### Inflationary Pressures to Remain Elevated

- Inflationary pressures rose to a 17-year high in 2022E
- 2023FY base case average inflation forecast: 18.56% y/y
- 2023FY baseline year-end inflation forecast: 18.01% y/y
- Medium-term risks to price pressures are tilted to the upside

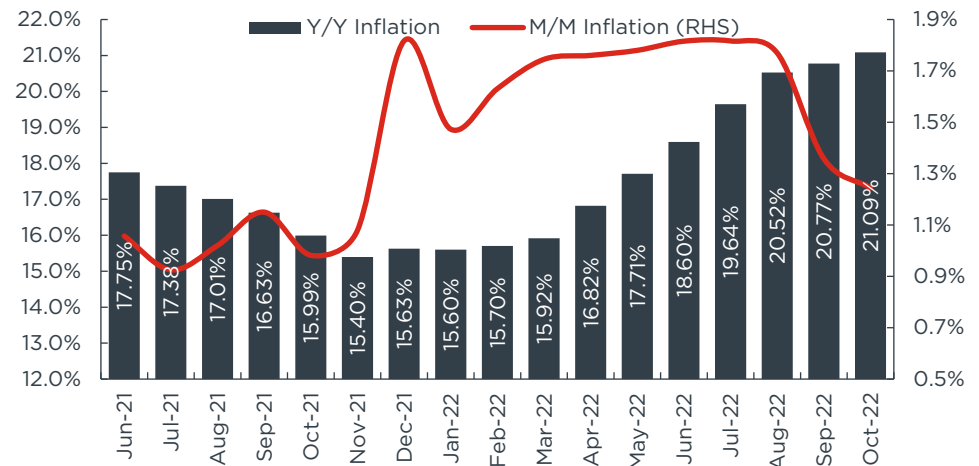
At the start of 2022FY, we expected consumer prices to moderate compared to 2021FY levels, given the favourable statistical base effects from 2021FY amid the challenges at the time. However, the Russia-Ukraine conflict added a layer of pressure in the form of higher energy prices. Furthermore, besides from the unprecedented increase in diesel and gas prices, the increased price pressures stemmed from (1) persistent currency weakness, (2) low domestic food supply, (3) higher global food prices, (4) increased taxes in line with the 2021FY Finance Act, and (5) intermittent scarcity of premium motor spirit (PMS). Consequently, headline inflation averaged 18.24% y/y in 10M-22 (10M-21: +17.28% y/y) and settled at 21.09% in October 2022 (October 2021: +15.99% y/y). Notably, the last time consumer prices were this high was September 2005, when the inflation rate printed 24.32% y/y.

Analysing the factors shaping domestic prices in 2023FY, we expect inflationary pressure to persist next year, albeit at a slightly moderate pace compared to 2022E. **Our base-case scenario suggests headline inflation will average 18.56% y/y in 2023FY, with the year-end figure settling at 18.01% y/y.** We premise our forecast on our expectations for (1) continuous progressive hikes in electricity tariffs, (2) a depreciation of the currency to NGN455.00/USD, and (3) partial removal of PMS subsidy, with an expected PMS price of NGN250.00/litre.

### High Food & Non-Food Prices Push Headline Inflation to Record High

In 2022E, there were broad-based price increases across the food and core inflation baskets. The increased pressures on the food basket (+635bps YTD to 23.72% y/y as of October) reflect the impact of (1) higher global commodity prices exacerbated by the Russia-Ukraine conflict, (2) low domestic food supply amid high demand, (3) higher transportation cost in line with increased fuel prices, (4) lingering local currency weakness, and more recently, (5) increased flooding incidents across most states. Similarly, the core inflation basket (+389bps YTD to 17.76% y/y as of October) witnessed significant pressures primarily due to the (1) unfavourable base effects from the prior year, (2) currency pressures and (3) elevated global gas and other energy prices. Based on the factors above, headline inflation rose by 546bps to 21.09% y/y between December 2021 and October 2022.

**Figure 16: Historical y/y headline inflation**



Source: NBS, Cordros Research

### Consumer Prices to Remain Elevated in 2023FY

In forecasting Nigeria’s headline inflation rate, we analysed various factors that may shape the domestic prices over 2023FY, which include but are not limited to:

- Energy costs
- Currency pressures
- Electricity tariff hikes
- Market-determined PMS price
- FX supply constraints
- Impact of flooding incidents in 2022FY
- Supply chain constraints

**Energy Costs:** Gleaning insights from the crude oil section of our global macroeconomic outlook, we expect oil prices to remain high in 2023FY, although slightly lower than 2022E levels. Accordingly, we believe high diesel and gas prices are here to stay for a while, entrenching themselves in the economy in the form of increased price pressures.

**Currency pressures:** We expect local currency pressures to remain intact in 2023FY, given our forecast for limited accretion to the gross FX reserves, amid a continued increase in FX demand. Moreover, the expected limited FX supply will be underpinned by little or no inflow from one-off sources (such as Eurobonds and multilateral financing) like in 2021, amid underwhelming crude oil earnings inflows. In addition, FX demand will be exacerbated by the election season, increased migration, and currency speculation amid calls for a devaluation. Accordingly, we expect the naira to remain pressured at the official and unofficial FX windows. As a result, our baseline expectation is for the currency to depreciate within the range of NGN450.00/USD and NGN460.00/USD over 2023FY.

**Electricity tariffs:** We expect the government to continue to implement phased increases in electricity costs, as it has done over the past two years from 2020FY, based on the new Multi-Year Tariff Order (MYTO) under the service-based tariff. Accordingly, we expect electricity tariffs to be higher in 2023FY than in 2022E. Overall, our baseline expectation is that the electricity tariff will be reviewed upward by an average of 10.5%/kWh across the board, just as it was done in January 2022.

**Market-determined fuel prices:** Like in the past two years, the finance minister revealed that the FGN would eliminate the PMS subsidy in the second half of 2023 as it only factored in subsidy payments for H1-23 in the proposed 2023FY budget. As usual, the current government is kicking the can down the road, leaving the decision to the next administration. We believe it is unlikely that a new administration will completely remove subsidy immediately after the swearing-in ceremony, given the acute domestic price pressures. Instead, the new administration may likely come up with a road map or timeline for subsidy removal in 2024 after assessing the impact of the Dangote refinery on domestic fuel prices. In the midst of these, we imagine that there will be intermittent PMS scarcity in the process of coming up with modalities for distributing PMS from the Dangote refinery (expected to commence operation in June 2023) and importing fuel as the refinery is expected to operate below capacity at the onset of operations. Consequently, we expect the government to adjust PMS prices upward to NGN250.00/litre (vs current national average price: NGN191.65/litre) to ease marketers' tension and save part of the PMS subsidy cost.

**FX supply constraints:** Gleaning insights from the currency section, we expect FX supply to remain at current levels, suggesting that the FX liquidity challenges will remain in 2023FY. Our prognosis is hinged on the expected limited FX inflows to the economy - (1) no likelihood of Eurobond issuance, (2) limited multilateral financing, and (3) limited inflows from crude oil receipts because of lower oil production volume (albeit higher than 2022E levels) and elevated subsidy cost. Accordingly, manufacturers are expected to recourse to the unofficial market to fill a substantial part of their demand at a higher cost.

**Flooding incidences:** The flooding incidents in 2022E were the most severe since 2012, with 35 out of 36 states affected by the water release from dams. Accordingly, we expect the impact to be felt until the off-season harvest in May. Thus, food shortages could linger through 4M-23, pressuring consumer prices upwards.

**Supply chain constraints:** Besides the abovementioned factors, it is essential to highlight that the domestic distribution chain is still not robust enough given the poor road infrastructure, weak storage system, epileptic power supply, and

vulnerable seedlings. Accordingly, we expect sellers to continue to price these challenges in the cost of their goods and services.

Based on the highlighted factors, we modelled three (3) scenarios for the headline inflation in 2023FY:

Table 1: Headline inflation (y/y) scenarios

	Base Case	Bull Case	Bear Case
<u>Factors</u>	<u>Expectation</u>	<u>Expectation</u>	<u>Expectation</u>
Electricity Tariffs Hike	10.50%	0.00%	15.50%
Currency Depreciation	I&E Window depreciates to NGN455.00/USD	I&E Window stable at NGN445.00/USD	I&E Window depreciates to NGN465.00/USD
PMS Price (NGN/litre)	NGN250.00	NGN190.00	NGN420.00
FX Supply Constraints	FX supply remains at current levels	FX supply improves up to pre-COVID levels	FX supply constraints worsen
Inflation (2023FY Avg.)	18.56%	17.70%	20.99%
Inflation (2023 Year-end)	18.01%	15.80%	25.35%

Source: Cordros Research Estimates

## Balance of Payments.

### CA Surplus to Weaken on Account of Lower Trade Surplus

- Higher trade surplus underpins the return of the CA balance to a surplus
- Trade balance surplus to moderate in 2023FY
- Service payments to increase but still below pre-pandemic levels
- CA surplus to settle at USD5.92 billion in 2023FY (2022E: USD11.45 billion)

Nigeria's external account settled at a surplus position over H1-22, primarily driven by an increased trade balance surplus as the increased oil prices drove total exports significantly higher than the increase in imports. To put it in a proper context, the Current Account (CA) turned to a surplus position in H1-22, settling at USD7.70 billion compared with a CA deficit of USD2.98 billion in H1-21. Notably, total exports grew significantly by 77.4% y/y to USD35.50 billion in H1-22 (H1-21: USD20.01 billion), given the rally in crude oil prices amid the ongoing Russia-Ukraine conflict. On the other hand, imports rose by 11.5% y/y to USD26.30 billion. Despite the growth in imports, we highlight that the overall number is 12.7% below the pre-pandemic level (H1-19: USD30.14 billion), likely reflecting the ongoing FX liquidity challenges and the impact of rapid local currency depreciation. Accordingly, the trade balance settled at a surplus of USDGN9.20 billion in the review period, relative to a USD3.58 billion deficit in H1-21. Elsewhere, the services account deficit growth remains muted, while the primary income balance deficit rose by 64.9% y/y. Finally, current transfers rose marginally by 8.5% y/y amid the tensions in Eastern Europe.

Over 2023FY, we expect the Current Account (CA) surplus to moderate. Our forecast is hinged on the anticipated reduction in the trade balance surplus as the crude oil price rally cools. Besides, we expect the deficit in the services account to widen, though below pre-pandemic levels, as FX liquidity pressures remain a challenge. Moreover, we expect the gains from current transfers to be dampened by an expected increase in dividend repatriation-induced pressure on the primary income account as (1) FX liquidity challenges, (2) global recession concerns, and (3) power transition uncertainties will ensure foreign investors have little will to reinvest dividends. **Overall, we expect the CA surplus to settle lower at USD5.92 billion in 2023FY, which translates to an absolute CA balance of 1.2% as a percentage of projected nominal GDP.**

### CA Surplus Increases on Improved Trade Balance

In Q2-22, the CA surplus rose by 92.5% q/q to USD5.07 billion (Q1-22: USD2.63 billion) – the highest point since Q2-18 (USD5.19 billion) – driven by a higher trade balance surplus and a lower primary income account deficit. Specifically, the

trade balance surplus rose by 63.1% q/q because of higher export earnings (+4.9% q/q) amid a 9.8% q/q decline in outflows for goods imports. Notably, export earnings continue to benefit from higher crude oil prices even as crude oil production volume remains low. At the same time, FX restrictions and the persistent depreciation of the local currency remain drivers of low imports.

Figure 17: Goods, Service, Income, Current transfer (USD billion)

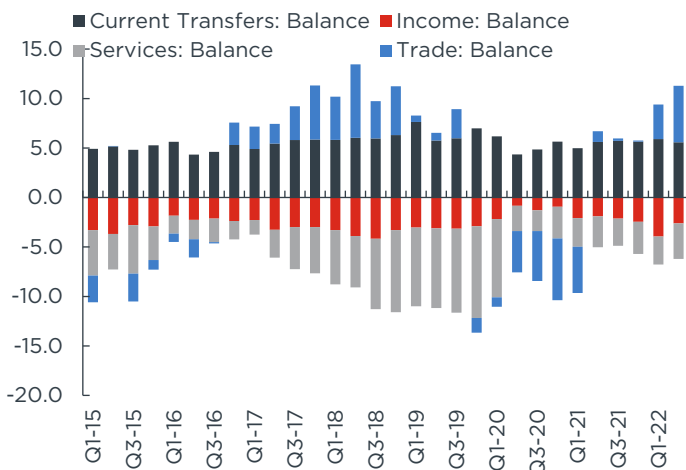
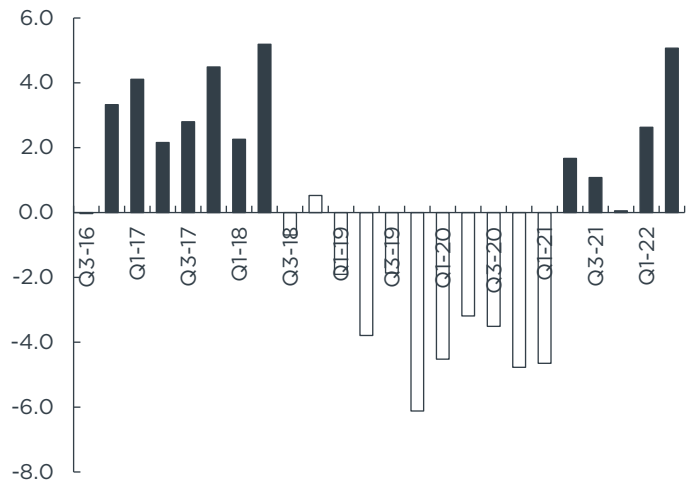


Figure 18: Current Account (USD billion)



Source: CBN, Cordros Research

Although the services balance (+26.7% q/q to USD3.59 billion) increased on a quarter-on-quarter basis, we highlight that it is still far from pre-COVID levels (c. USD8.44 billion). We believe this development is closely connected with (1) CBN's FX demand management strategy, (2) strict documentation requirements for FX allocation, and (3) high international travel costs amid elevated aviation fuel prices and persistent local currency pressures.

Elsewhere, the primary income balance deficit declined by 33.4% q/q due to (1) a decline in dividend repatriation by foreign investors and (2) reduced interest payments on loans during the review period. Simultaneously, current transfers declined by 5.5% q/q, likely due to the negative impact of the Russia-Ukraine conflict and the lingering effects of the COVID-19 pandemic on remittance inflows.

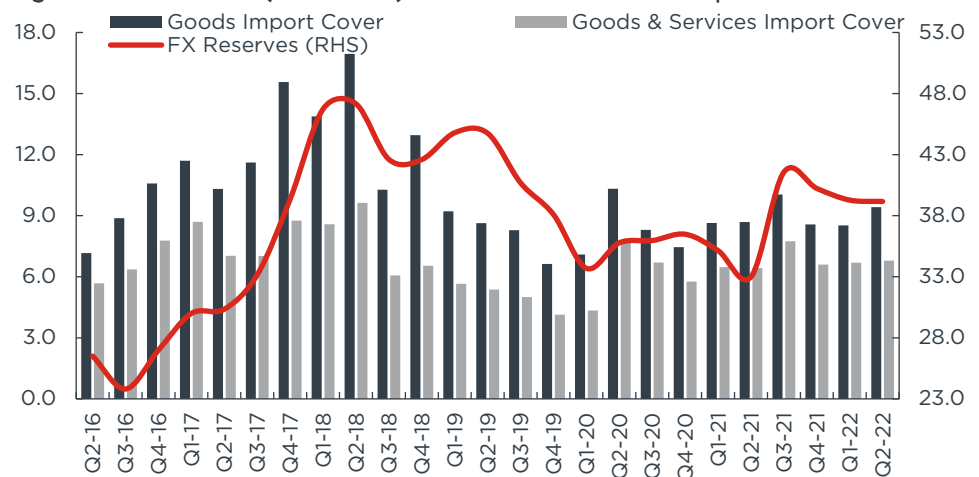
Despite the increased CA balance, gross FX reserves dropped by 8.4% year-to-date or USD3.42 billion to USD37.10 billion as of 1 December 2022. Analysing the balance of payment statistics further, we highlight that the net errors and omissions were significant at USD8.14 billion in Q2-22. The preceding suggests that some large outflows (such as import demand and services outflows) are occurring outside the official system, making the official CA statistics look more positive than they should otherwise be depicted. Ideally, the closer the errors and omissions to zero, the better because the errors and omissions reflect the imbalances resulting from

imperfections in source data and compilation of the balance of payments accounts. According to economic literature, poor coverage or absence of data are the primary reasons for large imbalances/ net errors and omissions.

### CA Surplus to Moderate on account of Lower Trade Surplus

For 2023FY, we expect the trade balance to remain in a surplus position, although lower than 2022E levels. On the one hand, we expect exports to decline by 1.0% y/y, given our expectation of crude oil prices coming off 2022E highs amid a relatively higher crude oil production volume as the government clamps down on theft and vandalism. On the other hand, we forecast a 5.3% increase in imports, given a relatively favourable base effect from the prior year in line with the significant FX liquidity constraints and US dollar appreciation that dampened imports. **On balance, we expect the trade surplus to moderate by 24.5% y/y to USD10.95 billion in 2023FY (2022E: USD14.49 billion).**

**Figure 19: FX reserves (USD billion) and Goods and Services import cover**



Source: CBN, Cordros Research estimates

We expect increased global mobility to lead to a rise in service-based transactions. However, FX challenges and intermittent suspension of flights by international carriers would ensure the deficit in the services account remain significantly below pre-pandemic levels. Consequently, we expect a 22.6% y/y rise in services account deficit to USD19.03 billion – 43.6% below pre-pandemic levels (c. USD33.76 billion). Similarly, we expect net income payments to increase by 26.9% y/y to USD10.86 billion (2022E: USD8.56 billion) due to increased investment income repatriations amid (1) election uncertainties, (2) heightened global uncertainties and (3) higher interest rates in the advanced economies. Finally, we project a 6.3% y/y increase in net current transfers to USD23.34 billion (2022E: USD21.96 billion), in line with the rise in emigration rates in the past few years.

Overall, our model suggests that the CA surplus will settle at USD5.92 billion in 2023FY, a 48.3% decline relative to our projected CA surplus of USD11.45 billion for 2022E. This translates to a 1.2% CA surplus as a percentage of GDP (2022E: 2.6%) at an effective exchange rate of NGN445.00/USD.

Figure 20: Trade balance: Historical and forecast (USD billion)

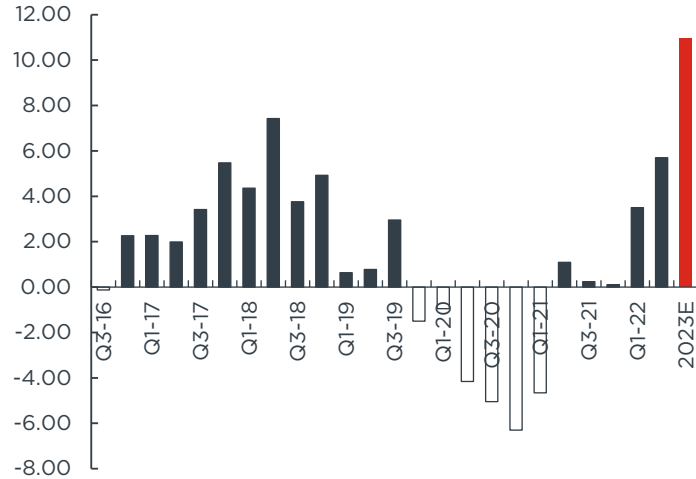
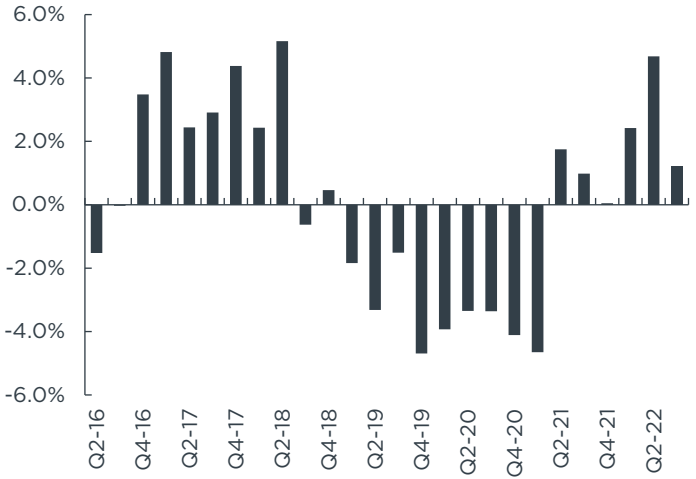


Figure 21: CA balance (as a % of GDP)



Source: CBN, Cordros Research estimates

## Currency.

### Naira Remains Mired in Persisting Illiquidity Situation

- Foreign inflows to remain tepid in the absence of FX reforms
- FX reserves to settle at USD36.76 billion by the end of H1-23
- IMF's food shock window could provide additional support for the reserves
- Naira to depreciate gradually between NGN450.00/USD and NGN460.00/USD at the IEW

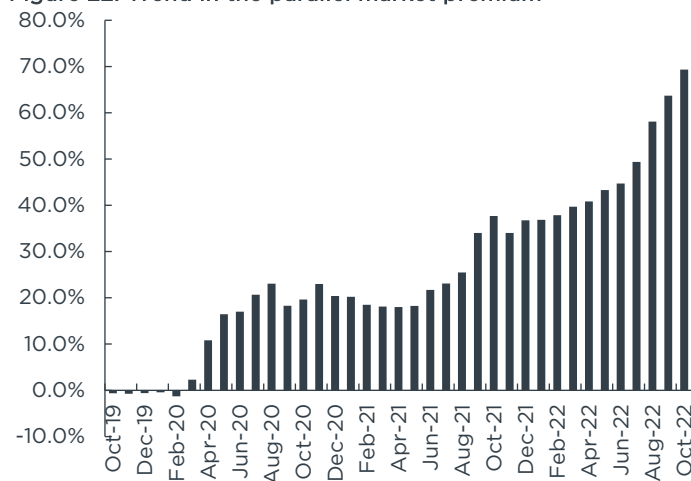
More than two years after the COVID-19 pandemic distorted the supposedly smooth functioning of the economy, Nigeria's FX pressures remained significant in 2022 as FX supply continues to trail demand for the greenback. A key takeaway is that monetary authorities cannot implement FX controls with limited interventions and not expect the existence of an unofficial or black market, especially in the face of an overwhelming scarcity. In situations like this, the black-market price likely reflects the equilibrium price, though we acknowledge that these prices tend to overshoot or undershoot 'fair prices' mainly because the market participants are searching for a clearing price. Moreover, when the official market lacks the necessary liquidity for the proper functioning of the market, the alternative market tends to price in three critical inputs for price discovery - liquidity premium, opacity premium, and speed to delivery.

Based on the preceding, we are unsurprised that the parallel market exchange rate is trading at a premium significantly above the official exchange rate. At the same time, the exchange rate at the official FX market continues to crawl toward its perceived fair value. Putting it in number terms, the exchange rate depreciated by 2.4% YTD (as of 28 November) to NGN444.70/USD at the official market, with CBN's FX supply through the various FX windows remaining frail, at a monthly average of USD1.37 billion as of H1-22 - 63.0% lower than the pre-pandemic monthly average supply (Q1-20: USD3.69 billion).

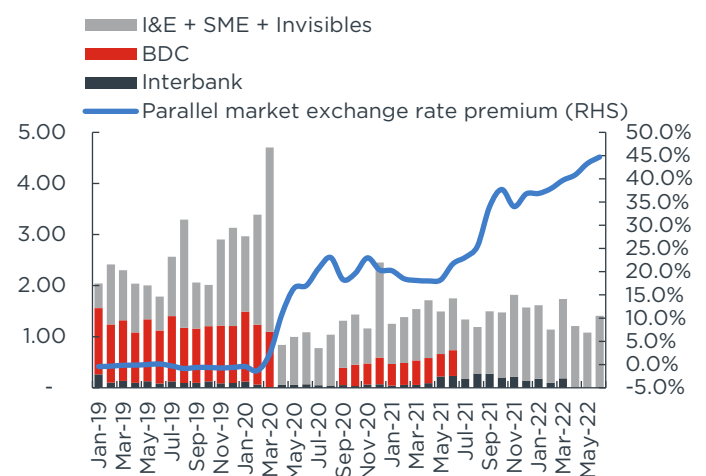
Meanwhile, we understand that the government is looking to participate in the IMF's newly created food shock window, which could unlock USD1.68 billion (50.0% of quota) in funding provided that Nigeria meets specific requirements. During the IMF/World Bank annual meeting in October, the finance minister spoke on the sideline, saying that the government is still studying the conditions. According to the IMF, the window would be open for one year (from 30 September 2022 to 29 September 2023), providing emergency fund financing to member countries that have an urgent balance of payment needs due to (1) acute food insecurity, (2) a sharp increase in their food import bill, or (3) a shock to their cereal exports. The IMF stated that assessing the qualification conditions

would involve a country-by-country evaluation and judgment. Given that the food shock window is operating within the IMF's Rapid Financing Instrument and Rapid Credit facility – which are usually disbursed quickly with less stringent conditions – we expect the FGN to tap into the facility, providing some respite for gross FX reserves.

**Figure 22: Trend in the parallel market premium**



**Figure 23: CBN's FX supply to various windows (USD billion)**



Source: CBN, FMDQ, Bloomberg, Cordros Research estimates

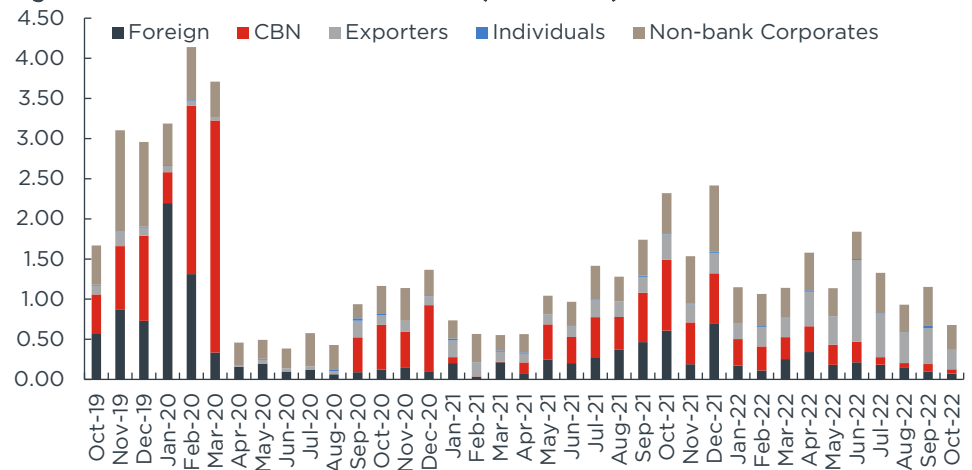
### IEW's FX Liquidity Remain Significantly Below Pre-Pandemic Levels

FX liquidity conditions remained weak at the IEW despite the CBN's efforts to boost FX inflows at the window by incentivising non-oil exports. Specifically, the average monthly inflows into the IEW as of 10M-22 settled at USD1.20 billion – 58.6% lower than the pre-pandemic average monthly inflows (2019FY: USD2.90 billion). Notwithstanding, we highlight that the inflows over 10M-22 are 7.3% higher than the monthly average in 10M-21 (USD1.19 billion), primarily due to the initial impact of the CBN's rebate scheme to attract non-oil exports. We discussed the scheme here ([Assessing the CBN's Attempts to Attract Non-Oil Exports](#)). Accordingly, inflows from exporters (USD406.24 million per month) contributed 33.9% of the total inflows to the IEW in 10M-22 compared with a 16.1% contribution in 10M-21. Elsewhere, foreign investors remained on the sidelines, given the lack of reforms in the FX framework, higher global interest rates, and weak macroeconomic narratives. As a result, in October, the inflows from foreign investors declined for the fourth consecutive month to USD72.0 million – the lowest since April 2021 (USD68.70 million).

Over the short-to-medium term, we do not expect liquidity conditions to retrace towards pre-pandemic levels due to still weak inflows from foreign investors (53.8% of total IEW inflows in 2019FY). We think foreign investors will need more convincing actions from the CBN regarding flexibility and clarity in the foreign exchange framework before a resurgence of interest in the market, as witnessed

in 2017FY when the IEW was established. In addition, our expectation that the government will be unable to patronise the Eurobond market in 2023, given the lingering tight liquidity conditions, will constrain the CBN’s ability to support the market, more so that accretion to the gross FX reserves remains weak amid low crude oil production and elevated subsidy cost.

**Figure 24: Trend in FX inflows at the IEW (USD billion)**



Source: FMDQ, Cordros Research | Foreign consists of FDI, FPI & other corporates.

### CBN Announces Plans to Issue New Naira Banknotes

The governor of the Central Bank of Nigeria (CBN), Mr. Godwin Emefiele, held a special press briefing on 26 October, announcing the apex bank’s intention to issue new naira bank notes. In his briefing, the governor cited (1) that over 80.0% of the currency in circulation was outside the vaults of commercial banks; (2) there was an increase in the ease and risk of currency counterfeiting; and (3) there had been increased shortages of clean and fit bank notes. Accordingly, these challenges have limited the currency management function of the CBN, undermining the integrity of both the CBN and the country. Consequently, the governor announced that the CBN has sought and obtained the approval of the President to redesign new series of banknotes for the NGN200, NGN500, and NGN1,000 denominations. In line with the approval, the new currency will be in circulation from 15 December. At the same time, the existing currencies will cease to be legal tender from 31 January 2023. We discussed the likely implications here: [Review of the CBN’s New Banknotes Announcement](#).

### Covering All Bases

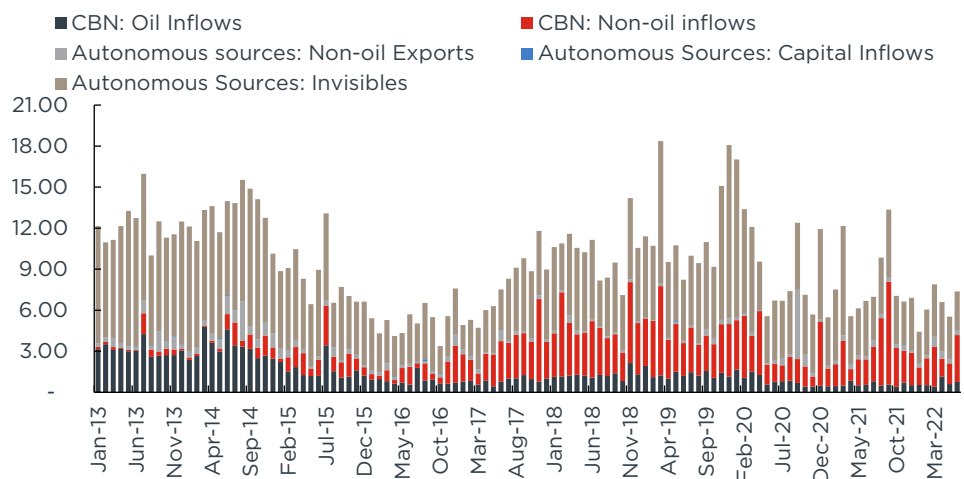
To examine where FX reserves would likely settle by the end of H1-23, we examined the inflows and outflows of the CBN. On inflows, we assume an average oil price of USD92.00/bbl. and an average oil production of 1.53mb/d, in line with our GDP forecast. In addition, we estimate that 76.0% of what is produced is exported based on past CBN data. Against the FGN’s subsidy estimates (USD1.29

billion per month), we estimate subsidy costs to come lower given our expectation of an increase in crude oil production compared to 2022 levels and moderation in crude oil prices (11M-22 average Brent price: USD101.72/bbl.). Hence, we estimate c. USD700.00 million monthly under-recovery payments in our estimates.

Consequently, we expect inflow to the FX reserves from crude oil receipts to average USD706.32 million per month in H1-23 (H1-22: USD661.88 million). We also expect non-oil inflows to grow by 4.1% y/y to an average of USD2.16 billion monthly (H1-22: USD2.07 billion). **Consequently, we expect the CBN's average monthly cash inflows to rise to USD2.86 billion in H1-23 (H1-22: USD2.73 billion).**

In framing the outlook for FX outflows, we assume the CBN will not lift its decision to halt FX sales to the BDCs. Instead, we consider that the CBN will slightly increase its allocation to the commercial banks for onward sales to the retail segment as FX demand pressures remain intact. Furthermore, we assume that CBN's inflows to the IEW will increase compared to 2022E levels, given our view that CBN's rebate scheme will continue to promote slight increases in export proceeds, although not enough to reach pre-pandemic levels. Notwithstanding, OMO maturities (USD875.02 million) are thin in H1-23, suggesting low capital repatriation, although we note that FX backlogs remain high at an estimated USD1.81 billion. On balance, we expect the CBN's monthly average spot sales at the IEW to increase by 28.7% y/y to USD481.16 million in H1-23 (H1-22: USD373.89 million). **Overall, we expect the CBN's average monthly cash outflow to increase by 9.9% y/y to USD3.09 billion.**

**Figure 25: FX inflows to the Nigerian economy (USD billion)**



Source: CBN, Cordros Research estimates

Covering all bases, we estimate the average monthly reserve drawdown of USD230.02 million in H1-23 (vs average monthly drawdown of USD177.86 million

in H1-22). Overall, we estimate the FX reserves will settle at USD36.76 billion by the end of H1-23, translating to import cover of 8.5x, higher than the IMF’s recommendation of six months for adequate reserve import cover for the West African Monetary Zone (WAMZ). In addition, if the FGN eventually accesses the IMF’s food shock window, it could unlock USD1.68 billion in additional funds to support the FX reserves over the short-to-medium term.

Elsewhere, the argument remains that the exchange rate is overvalued at the official FX market but grossly undervalued at the parallel markets. The preceding is that the monetary authorities remain reluctant to institute the necessary reforms and operate the managed floating exchange rate the way it should be run. However, we believe it is unlikely that the CBN will embark on a massive devaluation of the naira at the official market more so that there is no expectation of a huge influx of foreign currency over 2023, seeing that (1) global monetary conditions are expected to remain tight, (2) foreign investors are expected to remain on the sidelines, and (3) crude oil production volume returning to the peak level of c. 2.50mb/d is highly uncertain. In our view, for a significant devaluation to be meaningful, it needs to be followed by a massive increase in FX supply and flexibility in the FX framework. **Given that we do not expect the preceding to materialise, we think the CBN will favour a continuous gradual depreciation of the local currency at the official FX market. In that case, we expect the naira to trade within a range of NGN450.00/USD and NGN460.00/USD over 2023FY, other things being equal.**

Figure 26: Fair value of the Naira

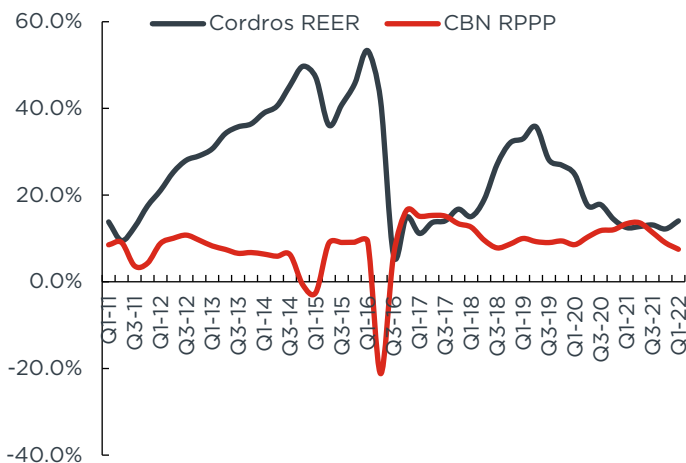
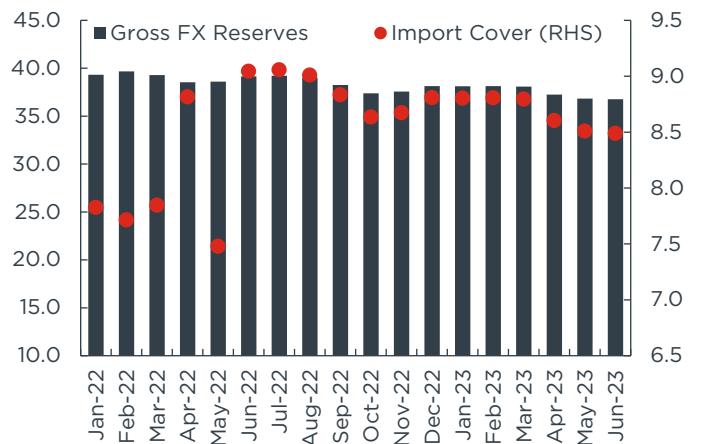


Figure 27: FX reserves (USD billion) and import cover (months)



Source: CBN, Cordros Research Estimates

## Monetary Policy.

### Monetary Policy Stance to Remain Tight Over 2023FY

- The MPC switched policy stance in 2022FY
- MPC raised the MPR by 500bps in 2022FY
- MPC to increase the key policy rate further by 100bps in 2023FY
- Actions from global central banks will influence policy decisions

In line with our expectations, the Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) shifted away from its accommodative policy stance, switching to a hawkish monetary policy stance from its May policy meeting. For proper context, the Committee kept the Monetary Policy Rate (MPR) unchanged at 11.50% at its January and March policy meeting. However, by May, the Committee highlighted the need to strike a delicate balance between containing inflationary pressures while supporting economic recovery and mitigating capital flow reversals associated with global central banks' normalisation of monetary policy. Accordingly, the MPC raised the key policy rate by 150bps – the first hike since July 2016. Since then, the Committee continuously raised the MPR at its next three meetings – 100bps in July, 150bps in September, and 100bps in November taking the 2022FY cumulative rate hikes to 500bps.

In framing our outlook for 2023FY, we primarily evaluated our expectations for growth and inflation outcomes in the coming year. We also examined the general expectations for global central banks' policy direction. Thus, while we expect domestic growth to remain resilient, albeit below the 2022E levels, we expect headline inflation to stay elevated, although slightly below 2022E levels, given the favourable base effects. However, global central banks are not yet considering switching from their current hawkish stance, given persistently high inflationary pressures, even as the risks to their respective domestic economies intensify. For instance, after the US Fed's November policy meeting, the Fed's chairman dampened markets expectations of a slowdown in rate hikes, stating that the terminal rate is being assessed as higher than was projected in September. However, the pace of rate hikes may slow from December. **Therefore, on a balance of factors, we expect the MPC to increase the MPR by an additional 100bps in H1-23 before holding the rate steady for the rest of the year.**

Figure 28: MPR & inflation

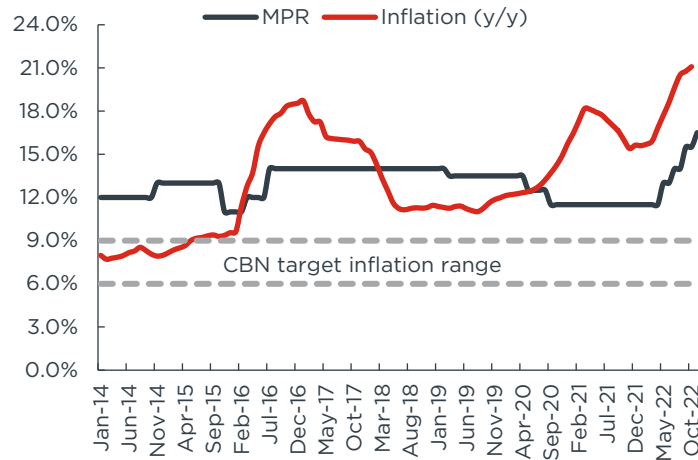
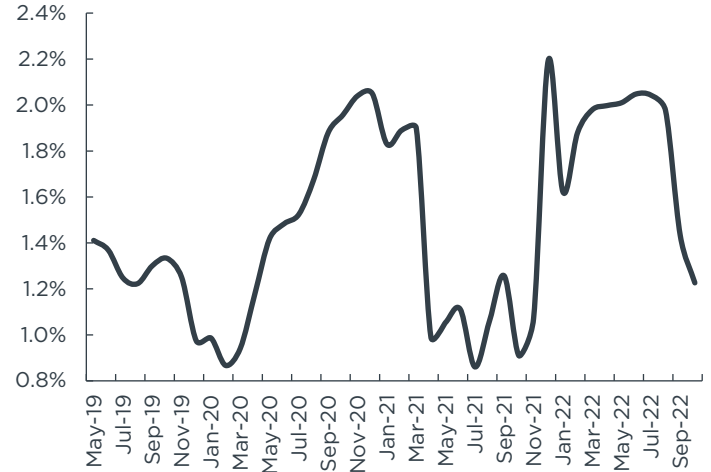


Figure 29: Food inflation (m/m)



Source: NBS, CBN, Cordros Research

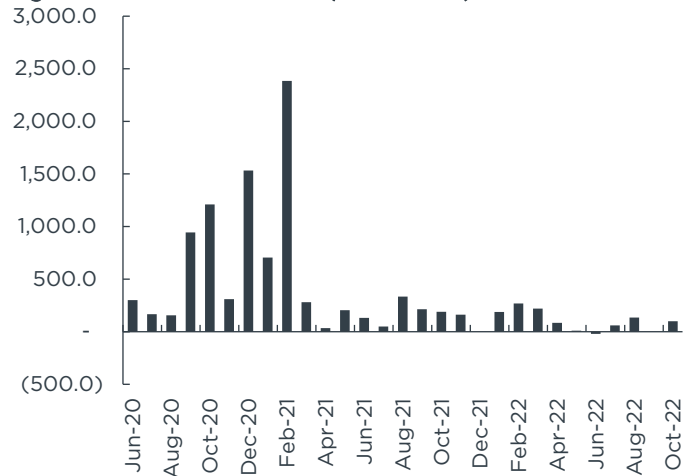
### MPC Joins the Global Interest Rate Hike Trend

At the start of the year, the central theme at the policy meetings was that (1) supply-side factors were the predominant drivers behind the elevated inflationary pressures, and (2) economic growth remains fragile given the lingering security challenges and structural impediments in the business environment. Accordingly, the Committee favoured holding the key policy rate constant at 11.50% at the January and March policy meetings, reiterating the need for the monetary and fiscal authorities to consolidate administrative measures to spur economic growth. Besides, the body language of the CBN governor at the March policy meeting also showed that the Committee was not in a hurry to start hiking interest rates to counteract capital flow reversals even as the Fed began raising its key policy rate and the Russia-Ukraine conflict evolved.

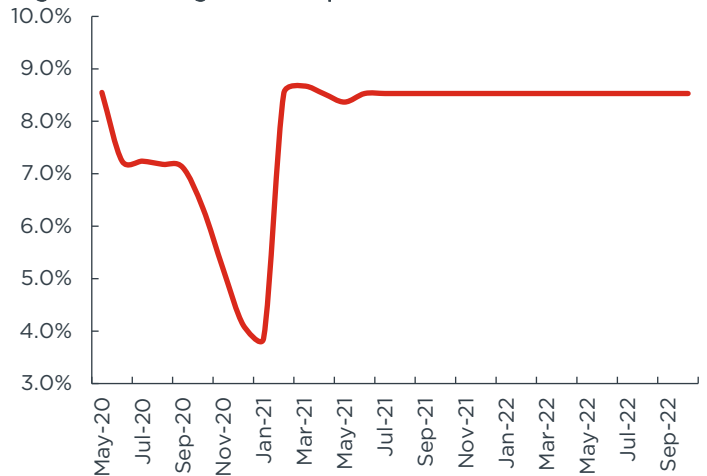
However, as external pressures mounted, the MPC switched tone without proper forward guidance, though we anticipated the move (see report: [MPC May Raise MPR to Stabilise the External Sector](#)). Notably, the Committee increased the MPR by 150bps at the May policy meeting. In justifying its decision, the MPC noted that major global central banks had provided strong guidance for a progressive shift away from monetary policy accommodation to drive market interest rates upward, which may ultimately impact capital flow away from emerging market economies. In addition, the Committee highlighted that domestic inflationary pressures had grown aggressively while the economy remained on a growth path, although at a more subdued pace. Since then, the MPC has gone on to hike the MPR by an additional 100bps and 150bps at the July and September policy meetings, respectively. Furthermore, the Committee also voted to increase the Cash Reserve Requirement (CRR) by 500bps to a minimum of 32.5% at the September meeting to consolidate its measures for taming inflation.

At its last meeting of the year on 22 November, the MPC unanimously voted to increase the Monetary Policy Rate (MPR) further by 100bps to 16.5% - the fourth consecutive rate hike and the highest rate since November 2002 (18.5%). The last time the MPR was at the 16.5% level was in July 2003. In addition to consolidating previous gains, the Committee opted for a further increase to (1) narrow the negative real interest rate margin, (2) improve market sentiments and (3) further restore investors' confidence. In addition, the Committee guided that there remained a need to continue to tighten but at a somewhat moderate pace. This is because holding the key policy rate unchanged at a period close to the December festive season and expected heavy spending ahead of the 2023 general elections would jeopardise the gains of previous policy rate hikes and plunge the economy deeper into the inflation trap.

**Figure 30: OMO Net Inflows (NGN billion)**



**Figure 31: Average OMO stop rate**



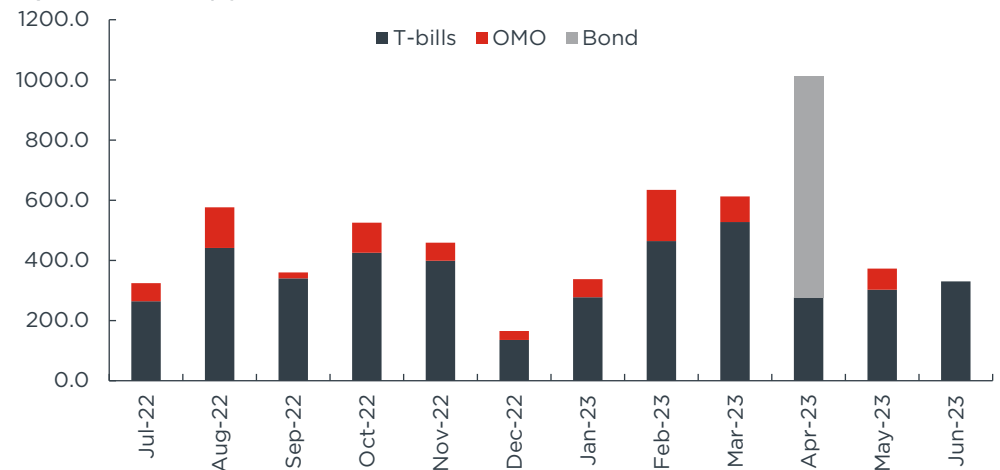
Source: FMDQ, CBN, Cordros Research

### Additional Rate Hike in the Offing before a Stretch of HOLD

Since switching monetary policy stance in May, the CBN governor has consistently maintained that the MPC would maintain its interest rate hikes until the inflation path decelerated, more so that “time-tested monetary policy has shown that inflation must lag policy rates”. Gleaning insights from our inflation outlook, we expect inflationary pressures to start decelerating from December 2022 but average 18.56% y/y in 2023FY. Accordingly, the preceding suggests that the MPC is likely to continue to raise the MPR, albeit slower than 2022E levels, based on the CBN governor’s forward guidance. To corroborate our views, we expect the domestic economy to remain on a steady growth path barring any major shock to the economy. However, growth is likely to weaken compared to 2022E levels, given election uncertainties and the lagging impact of higher interest rates on businesses.

Away to the external sector, global central banks are not backing out of their interest rate hiking cycle, for now, as they continue to reiterate that the labour market remains strong, although there are signs of loosening labour market conditions. Moreover, while inflationary pressures are softening, they remain at multi-decade highs, prompting more rate hikes to bring inflation back to the monetary authorities' target. Notwithstanding, market expectations favour a slowdown in the interest rate hikes if the softening inflation numbers persist into 2023. In that case, global central banks are expected to pause interest rate hikes any time after Q1-23. **Therefore, on a balance of factors, we expect the Committee to increase the key policy rate by additional 100bps in either the first or second meetings of 2023FY. After that, we would expect the Committee to keep the MPR unchanged as the risks of overtightening take centre stage at the meetings, more so that global central banks are expected to have ended their interest rate hiking cycle by then.**

Figure 32: Maturity profile (NGN billion)



Source: FMDQ, CBN, Cordros Research

## Fiscal Policy.

### 2023FY Budget: Ambitious Revenue Targets Support Widening Deficit

The Federal Government of Nigeria's (FGN) fiscal position remains dire (as of 8M-22) as overoptimistic revenue targets overshadowed progress made from non-oil revenue sources. On the one hand, oil revenue (NGN395.06 billion) underperformed the prorated budget estimate (NGN1.46 trillion) by 72.9% as low crude oil production volume and elevated PMS under-recovery costs undermined oil inflows. On the other hand, non-oil revenue overperformed the prorated non-oil income by 2.9% during the same period on account of improving domestic demand (ergo, tax revenue) and relatively better tax administration in line with the 2021 Finance Act. Meanwhile, other revenue items underperformed the prorated amount by 38.2%, primarily driven by revenue decline across FGN's independent revenue (-50.3% underperformance) and GOE's retained revenue (-50.8% underperformance). **It is pertinent to note that when annualised, the FGN's independent revenue could settle at NGN1.30 trillion in 2022E – marking a second consecutive year it will surpass the NGN1.00 trillion mark. However, given that the FGN has always been ambitious (2022E target: NGN2.62 trillion) with the revenue target from the independent sources, it tends to downplay the actual income growth from the source, contributing significantly to aggregate revenue's underperformance.** Overall, the total FGN's retained income settled at NGN3.67 trillion – 33.3% below the prorated budget (NGN5.49 trillion as of 8M-22). Including GOEs, the FGN's aggregate revenue (NGN4.23 trillion) was 36.3% below the prorated budget (NGN6.65 trillion).

Elsewhere, FGN's aggregate expenditure (excluding GOEs & project-tied loans) achieved a 93.9% performance ratio compared to the prorated expenditure (NGN9.63 trillion) as of 8M-22. We highlight through the breakdown provided that total debt service exceeded the prorated amount by 32.9%, while non-debt recurrent and capital expenditures underperformed by 17.9% and 50.8%, respectively. Including GOEs and project-tied loans, we highlight that the aggregate expenses settled at NGN9.56 trillion. Consequently, the fiscal deficit rose to NGN5.33 trillion – 8.8% above the period's prorated deficit (NGN4.90 billion) as retained revenue's underperformance was higher than the expenditure's underperformance.

For 2023FY, we expect the total retained revenue of the FGN to settle at NGN5.47 trillion – oil revenue of NGN1.04 trillion, non-oil revenue of NGN2.60 trillion, independent revenue of NGN1.25 trillion and other revenues of NGN585.81

billion. On expenditure, we expect capital expenditure (net of GOEs, project-tied loans, and statutory transfers) of NGN1.65 trillion compared to the budgeted estimate of NGN2.33 trillion. However, we expect a 103.6% performance of recurrent spending (NGN13.51 trillion) because of higher debt service than budget provisions, while the statutory transfers are expected to settle at NGN750.75 billion. **Accordingly, we see the total FGN expenditure, excluding the GOEs and project-tied loans, at NGN15.91 trillion. Consequently, our base case scenario suggests a total fiscal deficit of NGN10.44 trillion (excluding GOEs and project-tied loans). Considering GOEs and project-tied loans, our model implies that the fiscal deficit will settle at NGN12.69 trillion in 2023FY (vs FGN's estimate: NGN10.78 trillion).**

### **Budget of Fiscal Consolidation & Transition; Ironic?**

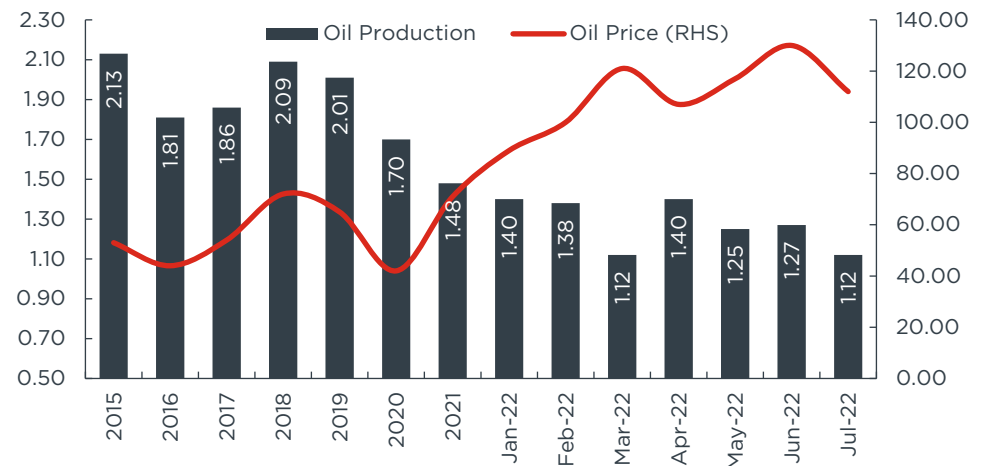
In line with the government's consistent resolve to maintain the organic calendar year (January to December) to enhance implementation, the President presented the 2023FY budget to the National Assembly on 7 October, representing the last full-year budget to be presented by the present administration. The 2023FY budget was tagged "Budget of Fiscal Consolidation and Transition". The FGN proposed to spend NGN20.51 trillion (including GOEs and project-tied loans), 18.4% higher than the 2022E revised budget (NGN17.32 trillion). At the same time, the government expects aggregate revenue to settle at NGN9.73 trillion, 2.4% lower than the 2022E revised budget (NGN9.97 trillion). The aggregate income and expenditure estimates translate to a 46.7% growth in the fiscal deficit to NGN10.78 trillion (2022 revised budget: NGN7.35 trillion) or 4.8% of GDP (2022 revised budget: 4.0%). Excluding the GOEs, the FGN expects the fiscal deficit to rise to NGN9.01 trillion (2022 revised budget: NGN6.21 trillion).

### **Aggressive Spending Plan on Optimistic Revenue Assumptions**

The FGN expects crude oil revenue to settle at NGN1.86 trillion in 2023FY (vs 2022 budget: NGN2.19 trillion) based on its assumptions of (1) crude oil production of 1.69 mb/d, (2) crude oil price of USD70.00/bbl., and (3) exchange rate of NGN435.57/USD. As stated in the GDP section, we expect crude oil production to increase by 11.9% y/y to 1.53mb/d in 2023FY (2022E: 1.37 mb/d), given our expectation of an improvement in crude oil production in line with the government's clamp down on illegal pipelines. However, constraints such as IOCs divestments and the lingering lagging impact of infrastructure decay would ensure crude oil production remains at a sub-optimal level. Indeed, the Nigerian Upstream Petroleum Regulatory Commission (NUPRC)'s CEO stated at a press briefing that current statistics showed that the volume of oil lost to theft in Nigeria is about 100.00 kb/d. At the same time, we expect the crude oil price to be ahead of the FGN's estimate, but this would not be enough to salvage the oil revenue's underperformance amid a huge PMS under-recovery burden. For instance,

despite the 51.3% increase in crude oil price compared with the budget assumption (USD73.00/bbl.) as of July, the FGN's oil revenue (NGN395.06 billion) as of 8M-22 underperformed the prorated budget (NGN1.46 trillion) by 72.9% because of (1) 21.3% decline in actual crude oil production (vs budget: 1.60mb/d), and (2) elevated under-recovery costs (+269.8% y/y as of 7M-22). **Therefore, on a balance of factors, we see oil revenue at NGN1.04 trillion in 2023FY - 43.9% lower than the FGN's estimate (NGN1.86 trillion) but 76.2% and 4.6% higher than 2022E and 2021FY actual oil revenue.**

**Figure 33: Trend in Crude Oil price (USD/bbl.) and production (mb/d)**



Source: CBN, NBS, NUPRC, Budget Office, Cordros Research

We like that the FGN projected a slow rise in non-oil revenue for 2023FY compared to the growth in 2022E, flattered by the low base in 2021. The FGN expects a 14.1% y/y increase in non-oil revenue to NGN2.43 trillion (vs 2022 budget: +43.2% y/y to NGN2.13 trillion), recognising the smoothing of the base effects that ushered the initial post-COVID boost previously. **In line with the non-oil revenue performance in the past three years and accounting for a positive impact of the 2022 Finance Act, we forecast non-oil revenue will outperform the government's estimate by 3.5% and settle at NGN2.52 trillion in 2023FY (2022E: NGN2.32 trillion).** The downside risks to our non-oil revenue forecast include a lower-than-expected increase in economic activities, persistent inflationary pressures, and weak income growth.

That said, other revenues (41.2% of the retained revenue) have been estimated at NGN3.01 trillion. The breakdown reveals that the FGN plans to receive N2.22 trillion as independent revenue, NGN248.27 billion from education tax, and NGN300.00 billion from special accounts, among others. We believe that the income from this segment will grossly underperform due to the ambitious targets set by the FG. Crucially, we are pessimistic about the proposed revenue from the independent revenue, given the inefficiencies in government parastatals which

undermines revenue-generating capacity. In fact, between 2009 and 2021, the average performance in this segment was 59.3%, while the same revenue source underperformed the budget by 50.3% in 8M-22. **Overall, we project FGN's total retained revenue will settle at NGN5.47 trillion (25.1% short of budget).** Assuming that 80% of the GOEs revenue is realised in 2023, we forecast the aggregate income to settle at NGN7.41 trillion (vs budget: NGN9.73 trillion).

**Table 2: Breakdown of FGN 2023 proposed budget (NGN trillion)**

<b>Fiscal Items</b>	<b>2023 (Proposed)</b>	<b>2022 (Revised)</b>
<b>Assumptions</b>		
Oil production volume (mb/d)	1.69	1.60
Benchmark oil price (USD/bbl)	70.00	73.00
Exchange Rate (USD/NGN)	435.57	410.15
<b>Revenue</b>		
FGN retained revenue	7.31	8.24
Oil & related revenue	1.86	2.19
Non-oil tax revenue	2.43	2.13
Other revenue	3.01	3.92
<b>Expenditure</b>		
Gross FGN Expenditure	16.32	14.45
Statutory transfers	0.744	0.803
Debt service	6.56	3.96
Sinking fund	0.200	0.350
Recurrent (non-debt) expenditure	6.49	5.67
Capital expenditure (ex-transfers)	2.33	3.66
<b>Fiscal deficit (ex-GOEs &amp; Project-tied loans)</b>	<b>9.01</b>	<b>6.21</b>

Source: Budget Office, Cordros Research

On a balance of factors, assuming a budget implementation rate of 97.5%, our scenario analysis indicates that the fiscal deficit (excluding GOEs) could range between NGN9.62 trillion and NGN11.25 trillion. Therefore, our baseline expectation is that the fiscal deficit (excluding GOEs) will settle at NGN10.44 trillion in 2023FY. However, considering the GOEs and project-tied loans, we expect the fiscal deficit to settle at NGN12.69 trillion (or 5.6% of GDP) in our base case scenario.

### Plugging the Deficit - FGN to Rely on Domestic Debt & CBN's W&M

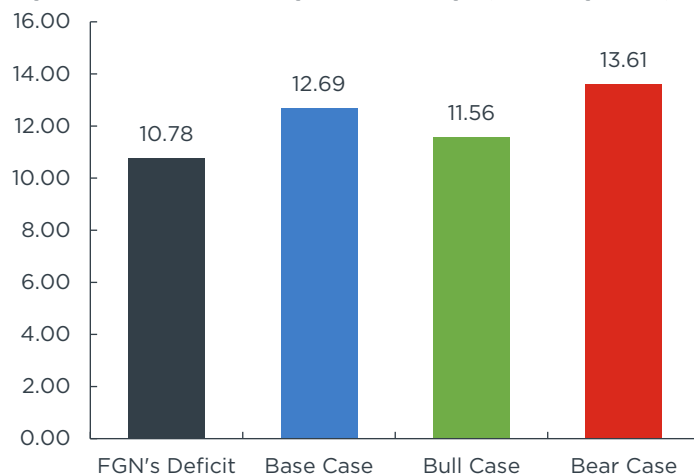
Based on the details of the budget proposal, we highlight the fiscal deficit of NGN10.78 trillion (including GOEs and project-tied loans) will be financed by the combination of domestic borrowing (NGN7.04 trillion), foreign borrowing (NGN1.76 trillion), multilateral/bilateral loan drawdowns (NGN1.77 trillion), and privatisation proceeds (NGN206.18 billion).

On foreign borrowings, we do not expect the FGN to tap into the Eurobond market, given our expectation that tight global financing conditions will remain in 2023FY, as highlighted in the global section of our report. Similarly, damaging sovereign credit downgrades by the global rating agencies would also make

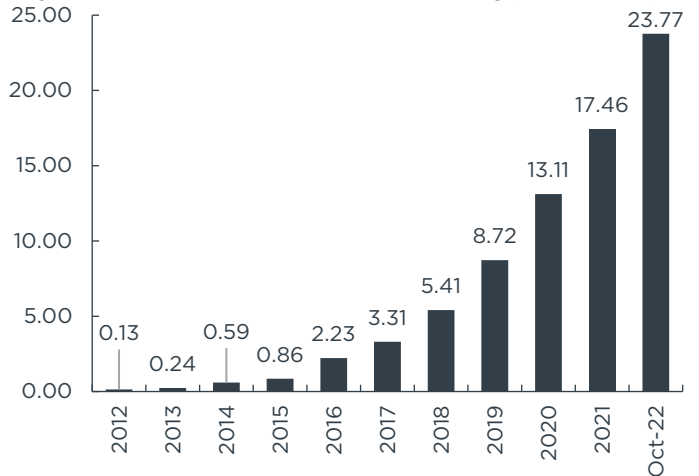
foreign borrowings more expensive, inhibiting the FGN's attempt to access the Eurobond market in 2023FY. On the credit downgrade, we note that Moody's Investors Services downgraded Nigeria's credit rating to 'B3' from 'B2' on 21 October, citing the deterioration in the FGN's finances and external position, weakening further the government's capacity to service debt and thereby increasing the probability of default. Elsewhere, we do not expect success in drawing down loans from the multilateral institutions (World Bank and the IMF), given the FGN's reluctance to implement the reforms requested by the institutions. Therefore, the scenario leaves the FGN with the option of increasing domestic debt issuances while simultaneously increasing reliance on the CBN's overdraft facilities compared to 2022E levels.

On domestic borrowing, we think the FGN will increase its domestic debt issuances more than it envisages, given our forecast of a higher fiscal deficit compared to the government estimates and limited foreign borrowing options. At the same time, the FGN's reliance on CBN's debt monetisation could rise to a record high as the domestic market is unlikely to absorb the government's borrowing needs. Given that the CBN's Ways & Means (W&M) advances to the FGN are on track to settle at NGN7.57 trillion in 2022E (vs 2021FY: NGN4.35 trillion), we do not rule out the W&M advances printing north of NGN7.00 trillion in 2023FY.

**Figure 34: Estimated budget deficit range (including GOEs)**



**Figure 35: Trend in CBN's W&M outstanding (NGN trillion)**



Source: Budget Office, CBN, Cordros Research estimates

## Appendix. Nigeria - Key Economic Forecasts.

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022E	2023F
<b>Activity</b>													
Real GDP (% YoY)	5.3	4.2	5.5	6.2	2.8	(1.6)	0.8	1.9	2.3	(1.9)	3.4	2.7	3.0
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	2.3
Government consumption (% YoY)	4.6	(2.0)	(10.3)	(7.0)	(11.9)	(15.1)	(12.4)	39.9	8.8	61.6	(34.0)	5.3	4.4
Oil production (million b/d year-end)	2.4	2.0	2.2	2.2	2.1	1.6	1.9	1.9	2.0	1.8	1.6	1.4	1.5
Nominal GDP (NGN billion)	62,980	71,714	80,093	89,044	94,145	101,489	113,712	127,737	144,210	152,324	173,528	184,382	210,195
Nominal GDP (USD billion)	410	459	515	569	495	405	376	398	448	402	423	434	483
Real GDP (NGN billion)	57,511	59,930	63,219	67,153	69,024	67,931	68,491	69,800	71,388	70,014	72,394	74,359	76,607
Population (million)	165	170	176	181	187	193	199	205	211	218	223	229	235
GDP per capita (USD)	2,490	2,700	2,931	3,134	2,641	2,093	1,886	1,941	2,121	1,846	1,895	1,893	2,055
Gross national saving (% of GDP)	10.2	11.0	11.9	12.7	12.4	13.7	12.6	12.4	12.5	14.3	14.6	13.4	14.3
The stock of bank credit to the economy (NGN billion)	7,313	8,150	10,006	12,889	13,086	16,117	15,741	15,134	17,188	20,373	24,378	28,583	32,013
The stock of bank credit to the economy (% of GDP)	11.6	11.4	12.5	14.5	13.9	15.9	13.8	12.1	11.1	13.4	14.0	15.5	15.2
Loan to deposit ratio (%)	44.8	42.3	38.0	64.2	69.6	80.0	78.2	64.3	59.9	65.0	65.0	65.0	65.0
<b>Fiscal balance (% of GDP)</b>													
Federal government balance	(2.8)	(1.4)	(1.3)	(1.0)	(1.6)	(2.2)	(3.3)	(2.9)	(2.9)	(4.3)	(4.0)	(4.5)	(5.6)
Total public debt	17.6	17.7	18.6	17.5	20.3	23.4	25.3	28.4	19.9	21.6	22.8	25.5	26.0
Capital Expenditure	1.5	1.0	1.1	0.7	0.6	0.2	1.3	1.3	0.8	1.1	1.7	2.0	0.7
<b>Debt Indicators</b>													
Gross external debt (USD billion)	5.7	6.5	8.8	9.7	10.7	11.4	18.9	25.3	27.7	33.4	38.4	44.6	48.5
Gross external debt (% of GDP)	1.1	1.0	1.7	1.8	2.3	3.4	5.1	6.1	6.2	8.3	9.1	10.3	10.0
Gross external debt (% of exports)	5.7	6.7	9.0	11.7	23.3	32.9	41.3	41.3	42.6	92.8	81.9	65.1	71.5
Total debt service (USD billion)	3.4	4.3	5.3	5.9	5.5	5.6	6.0	7.1	8.0	8.9	10.4	11.0	14.7
Total debt service (% of GDP)	0.8	0.9	1.0	1.0	1.1	1.4	1.6	1.8	1.8	2.2	2.5	2.5	3.1
Total debt service (% of exports)	3.4	4.4	5.4	7.2	12.0	16.2	13.0	11.5	12.3	24.8	22.1	16.1	21.7
<b>External Balance</b>													
Exports (NGN billion)	19,036	22,446	14,245	16,304	9,593	8,527	13,598	18,532	19,192	12,523	18,908	25,734	28,487
Exports (USD billion)	99.9	97.0	97.8	82.6	45.9	34.7	45.8	61.2	65.0	35.9	46.9	68.5	67.9
Imports (NGN billion)	10,033	5,625	7,016	7,374	6,698	8,818	9,563	13,165	16,960	12,701	20,844	24,700	27,491
Imports (USD billion)	65.2	35.7	44.6	46.5	34.7	34.8	31.3	43.0	62.1	52.4	50.1	54.0	(56.9)
Trade balance (NGN billion)	9,003	16,821	7,229	8,930	2,895	(290)	4,036	5,367	2,232	(178)	(1,936)	1,033	996
Trade balance (% of GDP)	14.3	23.5	9.0	10.0	3.1	(0.3)	3.5	4.2	1.5	(0.1)	(1.1)	0.6	0.5
Current account balance (USD billion)	12.7	18.9	20.1	1.3	(15.4)	2.7	10.4	3.9	(16.7)	(17.0)	(1.9)	11.4	6.0
Current account balance (% of GDP)	3.1	4.1	3.9	0.2	(3.1)	0.7	2.8	1.0	(3.7)	(4.2)	(0.4)	2.6	1.2
Net FDI (USD billion)	46.3	17.9	(36.5)	14.5	(41.2)	(11.1)	59.5	36.3	3.6	(34.8)	51.0	36.1	10.7
Net FDI (% of GDP)	50.9	(43.9)	24.7	5.1	(9.2)	31.6	8.5	37.7	28.8	(25.1)	64.1	18.5	11.3
Current account balance plus FDI (% of GDP)	32.6	43.8	42.8	34.2	28.3	27.0	39.4	42.6	38.1	36.5	40.2	38.1	36.8
Exports (% YoY, NGN value)	6.1	8.6	10.0	7.4	7.0	9.1	12.0	13.8	7.9	7.7	10.6	8.8	8.5
Imports (% YoY, NGN value)	19,036	22,446	14,245	16,304	9,593	8,527	13,598	18,532	19,192	12,523	18,908	25,734	28,487
Foreign exchange reserves (ex. gold, USD billion)	99.9	97.0	97.8	82.6	45.9	34.7	45.8	61.2	65.0	35.9	46.9	68.5	67.9
Foreign exchange reserves adequacy (months of import)	10,033	5,625	7,016	7,374	6,698	8,818	9,563	13,165	16,960	12,701	20,844	24,700	27,491
<b>Prices</b>													
CPI (average % YoY)	10.9	12.2	8.5	8.0	9.0	15.6	16.5	12.1	11.4	13.2	17.0	18.7	18.6
CPI (year-end % YoY)	10.3	12.0	8.0	8.0	9.6	18.5	15.4	11.4	12.0	15.8	15.6	20.8	18.0
<b>Interest &amp; Exchange Rates</b>													
Monetary policy rate (MPR), % year-end	12.0	12.0	12.0	13.0	11.0	14.0	14.0	14.0	13.5	11.5	11.5	16.0	17.0
Broad money supply (NGN billion)	13,303	15,481	15,681	18,886	20,030	23,592	24,141	27,069	28,783	37,829	43,818	48,375	51,422
Broad money supply (% YoY)	15.4	16.4	1.3	20.4	6.1	17.8	2.3	12.1	6.3	31.4	15.8	10.4	6.3
Credit to the private sector (NGN billion)	14,184	15,152	16,191	18,126	18,721	22,326	22,243	23,536	26,695	29,890	35,195	40,263	44,289
Credit to the private sector (% of GDP)	22.5	21.1	20.2	20.4	19.9	22.0	19.6	18.4	18.5	19.6	20.3	21.8	21.1
3-month interest rate (T-bill year-end %)	14.1	11.7	10.9	10.8	5.7	21.0	14.0	11.3	5.2	0.4	5.0	9.8	UR
5Y yield (% year-end)	11.2	12.0	13.3	15.3	11.0	11.4	14.0	15.2	10.3	6.3	12.3	14.9	UR
Official exchange rate (NGN/USD) year-end	156.7	155.8	155.7	168.0	197.0	305.0	306.0	307.0	307.0	380.0	435.0	445.0	453.9
Official exchange rate (NGN/USD) annual average	153.9	157.5	157.3	158.6	193.3	253.5	305.8	306.1	306.9	358.81	410.4	434.4	444.3
BDC exchange rate (NGN/USD) annual average	159.3	160.9	162.4	171.5	222.7	372.9	395.4	361.5	359.5	435.3	515.8	662.8	NA
BDC exchange rate (NGN/USD) year-end	165.0	159.0	172.0	191.5	267.0	490.0	363.0	361.0	362.0	475.0	565.0	810.0	NA
I & E exchange rate (NGN/USD) annual average							365.6	362.1	361.9	381.5	435.0	434.4	450.07
I & E exchange rate (NGN/USD) year-end							360.3	364.0	364.5	394.7	410.4	445.0	462.16

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.