THE 2010 BUDGET & THE MACROECONOMY

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OUTLINE

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THE 2010 FISCAL FRAMEWORK: KEY ASSUMPTIONS

- 2010 Fiscal Framework as approved by the National Assembly was based on the following assumptions:
  - Oil production of 2.35mbpd
  - Oil benchmark price of US$67 per barrel
  - Exchange rate of N150/US$
  - Inflation rate of 11.2%
  - GDP growth rate of 6.1%

THE 2010 FISCAL FRAMEWORK: BROAD AGGREGATES

- **Broad aggregates in the 2010 Fiscal Framework :**
  - **FGN Retained Revenue – N3.087 trillion**
  - **Aggregate Expenditure – N4.607 trillion**
  - **Personnel &Overheads – N1.461 trillion**
  - **Capital Vote – N1.853 trillion**
  - **Deficit – 4.75% of GDP**

- **Assumptions served as basis for the 2010 Budget passed by the National Assembly in March 2010.**

ALLOCATION OF 2010 BUDGET

- 40% of 2010 Budget allocated to Capital Expenditure

STATUTORY TRANSFERS
4%

OTHERS
13%

CAPITAL EXPENDITURE
40%

DEBT SERVICE
11%

NON-DEBT RECURRENT EXPENDITURE
32%

CAPITAL EXPENDITURE

NON-DEBT RECURRENT EXPENDITURE

DEBT SERVICE

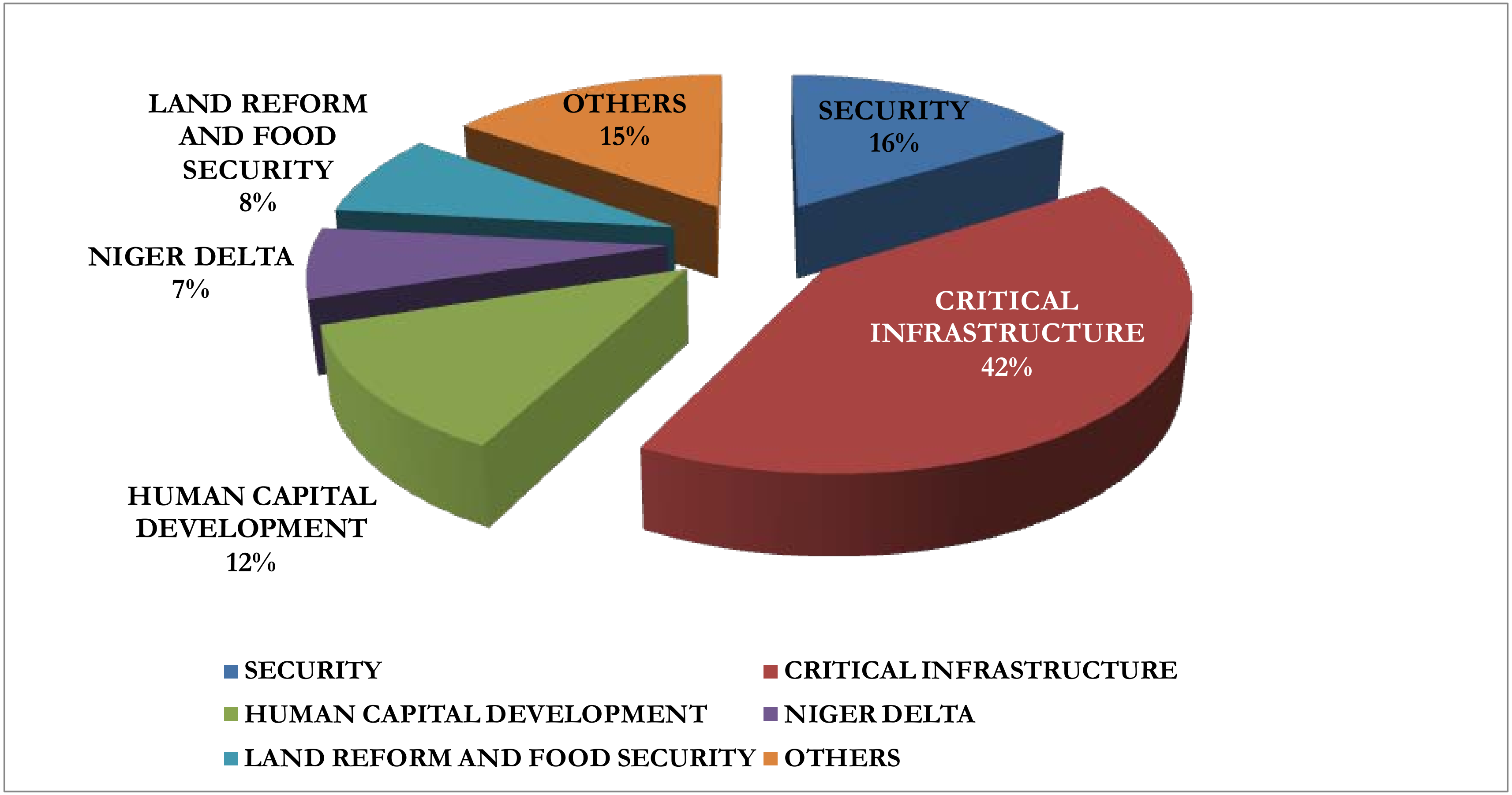
STATUTORY TRANSFERS

OTHERS

Source: Budget Office of the Federation

ALLOCATION OF CAPITAL VOTE

- **85% of Capital Vote allocated to Priority Sectors while 42% of Capital Vote in 2010 Budget NASS allocated to Critical Infrastructure**



Source: Budget Office of the Federation

FINANCING THE DEFICIT (1)

- **Higher deficit in 2010 Budget as FGN seeks to stimulate economy.**
- **Revenue shortfalls and new expenditure a challenge to financing the Budget.**
- **Proposed Deficit of 4.75% of GDP, which is higher than the 3% threshold recommended in FRA, 2007 (Section 12)**
- **FRA 2007 allows for this under exceptional circumstances, such as the recent economic recession.**
- **Increased deficit in line with global trends and to be financed through:**
  - Privatisation proceeds
  - Signature bonus
  - International bond
  - ECA withdrawals
  - Domestic borrowing

FINANCING THE DEFICIT (2)

- **International Bond Issuance:**
  - Ongoing work to quicken sovereign bond issue in spite of the situation in international financial markets.
- **Signature Bonus:**
  - FGN's share of signature bonus for 2010 oil bidding rounds.
  - Interest has been shown in oil blocks and estimates in budget are conservative.
- **Domestic Borrowing:**
  - FGN conscious of need to avoid crowding out private investment; so it is managing domestic borrowing.
- **Excess Crude Account:**
  - Some drawings from ECA. Much reduced now, but plans underway to adopt Sovereign Wealth Fund (SWF)
  - Intended to act as savings and stabilisation fund with clear and transparent guidelines

CHALLENGES TO IMPLEMENTING 2010 BUDGET

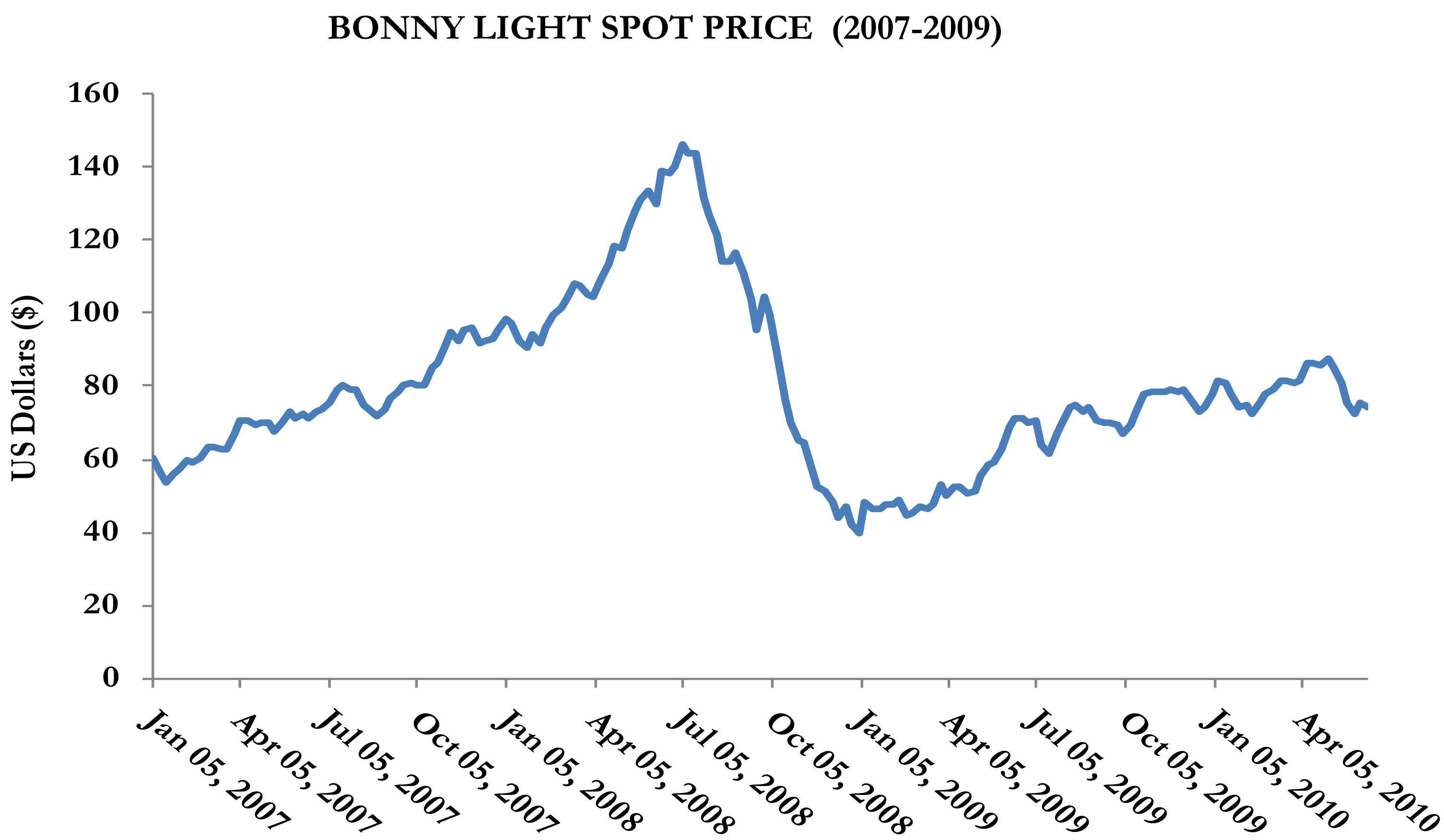
- Underperformance of Forecast Revenue
  - Oil revenue
  - Non-oil revenue
- Continued Fuel Subsidy
- New expenditure challenges came to the fore after submission of budget to NASS:
  - Wage increases to civil servants, tertiary institutions, etc.
  - PHCN arrears of monetisation
- This may result in a slightly higher deficit

COPING WITH THE CHALLENGE (1)

- Revision of both Fiscal Framework and Budget became necessary to reflect present revenue and expenditure realities
- 2010 Budget and Fiscal Framework being revised in consultations with the Legislature
- Several efforts being made by Government to plug revenue leakages:
  - Audit of NNPC
  - Process audit of all revenue-generating entities
  - Strengthening of pre-shipment inspection for crude oil
- Some expenditure cuts (overheads and capital)

COPING WITH THE CHALLENGE (2)

- **Oil price hedging possibilities being explored to manage downside risks associated with oil price movements**



Source: Energy Information Administration

GLOBAL ECONOMIC CRISIS & NEED FOR STIMULUS

- Given National Income Identity:

$$\boxed{Y = C_G + C_P + I_G + I_P + (X\text{-}M)}$$

- As recovery from global economic crisis continues, C_P and I_P not performing well due to effects of crisis on local capital market and banking sector and its knock-on effects on aggregate demand.
- Credit squeeze/freeze and risk aversion by DMBs has constrained credit and investment activities.
- Net exports (X-M) negatively affected.
  - ✓ Non oil exports in particular
  - ✓ M continues to be high
- Hence, I_G and C_G remain main drivers for stimulating the economy.
- I_G has potential to promote economic growth in the medium to long term especially if used to close infrastructure gap.
- But rate of capital budget implementation needs to improve
- I_G being complemented by PPP

BUDGET AS A FISCAL STIMULUS TOOL (1)

- **Fiscal stimulus being applied to stimulate aggregate demand.**

- **Several countries currently with high budget deficit levels as a result of increased spending:**

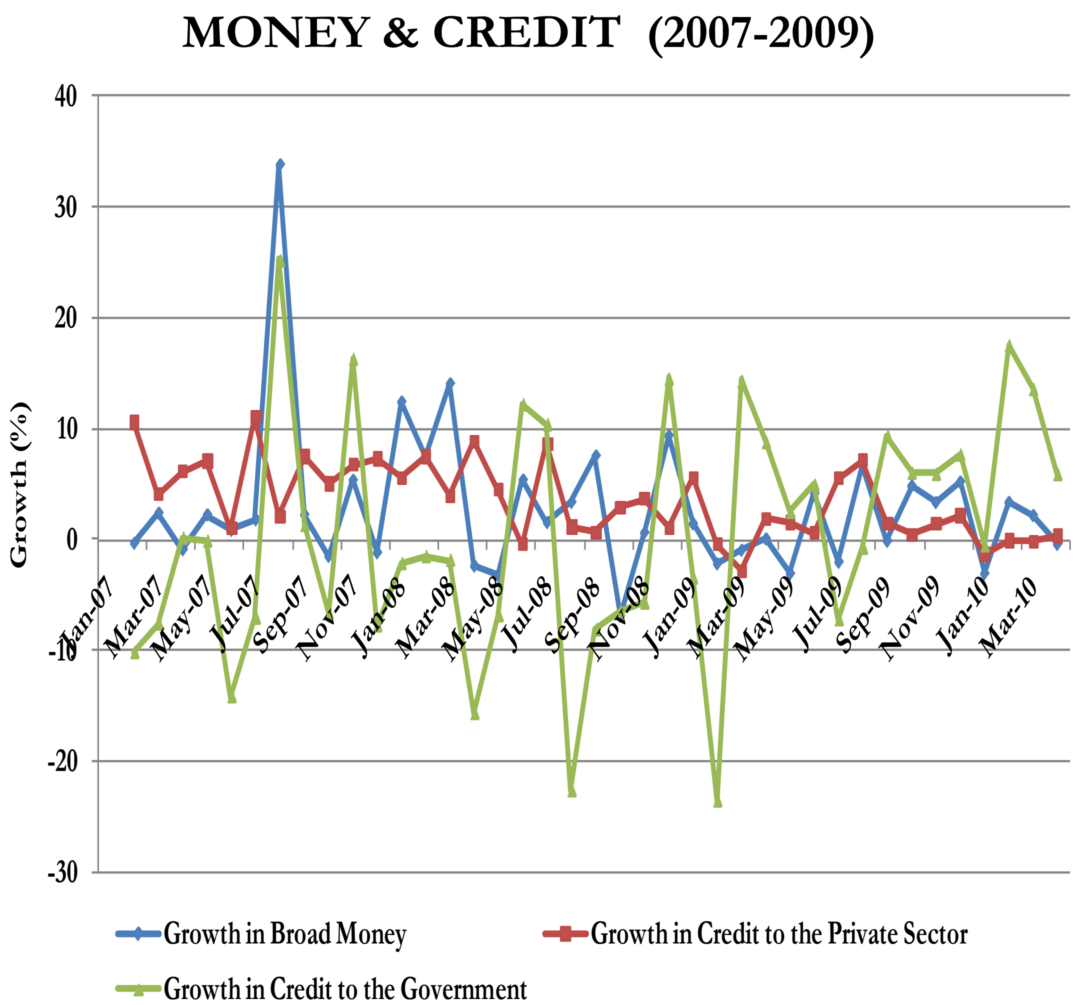
  - Greece (about 14% of GDP),
  - UK (12% of GDP),
  - US (about 11% of GDP),
  - Germany (above 4% of GDP).

- **Nigeria's proposed deficit for 2010 is 4.75% of GDP and is modest compared to some other countries although higher than 3% threshold recommended in FRA 2007.**

BUDGET AS A FISCAL STIMULUS TOOL (2)

- As is well known, countercyclical fiscal policy is most effective at stimulating aggregate demand during a recession.
- As the famous saying goes, 'we are all Keynesians now.'
- With current credit squeeze to the private sector, Government is best-placed to 'spend us out' of the crisis – although we recognise the challenges.
- Targeted spending on priority sectors such as infrastructure capable of creating 'a virtuous cycle of economic growth.'
- Growth will result in job creation: away from 'growth without jobs'.

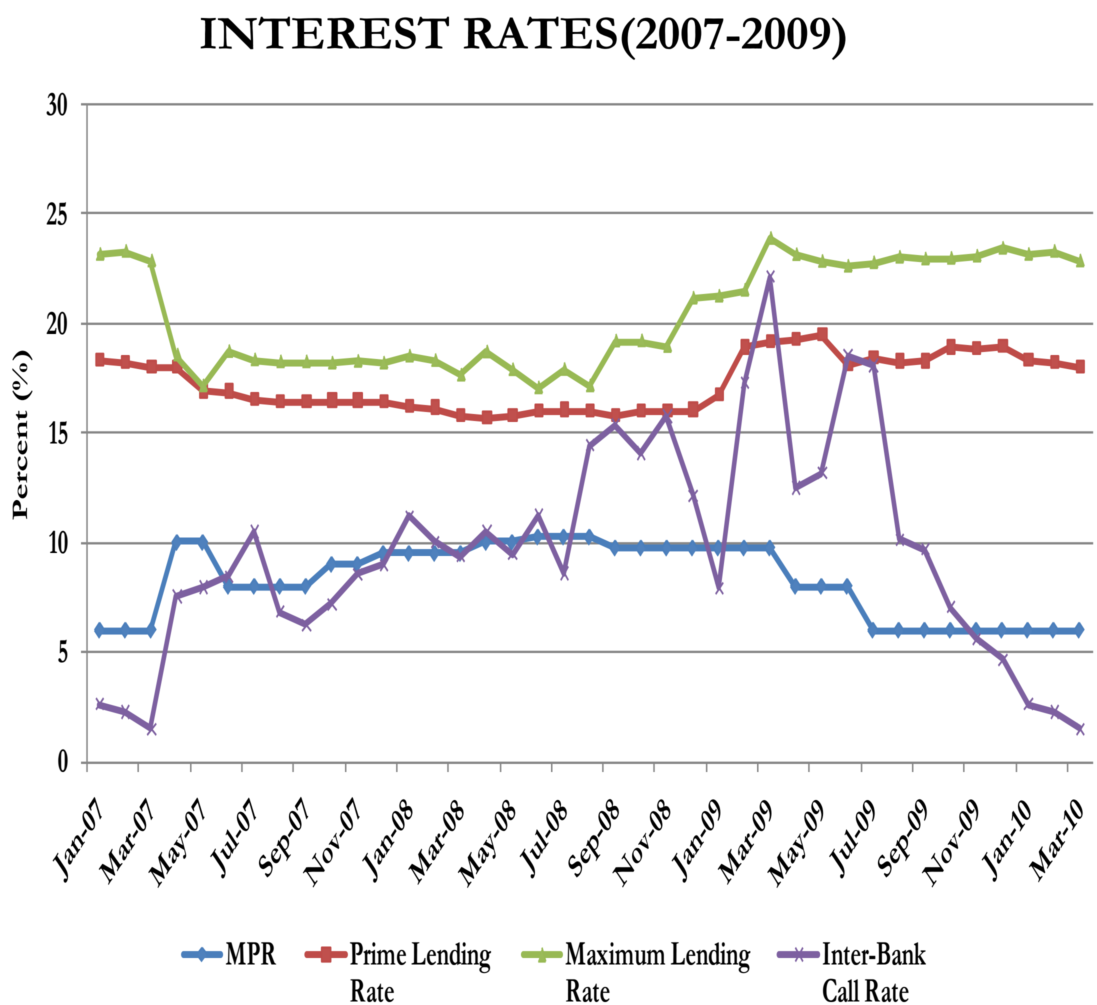
SELECTED MACROECONOMIC INDICATORS: MONEY & CREDIT



Source: Central Bank of Nigeria

- Credit to Government rising faster than credit to the private sector.
- Credit to Government grew by 28.4 per cent (or 113.6 percent on an annualized basis from December 2009 to March 2010) while credit to the private sector declined by 1.7 percent (or 6.8 percent on an annualized basis)
- Need for government stimulus to invigorate private sector activity in the absence of lending by DMBs.

SELECTED MACROECONOMIC INDICATORS: INTEREST RATES

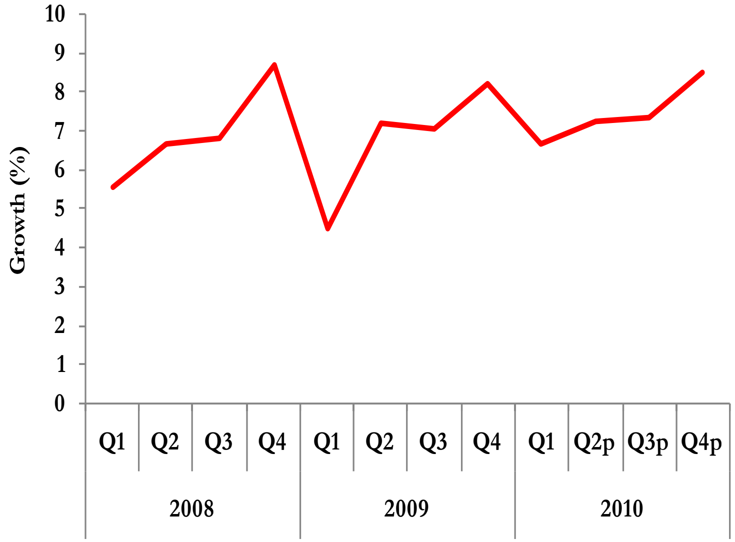


Source: Central Bank of Nigeria

- Monetary Policy also assisting recovery efforts by keeping interest rates down
- Retail lending rates relatively stable in recent months as CBN's efforts at maintaining stability in the financial markets begin to yield positive results
- Decline in interbank interest rates much faster than drop in retail lending rates
- Government mindful of need to avoid crowding out private sector; hence, it is keen to avoid overstretching the domestic bonds market

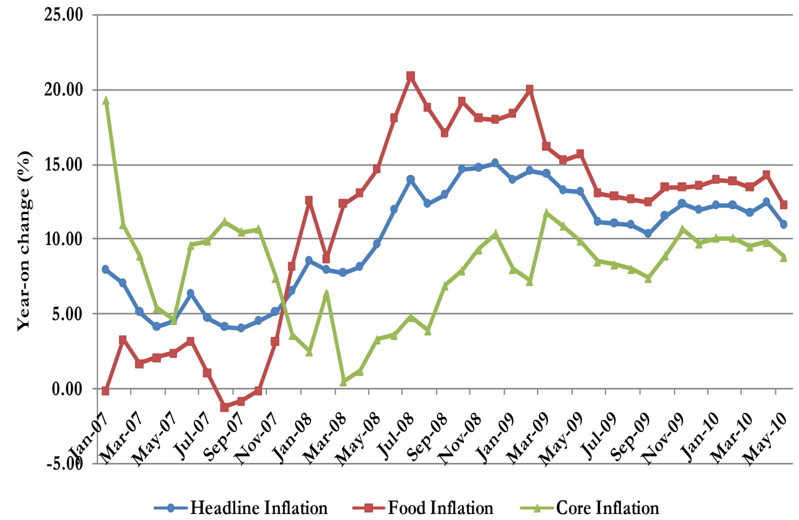
SELECTED MACROECONOMIC INDICATORS: GROWTH & INFLATION

REAL GDP GROWTH(2008-2010)



Source: National Bureau of Statistics

INFLATION (2007-2009)



Source: National Bureau of Statistics

- According to NBS, Oil GDP grew by 3.21% in Q1 2010 compared to -8.08% in same period in 2009
- Non-oil sector continues to be major driver of growth contributing 8.15% in Q1 2010 against 7.9% in Q1 2009.
- Agriculture and Telecommunications remain main drivers of non-oil GDP

- Inflation rates have been relatively stable since mid-2009.
- All measures of the consumer price index have moderated since Jan 2010, a reflection of the slowdown in aggregate demand.
- Any risk of inflation arising from expansionary nature of the 2010 Budget will need to be managed

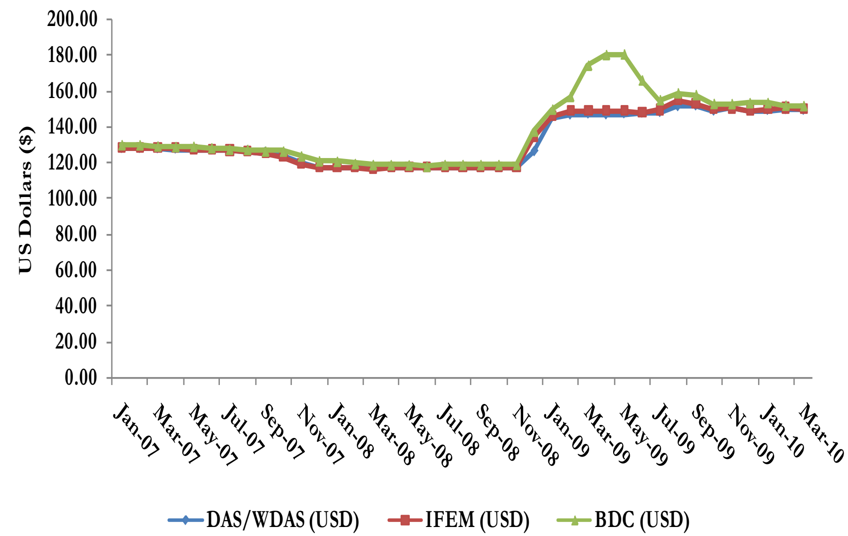
SELECTED MACROECONOMIC INDICATORS: EXTERNAL RESERVES & EXCHANGE RATES

EXTERNAL RESERVES (2007-2009)

Source: Central Bank of Nigeria

- Level of external reserves has fallen although enough to finance 17 months of imports (compared to 3-month benchmark recommended)

MONTHLY EXCHANGE RATES(2007-2009)



Source: Central Bank of Nigeria

- Exchange rate has been relatively stable in recent months
- Injection of liquidity through increased Government spending could place pressure on inflation and exchange rate as marginal propensity to import high in Nigeria

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MAKING GOVERNMENT INVESTMENT MORE EFFECTIVE

- To yield maximum returns from government investments in capital projects, implementation efforts stepped up
- Implementation of the 2009 capital budget as of March 2010 averaged 78.8% and efforts are underway to improve level of implementation in 2010 fiscal year
- Efforts made to remove identified bottlenecks to budget implementation by MDAs
- However, even with improved implementation, level of capital investment required too large to be borne by Government alone
- Hence, Government utilising PPP to fund large capital projects
- FGN passed the Infrastructure Concession and Regulatory Commission Act in 2005 and approved the National Policy on PPP in April 2009

END NOTES

- The 2010 Budget designed as a fiscal stimulus tool
- But some challenges have made it necessary to work with NASS to restructure budget
- Budget deficit of 4.75% of GDP above threshold in FRA but in line with global trends as means to stimulate economy
- To avoid adverse impact on macroeconomy, deficit needs to be managed carefully.
- Increased spending designed to target infrastructure
- Improved capital budget implementation efforts required
- Seeking alternative sources of funds to complement public investment, such as PPP
- These efforts will have a positive impact on output and employment

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