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The government prepares to introduce the 2015 budget amid economic turmoil caused by declining oil prices. The government twice reduces its benchmark price for oil and the Central Bank of Nigeria (CBN) devalues the naira by 8%. The two largest oil sector unions also begin strikes, resulting in fuel shortages. The opposition All Progressives Congress (APC) selects former military head of state Muhammadu Buhari (1983 – 1985) as its presidential candidate.

Declining oil prices cause turmoil before 2015 budget

Declining international oil prices have triggered economic turmoil in Nigeria, with a source in the government budget office confirming that the government was neither expecting nor prepared for the oil price drop.¹ The government has twice reduced its benchmark price for oil in recent weeks in line with international price falls, forcing the **Central Bank of Nigeria (CBN)** to devalue the naira (N). The finance ministry on 4 December announced that it had reduced its oil price forecast for 2015 to \$65 a barrel, an 11% decrease on its previous benchmark figure of \$73.² The ministry had, on 15 November, already revised downwards its earlier benchmark figure of \$78.³ The benchmark figure is key to annual federal government budgetary planning as the oil sector provides the state with the bulk of its revenue. On 16 December, the international Brent oil benchmark fell to \$58.50, approximately half the level it reached in June.⁴

The federal government will introduce its 2015 budget to the national assembly on 17 December. The fall in oil prices will seriously constrain all spending plans. The government will not want to cut expenditure substantially in the run up to February's national and state elections, as it could have immediate and negative political and economic ramifications for the ruling **People's Democratic Party's (PDP)** prospects, notably in the federal poll. But if government allows its overheads to increase without the income to meet them, this raises the risk of inflation in the short term and a worsening exchange rate in the longer term.⁵ The government may prefer to run a budget deficit in 2015 but this would not be sustainable into 2016.⁶ A broader decline in business activity, amid the expected general economic malaise due to the oil price fall, would further limit the government's ability to raise taxes.⁷

The budget office source confirmed that the federal 2015 budget will be lower than in 2014 due to the oil price reduction and the government's already-admitted failure to achieve non-oil revenue targets.⁸ This could, in theory, have a positive impact among the electorate and in the markets if the government chooses to rebalance its spending priorities and eliminate waste in the public sector.

¹ Source, budget office official, Abuja.

² Nigeria Guardian, 4 Dec 2014.

³ This Day, 15 Nov 2014.

⁴ FT, 16 Dec 2014.

⁵ Source, banker, Lagos

⁶ Source, banker, Lagos

⁷ Source, banker, Lagos

⁸ Source, budget office official, Abuja.

*"We've been spending more than 80% of our revenue on (the cost of) governance. The ratio of capital to recurrent expenditure of 80:20 or 74:26 is not good for any economy."*⁹

In the very short term, the government is likely to respond to the drop in its revenue by drawing upon the already-depleted **Excess Crude Account (ECA)** – in effect, Nigeria's oil revenue reserve. But this option would not be risk-free.

*"The main concern is the election and whether or not the PDP has the funds it needs to keep state governors onside. Instead of using the ECA as an insurance policy for [a crisis in the oil sector], the government has been using it to reward loyal governors and woo undependable ones. If the government [again] begins to draw upon the ECA for the benefit of governors in the north, it will anger [people] in the **Niger Delta** and then there is a very real risk of serious political violence."*¹⁰

The declining oil prices have depressed Nigeria's foreign reserves and the CBN is struggling to keep the naira within the new target band of 160 – 176 to the dollar that it introduced when devaluing the currency by 8% to protect its reserves.¹¹ The devaluation may make it harder for domestic banks to secure future borrowing (with existing **Eurobonds** currently trading at record lows), but they should be able to meet existing debt commitments.¹² **Fitch** has warned that the devaluation may make it harder for companies to service foreign currency debts owed to Nigerian lenders, which will impact on their asset quality.¹³

There is, however, limited risk to repayments in the banking sector. Much of their lending to the capital-intensive oil and gas and power sectors is in foreign currency. The naira's devaluation increases their asset values and the value of loans denominated in currencies other than the naira. But offshore portfolio investors are increasingly exiting¹⁴ and, in the longer term therefore, Nigeria's debt may be less attractive to investors. Foreign investors buying up debt has underpinned Nigeria's exchange rate in recent years, and the Nigerian government is banking heavily on them maintaining a similar level of interest.¹⁵

The CBN has intervened in the foreign exchange markets in December as pressure on the naira continues. The CBN has held regular foreign exchange auctions to lift the naira nearer to the target band and to curb naira liquidity. The naira has lost approximately 12% of its value against the dollar in 2014. This is putting additional pressure on foreign reserves. According to CBN data published on 28 November, Nigeria's foreign reserves stand at \$36.8 billion compared to \$44.6 billion a year ago.¹⁶ According to the budget office source,

*"We've believed in encouraging exportation and discouraging importation of goods to increase our foreign exchange earnings but it's not working."*¹⁷

Amid uncertainty about how sustainable the CBN's support of the naira will prove, there is also speculation that the state-owned **Nigeria National Petroleum Corp (NNPC)** may follow international oil companies in selling dollars. Over two days in December, **China-based Addax Petroleum** sold \$4.5m, **ExxonMobil Corp** \$36m and **Saipem SpA** \$15m to fund Nigerian operations.¹⁸ This suggests that currency fears are not so far leading to dollar stockpiling which would pose a further risk to liquidity. However, small and medium-sized enterprises in non-oil sectors don't have such options:

⁹ Source, budget office official, Abuja.

¹⁰ Source, western diplomat, Lagos

¹¹ FT, 25 Nov 2014.

¹² Fitch, 27 Nov 2014.

¹³ Fitch, 27 Nov 2014.

¹⁴ Vetiva Capital Management market analysis week ending 12 Dec 2014

¹⁵ Source, investment banker

¹⁶ CBN, 28 Nov 2014.

¹⁷ Source, budget office official, Abuja.

¹⁸ Reuters, 2 Dec 2014.

“What happens should the price drop further? Further devaluation? Companies that rely on imported raw materials and other inputs have to brace for more challenges ahead unless their products are highly elastic.”¹⁹

The turbulence in oil prices followed the **Organisation of Petroleum Exporting Countries (OPEC)** decision on 28 November not to cut production. During the same meeting, OPEC elected Nigeria’s petroleum minister **Diezani Alison-Madueke** as its president. A diplomatic source described this as “a good result”²⁰ for President **Goodluck Jonathan** (2010 – present) as it was becoming increasingly difficult for him to retain her amid serious and continuing corruption allegations (see *ARC Nigeria November 2014 Briefing*).

APC chooses Buhari as presidential candidate

The opposition **All Progressives Congress (APC)** selected former military head of state **Muhammadu Buhari** (1983 – 1985) as its presidential candidate on 11 December.²¹ Buhari is one of several credible candidates that the APC could have chosen but is unlikely to be able to challenge Jonathan’s power of incumbency.

Buhari is a Muslim northerner, who retains a strong and loyal following in the region,²² a key electoral consideration against southerner Jonathan.²³ His emergence as the APC candidate suggests he has a base of support, at least across traditional opposition heartlands.

“...with the primary victory of Buhari, I truly have faith that [the APC can win] because the powers that be have let this man win.”²⁴

This is a reference to Buhari enjoying the backing of the wider APC leadership, including former governor of **Lagos State, Bola Tinubu**. Tinubu’s “word is taken as decree on matters of regional politics in the southwest”²⁵ and his support is therefore crucial if Buhari hopes to unite the APC behind him.

Observers are looking back to Buhari’s previous time in power to analyse both his chances of victory and what a future Buhari administration may look like. His current aggressive anti-corruption stance may play well with the voters, especially in the south, but unnerve some APC financial backers (see *ARC Nigeria October 2014 Briefing*). Following Buhari’s 1983 coup against the notoriously corrupt President **Shehu Usman Aliyu Shagari** (1979 – 1983), Buhari prioritised the curtailing of corruption. His administration instituted a “*War against Indiscipline*”, with it being war in every sense of the word. Soldiers patrolled the streets with whips to police petty offences.

Austerity dominated Buhari’s economic policy as his government drastically reduced imports and cut civil service jobs.²⁶ The **International Monetary Fund** and the **World Bank** both offered loans to Nigeria that would help jumpstart the economy after oversupply of crude oil drove prices downwards, leaving a massive budgetary deficit that austerity alone could not cure. It was Buhari’s successor **Ibrahim Babaginda** (1985 – 1993) who accepted these international structural adjustment programmes, resulting in an increased inflow of capital and a restoration of services. The parallels between the 1980s and current economic uncertainty in Nigeria are uncanny, and Buhari will be able to point to a track record of some kind in dealing with economic crisis caused by declining oil prices.

¹⁹ Source, banker, Lagos

²⁰ Source, western diplomat, Lagos

²¹ Vangaurd, 11 Dec 2014.

²² This Day, 24 Sept 2014.

²³ Source, businessman, Lagos

²⁴ Source, banking professional, Lagos

²⁵ Source, analyst

²⁶ Source, journalist, Abuja

Buhari enters the election as second favourite to Jonathan and Jonathan's vice-presidential nominee, **Namadi Sambo**. Buhari's electoral record is not good: he has stood twice before and lost twice. And Jonathan's PDP enjoys the power of the incumbency (with access to state resources) and an effective electoral machine (see *ARC Nigeria November 2014 Briefing*). In addition, there are concerns about possible electoral fraud.

The one thing Buhari has going for him is that circumstances this time are different to his previous defeats. The consolidation of Nigeria's satellite opposition parties into the APC means that the opposition vote will no longer be split. Secondly, the fall in oil prices has reminded Nigerians of the corruption that flourished under Shagari and limited Jonathan's ability to distribute largesse. The surpluses achieved during the good oil price years of the 1970s, and which increased the national budget, disappeared rapidly in the cronyism and corruption of Shagari's administration.

Much could depend on who the APC selects as Buhari's running mate: speculation continues that it will be influential Lagos State governor **Raji Babatunde Fashola**. Fashola as a running mate would mean a track record in political and economic reform in Nigeria's business capital city. But there are doubts that Fashola would be attracted by the number two job:

*"If I was Fashola, I wouldn't touch the vice president position. It's easy to forget because of his influence that he's a relative newcomer to politics. Fashola would benefit from having four years of getting together a decent war chest for a run at the presidency next time around. I would let the APC lose [in 2015], and then sit back watching the PDP continue to mismanage the country – this is assuming that being free from worrying about electoral politics doesn't allow Jonathan to raise his game which it very well might – before emerging as Nigeria's saviour in 2019."*²⁷

The APC has selected **Akinwunmi Ambode**, former state accountant general, as its candidate to replace the outgoing Fashola as Lagos State governor.²⁸ A diplomatic source confirmed that Ambode is Fashola's choice and will act as a front for him: *"Ambode [would] allow Fashola to remain in control. He's a nobody."*²⁹

Oil workers' strike causes fuel shortage

The **Petroleum and Natural Gas Senior Staff Association of Nigeria** and the **Nigeria Union of Petroleum and Natural Gas Workers** began an oil sector strike on 15 December.³⁰ The strike is indicative of the higher risk of labour action as unions try to obtain concessions from the government in the run up to the election as well as pre-empting possible threats to their members from the slump in oil prices. The two unions are also protesting against delays to the passage of the **Petroleum Industry Bill** and overdue maintenance at state oil refineries. There is also popular pressure on the government to reduce (already-subsidised) fuel-pump prices amid declining international oil prices.³¹ The government on 12 December, in fact, decreased the petrol subsidy to N4.48 (\$0.024) per litre from its previous level of N7.93 (\$0.042) per litre.³² A similar strike in September caused disruption to levels of oil supply, with the government prioritising supply to domestic markets over regional exports. The strike has already caused fuel shortages in **Abuja, Lagos** and across **Bayelsa State**.³³ The NNPC has closed a number of its fuel stations.

²⁷ Source, western diplomat, Lagos

²⁸ This Day, 4 Dec 2014.

²⁹ Source, western diplomat, Lagos

³⁰ Leadership, 15 Dec 2014.

³¹ Reuters, 16 Dec 2014.

³² Punch, 16 Dec 2014.

³³ Reuters, 16 Dec 2014.

Implications

Nigeria's economy will become increasingly vulnerable to the risk of inflation, exchange rate volatility and savings stagnation. Debt servicing costs will rise further, increasing government budgetary pressures. If the price of oil remains at current levels or continues to drop, there will be an increased risk of the government defaulting on its payment obligations and credit-rating downgrades. The decline in oil prices is an opportunity for the government to be more prudent in future, to become less reliant on commodities for its revenue and embark on subsidy reform; but this will require political will and time, neither of which the February 2015 election allows for.

Buhari's candidacy is unlikely to influence current analyst forecasts of a narrow defeat for the APC in the election. Despite Jonathan's unpopularity and the failure to curtail the **Boko Haram** insurgency, the PDP electoral machine and its resources should be sufficient to see Jonathan re-elected. The Boko Haram insurgency will aid Jonathan's electoral fortunes, with security threats liable to deter large numbers from voting in Buhari's northern heartlands, though it could create procedural headaches for election administrators. Much is contingent upon Jonathan being able to offer sufficient economic concessions to governors in key states that he needs to win, despite the declining oil prices. If he is unable to do so, a platform of Buhari and Fashola (if he contests) could pose a real electoral threat.

The strike is indicative of the need for structural reforms in Nigeria's fuel sector. This would necessitate restructuring of the fuel-subsidy programme; but Jonathan will not consider this until after the 2015 elections, if at all.