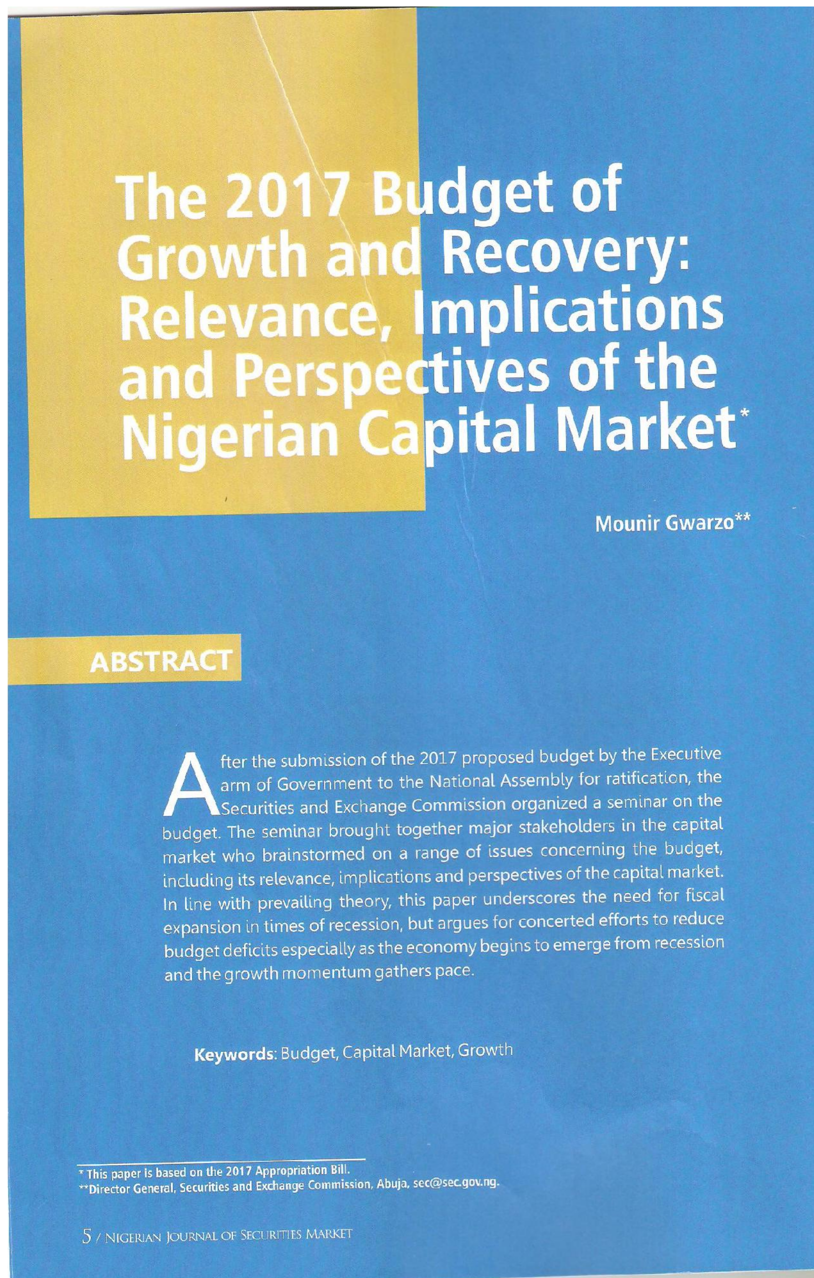

# The 2017 Budget of Growth and Recovery: Relevance, Implications and Perspectives of the Nigerian Capital Market*

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## ABSTRACT

After the submission of the 2017 proposed budget by the Executive arm of Government to the National Assembly for ratification, the Securities and Exchange Commission organized a seminar on the budget. The seminar brought together major stakeholders in the capital market who brainstormed on a range of issues concerning the budget, including its relevance, implications and perspectives of the capital market. In line with prevailing theory, this paper underscores the need for fiscal expansion in times of recession, but argues for concerted efforts to reduce budget deficits especially as the economy begins to emerge from recession and the growth momentum gathers pace.

**Keywords**: Budget, Capital Market, Growth

* This paper is based on the 2017 Appropriation Bill.

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# 1 Introduction

In December 2016, the Executive arm of Government submitted to the Senate the budget for 2017 for its consideration and passage into law. The budget is intended to foster economic recovery and growth. There is an intimate connection between the capital market and national budget, each feeding on the other in a mutually beneficial way. For example, budget deficits could be financed in part from bond issuance or privatization (especially when executed through share floatation). National budgets when they are properly implemented, could promote macroeconomic growth and stability, both of which could have significant positive influence on the capital market.

The effect of government budget deficit on the capital market is theoretically ambiguous. This is because deficit can influence the capital market directly as well as indirectly through a number of other macroeconomic variables. In the Keynesian argument, increase in government deficit is expected to raise aggregate demand in the economy and raise the national income. Listed companies that execute government contracts can therefore benefit directly from higher government spending. Equally, the capital market can benefit indirectly from general improvement in economic activities through improved household spending and higher expected cash flows (Roley & Schall, 1988).

Budget deficit can also affect the capital market indirectly through the interest rate channel. An increase in budget deficit often results in government issuing more bonds, lowering bond prices with the attendant increase in interest rate. The higher interest rate often 'crowds out' private investment by raising cost of funds available to companies. Since stock prices also reflect companies' discounted future earnings, increase in interest rate raises the discount rate and this will further depress firms' performances and their stock prices.

Another indirect way that deficit may affect the capital market is through its effect on inflation rate. In an environment of close to full employment, an increase in budget deficit often fails to proportionately raise aggregate output; but instead may lead to higher inflation rate. Given that increase in inflation is generally seen as an indication of uncertainty in future cash flows of companies, this lowers the current value placed on the stocks of companies.

Therefore, the net effect of budget deficit on the capital market depends on balancing the various direct and indirect effects via increase in economic activity, interest rate and inflation rate.

Theoretical issues on the relation between the economy and fiscal measures have predictably attracted attention in the literature. Again, the Keynesian view posits that expansionary fiscal measures, if properly implemented, could raise output and employment. The opposite view is that large budget deficits could be harmful as they

raise interest rates thereby crowding out private sector investment. In fact, countries facing large fiscal deficits have been advised to embrace the process of fiscal consolidation, a term used to denote tax hikes and/or reduction in government expenditure. A number of studies such as Ball and Loungani (2011) stress the short term pains of fiscal consolidation. They argued that in the short term, such consolidation could reduce output but that over the long term, as deficits fall, interest rates would fall, crowding in private sector investment and boosting growth. Ball, Leigh and Loungani (2013) note the long term benefits of such consolidation but argue that in the short term their distributional effects could be severe. The IMF (2010) also argues in favour of fiscal consolidation because in addition to lowering interest rates and reducing the burden of debt, such measures have the prospects of improving investment and growth in the long term.

This paper intends to further the understanding of the direct and indirect ways in which government expenditure may affect the capital market. To achieve this objective, the rest of the paper is organized into five sections. Section two begins with a snapshot of the budget, stressing its major components, both from the expenditure and revenues sides of it. Section three analyzes the past budget projections while section four assesses the direct and indirect effects of the budgets on the capital market. Section five reviews recommendations of the roundtable on the 2017 budget, while section six concludes the paper.

# 2 Snapshot of the 2017 Appropriation Bill

The 2017 proposed budget was for a total sum of N7.3 trillion, twenty per cent higher than the corresponding figure of N6.06 trillion for 2016. A breakdown of the budget shows a recurrent expenditure of N2.979 trillion, representing 40.81% as shown in Figure 1. Capital expenditures totaled N2.058 trillion, or 28.21%. As the figure shows, debt service is high, projected at N1.841 trillion or 25.23% of total. The figure also shows the statutory transfers, allocated N0.419 billion, account for 5.74%.

The Federal Government's share of the budget is projected at 52.68%, with states and local governments jointly projected to receive 47.32%. Although the budget figure accounts for 6.58% of the country's GDP, the government really has significant scope for influencing the course of the economy. The budget identifies seven major priority ministries, which include Works, Power and Housing for which a sum of ₦564.21 billion was allocated. Others are Interior (₦545.63 billion), Defense (₦465.49 billion), Education (₦448.44 billion) and Health (₦304.19 billion). The Transport and Agriculture ministries were allocated ₦276.86 billion and ₦123.44 billion, respectively.

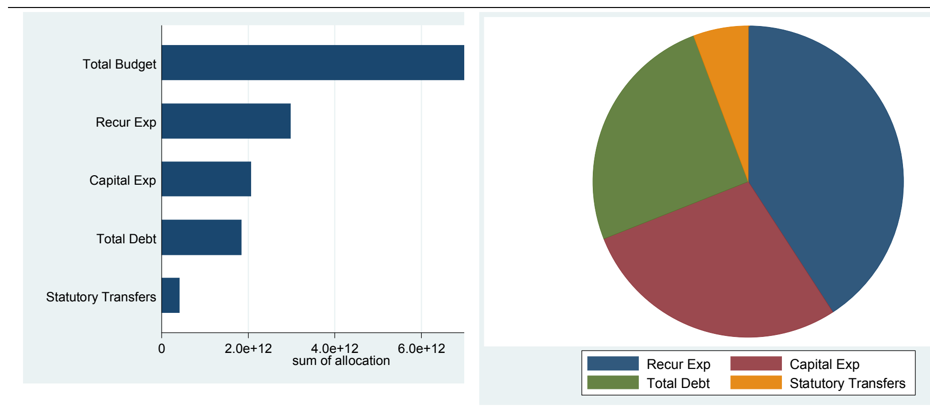


Figure 1: The 2017 Budget: Size and composition

*Source: Author's computation*

One other aspect of expenditure side of the budget is in relation to the initiatives, a number of which are worth mentioning here. Infrastructure development is a major initiative, and efforts in this direction are becoming more noticeable with the rehabilitation of major roads across the nooks and crannies of this country. Social programmes involving monthly stipend to hardcore poor are part of the initiatives the budget has proclaimed to pursue. Others are railway and airport concessions, presidential amnesty programme, support for export processing zones and a 20% reduction in overhead costs. There are other sets of initiatives contained in the budget such as alternative to Joint Venture Cash Call; expansion of Primary Health Care and National Health Insurance Scheme; and credit to SMEs through the Bank of Industry and Bank of Agriculture as well as access to agricultural inputs to boost the sector.

A second issue regarding the snapshot of the budget is in relation to revenue projections. According to the budget, a total of N4.94 trillion is the projected revenue, 28% higher than the corresponding figure for the previous year. The revenue projections are based on crude oil benchmark of US$42.5 and a daily production of 2.20mb/d. Crude oil price projection is easily attainable given that for the first quarter of 2017 crude oil prices have hovered above US$50/b and the prospects for them to maintain this recovery are bright. At the same time, quantity projections can be attained as progress is equally bright in overcoming security challenges in the oil producing regions of the country. While crude oil was projected to contribute nearly half of the budget in 2015, the 2017 budget expects the commodity to contribute only 40%. This is a good development for a country that wishes to reduce its dependence on the non-renewable, exhaustible resource. With revenue projections falling short of those for expenditure, the government seeks to run a deficit, which in

the 2017 budget amounts to N2.3 trillion. Government seeks to raise 54% of the shortfall from the domestic economy, and 46% from outside sources. Initiatives aimed at covering this revenue shortfall include the US$1billion Eurobond; the Sukuk bond, Green Bond, Diaspora bond, and a World Bank loan.

## 3 Past Budget Projections

The pattern of budget projections over the last eight years is presented in Figure 2. The figure shows the trend in total projections for expenditure, revenue, capital revenue and budget deficits (the balance between total expenditure and revenues). Three observations can be made in relation to the first panel of Figure 2. One, over time, federal government projected budget expenditures have risen from less than N3 trillion in 2008 to hover above N6 trillion by 2017. Second, throughout the period, projected expenditure has always exceeded revenues, implying a deficit. As Figure 2 reveals, the budget deficit projections have remained fairly stable, except in 2010 on the eve of the general elections. Compared to their levels in 2016, deficit projections for 2017 have remained stable, at slightly above N2 trillion.

Third, with its focus on three priority issues of security, employment creation and fighting corruption, the modest rise in the deficit, as the figure shows, can be understood. Moreover, earnings from the mainstay of the economy – crude oil – have nosedived although recovery from the commodity looks set to continue in 2017 and improve in the coming years.

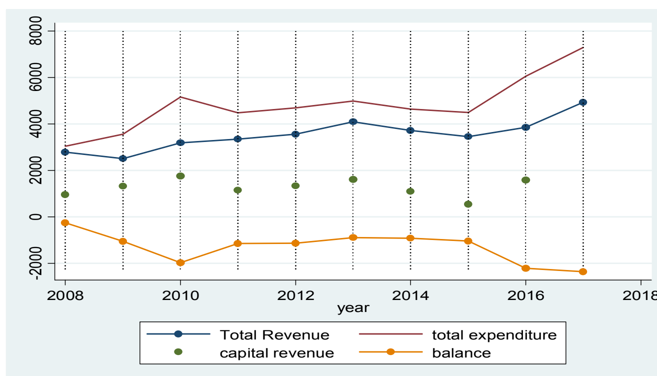


Figure 2: Trends in Government Budget Expenditure and Revenue Provisions

*Source: Author's computation*

Figure 3 shows the size of federal spending, both as a proportion of GDP (first panel) as well as in relation to market capitalisation (second panel). As the figure shows, the size of federal spending is of concern for the capital market. As a proportion GDP,

government expenditure accounts for a small proportion, hovering below 6.5% for the last 9 years. Clearly, there is a downward trend, with Federal Government expenditure accounting for smaller proportion of GDP over time. In 2012, for instance, it accounted for more than 6% of GDP, falling to 4.4% in 2016. Nevertheless, relative to the size of the capital market, government expenditure is huge, accounting for more than half of total market capitalisation for the most part of the last decade.

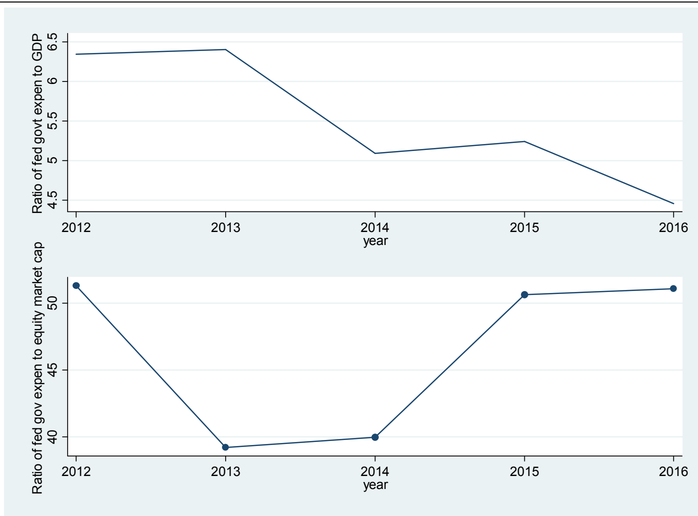


Figure 3: Relative size of federal expenditure

*Source: Author's computation*

# 4 Budget and the Capital Market: Direct and Indirect Effects

National budgets are predicted to exert direct and indirect impacts on the capital market. When budgets allow direct purchase of goods/services on listed companies, this will have a direct effect on the capital market, helping to boost confidence on the affected companies and in that way on the market. As Figure 4 shows, there are in addition, the indirect effects of budgets on the capital markets. An example of an indirect effect is when the budget helps to stimulate economic growth, which in turn boosts household and corporate earnings, both of which could restore confidence in the capital market. In addition, when such budgets are used to finance cost-reducing infrastructure, the effects on the capital market could be positive as well. As for the bond market, the direct effects could be mixed. On the positive side, there is the tendency for budget deficits to stimulate issuance of bonds, helping to boost

the capital market. A challenge however is when the deficit is wide and government issues bonds at interest rates that would crowd out private investment.

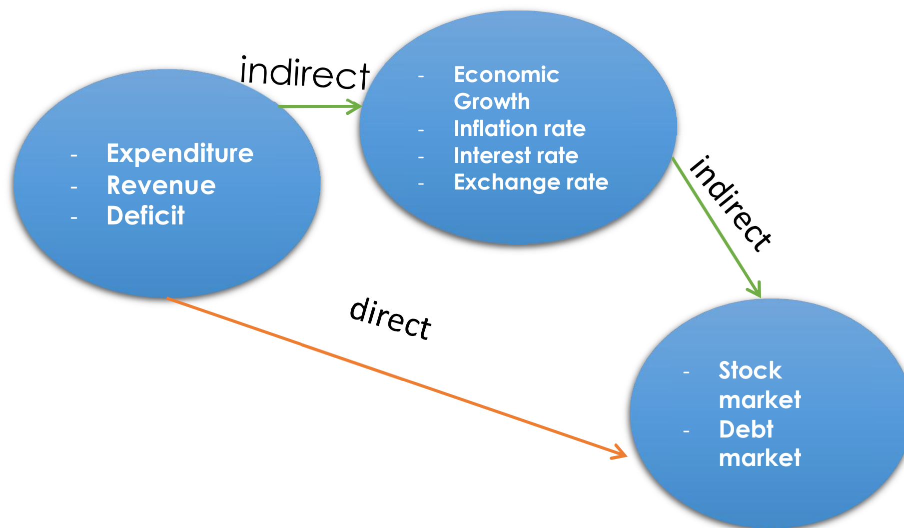


Figure 4: Direct and Indirect Effects of Budget on the Capital Market

However, the indirect effects of budgets on the capital market could be negative when they put upward pressures on inflation and interest rates, or cause uncertainties in the foreign exchange market. Inflationary spiral could be a cause and consequence of exchange rate bubbles and the net effect of such pressures could be negative on the capital market.

Thus far we have looked at the theoretical links between the capital market and budget. Using historical macroeconomic data for Nigeria, a visual appeal could be gained about the direct and indirect effects. Figure 5 shows that over the last 16 years, government expenditure has correlated well with GDP growth. The figure therefore is a graphical representation of the indirect relation between government expenditure and capital market since macroeconomic growth is predicted to have a direct effect on the capital market.

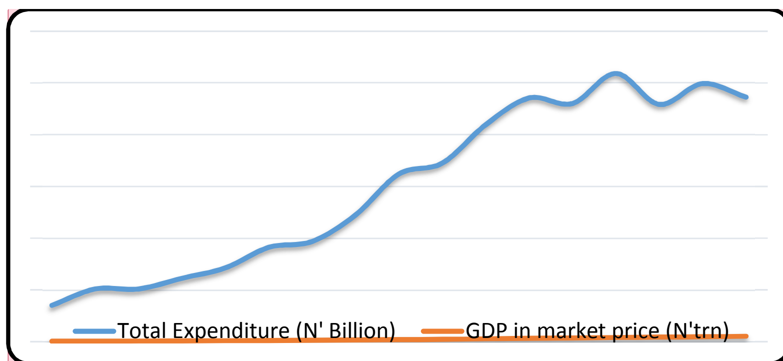


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Figure 5: Trend of Government Expenditure and Growth

## 4 Recommendations of the 2017 Budget Seminar

For the first time in several decades, the SEC organized a seminar on the national budget. The aim was to bring together major stakeholders in the capital market to brainstorm on the relevance of the 2017 budget to the capital market. A number of important recommendations came out when a communiqué was adopted at the end of the seminar. It is therefore important to take this opportunity to present highlights of the recommendations that emanated from the seminar.

First, participants saw the need for government to keep a tab on deficit financing since high budget deficits tend to increase the cost of borrowing. Second, investor education efforts particularly on the role of capital market in economic development should be strengthened and widened to include targeting the policymakers, practitioners and the academics.

Third, in order for the capital market to more effectively meet the challenges of the time, the seminar underscored the need to further develop and deepen the market by introducing (i) products that provide hedging opportunities for domestic and foreign investors and (ii) alternative asset classes such as infrastructure bonds, retail bonds and interest derivatives that would maximize the value of the market to investors and market operators.

Fourth, as pension contributors are of varying age groups and therefore have different capacities for risk exposures, participants recommended that National Pension Commission and Pension Fund Administrators should take active steps to encourage the creation of pension investment portfolios that are more diversified by exposing younger workers to take a greater percentage of equities since they have a longer time horizon to invest.

Fifth, privatization of government owned assets is a quick win, having strong potential to release funds from government handouts of ailing enterprises to facilitate funding of critical capital projects, especially infrastructure. The Federal Government should set specific timelines to identify the assets to be sold and ensure that the capital market is given a much more active role to play in privatization exercise. This would create efficiency as scarce resources being committed to manage these assets can be freed up and channeled to critical sectors of the economy.

Finally, government should elicit Public-Private Partnership (PPP) in developing infrastructure. There should be proper legal and regulatory frameworks to ensure that each party in these partnerships is held accountable for their parts of the agreement. Advocacy efforts are required to make the PPP arrangements more acceptable to the general public whose buy in is critical for the success of such arrangements.

# 6 Concluding Remarks

Though Nigeria remains an open economy, the role of government in stimulating the economy is indispensable. The 2017 Federal Government Budget was tagged the budget of “Growth and Recovery”, coming against the backdrop of an economic recession that started in August 2016. Given the critical role of the capital market plays in any economy, the paper assesses the direct and indirect links through which government budget affects the capital market and the economy. Within the context of macroeconomic theory, this paper traces the theoretical underpinnings of the links between capital market development and government budgets. Further, on the basis of historical data and graphical expositions, this paper demonstrates the various ways in which national budgets affect the capital market in Nigeria – directly through boosting the activities of listed companies and indirectly through cost reduction achievable from investment in critical infrastructure. A key recommendation is the need to keep a tab on budget deficits which could be done in a number of ways such as: The strengthening of Public-Private Partnership Schemes.

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