NIGERIA'S ECONOMIC OUTLOOK IN 2017

Ayo Teriba
CEO, Economic Associates
ayo.teriba@econassociates.com

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ABSTRACT

The economic events of 2016 taught us a lot of hard lessons about Nigeria's interface with the global economy, and the links with domestic growth, stability and policy responses. This paper attempts to distil some of the lessons and clarify the outlook.

Weak commodity prices brought Nigeria's growth to a very abrupt end and inflicted heavy bouts of devaluation of the Naira. The downturn tested our counter-cyclical policy capability and revealed weaknesses in both fiscal and monetary responses.

Falling revenue constrained counter-cyclical fiscal response, while the central bank pro-cyclically hiked rates twice in the year, and further amplified the downswing by obstructing legitimate foreign exchange transactions, while, it could easily have eased rates and sought increased capital inflows to counter the downswing, as the oversubscription of Nigeria's Eurobond issue has now revealed to be an option.

Nigeria needs to look beyond exports as a source of external financing, and boost foreign investment inflows. Nigeria is currently very closed to foreign investment as many large infrastructure sectors that could be major investment destinations remain under government monopoly.

Nigeria needs to break government monopoly across all infrastructure sectors, including rail transportation, power transmission, gas pipelines, oil refining, education and health, among others, and take immediate practical steps to open them up to foreign investment now.

Weaknesses in rail transportation and energy infrastructure makes agriculture, mining and manufacturing uncompetitive in Nigeria. Rebuilding rail transport and energy infrastructure by opening them up to foreign investment now will revive agricultural, mining and manufacturing production and exports in the medium term, and make the Nigerian economy more resilient to global shocks.

Although the cyclical tide has turned upward to brighten the outlook in 2017, boosting foreign investment inflows and rebuilding nationwide rail transport and energy infrastructure immediately is still required to ensure stability in the future, release Nigeria's latent growth energies, and ensure brighter long term economic outlook.

CONTENTS

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1. CYCLES: *Global Gluts and Nigeria's Growth and Stability*

Nigeria's economy came to be defined by recession and devaluation in 2016, pressing home the point that Nigeria's growth and exchange rate stability in the decade and half from 2000 to 2014 had been entirely dependent on favourable global commodity cycles. Weak commodity prices brought Nigeria's growth to a very abrupt end and inflicted heavy bouts of devaluation in the value of the Naira. It should be noted that Nigeria's growth would have been more resilient if Nigeria had a better rail transport and energy infrastructure that would have underpinned higher value addition in industry.

Both the recession and devaluation resulted from the foreign exchange shortage inflicted by the collapse in Nigeria's annual exports receipts from about US$100 billion up till 2014, to less than US$50 billion since 2015, because of the fall in oil price. Nigeria's dependence on export receipts as the sole source of external financing made the country more vulnerable than countries who receive large diaspora remittances and large FDI inflows in addition to exports revenue. A major learning point for Nigeria is that larger capital inflows would have made the oil price fall less hurtful.

Global trade flows are slowing because of global commodities supply glut, but global financial flows are growing because of global liquidity glut created by leading central banks. Past Nigerian governments and the central bank of Nigeria have been historically transfixed on external trade flows, while being largely oblivious of external capital flows. Nigeria now needs to take steps that reflect the realization that opportunities to grow exports are currently limited by global commodity glut, while opportunities to grow capital inflows are more abundant, given global liquidity glut.

There is an urgent need to increase the global rank of Nigeria as an investment destination now that the global liquidity glut presents the opportunity to do so. Inward FDI stock of US$20 billion in China was just about twice as large as Nigeria's US$8.538 billion in 1990. China now hosts US$1.1 trillion compared to Nigeria's paltry US$89 billion. India hosted a measly US$1.656 billion FDI stock in 1990, just about a sixth of Nigeria's stock at the time, but now hosts nearly US$300 billion, more than three times as large as Nigeria's stock today. Both South Africa and UAE have, like India, come from behind to now host more FDI than Nigeria.

India and China had each received remittances of about US$22 billion in 2005, compared with Nigeria's US$15 billion. That margin of US$7 billion in 2005 has widened to US$50 billion in 2015, as India received US$70 billion and China received US$68 billion, compared with Nigeria's US$20 billion[1]. Both countries' growth, stability and export successes depend on their successes in attracting foreign capital inflows. India's current account deficits are more than compensated for by capital account surpluses that are twice as large.

Trade reforms, such as export promotion or import substitution, take five years or much more to yield results. In contrast, foreign investment reforms, such as Eurobond issuance, diaspora bond

[1] FDI figures are from UNCTAD's 2016 World Investment Report, while Remittances figures are from World Bank's online remittances database.

issuance, brownfield/greenfield foreign direct investment inflows into infrastructure sectors that are currently under government monopoly, begin to yield results within a year. Nigeria's experiences with FDI inflows into telecoms and the recent US$1 billion Eurobond issue show that capital can flow in shortly after necessary steps are taken.

2. SECTORS: *Farms, Factories, Cities*- Where is the money?

Nigeria's nominal GDP stood at N101 trillion in 2016[2]. This was made up of: N64.9 trillion or 64 percent in Services; N21.5 trillion or 21 percent in Agriculture; N5.5 trillion or 5 percent in Oil; and N9.7 trillion or 9.5 percent in Non-Oil Industry (Manufacturing, Solid Minerals and Utilities). Thus, services now supply nearly two-thirds of economic activities, agriculture supplies one-fifth, non-oil industry supplies one-tenth and oil supplies one-twentieth.

The nominal GDP increased by N7.45 trillion in 2016. This came from the increase of N6.14 trillion or 82 percent in Services, N1.89 trillion or 25 percent in Agriculture, -N500 billion or -6.9 percent in Oil, and -N60 billion or -0.78 percent in Non-Oil Industry. Thus, services supplied most of the growth, with agriculture playing a supporting role, while oil and non-oil industrial activities declined. Nigeria's Cities supply most of the growth, with the Farms playing a supportive role, while the factories are in decline because of *foreign exchange shortage* and *infrastructure decay*.

Most inward foreign direct investment in Nigeria currently end up in telecoms, oil & gas, and banking[3]. Government urgently needs to open other sectors that have huge potentials to attract and retain large investments, such as rail transportation and energy (including power transmission, gas, and petrol). The Federal government must take immediate steps to open these sectors for large foreign equity investments, as was done in telecoms, oil & gas and banking.

Nigeria's sectoral strengths include:
- *agriculture* (21 percent of GDP in 2016),
- *crude oil extraction* (5.5 percent of GDP),
- *services* (64 percent of GDP), especially trade, telecoms, real estate and professional services.

Nigeria's sectoral weaknesses or *the missing middle* include:
- *mining* (weak in extracting abundant mineral resources), and must import minerals;
- *manufacturing* (weak in processing agricultural, minerals and crude oil resources), and therefore imports processed food, raw materials, intermediate goods (especially chemicals), fuel, minerals and finished manufactured items (especially machinery, electronics, and automobiles);
- *utilities* (weak in distribution of abundant gas resources for domestic and industrial use) we flare or reinject the gas, weak in the generation, transmission and distribution of electricity, weak in the purification and distribution of water;
- *transportation* (weak road, rail, water, and air transportation, especially weak in rail).

Weaknesses in transportation and utilities make manufacturing and mining uncompetitive, and hinder a big fraction of agricultural out from leaving the farm. Nigeria first needs to ensure that inputs and output can get to and leave factories and farms at the least possible costs, and ensure steady supply of electricity, gas, petrol, and water, before talking about treating agriculture, mining or manufacturing as priorities. Failures in transportation and utilities currently make agriculture,

[2] National Bureau of Statistics, Q4 2016 GDP Figures.
[3] National Bureau of Statistics, Nigerian Capital Importation, Q4 2016.

mining and manufacturing uncompetitive in Nigeria. We must therefore make rail transportation and energy infrastructure, public works, education and health our sectoral reform priorities.

3. **STATES:** *Sectoral and Fiscal Strengths.* Where in Nigeria?

There is always the pressing need to demonstrate where in Nigeria can the largest growth and investment opportunities be found by investors, and where in Nigeria would government officials and development partners find the biggest opportunities for making things better. A breakdown of national GDP and sectoral aggregates across the 36 States and the FCT provides such insights[4].

Sectoral activity continues to be regionally concentrated in a few states, to the exclusion of most States. Three states account for 66.64 percent of the huge service sector output. Eight States account for 75.84 percent of the agricultural sector output. Six states account for 84.68 percent of non-oil industry output. Nine states produce oil, but 89 percent of it comes from four states. Rebuilding rail transportation and energy infrastructure across the country will reduce sectoral concentration and make growth more regionally inclusive.

About half of the states are dependent on services, up to 90 percent in some cases, while about one-third of the states are dependent on agriculture, up to 80 percent in some cases. States must therefore either concentrate on creating more wealth in services, such as making cities more competitive, as Lagos is already doing, and/or concentrate on creating more wealth in agriculture, by making farms more competitive, until infrastructure that must underpin wealth creation in industry are rebuilt to permit the option of creating more wealth in industry.

Continued growth of Services and Agriculture in 2016 meant that States with relatively large shares of Services and Agriculture were insulated from the nominal contraction in economic activity, which was confined to Industry (both oil and non-oil). Thus, economic and fiscal conditions deteriorated markedly across states with relatively large shares of Industry and relatively small shares of Services or Agriculture.

States received N2.859 trillion in total revenue in 2015, this was N1.05 trillion less than the 3.905 trillion they had received in 2013. The fall in states revenue came from the slump in statutory allocation by N620 billion from 2.1 trillion in 2013 to 1.48 trillion in 2015 and the collapse in excess crude allocations from N560 billion in 2013 to N5.8 billion in 2015. While central allocations to states decline, internally generated revenues increased by N99 billion from N657 billion in 2013 to N756 billion in 2015, and value added tax receipts stayed just about the same over the two years at N381 billion in 2015, down by only N8 billion from N389 billion in 2013.

The statutory allocations of N1.48 was 51.86 percent of states' total revenue in 2015, IGR of N756 billion was 26.4 percent, VAT of 381 billion was 13.3 percent, and other revenues of N239 billion was 8.4 percent. While states got an average of 51.86 percent of their total revenues from central allocations in 2015, three of the states, Lagos, Enugu, and Ogun, relied much less on the federation account, with Statutory allocation respectively providing just 10, 30 and 34 percent of their total revenue, while internally generated revenue supplied 68.62, 53.13 and 50.13 percent of total receipts, respectively.

Those were the only three states who received considerably less revenue from the centre than they raised from within. 16 states (including FCT) got between 45 and 59 percent of their funding from the centre, while the remaining 18 states depended on the centre for 60 to 80 percent of their total receipts. Many of the states with the highest IGR/Total revenue ratios are service-led, suggesting

[4] Economic Associates, 2016 Sectoral Estimates for the 36 States the FCT States, March 2017.

that the continued growth of the service sector offered fiscal resilience, and that services are easier sources of revenue for states than agriculture or industry. Many of the states with the lowest IGR/Total revenue ratios are agriculture-led, suggesting that states need to learn how to generate internal revenue from their agricultural sectors.

4. **POLICY:** *Macroeconomic Policies and the Economic Recovery and Growth Plan*

The cyclical downturn of 2016 tested the countercyclical policy capability of the Nigerian government and revealed weaknesses in both fiscal and monetary responses. Apart from growth and stability, the other cyclical casualty was government revenue. It declined with the slump in oil price, constraining government's ability to provide counter-cyclical fiscal stimulus in the face of the recession. The central bank also found reasons not to provide any counter-cyclical monetary stimulus, pro-cyclically hiking rates twice in 2016, and just standing aloof and watching by holding all policy instruments on the other four occasions that the Monetary Policy Committee (MPC) met.

Nigeria has now put together an Economic Recovery and Growth Plan 2017-2020 (ERGP). The plan however blurs the line between what the government had intended to do before the recession and devaluation blew it all out of track, and an urgent crisis response package that is required to confront the recession and devaluation and lift Nigeria out of the crisis[5]. The projections in the plan do not include any action steps or any likely dates that such steps will be taken. The plan is also not backed by any legislation. Nigeria needs a swift action plan that is backed with appropriate legislation, and it might have been better to separate the crisis response package from broader economic plans of the government, so that the crisis response efforts can receive required urgency.

At a minimum, the following actions must be included in Nigeria's crisis response package:

i. First, Nigeria needs to reduce dependence on exports by opening to diaspora and FDI inflows, especially into government coffers, or into infrastructure activities that are currently under government monopoly. Currently most of the non-export external resource inflows into Nigeria are small and stagnant *private-to-private flows*. Diaspora remittances flow entirely to private recipients, and are on the current account. Some developing countries have successfully created a parallel *private-to-government streams of remittances* on the capital account by issuing large multiyear diaspora bonds. Also, some governments succeed in getting *private-to-government FDI inflows* by allowing investors to have a growing stake in infrastructure services that were previously under government monopoly. Nigeria urgently needs to join the frays, and a credible plan must commit to specific steps that will be taken to make these happen, and commit to specific dates that the steps will be taken.

ii. Second, Nigeria needs to rebuild rail transportation and energy infrastructure nationwide to make agriculture, manufacturing and mining more competitive. Services currently boom in Nigeria, and is growing as a share of GDP, in the face of stagnation in the share of agriculture in GDP, and a decline in the share of oil and non-oil industry in GDP. Rebuilding rail transport and energy infrastructure through increased foreign investment ought to be the number one priority of Nigeria today.

iii. Third, government should break its own monopoly in all infrastructure sectors, especially rail transportation and pipelines, power transmission, health and education, and give foreign investors a larger role in funding and managing the sectors as we have beneficially done in oil

[5] The Economic Recovery and Growth Plan (ERGP) is based on the Strategic Implementation Plan (SIP) that codified government's intentions ahead of the crisis, and such embodies little or no crisis responses.

& gas and telecoms. Immediate steps must therefore be taken to repeal monopoly laws across infrastructure sectors.

5. OUTLOOK: *Cycles vs. Policies*

2016 was lost to cyclical downturn

Policies lost to cycles in 2016 as there were no counter-cyclical fiscal or monetary policy responses to the recession and devaluation. Despite a lot of public debate about stemming the slide, and several public acknowledgements of government's desire to intervene, long response-lag meant economic conditions deteriorated throughout the year. Real GDP declined in all the four quarters, Naira weakened throughout the year despite administrative efforts and executive orders by the central bank aimed at obstructing legitimate foreign exchange transactions, and inflation soared.

The Cyclical Tide is Turning Upward in 2017

Despite the constraints on policy responses in 2016, cycles are now on the upturn in 2017, and the recession, inflation and weakness of the Naira are most likely to fizzle out. Oil price has risen from a low of US$28 per barrel in the first quarter of 2016 to US$55 in the first quarter of 2017, external reserves have risen steadily for six months to climbed above US$30 billion by March 2017, after reaching a low of US$23.9 billion in October 2016.

The oil price is likely to average about $55 in 2017. Government also expects oil production to be stable at 2.2 million barrels per day in 2017 as expressed in the federal budget proposals. The outlook for growth, inflation and exchange rate is brightened by this.

The parallel market rate is beginning to appreciate in response to improvements in the central bank's capacity to supply foreign exchange, with the parallel market rate rising to N380/US$ in March 2015, after touching an all-time low of 520/US$ the month before. If the oil price holds up at the current level and external reserves continue to grow, the parallel market rate will continue to appreciate until it converges with the inter-bank rate.

Both rates started to diverge after external reserves dropped below US$36 billion in November 2014, forcing the CBN to close its Wholesale Dutch Auction (WDAS) window and devalued the interbank rate from N150/US$ to N197/US$ by February 2015, only for the parallel market premium to widen steadily as falling reserves signalled weakness of the CBN to meet demand. CBN was forced to devalue the interbank rate again in June 2016, but premium continued to widen to signal unease.

Between the two devaluations of the inter-bank rate, CBN introduced a lot of obstructionist policies to suppress demand, like forcing recipients of inward remittances to receive their funds in Naira at the controlled inter-bank exchange rate, restricting foreign currency transactions on accounts held with Nigerian banks, and publishing an infamous list of 41 import items that would not be funded by CBN. Such demand restrictions amplified the cyclical downswing and triggered the recession.

A better response would have been for the CBN to look beyond the current account and boost foreign exchange inflows on the capital account to counter the downswing. The problem was the sharp drop in foreign exchange supply that a fall in oil price from US$110 per barrel in 2014, to US$53 in 2015, and US$28 in the first quarter of 2016 implied. Boosting supply would have been a better way to stabilise the market than restricting demand to amplify the downswing, or attempting to float the exchange rate in the face of the supply shortfall as the CBN did.

Now that the external reserves are rising, the central bank is beginning to drop some of its administrative restrictions and is likely to continue to do so once reserves keep rising, until we get back to a threshold of US$36 billion in external reserves when a stable supply can be assured, and the rates in the markets will converge. The central bank can be trusted to drop it list of prohibited items as we approach that point. Seeing external reserves above the US$36 billion threshold could even mean a reopening of the WDAS window of the central bank. The central bank should not be tossed up and down by cyclical swings.

From less than 10 percent in January 2016, year-on-year *inflation rate* rose sharply between February and May 2016, because of devaluation and other costs shocks like the upward adjustments in electricity tariffs and pump prices of petroleum products, but kept rising alarmingly towards 19 percent by January 2016, because of low base effects. Expectedly, it should decline as sharply as it rose from February, as already happened, through May 2017, as the base effects get corrected.

While the recession had intensified between the first and third quarters of 2016, it abated in the fourth quarter, and should abate further in the first quarter of 2017, if not end altogether, paving the way for a *resumption of growth* from the second quarter of 2017.

Policies can still brighten the outlook further

The economy already is on the upturn, even in the absence of any counter-cyclical fiscal, monetary, or investment policy responses. The outlook for 2017 is now brighter than the contractions of 2016 for purely cyclical reasons. During 2017, most economic variables, real growth, inflation and exchange rate, can be expected to improve towards conditions prevalent in 2015 when inflation was just below 10 percent, real growth was just below 3 percent, and the naira exchange rate was about N200/US$.

The bright outlook could be threatened by any adverse shock to oil price or oil production. Both fell in 2016 to inflict the hardships faced that year. The outlook in 2017 is better because both have recovered to levels last seen in 2015[6]. The brighter outlook will be premised on both holding up throughout 2017. But it is reasonable to expect that they would. If they do, Nigeria can expect a resumption of growth, a moderation of inflation, a return of stability to the foreign exchange market, a convergence of exchange rates, and a sustained strengthening of the inter-bank rate.

Nigeria's recovery in 2017 is currently premised on luck, cyclical upturn, rather than hard work, countercyclical policies or economic reforms. Assuring the sustenance of the recovery will require more than luck. Policies would be required to open Nigeria up for investment inflows that will rebuild rail transportation and energy infrastructure now, and create much needed external reserve buffers that would help Nigeria withstand future cyclical swings.

[6] Nigerian government deserves credit for the recovery of both oil price and output. On the global scene, a representative of the Nigerian government, His Excellency, Mohammad Sanusi Barkindo, the Secretary General of OPEC, was instrumental to the agreement by OPEC and 11 non-OPEC members on the production cuts that are widely acknowledged to have lifted price in the face of global glut. Back home, the Nigerian government dialogued with Niger-Delta nationalist groups to bring an end to the attacks on oil installations.

AYODELE OLALEKAN TERIBA

Ayo is the *CEO* of *Economic Associates (EA)* where he provides strategic direction for ongoing research

and consulting on the outlook of the Nigerian economy, focusing on: global, national, regional, state, and sector issues. He was a *Member* of the *National Economic Intelligence Committee (NEIC),* April 2009 to April 2012, where he conducted periodic reality checks on macroeconomic, fiscal and monetary developments in Nigeria.

He is well known for articulating his views on Nigeria's economic policy imperatives through articles, interviews and comments in the mass media. From 1996 to 1998, he spearheaded the advocacy for re-denomination of Naira notes and coins that led to the successful introduction of N100, N200, N500 and N1000 between 1999 and 2005. N50 note was the highest denomination prior to the advocacy. His current advocacy research is on what could be done to ensure democratic effectiveness in achieving desirable economic outcomes in Nigeria; how Nigeria can take necessary steps to open foreign investment inflow, and engage the world about investment opportunities in the country; and, the Nigeria's economic, fiscal and financial federalism can be reconfigured to strengthen the States.

Before becoming the CEO of EA in 2004, Ayo worked as Chief Economist and Member of Editorial Board at ThisDay Newspaper Group (2001-2004), Faculty Member at the Lagos Business School (1995-2001), Head of Research at the Lagos Chamber of Commerce (1993-1995), and Company Economist at UAC of Nigeria (1992-1993). He has served as Consultant to many blue-chip companies, Federal Ministry of Information, Senate Committee on Banking and Finance, several State Governments, DfID, USAID, UNIDO, World Bank, and was a Visiting Scholar to the IMF Research Department in Washington DC.

He has received grants from Ford Foundation and Rockefeller Foundation, and chaired the steering committee of Money, Macroeconomic and Finance Research Group of Money Market Association of Nigeria. He is a Council Member and Chair of Economic and Statistics Committee of Lagos Chamber of Commerce and Industry, and a Non-Executive Director of Greenwich Trust Group. His research output has included an annual economic, fiscal and sectoral report on the 36 States & the FCT, plus numerous scholarly publications resulting from his doctoral thesis, research grants, policy advocacy, and consultancy projects. Some of these are available at http://ssrn.com/author=358232.

Ayo earned B.Sc. in Economics from the University of Ibadan with Sir James Robertson Prize and Medal, UAC Prize in Economics, and Economics Departmental Prize as the all-round best economics graduate in 1988, M. Sc. Economics from Ibadan in 1990, M. Phil. Economics of Developing Countries as a Cambridge-DfID Scholar at the University of Cambridge in 1992, and Ph.D. in Applied Econometrics and Monetary Economics from the University of Durham in 2003. He is an Alumnus of the Lagos Business School (AMP 5).