

Nigeria in H2 2023: Navigating through tough times

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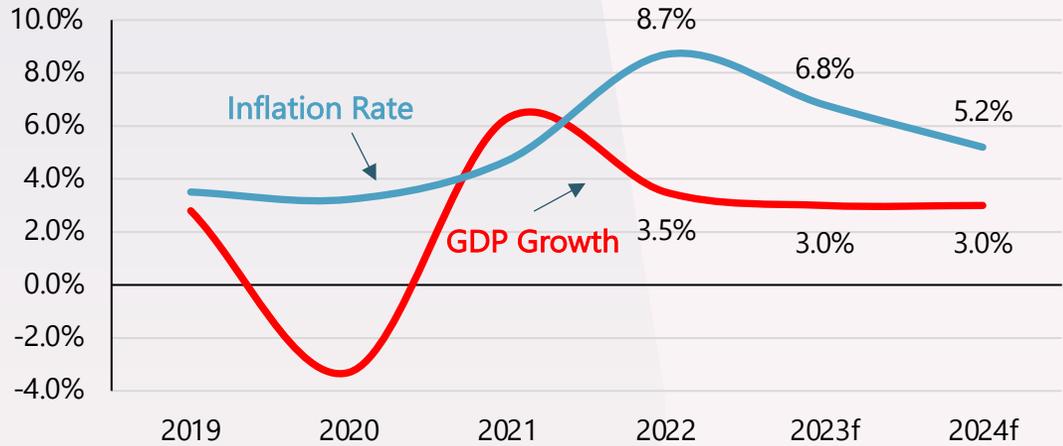
Outline

- Global Economic Review
- Nigeria's Macroeconomic Landscape: Growth, economic structure and Inflation
- Government policies and their impacts on the economy
- What to expect in H2 2023

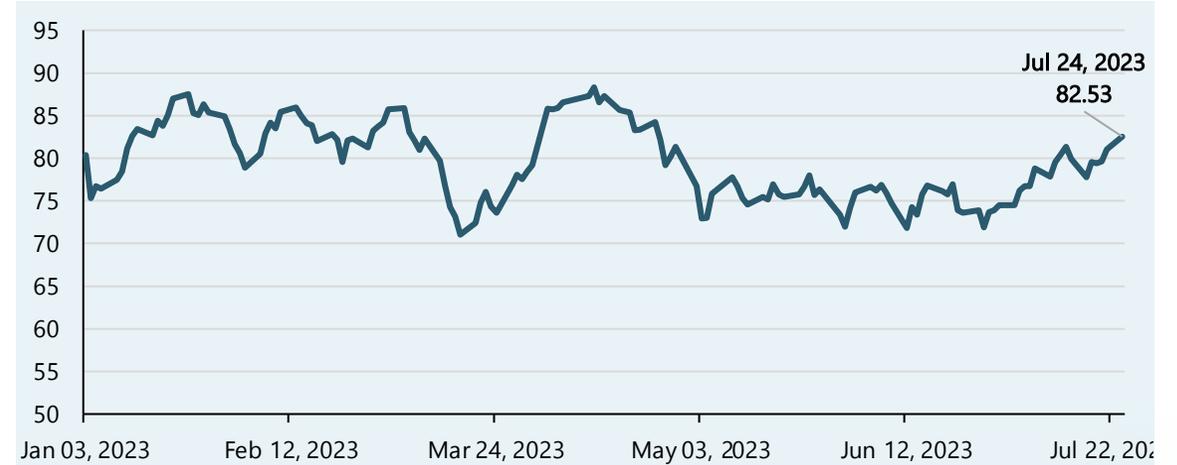
Global Economic Review

Global Economy: Inflation and slow growth are major concerns

Global GDP Growth and Inflation (%)



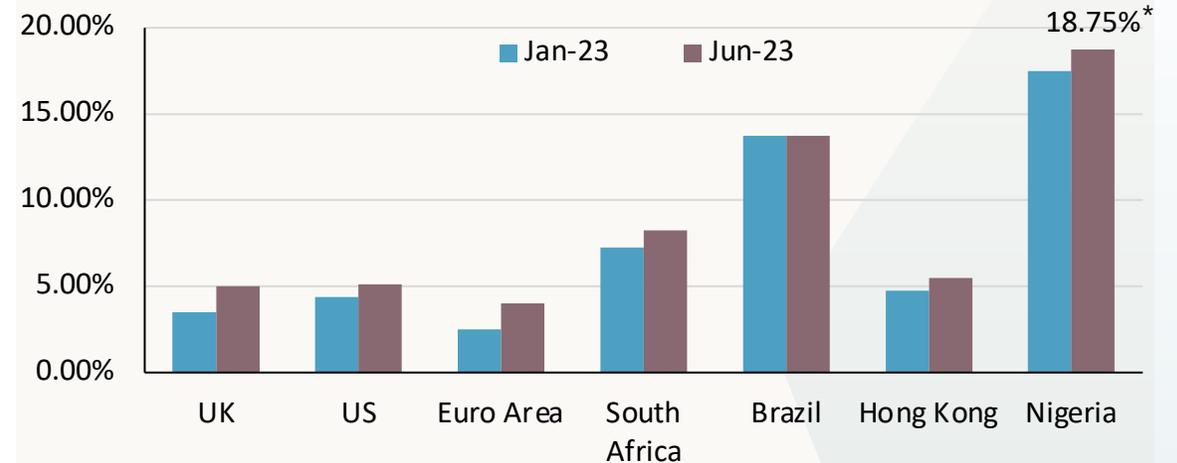
Crude Oil Price (US\$ pb)



"In sub-Saharan Africa, growth is projected to decline to 3.5 percent in 2023 before picking up to 4.1 percent in 2024.."

---IMF July 2023 Global Outlook

Central Bank Policy Rate (%)



*July 2023

Global economy: challenges persist in the short term

UNCERTAINTY

- No end in sight with the war in Ukraine
- Blockage of the black sea could raise food prices
- China's growth could slow due to potential real estate problems
- Climate change poses problems for economies.

PRESSURED

- Inflation above target in 96% of countries with inflation targets
- High interest rates add pressure on consumer spending
- Rising debt levels across countries raises the risk of sovereign debt distress, particularly in developing countries.

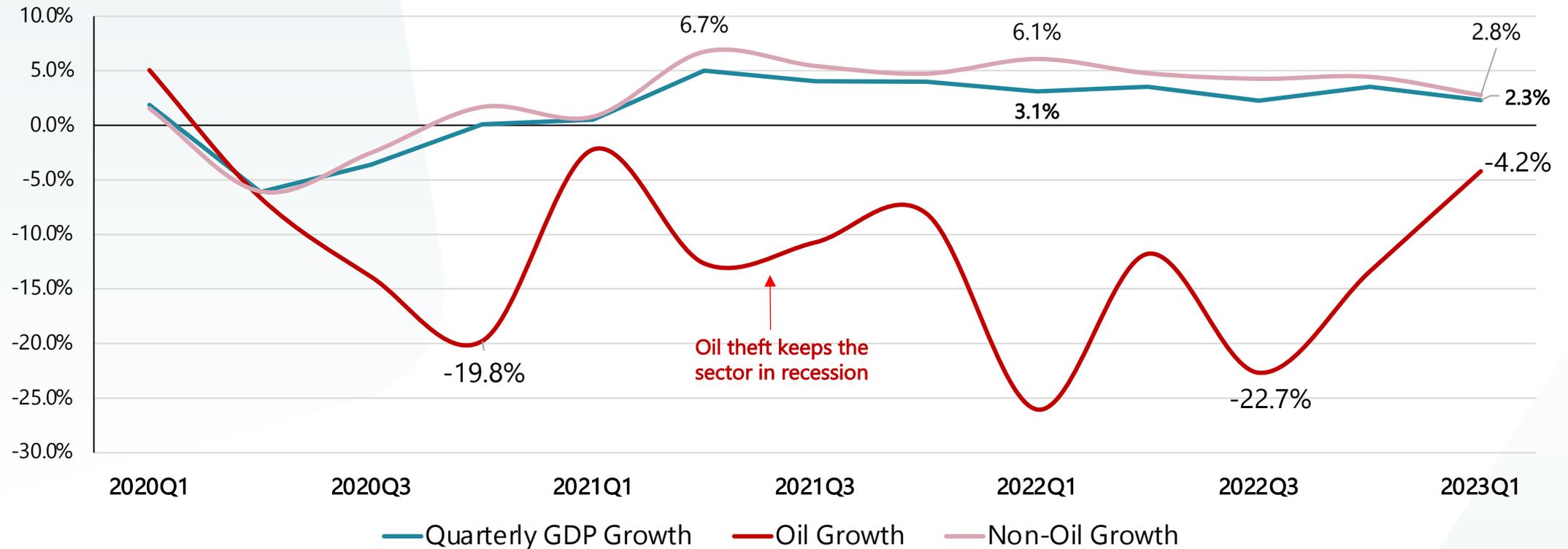
Medium-Term Recovery

- Growth is expected to improve in 2024
- Inflation will ease in the medium term
- Global demand will improve in 2024.

Nigeria's Macroeconomic Landscape

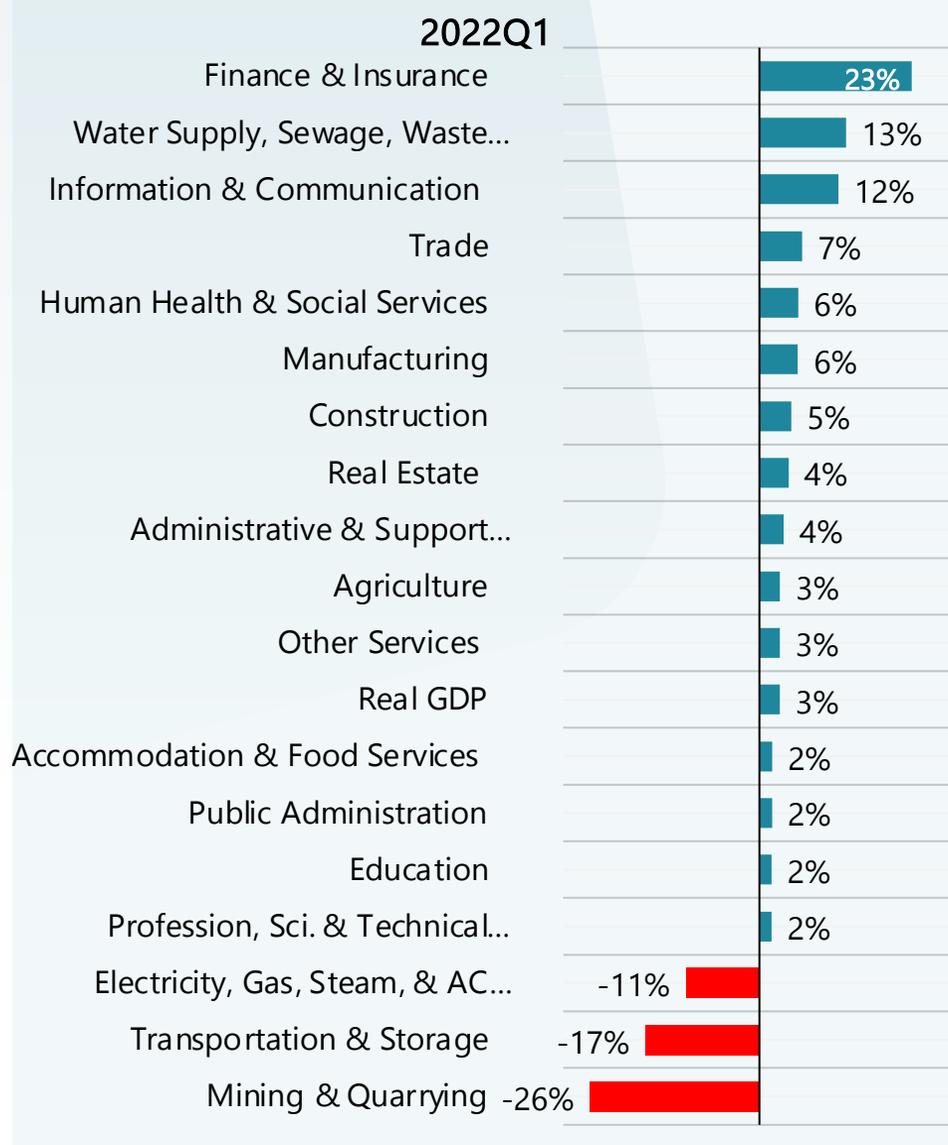
Nigerian economy: GDP growth slowed to 2.3% in Q1 2023

Nigeria's GDP Growth (%)



- Scarcity of the Naira and election uncertainty were responsible for the slow growth of output in 2023Q1.
- The oil sector is still in recession since 2020Q3 mainly due to oil theft: loss of revenue, negative growth contribution, loss of FX inflows.

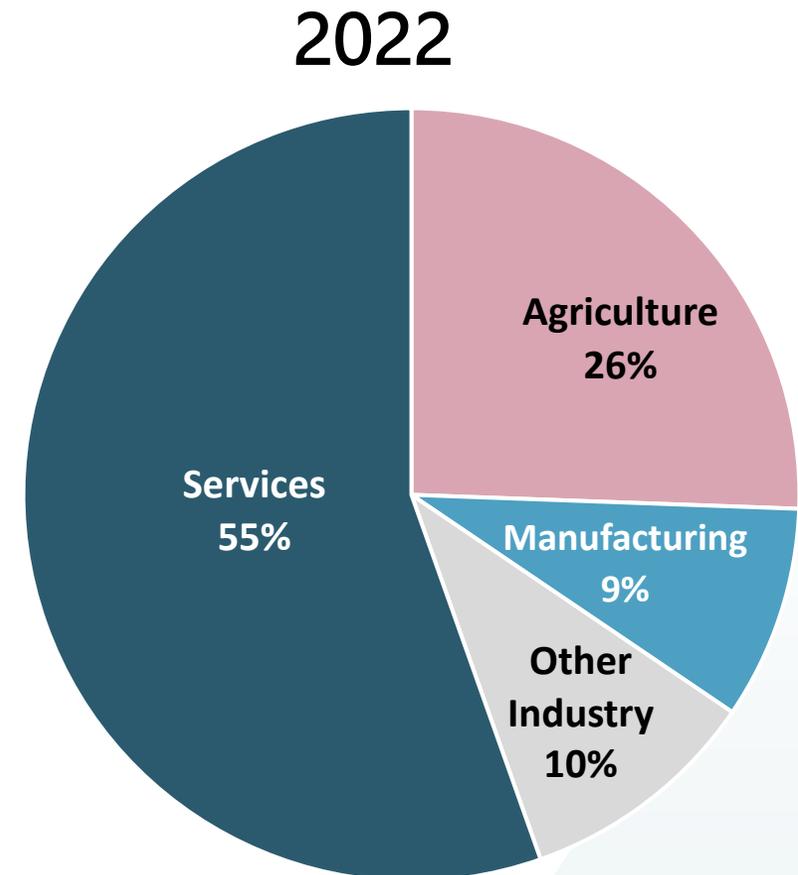
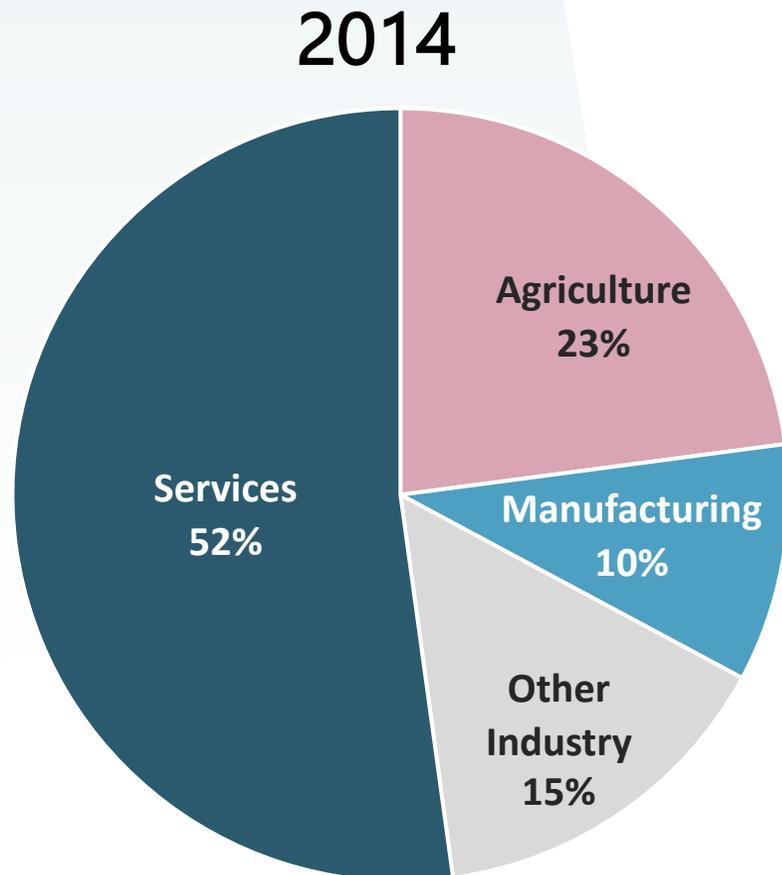
Finance is the fastest growing sector while agricultural output declined



Agricultural output declined for the first time since 1991! Reflects the impact of Naira scarcity & insecurity.

*Key sectors to watch based on government plans, demand trends, and the AFCFTA

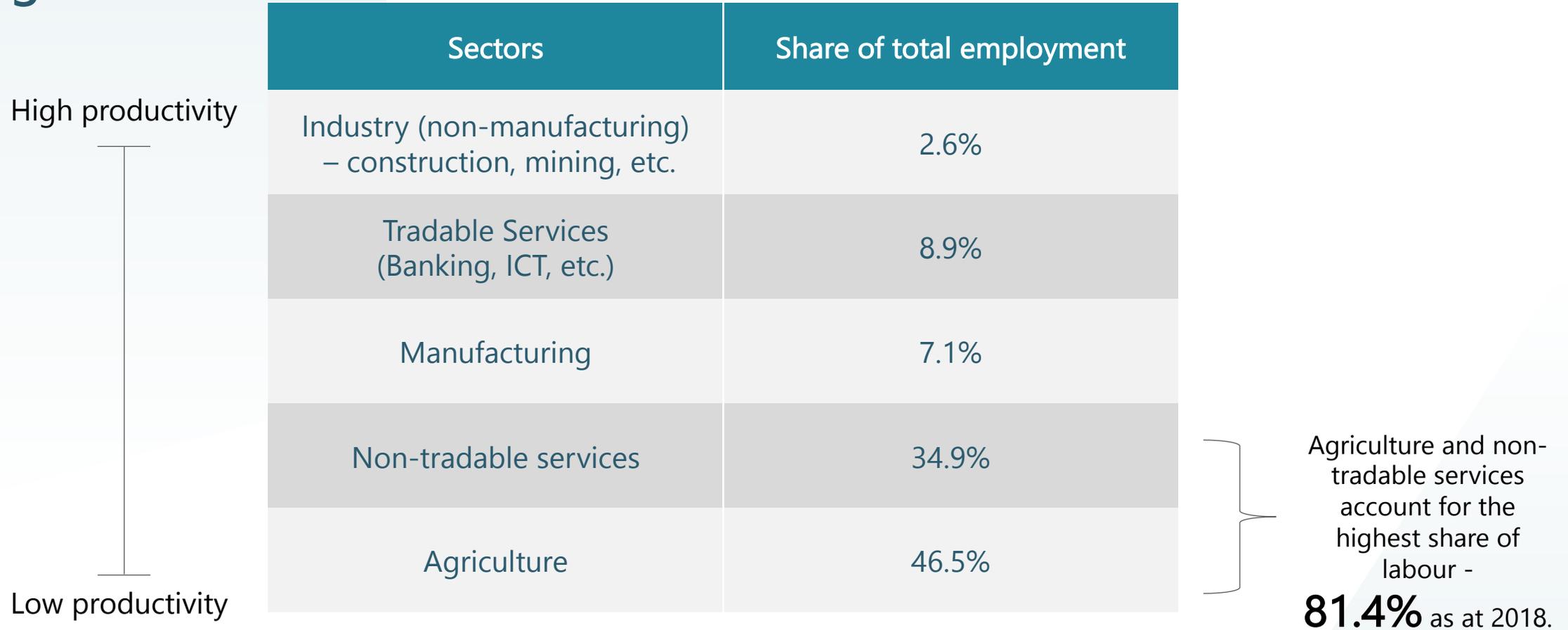
Agriculture's share in output is expanding. Not a good sign for a country like Nigeria



Agriculture is the sector with the lowest labour productivity in Nigeria but its share of GDP is increasing. Farmers are some of the poorest according to data from the NBS. Agriculture is important, but we need technology in agriculture to raise its productivity.

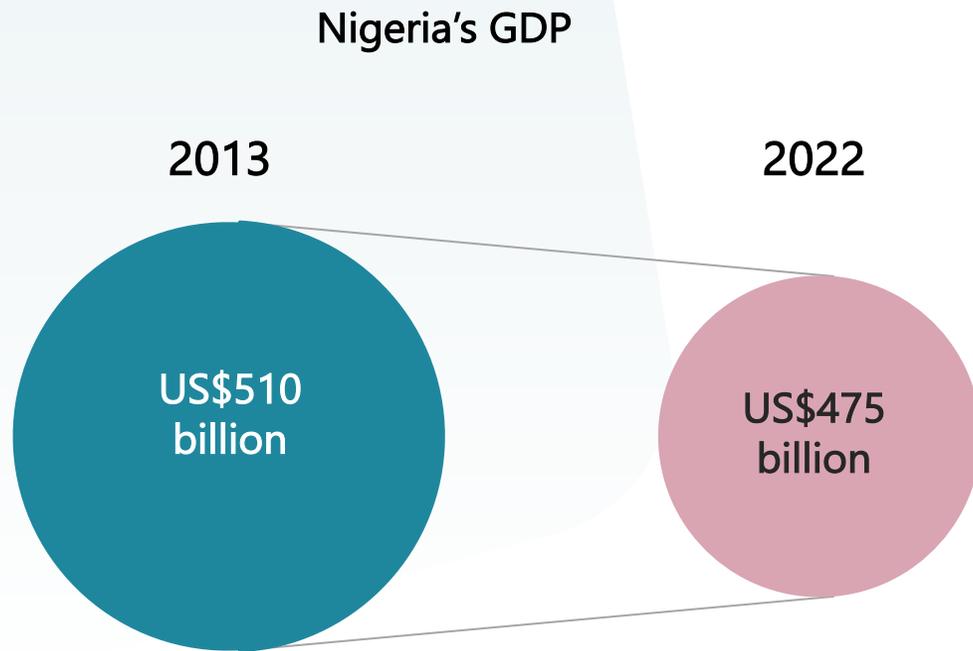
Data Source: CBN, NBS

The least productive sectors employ the largest share of workers in Nigeria



Essentially, the jobs that will lift people out of poverty in Nigeria do not exist in large numbers.

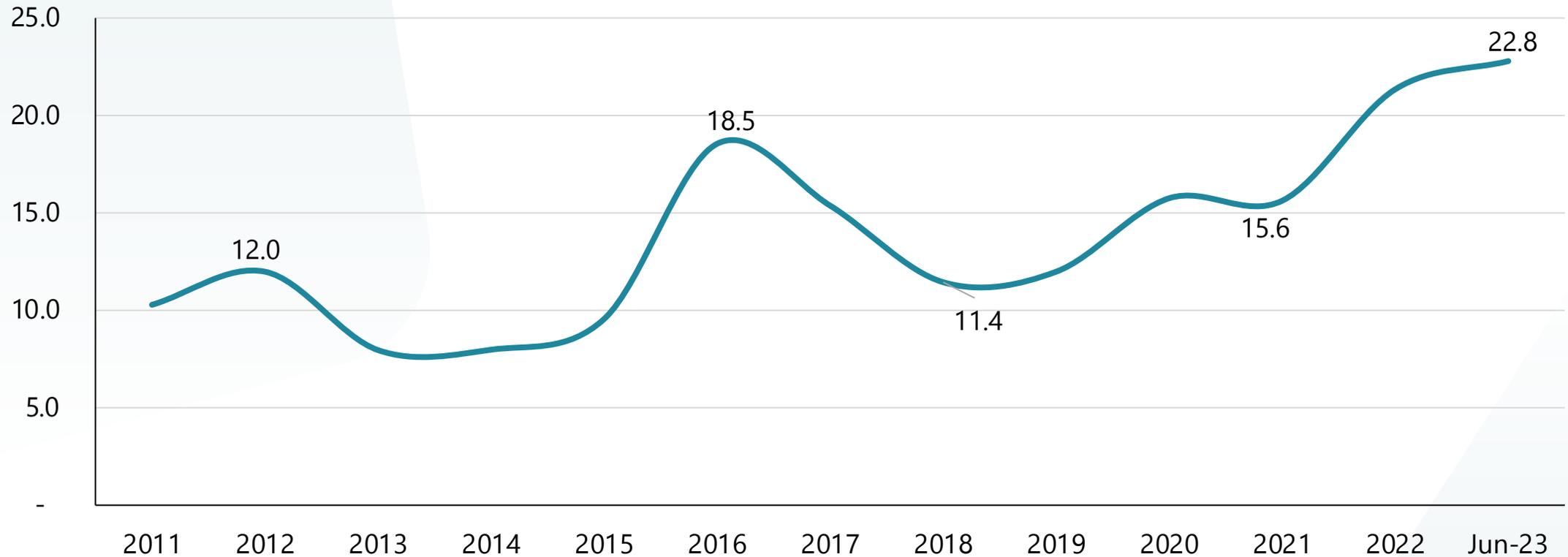
Economic pie vis-à-vis our population has shrunk in the last decade



The economic pie has shrunk significantly in the last 9 years and there is very little to share among the populace. Part of why there are 133 million individuals living in multidimensional poverty.

Inflation keeps pushing millions of Nigerians into poverty

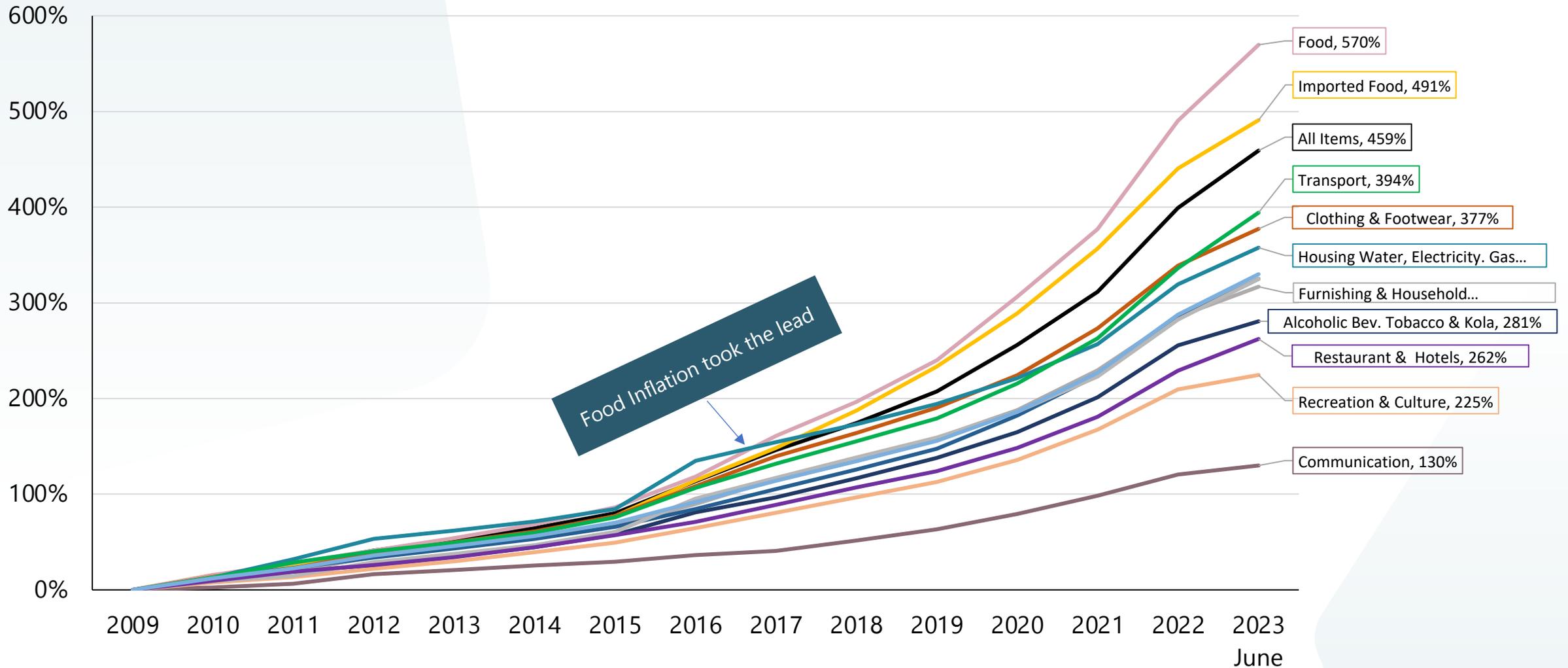
Nigeria's Year on Year Inflation Rate (%) – End of Period



Inflation rate rose marginally from 22.41% in May 2023 to 22.79% in June 2023, despite subsidy removal.

Food price is the main driver of inflation

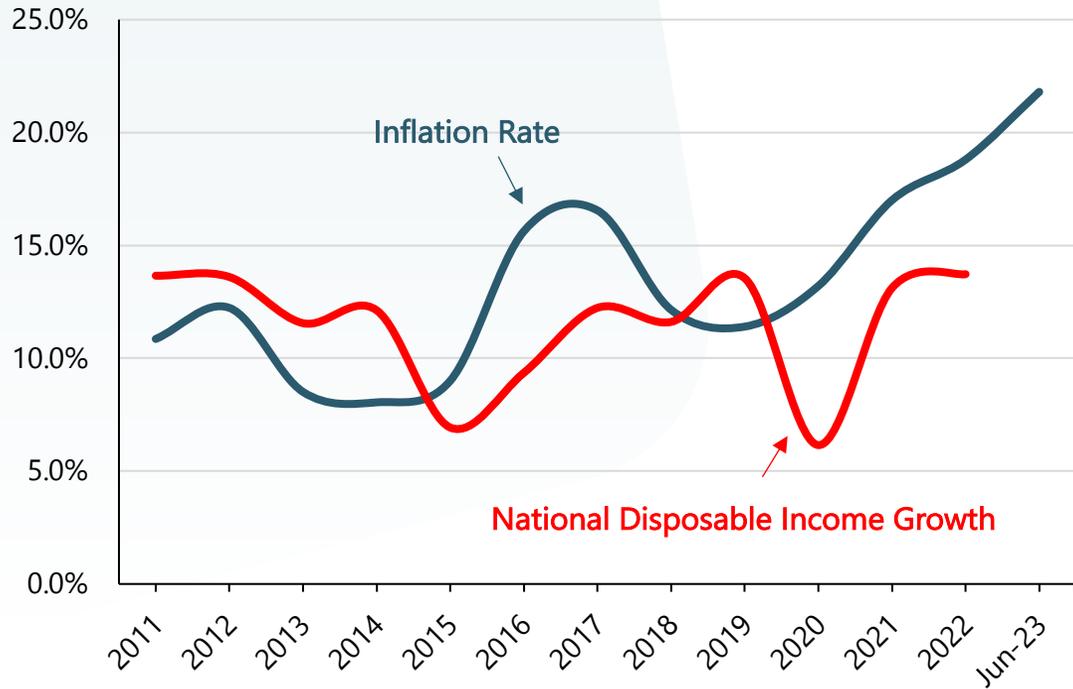
Changes in year-end CPI relative to 2009 base year



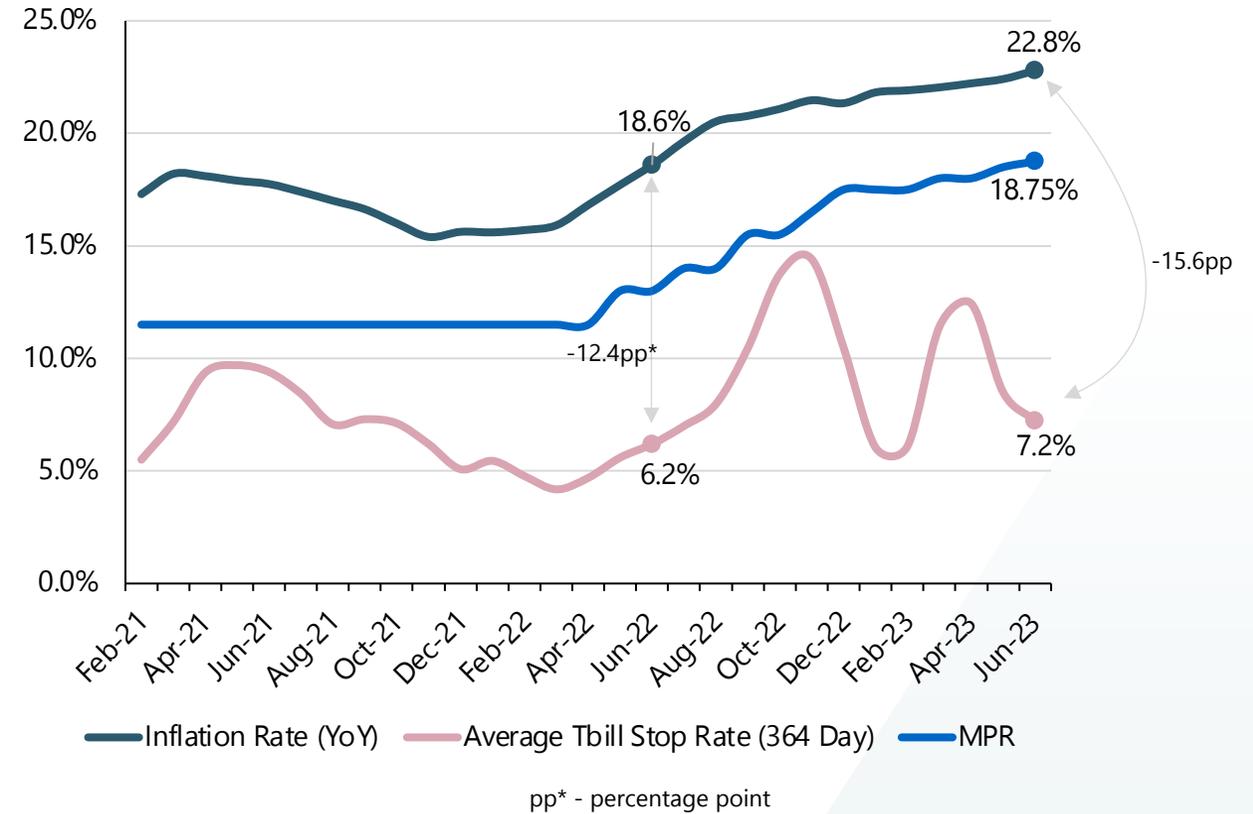
- Based on the consumer Price Index (CPI), if you spent N100,000 on food items in 2009, on average, that same food items would cost N669,700 in June 2023. Inflation figures are likely to be underestimated.

Inflation is bad for consumers and local investors

Nigeria's Inflation Rate vs Disposable Income Growth



Inflation Rate vs Interest Rate



- High Inflation erodes the value of returns on investment as well as income of individuals.

Drivers of Inflation in Nigeria – it is more than a monetary phenomenon

Monetary factors

- High lending rate
- Money supply growth-
Printing of money
- FX depreciation.

Fiscal factors

- Rising budget deficits
- VAT increases
- Subsidy removal.

Structural Factors

- Infrastructure deficits
- Border/Port charges
- Power supply deficit
- Logistics problems
- Extortions of traders during inter-state journeys
- Low productivity.

Other Factors

- Closure of land borders
- Insecurity
- Corruption
- Charges by non-state actors.
- Corporate greed.

What can the CBN do?

Key government reforms and the Nigerian economy

FX reforms and subsidy removal: Hallmark reforms of the new administration

FX Reforms

On Wednesday, June 14, 2023, the Central Bank of Nigeria, introduced key operational changes to the foreign exchange market in Nigeria.

Some key changes highlighted in the press release include:

- Introduction of a willing buyer willing seller model.
- Cancellation of the Naira4dollar scheme and RT200 rebate scheme.
- Collapse of all the foreign exchange market segments into the Investors and Exporters (I&E) window.
- More transparency in terms of FX orders in the market.

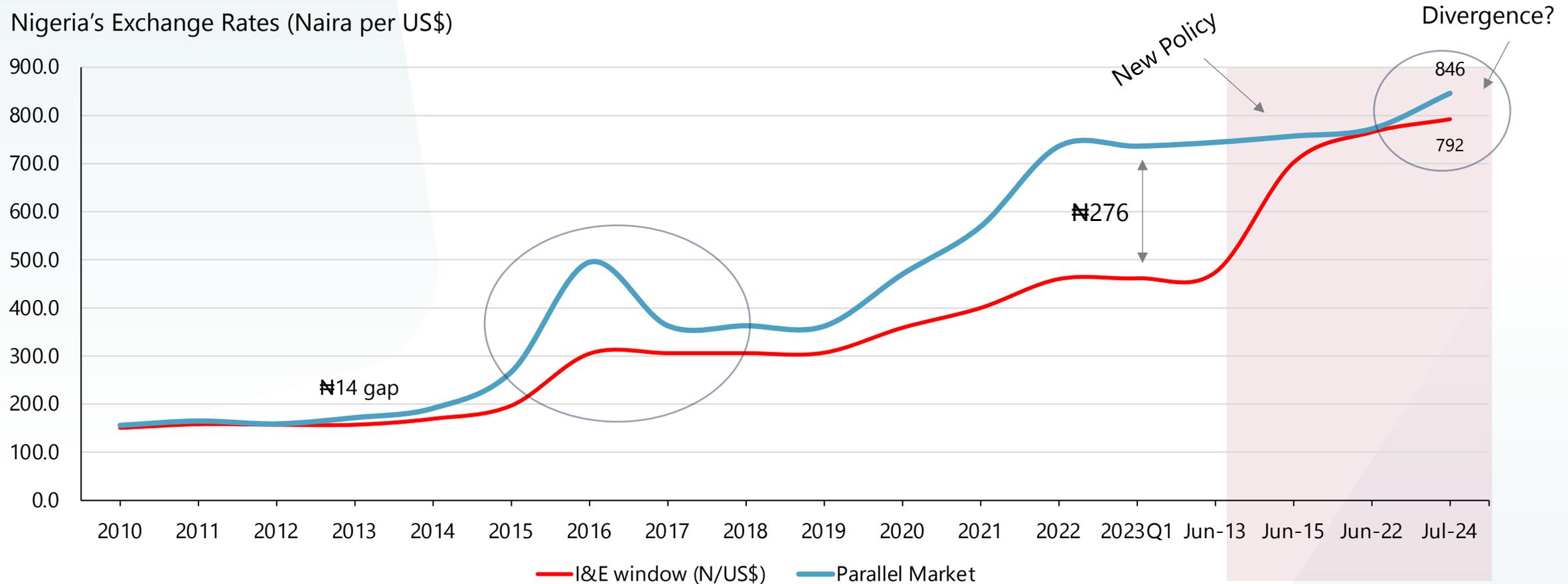
Fuel Subsidy Removal

“Fuel subsidy is gone!”

Unexpected announcement by the President without a plan

Exchange rates converged at first after the FX reforms and continued to depreciate with high volatility

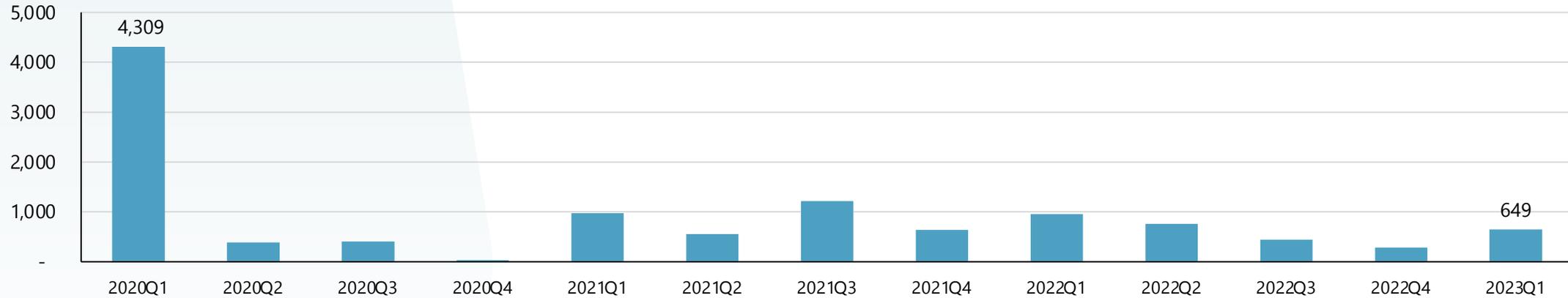
Nigeria's Exchange Rates (Naira per US\$)



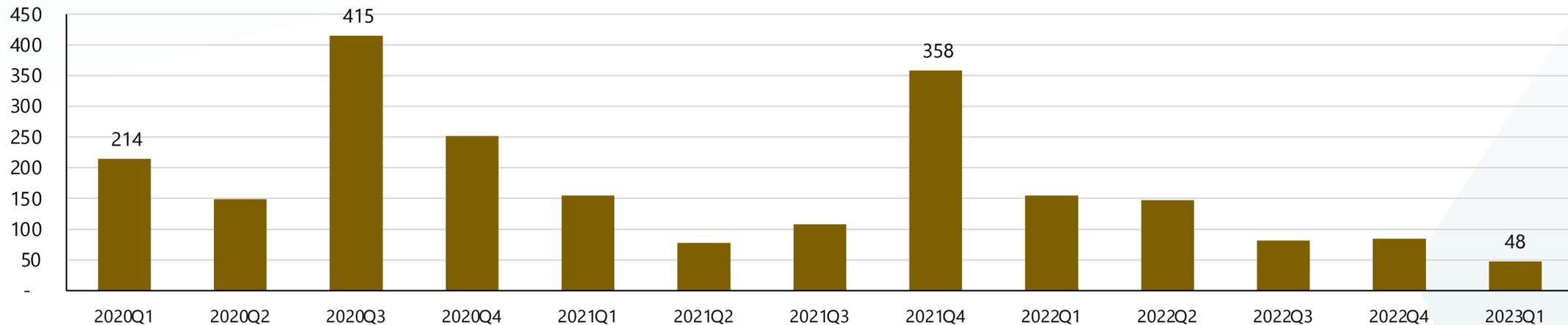
- Acting CBN Governor hinted at the MPC meeting in July that the CBN will continue to intervene to get the Naira to a "certain level". The question is "What is that certain level"? This suggests that the Naira is undervalued i.e. it needs to appreciate.

FX reforms were implemented on the back of weak fundamentals - Low investment inflow

Nigeria's Foreign Portfolio Investment Inflows (US\$ Million)



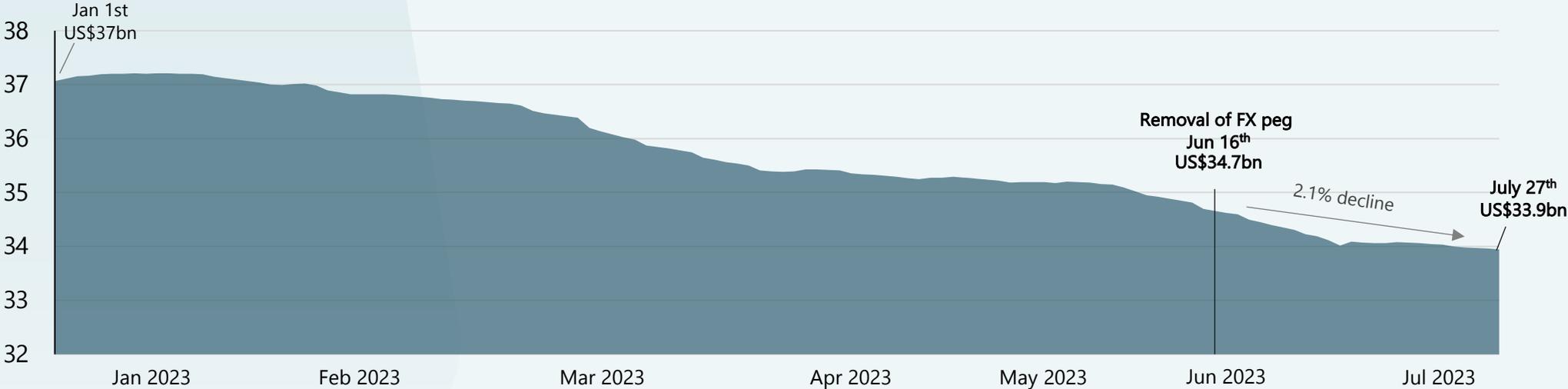
Nigeria's Foreign Direct Investment Inflows (US\$ Million)



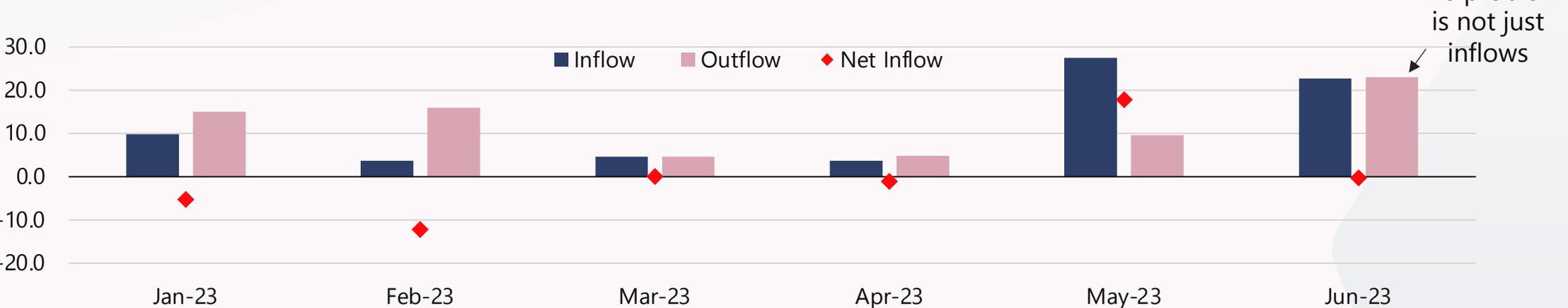
Data Source: NBS

External Reserves on a downward trend

Nigeria's External Reserves (Billion US\$)



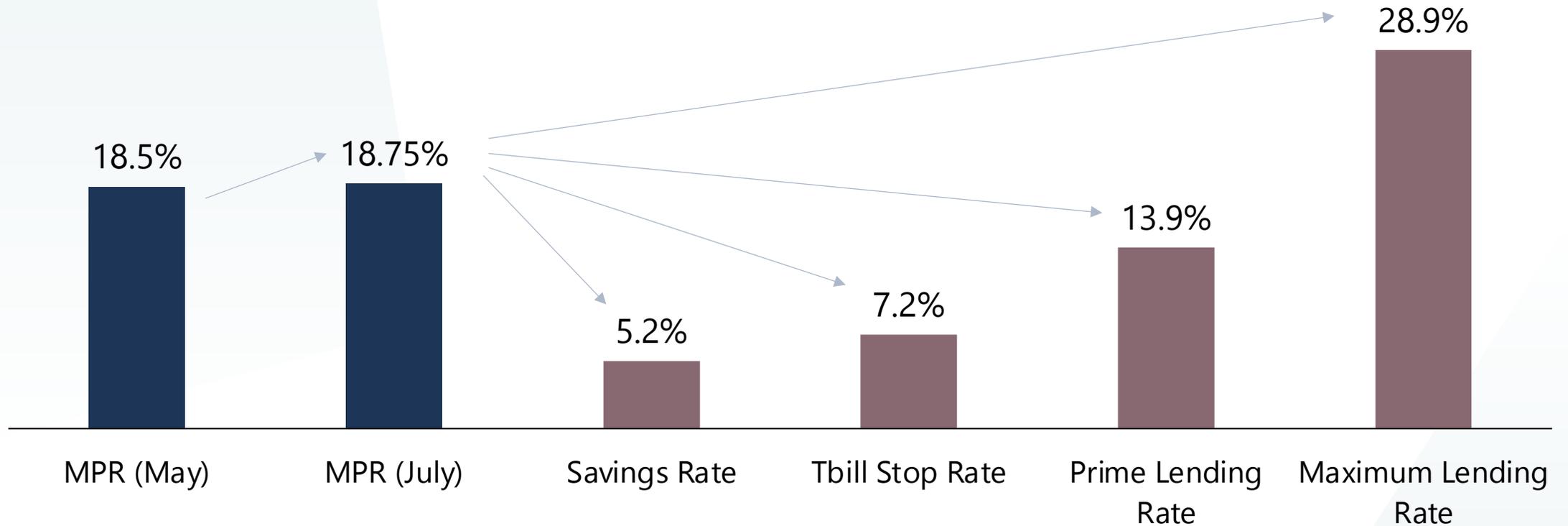
Foreign Investment in the NGX (billion Naira)



Data Source: CBN, NGX

CBN MPC raised MPR by 0.25 basis point to 18.75% in July

Nigeria's key Interest Rates as at June 2023

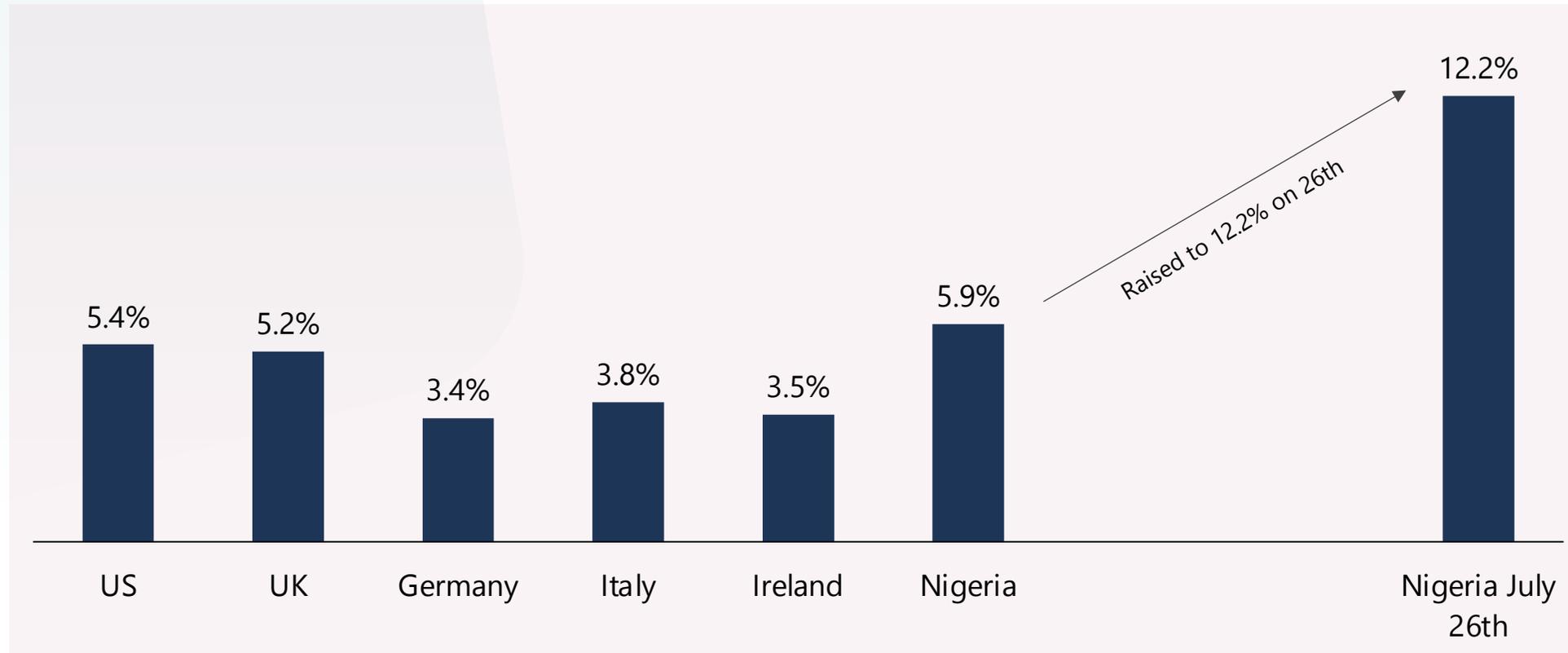


- The MPC also adjusted the asymmetric corridor to +100/-300 basis points around the MPR (from +100/-700). SDF Deposit in excess of N2billion shall not be remunerated. Vote to raise MPR – 6 Members; Hold MPR – 5 Members.

My view: Raising MPR is not the best monetary approach to fight inflation in Nigeria. More MPC members have seen the need to hold rates ✓

Yields on government T-bills rose to 12.2% with the aim to attract inflows

Yields on government securities (1 Year) as at July 25th



Nigerian Banks are major players in the public domestic debt market. They hold about 55% of the outstanding stock of government securities, according to the WB. The hike is good for the market but raises concerns on debt service payments.

Nigeria has a high CRR in the world at 32.5%. We need to start the conversation of financing development

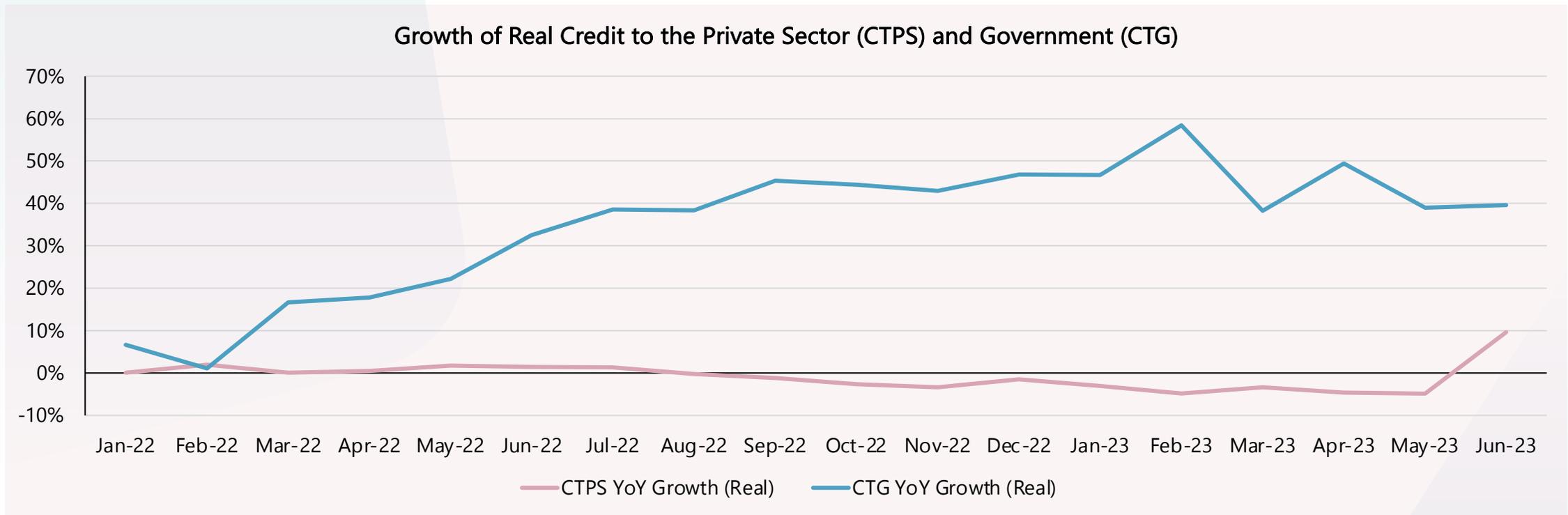
Bank Reserves as the June 2023



CRR for merchant banks was reduced from 32.5% to 10%.

Cash Reserve Ratio						
World	Europe	America	Asia	Africa	Australia	G20
Country	Last		Previous		Reference	
Angola	22		22		May/23	
Belarus	4		4		May/23	
Brazil	21		21		Jun/23	
China	10.75		10.75		Jun/23	
Croatia	2.68		5		Dec/22	
Czech Republic	2		2		May/23	
Hungary	10		10		Jun/23	
India	4.5		4.5		Jun/23	
Indonesia	9		9		Feb/23	
Iraq	13		13		Jan/23	
Malaysia	2		2		May/23	
Moldova	34		34		May/23	
Nigeria	32.5		32.5		Jun/23	
Philippines	9.5		12		Jun/23	
Poland	3.5		3.5		Jun/23	
Romania	5		5		May/23	

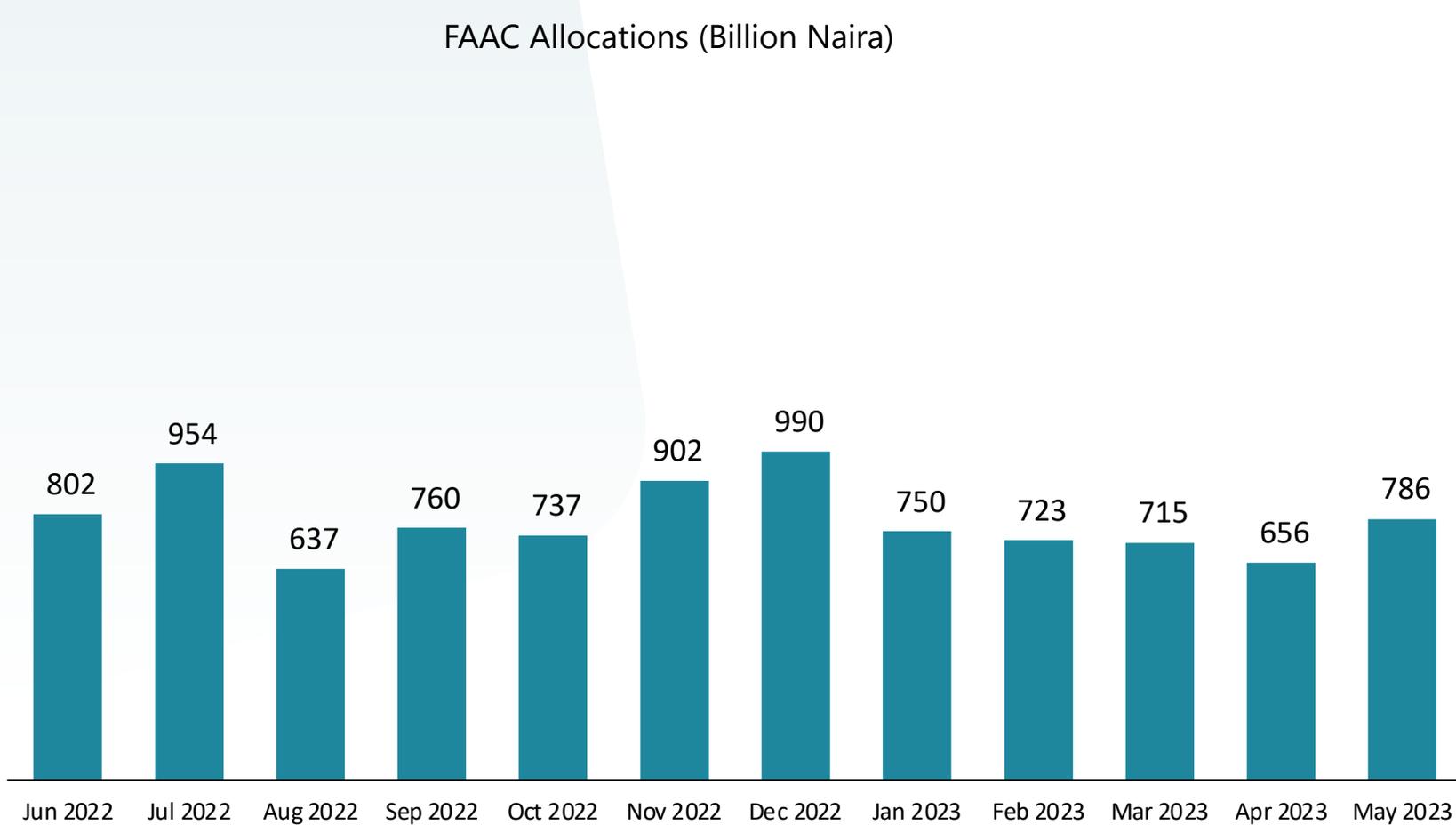
Looking at the issue of financing development, real credit to the private sector showed negative growth from August 2022 until June



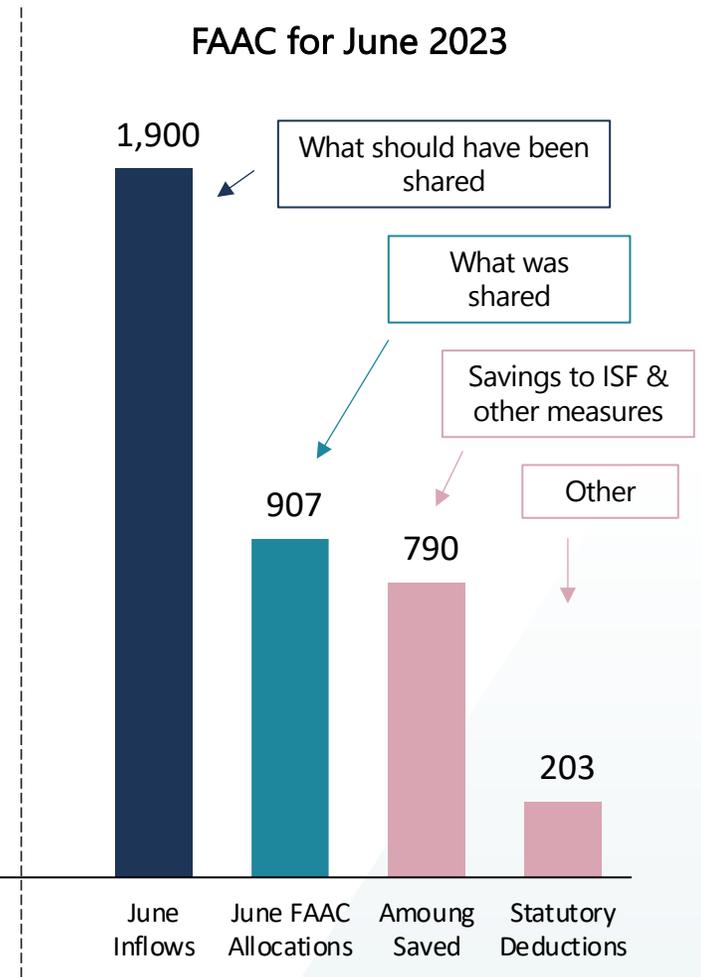
- When adjusted for inflation, credit to the private sector showed negative growth since August 2022 (until June 2023) but real credit to the government kept expanding. This is a clear case of crowding out of private sector investment.
- The CBN must incentivize banks to lend to the real sector. Raising the MPR only makes things worse – hike in maximum lending rate.

Inflow to the Federation Account increased based on FX reforms

FAAC Allocations (Billion Naira)



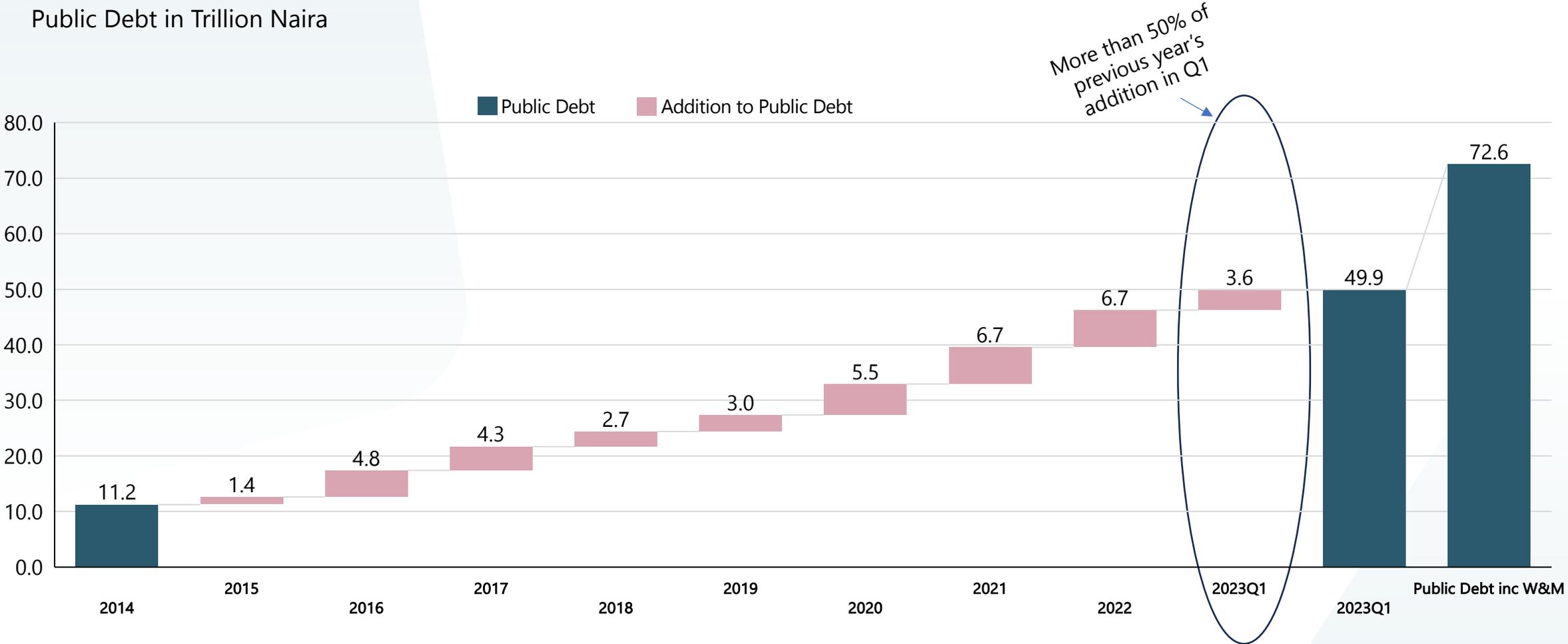
FAAC for June 2023



- More money to share: Citizens must hold Federal and state governments accountable.
- What are the modalities of the newly created Infrastructure Support Fund?

Net addition to Public Debt hits N3.6 trillion in 2023Q1

Public Debt in Trillion Naira

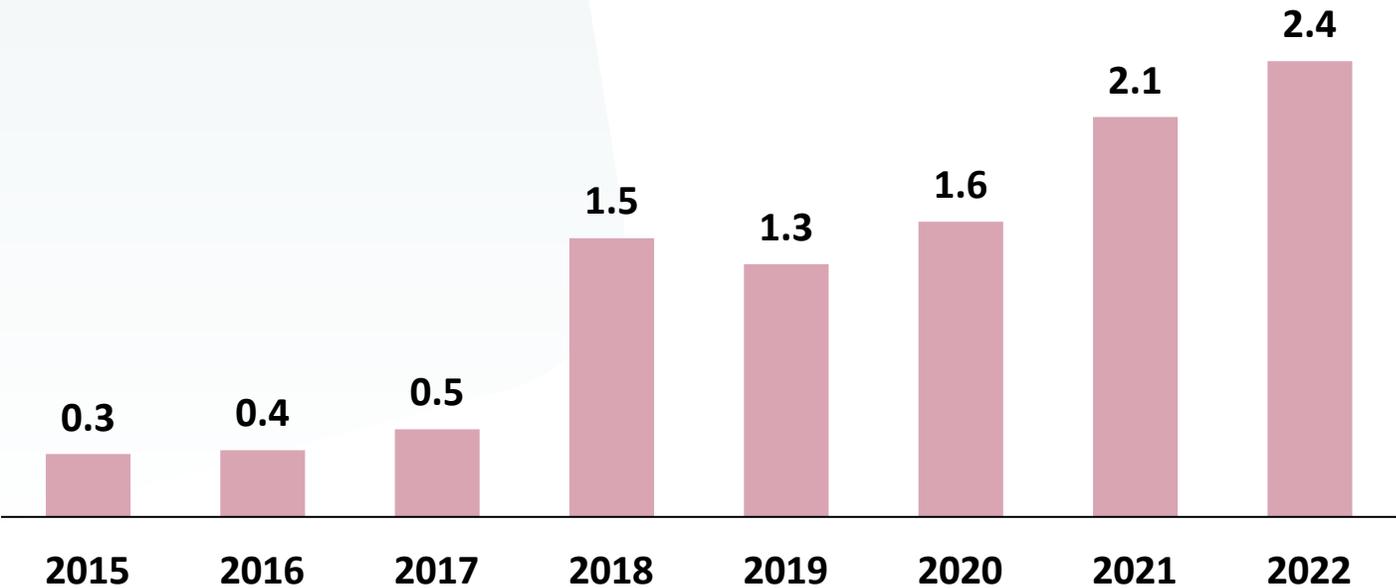


Increased projected revenue following the subsidy removal could slow down debt accretion vis-à-vis previous projections. However, full year addition to public debt in 2023 will still be higher than in 2022. Debt servicing to revenue was over 80% in 2022.

Data Source: DMO

External Debt Service Payments is growing rapidly, but still within sustainability limit

Actual External Debt Service Payments in Billion US\$



External debt service

US\$801.4 million
(2023Q1)

External debt service to export ratio in 2023Q1 was 5.7% - at comfortable levels. However, pressure on external reserves is imminent and needs to be observed carefully.

Data Source: DMO

How Nigeria's Subsidy and FX Reforms have affected economic agents

$I_{(investment)}$ $NX_{(net\ export)}$

Impact on the market

- NGX All Share index has increased from 52,973 in May 26 to 65,687 in July 26.
- Foreign Investment inflow into the NGX rose from N9.8 bn to N22.7bn in June. Outflow rose N15bn to N23bn.
- Growth of FX Turnover:

Foreign Exchange Turnover (billion \$)



$G_{(government\ exp)}$

Impact on the government

- Significant increase in inflows into the federation account – N750 bn in Jan 2023 to N1.9 trln in June.
- Higher government expenditure. Government spending at FG and State level will increase.
- Reduced pressure on debt servicing/revenue ratio.



$C_{(consumption)}$

Impact on the masses

- Increase in prices of goods and services – not reflected in June inflation figures.
- With no social support from the government, citizens' purchasing power have been weakened.
- Growing distrust among citizens, especially the poor and vulnerable.
- With limited domestic refining capacity, citizens are exposed to oil price & FX fluctuation.



$I_{(investment)}$ $NX_{(net\ export)}$

Impact on the real economy

- Added pressure on cost of doing business. Micro and small businesses to suffer the most – FX depreciation and subsidy removal. Some large corporates will also suffer.
- Negative impact on employment and business growth.
- Opportunity for non-oil export growth but increased cost could erode the gains.



Both reforms to address distortions in the economy have huge negative impacts on businesses and citizens

We need to move from here...



To here...



Some Implications of the disconnect

- Rising Unemployment
- Demand for higher wages from government workers and private sector employees
- Possible protests and strikes
- Depressed aggregated demand and limited investment growth.

Other Policies and Reforms

ELECTRICITY ACT

TAX REFORMS

PRESIDENTIAL COMMITTEE
ON FISCAL POLICY AND
TAX REFORMS

STUDENT LOAN ACT

NAIRA PAYOUT OPTION
FOR REMITTANCES

MPR AT 18.75%
+100/-300 CORRIDOR

N819.5 BILLION
SUPPLEMENTARY BUDGET

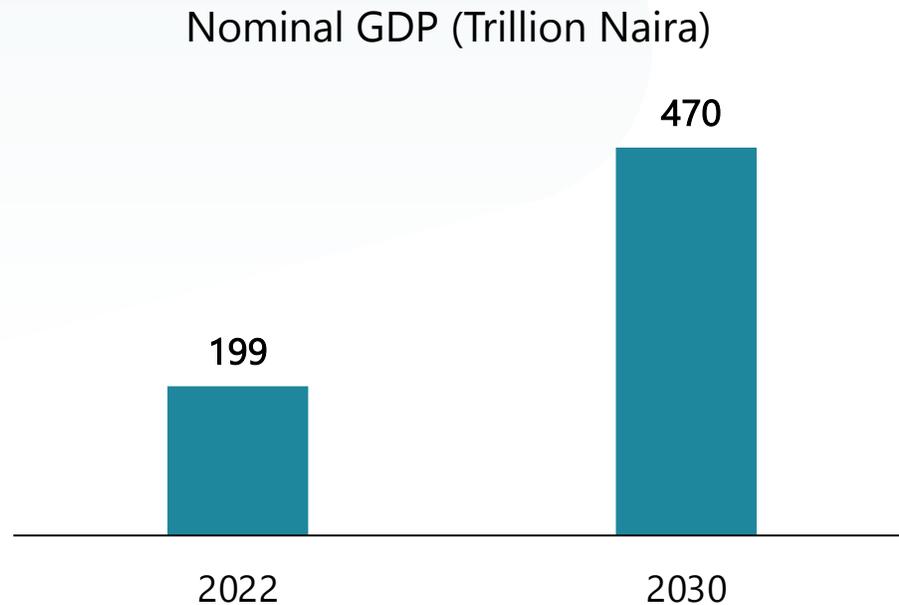
STATE OF EMERGENCY ON
FOOD SECURITY

\$800 MILLION LOAN
FACILITY

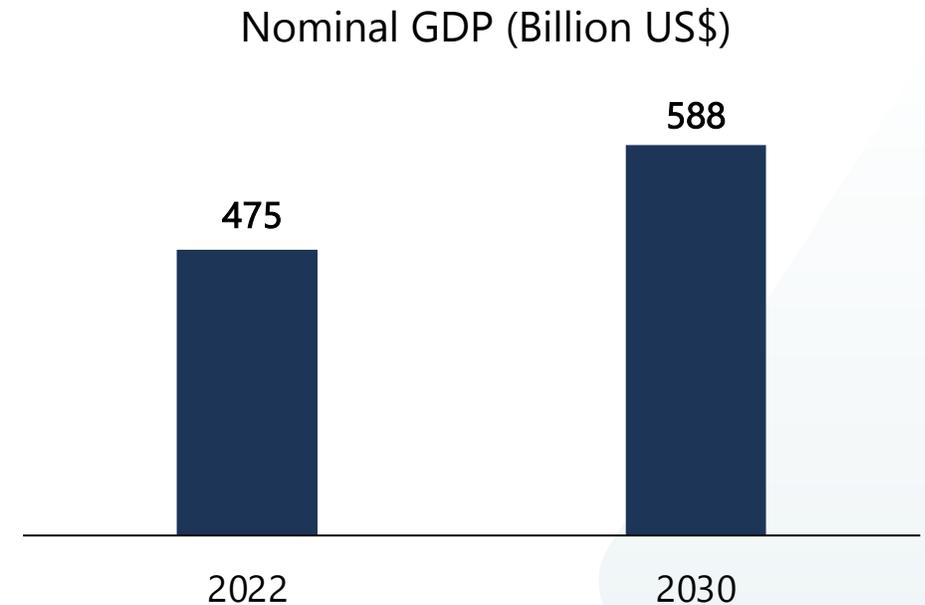
What to expect in H2

In the long term, the President's plan for Nigeria is a GDP growth of "not less than 6%". We must unlock economic opportunities to increase the pie!

Nominal GDP could more than double at an average real GDP growth of 6% in the next 7 years



With the 6% real growth and assuming an exchange rate of N800 per US\$, the size of the economy will still be far from US\$1 trillion by 2030



What to expect in 2023 H2



INTERNAL

Growth & Inflation

GDP Growth in H2 will be negatively impacted by weakened purchasing power and high cost of doing business. Prices of goods and services will remain elevated.

Fiscal and Monetary Policies

Revenue will increase, raising the opportunity to implement social support. The hike of rates on government securities is a positive move to attract foreign investment.

Foreign Exchange

Despite expectation of improved FX inflows in H2, pressure on External Reserve and Naira will continue. FX outflow/demand is still huge. Exchange rate will likely revolve around N800/US\$.



EXTERNAL

Oil Price

In the last few days, oil price exceeded US\$80pb. Higher oil price raises pressure on petrol prices - more hardship on citizens and businesses.

Foreign Investment

Foreign investment inflow, particularly FPIs, will increase at a moderate pace in Q3 and Q4 following the increase on T-bills rate. FDIs will require medium to long term structural reforms.

Remittances & Trade

Inflows expected to increase in H2 following the depreciation of the Naira. Petroleum products accounted for 38% of total imports in Q1 2023. This will continue to add pressure on reserves, in view of weak domestic refining capacity.

Policies to increase FX inflows: Tackle oil theft; provide clarity of CBN leadership; enhance non-oil exports; consider privatising refineries to limit petrol imports (medium term); target diaspora remittances; develop and implement an inclusive growth & investment strategy.

Conclusion

- **Nigeria's GDP growth prospect remains bleak** in the short term.
- **Fuel subsidy removal may not be sustained if oil price trends towards US\$100 pb.** With limited domestic refinery, Nigerians will be exposed to movements of oil price. Petrol price will hit over N650 per liter. This could trigger strikes and protests from labour unions.
- **Social support:** Provide conditional cash transfers to the poor and vulnerable, working with state governments.

- **Policy alignment:** Appoint a competent cabinet to drive reforms across sectors. Need for alignment of government policies.
- **Budget Reforms are urgently required** to improve spending transparency and channel funds to priority areas.
- **Industrial Reforms:** Implement industrial, trade policies to improve the manufacturing sector, attract investment and grow non-oil exports.

To ensure the effective delivery of government services, the President needs to prioritise institutional reforms and ensure proper coordination of MDAs. We need a **coordinated star team**. Key reform is to disentangle the Federal Ministry of Finance, Budget and National Planning. The National Planning Commission was established with the goal of playing that supervisory role.

Thank You



The views in this report are those of the author and do not represent the views of the organizations he is affiliated to.

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Appendix

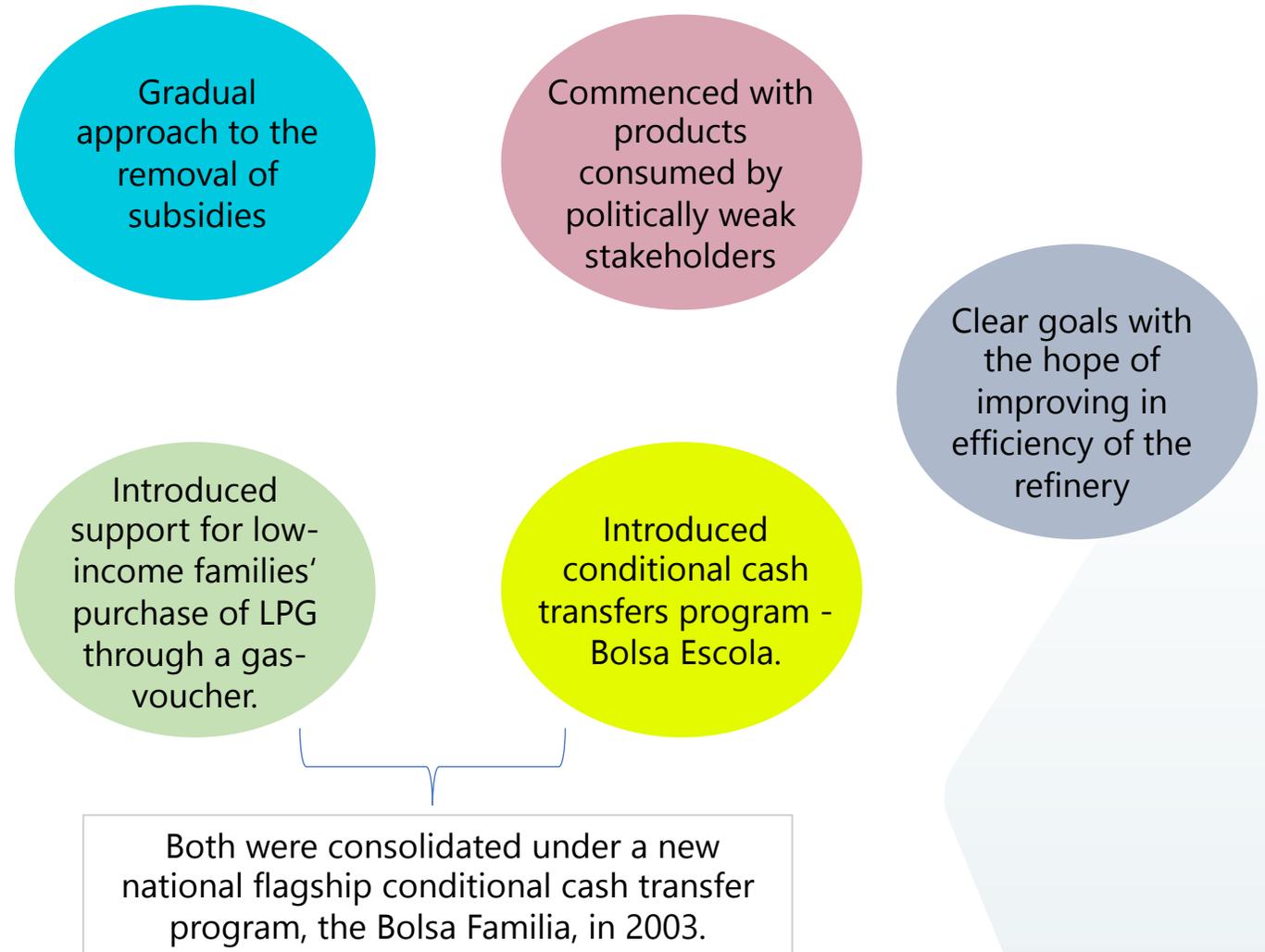


Subsidy Removal: The “how” is equally as important as the subsidy itself

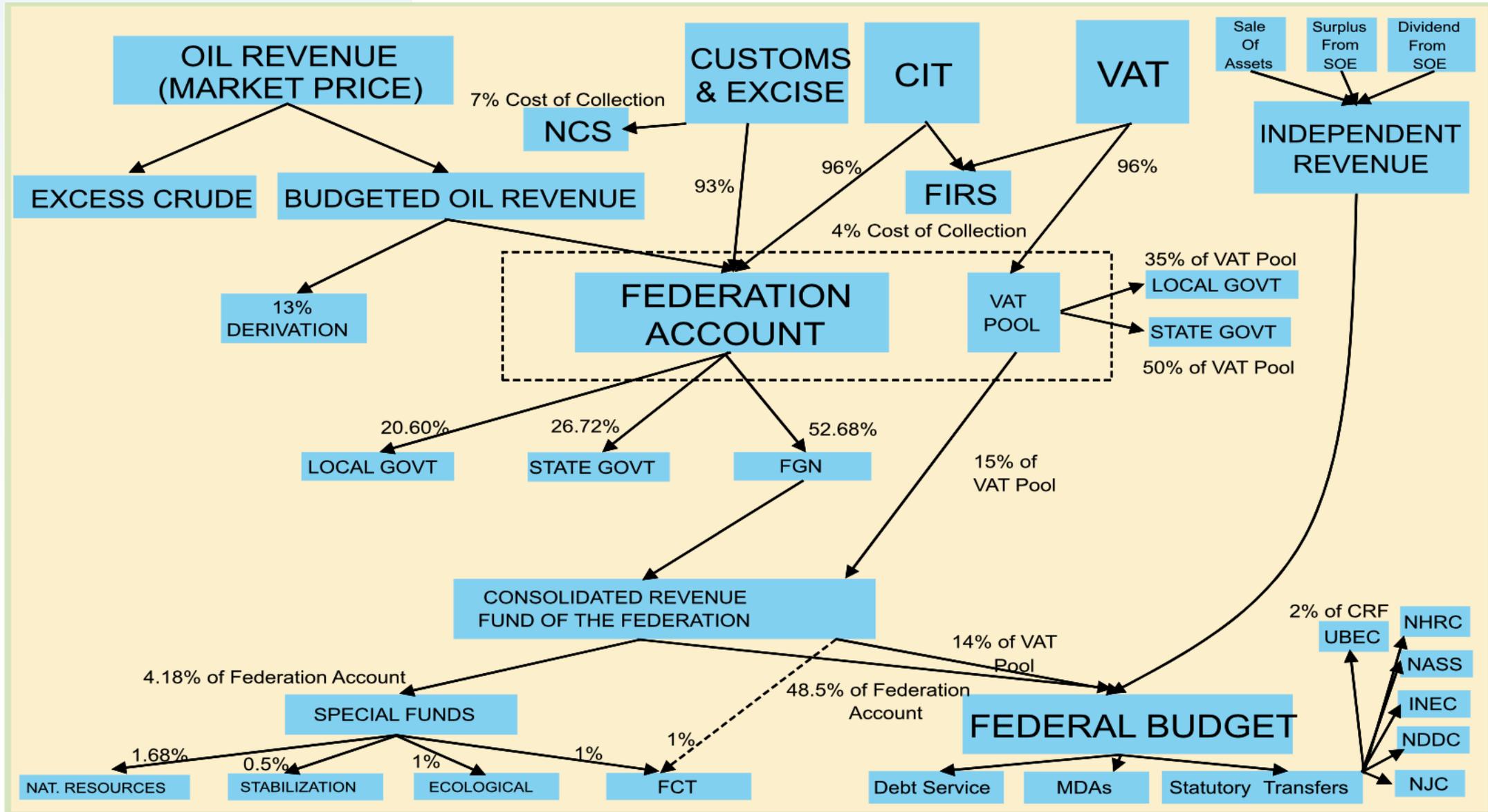
UNDP studied identified four key factors for a successful fuel subsidy reform

1. **A better understanding of the socio-economic contexts** of communities to be affected by such reforms
2. **Timing and sequencing of reforms:** Gradual approach
3. **Compensation and wider expenditures**, including capacity to deliver
4. **Communication strategies** and stakeholder engagement

Example of how Brazil removed subsidy



Nigeria's Revenue Flow



Source: World Bank Nigeria Economic Report 2013

FG is not only borrowing to finance capital projects and human devt.

Framework for debt management

“Government at *a*/tiers shall **only borrow** for **capital expenditure and human development**, provided that, such borrowing shall be on concessional terms with low interest rate and with a reasonable long amortization period subject to the approval of the appropriate legislative body where the necessary...”

~

Section 44, 1a - Fiscal Responsibility Act 2007

Actual FG Borrowing, CAPEX, Hum. Devt. in 2022 (Trillion Naira)

