NESG 2019 Capital Importation Alert

March 2020

Overall investment inflows into Nigeria improved in 2019 but showed a declining trend from Q1'2019

Summary

- Foreign investment inflow reached its highest in over five years at US$24 billion but showed a declining trend from Q1'2019. Inflows peaked at US$8.5 billion in the first quarter and declined consistently to US$3.8 billion in the fourth quarter.
- Foreign Portfolio Investment (FPI) sustains momentum whilst FDI suffers a decline. FPI maintained its position as the major contributor to Nigeria's foreign inflows at 68%. On the other hand, Foreign Direct Investment (FDI) continued its declining trend, contributed 4% to investment inflows in FY'2019.

Investment Inflows into Nigeria surged to $24 billion in 2019, the highest inflow ever recorded

According to National Bureau of Statistics (NBS), foreign investment inflows for full year 2019 spiked 42.7% to $24 billion from $16.8 billion in 2018. The 2019 figure of inflows represents three consecutive years of expansion and marked the highest inflow ever recorded. The increase in foreign investment inflow in FY'2019 continued to be dominated by Portfolio Investments. In FY'2019, FPI accounted for 68.2% of total inflows down from 70.2% the previous year while Foreign Direct Investment and other Investment Inflows accounted for 3.9% and 27.9% respectively. Meanwhile, all through year 2019, foreign investment inflows exhibited a downward trend on a quarterly basis; closing the year lower at $3.8 billion in Q4'2019 from $8.5 billion in Q1'2019 and $5.6 billion in Q3'2019.

Figure 1: Annual foreign investment inflows (US$ billion)

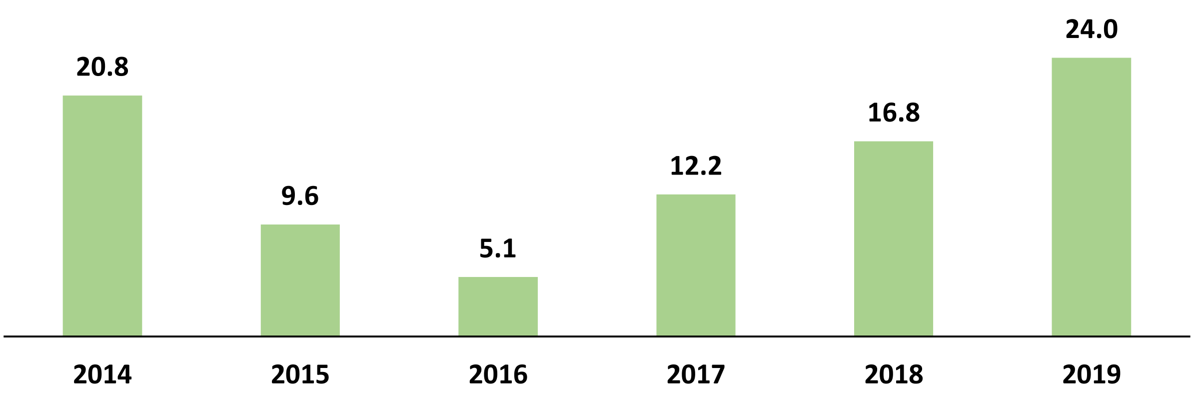
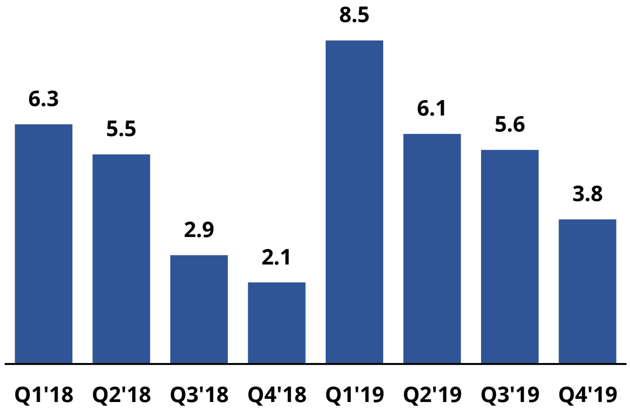
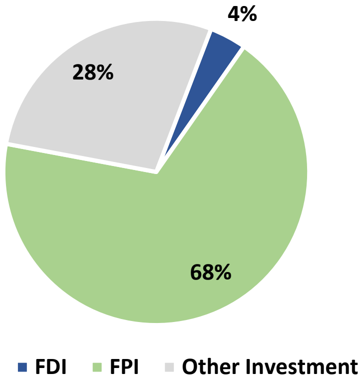


Figure 2: **Quarterly Capital Importation (US$ billion)**



Source: NBS & NESG Research

Figure 3: Composition of foreign investment inflow in FY'2019



FDI sinks below $1 billion as FPI jumps to $16.4 billion in 2019

Foreign Direct Investment (FDI) – which is a relatively stable source of capital flows – declined by 22% to $934.3 million in FY'2019 from $1.2 billion in 2018. In terms of quarterly trend, FDI declined consistently from the first to the third quarter of 2019 but rose in the fourth quarter. One major reason for the decline in FDI is uncertainty that shrouded the economy in 2019 arising from inconsistent and ad-hoc policy interventions and unstable business environment. Correspondingly, the proportion of FDI in total foreign investment inflow fell to 4% in 2019 from 7% in the previous year.

Figure 4: FDI Inflows (US$ billion)

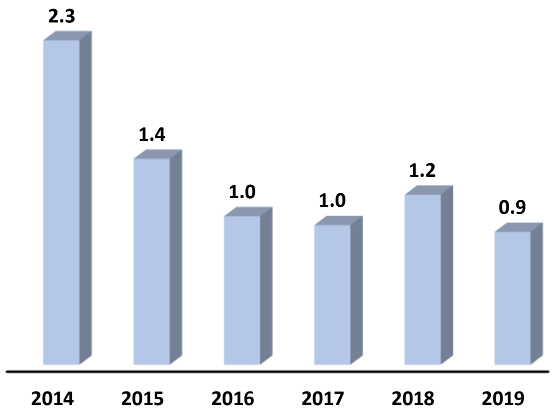
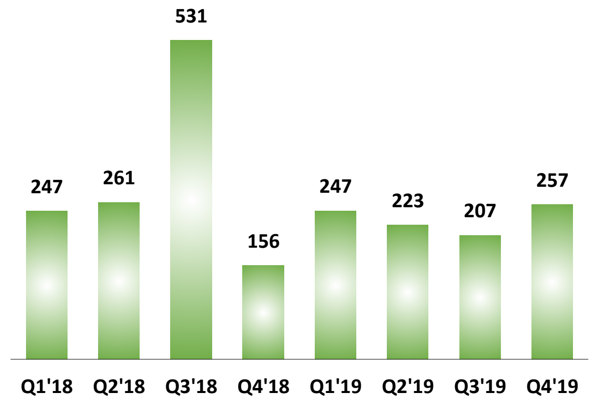


Figure 5: Quarterly FDI Inflows (US$ million)



Source: NESG Research

FPI inflows buoyed by Investments in Money Market Instruments

Hot money in the form of FPI sustained its dominance with an inflow of $16.4 billion, 39% higher than its level in 2018 ($11.8 billion). This represents a share of 68% of foreign investment inflows in 2019. This is an indication that the Nigerian economy is highly vulnerable to capital flow reversals. Nonetheless, FPI inflows benefitted from accommodative monetary policy stance in advanced economies in 2019.

The influx of foreign portfolio investment in 2019 was led by huge investments in money market instruments – T/bills and OMO bills – whose share of FPI stood at 82% ($13.4 billion), which is 57.6% higher than in 2018 ($8.5 billion). Investors' appetite for Nigeria's T/Bills at the secondary market remained very high due to the impressive yields, which averaged 13% in the first three quarters of 2019, according to the FMDQ data. Though foreign investment in Nigeria's bonds declined from Q1 to Q4'2019, overall inflows into the bond segment increased by 5.7% to $1 billion in 2019. Similarly, the equity component of FPI fell throughout 2019, closing the year lower at $1.9 billion from $2.4 billion in 2018. According to the data from the Nigerian Stock Exchange (NSE), there was a drop in foreign participation in Nigeria's equities market to 49% in 2019 from 51% in 2018.

Figure 6: Quarterly FPI Inflows (US$ billion)

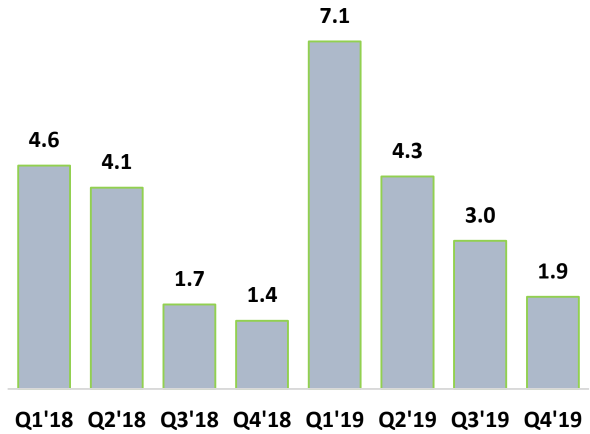
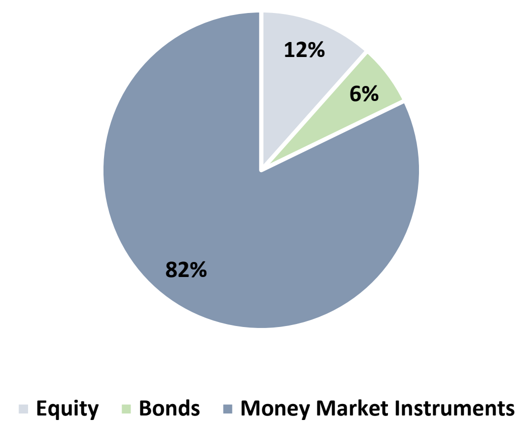


Figure 7: Composition of FPI in 2019



Source: NESG Research

"Other" Foreign Investment Inflows gained momentum

Unlike FDI and FPI, the contribution of other sources of foreign investments rose to 28% of total inflows in 2019 ($6.7 billion) from 23% in 2018 ($3.8 billion). This represents a year-on-year increase of 75.3%. On a quarterly basis, other inflows expanded by 181.9% in Q4'2019 relative to Q4'2018 and inched down by 30.6% compared with the previous quarter. Foreign loan inflows constituted a major driver of other international investment inflows as its contribution averaged 75% in 2019.

Figure 8: Trend of Other Investment Inflows ($' Billion)

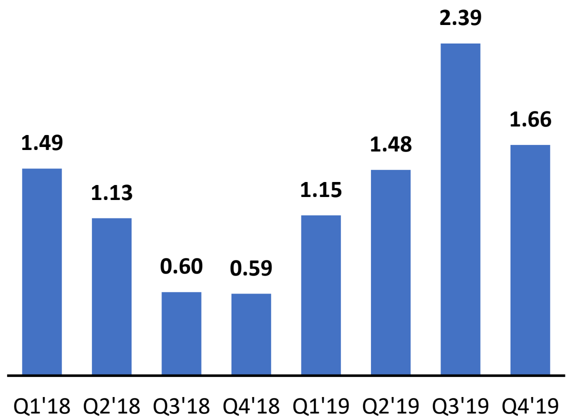
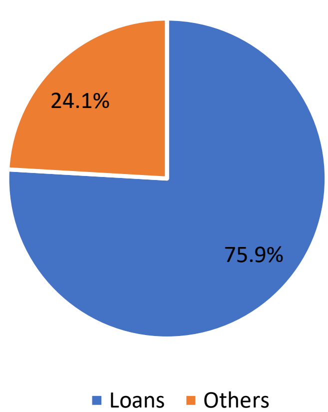


Figure 9: Composition of Other Investment Inflows in 2019

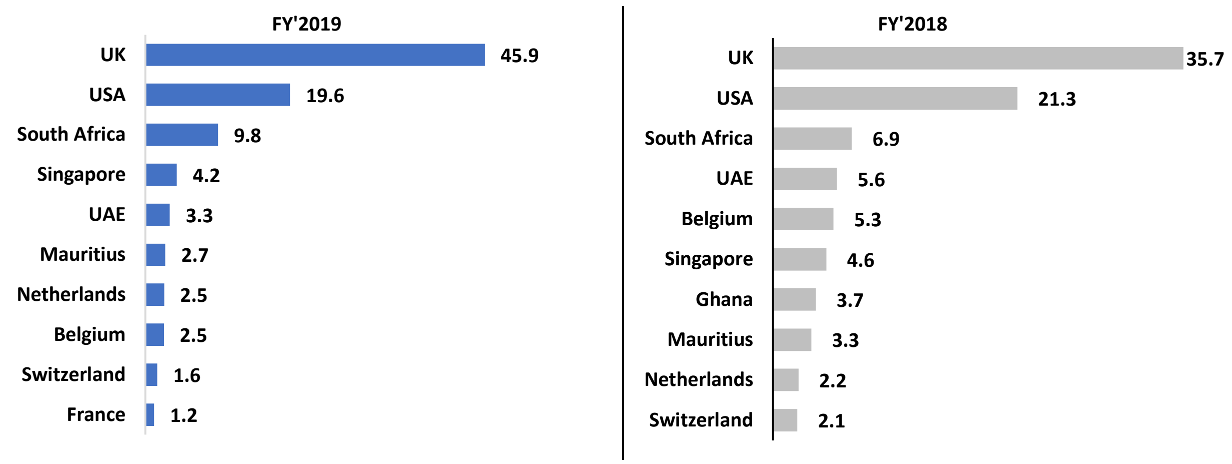


Source: NESG Research

United Kingdom, United States of America and the Republic of South Africa maintain top location of investment inflows

Nigeria's source of foreign capital continues to be undiversified with UK, US and South Africa topping the chart. Capital contributions from UK, US and South Africa stood at 45.9%, 19.6% and 9.8% respectively as UK and South Africa's contribution expanded from 35.7% and 6.9% respective while USA contributions shrunk from 21.3%. Capital investments from sub-Saharan African countries expanded especially from South Africa and Mauritius but then inflows from Ghana dipped significantly.

Figure 5: Capital Importation by Origin (% Share of Total) in 2019 & 2018



Source: NESG Research

The monopoly of Foreign Inflows still domiciles in Lagos and Abuja

Foreign investors continue to concentrate their investment in Lagos and Abuja. Lagos maintained its spot as the most attractive state in the country as it attracted 73.7% of total investment inflows while Abuja attracted 25.9%. Both sub-regions of the country accounted for 99.5% of all the foreign investment that came into Nigeria in 2019. This is unsurprising given that Lagos is the centre of commerce in Nigeria and Abuja is the seat of power. This is however, unimpressive given the dearth of foreign investment in other states of the country. Still, states such as Cross River, Benue, Adamawa, Ogun and Kaduna attracted inflows amounting to US$25.9 million, US$25 million, US$25 million, US$16 million and US$4.6 million respectively.

Foreign Banks facilitated 76.32% of Foreign Capital flows

A total of 22 banks facilitated the inflows of capital in 2019, three of which were merchant banks. Banks with international authorisation dominated the institutions that facilitated the foreign capital inflows in 2019 as they facilitated 76.32% of total inflows into Nigeria.

Conclusion

- **Predominance of FDI over FPI suggests increasing exposure to capital flight.** There are significant mutations in the structure of foreign capital inflows as it was dominated by foreign portfolio investment while foreign direct investment keeps dwindling. This makes the Nigerian economy more susceptible to external shocks arising from capital flight or incessant capital outflows. Moreover, the downgrade of the country's economic outlook from stable to negative outlook by global credit rating agencies – Fitch, Standard & Poor's (S&P) and Moddy's – is negative for investor confidence and foreign capital inflows going forward.

- **Portfolio investors target safe-haven assets on higher yields**. Since recovery from recession, portfolio investors continued to display apathy towards the equity market in favor of money market instruments, which are considered risk-free. This was motivated by high yields obtainable at the Secondary T/bill market in the first three quarters of 2019. Meanwhile, the CBN's policy banning local corporates and retail investors from participation in OMO market since October 2019 led to a crash in T/bill yields to single-digits across tenors. Persistent decline in T/bill yields coupled with falling crude oil prices could sustain the depletion in external reserves, thereby constraining the ability of the CBN to defend the domestic currency (Naira). Given the current unimpressive performance of key domestic and external economic fundamentals (GDP growth, T/bill yields, oil price and external reserves), we are likely to see lower capital inflows in 2020 compared to 2019, pending the recovery of crude oil prices.

- **FDI continues to underperform.** The decline in direct investment into the economy speaks to the need to revisit Nigeria's investment policy framework and the business environment. Despite the strides in the ease of doing business, foreign investor's confidence and optimism on the real economy is still relatively low. This is evident from the ratio of FDI to FPI at 1:18 in FY'2019. Businesses thrive in a friendly, safe and secure business environment and the government must intensify its efforts towards creating such environment, as this is essential in attracting FDI.

About NESG

The NESG is an independent, non-partisan, non-sectarian organization, committed to fostering open and continuous dialogue on Nigeria's economic development. The NESG strives to forge a mutual understanding between leaders of thought so as to explore, discover and support initiatives directed at improving Nigeria's economic policies, institutions, and management.

www.nesgroup.org| Info@nesgroup.org

THE SUMMIT HOUSE
6, Oba Elegushi Street, Ikoyi, Lagos. P.M.B 71347, Victoria Island, Lagos.
ABUJA LIAISON OFFICE: 4th Floor, Unity Bank Tower, Plot 785, Herbert Macaulay Way, Abuja
officialNESG

Contact

For more information about the content of this report and other research services, please contact:

NESG Research Team

Email: research@nesgroup.org
Tel:
+234-01-295 2849
+234-01-295 2003