Global economy slowed amidst covid-19 pandemic.

The year 2020 has been forecast to hold great promises for not only Nigeria but also the rest of the world, particularly, as the US-China trade tension was expected to become subdued. This optimism was, however, shattered by the sudden outbreak and rapid spread of coronavirus pandemic from Wuhan City of China to other countries. The viral infection has pervaded over 190 countries and territories of the world, with the worst hit being the United States, which slipped into recession in Q2'2020. Other advanced countries including the United Kingdom, Spain, France, Italy and Germany officially slipped into recession after contracting sharply by -20.4%, -18.5%, -13.8%, -12.4% and -9.7%, respectively, in Q2'2020 (see Figure 1). This is not unexpected as most countries are returning to lockdown restrictions following the second wave of coronavirus outbreak. However, China recorded a growth rebound in Q2'2020, following a contraction of 6.8% in the previous quarter. In its revised global economic outlook for 2020, the International Monetary Fund projected that most advanced countries, as well as emerging and developing economies, would contract sharply in 2020. Nigeria is no exception as the IMF projects the economy to contract by 5.4% in 2020.

Figure 1: Growth Trend in Some Advanced Countries & Nigeria

Most countries are currently suffering from the outbreak of the second wave of coronavirus pandemic. Nigeria’s major export market for crude oil, India, is not an exception. This implies that the demand for Nigeria’s crude oil would remain tepid. When combined with weak global oil prices, the country is expected to suffer a huge revenue loss, thereby worsening the trade balance. Against the backdrop that COVID-19 has disrupted supply chains, global FDI is expected to plunge in 2020. The United Trade Conference on Trade and Development (UNCTAD) projects a 40% decline in global FDI in FY’2020. This would further drive down the FDI inflows into Nigeria, which is currently at less than $1 billion annually. Due to uncertainties around coronavirus pandemic, portfolio investors are likely to adopt a flight-to-safety approach towards investment. By implication, portfolio investments would plunge in emerging markets with high indebtedness and weak external positions. Owing to the persistent decline in oil prices and lower foreign investment inflows, the Central Bank of Nigeria (CBN) has started rationing forex among end-users to protect the already weak external reserves, which currently stands at $35.6 billion.
Nigerian economy contracted by -6.1% in Q2’2020

The Nigerian economy bucked the positive growth trend it has maintained in the past three years as it contracted by 6.1% in the second quarter of 2020. On the backdrop of an expansion of 1.9% in Q1’2020, the economy contracted by 2.1% in H1’2020 compared with a cumulative growth of 2.1% in the first half of 2019. The contraction was a direct fall-out of measures taken to mitigate the spread of COVID-19 pandemic including lockdown restrictions and travel bans coupled with weak global oil prices. In nominal terms, the size of the economy in the second quarter of 2020 was N34.3 trillion (US$90.1 billion) from N36 trillion (US$94.4 billion) in the first quarter of 20201. In the first half of 2020, the nominal GDP stood at N70.3 trillion (US$184.5 billion).

Figure 2: Nigeria’s GDP growth rate

Growth fragility worsened as sectoral growth disparity widens

The impacts of the coronavirus pandemic hit deeper on major sectors of the economy as growth disparity widens. The second quarter of 2020 saw a downturn in the growth performance of major sectors and subsectors. The industrial sector has been the most affected having contracted by 12.1% in real terms in Q2’2020 compared with 2.84% positive growth in Q2’2019 and 2.26% expansion in the previous quarter. This is due to the significant role been played by the oil & gas activities in the sector, restrictions on the movement of labour and constraints on the supply chain that came with curtailing the spread of the virus. On the back of the need for social distancing, the service sector, which accounted for 53.5% of total GDP contracted by 6.8% compared with 1.9% in the corresponding quarter of 2019 and 1.6% growth in Q1’2020. Though a slower growth figure compared with 1.8% and 2.2% in Q2’2019 and Q1’2020 respectively, the agricultural sector expanded by 1.6%. Consequently, the agricultural sector increased its share to 24.7% from 22% in the previous quarter. Put together, this amount to 1.9% growth in the agricultural sector in H1’2020 compared with 2.5% in H1’2019. The industrial and the service sectors, however, contracted by 4.9% and 2.6% in H1’2020 compared with 1.6% and 2.2% positive growth respectively.

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1We utilized the official exchange rate of N381/$ for currency conversion.
In terms of the activity sectors, only 13 of the 46 subsectors recorded positive growth led by the financial institution sub-sector that gained momentum to 28.4% in Q2’2020 from 24% the previous quarter. The telecommunications subsector continues to impress expanding growth figure from 9.7% in Q1’2020 to 18.1% in Q2’2020. The four agricultural subsectors (Crop production 1.4%, Livestock 2.3%, Forestry 1.1% and Fishing 5.7%) are among the sectors that expanded in Q2’2020. Despite the gloomy growth figure, eight of the growth sectors accelerate in the second quarter, recording higher growth. Telecommunications subsector alongside the financial institution subsector is among the accelerating sectors. Meanwhile, activity subsectors such as Coal Mining; Public Administration; and Water Supply, Sewerage, Waste Management and Remediation recorded positive growth in Q2’2020 from recession position in Q1’2020.

Forex shortage and currency devaluation impacted the manufacturing sector negatively
Apart from the impact of coronavirus-induced disruptions on input supplies, the manufacturing sector in Nigeria was also challenged by forex shortage due to dwindling external reserves. For instance, the FMDQ data showed that there were no forex sales by the CBN in April 2020, after the Apex Bank intervened with a total forex auction of $2.9 billion (78% of total forex inflows) in March 2020. Similarly, the devaluation of Naira at the official Forex market coupled with the attendant production costs dampened the performance of the sector in the second quarter of 2020. Consequently, the manufacturing sector contracted sharply by 8.8% in Q2’2020 from the very slow growth of 0.43 in Q1’2020. This culminated to a 4.2% contraction in the manufacturing sector in the first half of 2020.
Domestic and international travel bans crippled the transport and trade sectors
The restriction of inter-state travels coupled with the ban on international flights impacted the transport and trade sectors negatively. The transport sector slipped into contraction territory by 40.2% in Q2'2020, to the extent that the profitability of the existing airline operators was adversely affected. It was reported that the largest Nigerian airline – Air peace – has laid off about 1,000 workers including pilots. Other airline operators are also embarking on retrenchment. On the other hand, the trade sector further contracted by 16.6% in the second quarter of 2020 as activities were highly constrained at the wholesale and retail segments of the trade sector. This led to 9.7% and 23.2% contraction in both the trade and transport sectors in H1'2020 respectively.

The telecoms, as well as the financial institution sectors, received some boost from the stay-at-home policy and social distancing rule
The stay-at-home policy, as well as the compliance of Nigerians to the social distancing rule, led to a significant demand for ICT services such as teleconferencing, video-conferencing and telecommunication, among others. This is reflected in a sharp increase in voice and internet connection in the second quarter of 2020. According to NBS, the size of active internet subscribers grew by 17.1% year-on-year to 136.2 million in Q1'2020. Similarly, the number of voice subscribers rose by 9% year-on-year to 189.3 million in the same quarter. The movement restriction orders also impacted the financial institutions as many of the transactions that would have ordinarily escaped the banking system now have to pass through the banks. This is obvious in the growing adoption rate of different banking platforms. This led to increased sectoral income for the financial institutions, especially the non-interest income. Based on H1'2020 performance, the telecommunications and the financial institutions sectors recorded growth of 13.9% & 26.2% compared with 11.8% & -6.37% in H1’2019 and 3% & 11.5% in H2'2019 respectively.

Foreign trade deficit expanded with falling oil prices and crude oil production
The disruption in the global supply chain as a result of the Coronavirus pandemic is affecting oil prices as the economies of major oil importers is slowing down/contracting. Coupled with the supply cut deal which Nigeria has confirmed compliance, the value of Nigeria’s export is falling. According to the NBS Foreign Trade Statistics Report, Nigeria recorded a trade deficit of N421.3 billion in Q1’2020 as total export declined by 14.4% (Quarter-on-Quarter) and 10.0% (Year-on-Year) to N4.1 trillion while import was N4.5 trillion. Due to the fallout of the Coronavirus, the trade situation worsened as the trade deficit expanded to N1.8 trillion in Q2’2020 – export value declined to N2.2 trillion against import value of N4 trillion. Half-year, this amount to –N2.2 trillion in trade deficit down from N1.4 trillion in trade surplus in the corresponding period of 2019 and N810.3 billion in the previous half-year. The current account balance maintained similar trend, Nigeria recorded a deficit of US$4.9 billion in Q1’2020 also from a deficit position of US$2.7 billion same period in 2019 and US$7 billion the previous quarter.
Foreign Investment Inflows nosedived on the back of plummeting investors’ confidence
The spread of COVID-19 as it affected the global economy impacted investors’ confidence across countries. Couple with its impacts on the oil market, the major source of foreign exchange inflows to Nigeria, foreign investors held back on their investments in Nigeria. In Q1’2020, foreign investment inflows declined year on year by 31.2%, however, increased quarter on quarter by 54% to US$5.9 billion. The Q1’2020 foreign investment figure was dominated by the foreign portfolio investments (FPI) at N4.3 billion accounting for 73.6% of total inflows. Foreign direct investment, on the other hand, accounted for 3.7% of total accruing US$214.3 million. As a fallout from the COVID-19 pandemic, foreign investment inflows declined further by 78.6% year on year and 77.9% quarter on quarter in Q2’2020 to US$1.3. All the components of foreign investment inflows recorded a significant decline – FDI declined by 33.4% (Year on Year) and by 30.6% (Quarter on Quarter) while FPI recorded the most decline by 91.1% both year on year and quarter on quarter to US$385.3 million. Put together, foreign investment inflows in the first half of 2020 decline by 50.9% to US$7.1 billion when compared with H1’2019 figure. It also declined by 24.2% when compared with H2’2019. Particularly, the difficulties experience by foreign investors to repatriate their funds as Forex scarcity hits harder in Q2’2020 and dousing yields across alternative assets motivated by CBN OMO policy instigated the sharp decline in foreign investment inflows.
Exchange rate devaluation came with the shortage of Forex

The declining oil export as it affects the inflow of petrodollar dampened the stability in the foreign exchange market. This impacted the already depleting foreign exchange reserves and caused the Central Bank of Nigeria (CBN), to devalue the naira within the first half of 2020. To open the year, Nigeria’s stock of foreign reserves stood at US$38.6 billion in June 2019. This, however, declines further to US$33.4 billion in April 2020 before reaching US$36.2 billion at the close of H1’2020. The slight recovery in reserves was due to the IMF’s US$3.4 billion loan targeted at correcting foreign imbalances. In response to the constrained foreign exchange management and bid to align with the conditions of multilateral lenders, the CBN devalued the naira from NGN307/US$ it opened the year to NGN361/US$ that ended the month of June 2020.

Constrained supply chain and the slowdown in the agricultural sector was reflected in rising inflation trend

The outbreak of COVID-19 and the resulting lockdown measures disrupted the global supply chain, transport system and especially the planting season in Q2’2020. The slower pace of growth in the agricultural sector was reflected in an upward trend in food inflation, which rose consistently since the beginning of the year 2020 from 14.9% to 15.2% in June. Given that food items account for over 50% in the composition of Nigeria’s consumer price index (CPI), it propelled a persistent increase in headline inflation. The constraint on the general supply chain alongside a hike in transport cost impacted the core inflation. In addition to adjustments in the exchange rate, there was a steady increase in core inflation from 9.4% in January 2020 to 10.1% in June 2020. Put together, the headline inflation increased to 12.6% in June 2020 from 12.1% in January 2020.

The aftermath of COVID-19 constrained the already challenging fiscal position

Beyond the health implications of the spread of COVID-19, it strained the global supply chain and economy. This led to a fall in the demand for oil and the eventual crash in oil prices. This impacted Nigeria’s government revenue mobilization strategy as oil revenue still accounts for over 60% of government revenue. Moreover, the impact of various lockdown rules (especially in the Lagos, Ogun and Abuja, the three business and manufacturing hubs of the nation) and need for social distancing and compulsory stay-at-home further constrained domestic revenue mobilization. This dampened the possibility of achieving the 2020 budget revenue projection and threatened meeting the expenditure target of the government for 2020. Coupled with the surge in emergency spending and provision of relief measures, the government will have to spend more than budgeted, which will expand the fiscal deficit for the year.
The Federal Government earlier budget expenditure for 2020 was N10.6 trillion with N8.4 trillion in revenue and N2.2 trillion in the budget deficit. The fallout from COVID-19 spread led to a revision in government budget as expenditure target increased to N10.8 trillion while budget deficit now N5.4 trillion. Budget assumptions were also revised: the oil price benchmark was revised to $25 per barrel from $57 per barrel and oil production was revised to 1.94 million barrels per day from 2.18 million barrels per day.

Figure 9: Signed 2020 Budget

Data: NBS; Chart: NESG Research

Government debt position gets increasingly concerning especially as external debt picked up pace against the domestic debt. Sequel to the increased spending need of the government to meet up with COVID-19 interventions and relief measures, the government is increasing its stock of both domestic and external debt. Just in Q1’2020, according to the Debt Management Office publication, the Nigerian government incurred a total of N1.2 trillion, which spurred the total debt stock to N28.6 trillion as at 31st March 2020. This was manifested by N964.9 billion and N262.2 billion increase in external and domestic debts respectively. Moreover, based on the government’s activities in the capital market, it is observed that the federal government in H1’2020 conducted six scheduled FGN Bond Auctions and allotted a total of N1.31 trillion to investors. In the Treasury bill space, the federal government conducted 14 Primary Auctions in H1’2020 and allotted a total of N1.5 trillion. Also, the federal government has received approval from the National Assembly to secure $5.5 billion in multilateral loans from IMF, World Bank, AfDB and IsDB to tackle the backlash from COVID-19 pandemic. As at the end of June, the government has completely secured $3.4 billion from the IMF and working to meet the conditions from the World Bank and other bodies.

Figure 10: Distribution of Public Debt Stock

The monetary policy position was mixed in the first half of 2020.

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The CBN intensifies on its unconventional measures as monetary policy tools become constrained in the face of rising liquidity, inflationary pressure, foreign exchange instability and economic fallout of COVID-19 pandemic. The rising liquidity is, however, the aftermath of the Open Market Operation (OMO) policy of the CBN in 2019 that restricted non-bank corporates and individuals from participating in OMO transactions both in the primary and secondary market. This made it impossible for some existing investors to roll over their investments in the OMO market, thereby shoring up the liquidity level. Consequently, yields across all sovereign instrument kept on nosediving – average yields on FGN Bond, Treasury Bills and OMO declined further to 8.6%, 2.2% and 5.1% at the close of June 2020 from 10.8%, 4.9% and 13.2% that opened the year respectively.

On the other hand, rising inflation was a sequel to the border closure order by the federal government and amplified by the spread of COVID-19 as it affected the global supply chain. In light of this, the Monetary Policy Committee in its first meeting voted to increase the Cash Reserves Ratio for banks by 500 basis points to 27.5% while the Monetary Policy Rate (MPR), Liquidity Rate and Asymmetric Corridor remained at 13.5%, 30% and +200/-500 basis points they opened the year respectively. However, the MPC adjusted the MPR downward by 100 basis points to 12.5% in May 2020, in response to the impact of COVID-19 on the economy.

In the Foreign exchange market, the CBN, having established I & E Window in 2017, continues to perform its interventionist role in the market. Sequel to the spread COVID-19 suspended sales of Forex to the Bureau De Change operators and interventions in the I & E Window. The CBN, however, resolved to embark on selected sales of Forex.

**Lockdown measures exacerbated Nigeria’s unemployment problem in Q2’2020**

The lockdown restrictions that were observed in a number of states, particularly Lagos, Ogun and FCT-Abuja crippled business activities and prompted most companies to scale down their staff strength. According to a COVID-19 Monitoring Survey conducted by NBS between April and May 2020, about 42% of the respondents that were on paid-employment before coronavirus outbreak in Nigeria lost their jobs during the pandemic. Consequently, the unemployment rate jumped to an all-time high of 27.1% as at Q2’2020 from 23.1% as at Q3’2018. The downsizing of manpower culminated in the production slowdown of manufacturing companies, with an attendant decline in overall output or real GDP in Q2’2020. According to CBN, the manufacturing PMI remained in negative territory at 42.4 points in August 2020, indicating contraction in the manufacturing sector for the fourth consecutive month in the year.

**Figure 11: Trends of Unemployment Rate in Nigeria**

![Figure 11: Trends of Unemployment Rate in Nigeria](image)

Data: NBS; Chart: NESG Research

**Economic Outlook for H2’2020**

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Several industry estimates showed that the Nigerian economy would contract by over -5% in FY'2020. The growth numbers for the first quarter showed that the economy contracted by 2.1%. The continuation of Forex rationing among end-users and the multiple windows are expected to hurt Nigeria’s import-dependent manufacturing sector. The manufacturing PMI, which remained in contraction territory at 44.9 points in July 2020, is an indication that the economy is not likely to have recovered from the recessionary impact of COVID-19 in Q3'2020. Another quarter of negative growth would imply that the Nigerian economy has slipped into a recession in five years. Given the concerted efforts towards the gradual re-opening of the economy coupled with attempts towards the lifting of the ban on international flights, we anticipate an improved economy in the Q4’2020 with potential positive growth. The real GDP growth would largely be driven by the non-oil sector. We expect the oil sector to remain in contraction territory due to lower investment in the upstream oil and gas sector arising from weak global oil prices and the Nigerian government’s decision comply with the OPEC’s oil production cut agreement previously reached in April 2020.

Table 1: Growth Forecasts for 2020

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Action Points for Economic Recovery

- **Need for clarity and transparency in the FOREX market intervention strategies.** The Naira is currently believed to be overvalued due to regular CBN interventions in the Forex market. This has come at the expense of external reserve. The existence of multiple Forex windows brings about uncertainty in evaluating the profitability of alternative investments. Moreover, the difference in exchange rates across windows allows round tripping and arbitrage, which puts unnecessary pressure on Forex demand while the inflows remain relatively unchanged. Hence, there is a need for clarity as to what the central exchange rate for the country should be to improve investors’ confidence. In a country like Nigeria where the source of Forex inflow is fragmented, a managed float exchange rate will continue to be the optimal choice. Stability in the Forex market can only be achieved by identifying targeted market reflective exchange rate. CBN intervention can then be a cross-border auction for market operators in the form of liquidity mopping. The CBN can then set the direction of the market by selling at a policy desired rate and volume.

- **Development of Agro-allied industries to kick-start Nigeria’s industrialization drive.** The supply disruptions caused by COVID-19 presents a suitable case for Nigeria to boost inter-sectoral linkages, particularly between the agricultural sector and the manufacturing sector. Improved commitment towards value chain development would not only speed up economic recovery but also boost the resilience of the industrial sector during the crisis period.

- **Refurbishment of the existing refineries is instrumental to the recovery of the manufacturing sector.** The performance of the manufacturing sector has overtime been suppressed by the persistent contraction in the oil-refining subsector. The existing refineries could be revived through a joint venture deal between the government and equity stakeholders, which would put an end to the monopoly that is currently being enjoyed by the NNPC. Increased production of refined petroleum would not only boost manufacturing sector growth but would also reduce the pressure on Nigeria’s weak external reserves. For example, in FY’2019, mineral fuel import accounted for 15.5%, amounting to US$8.6 billion (N2.6 trillion at NGN307/US$ 2019 exchange rate). A substantial part of this could have been saved in Forex reserves. The eventual deregulation of the oil and gas sector would be the way forward, which will attract foreign investment inflows into the economy.
The contraction in the construction sector suggests the need to emphasize Public-Private-Partnership (PPP) project financing. The growth of the construction sector was reversed due to the sector’s huge reliance on government spending on infrastructure, which is being threatened by dwindling oil revenue. The possible recovery of the construction sector would require alternative project financing such as public-private partnership (PPP) to reduce the burden on the government. Exploring alternative financing sources would also help reduce the country’s infrastructural deficit (estimated at $3 trillion by the AfDB) and free resources for investment in other critical areas of the economy such as education and health.

Need for huge investment in the ICT sector to sustain performance and drive the growth of other sectors of the economy. For the ICT sector to sustain its growth momentum, there is a need to expand the capacity of the country’s ICT infrastructure, which can only be achieved through massive investment in the sector. Improving the ICT infrastructure at public higher institutions would bring about a multiplier effect on the education sector, which contracted sharply by -24.1% in Q2'2020. This would, in turn, moderate the impact of coronavirus on the performance of the overall services sector going forward.

Ease the Doing Business Constraints for private sector development. The current business environment is constrained by the inadequate power supply, infrastructural deficit, ad-hoc and inconsistent policies, among others. Addressing these constraints would not only enhance private sector development but would also unlock more job opportunities for the youths.