Nigerian Economy in Review:

Emerging Issues and Ways Forward

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Background

The emergence of a new dispensation offers an opportunity for Nigeria to reassess and adjust its development priorities. The Nigerian economy continues to evolve, especially in the face of a targeted market reform environment. However, this has a downside, particularly as removing petrol subsidies and harmonising the foreign exchange market have amplified some of the existing economic challenges.

So far in the year, the economy's performance has been subdued and vulnerability amplified. In the first three quarters of 2023, average real Gross Domestic Product (GDP) growth slowed to 2.5 percent from 3.0 percent recorded in the same period of 2022. This is motivated by subdued performance across major sectors due to the impact of policy shocks of the Naira redesign policy, fuel subsidy removal, and exchange rate unification on businesses and the overall economy.

Besides, by extending its recession to 14 successive quarters, the oil and gas sector continues suppressing the economy. Meanwhile, inflationary pressures intensified, reaching a record high of 27.3 percent in October 2023. The exchange rate also fell mainly due to the unification, fluctuating between N750/US$ and N1000/US$ compared with N460/US$ that opened the year's trading. Although the external trade balance improved in the year, it was too weak to support the economy as capital inflows maintained a downward trend.

While Nigeria is not alone in the current challenging economic environment, the economy's performance continues to reflect some inhibiting issues that need to be addressed to further ease Nigeria's growth space. Hence, this brief highlighted some of the burning issues and ways forward.

Economic Issues

Low domestic crude oil production and constricted fiscal space: Low crude oil production could be traced to many causal factors, including oil theft, low investment, and ageing infrastructure. The low-hanging fruit is to reduce the incidence of crude oil theft while improving the business and policy climates to attract substantial investment inflows into the Oil and Gas sector. The removal of fuel subsidies constitutes a crucial incentive for prospective investors. Meanwhile, crude oil monetisation (driven by oil price and production) remains the dominant source of fiscal revenue and a significant source of vulnerabilities. With one of the world's lowest tax revenue-to-GDP ratios, Nigeria needs to focus efforts on collecting non-oil revenues, particularly taxes. The other side of the coin to fiscal revenue is the insensitivity of public spending growth to low revenues. This has been bulging Nigeria’s fiscal deficits and mounting public debts. To this end, there is an urgent need to prioritise public spending and ensure that a large chunk of public debt is channelled to funding capital expenditure.

Insecurity and its impact on economic activities: The urgent need to tackle social, economic, and political exclusion to curtail insecurity cannot be overemphasised in Nigeria. Similarly, there is a need to track the activities of insurgents by monitoring Nigeria's porous borders and ungoverned territories. Also, there is a need to convene a national conference to address the rising secessionist agitations nationwide. Moreover, the policing function of the Federal government must be devolved to enhance effectiveness. This also entails establishing a community policy system leveraging local intelligence gathering. Similarly, the constitution should be reviewed to strengthen the role of traditional rulers in security management.

Infrastructural bottlenecks and the need for collaboration between fiscal and monetary authorities: In his Speech at the 60th Anniversary of the CIBN, the CBN governor hinted on the need for a well-crafted structural policy to address infrastructural bottlenecks. This needs to be complemented by coordinated monetary and fiscal efforts. There is a need for a clear-cut framework that spells out the range of areas where the fiscal and monetary authorities can collaborate. Also, the collaboration should be done such that one jurisdiction recognises the limits/responsibilities of the other. This leaves more room for operational independence. In addition, this complemtyentary status of the two policy authorities would reduce policy risks/conflict, such as the failed Naira redesign policy, and boost investors' confidence in the economy.

Ways Forward

Achieve Macroeconomic Stability: The Ukraine war has rapidly amplified the instability presented in the form of rising inflation rates, acute exchange rate depreciation, and fiscal deficit. To the extent that exchange rate depreciation also contributes to rising inflation, there is a need to double efforts on driving non-oil Foreign Exchange (FX) earnings as the weak domestic currency is primarily caused by FX scarcity. The government needs to prioritise attracting adequate FX inflows from the sales of other commodities, foreign investment inflows, and remittances to diversify the FX sources to reduce the pressure on the Naira and the external reserves as the oil and gas sector continues to struggle.

The CBN's revert to orthodox policy and focus on the price stability objective while dropping its previous quasi-fiscal activities is commendable. Approving the explicit inflation-targeting framework, enhancing the effectiveness of our monetary policy, providing forward guidance, enhancing transparency, and maintaining effective communication with the public to anchor expectations and build trust among stakeholders under the current CBN leadership will also ensure that the Apex Bank achieves its core mandate. Furthermore, efforts at reducing banking liquidity are acknowledged and commendable; however, the Apex Bank must refrain from outrageous monetisation of fiscal deficits. The other regulatory measures against high inflation could be ineffective if not checked.

Support banking adequacy for the envisioned Nigeria: The current macroeconomic environment, marred by instability, rising inflation rate and currency devaluation, has eroded the capital base of financial institutions. While the financial system's soundness meets regulatory benchmarks, it may not be resilient against internally and externally transmitted shocks or sufficient to finance the ambitious goal of achieving a US$1.0 trillion economy over the next seven years. Therefore, the CBN needs to develop a more coordinated framework for the financial system management to improve the performance of Nigerian banks and develop a new regulatory and compliance framework.

Improve financial Inclusion: Financial inclusion is one of the areas for collaboration between the fiscal and monetary authorities. With a financial inclusion rate of 64.1 percent, most Nigerian adults may not have difficulty accessing essential financial services. Still, access to credit for business and consumer credit is rare for most of them. Besides, access to finance significantly contributes to many forms of deprivation. Beyond access to banks, there is a need for an improved credit system to achieve considerable progress in the CBN's financial inclusion drive.

Improve access to finance for businesses: Beyond ensuring capital adequacy for banks (particularly Tier 2 banks), the CBN needs to improve business financing, especially as it concerns Nano, Micro, Small and Medium Enterprises (NMSMEs). Credit to the NMSMEs needs to be higher than their contribution to the economy. According to SMEDAN, MSMEs account for 97 percent of businesses in Nigeria and contribute about 50 percent to the GDP. The CBN needs to work out an arrangement with Deposit Money Banks (DMBs) and other players in the financial ecosystem to promote development finance, especially for NMSMEs (either through moral suasion or tapping into banks' excess reserves).

Attract capital investments and support NMSMEs as a growth accelerator: There is an urgent need for a financial system overhaul for Tier 1 banks to facilitate large inflows of private capital into different sectors of the economy. Also, there is a need to provide suitable financial instruments to ensure that NMSMEs thrive. Various segments of micro-financial institutions need to be strengthened for this purpose, including micro-credit, micro-insurance, micro-pension, national development financial institutions, and digital financial services.

- **Micro-Credit Institutions:** These micro-finance institutions were established purposely to meet the demands of the NMSMEs, which could not access credit in large financial institutions (Tier 1 and Tier 2 banks). This segment should be encouraged to channel substantial funds to NMSMEs at affordable interest rates rather than investing heavily in short-term government securities.

- **Micro-Insurance:** This channel could provide adequate insurance coverage against the risk of financial loss for NMSMEs. Hence, there is a need for mass campaigns and displays of transparency to regain the trust of business owners and boost enrollment rates.

- **Micro-Pension:** This segment provides a savings plan until old age for NMSME operators, and it is expected to improve the behaviour of business owners. Regaining public confidence and widespread publicity are key inputs towards improving enrollment rates.

- **Digital Financial Services:** Due to the lack of adequate credit facilities from micro-financial institutions, many NMSMEs operators have been exposed to digital financial services, particularly the digital lending space, which perpetrates exploitative activities. Hence, there is a need to balance innovation and regulation.

- **National Development Financial Institutions:** This segment, including the Bank of Industry and the Nigerian Export-Import Bank, should be encouraged to provide trade finance to NMSMEs operators to facilitate the production and exportation of their products on a large-scale basis.

Conclusion

The year 2023 ushered in a new administration with many hard choices. The Federal Government has recently implemented two tough reforms – fuel subsidy removal and unification of the multiple exchange rates, which has amplified the pre-existing economic challenges in the country. While we anticipate the upsides of recent reforms in the medium to long term, this brief highlighted some of the burning issues that must be addressed to avoid losing out on potential gains.

About the NESG

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

Our views and positions on issues are disseminated through electronic and print media, seminars, public lectures, policy dialogues, workshops, specific high-level interactive public-private sessions and special presentations to the executive and legislative arms of government.

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