2021 Q1 ECONOMIC REPORT

JUNE 2021

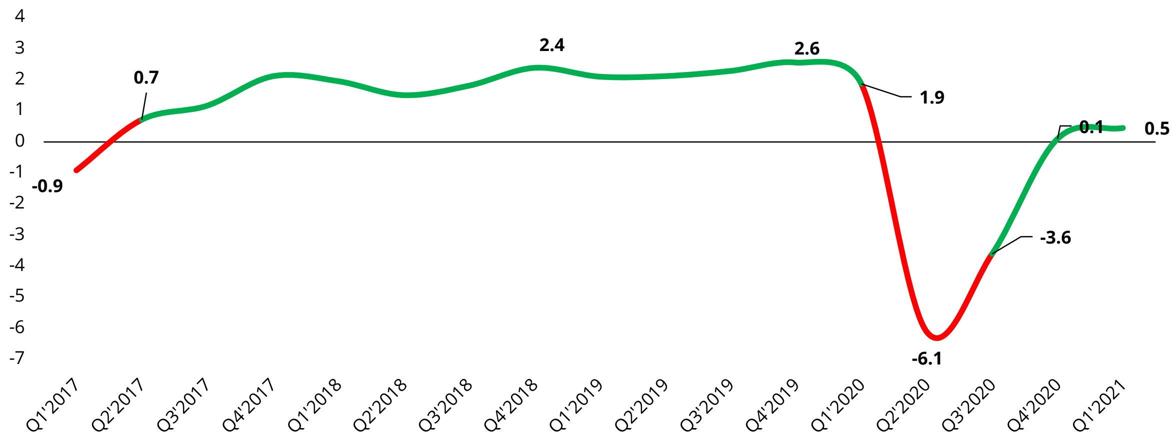
Real Sector Developments

Nigerian economy consolidates recovery, grew further by 0.5% in 2021Q1

According to the National Bureau of Statistics (NBS), the Nigerian economy expanded by 0.5% in the first quarter of 2021. This performance represents the second consecutive expansion following the country's recovery from recession in 2020Q4. It is, however, a slower growth when compared with the real gross domestic product (GDP) growth recorded in 2020Q1 (1.9%). Despite the positive growth trajectory, the current level of economic growth is relatively weak and aligns with the trend observed following the exit of the economy from the previous recession in 2017Q2. In nominal terms, the size of the Nigerian economy in 2021Q1 stood at N40 trillion (US$105.5 billion)[1].

The gradual improvement in economic activities was largely driven by the non-oil sector, which accounted for 91% of total real GDP. The non-oil sector grew by 0.8% in 2021Q1, representing a slow pace of expansion relative to its performances in 2020Q1 and 2021Q4. The key contributors to the non-oil sector growth in the quarter were the agricultural and industrial sectors, with a combined share of 46% in total real GDP. Similarly, the agricultural and industrial sectors, respectively, contributed 98% and 44% to the overall real GDP growth between 2021Q1 and 2020Q1. However, the oil sector – which accounted for 9% of real GDP - remained in contraction territory at –2.2% in 2021Q1. This poor performance could be attributed to a sharp fall in crude oil production to 1.7 million barrels per day in 2021Q1 from 2 million barrels per day in 2020Q1; thus, reflecting mainly improved compliance of Nigeria with its OPEC's output quota.

Figure 1: Nigeria's GDP growth rate (%)



Data: NBS; Chart: NESG Research

Amid several socio-economic challenges, particularly the high rate of insecurity in the major food-producing regions, the agricultural sector maintained its positive growth trajectory into 2021Q1. The sector expanded by 2.3% in the quarter, representing an improvement relative to 2.2% in 2020Q1. This performance was driven by the accelerated growth in fishing and livestock sub-sectors in 2021Q1 relative to 2020Q1. The industrial sector also witnessed a rebound, and posted a growth of 0.9% in 2021Q1; though relatively slower than the sector's growth of 2.3% in 2020Q1. Nonetheless, the recovery of the industrial sector was largely buoyed by the significant improvement in manufacturing

[1]We utilized the official exchange rate of N379/$ for currency conversion which was the subsisting rate before the CBN adopted the NAFEX or IEFX exchange rate starting from May 11, 2021.

activities in 2021Q1. The manufacturing sector largely benefitted from strong growth recorded in key activities including cement and food & beverages sub-sectors. However, the Services sector, which has been hard-hit by the COVID-19 crisis since 2020Q2, contracted by -0.4% in 2021Q1, compared with a growth of 1.6% in 2020Q1. The reversal to a negative growth path in 2021Q1 could be attributed to a significant slowdown in the ICT sector, as well as, a contraction in transport, accommodation and food services, trade and finance sectors.

Inflation continued to surge amidst rising levels of insecurity

Despite the re-opening of the country's land borders in December 2020, inflationary pressures remained elevated going into the year 2021. The upward trend in inflation could be largely due to the increasing spate of insecurity in the Northern region – Nigeria's food basket. In March 2021, the headline inflation reached a four-year high of 18.2%. Higher food prices largely caused the continuous rise in inflation. Accordingly, food inflation peaked at a 16-year high of 23% in March 2021. Core inflation also stood high at 12.7% in March 2021, due to other inflation stocking factors, such as, electricity tariff hike, fuel price increase, high transport and logistic costs and continued implementation of VAT increase. Although relatively high, both headline and food inflation moderated to 18.1% and 22.7% in April 2021. Meanwhile, the core inflation stood flat at 12.7% in the same month.

The rising scourge of unemployment and poverty is reflected in youth restiveness and social unrest

Nigeria's economic growth trajectory is better described as jobless and less inclusive even in the heydays of high growth regime in the 2000s. While the Nigerian economy recovered from recession in 2020Q4, unemployment rate spiked to its highest level ever at 33.3% in the same quarter. With the COVID-19 crisis heightening the rate of joblessness, many Nigerians are expected to fall into the poverty trap, going forward. The World Bank estimated an increase in the number of poor Nigerians to 90 million in 2020 from 83 million in 2019; this corresponds to a rise in headcount poverty ratio to 44.1% in 2020 from 40.1% in 2019. The rising levels of unemployment and poverty are reflected in the persistent insecurity and social vices, with attendant huge economic costs.

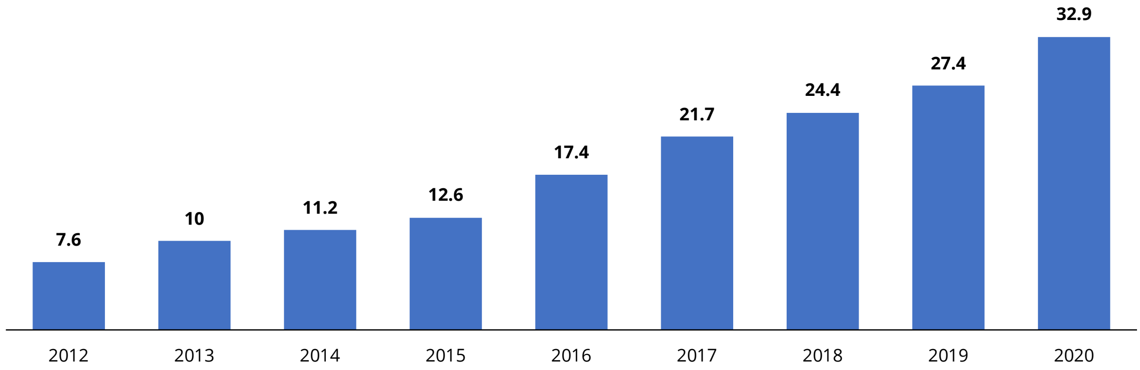
Fiscal and Monetary Policy Developments

The limited fiscal space suggests that public debt stock is not set to buck its upward trend

Huge dependence on proceeds from crude oil, leaving other revenue sources unexplored, indicates that Nigeria is not set to rein in debt accumulation in the short to medium term. Public debt stock continued to trend upwards, with a jump from N7.6 trillion (US$48.7 billion) in 2012 to N32.9 trillion (US$86.8 billion) in 2020 . Very interesting to note is that public debts grew by 20% between 2019 and 2020. This is partly due to the need for emergency funds to combat the global pandemic and alleviate its adverse economic impacts on households and businesses. A large chunk of Nigeria's public debts is linked to domestic borrowing – which accounted for 61% of total debts as at 2020Q4. Meanwhile, in recent times, external borrowing started gaining momentum as it surged from N1 trillion (14% of total debts) in 2012 to N12.7 trillion (39% of total debts) in 2020. Similarly, total debt service-to-revenue ratio jumped from 12.3% in 2012 to 40.3% in 2020.

[3] We utilized the official exchange rates of N156/$ and N379/$ for 2012 and 2020, respectively, for currency conversion.

Figure 7: Nigeria's Public Debt Profile (N'Trillion)



Source: Data: Debt Management Office (DMO); Chart: NESG Research

The rising debt levels could be partly attributed to weak revenue generation, particularly arising from the negative impact of COVID-19 on oil export earnings in Nigeria. Year-on-year, the country's total gross revenue (FAAC disbursements) declined by 5.3% to N1.9 trillion in 2021Q1 from 2 trillion in 2020Q1. Moreover, the persistent accumulation of external debts – largely dominated by commercial debts, particularly, Eurobonds – has only magnified the external vulnerability of the economy in terms of rising debt servicing costs, with intense pressure on the weak revenue base, external reserves and the domestic currency. Consequently, Nigeria's credit rating was downgraded from stable to junk by the global rating agencies in 2020. This, to a large extent, is an unwelcome development for domestic and foreign investors.

The Monetary policy environment remains constrained amidst the inflation-growth trade-off

The persistent increase in inflation in the face of slow economic recovery has largely constrained monetary policy stance so far in the year 2021. At its sessions in January and May 2021, the Monetary Policy Committee of the Central Bank of Nigeria maintained status quo on all monetary parameters: Monetary Policy Rate (at 11.5%), Cash Reserve Ratio (at 27.5%) and Liquidity Ratio (at 30%). Though the CBN is expected to deploy its traditional instruments, including OMO Bill and the recently introduced Special Bill to manage excess liquidity, key factors, such as, fuel price hike, high transport costs, VAT increase, electricity tariff hike and insecurity, would keep inflation elevated in 2021. Year-on-year, broad money supply rose sharply by 11.5% to N38.7 trillion in 2021Q1 from N34.7 trillion in 2020Q1. The MPC has always extolled the CBN's 65% LDR implementation since 2019, which led to the spike of aggregate domestic credit to N43.2 trillion in 2021Q1 from N37.3 trillion in 2020Q1. In addition, the ineffectiveness of the MPR as an anchor rate is reflected in its wide variance with some market rates as at 2021Q1, including: the average T/bill rate across tenors (3.6%) and average maximum lending rate (28.5%).

External Sector Developments

Global economy is set to return to a recovery path, amid rising COVID-19 cases

Despite the rising number of COVID-19 cases, which stood at 169.6 million as at May 31, 2021, the global economy is set to enter a recovery phase. This is largely attributed to the resumption of activities in many countries since 2020Q4 and due to mass vaccination aimed at taming the spread of the pandemic. The gradual recovery of the global economy was reflected in the improvement in global trade volumes, which rose by 10% year-on-year in 2021Q1. This favourable performance was largely driven by the speedy recovery of many East Asian economies, led by China. Accordingly, UNCTAD projected that global trade would grow by 16% in 2021 . The IMF is also optimistic in its growth projection for the global economy, as it expected an economic rebound at 6% in 2021 relative to a contraction of –3.3% in 2020. The global economic recovery is expected to be significantly driven by the United States and China.

Persistent contraction in crude petroleum sector amidst rising global oil prices would translate to wider trade deficits

In light of improved compliance to OPEC's output quota, the Nigerian economy is set for a persistent shortfall in domestic crude oil production. This would, however, limit the gains from rising global oil prices – which averaged US$61 per barrel in 2021Q1 relative to an average oil price of US$52.5 per barrel in 2020Q1. The prospect of lower oil export earnings – which accounted for 87% of total forex earnings in 2020 – could further worsen the country's trade balance position, which stood at a deficit of -N3.9 trillion in 2021Q1.

Negative real returns on investment and FX market instability would discourage foreign investors' participation in Nigeria's financial markets

Widening trade deficits amidst the investors' risk aversion and weak oil export earnings could mean that external reserves would continue to deplete, while weakening the domestic currency. Nigeria's external reserves declined to US$34.8 billion as at 2021Q1 from US$35.2 billion as at 2020Q1. Similarly, the exchange rates depreciated by 17.2% and 9% in 2021Q1 to average N379/$ and N403/$ at the official and IEFX markets, respectively, in 2021Q1 relative to their levels in 2020Q1. The weak domestic currency could be traced to the series of devaluation at the official market in March and July 2020. A likely return to forex rationing - which was the CBN's practice in most parts of 2020 - would somewhat impair the confidence of foreign investors in Nigeria's financial markets; while they adopt a flight to safety approach due to negative real return on investment and uncertainty around their forex repatriation. According to NBS, foreign investment inflows plunged by 59.7% to US$9.7 billion in 2020. This was due to a sharp drop in foreign portfolio investments, which accounted for 53% of total investment inflows in 2020. Meanwhile, the CBN's adoption of the NAFEX or IEFX exchange rate in May 2021 and the rising interest rate environment could reduce the rate of capital outflows, going forward.

[3] UNCTAD. Global Trade Update as at May 2021, retrieved from: https://unctad.org/

[4] See, NESG Macroeconomic Outlook for 2020. Nigeria in a New Decade: Priority for Accelerated Growth, Job Creation and Poverty Reduction, retrievable via: https://www.nesgroup.org/research for more details.

Key Policy Recommendations

1. The Nigerian Economic Summit Group (NESG) notes that Nigeria needs more than an economic rebound; there is a need to improve growth inclusiveness. Nigeria has struggled to achieve inclusive growth for many decades. Since recovery from the 2016 recession, the economy has been on a fragile growth path until it slipped into another recession in 2020 due to the COVID-19 pandemic. This suggests that the country needs to attain high and sustainable economic growth to become strong and resilient. The relationship between economic growth and unemployment rate in Nigeria suggests that economic growth has not led to a reduction in unemployment rate – jobless growth. To reverse this recurring trend, there is an urgent need for collaborative efforts between the government and relevant stakeholders towards addressing the constraints to value chain development in high growth and employment-elastic sectors, including: manufacturing, construction, trade, education, health and professional services, with ICT and renewable energy sectors as growth enablers .

2. The NESG believes that COVID-19 has unveiled the urgent need for value chain development, particularly in the light manufacturing industry, in Nigeria. The outbreak of COVID-19 and its disruption of the global supply chains have shown the increasing need for countries to explore local sourcing of raw materials and intermediate inputs. This is expected to support and improve domestic value chain development. Considering that Nigeria is a net importer of manufactured products, there is a need to address key constraints to the growth of the manufacturing sector, including the illiquidity of the foreign exchange market and limited forex access, infrastructural and logistic bottlenecks policy lop-sidedness and distortions, among others.

3. The NESG notes that improved agricultural production will be insufficient to ease inflationary pressures, except the issue of insecurity is addressed. Despite the re-opening of the land borders that the Nigerian government shut since October 2019, inflation reached a 4-year high of 18.1% in April 2021. While we expect improved agricultural production in coming months to partially ease inflationary pressures, this positive impact could be suppressed by recurring key structural bottlenecks including insecurity in the food-producing regions, electricity tariff hike, fuel price increase and hike in transport and logistic costs.

4. The NESG commends the Federal Government on the establishment of the Infrastructural Development Company. Nonetheless, there is an urgent need to develop an effective Public-Private Partnership (PPP) framework in no distant time. In 2018, the African Development Bank estimated that Nigeria requires as much as US$3 trillion in the next 26 years to plug her infrastructural gap. Achieving this feat would require exploring alternative financing sources, such as, the Public Private Partnership (PPP) framework. An instance is a road leading to Apapa seaports, which the Dangote Group previously built under the Federal Government's Tax Credit Scheme. Creating such an environment that is suitable for private sector investment would improve the performance of the construction sector and reduce the fiscal burdens on the government.

5. The NESG lauds the re-opening of land borders. Still, more attention needs to be paid to how Nigeria can fully maximize the benefits associated with the African Continental Free Trade Area (AfCFTA) Agreement. Nigeria is expected to reap more gains through export

diversification away from crude oil, as manufacturing exports accounted for 8.6% of the country's total exports in 2021Q1. This suggests that efforts should be directed at strengthening domestic value chains, particularly the agro-allied industrial base. To achieve this, (i) there is a need to attract private capital, especially FDI, allowing for knowledge and technological transfers; (ii) there is an urgent need to address transport infrastructure bottlenecks and provide improved logistics; (iii) there is a need to find a lasting solution to the Apapa gridlock by making seaports outside Lagos more functional so as to ensure speedy clearance of consignments; (iv) Nigeria also needs to set standards for locally-made goods to enhance their attractiveness on the regional market, and (v) the Nigerian government, as a matter of urgency, needs to operate an efficient land border system to guide against the importation of low-cost sub-standard products into the country, leveraging on technology.

6. The NESG suggests the need for investment-friendly Forex management to improve investors' confidence in the Nigerian economy. The Apex Bank should rather be an independent trader in the forex market than being the main influencer. The Naira, no doubt, has been overvalued due to the CBN's forex interventions over time. Meanwhile, the NESG lauds the CBN for its recent adoption of NAFEX or IEFX exchange rate, which reflects the forces of demand and supply of forex amongst investors and exporters. This development is more likely to arouse investors' interest in the Nigerian economy, going forward.

ABOUT THE 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.

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