Looking Inwards:

Will Nigeria tread the path of Economic Recovery and Growth in 2017?

NESG Research

Abstract

In 2016, the Nigerian economy slipped into a recession. The business environment faced series of shocks arising majorly from the foreign exchange crisis, which had severe impact on operating cost, inflation and overall output. Following the lower crude oil prices, foreign exchange shortage became a major headline in the year, as Nigeria could not finance its rising import bills, while non-oil export plummeted. In this article, we present to you a review of Nigeria's economic activities in 2016 as well as the NESG's expectations for 2017. We have anchored this macroeconomic outlook on the theme "Made-in-Nigeria" and therefore stressed the need for Nigeria to look inwards by harnessing the potential that exist within the local economy.

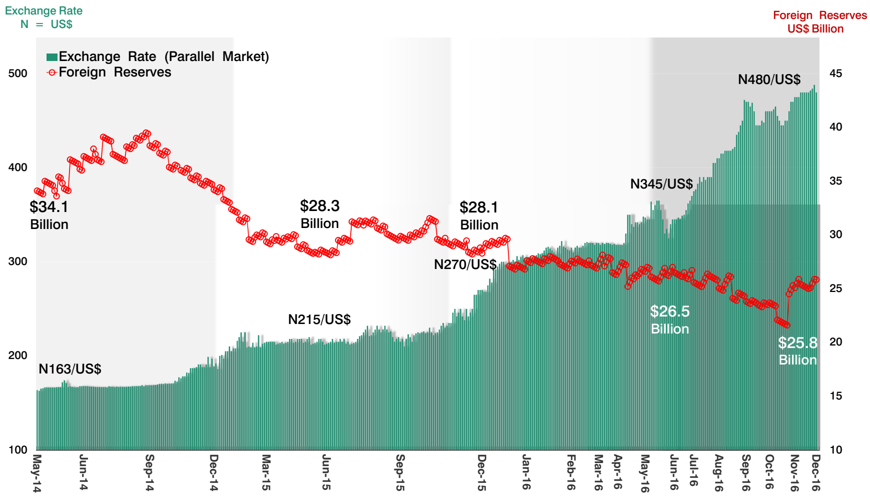
Keywords: economy, recession, GDP, manufacturing, agro-processing, looking inwards, Made in Nigeria

Introduction

Nigeria's economy suffered severe setback in 2016

The economic roller coaster, which started in mid-2014, became severe in 2016. Nearly all expectations and the much-awaited impact of policy measures did not come out in the wash. Nigeria's real Gross Domestic Product (GDP) contracted by 1.6% in 2016, a far cry from 3% growth rate recorded in 2015. A wide range of economic sectors faced severe capacity shock on the backdrop of higher input cost and foreign exchange shortage. For instance, in the third quarter of 2016, agricultural sector was held up to a growth of 4.54% from the usual 6%, industrial sector fell sharply into the negative territory of 12.21% and services sector (which makes up more than half of economic activities) progressively became weaker with a growth of -1.17%. It was not a surprise that the economy, which experienced decelerating growth in 2015, eventually climaxed into recession in 2016.

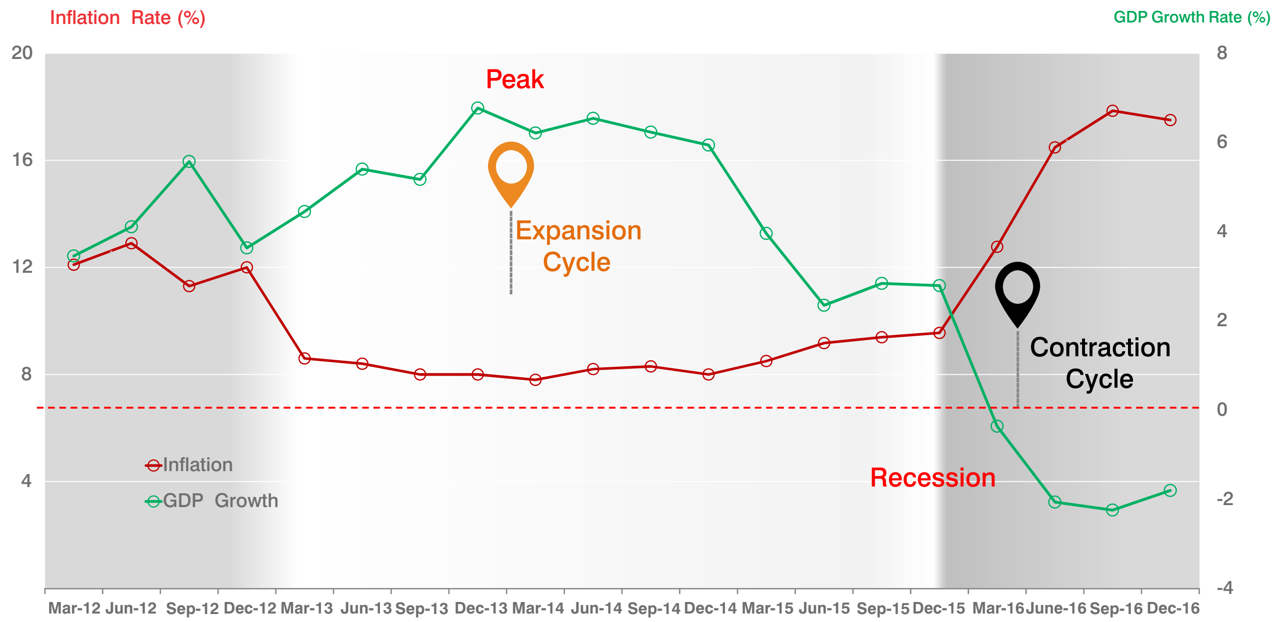
Figure 1: Nigeria's Foreign Reserves and Parallel Market Exchange Rate



Source: Central Bank of Nigeria (CBN) and National Bureau of Statistics (NBS)

With Central Bank of Nigeria (CBN) spending billions of US dollars trying to shore up the Naira, the over-burdened foreign exchange reserves could not salvage the struggling naira from the cross-currents. The various raft of measures and ad-hoc interventions in the exchange rate market were almost not effective in halting the widening exchange rate premium and resolving the liquidity challenges. For a country with heavy imports component in its consumption profile, inflation could not hold back. For the first time in 11 years, inflation closed at 18.55% in December 2016.

Figure 2: GDP Growth and Headline Inflation



The year 2017 requires the Nigerian government to be proactive and implement structural reforms

What is the main culprit of Nigeria's economic woes? Is it the low oil prices and its knock-on effects on government revenue or the shift in the global monetary policy cycles and the downside risks it has created for Nigeria's financial markets? Both are parts of recent global evolution that have contributed to Nigeria's economic deceleration and have reaffirmed how vulnerable the economy has been to external shocks. Perhaps, more importantly is the inability of the Nigerian government to respond swiftly and foreclose the expected economic shocks or at the least reduce their negative effects on broad economic indicators. But in 2017 and beyond, quick fixes should not solely be relied upon to upturn the economy towards the path of recovery and sustainable economic growth for the following reasons:

- The recent reversal in oil prices is subject to, unpredictable shocks due to the unstable global economic environment.
- Global economic policies have become fierce, playing around the risk appetite of investors and competing for investment flows.
- CBN's monetary policy has reached its crest and the various measures introduced in the FX market are approaching the limit point.

NESG research believes that the country's economic woes present an opportunity to implement some tough fiscal and structural reforms to improve the business environment, ensure self-sufficiency and export-led growth.

Yet 2017 could be an opportunity for non-oil sector and export-oriented production

2017 may not be the year for “business as usual” if any substantial gains are to come by. However, we believe there are windows of opportunities for the government to revive and transform the economy into a more productive and diversified entity with strong resilience to global shocks. In the short to medium term, the Nigerian economy needs comprehensive policy measures that will not only boost growth but also reduce its vulnerability and pave way for higher levels of broad-based production and diversified exports. Facing the downside risks from the global economy, the year 2017 will likely see macroeconomic policy shifting inwards to leverage on competitive advantage domicile in key economic sectors. Priorities will inevitably be shifted towards promoting local production through growth-enhancing measures and incentivizing local and international investors to drive “Made-in-Nigeria” goods and services.

Ideally, the recent foreign exchange crisis, which worsened in 2016, presents three major opportunities for the Nigerian economy:

- Produce goods and services that are currently imported
- Produce goods for the export market
- Source raw materials locally.

Only if the right policies are implemented

To achieve a smooth running, the need to stabilise the macroeconomic environment and ensure that Nigeria retains the trust and enthusiasm of national and international investors should be the front and centre of economic policies. This entails the mutually supportive use of the four policy prongs - monetary, fiscal, trade and structural - being tailored to sector-specific circumstances. Such comprehensive policy actions will exploit synergies of SMEs, local and foreign investors in sectors such as Agriculture, Solid Minerals, Manufacturing and ICT to drive the economy out of the recession. The federal government has covered some miles in this direction and will be rolling out its Economic Recovery and Growth Plan in 2017. Many expectations are emerging as to how the plan will sail through 2017. What are the crucial infrastructure development needed to accelerate delivery of an ideal “Made-in-Nigeria”? What budget envelope is needed from federal and state governments to finance growth-enhancing measures? What are the sector-specific elements of business environment that would deliver globally competitive economy with strong non-oil export base? These are some of the themes that will make the economy advance in 2017.

Looking inward for recovery and growth

Nigeria's quest towards economic recovery in 2017 and beyond will depend largely on how it supports the production of strategic goods and services on a large-scale to meet local and exports market needs. One justification for Nigeria to promote "Made-in-Nigeria" by improving the business environment lies in the fact that any economic recovery achieved outside the scope of supporting the productive base of the economy will not be sustainable. It would only depict a typical case of postponing the "evil day." Nigeria therefore must realize that looking inward remains the sustainable way to create jobs, enhance foreign exchange earnings through the increase in net-exports and ultimately get Nigeria out of the economic recession. It is, undoubtedly, true that a strong productive sector protects the economy from unforeseen external shocks and, therefore, engenders sustainable economic growth through job creation and value-addition.

In our view, two activity areas- agriculture/agro-processing and manufacturing are crucial in enhancing local capacities, job creation and improving Nigeria's external position through an increase in net exports. These strategic sectoral activities are primary drivers of Made-in-Nigeria initiative.

Agriculture and Agro processing

Globally, the challenge of food sufficiency and security remains at the front burner of policy concern. Whereas Nigeria's inability to meet its domestic food requirements is a major challenge; the situation also presents enormous opportunities to get the economy back on the recovery path.

At 4.5%, agriculture was the fastest growing economic sector in 2016 Q3, accounting for 24% of GDP, 30.5% of the labour force and 75% of non-oil export earnings. Despite the significant contribution of Agriculture to the Nigerian economy, it is, rather, worrisome that the sector is dominated by crop production, which accounted for 92% of agricultural output. This implies a huge supply gap in the fishery, livestock and forestry subsectors and, thus, confirms the huge importation of live animals, wood and wood-related products into Nigeria.

Although Nigeria has a huge agricultural potential, processing and storage of agricultural products remains largely untapped. Several products such as cotton, oil palm and wheat are vital inputs required in the manufacturing industry while others can be easily exported to diversify foreign exchange earnings in the country. To actualize this, there must be conscious effort by the Ministries of Agriculture, Trade, Industry and Investment to showcase existing untapped opportunities within these industries/products and implement key reforms to attract investments into the subsectors and stimulate output.

Issues and Challenges of Agro Processing Industry

- No clear and articulated national policy on the development of agribusiness in Nigeria detailing commodity standardization, processing, storage, packaging, transportation, marketing and exportation.
- Inadequate funding given to agribusiness investment leading to inefficient funding mechanisms
- Inconsistent, inapt and often blurred macroeconomic policy environment which ultimately jeopardizes any meaningful development in the agribusiness and value chain initiatives
- Dispersed farmland and subsistence production units inherently promote inefficiency and agro-product waste

Some policy recommendations for the sector are as follows:

- Improve efficiency of government interventions plans
- Provide incentives to stimulate greater private sector participation in the sector
- Simplify business processes and strategies
- Initiate a clear actionable agro-processing industrial policy

Manufacturing

The bane of Nigeria's economy is rooted in its manufacturing sector which is expected to drive the value addition economy. Unfortunately, this sector remains neglected without clear policy direction from the government. Myriads of studies and stakeholders interactions have univocally traced the abysmal performance in this sector to the age-long growth and development challenges the country has been facing. Why do a good number of Nigerians fail to patronize locally made finished goods or raw materials and what should manufacturing sector be doing to address the situation? How should quality and safety standards of the locally produced goods be encouraged to foster productivity? And what roles should improved infrastructure and business friendly policies play in facilitating the rapid growth of the manufacturing sector?

We have identified challenges faced by the manufacturing sector, and presented the strategies for overcoming these challenges and necessary ingredients needed to develop the sector.

Recommendations

1. **Research and Relevant Statistics**

- Nigerian manufacturing output should be focused on areas of competitive and comparative advantage
- Appropriate policy to enhance the capacity of industries with comparative advantage should be implemented.
- Engage research institutions in an effort to identify new and improved operational procedures to drive prices lower and also increase the quality and quantity of outputs.
- Carry out a survey of the Nigerian manufacturing sector in an effort to determine goods that are produced locally and their level of patronage. This will influence policy formulation and direction by government.

2. **Technical training and skills development**

- Invest in capacity building and skills upgrade of employees for enhanced productivity by dedicating a percentage of annual budget to training and exposure.

3. **Quality and Standards**

- Enforce effective regulatory interventions by relevant agencies to enhance public confidence.
- Collaborate with the private sector to ensure improved quality of inputs (local raw materials).
- Ensure regulatory authorities improve their level of compliance verification and mete out sanctions for non-compliance.
- Nigerian Customs Service should intensify efforts on surveillance at the borders to prevent smuggling and importation of sub-standard goods.

4. **Legislation on procurement**

- Enact legislations to encourage Ministries, Departments and Agencies (MDAs) purchase “Made-in-Nigeria” goods.
- Implement existing legislations to promote “Made-in-Nigeria” goods such as redefining the Procurement Act that makes government patronage of local manufactures mandatory.
- Collaborate with donor agencies to ensure that they also procure “Made-in-Nigeria” goods in the course of their interventions in the country.

Getting the fundamentals right

Whether the Nigerian economy will recover or not in 2017 depends largely on the actions and inactions of policymakers. Global events such as the movement in crude oil price and the flow of foreign capital will also be a driving force, however, policymakers have the option to respond to the changes of the economy or be proactive in dealing with such changes.

The Macroeconomic Environment

On the macro scale, sound macroeconomic policy environment would be the main anchor of the “Made-in-Nigeria” initiative. While we note that the growth-enhancing stimulus would require that interest rate is adjusted downwards to a business-friendly level in order to spur credit growth and economic activity, the situation becomes more complex, considering the need to ensure stable inflation and exchange rates. This will remain a conundrum for the CBN in 2017.

As a way forward, we propose the strengthening of development finance institutions to support businesses on a wide-scale. In the 2017 Budget, the government has expressed commitment to recapitalize the Bank of Agriculture and Bank of Industry with a sum of N15 billion and hasten the process to start the Development Bank of

Nigeria. While we note that this is a welcomed development, we propose that its implementation be prioritized in the year. We also believe that monetary policy choices in 2017 are limited and may not significantly drive foreign investment inflows or prevent outflows to stabilise the naira exchange rate. Hence, monetary policy must complement growth-enhancing fiscal policy along with other trade and structural reforms.

By proposing a budget size of N7.3 trillion, the federal government has shown it has plenty of firepower for fiscal stimulus in 2017. We believe that the impact of the budget to stimulate economic activities would depend largely on three main factors:

- the attainment of key assumptions of the budget
- the implementation of the capital component of the budget
- the success of social intervention programs.

To improve the implementation of the capital budget in 2017, the government must ensure quick passage of the budget and prioritize disbursement of funds for capital projects. Also, certain reforms must be enacted to simplify and make efficient the procurement process. This is key in ensuring swift implementation of capital budget in 2017.

To hasten the recovery process and achieve sustainable growth, the government must remove regulatory and operational bottlenecks facing the business environment. Some major recommendations include:

- Streamline regulatory agencies to eliminate bottlenecks and excessive costs attached to over-regulation of businesses
- Review cumbersome licensing procedures and multiple costs, which acts as a disincentive to MSMEs
- Fast-track the kick-off of one-stop shop in major parts of the country
- Implement the National Tax Policy to ensure a harmonized taxation regime
- Hasten passage of the competition bill.

Sector-Specific Intervention

For both agriculture/agro-processing and manufacturing sectors, it is essential for the government to define priorities, choices, paths, linkages and strategies, all of which must be encapsulated in a plan, which ultimately will provide direction for the sectors. Currently, the Nigerian Industrial Revolution Plan (NIRP) represents a great reference tool, which must be urgently reviewed and updated to reflect current realities and aspiration for the sector. Meanwhile, communication of the plan to both domestic and foreign stakeholders is crucial in mobilizing investments into strategic sectors of the economy. Investors need assurances and the NIRP coupled with the demonstration of commitment to implement the plan would be useful to guarantee investors' confidence.

In addition, support structures must be built across these sectors to unleash productivity by removing the bottlenecks across board. Several action-oriented reforms targeting key areas such as infrastructure, financing, skills development, technology & innovation and quality assurance are also crucial to revive economic activities in the medium term.

Policy Directions and Choices that would influence 2017

As the government is refocusing its efforts to jumpstart growth, the policy measures and implementation will play a key role in how the dynamics of will emerge in 2017. Government will be reeling out various interventions and initiatives and businesses are perking up with high expectation for the direction the policies may tilt in the year. We identified four interlinked themes that may pervade the policy cycle in 2017. These are:

- Implementation of Nigeria Economic Recovery and Growth Plan (NERGP)
- Budget Processes and Implementation
- Insurgency and Insecurity
- Global Events

Each of these focus areas will run as a major unit of policy watch in 2017 being propelled and paced by various policy measures, interventions, events and market sentiments that will turn up in the year. However, each theme is not isolated. Global events pose threat to Nigeria's fiscal and macroeconomic stability. On the other hand, the extent to which revenue target is achieved determines the pace of NERGP implementation in 2017.

- Implementation of Nigeria Economic Recovery and Growth Plan (NERGP)

Some of the policy choices that may come to play in the implementation of government recovery plan include:

- Sector-specific interventions
- States Bailout Strategy
- Improving business regulation and governance processes
- Development of Export Processing and Special Economic Zones, etc

- Budget Processes and Implementation

The level of the advance made by the government in bringing the economy to growth path will be propelled by the processes in the implementation of 2017 budget. Some of the pointers to keep on watch include:

- Early or late passage of the budget
- Government Spending: Expansionary Measures
- Government Revenue Streams
- New funding mechanism for Joint Venture
- Whistle Blowing Policy
- Mounting Debt Profile, etc

- Insurgency and Insecurity
  - Militancy in the Niger-Delta
  - Insurgency in the North-East

- Global Events

Uncertainties around the global events in 2017 could derail the implementation of budget and recovery plan. Three events that may influence policy choices in Nigeria in 2017 include:

- Global oil Market
- OPEC vs Non-OPEC Output Freezing
- Growth and Market Drivers in Emerging Market

Our Scenarios for 2017

Our outlook for 2017 is based on two scenarios. While scenario 1 acknowledges the current state of crude oil price in the international market at US$55 per barrel in 2017 and crude oil production hovering around 1.8 million barrels per day, scenario 2 assumes US$42.5 per barrel in 2017 and average crude oil production of 2.2 million barrels per day. Both scenarios are based on implementation rate of 65% and 70% for capital budget in the year 2017 respectively.

Table 2: NESG Scenarios for 2017

	Assumptions	Outcome
Scenario 1: Optimistic Case	• Crude oil price averages US$55 per barrel in 2017 • Crude oil production averages 1.8 million barrels per day • FGN Capital Expenditure totals N1.5 trillion in 2017.	• Real GDP grew by 0.6% in 2017 • Inflation rate overs around 15.7% • Government oil revenue increases by 20% to N2.4 trillion in 2017 from the proposed figure of N2 trillion in the 2017 budget • Exchange rate stabilizes due to increase in FOREX inflows to N305/$.
Scenario 2: Pessimistic Case	• Crude oil price averages US$42.5 per barrel in 2017 • Crude oil production averages 2.2 million barrels per day • FGN Capital Expenditure totals N1.7 trillion in 2017.	• Real GDP grew by 0.6% in 2017 • Inflation rate averages 16.3% in 2017 • Government oil revenue decreases by 7% to N1.85 trillion in 2017 from proposed figure in the 2017 budget • Exchange rate depreciates further to N310/$.

The outcome of this scenario 1 is largely positive. As oil prices averages US$55 pb, we believe real GDP will increase by 0.6% in 2017. Improved revenue associated with the high oil price will result in higher government spending, which is instrumental in the economic recovery process. Specifically, oil revenues for 2017 will increase by 20% to N2.4 trillion when compared with budgeted figure of N1.99 trillion. Consequently, we believe, the exchange rate will remain stable even as external reserve improves. We expect inflation to average 15.7% in the year, largely due to a stable exchange rate. This scenario is likely to play out in 2017.

With scenario 2, real GDP will grow by 0.6% in 2017, same as scenario one. Oil revenue is expected to decrease by 7% to N1.85 trillion from budgeted figure in 2017. This is largely based on uncertainties that prevail in the industry, particularly relating to signature bonuses, funding of Joint Ventures among other factors. Inflation is also expected to average 16.3% in 2017.

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