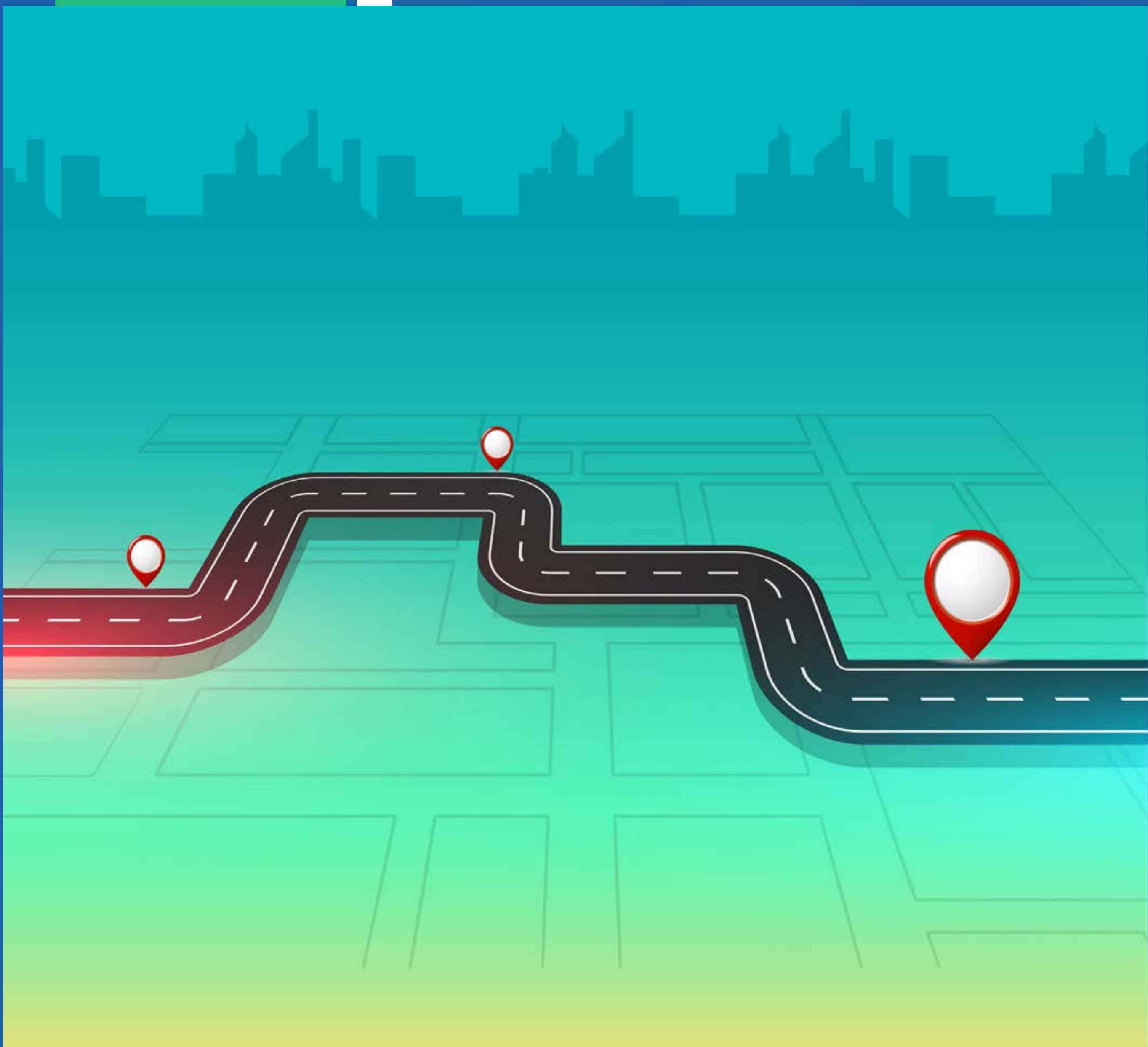
REVIEW OF THE NIGERIAN ECONOMY IN 2021 & H1'2022 AND KEY POLICY RECOMMENDATIONS

NESG RESEARCH



Abstract

Nigeria is rapidly consolidating its recovery from the pandemic-induced recession, but the pre-COVID-19 narrative of poor inclusiveness and macroeconomic instability persists. Despite a Gross Domestic Product (GDP) growth of 3.4 percent in full-year 2021, data from the National Bureau of Statistics (NBS) showed that average prices of goods and services were high; the trade balance remained in deficit in 2021 (but transited to a surplus in 2022Q1) and foreign investment inflows were constrained in the year and deteriorated further the first quarter of 2022. The World Bank estimated that an additional 8 million Nigerians fell into poverty between 2020 and 2021 due to lower purchasing power. Although Nigeria's potential is enormous, job creation across sectors has been lagging, resulting in an increase in unemployed individuals. While there has been considerable improvement in some areas, such as the mobilisation of non-oil revenue in the last few years, the challenges associated with insecurity, rising prices, unemployment, and lower investments intensify the need for reforms that will lead the country to a sustainable path of substantial economic progress and improved social inclusion. With about one year left in office, the current administration must intensify the pace of reforms, especially given the impact of the twin challenges of poverty and unemployment on insecurity and social cohesion of the nation. In its 2022 Macroeconomic Outlook Report, the NESG prioritized three key reforms: oil and gas liberalisation and subsidy reforms, foreign exchange management reforms, and critical sectoral reforms[1]. Moreover, the Nigerian Economic Dialogue organised by the NESG in May 2022 unraveled the urgency to address key structural challenges facing the Nigerian economy[2].

Introduction - Macroeconomic Stability

Real Sector Developments

Nigeria posted strong growth in 2021 and the first quarter of 2022 amidst the waning impact of the COVID-19 pandemic. The Nigerian economy grew by 3.4 percent in 2021 compared with an output decline of 1.9 percent in 2020. The current economic growth is stronger than its pre-pandemic level, which stood at 2.3 percent in 2019. The rapid economic recovery could be attributed to significant improvements in non-oil sector performance and the complete re-opening of the economy to productive activities after the COVID-19 lockdown measures. The non-oil sector – which accounted for 92.8 percent of the country's GDP - grew by 4.4 percent in 2021 compared with a 1.3 percent contraction in 2020. This performance was bolstered by impressive growth recorded across some industrial activities (notably, Manufacturing and Construction sectors) and Services sub-sectors (particularly, Transportation & Storage, Financial Services, Trade, and Information & Communications Technology). Conversely, the oil sector posted a negative growth of 8.8 percent in 2021 relative to a contraction of 8.3 percent in 2020. In nominal terms, the size of the economy in 2021 stood at N173.5 trillion (US$417.1 billion)[3]. Having recovered from the pandemic-induced recession in the fourth quarter of 2020, Nigeria consolidated its recovery with economic growth of 3.1 percent in the first quarter of 2022. However, the current economic growth is lower when compared with its level in the fourth quarter of 2021 (4 percent). This stellar growth was driven by the improved performance of sectors including Agriculture (3.2 percent),

[1]Refer to the 2022 Macroeconomic Outlook Report and Policy Briefs for detailed information on the three reforms, retrievable via: https://www.nesgroup.org/research

[2]Refer to the NESG National Economic Dialogue Report for detailed information, retrievable via: https://ifnotnowwhen.ng/

[3]We utilized the official exchange rate of N416/US$ for currency conversion.

Manufacturing (5.9 percent), Construction (4.8 percent), ICT (12.1 percent), Trade (6.5 percent) and Finance (23.2 percent) in the first quarter of 2022. The non-oil sector grew faster to 6.1 percent (year-on-year) in 2022Q1 relative to 0.8 percent growth in 2021Q1. Meanwhile, the oil and gas sector, remained in the contraction territory, posting a negative growth of 26 percent in 2022Q1.

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

Data: NBS; Chart: NESG Research

The three broad sectors exhibited mixed patterns of growth performance in 2021 and the first quarter of 2022. Although the Agricultural sector growth slowed slightly to 2.1 percent in 2021 from 2.2 percent in 2020, the sector remained the most resilient, having sustained growth for five consecutive quarters since the economic recession of 2020. The impressive performance of the agricultural sector, particularly in the last quarter of 2021, was primarily due to faster growth in sub-sectors, including crop production (3.9 percent) and fishing (1.7 percent) in the quarter. Similarly, the Services sector grew by 5.6 percent in 2021 relative to a negative growth of 2.2 percent in 2020. This is the sector's first year of positive annual growth since 2016. The performance of the Services sector in 2021 was largely due to the expansion recorded by major sub-sectors, including Transportation & Storage (16.3 percent), Finance and Insurance (10.1 percent), Trade (8.6 percent), as well as, Information and Communications Technology (6.5 percent). However, the industrial sector contracted by 0.5 percent in 2021, representing an improvement compared with a negative growth of 5.9 percent in 2020. The industrial sector growth was driven by improved performances in three out of five broad subsectors – manufacturing (3.3 percent in 2021 against -2.8 percent in 2020), construction (3.1 percent against -7.7 percent), electricity supply (27.6 percent against -2.9 percent). Meanwhile, the impressive performance of these sub-sectors was overshadowed by the persistent contraction of the Mining & Quarrying activities (-7.8 percent versus -8.5 percent). Moreover, in broad terms, the Services sector recorded the strongest growth at 7.5

percent in the first quarter of 2022, followed by the Agricultural sector with a growth of 3.2 percent. Meanwhile, the Industrial sector contracted by 6.8 percent in the quarter. It is worthy of note that the Agricultural sector has remained resilient since the COVID-19 pandemic broke out by recording positive growth. In contrast, the other sectors hovered between the expansion and contraction territory.

Figure 2: Expanding Sectors in 2021 (percent)

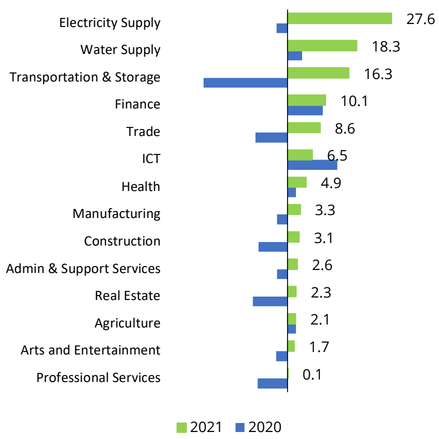
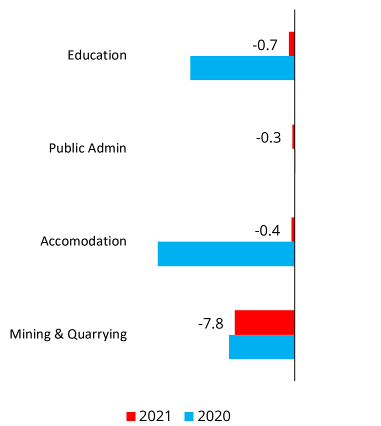


Figure 3: Contracting Sectors in 2021 (percent)



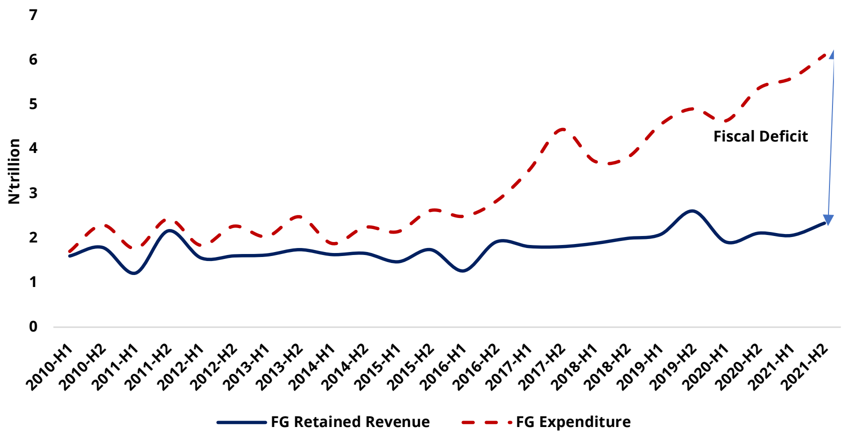
Data: NBS; Chart: NESG Research

Inflationary pressures tapered gradually from the second quarter of 2021, but many more Nigerians were pushed into poverty in 2021. After reaching a peak at 18.2 percent in March 2021, the headline inflation rate maintained a downward trend as it stood at 15.6 percent in December 2021. However, there is a renewed build-up of inflationary pressures as the headline inflation rose to 17.7 percent in May 2022 from 15.6 percent in January 2022 and averaged 16.4 percent in the first five months of 2022. The key drivers of inflation in Nigeria are structural factors, including insecurity, infrastructural decay, exchange rate depreciation and supply chain disruptions due to poor logistics, and rising energy and transport costs. The Nigerian government's successful implementation of a planned tax on phone calls would also contribute to inflation build-up in 2022. With the inflation rate remaining high and real income eroded, the World Bank's estimates showed that the poverty headcount increased to 90 million people in 2021. It also projected that an additional 7 million Nigerians would fall into poverty in 2022.

Domestic Policy Environment

Fiscal space remained constrained amidst the rising global energy prices. While government revenue from non-oil related activities is improving, the Nigerian government continues to experience fiscal constraints as the overall revenue persistently falls short of the total expenditure. Between 2015 and 2021, the Federal Government of Nigeria's total expenditure increased by 163.5 percent, whereas its revenue grew by 33 percent. While global oil prices have maintained an upward trend into the year 2022, Nigeria has not been able to benefit from the oil price rally due to low domestic crude oil production, the exit of International Oil Companies (IOCs), high cost of crude oil extraction and huge fuel subsidy payments. While the enactment of the Petroleum Industry Act (PIA) is laudable, the delay in implementing some of its key priorities - including the removal of fuel subsidies - would further strain public finances and widen the fiscal deficit amidst the difficulty in growing the country's revenue base juxtaposed against the huge public spending in the pre-election year (2022).

Figure 4: Trend of Nigeria's Fiscal Position (N'Trillion)



Data: Federal Ministry of Finance, Budget & National Planning, CBN; Chart: NESG Research

Concerns about the rising public debt level and its sustainability have continued to grow. Over time, the widening fiscal deficit has contributed significantly to Nigeria's public debt stock build-up. According to the Debt Management Office, Nigeria's public debt stock as of December 31, 2021, expanded to N39.6 trillion, representing an increase of 20.2 percent and 213.8 percent when compared with public debt levels in 2020 and 2015, respectively. However, the reported public debt stock in 2021 excluded an estimated N17 trillion in Central Bank of Nigeria's (CBN) Ways and Means and other Asset Management Corporation of Nigeria (AMCON) related debts. While the public debt stock is fast expanding, Nigeria's public debt-to-GDP ratio is one of the lowest globally, at 35.7 percent in 2021, according to the International Monetary Fund (IMF). This has motivated aggressive borrowing in more recent years. As at the first quarter of 2022, Nigeria's public debt stock stood at an all-time high of N41.6 trillion. This public debt figure, however, precludes CBN's Ways and Means in the sum of 18.8 trillion in 2022Q1. However, public debt service-to-revenue ratios of 82.9 percent and 96 percent in 2020 and 2021, respectively, suggest that the Nigerian government spends nearly all its revenue on servicing debts while resorting to excessive borrowing to run governance and finance developmental projects.

Figure 5: Public Debt Position (N'Trillion)

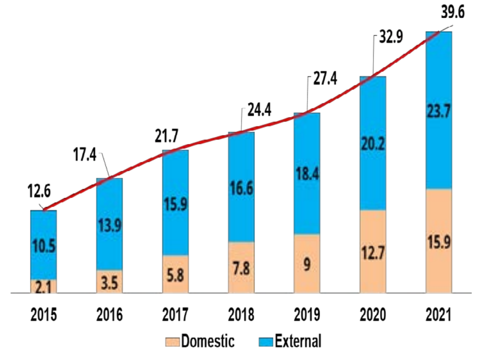
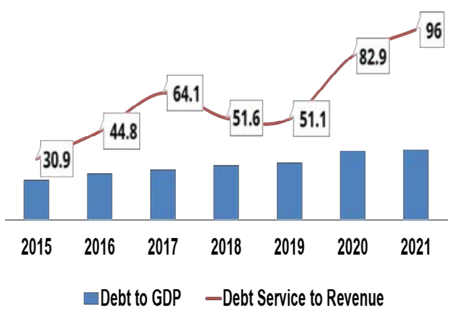


Figure 6: Debt/GDP & Debt Service/Revenue Ratio (Percent)



Data: Debt Management Office, IMF; Chart: NESG Research

The monetary policy unit contends with risks to economic recovery and inflationary pressures. Structural bottlenecks and external shocks related to the Russia-Ukraine crisis continue to drive up food prices and exchange rate volatility amidst low domestic crude oil production, low accretion to external reserves, liquidity volatility and rising interest rates in the global market. These factors, coupled with an elevated inflation rate at 16.8 percent in April 2022, motivate negative real returns on investments, particularly government securities. To sustain recovery amidst high inflation, the CBN's monetary policy committee has maintained a static position across the policy parameters since May 2020. However, the meeting held in May 2022 birthed the hike in the Monetary Policy Rate (MPR) by 150 basis points to 13 percent from 11.5 percent. The Committee, however, kept the other monetary policy parameters unchanged: Cash Reserve Ratio at 27.5 percent, Liquidity Ratio at 30 percent and an asymmetric corridor of +100/-700 basis points around the MPR. While this policy action would tame liquidity-induced inflationary pressures, a monetary policy tightening at this time could drag Nigeria's economic recovery process.

The Medium-Term National Development Plan (MTNDP) 2021-2025. This is the new medium-term development plan which succeeded the Economic Recovery and Growth Plan (ERGP) that expired in 2020. The new development plan aims to lift 35 million people out of poverty by 2025 and seeks to mobilise N348.1 trillion to finance development across seven cluster areas that cut across economic growth and development, infrastructure, public administration, human capital development, social development, regional development and Plan implementation. In terms of financing needs, the Plan outlines that the government contributes 14.3 percent (N49.7 trillion), while the private sector is expected to drive investments worth N298.3 trillion (85.7 percent of the total investment requirement) over the plan period. While the Plan is well-detailed and broad in identifying critical elements, drivers and enablers of national development, the issue of effective implementation remains a crucial concern for relevant stakeholders.

External Sector Developments

Despite the persistent rise in global crude oil prices, Nigeria's trade balance remained in deficit in 2021, but reverted to a surplus in 2022Q1, amidst the sustained contraction of the oil and gas sector. Despite the record of a trade surplus of N327 billion in the second quarter of 2021, Nigeria's trade balance maintained an overall deficit of N1.9 trillion in 2021. This represents a trade balance deterioration compared with a surplus of N2.2 trillion and a deficit of N178.3 billion reported in 2019 and 2020, respectively. Remarkably, growth in exports outpaced that of imports, resulting in the shift of the trade balance to a surplus of N1.2 trillion in 2022Q1 from a deficit of N1.9 trillion and N0.2 trillion in 2021Q1 and 2021Q4, respectively. Moreover, the favourable trade balance position could be attributed to the persistent increase in oil and non-oil commodities prices on the global market, triggered by the geopolitical tensions between Russia and Ukraine since February 2022[4]. Despite that Nigeria’s oil and gas sector contracted further by 26 percent in 2022Q1, the trade balance, at a surplus of US$1.9 trillion, was significantly driven by the persistent increase in the global oil prices. Nigeria’s Bonny Light price, on average, spiked to US$104 per barrel in 2022Q1 from US$61.3 per barrel in 2021Q1.

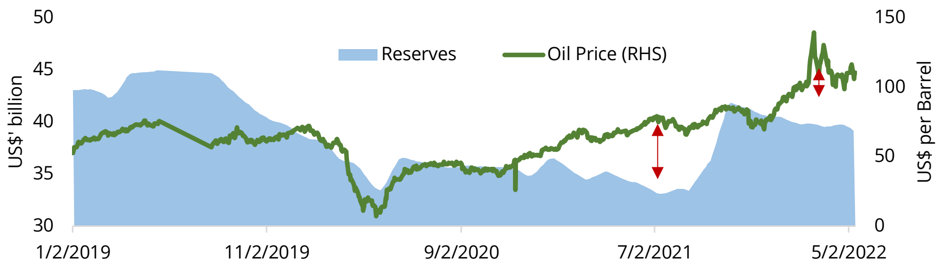
Overall investment inflows into Nigeria plunged by 45 percent in 2021 and further decelerated in 2022Q1. Total foreign investment inflows fell to a 5-year low of US$6.7 billion in 2021 from US$9.7 billion in 2020. Despite the waning impact of the global pandemic, foreign investors showed less appetite for Nigeria's financial instruments in 2021. The illiquidity of the foreign exchange market and negative real returns on investment largely fueled negative investors' sentiment. On a disaggregated basis, the decline in total investment inflows was largely driven by a sharp fall in Foreign Portfolio Investments (FPI) to US$3.4 billion in 2021 from US$5.1 billion in 2020. Correspondingly, the share of FPI in the overall foreign investment inflows dropped to 51 percent in 2021 from 53 percent in 2020. In 2021, the contribution of Foreign Direct Investment (FDI) to the overall foreign investment inflows fell slightly to 10 percent (US$698.8 million). In contrast, the share of Other Investments was higher at 39 percent (US$2.6 billion). In addition, foreign investment inflows into Nigeria fell to US$1.6 billion in 2022Q1 from US$1.9 billion and US2.2 billion in 2021Q1 and 2021Q4, respectively. This reflects the declining investors’ confidence in the Nigerian economy as illiquidity in the foreign exchange market persists, real returns on investment remains negative and structural rigidity continues to constrain domestic crude oil production.

As the economic impact of COVID-19 endured, Nigeria sought direct borrowing to ease pressure on the external reserves and exchange rate. For most of the first three quarters of 2021, the external reserves and exchange rate faced tremendous pressures, predominantly due to strong foreign exchange (FX) demand for imports and low foreign investment inflows. Consequently, Nigeria's external reserves increased to US$41.8 billion in October 2021 before retreating to close the year 2021 at US$40.5 billion. In the first quarter of 2022, Nigeria's external reserves averaged US$39.9 billion, falling by 2.2 percent when compared with the average external reserves of US$40.8 billion in the fourth quarter of 2021. This suggests that Nigeria is yet to benefit from the current rally in global crude oil prices (see

[4]Refer to the NESG Occasional Paper titled: “Implications of the Russia-Ukraine War: Risks and Opportunities for Nigeria” for detailed information, retrievable via: https://www.nesgroup.org/research

Figure 7)[5]. Following the FX pressures in the year, there was an adjustment in the exchange rate on the Investors' & Exporters' (I&E) Window. At the same time, the CBN adopted the I&E exchange rate as its official rate to harmonise the multiple exchange rates. Notwithstanding, the gap between the I&E Window and the parallel market exchange rates has widened, stood at about N170/US$1 in May 2022.

Figure 7: Movements in Nigeria's External Reserves and Oil price



Data: CBN; Chart: NESG Research

Critical Challenges confronting Nigeria and Key Measures to address them

The wide array of socio-economic challenges that beset the Nigerian economy has clearly shown that the country cannot rely on the business-as-usual practice. This suggests that there is a need for urgent turnaround in policy choices and economic management for Nigeria to achieve improved socio-economic outcomes. Ahead of the 2023 general election, the Nigerian Economic Summit Group (NESG) organised a National Economic Dialogue (NED) in May 2022, which unraveled the key structural bottlenecks and challenges that the country has faced overtime. This event is meant to ensure that the political elite are rightly guided in terms of policy choices and implementation. To this end, the top five critical socio-economic narratives that have shaped the Nigerian economy overtime include:

- **Weak and Non-inclusive economy**

Nigeria's economic growth path since 2012 has been weak and non-inclusive. The compound annual growth rate is estimated at 1.92 percent between 2012 and 2021, which is below the yearly population growth of 2.6 percent. As of 2021, the strategic sectors, including Agriculture, Manufacturing, Construction, Real Estate, ICT, and Finance, grossly underperformed their vibrant performances in 2012. After netting out inflation and other costs, the real size of the Nigerian economy has remained relatively the same since 2012 - which implies that the country is experiencing economic stagnation. Consequently, the income of an average Nigerian has declined sharply to US$2,097.1 in 2020 from a peak of US$3,098.8 in 2014.

[5]Refer to the NESG Occasional Paper titled: "Nigeria's Dwindling Revenue and Reserves in the face of Rising Oil Price" for detailed information, retrievable via: https://www.nesgroup.org/research

- **Highly volatile Macroeconomic Environment**

The sharp decline in labour productivity growth from 16.9 percent in 2012 to 1.7 percent in 2021 reflects the extent of macroeconomic imbalance/instability in Nigeria. Nigerians are currently facing tough times as inflationary pressure remains heightened and labour market conditions deteriorate. The unemployment problem is pervasive irrespective of gender, location and educational qualification. Despite improving global oil prices, the economy suffers from worsening external trade position and dwindling foreign investment inflows. This suggests that Nigeria has failed to appropriate the benefits of rising oil prices due to low crude oil production, high production costs, low investment and a fuel subsidy regime.

- **Weak economic competitiveness**

Since 2017, Nigeria has maintained the 133rd position out of 133 countries on the global complexity index. This suggests that Nigeria's productivity base is fundamentally archaic and structurally deficient.

- **Infrastructure and Social sector collapse**

About 100 million Nigerians do not have access to electricity. Nigeria ranked 161st out of 189 countries in 2019 on the global human development index (HDI), with the country's life expectancy averaging 54 years. This is not unexpected considering that Nigeria's healthcare system ranked 178th out of 192 countries in 2018, according to the World Health Organisation (WHO). In addition, about 20 percent of global out-of-school-children are Nigerians.

- **National Insecurity**

In 2021, Nigeria ranked 146th out of 163 countries on the Global Peace Index and was the 8th least peaceful in Africa. Nigeria has not fared well with the different dimensions of human security: economic, food, health, environmental, personal, community and political security.

How do we change the current narrative? What constitutes the game changer?

As part of the outcomes of the NED event, the NESG proposes seven (7) pragmatic policy actions to address the identified socio-economic challenges in Nigeria.

- There is a need to reconsider what socio-economic development means for an average Nigerian. The Nigeria of Our Dream is one in which fundamental human rights are guaranteed, and economic opportunities are equitably distributed.

- There needs to be a reconsideration of the role of the market and the private sector in Nigeria's socio-economic development. A free-market orientation should guide policy interventions and reforms. This will support growth, deepen social inclusion, ensure appropriate pricing, and unlock private capital for national development.

- Critical sectoral reforms are urgently needed to support broad-based economic growth and Nigeria's global competitiveness. Achieving this requires addressing value chain constraints in critical sectors of the economy and prioritising value-addition across products where Nigeria has a high comparative advantage, particularly agricultural products and crude oil.

- An integrated national and sub-national approach to economic inclusion will aid the realisation of Nigeria's critical developmental goals. As a result, economic cooperation between subnational governments is encouraged. This will aid intra-regional wealth transfer, as well as, the reduction of socio-economic polarisation across the country.

- A functioning and efficient social sector is critical to developing a strong and resilient economy. There is a need for pragmatic social sector reforms, particularly in education and health.

- In a peaceful environment, economic progress leads to robust prosperity. To this end, the NESG advocates for developing a practical and inclusive national security strategy across all dimensions.

- Finally, NESG believes that deep institutional, regulatory, and structural reforms are the most reliable way to ensure long-term development outcomes. Workable policy and institutional reforms are needed to promote stability in the macroeconomic and policy environment.

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