State of the Nigerian Economy in H1'2023: Matters Arising & Key Policy Imperatives

NESG Research

Abstract

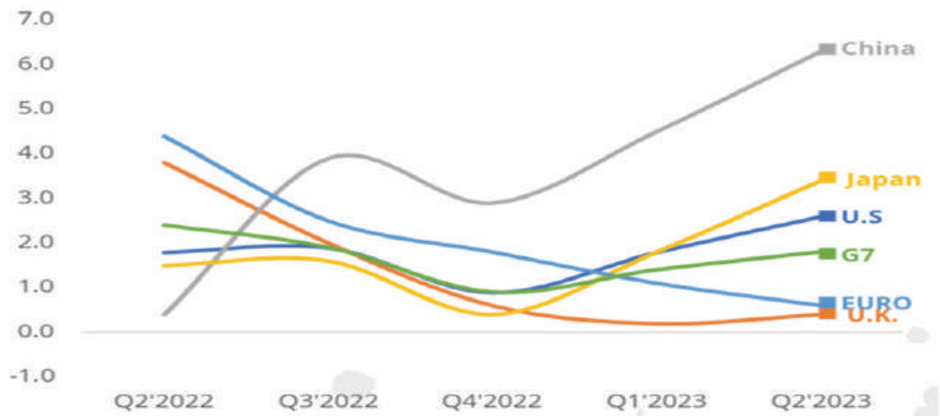
As the world economy grapples with the aftermath of the COVID-19 pandemic and new challenges induced by the Russia-Ukraine conflict, economic growth has trended lower, and the inflation rate has heightened in advanced and emerging economies. Overall, the combination of rising commodity prices, global inflationary pressures, and slow growth in many countries weakened the performance of the global economy in the first half of 2023. In a fashion similar to global economic performance, the Nigerian economy experienced slowed growth in the period under review. The real Gross Domestic Product (GDP) growth of 2.4 percent was the lowest economic growth since Nigeria's full recovery from the COVID-19 pandemic. The country experienced a surge in inflation, leading to a significant erosion of the local currency's value. Poverty level and other socio-economic indicators also deteriorated. In addition, the implementation of new reforms in the first half of 2023 has had a considerable impact on Nigeria's socioeconomic performance and has informed an alteration to socioeconomic projections since the beginning of the year. In light of the assessment of global and domestic economic conditions so far in 2023, this paper suggests key measures to bring inflation under control and sustain economic growth in Nigeria.

(A) Global Economic Environment

Global economic growth was uncertain and low due to fear of recession in the United States & Europe.

Since the beginning of the post-COVID-19 pandemic era, productivity and growth levels of the global economy have been persistently weak. The global GDP expanded by 3.4 percent (year-on-year) in the second quarter of 2023 (IMF, 2023). This growth did not match the performances of many advanced countries, which posted growth rates below 3 percent (see Figure 1). Only China has proved more resilient to the crisis-induced global shocks as reflected in its strong economic growth in the first half of 2023.

Figure 1: Year-on-Year GDP Growth (percent)



Data: OECD; Office of National Statistics, UK; National Bureau of Statistics, China; Charts: NESG Research

Notwithstanding, the slowdown experienced in major economies in the first half of 2023 coupled with escalated geopolitical tensions between Russia and Ukraine and the recent crisis in the Middle East indicated that global economic activities would remain depressed in the rest of the year. To this end, global economic growth is expected to slow to 3 percent in FY'2023.

Despite the gradual slowdown in recent times, inflation remains stubbornly high amidst monetary tightening in many countries. Inflation was easing, but at a slow rate because core (non-food) inflation is sticky downwards, primarily caused by elevated global commodity prices (including raw materials, crude oil, and natural gas). On the global level, the inflation rate nosedived from its peak of 11.6 percent in 2022Q2 to 5.3 percent in 2023Q2 (IMF, 2023). This magnitude of decline in inflation is however not observed at the country level. Many advanced countries including the US, UK, and the Euro Area are yet to revert to their long-run inflation target of 2 percent (see **Table 1**). In reaction, many advanced economies, emerging markets, and developing countries continue to tighten monetary policy to combat the war-induced inflationary pressures that started in February 2022. This hawkish stance coupled with moderating global commodity prices (energy and non-energy price indices fell by 30 percent and 14 percent, respectively, in the first half of 2023 relative to the corresponding period in 2022), the average global inflation rate is expected to drop to 6.9 percent in FY'2023 from 8.7 percent in 2022 (IMF, 2023).

Table 1: Year-on-Year Inflation Rate (Percent)

INFLATION RATE (PERCENT) CPI																		
	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23
U.S.	7.5	7.9	8.5	8.3	8.6	9.1	8.5	8.3	8.2	7.7	7.1	6.5	6.4	6.0	5.0	4.9	4.0	3.0
U.K.	5.5	6.2	7.0	9.0	9.1	9.4	10.1	9.9	10.1	11.1	10.7	10.5	10.1	10.4	10.1	8.7	8.7	7.9
Germany	5.1	5.5	7.6	7.8	8.7	8.2	8.5	8.8	10.9	11.6	11.3	9.6	9.2	9.3	7.8	7.6	6.3	6.8
France	3.3	4.2	5.1	5.4	5.8	6.5	6.8	6.6	6.2	7.1	7.1	6.7	7.0	7.3	6.7	6.9	6.0	5.3
China	0.9	0.9	1.5	2.1	2.1	2.5	2.7	2.5	2.8	2.1	1.6	1.8	2.1	1.0	0.7	0.1	0.2	0.0
Euro	5.1	5.9	7.4	7.5	8.1	8.7	8.9	9.2	9.9	10.6	10.1	9.2	8.7	..	..	..	..	..
India	5.8	5.0	5.4	6.3	7.0	2.5	2.7	2.5	2.8	2.1	1.6	1.8	2.1	1.0	0.7	0.1	0.2	0.0
Brazil	10.4	10.5	11.3	12.1	11.7	11.9	10.1	8.7	7.2	6.5	5.9	5.8	5.8	5.6	4.7	4.2	3.9	3.2

Heatmap: Inf=>5 | Inf<5 but >2 | Inf<=2

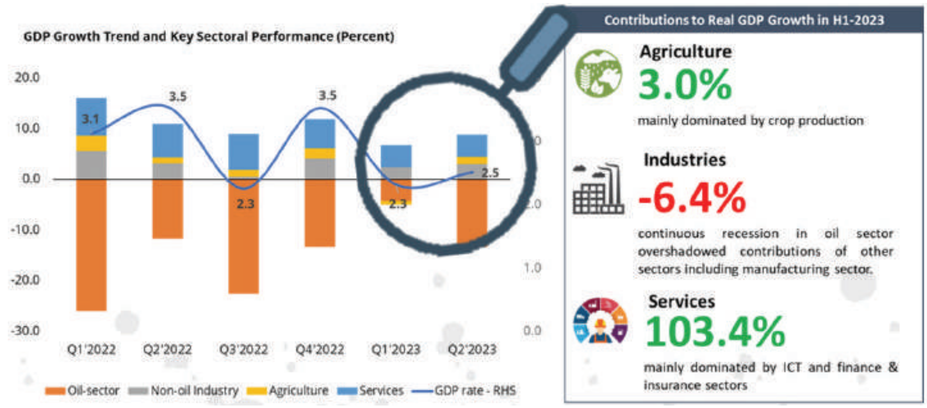
Data: OECD; Office of National Statistics, UK; National Bureau of Statistics, China

(B) Domestic Economic Environment

Economic Growth Performance - Non-oil sector remained the main growth catalyst.

The Nigerian economy continued to post positive growth in H1'2023 but at a slow pace relative to the performance in H1'2022. The country's real GDP expanded by 2.4 percent in H1'2023, with Q1'2023 and Q2'2023 experiencing growth rates of 2.3 percent and 2.5 percent, respectively (see Figure 2). The Naira liquidity crunch in the first quarter of 2023 took a toll on the economy in the first quarter of 2023. The slow growth was more evident in the Agriculture sector which recorded negative growth for the first time in many years in Q1'2023, while the Non-oil sector growth was at its lowest level in two years. The growth composition analysis revealed that the non-oil sector played a crucial role in sustaining the overall economic growth momentum.

Figure 2: Performance of the Nigerian Economy in H1'2023



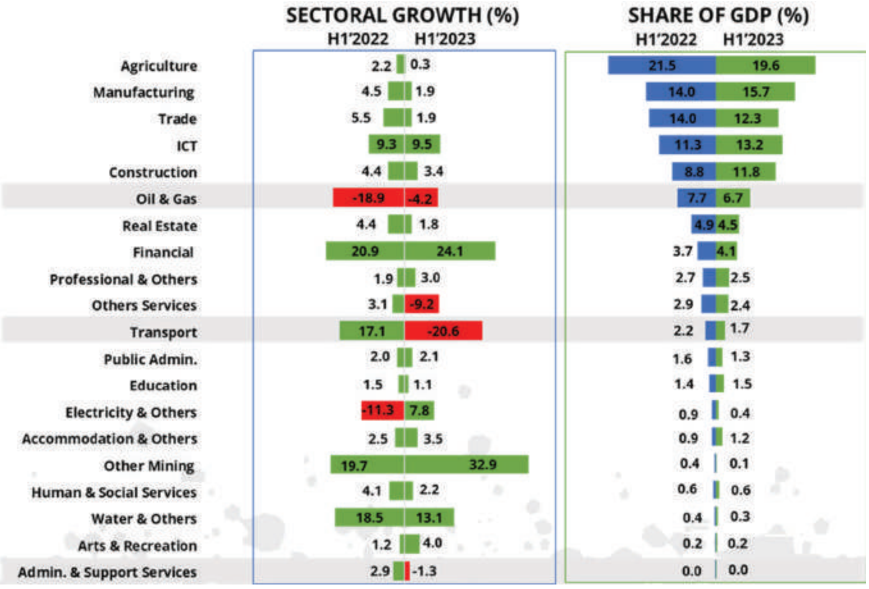
Data: National Bureau of Statistics (NBS); Calculation & Chart: NESG Research

The impressive performance of various Non-oil activities, including Non-oil Industrial, Services, and Agriculture sectors, significantly contributed to economic expansion. Notably, the Non-oil Industrial sector grew by 2.6 percent, the Services sector by 4.4 percent, and the Agriculture sector by 0.3 percent. By maintaining an upward growth trajectory, the Non-oil sector effectively offset the adverse impact of the struggling Oil sector, whose prolonged recession since 2020 Q1 has posed challenges to economic growth, making the resilience of the Non-oil Industrial sector even more critical. This makes the diversification in the sources of economic growth essential to achieve long-term stability and economic prosperity.

Sectoral Development - Traditional growth drivers had a poor performance in H1'2023.

The sectoral performance of the Nigerian economy in H1'2023 reflected the impact of dysfunctional policy on the economy, especially the liquidity crunch caused by the Naira redesign policy. Most of the traditional growth drivers - particularly, Agriculture and Trade - are cash-driven sectors and thus experienced huge performance declines in H1'2023 when compared with H1'2022. In addition, all sub-sectors of the Services sector, except the ICT and Finance sectors, also experienced weaker growth in H1'2023 when compared with their performance in H1'2022 (see Figure 3). The weak growth performance is not far-fetched as these sectors have strong linkages with the informal sector. Hence, the liquidity crunch experienced by the economy in this period resulted in weak informal sector performance and this adverse impact shock was transmitted to many Services sub-sectors.

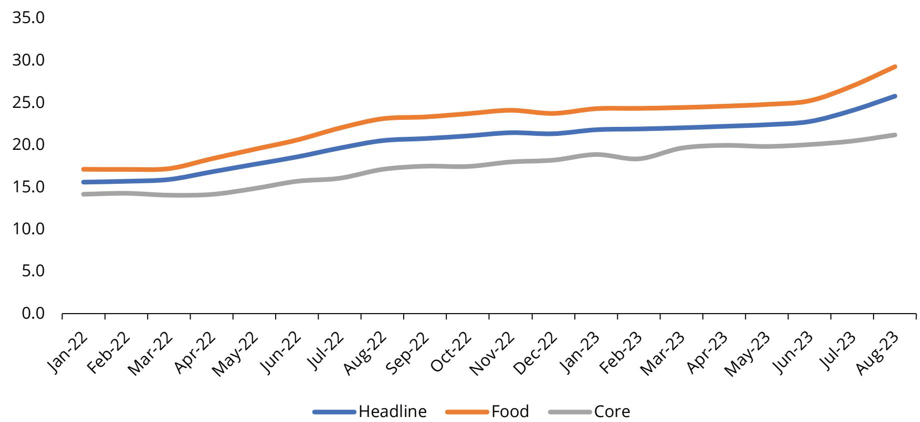
Figure 3: Sectoral Performance of the Nigerian Economy in H1’2023



Data: NBS; Calculation & Chart: NESG Research

Inflation is yet to buck its rising trend amidst multiple headwinds. Nigeria's headline inflation rose to an 18-year high of 25.8 percent in August 2023 (see **Figure 4**). This amounts to an average inflation rate of 22.9 percent in the first eight (8) months of 2023, which is above the average inflation rate of 17.6 percent in the corresponding period of 2022. The persistent inflationary pressures are attributable to global supply chain disruptions due to the protracted geopolitical tensions between Russia and Ukraine and domestic structural bottlenecks, including exchange rate depreciation, rising logistic costs, and increased food and energy prices (including petrol and cooking gas). According to the World Bank, the CBN financing of budget deficits has also contributed to rising inflation. The removal of subsidies on petrol has had a direct (first-round) impact on fuel and transport costs and an indirect (second-round) effect on the prices of food and non-food items. This fact is supported by the persistent rise in food and core inflation (see **Figure 4**). Consequently, the weak purchasing power due to high inflation has plunged about four (4) million additional Nigerians into poverty in the first five (5) months of 2023, according to the World Bank (2023a). The persistent decline in real incomes will translate to an increase in the poverty headcount.

Figure 4: Nigeria’s Year-on-Year Inflation (percent)



Data: NBS; Chart: NESG Research

Policy Environment

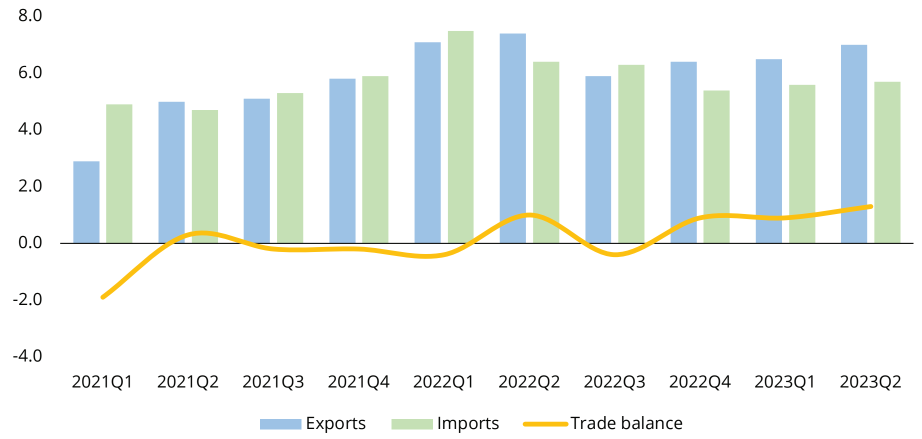
Monetary policies resulted in limited gains for the Nigerian economy. In H1’2023, Nigeria’s overall monetary policy stance remained heterodox – sustaining its unconventional practices. The Central Bank of Nigeria (CBN) started the year by adopting stricter implementation of the introduction of new N200, N500, and N1,000 notes which caused a significant squeeze of the currency in circulation. Also, the Monetary Policy Committee (MPC) continued to raise the Monetary Policy Rate (MPR) as the inflation rate maintained an upward trend. The MPR has been increased from 11.5 percent in March 2022 to 18.75 percent in July 2023. Despite the cumulative hike in the monetary policy rate (MPR) by 725 basis points since March 2022 to date, inflationary pressures have remained unabated, reflecting the ineffectiveness of monetary policy instruments in single-handedly combating high inflation.

Fiscal space is being marred by growing public debts. According to the Debt Management Office - DMO (2023), Nigeria’s public debt stock stood at an all-time high of N87.4 trillion as of the second quarter of 2023, rising multiple-folds from N7.5 trillion in 2012. Setting aside the cumulative Ways and Means of N23.8 trillion as of December 2022, a sum of N17.3 trillion has been added to the country's public debt stock. The public debt profile continues to be dominated by domestic debts, which accounted for 62 percent of the total public debt stock as of Q2’2023. Meanwhile, growing debt levels defy the improvement in oil revenues against the backdrop of the fuel subsidy removal and currency devaluation. The distributable revenue from the Federation Account Allocation Committee (FAAC) expanded by 18.1 percent to N907.1 billion in June 2023 from N786.2 billion shared in May 2023. In addition, the total deductions for savings, transfers, and refunds grew to N979.1 billion from N163.2 billion in May 2023. This implies that the FAAC accrual for June 2023 expanded to N1.9 trillion.

External Sector Developments

Despite the fall in export earnings and imports, the external trade balance remained in surplus in H1’2023. The total value of goods exported dropped to N13.5 trillion in the first half of 2023 from N14.5 trillion in the corresponding period of 2022 (see Figure 5), partly due to a decline in oil exports by 6.9 percent (year-on-year) to N12.2 trillion in H1’2023. This signifies the sustained improvement in global oil prices despite the fall in domestic crude oil production. Similarly, non-oil exports – which accounted for 9.6 percent of total export earnings in H1’2023 – fell by 7.1 percent (year-on-year) to N1.3 trillion. Also, the value of imported commodities fell by 18.7 percent (year-on-year) to N11.3 trillion in H1’2023. This could be partly due to easing global commodity prices in the review period. According to the World Bank (2023b), energy and non-energy price indices fell by 30.4 percent and 0.9 percent, respectively, in H1’2023 relative to their levels in H1’2022. Remarkably, growth in exports outpaced that of imports, resulting in a trade surplus of N2.2 trillion in H1’2023, which outpaced the trade surplus of N618.8 billion in H1’2022.

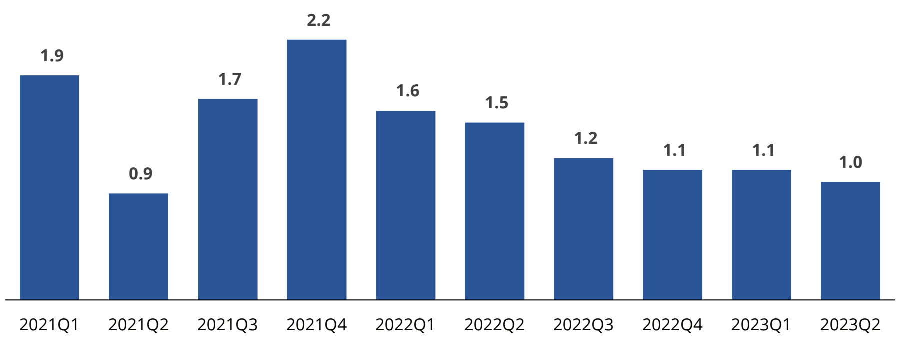
Figure 5: Nigeria's Values of Import, Export Trade & Trade Balance (N'trillion)



Data: NBS; Chart: NESG Research

Foreign Investment inflows continued to decline amidst an unfavourable investment climate. The overall foreign investment inflows fell to US$2.1 billion in H1'2023 from US$3.1 billion in H1'2022 (see Figure 6). Weakening foreign investment inflows suggest the persistently high risk aversion towards investing in Nigeria by foreign investors due to factors such as foreign exchange shortage, negative real returns on investment, and challenges in repatriating funds abroad. In H1'2023, Foreign Direct Investment (FDI) remained the least attractive type of investment inflows at US$133.6 million (a 6 percent share), whereas Foreign Portfolio Investment and "Other" investment accounted for 35 percent (US$756.1 million) and 59 percent (US$1.3 million), respectively, of the total foreign investment inflows.

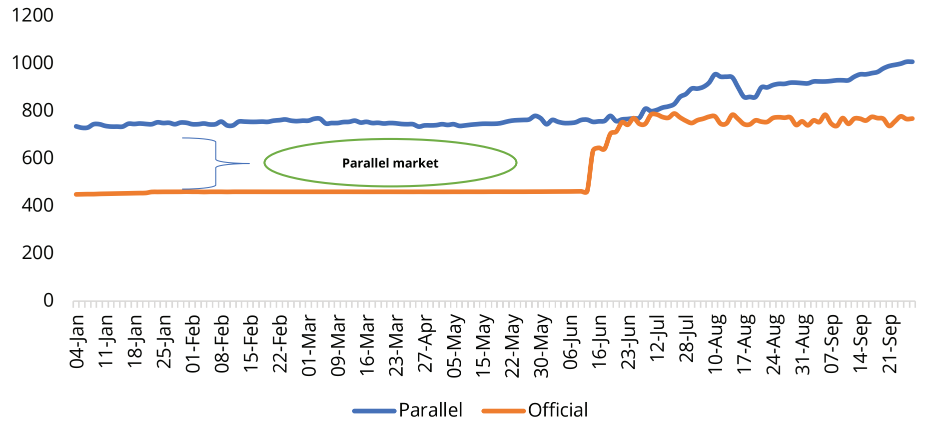
Figure 6: Trend of Foreign investment inflows (US$ billion)



Data: NBS; Chart: NESG Research

The recent foreign exchange (FX) reform has narrowed the parallel market premium, but the FX market remains illiquid amidst falling external reserves. The previously managed float regime was characterized by distortions emanating from inappropriate FX pricing, multiple FX windows, and institutional weakness (in terms of lack of transparency and predictability). This allowed currency speculators to take advantage of the parallel market premium. As a result of the recent reforms introduced by the current administration in June 2023, the official exchange rate depreciated by 39 percent between June and July 2023. In addition, there was a convergence of the official and parallel market exchange rates in late June 2023 and a significant reduction in the parallel market premium relative to its level before the FX reform in June 2023 (see Figure 7). Meanwhile, the challenge of persistent dollar scarcity has continued to weaken the Naira at the official and parallel markets with the corresponding exchange rates at N769/US$1 and N1,008/US$1 at the end of September 2023.

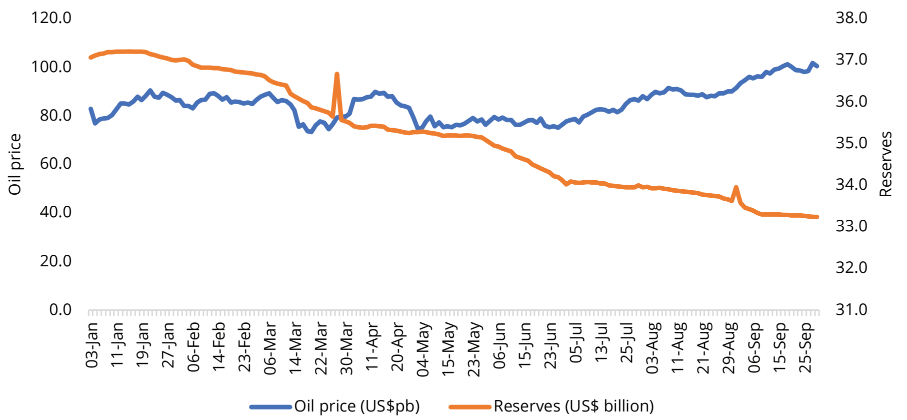
Figure 7: Nigeria's Exchange Rate (NGN/US)



Data: Central Bank of Nigeria (CBN); Chart: NESG Research

In addition, the decline in export earnings and dwindling foreign investment inflows have weakened the external reserves, which stood at US$33.95 billion as of August 31, 2023. Following a temporary jump to US$36.7 billion on March 28, 2023 (see Figure 8), attributable to a US$1 billion inflow from crude oil sales (see Moses-Ashike, 2023), the external reserves have continued to be insensitive to the recent increases in global oil prices, which averaged US$84.8 per barrel in the first nine (9) months of 2023.

Figure 8: Nigeria's External Reserves & Crude Oil Prices



Data: CBN; Chart: NESG Research

(C) Revised Macroeconomic Projections for Nigeria in 2023

The year 2023 in Nigeria comes with the peak of the political climax with the general election and transition to a new administration. With the conclusion of the four-year election cycle in the first quarter of the year, the country's economic performance is affected by the usual political instability and policy uncertainties that ushered in this period and caused some adverse implications on the performance of key macroeconomic and socio-economic indicators. On the back of the foregoing and other external/global developments and domestic economic conditions, the macroeconomic projections made in the NESG's Macroeconomic Outlook 2023 will be adjusted to reflect current economic realities. In achieving this fate, key global developments including growth patterns, crude oil prices, and other factors that would shape the domestic economic environment are analyses alongside crucial internal events in Nigeria.

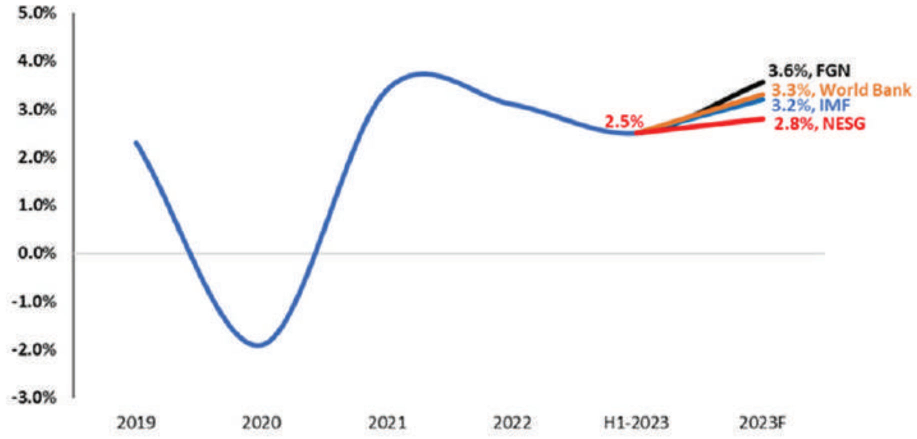
Rationale

The revised projection for 2023 assumes that crude oil prices will average US$80/barrel. This assumption is informed by the effect of the Russia-Ukraine crisis on the energy market and higher crude oil demand due to improved industrial activities in advanced economies and emerging markets. The performance is higher than the US$70/barrel proposed in the 2023 budget. As efforts to contain crude oil theft in Nigeria intensify, crude oil production will average 1.5 million barrels per day (mbpd) in H2'2023. This represents an improvement over 1.15mbpd in 2022 but is 9.1 percent lower than the 2023 budgetary oil production of 1.69mbpd. There is also an anticipated improvement in government capital expenditure due to fuel subsidy removal and convergence of exchange rates and also increase in the FGN budget implementation rate. Based on these underlying assumptions, the outcomes are presented as follows.

Outcomes

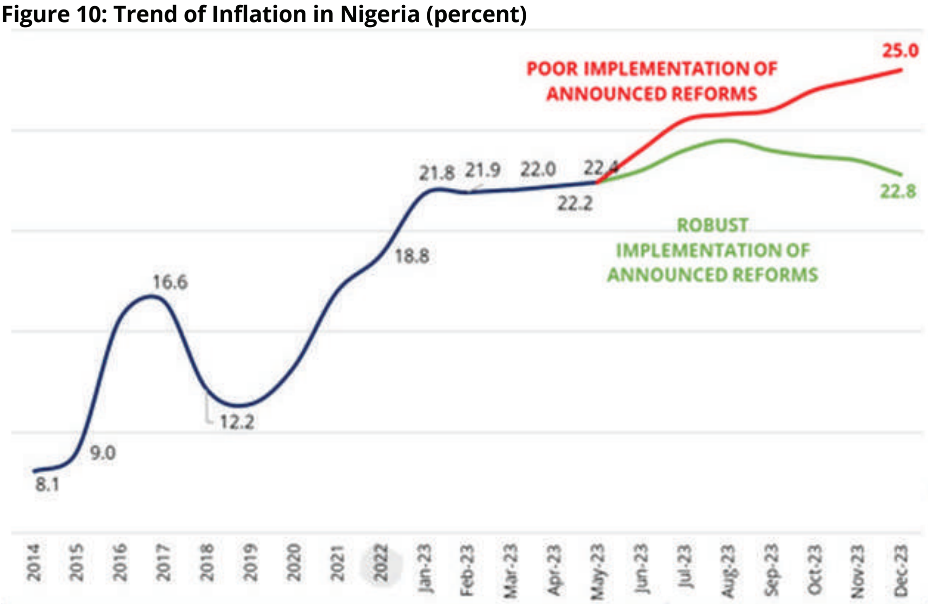
RGDP growth is expected to moderate to 2.8 percent (see Figure 9). Economic growth will be subdued in 2023 due to strains on consumer purchasing power and higher cost of operations which will adversely affect productivity in critical sectors. The services sector will sustain economic growth momentum in H2'2023 with weaker growth performance in the agriculture and industrial sectors. The oil sector will continue to drag the performance of the industrial sector but likely move out of recession in 2023Q4. Economic growth will not be strong enough to generate a significant increase in per capita income and jobs for Nigerians in 2023. As a result, the per capita income of average Nigerians will still stand around US$2300 while the real per capita income will be lower than US$1000.

Figure 9: Actual and Revised Projected Real GDP Growth for 2023



Inflation rate projection has two scenarios of averaging 22.8 percent and 25.0 percent in 2023 for robust and poor implementation of current reforms respectively (See Figure 10). Inflationary pressure is expected to remain elevated due to the immediate impacts of fuel subsidy removal and depreciation of the Naira occasioned by the convergence of exchange rates. Existing structural, cost and monetary policy-induced factors will significantly contribute to keeping the inflation rate high. However, the quality of implementation of current reforms by the new administration will significantly influence the rate of acceleration or deceleration of inflationary pressure in 2023. If these are properly implemented, the average inflation rate is expected at 22.8 percent for the year. In the opposite case, inflation will close the year at 25.0 percent.

Figure 10: Trend of Inflation in Nigeria (percent)



The unemployment rate will increase with more people being pushed into the poverty bracket due to weak performance in the job-elastic sectors, low labour absorption of sectors that will drive growth, and higher population growth. High inflationary pressure will also erode the purchasing power of households while businesses, especially MSMEs, will have no or limited capacity to create new jobs. The business community or private sector will focus on survival rather than expansion in H2'2023. Going by this situation, businesses will be forced to reduce the workforce, which will heighten the unemployment problem, cut wages/salaries, and amplify the poverty level.

Monetary policy tightening will continue till the end of 2023, but the rate of acceleration will slow down. The CBN is expected to slow down its hawkish policy stance in H2'2023 to support economic growth while using other measures to rein in rising inflationary pressure in Nigeria.

(D) Policy Recommendations

Reducing Inflationary Pressures

Boosting agricultural productivity to reduce food import inflationary pressure. Enhancing agricultural productivity to alleviate food import inflationary pressure requires the government to address key challenges. Foremost, tackling the insecurity issues prevalent in major food-producing regions is imperative. By providing adequate security measures, farmers can focus on their work without fear of disruption, leading to increased yields and a stable supply of food products. Moreover, an efficient and well-connected transport system is crucial to ensuring that agricultural produce can reach the market promptly and with minimal spoilage. Upgrading and maintaining roads and transportation infrastructure will facilitate the seamless movement of goods from farms to markets, reducing wastage and increasing the availability of food products at competitive prices.

Implementation of a coherent policy to govern the Central Bank's interventions in the foreign exchange market. The Economic Management team of the Federal Government must achieve unanimity on supporting Forex market liquidity, among other essential measures. Such a coherent policy stance is paramount in enhancing investors' confidence, both from local and foreign stakeholders, in the country. In addition, a well-articulated policy governing the Central Bank's interventions in the foreign exchange market, backed by a unanimous stance from the Economic Management team, is pivotal in fostering investor confidence in Nigeria. This confidence will, in turn, attract more local and foreign investments, ultimately bolstering the nation's economic stability and growth.

Supporting Sectoral Productivity Growth

Supporting linkages among sectors for positive spillover of growth and productivity. There is a need to kick-start an economic framework that links sectors with complementary activities in Nigeria. For example, through the development of appropriate pricing for agricultural products to keep farmers' incomes stable and quality output, since the Agricultural sector supplies its output as industrial inputs for the Manufacturing sector. Similar sector-level interaction must also be activated between industrial and services as well as services and agriculture.

Develop tailor-made finance and competitive grants to support innovative development and start-up of nascent industrial and manufacturing enterprises. Sectors that are fundamental to economic growth must be supported with the required capital outlay for production and expansion. This strategy is important to support local productivity and reduce the country's reliance on imports for manufactured goods.

Set up a home-grown quality control system to ensure that Nigerian-made products become attractive to foreign buyers. This will help boost forex earnings from non-oil export commodities. In addition, this will provide adequate incentives such as affordable credit facilities to manufacturers to facilitate mass production of exportable commodities.

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