NIGERIA

DOUBLE WHAMMY HITS WEAKENED ECONOMY

Although the pandemic is well contained from a health perspective, the Covid-19 crisis combined with the downturn in oil prices will have severe economic consequences. With no real fiscal leeway, the government has implemented a very modest economic stimulus plan, while massive capital outflows and the collapse of oil exports have fuelled the rapid erosion of foreign reserves, bringing the naira under pressure. The deterioration in public and external accounts despite support from donor funds hampers any prospects of a recovery. Just four years after the last recession, real GDP is expected to contract significantly again in 2020. Without an upturn in oil prices, the rebound will be mild in 2021.

With just 684 deaths reported in early July and more than 30,000 confirmed cases for a population of 200 million inhabitants, the coronavirus pandemic has been relatively mild so far. Yet the number of new cases is rising constantly. Nigeria is one of the African countries that tests the least, and it is in the midst of easing the lockdown restrictions that were implemented at the end of March. Although reintroducing a strict lockdown does not seem very feasible given its socioeconomic consequences (the informal sector accounts for more than 40% of the economy according to the World Bank), persistent health risks will continue to weigh heavily on the prospects of an economic recovery. Above all, with its deteriorated macroeconomic fundamentals, Nigeria must deal with a powerful oil and financial shock.

EXTERNAL ACCOUNTS: PERSISTENT PRESSURE

Nigeria's external position is not nearly as comfortable as it was during the previous shock of 2015. After three years of surpluses, the current account balance swung back into a deficit in 2019 due to surging imports of goods and services. In 2020, imports will decline with the drop-off in domestic demand, but this will not be sufficient to fully offset the loss of oil exports (90% of total exports). In addition to the collapse of Brent oil prices, commitments taken by Nigeria under the Opec+ agreement should reduce its oil production by more than 10% over the full year. All in all, oil exports are expected to be slashed in half in 2020 to less than USD 30 bn. To make matters worse, there has been unusual pressure on remittances from the Nigerian diaspora, which has accounted for more than 25% of current-account receipts in recent years.

Consequently, the current account balance will continue to post a large deficit, estimated at more than 3% of GDP. The financial situation is also precarious. Massive capital outflows beginning in H2 2019 have led to a steady erosion of external liquidity. After declining to USD 35 bn at the end of April 2020, FX reserves have been rebuilt slightly thanks to the USD 3.4 bn emergency assistance from the IMF. Yet this respite is bound to be short-lived. In Q1 2020, the stock of portfolio investments in short-term naira debt securities amounted to more than USD 20 bn, the equivalent of 60% of FX reserves. Non-resident investors sold a large share of their stock of securities issued by the central bank. After peaking at USD 18 bn in mid-2019, this stock has fallen back to about USD 8 bn, 70% of which matures by year-end 2020. Sovereign spreads are still high at 753 basis points, signalling the persistent aversion to Nigerian risk.

Despite upcoming financial assistance from several donors (about USD 3.5 bn), FX reserves are expected to decline again in H2 2020 to end the year at less than USD 30 bn. This is barely equivalent to 4.7 months of imports of goods and services, compared to 9.3 months at year-end 2017. This would bring FX reserves back to the 2015-2016 level, when the authorities decided to restrict considerably their foreign-currency allocations. The emergence of a significant spread in the parallel forex market since the beginning of the year despite the devaluation of the naira suggests that this might already be the case (see chart 1).

FORECASTS

	2018	2019	2020e	2021e
Real GDP growth (%)	1.9	2.3	-4.2	2.4
Inflation (CPI, year average, %)	12.1	11.5	13.0	12.0
Gen. Gov. balance / GDP (%)	-4.3	-5.0	-7.1	-6.0
Gen. Gov. debt / GDP (%)	23.1	25.0	31.0	32.5
Current account balance / GDP (%)	0.9	-3.6	-3.4	-2.6

TABLE 1 — e: ESTIMATES AND FORECAST
SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH

EXCHANGE RATE ADJUSTMENT AGAINST THE US DOLLAR

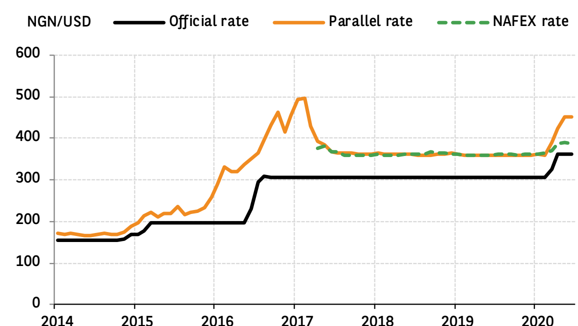

CHART 1 — SOURCE: CBN, BLOOMBERG, ABOKI FX

NAIRA ADJUSTMENTS: NECESSARY BUT INSUFFICIENT

Under this environment, the exchange rate system has become a key issue again. After virtually four years of stability, the monetary authorities adjusted the official exchange rate by 15% on 20 March. At 360 NGN per USD, the naira is nearing the NAFEX rate (70-80% of commercial and financial transactions) without completely eliminating the spread: the NAFEX rate is still about NGN 390 per USD. The central bank has indicated that it might unify the two exchange rates in the near future. The project is still vague but seems to be advancing.

According to Bloomberg, at an auction for importers on 4 July, the monetary authorities asked that bids for foreign exchange be made at NGN 380 per USD, implying another 5.3% devaluation.

Although unifying exchange rates would be an undeniable step forward, the strength of the naira will continue to be a problem. Even aligned with the NAFEX rate, the official exchange rate would still be 20% lower than in the parallel market. Fierce downward pressure can also be seen in the offshore market, where the 1-year forward rate is NGN 460 per USD. Moreover, nothing says that the monetary authorities are prepared to move towards greater flexibility. Persistently high inflation amid a stable exchange rate leads to an appreciation in the Real Effective Exchange Rate (REER), which is a source of external imbalances. Despite the nominal adjustment of the exchange rate in March, REER is still 22% higher than at year-end 2016.

PUBLIC FINANCES: LITTLE FLEXIBILITY

The double whammy of the pandemic and the downturn in oil prices has made the fiscal equation even more complicated. Based on an initial assumption of oil prices at USD 57 a barrel, the budget had to be modified repeatedly before being approved using the conservative hypothesis of USD 28 a barrel. With the oil sector generating over half of its resources, one of the world's narrowest fiscal base (non-oil revenues barely exceeded 4% of GDP in 2019) and capital expenditure amounting to less than 1% of GDP, fiscal flexibility is virtually non-existent. Despite adjustments in non-essential spending and the elimination of energy subsidies, the consolidated fiscal deficit could reach 7% of GDP this year, which is two points higher than in 2019.

Covering financing needs will continue to be problematic. Faced with deteriorated conditions, the government is unlikely to tap the international bond markets this year. Despite major support from donors, the central bank will be largely called on once again. In 2019, 75% of the fiscal deficit was monetised, essentially via overdraft facilities. Given the squeeze on domestic liquidity, this year the proportion should be relatively similar. Yet direct financing from the central bank is costly (key rate +3%). Although public debt is small (31% of GDP in 2020, less than a third of which is in foreign currencies), interest payments could absorb more than 40% of general government revenues in 2020, more than twice the 2019 figure. In comparison, the state allocated less than 10% of its resources to interest payments in 2014. Given this environment, the rating agencies S&P and Fitch downgraded Nigeria's sovereign rating in March-April, while Moody's switched to a negative outlook. There is also regular speculation that the authorities seek to benefit from a temporary freeze of their debt servicing with official creditors, although the finance ministry denies this.

REAL GDP GROWTH: ANOTHER RECESSION

Economic growth was still positive at 1.9% year-on-year in Q1 2020, but leading indicators signalled a sharp drop in Q2 GDP. Despite a slight rebound since May in tandem with the easing of lockdown restrictions, PMI is still below the 50 threshold (see chart 2) after hitting an all-time low of 37.1 in April. The economy will continue to face powerful headwinds because the drop-off in oil exports is having numerous repercussions on the economy as a whole. Faced with this situation, the fiscal stimulus package seems small (1.6% of GDP) as do the support measures implemented by the monetary authorities.

In addition to liquidity injections in the banking sector (2.4% of GDP) and the possibility of temporary loan restructuring for clients hit hardest by the crisis, the central bank has cut its key rate by 100 basis points to 12.5%. This was a surprising decision because it coincided with accelerating inflation (+12.4% in May). Moreover, the transmission channels seem to be reduced. The banking sector will come under pressure given its high exposure to the oil sector (27% of loan portfolios) and the high level of dollarization (40% of loans are in foreign currencies). Moody's expects to see the doubtful loan ratio more than double to between 12% and 15%.

DRAMATIC FALL IN ECONOMIC ACTIVITY

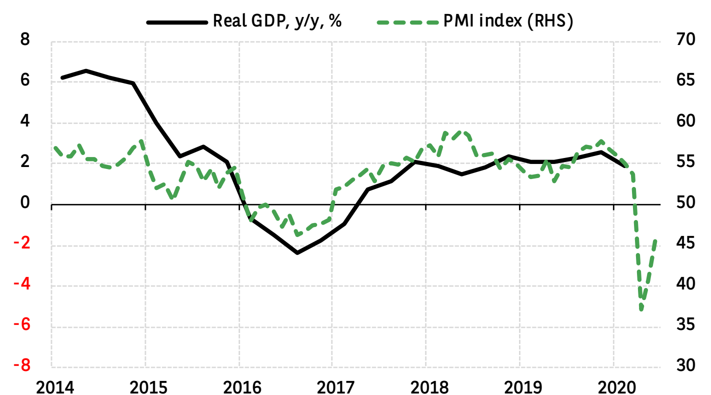

CHART 2 SOURCE: NBS, STANBIC IBTC

All in all, real GDP is expected to contract by more than 4% in 2020, just four years after the previous recession. Without a significant rebound in oil prices, the expected recovery in 2021 is bound to be mild, estimated at 2.4%, which is even lower than demographic growth. Although a positive outcome is still possible (thanks to reforms), this time the alarming erosion of macroeconomic fundamentals could force the authorities to request a financing programme with the IMF. They were opposed to such a move during the previous shock.

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