NIGERIA

MIXED PROSPECTS

The Nigerian economy is experiencing mixed fortunes. Its low level of oil production does not allow it to benefit fully from the rise in oil prices. The current account balance is expected to return to a surplus this year, though the persistence of a rigid exchange rate regime continues to weigh on the economy's attractiveness and the availability of liquidity in dollars. The commodity price shock is exacerbating already strong inflationary pressures, and the budget deficit will remain high due to the continuation of an energy subsidies policy that has become too expensive. For the time being, this is not jeopardising the strength of the economic recovery. However, the weakening macroeconomic stability leaves the economy vulnerable to further setbacks in the future.

As the largest oil producer in sub-Saharan Africa, Nigeria should benefit from the current global context. However, while growth prospects are positive, gains in terms of macroeconomic stability will be modest. The poor performance of the oil sector is one of the main reasons. Crude oil production (excluding condensate) has just reached a low point of only 1.2 million barrels per day in May 2022, compared with a quota set in the OPEC+ agreements of 1.76 million barrels per day. Since early 2020, the country has been unable to meet its targets due to repeated technical incidents and insecurity. Even if we factor in an improvement in the coming months, total oil production is expected to reach an average of 1.6 million barrels per day this year at best, a level similar to 2021 but 20% lower than in 2019. Added to this are imbalances caused by economic policy inertia. Admittedly, the country's Central Bank has just raised its key rate, but the timing raises questions. Furthermore, it still does not seem ready to relax its foreign exchange regime despite significant, lingering dysfunctions. Above all, the decision to postpone the reform of the oil subsidy system to mid-2023 will weigh considerably on Nigeria's public finances.

FORECASTS

	2019	2020	2021	2022e	2023e
Real GDP growth, %	2.3	-1.9	3.4	3.4	3.2
Inflation, CPI, year average, %	11.5	13.2	17.0	17.9	14.9
Gen. Gov. balance / GDP (%)	-4.7	-5.7	-5.9	-5.5	-5.4
Gen. Gov. debt / GDP (%)	25.0	29.4	30.0	31.1	31.7
Current account balance / GDP, %	-3.6	-3.9	-0.4	0.9	1.2
External debt / GDP, %	17.9	19.4	20.7	18.0	16.0
Forex reserves, USD bn	38.3	36.7	40.4	43.7	48.3
Forex reserves, in months of imports	4.6	6.1	7.3	7.0	8.3

e: ESTIMATE & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

INFLATION: THE CENTRAL BANK FINALLY REACTS

Inflation was already a problem before the conflict began in Ukraine. It has worsened since then. The rise in the Consumer Price Index (CPI) reached 17.7% year-on-year (y/y) in May 2022, and should soon exceed the last peak of 18% reached in the first quarter of 2021 (chart 1). Nigeria is a net importer of food and is therefore heavily impacted by the surge in international commodity prices. In addition, food accounts for 51% of the consumer basket. Therefore, rising food prices (19.5% y/y in May) largely explain the strong inflationary pressures, but not only. Excluding food, inflation is also rising (14.9% in May compared to 13.8% in January), notably due to the energy shock. In fact, while petrol prices are stable thanks to the system of subsidies, gas and diesel prices are deregulated. Yet approximately 70% of the gas consumed is imported, while diesel is widely used to compensate for the deficiencies of the national electricity network.

Against this backdrop, the Central Bank raised its key rate by 150 basis points to 13% in May. This decision came as a surprise – it was the first rate hike since mid-2020, and we have to go back as far as July 2016 to see the Central Bank tighten its monetary policy, despite inflation consistently remaining above its target (6-9%). Should this be interpreted as a shift towards greater discipline? It is difficult to say. The Central Bank is simultaneously pursuing objectives that could conflict with the fight against inflation, starting with its continuing policy of supporting certain sectors via subsidised loans. Severe dysfunctions caused by the exchange rate system are another example. In any case, further rate hikes will be necessary if the Central Bank wants to reanchor inflationary expectations. But visibility is limited.

NIGERIA: MONETARY ENVIRONMENT

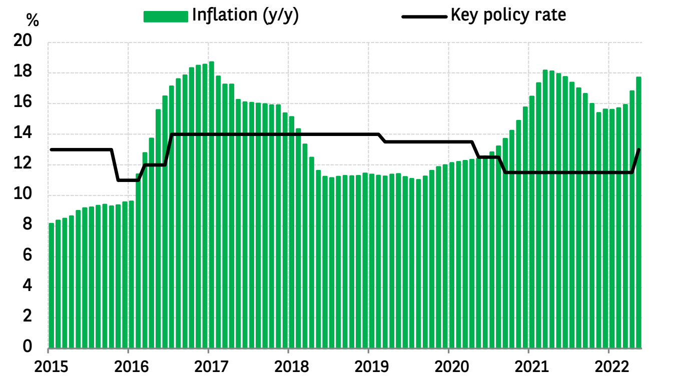

CHART 1 SOURCE: CENTRAL BANK, NBS, BNP PARIBAS

MACROECONOMIC STABILITY: STILL FRAGILE

The surge in oil imports is weighing on the recovery in external accounts, but the current account deficit is narrowing and Nigeria should be able to achieve a current account surplus this year. Nevertheless, external liquidity problems persist. Forex reserves fell to a low point of USD 33.7 bn in March 2020, but then stabilised at around USD 35 bn. However, this stabilisation was achieved at the cost of strict foreign currency rationing and a strong compression of imports. After rising to

USD 41.5 bn in September 2021 thanks to both the IMF's allocation of Special Drawing Rights and a large issue of Eurobonds, forex reserves have fallen again since October (USD 38.4 bn in May). The gap between the official exchange rate and the parallel (black market) rate also widened to over 40% today compared to 22% in mid-2021 (chart 2).

The monetary authorities' willingness to preserve a stable exchange rate (despite some adjustments) continues to weigh heavily on the amount of US dollar liquidity available in the economy. This shortage has a knock-on effect on inflation insofar as large parts of the economy have turned to the black market to purchase imported products. This also weakens Nigeria's financial attractiveness. Capital inflows collapsed further in 2021 after the shock of 2020, dropping from USD 23.7 bn in 2019 to USD 6.7 bn in 2021. The situation is unlikely to improve much in the short term, given the tightening of global liquidity. The authorities already issued Eurobonds in March 2022, but the widening of Nigerian sovereign bond spreads (EMBI) by 344 basis points (bps) since April reflects increased investor mistrust. They have now reached 962 bps, one of the highest spreads among African issuers.

While foreign capital inflows are likely to remain depressed, Nigeria is also exposed to the risk of short-term capital outflows due to US monetary policy tightening and rising risk aversion among international investors. Indeed, the total stock of « hot money » (portfolio investment stock and short-term debt) remains significant, equivalent to 44% of forex reserves at the end of 2021.

The situation of public finances is even more worrying. The heavy burden of energy subsidies and the drop in oil production meant the Nigerian government did not benefit from the rise in oil prices in 2021. This will remain the case in 2022. The cost for the Nigerian National Petroleum Corporation under the country's energy policy is expected to reach almost 2% of GDP, i.e more than 20% of the government's total revenue. Excluding hydrocarbons, revenue is structurally weak (less than 5% of GDP), and flexibility is limited due to the extremely low level of capital spending (around 2% of GDP). Despite the sharp rise in nominal GDP, public finance indicators will therefore remain deteriorated this year. The budget deficit is expected at 5.5% of GDP in 2022, and public debt is set to rise slightly to 31% of GDP. At this stage, debt sustainability is not under threat, especially since its structure is favourable (70% of debt outstanding is denominated in local currency) and Nigeria does not have significant Eurobond debt amortization in the short term. Nevertheless, the debt dynamics is a source of a concern – public debt stood at only 13% of GDP in 2014 – and its significant cost hampers the government's room for manoeuvre and its ability to cope with further shocks. More than 30% of government revenue is now allocated to debt interest payments, compared to less than 10% in 2014.

GDP GROWTH: VIGOROUS IN 2022, WITH UNCERTAINTY BEYOND

Persisting pressures on external accounts and public finances has not dampened the strength of the recovery for the time being. Real GDP growth slowed to 3.1% in Q1 2022 from 4% in the previous quarter, but this primarily reflects the 26% drop in oil GDP. Excluding hydrocarbons, momentum remained strong (up 6.1%) thanks to a good performance of services (+7.4% y/y; 54% of GDP). Leading indicators for Q2 remain rather well-oriented. Provided that oil production does not fall any further, Nigeria's growth could reach 3.4% in 2022, the same rate as 2021, which would constitute a quite remarkable performance given the dissipation of the post-Covid catch-up effect.

NIGERIA: EXCHANGE RATE

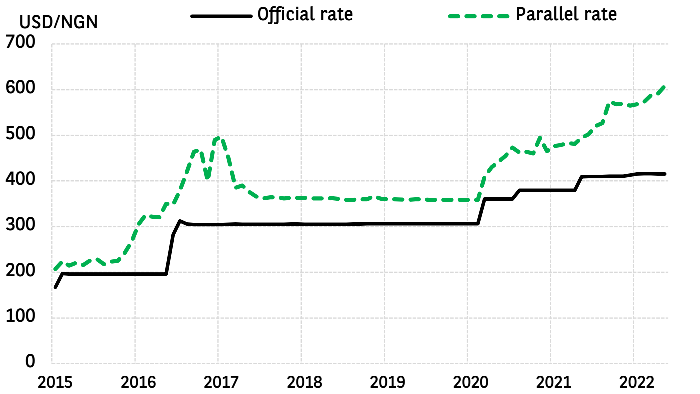

CHART 2

SOURCE: CENTRAL BANK, NAIRAMETRICS, BNP PARIBAS

Nevertheless, at this pace, it will take until 2025 for real GDP per capita to return to its 2019 level. Furthermore, in the absence of deep structural changes, Nigeria will remain exposed to oil price fluctuations.

Presidential elections will take place in February 2023. While the candidates are already known, their reform programmes are yet to take shape. The overhaul of the energy subsidy sytem should be a priority, but socially, this will remain a highly sensitive subject. For the same reasons, the governor of the Central Bank (whose term of office expires in June 2024) has continuoulsy repeated his opposition to greater flexibility in the exchange exchange system.

However, in the second half of 2022, the situation should improve once operations begin at a mega-refinery that will have sufficient capacity to cover Nigeria's oil needs. Investors' renewed interest in the country's vast gas reserves could also revitalise a sector that has been struggling for many years. But it will take much more to allow Nigeria to find its way back to over 5% economic growth, the prevailing rate at the turn of the 2010s.

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