NIGERIA

ONGOING REFORMS

Since the beginning of 2024, the Nigerian authorities have accelerated the implementation of reforms aimed at curbing the deterioration in external accounts and restoring macroeconomic stability. By relaxing the exchange rate regime and raising interest rates, the central bank has sent a strong signal to foreign investors. However, it will take time and the implementation of major structural reforms for capital inflows to take off significantly and durably. At the same time, fiscal consolidation is being complicated by an unprecedented inflationary shock and its impact on economic growth. The high cost of implementing reforms could force the government to backtrack.

REFORMING THE EXCHANGE RATE REGIME

Since 2015, Nigeria's external accounts have deteriorated as a result of the downward trend in oil production and negative price shocks. Faced with this situation, the Central Bank of Nigeria (CBN) has worked to maintain exchange rate stability, in order to limit inflation via rising import prices. However, maintaining the exchange rate at an artificially overvalued level has been to the detriment of two elements. On the one hand, to support the naira, the central bank has drawn on foreign exchange reserves, which have declined steadily since 2019 (with the exception of a brief rebound in mid-2021 due to a Eurobond issuance and the granting of IMF special drawing rights). On the other hand, the CBN has had to introduce capital controls on several occasions to ration access to foreign currency, creating distortions on the official foreign exchange market that have discouraged foreign capital inflows, which are already historically low.

Acknowledging this untenable situation, the authorities who came to power in May 2023 immediately broke with their predecessors by embarking on an in-depth reform of the exchange rate regime, with the aim of eventually returning to an exchange rate determined by market forces. As a first step, they carried out an unprecedented devaluation of the naira, with the aim of closing the gap between the official exchange rate and the rate prevailing on the parallel market in May 2023. However, in the absence of additional measures, the gap with the official rate widened further, reaching 37% in October 2023.

The authorities had to speed up reforms aimed at eliminating the many distortions on the foreign exchange market. In October 2023, the CBN repealed an eight-year-old ban on access to foreign currency for imports of 43 categories of goods. In February 2024, it put an end to exchange rate ceilings on interbank transactions and international money transfer operations. At the same time, it improved the transparency of the official market by making public the methodology used to calculate the overnight exchange rate.
Combined with a further devaluation in January 2024, this wave of reforms seems to have borne fruit: since last February, the gap between the official and parallel exchange rates has closed. However, capital controls persist. In order to attract foreign capital despite this, the CBN is counting on a return to a more orthodox economic policy.

TOWARDS A RETURN TO MONETARY ORTHODOXY

The CBN has long pursued objectives that conflict with its mandate to combat inflation, notably due to the frequent monetisation of the budget deficit.

In order to restore confidence in monetary policy, it was therefore crucial for the new authorities to signal a change of course. With a new governor at the helm, the CBN suspended budget deficit financing in H2 2023 and reiterated the long-standing rule that all new advances contracted by the government from the CBN must be repaid within three months. At the same time, the government has paid off half of the advances that were taken out in H1 2023, and plans to repay the remaining NGN 4,000 billion (1.7% of GDP) in the coming months. With this reduced burden, the CBN has been able to act more freely to combat inflation, albeit belatedly. Between February and the end of May 2024, the main policy rate was raised by 750 basis points to 26.25%. At this level, the *ex ante*

FORECASTS

	2021	2022	2023	2024e	2025e
Real GDP growth, %	3.6	3.3	2.9	3.3	3.0
Inflation, CPI, year average, %	17.0	18.8	24.7	26.3	23.0
Gen. Gov. balance / GDP (%)	-5.2	-6.7	-4.8	-4.7	-4.2
Gen. Gov. debt / GDP (%)	35.7	39.4	46.4	46.7	47.0
Current account balance / GDP, %	-0.7	0.2	-0.2	0.5	-0.1
External debt / GDP, %	18.5	18.8	22.7	32.9	34.8
Forex reserves, USD bn	33.2	32.8	27.3	27.7	28.6
Forex reserves, in months of imports	5.9	5.1	4.5	4.8	5.0

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

NIGERIA: EXCHANGE RATE ON THE OFFICIAL AND PARALLEL MARKETS

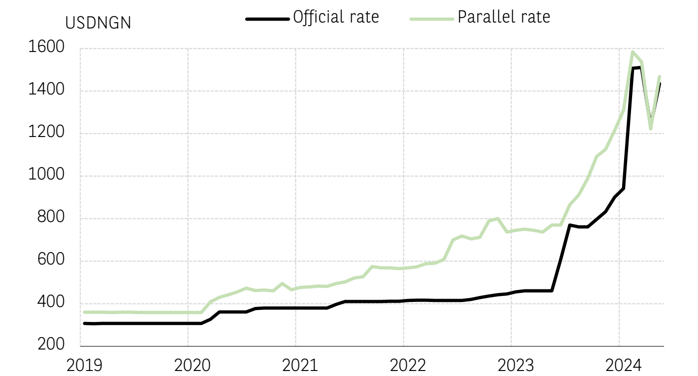

CHART 1 SOURCE: CBN, NIGERIAGALLERIA, BNP PARIBAS

real interest rate is now estimated to be slightly positive, as inflation is expected to fall in H2 2024. Further increases in the policy rate cannot be ruled out. The CBN has also resumed open market operations aimed at absorbing banks' excess liquidity.

By giving priority to the fight against inflation and reforming the foreign exchange market, the CBN has sent a strong signal to investors. As a result, according to data from the National Bureau of Statistics, net foreign capital inflows jumped to USD 3.4 billion in Q1 2024 (compared with USD 1.1 billion in the previous quarter). Driven mainly by net portfolio investment inflows (61% of total net capital inflows), they reached a level not seen since Q1 2020. This helped the CBN to honour its arrears on the foreign exchange market, which had been totalling USD 7 billion for several months. In addition, the exchange rate appreciated in March and April for the first time in over a year. However, the improvement was short-lived. The naira depreciated again in May, and is likely to remain highly volatile over the coming months. Above all, foreign exchange reserves remain at an alarmingly low level. According to the CBN, after a period of volatility in April-May, they reached USD 34 billion at the end of June, the same amount as a year earlier. However, according to the IMF, almost a quarter of these assets are illiquid. In order to attract capital on a sustainable basis and regain a comfortable level of external liquidity, the authorities will need to maintain their new policy mix over the long term and introduce major structural reforms. However, the difficulties are mounting, given the challenging pursuit of fiscal consolidation and the unprecedented inflationary shock.

FISCAL CONSOLIDATION INCREASINGLY DIFFICULT

With fiscal revenue of less than 10% of GDP, of which an average of 40% comes from oil, public finances are very fragile. In addition, against a backdrop of high oil prices, fuel subsidies had become increasingly costly, absorbing 24% of fiscal revenue in 2022.

The new government has therefore inherited a challenging situation in terms of public finances too, and has set the goal of fiscal consolidation. In 2023, the deficit contracted to 4.8% of GDP, compared with 6.7% in 2022. Non-oil revenue increased by one percentage point of GDP, thanks to improved tax collection. The government also moderated its spending. However, despite the shock announcement in May 2023 of the end of fuel subsidies, these have been reintroduced implicitly through the devaluation of the naira, which has had an impact on consumers and the government. Indeed, while pump prices have risen for consumers (they rose by 129% in June 2023 and were relatively stable thereafter until April 2024), the government has continued to sell fuel on the local market at a price significantly lower than the cost of its refined oil imports. As a result, indirect fuel subsidies still represented 0.8% of GDP in 2023, and are expected to rise to 2.8% of GDP in 2024, taking into account last January's devaluation. At present, the government has no plans to raise the domestic price of fuel towards a price determined by global market forces, as the impact of such a measure would be devastating for an economy already stifled by record inflation. To support households, the government plans to increase social benefits, some of which were suspended in 2023 because of embezzlement scandals. Overall, further fiscal consolidation will therefore prove difficult in 2024, and the deficit is likely to remain close to its 2023 level. Given the tense social climate, the risk of fiscal slippage is high.

NIGERIA: MONETARY ENVIRONMENT

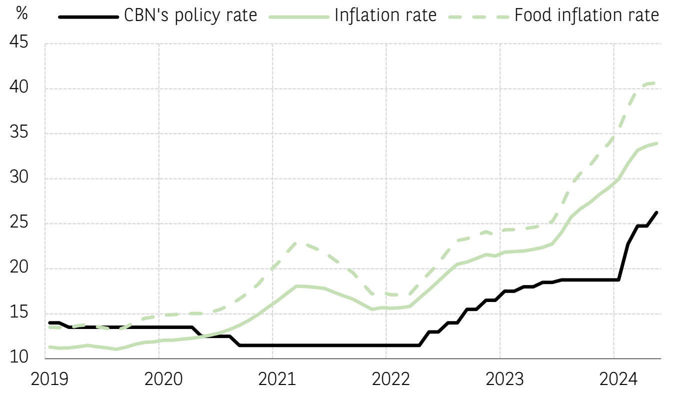

CHART 2 SOURCE: CBN, BNP PARIBAS

In addition, the drastic rise in domestic interest rates is likely to weigh heavily on interest payments on the public debt, which were already absorbing 35% of fiscal revenue in 2023. On a positive note, thanks to the reforms, increased support from multilateral donors in the form of loans at concessional rates should mitigate somewhat the upward trend in the interest burden on public debt. Besides, at 46% of GDP in 2023, public debt is still moderate.

RAMPANT INFLATION AND SLUGGISH ECONOMIC GROWTH

Rising fuel prices and the depreciation of the naira (by 71% between May 2023, before the first devaluation, and mid-June 2024) have plunged Nigeria into a deep economic crisis. The country is a net importer of food products, which make up 51% of the consumer price index basket. Year-on-year inflation reached 34% in May 2024, a level not seen since 1996. In recent months, there have been numerous demonstrations across the country, notably against the rise in electricity prices imposed by the government, and for an increase in the minimum wage. While economic growth is expected to accelerate to 3.3% in 2024 thanks to the upturn in oil production, non-hydrocarbon activity could be affected by a slowdown in demand and the rise in public unrest.

The current crisis comes on the back of years of virtual economic stagnation. Between 2015 and 2023, Nigeria's GDP grew at an average annual rate of 1.5%, well below the population growth rate of 2.6%. In 2023, the poverty rate reached 46% of the population, and according to the United Nations, more than 26 million Nigerians will be exposed to food insecurity in 2024. This social context could force the authorities to reconsider some of their recent policy mix reforms.

In addition, a number of structural reforms are yet to be implemented, for example to improve infrastructure in the energy sector and increase aid to the agricultural sector – which would support the CBN in the fight against inflationary pressures through supply-side measures.

Lucas Plé
lucas.ple@bnpparibas.com