NIGERIA

STRUGGLING TO REBOUND

After declining 1.9% in 2020, Nigeria's GDP is unlikely to rebound but mildly in 2021 due to persistent and significant macroeconomic imbalances. Despite the first signs of stabilization, inflation is still very high, and several adjustments to the naira have failed to correct the dysfunctions in the foreign exchange market. Although the rebound in oil prices should help reduce somewhat the squeeze on external liquidity, it will surely take more than that to restore the confidence of investors. Without reforms and with no fiscal manoeuvring room, the economy will continue to be vulnerable to external shocks.

Nigeria did not escape recession last year, although it was smaller than expected, with GDP contracting only 1.9%. On top of restrictions to combat the pandemic, the country had to deal with massive capital outflows and plummeting oil revenues. The economy has picked up again since Q4 2020, after two quarters of contraction. Even so, its growth dynamics are fragile. GDP rose only 0.5% YoY in Q1 2021 despite a good performance in agriculture and an upturn in oil production (including condensates), which rose to 1.72 million barrels a day on average, up from 1.56 m b/d the previous quarter. Excluding agriculture and the oil sector, growth slowed to 0.3%, from 1% in Q4 2020, due to a downturn in the services sector (-0.4%) after the pandemic flared up again. GDP growth is expected to rebound, albeit mildly, starting in Q2 as the second wave of COVID-19 infections dissipates and oil prices rise. Yet with the unemployment rate now at 33% and GDP per capita (in PPP) falling back to the 2017 level, household consumption will have a hard time recovering. This is especially true given the slow pace of the vaccination campaign (only 1% of the population has received a first dose). Moreover, inflation is at a record high. Other major constraints are the persistent pressure on the currency and external liquidity, as well as the low level of fiscal leeway.

FORECASTS

	2019	2020	2021e	2022e
Real GDP growth (%)	2.3	-1.9	2.4	2.3
Inflation (CPI, year average, %)	11.5	13.2	16.8	12.4
Gen. Gov. balance / GDP (%)	-4.8	-6.1	-4.0	-4.4
Gen. Gov. debt / GDP (%)	25.0	29.4	29.6	30.8
Current account balance / GDP (%)	-3.6	-4.0	-1.8	-1.7
External debt / GDP (%)	11.5	12.7	13.2	13.6
Forex reserves (USD bn)	38.3	36.7	38.2	39.5
Forex reserves, in months of imports	4.6	6.1	5.7	5.7

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH

MONETARY ENVIRONMENT

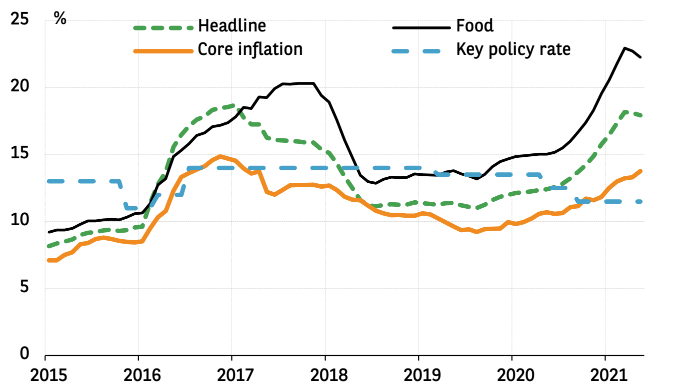

CHART 1 SOURCE: CENTRAL BANK

INFLATION AND THE EXCHANGE RATE: UNRESOLVED PROBLEMS

The monetary policy stance continues to raise numerous questions. Although inflation has risen constantly since mid-2019, the central bank decided to maintain its key rate (Chart 1). To bolster the economy at the height of the health crisis, the key rate was cut by 200 basis points to 11.5% in 2020. The sluggish pace of growth argues against a too early tightening of monetary policy. Inflation has also been showing signs of levelling off over the past two months, thanks to a slowdown in food prices (51.8% of the index). Yet headline inflation was still high at 17.9% in May, and core inflation rose again to 13.7%. Although the current shock on prices can be attributed in part to external factors that are beginning to wind down (mostly food supply constraints and the naira's devaluation), inflationary pressures are also being fed by the absence of a clear mandate for the central bank's targets and the recurrent monetisation of the fiscal deficit.

Efforts to stabilise the exchange rate are also generating major monetary distortions. Faced with the drop-off in oil exports, the authorities tried to protect forex reserves by limiting access to foreign currency and by adjusting the naira's official exchange rate on two occasions in 2020 before merging the official exchange rate with NAFEX rate (Chart 2) in May 2021. The AFEX rate is used in the majority of commercial and financial transactions. Although it is supposed to reflect an equilibrium of market forces, this rate is still controlled by the central bank. Naira is now trading at NGN 410 against the US dollar, up from NGN 306 in early 2020, a devaluation of 25%. The unification of the two exchange rates is a step forward, albeit a symbolic one, in the reform of the exchange rate regime. Yet it is still insufficient. The spread with the parallel rate continues to widen. The current premium is more than 20%, reflecting high demand for dollars fed in part by expectations of further devaluation. Another adjustment in the exchange rate seems inevitable. Adopting a more flexible exchange rate regime seems unlikely, however, despite the insistence of the IMF and the World Bank, which made it a prerequisite for unblocking a USD 1.5 bn loan. But the monetary authorities continue to oppose a move that they fear would strengthen the inflationary dynamics. This point is debatable: entire segments of the economy have already turned towards the parallel market to obtain foreign currencies. Compared to the previous oil shock, when imports of goods fell by nearly half between 2014 and 2017, the decline in imports was relatively limited in 2020 at 16%.

FRAGILE DYNAMICS OF THE EXTERNAL ACCOUNTS

The squeeze on external liquidity is expected to ease although it will not disappear. According to the central bank's preliminary estimates, the current account deficit narrowed significantly to USD 1.7 bn in Q1 2021, down from USD 5.2 bn in the previous quarter. This is essentially due to a rebound in remittances from the Nigerian diaspora (two thirds of current account non-oil revenues, even though they are still a quarter below pre-crisis level), and to travel restrictions (more than a quarter of current account spending). Moreover, the Nigerian economy has not benefited much from the rebound in oil prices so far. Exports even contracted during the quarter, down 8.6%, due to an unfavourable volume effect. Assuming India, the largest export outlet for Nigerian oil, does not slide into a protracted recession, the dynamics should improve in the months ahead, although without fully balancing the external accounts. At 1.8% of GDP in 2021, the current account deficit is expected to remain high, although that would be a big improvement over the 2020 level of 4% of GDP.

The financial horizon is also expected to clear up somewhat. The authorities are preparing to issue at least USD 3 bn in the international financial markets. With external government debt amounting to only 8% of GDP, and with the considerable easing of financing conditions in recent months, the bond issue should be well received. Moreover, with the IMF's general allocation of special drawing rights (SDR), Nigeria could receive funds of between USD 2.5 bn and USD 3 bn.

All in all, forex reserves could reach USD 38 bn at the end of the year, the equivalent of 5.7 months of imports of goods and services. As comfortable as the level of external liquidity may seem, it is much less certain that the situation in the forex market will return to normal. The monetary authorities must already clear a backlog of FX accumulated in 2020 (USD 2 bn for non-resident investors). The current economic environment seems propitious, but nothing says this will be sufficient to restore the attractiveness of Nigeria, given the uncertainty over the evolution in the foreign exchange regime. The stock of portfolio investments remains significant, despite massive capital outflows in Q1 2020. At year-end 2020, it totalled USD 27 bn (the equivalent of 73% of foreign reserves), including more than USD 11 bn in short-term debt issued in the local currency. And since the level of foreign direct investment is structurally low (averaging USD 2 bn over the past five years), Nigeria thus exhibits strong financial vulnerability both in terms of stock and flows. Above all, the economy is not sheltered from corrections in oil prices, which account for more than 90% of total exports.

OUTLOOK: RISK OF STAGNATION

Another constraint is the low level of government revenues. They contracted by nearly 2 points of GDP to only 6% of GDP in 2020, due to the downturn in oil prices and the economic shock. Despite a relatively small fiscal support package in 2020 (0.3% of GDP), budget deficit rose to 6% of GDP. Despite the expected upturn in oil revenues, it is still expected to reach at least 4% in 2021. Spending is rigid, and given the fragility of the social-economic environment, the authorities are adopting costly support measures, as illustrated by the reintroduction of oil subsidies (about 0.5 points of GDP). The accumulation of budget

MULTIPLE EXCHANGE RATES

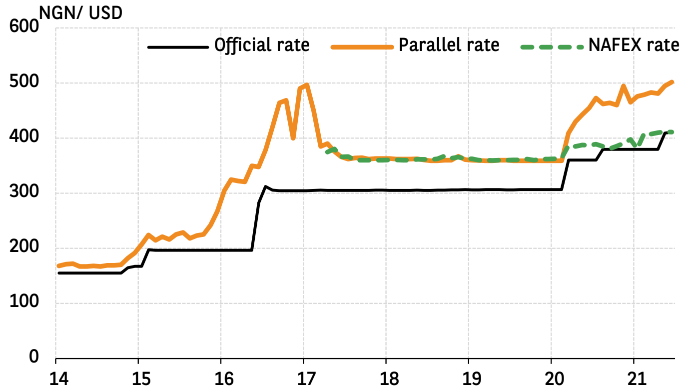

CHART 2 SOURCE: CENTRAL BANK, BLOOMBERG, ABOKIFX

deficits in recent years also goes hand in hand with a rapid increase in the public debt and interest cost. Interest payments are expected to absorb a quarter of fiscal revenues in 2021, up from less than 10% in 2014. Even so, the sustainability of the debt is not a problem since it is still moderate at 30% of GDP.

In the end, the rebound in GDP is likely to be very small at 2.4% in 2021, and growth should continue to be limited to 2-2.5% as of 2022. As a result, GDP growth will continue to fall short of population growth, as has been the case since 2015. It is thus vital to accelerate reforms. One positive point is that apparently the government has never been closer to passing the draft oil industry bill. At this stage, however, it is difficult to determine what impact it will have given the persistent safety and security issues. Most importantly, it will not resolve the problem of diversifying the economy, whose development is hampered by numerous structural constraints (lack of infrastructure) and a macroeconomic environment that is not propitious for investment (high inflation, dysfunctions in foreign exchange market).

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Stéphane ALBY
stephane.alby@bnpparibas.com