Nigeria

The growth engine is still jammed

Nigeria is having a hard time recovering from the 2014 oil shock. Although the economy has pulled out of recession, growth remains sluggish at 1.9% in 2018. Moreover, the central bank's recent decision to cut its key policy rate is unlikely to change much. With inflation holding at high levels, it is still too early to anticipate further monetary easing. Defending the currency peg is another constraint at a time when the stability of the external accounts is still fragile. Between soaring debt interest payments and the very low mobilisation of public resources, there is only limited fiscal manoeuvring room. It is hard to imagine a rapid economic turnaround without the intensification of reforms.

The beginning of the year was dominated by the presidential election held on 23 and 24 February. In what was expected to be a tight race, Muhammadu Buhari, the incumbent, won a clear-cut victory with 56% of the vote, compared to 41% for his main rival. Shortly thereafter, the monetary authorities lowered the key policy rate by 50 basis points (bp). Although there is no apparent link between these two events, the central bank's decision might signal a change in economic policy goals towards greater support for growth after a first mandate focused essentially on strengthening the external position. Yet there is very little manoeuvring room. Without any structural reforms, the recovery is bound to be slow.

Key policy rate cut: a symbolic move

The Central Bank of Nigeria (CBN) surprised the markets by lowering its key policy rate from 14% to 13.5% at the end of March, the first move since July 2016. Although inflation has stabilised at 11%, this is nonetheless higher than the monetary authorities' target range of 6-9%. There is even a risk that inflation could rise again if the public sector minimum wage is raised from the current level of NGN18000 currently (USD 60 at the official exchange rate) to NGN30000 (USD 98). It is difficult to assess the impact of this measure given the numerous obstacles to its implementation, starting with the very delicate financial situation of numerous states.

According to the governor of the central bank, the monetary policy easing is supposed to boost economic activity by stimulating bank lending. At this stage, however, we think the decision is mainly symbolic. First, issuance of CBN bills is the main tool used by monetary authorities to manage liquidity. Since 2016, interbank rates have regularly surpassed the key policy rate, diluting the signals it transmits. Second, transmission channels to the economy are limited. Nigeria not only has a low bank penetration rate, but the oil shock has also weakened the financial system, and the correction phase is not yet complete. The growth of lending to the private sector was still a negative 2.6% at the end of February. Although they have begun to improve, financial soundness indicators are still deteriorated. Especially, the doubtful loan ratio remains high at 12.4%, compared to 3% at year-end 2014.

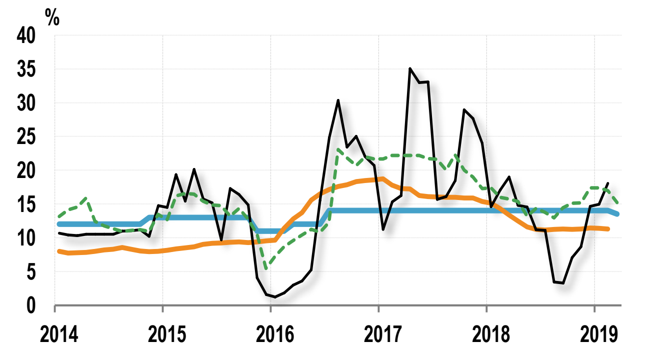
In a context of strong risk aversion for the banks, monetary policy will surely have to be more accommodating to have an impact. But the room for manoeuvre is thin. In addition to latent inflationary pressure, the fact that non-residents hold nearly 30% of bills issued by the central bank implies that yields must be high enough to maintain their attractiveness. An abrupt surge in short-term rates in the second half of 2018 (interbank rates and Treasury notes) was a stark reminder of the persistent fragility of Nigeria's macro-financial situation.

1-Forecasts

	2017	2018	2019e	2020e
Real GDP growth (%)	0.8	1.9	2.2	2.5
Inflation (CPI, year average, %)	16.5	12.1	11.5	11.0
Gen. Gov. balance / GDP (%)	-5.3	-4.9	-4.7	-4.0
Gen. Gov. debt / GDP (%)	18.9	21.3	23.7	25.3
Current account balance / GDP (%)	2.8	1.2	1.5	1.1
External debt / GDP (%)	19.4	19.8	18.9	17.8
Forex reserves (USD bn)	39.6	42.9	46.1	48.9
Forex reserves, in months of imports	9.3	7.2	8.4	8.2
Exchange rate USDNGN (year end)	305	305	305	305

e: BNP Paribas Group Economic Research estimates and forecasts

2- Monetary environment



Source: Central bank

Macroeconomic stability: still fragile

The strengthening of external accounts came to a sudden standstill in 2018. Not only did the current account surplus contract sharply, to 1.2% of GDP in 2018 (vs. 2.8% in 2017) due to a surge in imports of services, but Nigeria was also hit by massive capital outflows as of April (USD 9 bn according to the IMF), the impact of which was only partially offset by a new USD 2.86 bn Eurobond issue in November, after February's issue of USD 2.5 bn. Foreign reserves shrank by

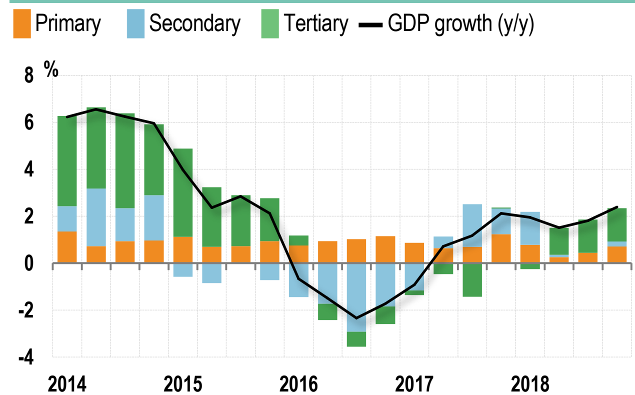
10% in the last 9 months of 2018, ending the year virtually flat after doubling between October 2016 and year-end 2017.

Pressures have eased since the presidential election. In the month of March alone, foreign reserves increased by USD 2 bn. The 100bp decline in 1-year Treasury notes indicates the return of non-resident investors to the local debt market. By removing uncertainty about naira trends, Mr. Buhari's victory seems to have been decisive for restoring attractiveness. Under the current system, several exchange rates co-exist, with a 20% spread between the official exchange rate, set at NGN/USD305 (used for oil product imports and external debt servicing) and the NAFEX rate, which fluctuates around NGN/USD360 (70-80% of transactions). Despite the distortions this dual system implies, president Buhari and the CBN governor do not favour converging the two rates, which they believe would mainly have an inflationary effect. Moreover, foreign reserves are still high (covering 7 months of imports of goods and services at year-end 2018) and the current account should continue to run into a slight surplus. Everything suggests that the status quo will be maintained for the next two years.

All in all, we do not think the stability of the external accounts is at risk in the short term, although the situation is still fragile because portfolio investment are making up an increasingly big share of capital flows.

However, the public finance situation continues to be a source of concern. Very low progress in improving tax collection makes any prospects of a rapid consolidation of the public accounts a distant possibility. The government's consolidated revenues fell to an all-time low of 5.6% of GDP in 2016, but have since recovered somewhat thanks to the rebound in oil prices. Even so, they only amounted to 8.7% of GDP in 2018, one of the lowest rates in Sub-Saharan Africa. The current oil market environment does not raise much hope for potential fiscal gains. Yet the state also faces other major financial headwinds. The widening of the budget deficit since 2014 has been accompanied by an increase in the cost of debt on the domestic market. Interest payments now absorb more than 20% of government revenues, up from 9% in 2014. The government is trying to circumvent the problem by borrowing more on the international financial markets. This would seem to be a coherent strategy given the favourable financial conditions (about 6% vs 15% on the domestic market) and the low level of public debt in foreign currencies (5% of GDP), but it will expose public finances to currency risk. Above all, with a budget deficit remaining above 4% of GDP in 2019-2020, the government will continue to cover a large part of its financing needs on the domestic market at interest rates that are bound to remain high (due to inflationary pressures and the necessity to defend the currency peg). Consequently, there is reason to doubt the authority's capacity to go ahead with majors economic projects. Public investment amounted to only 3.3% of GDP in 2018, which is also extremely low compared to the other African economies. Given the need to clean up public finances, this figure could even drop below 3% by 2020.

3- Sector contribution to growth



Source: NBS

Growth prospects: towards a slow recovery

Under these circumstances, how can Nigeria revive its economy? The country may have pulled out of recession in 2017, but growth remains sluggish at 1.9% in 2018. Excluding the net rebound in the momentum of the Information and Communication Technologies sector as of Q2, the overall picture is even more deteriorate, with real GDP growth of only 0.9%, vs. 1.1% in 2017.

Moreover, the IMF does not foresee any significant improvements. Even though the start-up of production at the Egina oil field adds an extra 200,000 barrels per day (10% of national production), economic growth will pick up only slightly, to 2.5% in 2020, before levelling off thereafter. At this growth rate, real GDP per capita will continue to contract. According to the IMF, another scenario is also possible. Through the intensification of reforms, Nigeria could reach its potential growth rate to 4.5% in the medium term, assuming the macroeconomic and external environment were to stabilise. This roadmap has been clear for some time and boils down to two priorities: 1) improving the business climate, including in the oil sector, and 2) upgrading infrastructure. But, during President Buhari's first term, only limited progress was made in these two areas.

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