

DEALING WITH THE PRICE OIL SHOCK: NIGERIA'S QUANDARY

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STYLIZED FACTS

- 1. Nigeria is full of paradoxes, a country in which the majority of its citizens are suffering in the midst of plenty.
- 2. The current state of Nigeria's economy is the resultant effects of external and internal factors. The internal factors for the worsening economic situation can be aggregated under macroeconomic policy errors of the past and recent policymakers, mainly bad mix of macroeconomic stabilization policies, lack of vision, misconception on the stability of oil revenue, corruption and poor governance.
- 3. The impact of the sharp and prolonged decline in commodity prices have been most severe, and exacerbated by vandalism and gangerism in the oil-producing Niger Delta.

STYLIZED FACTS CONTD

- 4. Being the largest crude oil producer in the region and heavily dependent on oil revenue, Nigeria recorded weak economic growth from 2015 to now. That Nigeria is currently in recession is not in doubt.
- 5. The adverse impact of lower commodity prices was compounded among other factors by weaker export demand. The decline in crude oil demand from India, China and the US (Nigeria's top export destination) led to a decline in Nigeria's export performance in Q1 2016. In the first half of 2016, India and the US slashed crude oil imports by 43% and 53%, respectively.

STYLIZED FACTS CONTD

- 5. Domestic conditions such as policy uncertainty and security conditions have exacerbated economic woes that Nigeria face.
- 6. Nigeria's crude oil production constrained greatly by vandalism and attacks on oil and gas facilities, and pipelines. All these have had negative impacts on Nigeria's foreign exchange earnings and revenue prospects.
- 7. The bottom line is that the present crisis shows the need for a deep rethink of Nigeria's developmental strategy: diversify economy, develop new sources of sustainable inclusive growth, and zero tolerance for corruption.

2. IMPORTANCE OF OIL

- Oil is very important to Nigeria's economy and has been so since all was discovered, and exported.
- In order to gauge the economy's exposure to oil or its export dependency, one can look at oil exports as a share of total exports, oil as percentage of government budgetary revenue and oil as % of GDP.
- In all the three criteria, the share of oil in total exports and share of oil revenue in total government revenue stand out to be very important.
- According to the NBS oil revenue contributes more than 70 % of total government revenue.

GROWTH OF THE ECONOMY

- In the period 2005-2014 real GDP growth was 6.3% making Nigeria one of the fastest growing countries in the world.
- The growth notwithstanding however, unable to create jobs for the teeming graduates from various tertiary institutions, level of poverty has remained high (poverty which was 54.4% in 2004 rose to 69% in 2010, social indicators have been poor (unemployment rising, HDI country index 152/187; the Gini coefficient which was 0.42% in 2004 rose to 0.45% in 2010 and there is no evidence that it has improved six years after.

THE WAKE-UP CALL OF 2014

- Year 2014 was a year of contrasts: In the first half, oil price peaked at about \$112 per barrel, rebasing of Nigeria's GDP making it the largest economy in Africa.
- In the second half: twin shock: Global commodity price slump and global liquidity volatility that caused both export income and capital flows to dwindle.
- By the end of the year, oil price per barrel fell to about \$48
- Since the 3rd quarter of 2014, Nigeria has to deal with (i) over 70% drop in the price of oil (ii) global slowdown and geopolitical tensions along critical trading routes in the world.
- At beginning of 2015 uncertainties about the oil price dominated.

THE WAKE-UP CALL CONTD

- There was great challenge for fiscal policy in a year of election.
- The uncertainty was complicated by the menace of the militant Islamic group, the Boko Haram insurgency which grew increasingly active and deadly in its attacks on state and individuals including the abduction of Chibok girls which gained international attention. Election was delayed for a while as a result of the insurgency.
- When the APC won under Buhari, it took time for the administration to settle down to the issues of governance. This limited the scope for timely and necessary response to the crisis at hand and elongated the inside lag of policy.

POLICY RESPONSE TO THE CRISIS

- Reliance was placed on utilization of monetary and fiscal policy.
- The CBN responded by tightening MP
- As a result of the pressure on the exchange rate, the CBN imposed restrictions on commercial forex trading, closed the official forex auction and window and channeled these transactions to the interbank market.
- The CBN depreciated the naira from N155/\$, to N168/\$ and subsequently depreciated to N198/\$. While maintaining this rate it provided available but limited forex to needs: importation of raw materials, petroleum products, school fees and matured letters of credit.

POLICY RESPONSE CONTD

- In addition, the CBN (Thru the MPC) increased interest rate, cash reserves
- At its meeting on May 24, the MPC realising the weakened macroeconomic environment as shown by rising inflation, contraction of real output and rising unemployment voted to: (i) retain MPR at 12% (2) cash reserve ratio at 22.5% and (iii) liquidity ratio at 30%
- As a result of varying circumstances, the CBN on June 15, 2016 announced a new forex market structure (managed float exchange rate system).

POLICY RESPONSE CONTD

- Fiscal policy response:
- A number of adjustments made. The major ones include (i) Revision of oil price in the budget (ii) expenditure cut in the area of oil subsidy (iii) reduction of 2015 budget while seeking foreign financing of \$2billion (?) (iv) removal of oil subsidy with petrol pump price rising from N86 per liter to N145 per liter. (v) a surcharge on luxury goods – private jets, yachts, exotic cars etc.

THE MACROECONOMIC EFFECTS

- What are the major macroeconomic effects of all of these?
Let me mention some of them:
- Fall in FOREX Reserves from \$42.8 billion in June 2014 to \$26.7 as of June 2016
- Fall in CBN foreign exchange earnings from about \$3.2 billion monthly sometimes in 2013 to about \$1 billion per month in June 2016
- Fall in government Revenue and fall in the Federation account, and therefore fall in the amount available for distribution to States and local governments
- Fall in Capital flows

MACROECONOMIC EFFECTS CONTD

- Slower Real GDP growth. In the first half of 2015, real GDP growth was 3.14%. This was short of what it was in the previous year which was 6.4%
- The latest figures by NBS indicates that Nigeria is in recession as GDP contracted by -0.36% in 1Q2016 as opposed to 3.9% growth in 1Q2015.
- In 2Q2016, GDP declined by -2.06 (year on year) in real terms. This was 1.70% points from the growth rate of -0.36% in 1Q 2016 and lower by 4.41% from the growth rate of 2.35% recorded in corresponding quarter of 2015

MACROECONOMIC EFFECTS CONTD

- Inflation continued to skyrocket above the 6-9% target of the CBN with price rise of 11.4%, 12.8% 13.7% and 15.6% in February, March, April and May 2016, respectively.
- Problems in payments of salaries and emoluments especially in states. Claim that 27/36 states are insolvent.
- Problems of states are many: cake sharing attitude, overblown bureaucracy, not prudent with management of resources, corruption, illegal transfer of funds (some have been accused of money laudarying)
- Theft and Vandalization (more prominent since May 2016)

MACROECONOMIC EFFECTS

- Rise in non-performing loans (Tied to payments of salaries etc)
- Effects on some airlines: United and Iberia

DIVERSIFICATION OF NIGERIA'S REVENUE BASE

- Present crisis overwhelming evidence on the need for the diversification of the economy
- While increase in the resource envelope is necessary it is not sufficient. There are some important issues:
- Need to take critical look at the size of government at all levels
- Need to take a look and assess the remunerations of the political class, the senators, the national assembly members etc and ministers as well. The remuneration of these classes of people is the major cause of waste, political clashes, murder and thuggery in politics.
- Need to create limited institutions that would work. Creating overlapping myriads of institutions creates waste and avenues for bribery and corruption.

CREATING THE REVENUE BASE

- The following are the suggestions that can be made at this time:
- A critical look at the sectors of the economy is important and crucial. Particular attention paid to agriculture given Nigeria's historical past. What happens to the cocoa and groundnut pyramids of the earlier years? What about the palm produce plantations? (The Malaysian example is useful here)
- Agriculture should be value-added centered – development of agro-allied industries with a view to earning foreign exchange.
- Looking at non-oil tax revenue. What has been Nigeria's problems?
- What about VAT? What evidence do we have of its utilization as source of sustained revenue?

CREATING THE REVENUE BASE

- What about money stored abroad by looters
- What about capital flight?
- Development of talents and professionalism : The Nollywood issue : This is a neglected area that should be developed given how much Hollywood (USA) and Bollywood (India) are contributing to their respective GDP. The preliminary earlier work I did in this area for Brookings shows that not less than \$26 billion can be earned from this source alone. It could be more now. We need to explore this sector seriously.
- There is need to develop the right attitudinal changes for efficiency in government spending and service delivery.
- The overall conduct should be zero tolerance for corruption.

THANKS

- I THANK YOU ALL FOR YOUR ATTENTION.