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A note on the economic downturn in Sub-Saharan Africa: the Nigeria-South Africa comparison

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Preamble

The recent movements in the dollar-naira exchange rate, following the removal of the currency peg, has stimulated ongoing debate in the media that South Africa has regained its position as the largest economy in Africa. The prevailing notion is that the depreciation of the naira and simultaneous appreciation of the rand against the US dollar implies that South Africa's GDP has surpassed that of Nigeria. However, this argument needs some re-examination, given that the value of the GDP (in current US\$) is sensitive to the choice of exchange rate and GDP figures used for its computation. This piece situates the present argument in the context of recent commodity market crisis and its implications for the two largest economies in Sub-Saharan Africa. It then sheds light on the present debate on the comparative size of the Nigerian and South African economies. It also searches through the looming recession in both economies and provides an outlook for the rest of the year.

A commodity-driven downturn

Economic activities in sub-Saharan Africa have slowed remarkably; from a growth rate of 5-7 percent witnessed over the past decade, to 3.5 percent in 2015 (the lowest growth rate in 15 years)¹. Regional growth is projected to decelerate further to 3 percent in 2016². The recent downward growth trend in the region is occasioned by multiple factors: the slump in commodity prices, tighter global financial conditions, weak export demand and policy uncertainty amongst others. Notably, the sharp and prolonged decline in commodity prices have been most severe on the two largest economies and commodity exporters in the region (Nigeria and South Africa), with shocks in their terms-of-trade.

The downward trajectory of commodity prices since 2011, and its trough in January 2016, have played huge roles in dampening economic growth in Nigeria and South Africa. With Brent crude oil price falling to a low of \$30 per barrel in January 2016, from a high of \$111.26 in 2011, economic growth have slowed significantly in Nigeria³. Being the largest crude oil exporter in the region and heavily dependent on crude oil revenue, Nigeria recorded weak economic growth with an eventual 0.38 percent contraction in 2016Q1⁴. In a similar vein, the plunge in gold (by 43 percent) and platinum (by 56 percent) amongst other commodities, between September 2011 and January 2016⁵, is mainly behind the lacklustre performance of South Africa – a top metal producer in the

¹ "Sub-Saharan Africa: Time for a Policy Rest", Regional Economic Outlook, IMF, April 2016.

² "Too Slow for Too Long", IMF, World Economic Outlook, April 2016.

³ "Statistical Database", Central Bank of Nigeria, 2016.

⁴ "Nigeria's Gross Domestic Product", National Bureau of Statistics (NBS), 2016

⁵ Bloomberg, 2016. Retrieved: <http://www.bloomberg.com/markets/commodities/futures/metals>

region. The South African GDP contracted by 1.2 percent in 2016Q1, largely due to the significant contraction in mining output⁶.

The adverse impact of lower commodity prices was compounded by weaker export demand in both countries. Particularly the economic slowdown in China, South Africa's largest trading partner, weakened export demand for major commodities. The decline in China's demand for iron ore, coal, gold and other precious metal and minerals (South Africa's largest exports) was mainly responsible for the 7.1 percent decline in South Africa's overall export in 2016Q1^{7,8}. Similarly, the decline in crude oil demand from India, China, and U.S (Nigeria's top export destination) contributed to the 30.4 percent decline in Nigeria's export performance in 2016Q1. In the first half of 2016, India (importing about 21 percent of Nigeria's crude oil⁹) and U.S slashed crude oil imports by 43 percent and 53 percent, respectively¹⁰.

Domestic conditions such as policy uncertainty and security situation have also exacerbated economic woes and contributed to capital outflows in both countries. In South Africa, the unexpected hike in interest rate in November 2015, the dismissal of the finance minister in December 2015 and unusual contraction in GDP growth rate in 2016Q1 have driven uncertainty over the country's economic prospects and unnerved investors. Capital flows into South Africa declined from \$53.5 billion in 2015Q4 to \$27.6 billion in 2016Q1¹¹. In Nigeria, the passage of the 2016 budget delayed until June 2016, the unusual negative GDP growth rate in 2016Q1, and an unexpected hike in interest rate in July amid security challenges have also unnerved investors. The total value of capital inflows into Nigeria, in the first quarter of 2016, stood at \$7.12 billion – the lowest since 2014¹².

Given the foregoing trend in commodity export and capital import, domestic currency in both countries weakened remarkably. The value of the South African rand depreciated; with the rand-dollar exchange rate rising as high as R16.88/\$ in January 2016¹³. On the other hand, the Nigerian naira depreciated unofficially; with naira-dollar rates at the parallel market rising to N289.8/\$ in January 2016 (although official rates remained pegged at N197/\$)¹⁴. But, while the rand appreciated in subsequent months– averaging R13.56/\$ August (between 1st and 16th), the naira depreciated rapidly (at both the official and parallel markets) following the adoption of a flexible exchange rate in June. The naira reached an average of N311.16.76/\$ at the official market (Interbank Foreign Exchange Market - IFEM) in August (between 1st and 16th) while rising even

⁶ "Economic Overview: Recent Developments in the Global and South African Economies", IDC, June 2016.

⁷ <http://www.dailymaverick.co.za/article/2016-06-08-exports-and-imports-shrink-by-7.1-stats-sa/#.V7BvofkrJac>

⁸ "Economic Overview: Recent Developments in the Global and South African Economies", IDC, June 2016.

⁹ <http://www.vanguardngr.com/2016/08/india-spain-netherlands-buy-43-nigerias-crude-oil-nnpc/>

¹⁰ <http://www.financialwatchngr.com/2016/08/14/nigeria-loses-n88bn-india-us-reduce-oil-imports/>

¹¹ South African Reserve Bank, 2016.

¹² "Capital Importation", National Bureau of Statistics (NBS), 2016

¹³ South African Reserve Bank, 2016.

¹⁴ Central Bank of Nigeria, 2016

higher at the parallel market¹⁵. Notably, the trend in exchange rate presents a comparative implication for GDP, at current prices, of both economies.

A look into the debate on the largest economy in Africa

With the rebasing of the Nigerian economy, Nigeria stood as the largest economy in Africa, surpassing South Africa, in 2012. According to the World Bank, the size of the South African economy averaged \$416.60 billion in 2011 while the Nigerian economy averaged \$411.74 billion in 2011. But by 2012, following the rebasing, Nigeria's GDP rose to \$460.96 billion while South Africa's GDP fell to \$397.39 billion¹⁶. Based on World Bank's GDP (at current US\$) data, Nigeria has maintained higher GDP relative to South Africa, since 2012. However, present economic challenges and exchange rate trends in both countries, have sparked arguments that South Africa may have regained its place; surpassing Nigeria, as Africa's largest economy. This argument is particularly hinged on the fast depreciating value of the naira since the country abandoned its pegged exchange rate at N197/\$ and allowed the naira to float at the interbank rate in June 2016. The argument was particularly sparked by an article first published by Bloomberg which calculated that "the size of South Africa's economy is \$301 billion at the rand's current exchange rate, while Nigeria's GDP is \$296 billion [at present]"¹⁷.

However, we argue that the logic behind the computation is flawed for many reasons. First, the calculation uses 2015 GDP (at current US\$) data against current exchange rate (for August 2016) to determine the present sizes of both economies. This is not logical as computing with 2015 GDP data does not adequately reflect the present state of both economies in 2016. It would be more appropriate to use national GDP figures for 2016Q2 (converted to US\$) against average exchange rate for 2016Q2. However, we understand that the author was constrained by data availability, given that the most recent data on GDP (at current US\$) obtainable from International Monetary Fund is for 2015. Second, the argument is flawed in its use of an end-point exchange rate in calculating 2016 GDP. When flows are measured, as in this case, it is more appropriate to use the average exchange rate for the year to arrive at 2016 GDP figures.

Therefore, as far as data is concerned, Nigeria still stands as the largest economy in Africa. Both economies have seen their currencies depreciate in 2016 relative to 2015 figures and their economies contract in 2016Q1, largely on the account of the slump in commodity prices. However, while the South African rand is picking up, the Nigerian naira is further depreciating. If the naira continues to depreciate at current pace over the year which would severely hamper production, it is plausible that South Africa could overtake Nigeria as the largest economy in Africa.

¹⁵ Central Bank of Nigeria, 2016

¹⁶ World Development Indicators, World Bank 2016.

¹⁷ <http://www.bloomberg.com/news/articles/2016-08-10/south-africa-s-economy-regains-rank-as-africa-s-biggest-on-rand>

An imminent recession?

Irrespective of the comparative differences in GDP, both economies are at the brink of a recession in 2016Q2. Ongoing economic trends, based on available data in both economies corroborate the hypothesis. In Nigeria, inflation has continued to skyrocket further above the 6-9 percent target of the Central Bank of Nigeria (CBN); from 12.77 (March) to 16.48 percent (June). Average diesel price steadily increased from N146.19 (March) to N183 (June) and Petrol price increased from N135 (March) to N150.28 (May), at the same time electricity situation worsened – from an average national electricity distribution of 81.9GWh (March) to 51.6GWh (June)¹⁸. Naira-dollar exchange rate remained high at around N320/\$, while Interest rate (borrowing cost) increased from 12 percent (March) to 14 percent (June). CBN's Purchasing Manufacturing Index (PMI) remain below average and dropped from an average of 46.2 index points in 2016Q1 to an average of 43.8 index points in 2016Q2. All these indicators in Q2, Q1 lagged effects inclusive, suggests weak business performance and most likely a negative GDP growth in 2016Q2.

For South Africa, inflation continued to rise above the 3-6 percent inflation target of the South African Reserve Bank (SARB) slightly; from an average of 6.5 percent in 2016Q1 to 6.2 percent in 2016Q2. Exchange rate have fallen slightly from its 2016Q1 average of R15.664/\$ to R15.106/\$ in 2016Q2. Similar to Nigeria, petrol (from R513.88 in Q1 to 546.30 in Q2) and diesel (from R437.63 in Q1 to R512.30 in Q2) prices increased, but electricity distributed increased from 95.5 GWh (March) to 99.1GWh (June)¹⁹. Unemployment fell slightly from 26.7 percent in 2016Q1 to 26.6 in 2016Q2. Barclay's PMI for South Africa improved; from an average of 47.0 index points in 2016Q1 to 53.5 index points in 2016Q2²⁰. Interest/repo rate increased from 6.75 percent recorded in the first two months of 2016 but remained at 7 percent from March throughout 2016Q2²¹. While these indicators point towards weak business performance, they seem to suggest that the South African economy may have seen its trough in 2016Q1 and now schedule for a resurgence.

Looking Forward

While commodity prices have recovered from the lows recorded at the start of 2016, the economic outlook in both economies for the rest the year remain bleak, especially for Nigeria. Brent crude oil price have gained some momentum; from \$33.70 (Q1 average) to \$45.52 (Q2 average)²². However, Nigeria's crude oil production have been heavily constrained by vandalism and attacks on oil and gas facilities and pipelines, despite government's repeated efforts at revamping domestic oil refineries. This weakens Nigeria's foreign exchange and revenue prospects. In a

¹⁸ National Bureau of Statistics, 2016

¹⁹ South African Reserve Bank, 2016

²⁰ PMI, Bureau for Economic Research, 2016

²¹ Central Bank of Nigeria, 2016

²² EIA, 2016

similar vein, the prices of platinum, gold and iron ore have gained slight momentum²³. South Africa's exported commodities have increased by 2.4 percent between April and May mainly on the account of the 4.2 percentage point increase in metal products, machinery and equipment²⁴. Despite the prolonged drought, South Africa's agricultural productivity has improved by 1.8 percent between April and May. The country's mine supply is anticipated to continue declining in the short-term as it is, at best, only marginally profitable at current prices²⁵. However, the gradually improving global demand presents some positive outlook.

While the rest of the year seems challenging for both economies, it may also mark gradual reversal in the current economic downturn in South Africa. However, it appears that the Nigerian economy is yet to reach a trough. Considering the low levels of consumer and business confidence, weak domestic credit to private sector, higher interest rates, rising inflation and poor employment prospects, consumption expenditure will most likely remain a drag on economic growth for the remainder of the year. However, the pace of expansion should gain traction gradually in subsequent years. Both countries have committed to improving infrastructures (critical for economic growth), especially Nigeria, given the 184 percent increase in the allocation to capital expenditure for 2016 budget relative to 2015.

Conclusion and Policy Recommendations

Commodity prices may have bottomed out and are now poised for resurgence. However, sub-Saharan African countries will continue to face low and volatile prices in global commodity markets. This will continue to intermittently subject them to shocks on their terms-of-trade; thus impacting exchange rate and general economic wellbeing. Therefore, governments must take steps to adjust to lower commodity prices and diversify export base, to address economic vulnerabilities and develop new sources of sustainable and inclusive growth. Most especially the Nigerian economy (which is far less diversified than South Africa) should take decisive steps to develop its export base in agriculture and services. Nigeria's commitment to increasing investments in infrastructure, expanding its tax base, and fighting corruption; and South Africa's commitment to minimizing policy uncertainty, improving infrastructure and debt sustainability are applauded. However, both countries need to also deal with deep-rooted structural problems in running government institutions and public sector enterprises, managing public finances, and regulating the financial sector; with the aim of optimally supporting private sector businesses to spur economic transformation.

²³ Bloomberg, 2016

²⁴ South African Reserve Bank, 2016

²⁵ "Economic Overview: Recent Developments in the Global and South African Economies", IDC, June 2016.