CSEA
Centre for the Study of the Economies of Africa
Quality Research For Sound Policies

Nigeria Economic Review

Second Quarter Report
2016

ACKNOWLEDGEMENTS

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We also appreciate the contribution of the Research Assistants: Enemaku Okpanachi and Peace John.

The report draws from monthly and quarterly data and publications from organisations including: National Bureau of Statistics (NBS), Central Bank of Nigeria (CBN), International Monetary Fund (IMF), International Energy Agency (IEA), and World Bank.

The report builds on the analysis of data from the aforementioned sources, but the findings, interpretations and conclusions expressed herein are those of the authors and do not necessarily reflect the views of the Centre for the Study of the Economies of Africa, its trustees, or advisory council members.

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ACRONYMS

BDC: Bureau de Change

CBN: Central bank of Nigeria

CRR: Cash Reserve Ratio

ECOWAS: Economic Community of West African States

EU: European Union

FIRS: Federal Inland Revenue Service

FDI: Foreign Direct Investment

FPI: Foreign Portfolio Investment

FOREX: Foreign Exchange

FGN: Federal Government of Nigeria

GDP: Gross Domestic Product

IMF: International Monetary Fund

IEA: International Energy Agency

ITAS: Integrated Tax Administration System

MPC: Monetary Policy Committee

MPR: Monetary Policy Rate

NBS: National Bureau of Statistics

NDC: Net Domestic Credit

NSE: Nigeria Stock Exchange

OECD: Organization for Economic Corporation and Development

OPEC: Organization of Petroleum Exporting Countries

OMO: Open Market Operation

PCE: Private Consumption Expenditure

PMR: Parallel Market Rate

PMS: Premium Motor Spirit

Q1: First Quarter

Q2: Second Quarter

Q3: Third Quarter

Q4: Fourth Quarter

SMEs: Small and Medium Scale Enterprises

TSA: Treasury Single Account

USA: United States of America

UK: United Kingdom

UNCTAD: United Nations Conference on Trade and Development

VAT: Value Added Tax

PREFACE

The Nigeria Economic Review is a quarterly publication of CSEA that provides a concise and timely analytical overview of key aspects of the Nigerian economy. The report is an attempt to track the developments in the relevant aspects of the economy over a three-month period. It provides valuable insights into potential drivers of the economic trends and outlines expectations for subsequent quarters of the year. The areas of focus are Global Economic Performance, Domestic Economic Performance, External Sector Performance, and Sectoral Performance.

Section 1, Global Economic Performance, tracks key global and regional trends in Gross Domestic Product (GDP) growth, macroeconomic challenges, as well as monetary and fiscal policy responses. This is to enhance an understanding of the global economic stance and its potential spill over effects on the Nigerian economy, as well as to provide a basis for comparison with the domestic economy over the period under review. Section 2, Domestic Economic Performance, delves into key internal macroeconomic indicators (GDP growth, inflation and unemployment) and reports macroeconomic policy responses influencing financial and economic performances recorded in Nigeria over the review period. This is to provide an understanding of factors driving domestic economic performance, as well as some guidance to government, businesses and individuals in making informed decisions.

Section 3, External Sector Performance, captures key indicators of Nigeria's external sector performance (foreign trade, foreign investment, exchange rate and external reserve) in 2016Q2. This is to shed light on the factors affecting trade and investment flows into the country, and their policy implications. Section 4, sectoral performance, provides analyses of key sectors and sub-sectors of the Nigerian economy to provide deeper insight into sectors driving domestic growth, employment and trade, as well as the impact of macroeconomic policy environment on key sectors of the economy. The report also includes a Special Feature Article section, which provides insights into a contemporary issue within the review period.

Thus, the broad aim of the quarterly report (2016Q2) is to provide an evidence-based analysis of the state of the Nigerian economy to inform economic policies in Nigeria. The report presents some analyses of significant economic events in Nigeria within the period, and provides an outlook on what policymakers, businesses, and individuals should expect in subsequent quarters of 2016. The report relied mainly on data and publications from Central Bank of Nigeria (CBN), National Bureau of Statistics (NBS), International Energy Agency (IEA), International Monetary Fund (IMF) and World Bank. Analyses are based on available monthly and quarterly data from the aforementioned sources.

EXECUTIVE SUMMARY

The global economy is projected to grow by 3.0 percent in 2016 on the account of falling domestic and export demand in some developed and emerging economies, as well as falling output growth of major oil producing countries. While the U.S, U.K and China witnessed slow growth in output, the Eurozone witnessed marginal decline in output with implications for Nigeria's external sector. On a regional basis, low but rising commodity prices yield positive growth in diversified economies such as South Africa (0.7 percent) while growth in less diversified economies like Nigeria (-2.06 percent) continue to contract.

Domestically, the stagflation in the Nigerian economy deepened into a recession in 2016Q2 upon witnessing negative GDP growth rate for two consecutive quarters. The contraction in GDP growth remain largely attributed to the decline in crude oil production due to a series of attacks on oil and gas facilities, with attendant impact on the oil sector and to a lesser extent the non-oil sector. Against the backdrop of lower output production, Nigeria's unemployment rate rose for the seventh consecutive time, reaching 13.3 percent in 2016Q2. Underemployment also increased to 19.3 percent in 2016Q2. Both unemployment and underemployment remained highest amongst youths and women. Headline inflation continued to rise, reaching 16.5 percent by June 2016 on the account of structural factors and exchange rate constraints. Both food and core sub-indices increased throughout the quarter, with core sub-index increasing at a faster pace. This implies that key macroeconomic indicators are performing poorly, and this calls for corresponding and urgent response on the part of the government and monetary authorities.

On the fiscal policy landscape, gross federally-collected revenue stood at N1.16 trillion in 2016Q2 – 8.6 percent lower than the preceding quarter. After distribution amongst the three tiers of government, federal government's retained revenue stood at N677.88 billion. On the other hand, Federal government expenditure stood at N1.77 trillion in 2016Q2, with recurrent spending accounting for 72.6 percent of total expenditure. Thus, the fiscal operation of the federal government incurred an estimated deficit of N1.1 trillion. This suggests that government is borrowing more to spend on salaries and interest payments, as opposed to infrastructure development.

On the monetary policy side, the Central Bank of Nigeria (CBN) adopted a flexible exchange rate framework; with exchange rates to be determined by the interbank foreign exchange market (IFEM) in 2016Q2. In efforts to improve forex liquidity, the futures market and primary dealers were introduced in the new exchange rate regime. Nevertheless, the value of the naira continued to depreciate. Given low investor confidence on the Nigerian economy and business performance, the capital market remains bearish although market capitalization for all listed stocks and bonds grew by 8.8 percent in the review period.

In the external sector, Nigeria's total trade value rose by 10.88 percent to $6.18 billion in 2016Q2 on the account of foreign exchange rate gains in the period. Both imports and, to a lesser extent, exports rose to record a trade deficit of $1.21 billion. Capital importation declined by 8.8 percent as foreign direct investment inflows fell by 23.75 percent and foreign portfolio investment fell by 1.24 percent. In the exchange rate market, the value of the naira fell by 18.48 percent to N233.42/$1 with the removal of N197/$1 peg. Meanwhile, efforts by the CBN to defend the Naira led to a further depletion of external reserves to $26.54 billion in 2016 Q2; an amount which roughly covers imports for 6 months. This hampers the policy options of the CBN.

Key sectors of the Nigerian economy performed poorly in 2016Q2 mainly on the account of persistent macroeconomic challenges and weak consumer demand. The manufacturing, transport and storage, and financial services sectors were most severely hit by forex challenges. The construction sector also witnessed significant decline on the account of the dearth of government revenue. However, the

Agriculture sector recorded significant year-on-year growth of 13.24 percent. This was largely driven basically by early harvest activities as well as the increase in agricultural credit signalling the commitment of the government to diversify the revenue base of the Nigerian economy.

Overall, the Nigerian economy is severely contracting and the outlook remains bleak. Output growth is expected to continue to underperform throughout 2016 as underlying issues such as crude oil production and forex difficulties are yet to be effectively addressed.

1. GLOBAL ECONOMIC PERFORMANCE

Global economic growth weakened in 2016Q2, on the account of falling domestic and export demand in some developed and emerging economies, as well as falling output growth of major oil producing countries.

The global economy experienced falling output growth in the second quarter of 2016 (2016Q2). This prompted the International Monetary Fund (IMF) and the Organization of Economic Cooperation and Development (OECD) to review the forecast for global output for 2016 downward from 3.2 percent to 3.1 percent and 3.0 percent, respectively. The World Bank also reviewed its global output growth projection for 2016 downward to 2.4 percent, from the previous projection of 2.9 percent. The falling global output growth reflects the overwhelming influence of decelerating growth in some national economies across developed, emerging and sub-Saharan economies. This may however be traced to weak trade, sluggish investment, protracted weak aggregate demand, and to a lesser extent the outcome of the "Brexit" referendum[1], amongst other factors.[2]

Evidence from the available data show that the growth performance of developed economies in 2016Q2 was mixed. Output growth of United States of America (USA) and United Kingdom (UK) improved in 2016Q2, while growth in France and the rest of the European Union (EU) stagnated and declined, respectively *(figure 1)*. Specifically, the USA recorded 1.2 percent growth in 2016Q2 – a 0.1 percent increase from growth recorded in 2016Q1. Improved performance of the US economy was attributed to increased private consumption spending, a robust labour market and increased exports. The growth was however limited by falling retail sales and manufacturing output.[3] Furthermore, the rise in US crude oil import on the account of low crude oil prices has adversely affected the competitiveness of US shale oil production. This may have had positive impact on Nigeria's trade export which increased significantly in 2016Q2 (*See section 3.1.1*).

Similarly, the UK experienced 0.2 percent increase in output growth, which increased from 2.0 percent in 2016Q1 to 2.2 percent in 2016Q2. This is as a result of improvement in consumption spending, which increased by 0.9 percent between April and June 2016[4]. However, the European Union witnessed a 0.1 percent decline in output growth; from 1.9 percent in 2016Q1 to 1.8 percent in 2016Q2. This may have been due to financial speculations and adverse impact of the "Brexit" on output growth, which may further worsen in the succeeding quarters. This may also be related to weak demand for Eurozone exports from large developing countries that are themselves struggling to revive flagging economies[5]. Moreover, in France, the rising trend in output growth since 2015Q2 was truncated with stagnation in 2016Q2, as the 2016Q1 growth of 1.4 percent is retained. This may be attributed to sharp slowdown in domestic demand, caused by stagnation in private consumption and a contraction in fixed investment[6]. Falling domestic demand in some of these developed economies may be responsible for the reduction in Nigeria's export to France and Japan in 201Q2 (See section 3.1.1).

[1] "Brexit" (The voting of the United Kingdom to exit the European Union), was conveyed on June 23, 2016
[2] CBN Communique No.108, July 2016.
[3] CBN Communique No.109, September 2016.
[4] http://www.bbc.com/news/business-37194324
[5] http://www.wsj.com/articles/french-economic-growth-stalls-1 469771132
[6] http://www.focus-economics.com/countries/france/news/gdp/gdp-growth-stalls-in-q2-on-weak-domestic-demand-0

Figure 1: Real GDP growth of selected Developed Economies (%)

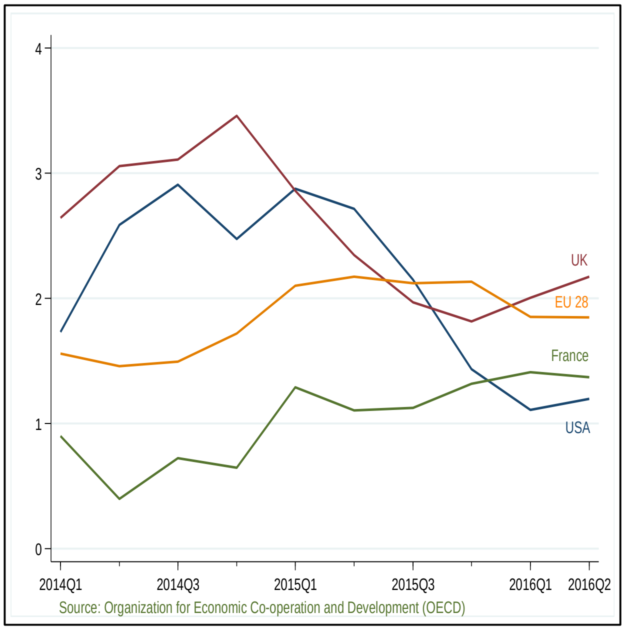
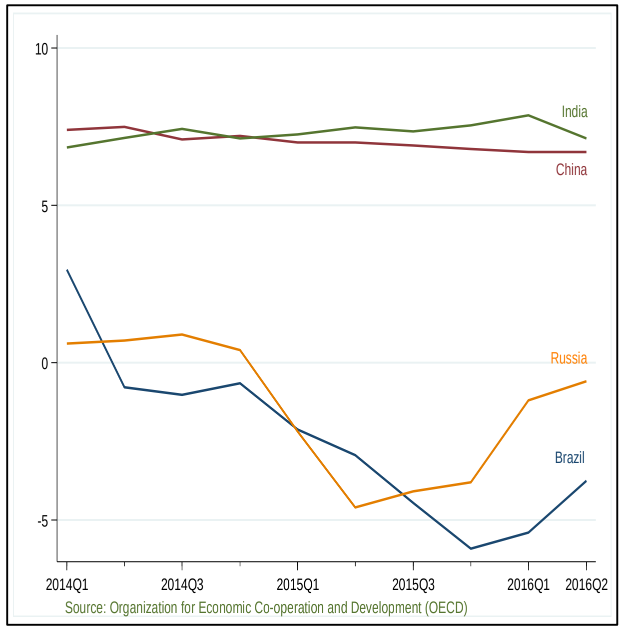


Figure 2: Real GDP growth of selected Emerging Economies (%)



Output growth for emerging economies in 2016Q2 was uneven, but with indication of remarkable improvements in some countries *(figure 2)*. The slowdown in China moderated in 2016Q2, maintaining a growth rate of 6.7 percent as in 2016Q1. The gradual improvement in Chinese growth is attributable to the increase in government spending and housing boom which boosted industrial activity in 2016Q2[7]. However, the slump in private investment growth remains a major challenge for the Chinese economy. On the other hand, India witnessed falling output trend in 2016Q2, as its GDP growth rate declined from 7.9 percent in 2016Q1 to 7.1 percent in 2016Q2. While India remains among the fastest growing economies in the world, the falling growth recorded in 2016Q2 was due to high inflation and falling manufacturing activities, arising from gradual increase in oil price. Further improvement in the Chinese economy is expected to result in higher output and thus lower prices for Chinese product in the Nigerian market. This could contribute to a fall in Nigeria's inflation rate given that China is the dominant source of Nigeria's imports (See section 2.1). Meanwhile, as largest shares of Nigeria's imports and exports are from China and India respectively (see Section 3.1), weak growth in the Chinese and Indian economies may be responsible for the challenges in Nigeria's trade balance, exchange rate and inflation rate, as recorded in 2016Q2.

Conversely, Brazil and Russia remained in recession since the beginning of the 2016 fiscal year. Despite the negative growth rate, recent growth records indicate that both countries are heading towards recovery. The Russian economy improved for the fourth consecutive period; as the GDP growth contracted by merely 0.6 percent in 2016Q2, compared to 1.2 percent contraction in the preceding quarter. Similarly, the Brazilian economy recorded improved growth performance for the second consecutive period, as it recorded a GDP growth rate of -3.8 percent in 2016Q2, relative to the growth rate of -5.4 percent in the preceding quarter. Russia's performance was attributed to expansion in agricultural and industrial sectors while the services sector continued to perform poorly, mainly due to falling private consumption[8]. As an oil exporting economy dragged into recession by low energy prices, weak Russian rubble and western

[7] http://www.reuters.com/article/us-china-economy-gdp-idUSKCN0ZU2Q8
[8] http://www.focus-economics.com/countries/russia/news/gdp/economic-recession-nears-end

sanctions, Russia's path towards recovery has been aided by government's anti-crisis plan, including accommodative monetary policy, floating exchange rate and promotion of agricultural and industrial sectors. The potential benefit of the adoption of similar economic policies to the Nigerian economy, presently in recession, could be considered by the Nigerian government in its plan to kick start growth in the Nigerian economy.

Sub-Saharan Africa's (SSA), largest economies (Nigeria and South Africa) experienced consistent declining growth since 2015Q1, and eventually recorded negative growth in 2016Q1 *(figure 3)*. This was mainly due to the fall in commodity prices of oil and gold, which are the main sources of revenue for the two countries respectively. Meanwhile, as recession is defined by two consecutive negative growth, South Africa was able to avert recession, as it made positive growth of 0.7 percent in 2016Q2 following its contraction by 0.6 percent in 2016Q1. Conversely, the Nigerian economy has been officially declared to be in recession, as it contracted for the second consecutive quarter; by 2.1 percent in 2016Q2 following 0.36 percent in 2016Q1 (see section 2.1). Better performance of South African economy is attributed to a 6.8 percent increase in the price of gold in the 2016Q2 *(figure 4)*. While the slight increase in the price of crude oil (Brent) from US$33.7 in 2016Q1 to US$45.52 in 2016Q2 could have amplified Nigeria's economic performance, the opportunity was ripped off by dwindling crude oil production occasioned by vandalism of oil facilities in the Niger Delta region.

Figure 3: Real GDP growth of selected Sub-Saharan African Economies

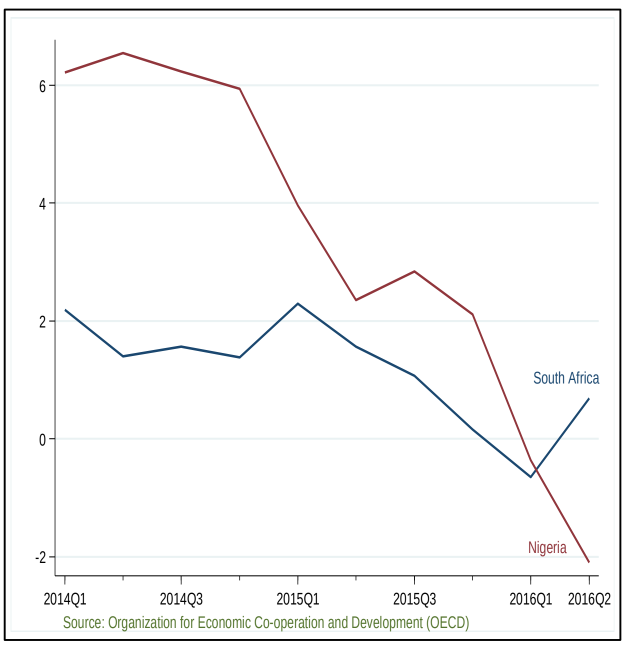
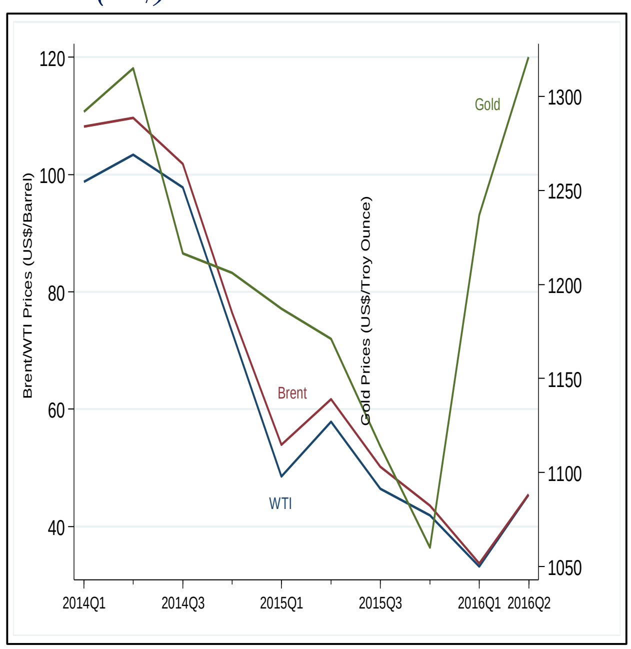


Figure 4: Brent, WTI Crude Oil Prices and Gold Prices (US$)



The gradual increase in crude oil prices could be attributed to reduction in supply, as a result of the disruption in oil production in major oil exporting countries such as Nigeria and Canada. Evidently, output growth of major oil exporting countries such as Saudi Arabia, Canada, Mexico and Nigeria declined in 2016Q2 *(figure 5)*. In response to low oil prices, several austerity measures such as cutting of government expenditures, energy price adjustments and floating exchange rate have been adopted by major oil exporting countries including Saudi Arabia, Russia and Nigeria. However, the outcome of these policy responses have varied across these countries: while Saudi Arabia, Canada and Mexico maintained positive growth, Nigeria entered recession in 2016Q2.

Figure 5: Real GDP growth of selected Oil-exporting Economies

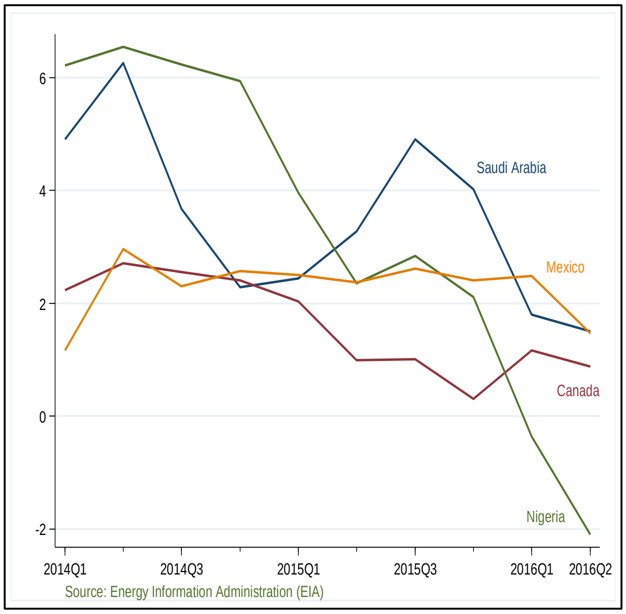


Figure 6: Real GDP growth of selected Oil-importing Economies

Similarly, the effect of low oil price on growth performance of oil importing countries is uneven. While these countries are expected to record higher growth rates due to attendant reduction in their industrial cost, falling global demand is reducing their trade and production potentials. Notably, the output growth of Germany declined by 0.1 percent from 1.8 percent in 2016Q1 to 1.7 percent in 2016Q2, while Japan and USA are among the oil importing countries that recorded higher growth in 2016Q2. Output growth of Japan increased from 0.1 percent in 2016Q1 to 0.6 percent in 2016Q2, while USA grew for the first time since 2015Q1, as it recorded 0.1 percent rise in 2016Q2 (*figure 6*).

Overall, global economic growth underperformed in 2016Q2. Economic performance of developed, emerging and sub-Saharan countries was uneven. Increased private consumption and export are the major drivers of growth in USA and UK, while fall in export and domestic consumption are major challenges to growth in France and Euro area. Post "Brexit" period, falling under 2016Q2, was too short for "Brexit" to have significant impact on the economies of UK and Euro area. The slowdown in China was moderated, while Russia and Brazil moved towards economic recovery. Oil price firmed up in 2016Q2, but still remained significantly low to foster growth in oil exporting countries. Major oil exporting countries recorded weaker growth in 2016Q2. While Nigeria and Russia witnessed a recession, South Africa recorded positive growth. In addition, the low global demand and the eventual low exports is regarded as one of the main factors curtailing the potential benefits of oil importing countries from the low oil price.

Evidently, the global economy may not perform better in the next quarter given that oil prices remain low. Many oil dependent economies have embarked on austerity measures with negative implications for trade, investment, consumption demand and output for both oil-exporting and oil-importing countries. On a positive note however, oil price may increase in the fourth quarter of the year if the objective of the proposed meeting of oil producers is achieved.

2. DOMESTIC ECONOMIC PERFORMANCE

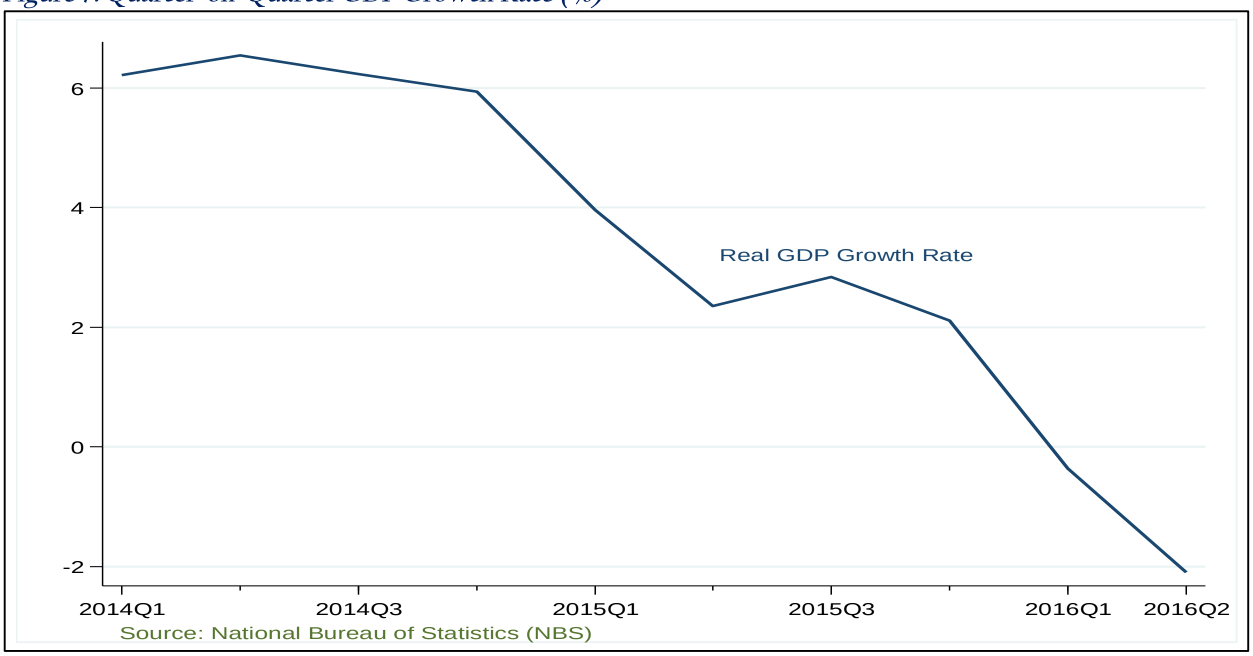
To capture and analyse Nigeria's economic performance in the second quarter of (2016Q2), this section highlights key domestic macroeconomic indicators (GDP growth, inflation and unemployment). It also reports macroeconomic policy responses (fiscal and monetary policies) influencing domestic financial and economic performances recorded in the period under review.

2.1 Economic Growth

The Nigerian economy slides into a recession for the first time in over two decades

The Nigerian economy witnessed a decline in domestic output in the second quarter of 2016 relative to the preceding quarter. Gross Domestic Product (GDP) growth rate declined from -0.38 percent in 2016Q1 to -2.06 percent in 2016Q2[9] *(figure 7)*. With two consecutive negative GDP growth rates, the country slipped into economic recession for the first time in 23 years.

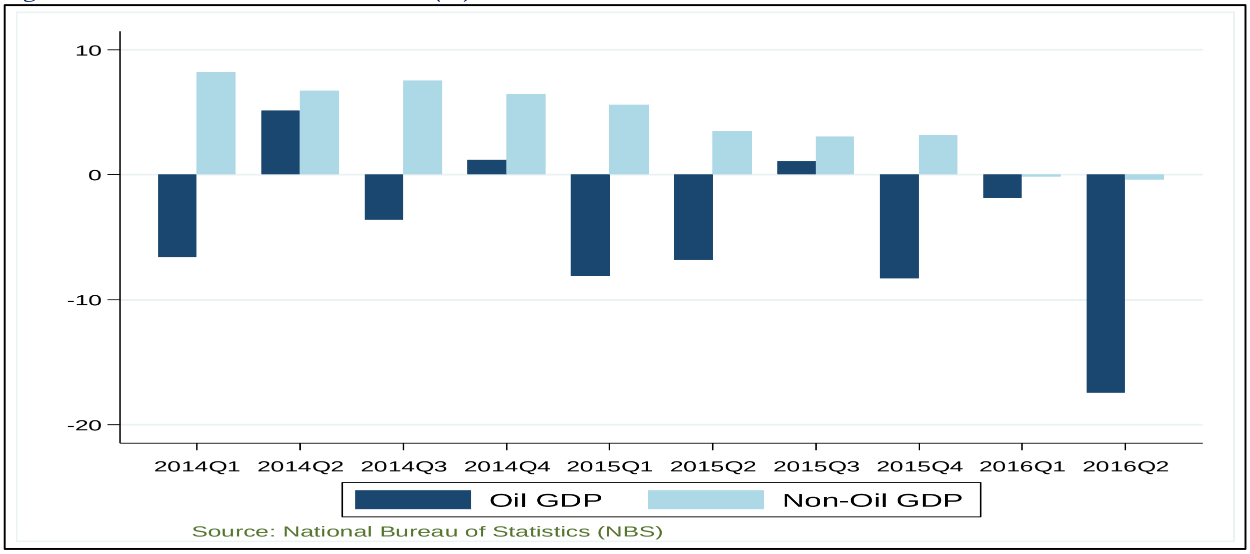
Figure 7: Quarter-on-Quarter GDP Growth Rate (%)



The negative growth rate observed in the second quarter of the year was largely driven by contraction in the oil sector: from -1.89 in 2016Q1 to -17.48 in 2016Q2 *(figure 8)*. Although growth fell slightly in the non-oil sector (from -0.18 in 2016Q1 to -0.38 percent in 2016Q2), it contributed 91.74 percent to the country's GDP with Agriculture, Information and Communication, Arts entertainment and recreation, and Education sub-sectors recording positive growth. The negative growth rate recorded in the non-oil sector is attributed mainly to the severe decline in the Mining and Quarrying, Trade, and Accommodation and Food Services sub-sectors.

[9] "Nigeria's Gross Domestic Product", National Bureau of Statistics (NBS), 2016Q2

Figure 8: Oil and Non-Sector Growth (%)



The severe decline in oil sector activities recorded in 2016Q2 was orchestrated by the decline in crude oil production due to a series of attacks on oil and gas facilities. Although oil price gained some momentum (from USD34.36 in 2016Q1 to USD46.44 in 2016Q2), oil production fell significantly by 420,000 barrels per day relative to the preceding quarter (*figure 9*). For the non-oil sector, the poor performance of the Mining and Quarrying sub-sector is connected to the slowdown in crude oil drilling activities due to frequent force majeure[10] by oil companies arising from concerns over sabotage by Niger Delta militants. In addition, the poor performance of the Trade sub-sector is attributable to severely weakened consumer demand and rising input prices due to foreign exchange constraints and domestic inflation (*figure 10*).

Figure 9: Oil Production (mbpd)

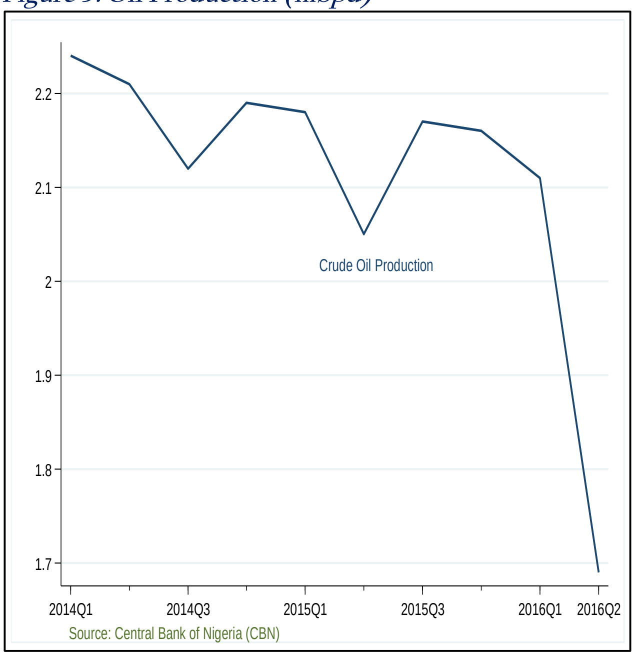
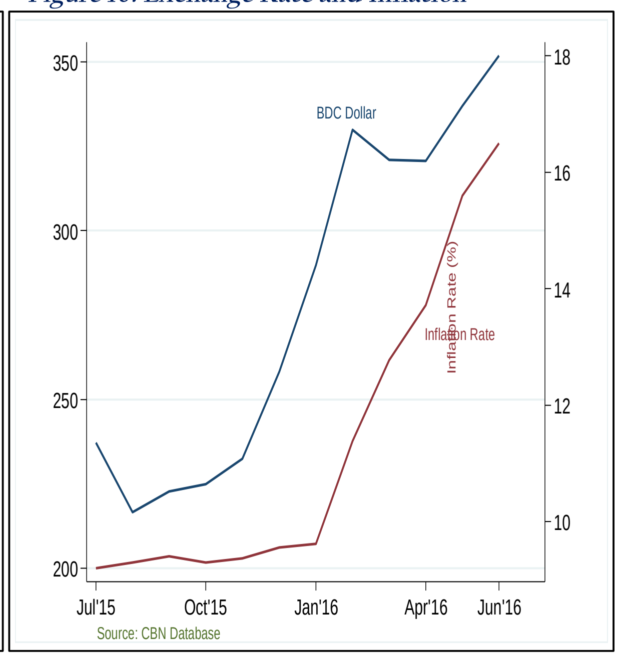


Figure 10: Exchange Rate and Inflation



[10] A freedom from contractual obligations because of unfavourable conditions and circumstances.

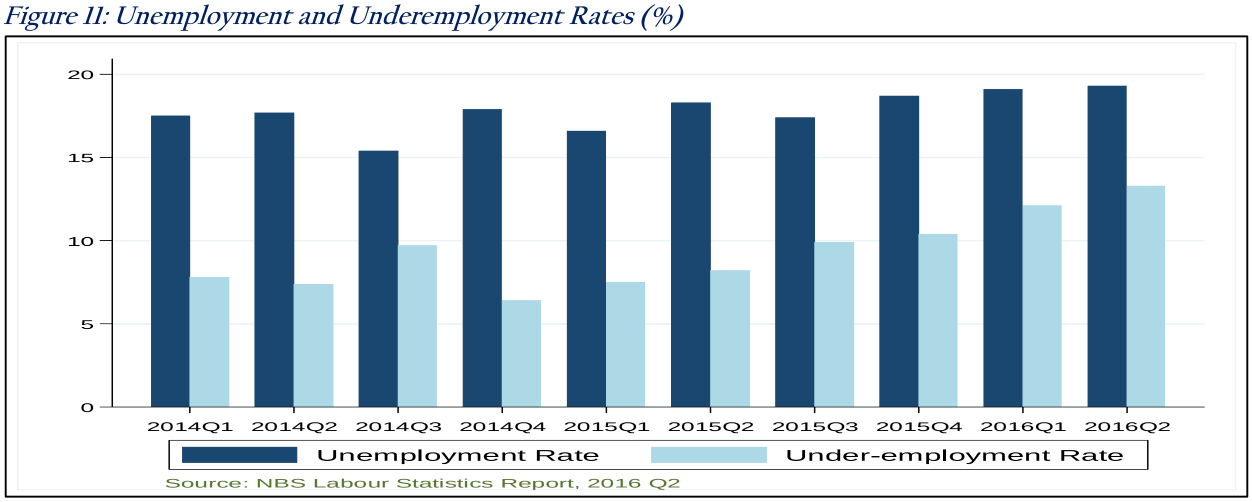
Output growth is expected to continue to underperform into 2016Q3 as major issues, such as crude oil production shortages and FOREX difficulties, are yet to be addressed effectively. The Nigerian government is taking steps to diversify the nation's revenue base towards agriculture which will potentially improve foreign exchange earnings and ameliorate the nation's economic woes. However, the macro-economic impacts of the investments in the agriculture sector would not surface in the short term. Thus, in the meantime, the government should intensify efforts aimed at addressing the Niger Delta situation in order to improve oil production level. It is also recommended that the fiscal authorities should intensify efforts at mobilizing domestic revenue sources by encouraging voluntary tax compliance amongst citizens. On the other hand, the monetary authorities, and government, should take steps to address the political and regulatory constraints to forex liquidity with utmost priority in order to improve access to input materials at lower price by domestic businesses. The fiscal and monetary authorities could work hand-in-hand to engage Nigerians in diaspora to contribute to forex liquidity with an incentive premium. For instance, the government could sell diaspora bonds with reasonable returns to create incentives, and thus potentially increase remittances. Furthermore, experts around the world could be converged to discuss Nigeria's foreign exchange crisis and proffer credible solutions, as well as provide incentives to attract foreign and domestic investors. Monetary authorities also need to improve its monitoring mechanisms to minimize currency hoarding which constrains forex liquidity.

2.2 Unemployment

Unemployment rate records its seventh consecutive rise on the account of waning consumer demand and output.

The rate of unemployment and underemployment continued to rise in the second quarter of 2016. Unemployment rate rose from 12.1 percent in 2016Q1 to 13.3 percent in 2016Q2, the seventh consecutive rise since 2014Q4 *(figure 10)*. That is, the number of unemployed people increased by 1.2 million persons between 2016Q1 and 2016Q2. As has often been the case, unemployment was higher in urban centres compared to rural areas given graduate's preference for white collar jobs available in urban centres. Underemployment also increased from 19.1 percent in 2016Q1 to 19.3 percent in 2016Q2 *(figure 11)*. In similar vein, underemployment was highest in rural areas due to the seasonal nature of farming. Unemployment and underemployment remained highest amongst youths: an estimated 17.6 million of 39.6 million Nigerian youths (aged 15-34) in the labour force were either unemployed or underemployed in 2016Q2. Both unemployment (15.3 percent) and underemployment (22.4 percent) rates remained highest amongst women compared to their male counterparts.

Figure 11: Unemployment and Underemployment Rates (%)



The increase in unemployment level was largely due to the rise in input prices (due to foreign exchange difficulties) and drop in consumer spending, thus stifling business activities. Against the backdrop of unfavourable business climate, many firms were reported to have shut down operations, and several others laid-off workers or cut back on hiring new labour in a bid to cut costs[11,12]. With the shortfall in job creation and the increase in labour force population (from 78.5 million in 2016Q1 to 79.9 million in 2016Q2), the number of unemployed people were bound to rise. In addition, the higher rate of unemployment, particularly amongst youths continues to be fuelled by skill gap and lack of access to capital, amongst other factors. Many graduates are seen short of critical skills that are applicable to companies and industries. Given present economic woes, many companies find it less desirable to make necessary investments to: provide graduates with preliminary skill trainings, assist with geographic mobility to enable them take on new jobs, and provide them with skills from work experience. The skill gap appears to be orchestrated by, first, the observed poor connection between schools and the private sector –which is needed to enhance training and work experience. Second, the poor school curriculum which neglects vocational, employability and entrepreneurial training seem to have also played a role in the skill gap. Furthermore, even amongst entrepreneurial graduates, employment prospect is made bleak by the poor access to affordable loans due to their lack of collateral and high interest rates that make it difficult to repay loans. This makes many people opt for jobs in the informal sector. Thus, the rise in underemployment is attributable to the slow job creation in the formal sector, causing many to settle for lesser preferred jobs in the informal sector.

Given ongoing economic recession which is likely to continue into the third quarter, unemployment rate may continue to rise throughout the rest of the year. Although there is job creation in the agriculture and education sectors[13], other real sectors of the economy are witnessing contraction in job creation due to unfavourable business climate. An effective strategy for job creation through the collaboration of all stakeholders (monetary and fiscal authorities, banking sector, private sector operators and households) would be beneficial. First, there is a need for government stimulus for infrastructure projects and social intervention policies in order to support business growth and increase consumption demand respectively. Furthermore, both monetary and fiscal authorities should work together to enforce policies that channel consumption to locally-produced goods in order to stimulate domestic demand. For instance, tightening Customs administration to reduce the illegal import of banned goods. Critically, this should be backed by efforts to support domestic production. In addition, enactment of policies must be clear, credible, consistent and sustainable in order to boost investor confidence and ensue an injection of private capital. Furthermore, empowering the economically marginalized (which constitutes a majority of the Nigerian population) will also be critical to stimulating consumer demand and job creation.

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[11] http://naija247news.com/2016/02/50000-nigerian-workers-sacked-as-companies-businesses-shut-down-operation-over-foreign-exchange-crisis/

[12] This Day http://www.thisdaylive.com/index.php/2016/04/12/145-textile-companies-shutdown/

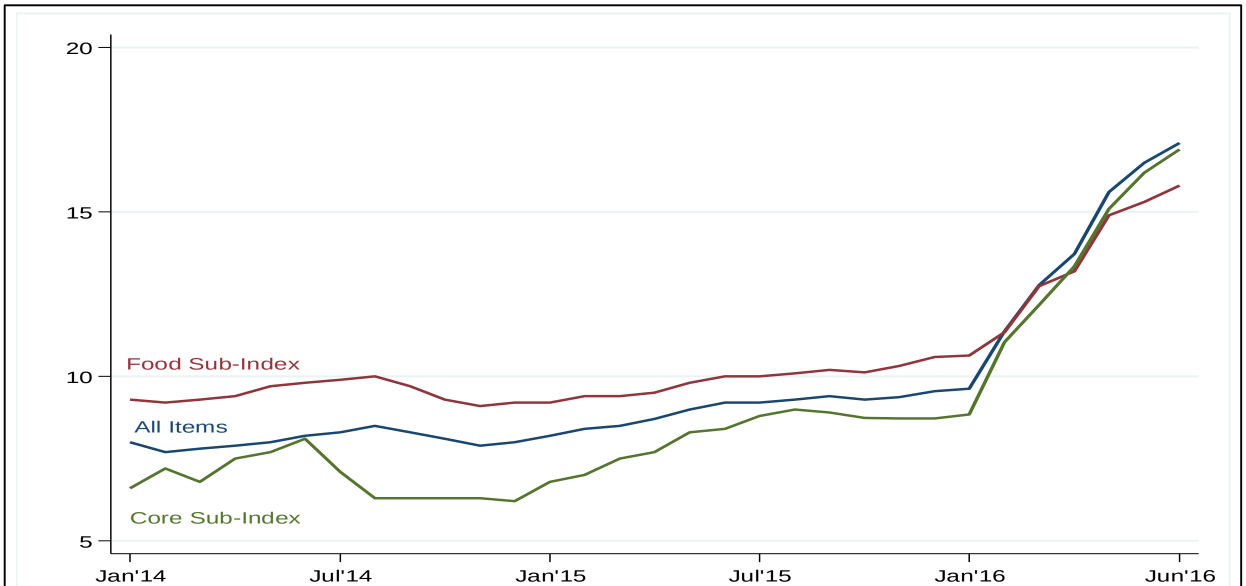
[13] Premium Times (June 8, 2016), "Nigeria begins recruitment of 500,000 unemployed graduates" Retrieved from: http://www.premiumtimesng.com/news/headlines/204953-nigeria-begins-recruitment-of-500000-unemployed-graduates.html

2.3 Inflation

Headline inflation continue to rise on the account of structural factors and exchange rate constraints

In 2016Q2, headline inflation rose farther above the 6-9 percent inflation target of the CBN. Inflation rate rose from 12.77 percent in March 2016 to 16.5 percent in June 2016, yielding an average of 15.27 percent in 2016Q2 *(figure 12)*. Both food and core sub-indices increased in the three months of 2016Q2, with core sub-index increasing at a faster rate compared to preceding quarters. In the food sub-index, inflation was most severe in both domestic and imported fish, meat, vegetables, fruits, bread and cereal. In the core sub-index, inflation was most severe in the rising price of electricity, kerosene, furniture and furnishings, fuel, vehicle spare parts. The general price level rose consistently in both urban and rural centres throughout the second quarter of the year.[14]

Figure 12: Headline Consumer Price Index (Year-on-Year Change)

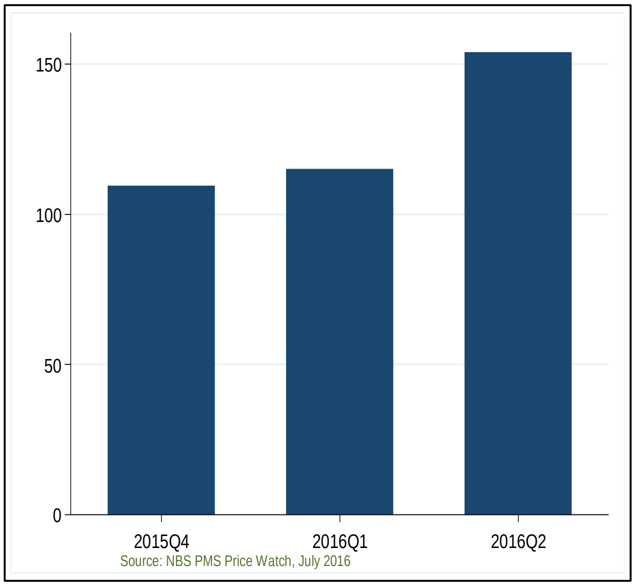


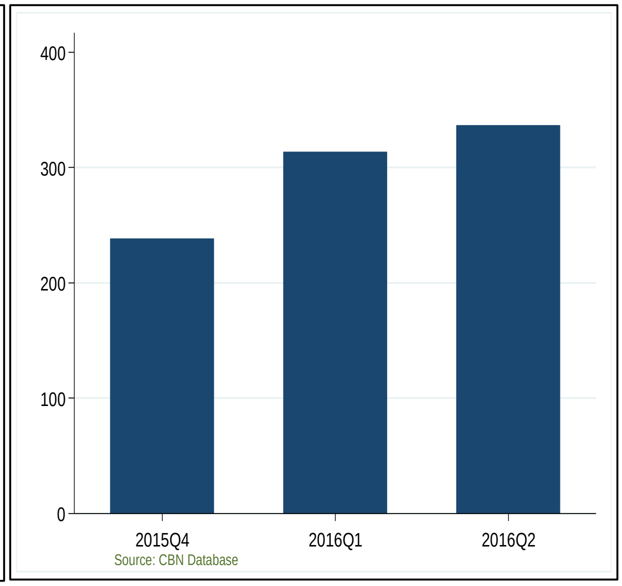
Source: CBN Database

The rise in inflation was driven by structural factors including the rise in energy costs for both transportation and electricity. In addition to the 45 percent hike in electricity tariff effected on February 2016, petrol prices (Premium Motor Spirit – PMS) rose from an average of N115.01 in 2016Q1 to N153.88 in 2016Q2, and diesel price also increased from an average of 151.64 in 2016Q1 to N161.46 in 2016Q2. These were compounded by the depreciation in the value of the naira which contributed to the rise in the prices of imported products, high cost of inputs, and low industrial activities. Seasonal factors in agricultural supply also contributed to the rise in price of domestic food produce within the period.

[14] "CPI and Inflation Report", National Bureau of Statistics, 2016

Figure 13: Average Prices (PMS and Exchange rate) 2015Q4 – 2016Q1





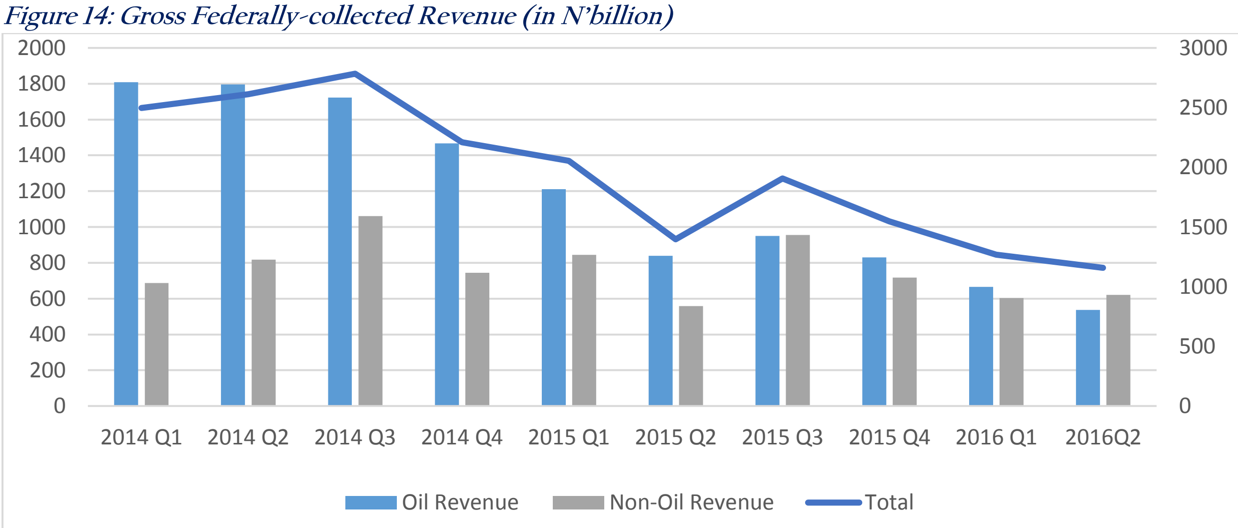
Given that the structural factors that have led to high energy costs as well as forex liquidity constraints that have led to the depreciation of the naira are unlikely to be addressed in the near term, inflation may continue its uptick in subsequent quarters of the year. However, in the absence of further shocks, the pace of inflation is likely to slow down in subsequent months if monetary stance remain contractionary

2.4 Fiscal Policy Landscape

Rising deficit spending, largely on recurrent expenditures

Gross federally-collected revenue fell to N1.16 trillion in 2016Q2, from N1.27 trillion in 2016Q1 – an 8.6 percent decline *(figure 14)*. Receipts collected by the federal government at the end of the second quarter were also 51.3 percent lower than the quarterly budget estimate for 2016Q2. The decline in federally-collected revenue is attributed to the shortfall in receipts from oil revenue within the review period.

Figure 14: Gross Federally-collected Revenue (in N'billion)



Source: CBN Quarterly Economic Report, 2016Q2

Gross oil receipt in 2016Q2 was 19.4 percent lower than receipts in the preceding quarter *(figure 15)*. This is attributed to the incessant decline in crude oil and gas export due to production shortages occasioned by vandalism of pipelines in the Niger Delta region during the period. In contrast, gross non-oil revenue was 3.2 percent higher than receipts in 2016Q1. This is attributed to the increase in Customs Special Levies component of non-oil revenue *(figure 16)*.

Figure 15: Components of Oil Revenue (N billion)

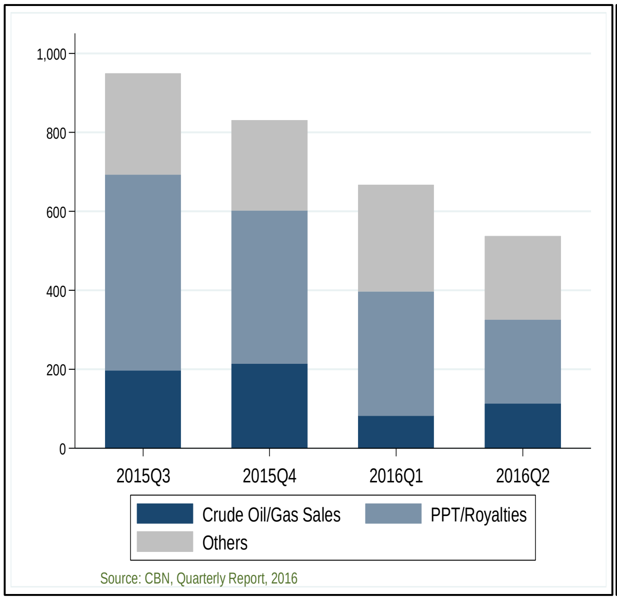
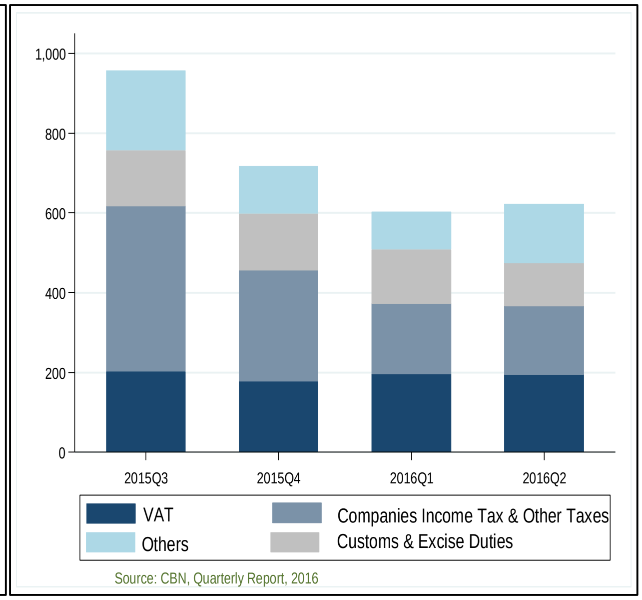
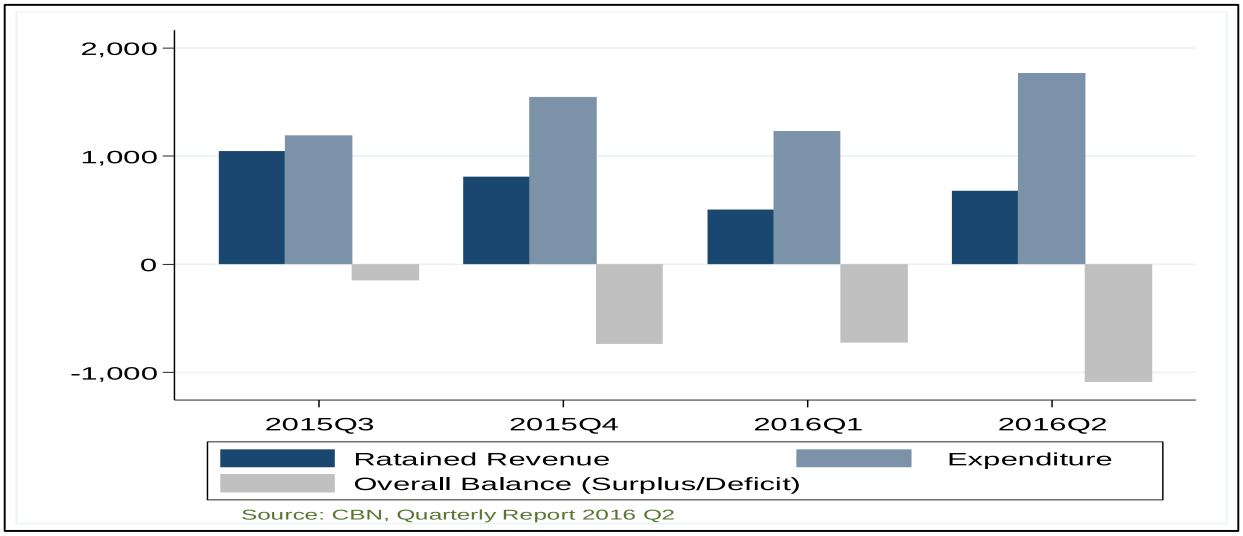


Figure 16: Components of Non-Oil Revenue (N billion)



After the distribution of gross federally-collected revenue amongst the three tiers of government, federal government's retained revenue was estimated at N677.88 billion for 2016Q2 – this is 34.2 percent higher than retained revenue in the preceding quarter but 33.0 percent lower than budgeted estimate for the quarter *(figure 17)*. The federal government's expenditure for 2016Q2 stood at N1.77 trillion which was 12.8 percent higher than the preceding quarter. An analysis of the federal government's total expenditure show that recurrent expenditure accounted for 72.6 percent, capital expenditure accounted for 19.8 percent, and statutory transfers accounted for 19.8 percent of overall expenditure. A deeper examination of the recurrent expenditure shows that non-debt service component represent 73.4 percent, while debt service component represented 26.6 percent recurrent spending by the federal government. Therefore, given that the federal government's retained revenue was lower than expenditure, the fiscal operation of the federal government incurred an estimated deficit of N1.09 trillion – which is higher than the provisional quarterly deficit of N555.49 billion *(figure 17)*.

Figure 17: Federal government fiscal operation (N billion)



Given that the prospects for oil and non-oil revenues are damp in the short term on the account of the incessant shortfall in crude oil production and weak business performance, the federal government is likely to continue to record deficits in subsequent quarters. Moreover, given prevailing stagflation[15], deficit spending (expansionary fiscal policy) targeted on infrastructure project and backed by rising interest rate (tight monetary policy) seems critical to reviving the economy. Despite the reluctance of the government to incur external debt, the foregoing presents an unavoidable need to expand domestic and foreign debt. However, the main issue of concern with incurring external debt lies in the expenditure trend, which has implications for Nigeria's economic outlook. So far, recurrent expenditure (such as salary payment) account for a huge chunk of deficit spending which is worrisome as it does not support Nigeria's growth in the medium term, due to its restricted effect on private sector investments and job creation as opposed to capital expenditure.

Looking forward, the government in conjunction with monetary authorities should vigorously pursue polices directed towards increasing foreign capital inflows to provide more funds for capital expenditure and support foreign exchange reserve. This would entail partnering with the private sector through, for instance, embarking on large infrastructure spending that will not only improve business environment but will also attract private (domestic and foreign) capital flows. In this regard, the fiscal authorities have a greater role to play, as drivers of the present economic downturn are skewed to structural factors, largely outside the purview of monetary policy. In terms of infrastructure spending, at this time, priority should be given to 'low hanging fruits' such as revamping dilapidated roads, before commissioning new projects. Given the shortfalls in government revenue, the government should work with tax authorities to secure the Nigerian tax base; by formulating and implementing policies that allow for better coordination amongst non-oil revenue-collecting agencies.

[15] Simultaneously rising unemployment, rising inflation and declining output

2.5 Monetary Policy and Capital Market Developments

In efforts to improve forex liquidity, the CBN adopts a flexible exchange rate framework with futures market and primary dealers. This influenced the direction of the financial market thereafter, but naira continues to depreciate.

In 2016Q2, most of the key monetary policy decisions were retained in a bid to give past policy decisions time to crystallize and avoid complicating prevailing economic conditions. On the 23rd and 24th of May 2016, the monetary policy committee (MPC) made the decision that the least risky option at the backdrop of stagflation was to hold monetary policy rate (MPR) at 12 percent, cash reserve requirement (CRR) at 22.50 percent, liquidity ratio at 30 percent, and the asymmetric window at +200 and -500 basis points around the MPR *(figure 18)*. However, the MPC voted unanimously to restore the automatic adjustment properties of the exchange rate but retaining a small window for funding critical transactions at official rate. This was in an effort to address the exchange rate situation, as it became more difficult for the CBN to meet all forex demands at official rate. Thus, on 20th June 2016, the CBN officially adopted a single flexible exchange rate framework which determined the Interbank Foreign Exchange Fate (IFEM); thus, officially eliminating the N197/$ peg *(figure 19)*. To ensure foreign exchange liquidity, primary market dealers were introduced in the new exchange rate framework, while the CBN participates in the market through periodic interventions. A futures market was also introduced in the new exchange framework to allow businesses and individuals hedge against future unpleasant movements in exchange rates; that is, CBN began to offer long-tenured FOREX forwards, between 6-12 months, to primary market dealers to ensure forex liquidity. However, the value of the naira at the parallel market (Bureau de Change – BDC) continued to depreciate *(figure 19)*.

Figure 18: MPR and CRR (%)

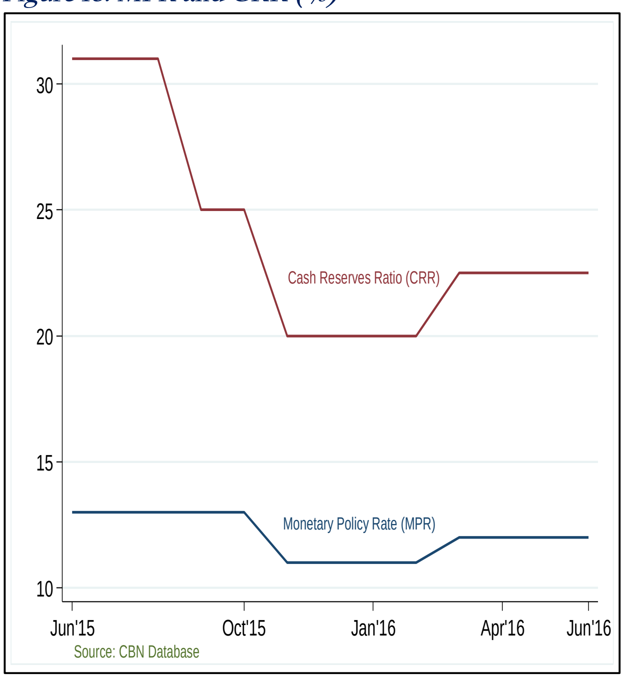
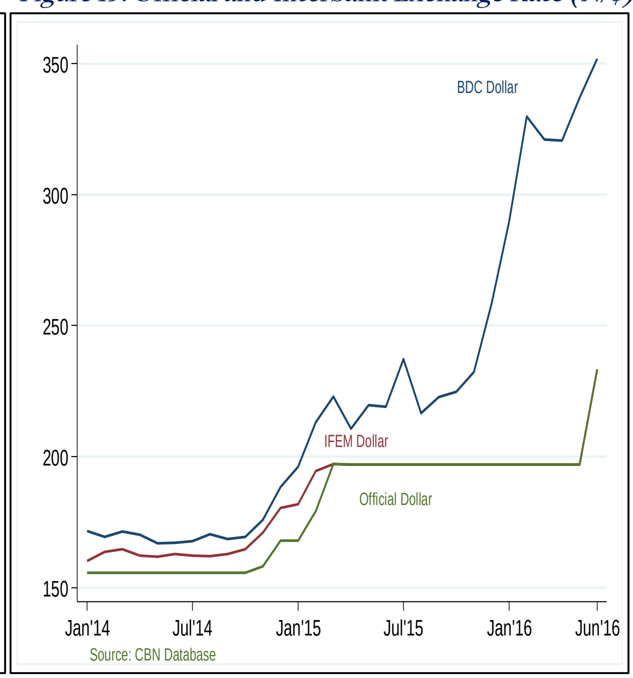


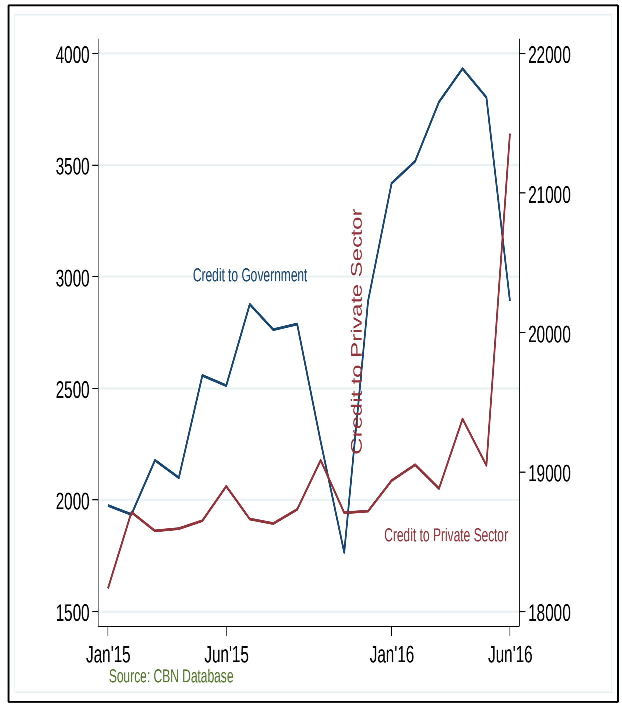
Figure 19: Official and Interbank Exchange Rate (N/$)



Nevertheless, growth in key monetary aggregates accelerated in 2016Q2. On a quarter-on-quarter basis, broad money supply (M2) grew by 5.9 percent to N21.68 trillion in 2016Q2 relative to the 2.2 percent growth recorded in 2016Q1 *(figure 20)*. The growth in M2 reflects increase in net foreign assets, domestic credit, and other assets of commercial banks. On a quarter-on-quarter basis, narrow money supply (M1) grew by 0.9 percent to N9,125.9 billion in 2016Q2 above 2016Q1 growth of 5.5 percent *(figure 20)*. The growth in M1 is wholly attributed to the 1.9 per cent growth in demand deposits of banks. On a quarter-on-quarter basis, aggregate domestic credit grew by 7.3 percent, to N24.32 trillion, in 2016Q2 compared with a growth of 4.9 percent in 2016Q1. This is as a result of the growth in claims on the private sector. Particularly, banking system's credit to the Federal Government fell by 23.5 percent, to N2.89 trillion, in 2016Q2 relative to the growth of 30.7 percent in 2016Q1. The development was due to the fall in banks' holding of government securities, on the account of Treasury Single Account (TSA). In contrast, banking system's credit to the private sector grew by 13.5 percent, to N21.42 trillion, in 2016Q2 compared to the growth of 0.9 percent in 2016Q1 *(figure 21)*.

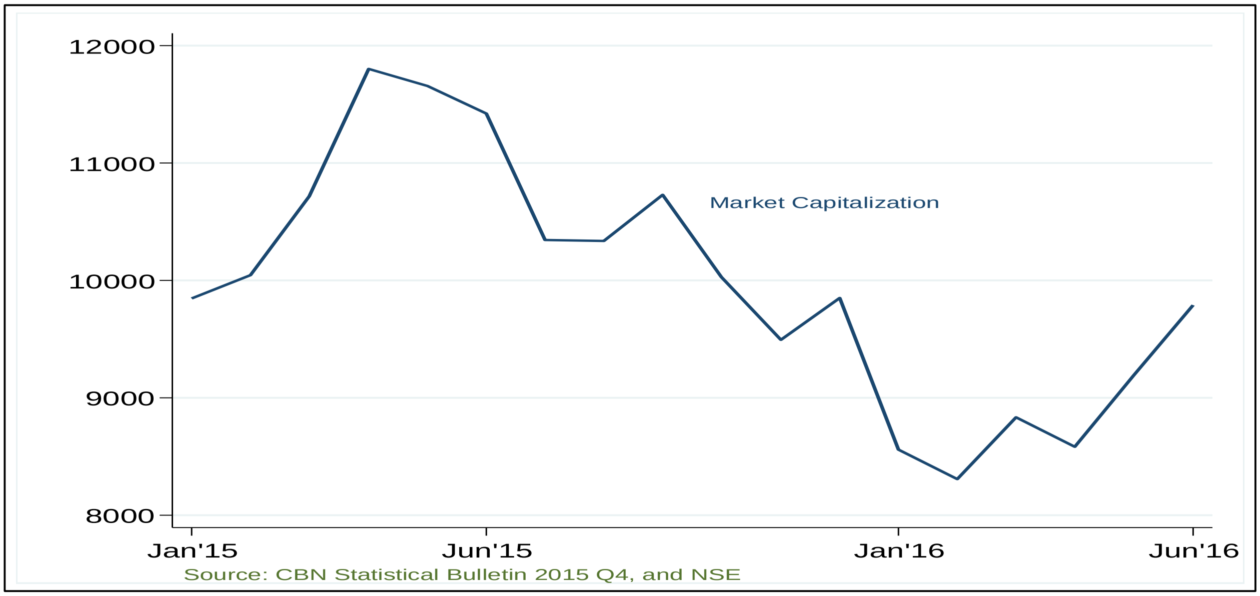
Figure 20: Money Supply (N billion)

Figure 21: Domestic Credit (N billion)



At the capital market, the total volume of traded securities at the Nigerian Stock Exchange (NSE) declined by 22.6 percent, to 27 billion shares, at the end of 2016Q2 compared with the previous quarter. However, the value of shares traded on the floor of the NSE increased by 9.8 percent, to N163.4 billion, in 2016Q2 relative to the preceding quarter. The Financial Services Industry dominated the trading activities on the NSE with a volume of 51.8 billion shares valued at N105.5 billion. The banking sector was the most active sub-sector in the industry. Aggregate market capitalization for all listed securities (Equities and Bonds) grew by 8.8 percent to N17.28 trillion in 2016Q2 relative to the previous quarter *(figure 22)*. The All-Share Index (ASI), which opened at 25,306.722 at the beginning of 2016Q2 (April), closed at 29,597.79 at the end of 2016Q2 (June) representing an increase of 16.9 per cent above the level at the end of previous quarter. This was on the account of the rise in all sectoral indices which rose above the levels in the preceding quarter, with the exception of the NSE-Oil and Gas index which fell by 8.1 per cent to 324.00 at end-June2016. The rise in ASI at the end of June is attributable to the new flexible foreign exchange framework which sent positive signals to investors.

Figure 22: Market Capitalization for Equities and Bonds (N Billion)



Looking forward, the new flexible policy framework could potentially improve access to foreign exchange (forex liquidity), improve foreign capital inflows, and deepen the Nigerian financial market (on the account of the forex futures market) in the long-term. However, the sustainability of these impact is dependent on the ability of the CBN to proactively block regulatory loopholes that render the new policy counterproductive, e.g. arbitrage opportunities inherent in the critical transaction window. Given inflationary pressures, monetary authorities should continue to pursue contractionary policy while the fiscal authorities must supplement this with massive stimulus directed towards critical infrastructures such as roads, oil and gas, power and housing.

In conclusion, the domestic economy underperformed in 2016Q2. The Nigerian economy slipped into a recession in 2016Q2 on the account of persistent foreign exchange issues occasioned by crude oil production shortages and depressed (but rising) crude oil price. Inflation worsened in the review period on the account of seasonal and non-seasonal factors leading to the rise in domestic and imported food prices as well as input costs (energy costs and raw materials). Unemployment continued to rise in both urban and rural centres, and remained most severe amongst youths and women. On the fiscal landscape, the revenue of the federal government fell largely on the account of crude oil production shortages occasioned by attacks on oil and gas facilities. However, federal government expenditure increased significantly to largely cater for recurrent spending, leaving the fiscal operations of the federal government with a huge deficit. In response to persisting forex crisis situation, the CBN introduced the flexible exchange rate policy framework. While the monetary policy contributed to the growth in aggregate market capitalization for all listed securities (Equities and Bonds) at the end of 2016Q2 (on the account of rising investor confidence), it is yet to yield concrete improvements in Nigeria's exchange rate. Therefore, there is a great need for the harmonization of fiscal and monetary policies. While the CBN continues to pursue contractionary policy and implement clear, consistent and credible exchange rate policies, a greater role must be played by the government in providing necessary stimulus in capital investments to improve the Nigerian business environment.

3. EXTERNAL SECTOR

This section provides indicators of Nigeria's external sector performance focusing on its foreign trade and investment, exchange rate and external reserves in the second quarter of 2016. This is expected to give insights into expectations of the public and private sectors in the remaining quarters of the year.

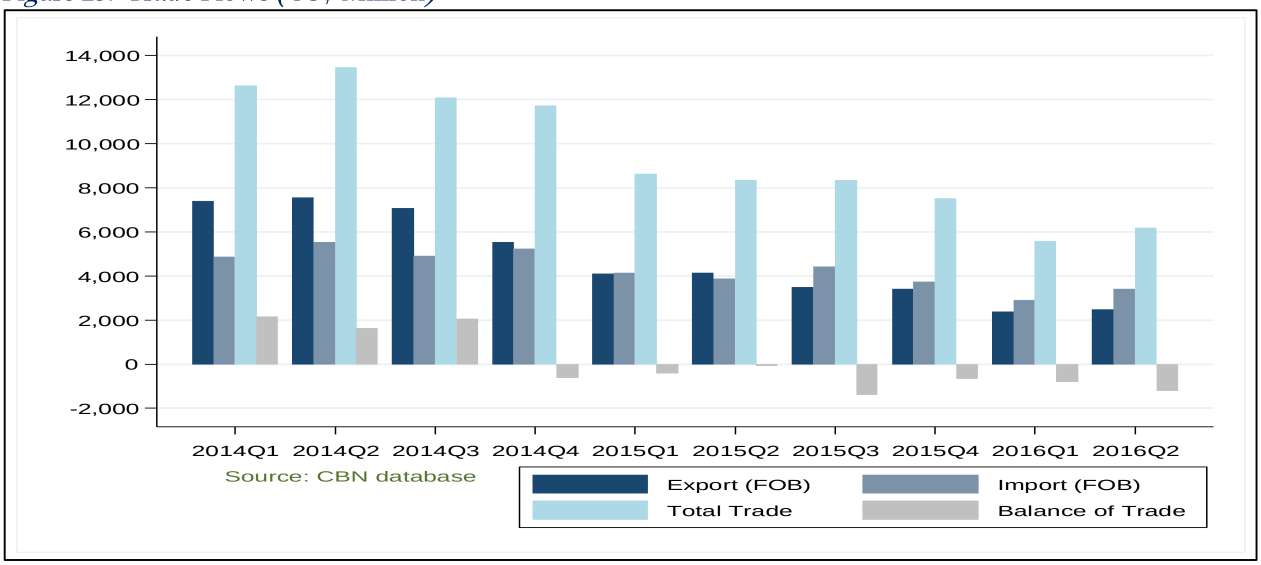
3.1 Trade and Investment

3.1.1 Foreign Trade

Nigeria's trade value rose considerably with trade deficit, on the account of flexible exchange rate gains

In 2016Q2, Nigeria's total trade averaged $6.18 billion, an increase of 10.88 percent from $5.58 billion, recorded in 2016Q1 (*figure 23*). On quarter-on-quarter basis, both imports and exports rose marginally but import component rose more significantly by 17.40 percent to record $3.40 billion in 2016Q2. The increase in import above export brought the country's trade balance down to a deficit of $1.21 billion, which is $388.69 million more than the preceding quarter.

Figure 23: Trade Flows (US$ Million)



The increase in export may have been driven, among other things, by the flexible exchange rate gains that have made Nigeria's non-oil exports relatively more competitive, given that crude oil exports fell by 20.4 percent in 2016Q2 (CBN economic report, second quarter 2016)[16]. The non-oil export must have been driven, among other factors, by agricultural exports because its percentage share of the sector in non-oil export was 34.1 percent (CBN economic report, second quarter 2016) and the sector also led in positive growth in 2016Q2. The increase in imports, given that refined petroleum products imports tops Nigeria's importation profile (ITC trade map database), may not be unconnected with increase in measures to correct the distortion and imbalance created by the reduction of the private marketers' allocation to 28 per cent in the 2016Q1[17]. This imbalance created by the scarcity of refined petroleum products was corrected in the 2016Q2 by slashing the allocation given to the NNPC from 78 per cent in the 2016Q1 to 41.73 per cent in 2016Q2, thus giving private marketers the opportunity to import in order to ease the scarcity. Furthermore, the huge import demand for refined petroleum products might have overwhelmed export

[16] https://www.cbn.gov.ng/Out/2016/RSD/CBN%20ECONOMIC%20REPORT%20second%20QUARTER%202016.pdf
[17] http://www.thisdaylive.com/index.php/2016/03/31/relief-as-pppra-slashes-nnpcs-allocation-for-q2-fuel-imports/

gains, created by the floating exchange rate regime, leading to larger trade deficit above what was recorded in the 2016Q1.

In terms of export trade direction, the top destination for Nigeria's exports, in 2016Q2, is India, followed by other African countries and the United States *(Table a)*. The export direction in 2016Q2 is related to what was observed in 2016Q1 except that United States has been marginally displaced by other African trade partners of Nigeria, in terms of its export direction. This is a desired export diversification that enhances African regional integration. Between 2016Q1 and 2016Q2, Nigeria's exports to the identified trading partners grew significantly except with Brazil, France, Japan and China. In terms of supplying markets, China, Netherlands and United States top the list of suppliers of commodities imported by Nigeria in the 2016Q2 *(Table b)*. The trend in supplying markets in 2016Q2 for goods imported by Nigeria is similar to the preceding quarter, except that Netherlands displaced India in the top three supplying markets. Nigeria's regional trade in Africa is more of intra-regional exports than imports. This trend can be explained by weak industrialization in the region and the nation's high taste for manufactured goods. To facilitate regional trade integration, there is urgent need to deepen regional investment in critical infrastructure which is one of the requirements for industrialization.

Table a. Nigeria's Top 10 export destinations (N' Billion)

Year Quarter	AFRICA		America			Europe						Asia		
	TOTAL	ECOWAS	USA	Canada	Brazil	Germany	UK	Netherlands	Italy	France	Spain	Japan	India	China
2013 Q1	304	178	414	51	343	96	183	386	222	218	328	5		50
Q2	504	218	441	84	443	117	223	201	227	239	210	19		25
Q3	545	192	278	86	273	46	174	512	234	211	262	13		38
Q4	440	168	70	37	290	51	150	394	311	167	195	35		57
2014 Q1	424	171	147	2	377	57	268	462	151	311	346	144		101
Q2	411	175	250	0	414	57	304	450	287	248	514	122		77
Q3	628	327	138	3	287	55	153	467	166	219	388	124		32
Q4	463	152	81	25	240	106	100	284	109	157	270	126		55
2015 Q1	497	253	44	23	160	77	68	304	64	102	235	132	437	64
Q2	382	122	116	24	202	56	92	380	68	164	235	79	554	18
Q3	288	140	86	20	169	34	192	245	29	107	211	80	408	29
Q4	223	84	89	39	100	21	63	207	56	140	228	43	381	46
2016 Q1	140	49	148	23	63	17	28	42	23	78	124	33	190	42
Q2	266	87	235	86	11	83	35	133	42	73	215	25	403	40

Source: *NBS 2016Q2 foreign trade report.*

Table b. Nigeria's Top 10 import Sources

Year Quarter	AFRICA		America			Europe						Asia		
	TOTAL	ECOWAS	USA	Canada	Brazil	Germany	UK	Netherlands	Italy	France	Spain	Japan	India	China
2013 Q1	59	5	84	6	28	47	99	81	23	55	18	17		336
Q2	119	60	155	8	31	56	89	100	32	35	54	16		388
Q3	392	9	189	16	91	70	121	101	27	40	54	31		378
Q4	103	48	185	14	50	61	58	96	30	55	20	28		374
2014 Q1	65	8	165	11	42	65	70	76	34	36	27	24		368
Q2	78	12	236	14	38	77	77	139	31	64	39	27		426
Q3	317	15	183	11	54	65	74	94	33	38	33	31		429
Q4	61	10	167	21	53	76	68	141	65	47	23	45		394
2015 Q1	108	56	137	12	43	55	75	124	69	38	41	29	97	388
Q2	107	46	147	12	41	52	78	109	31	41	63	19	115	336
Q3	65	16	161	12	40	55	54	102	27	31	16	17	97	459
Q4	139	96	138	13	49	48	76	80	30	48	20	26	99	385
2016 Q1	83	36	132	15	52	45	69	83	31	59	26	17	90	346
Q2	89	21	199	16	35	74	119	286	28	58	21	61	125	494

Source: *NBS 2016Q2 foreign trade report*

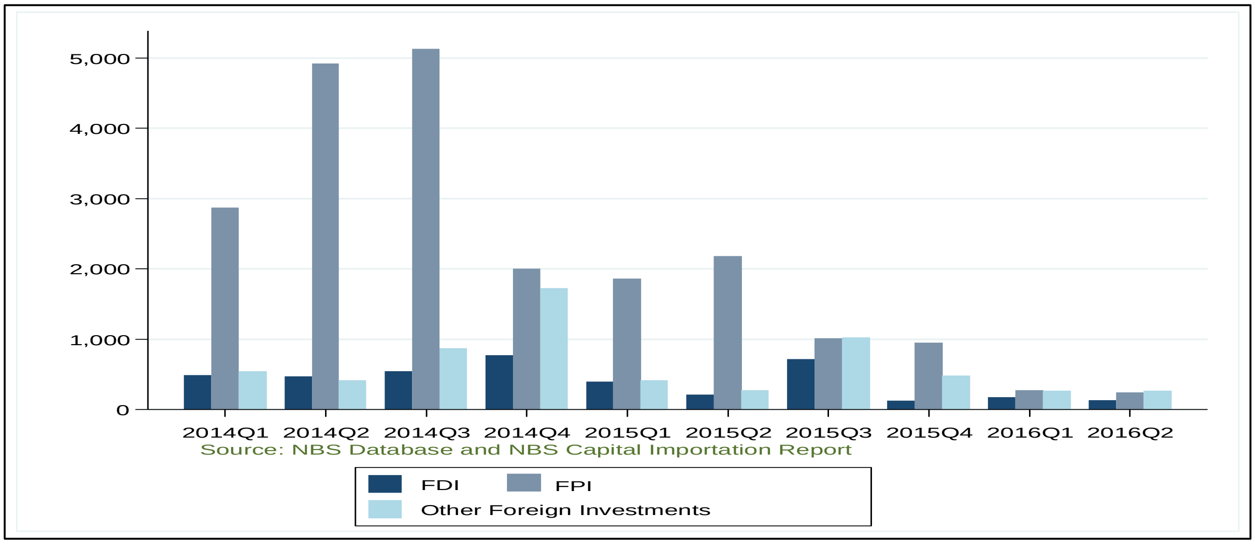
The available information from ITC trade map also revealed that Nigeria's trade position is still largely dictated by crude oil and natural gas export, and import of refined petroleum products. Hence, it would be recommended that the government deepens its pursuit of economic diversification in order to reduce vulnerability of the Nigerian economy to negative oil price shocks and forestall persistent trade imbalance. Also, efforts at making refineries work should be intensified to reduce trade deficit and persistent depreciation of exchange rate, which are often caused by import of refined petroleum products. In the direction of trade, enhanced diversification is recommended to reduce undesired effects of trading with very few partners.

3.1.2 Foreign Investment

Capital importation into the Nigerian economy, particularly FDI, declined considerably in the review period

The total value of capital imported into Nigeria in 2016Q2 stood at $647.11 million *(Figure 24 and Table c)*. This represents a decline of 8.98 percent relative to 2016Q1. There are variations across foreign investment types. Compared to 2016Q1, Foreign Direct Investment (FDI) recorded $133.02 million, the largest decline of 23.75 percent, compared to a decline of 9.49 percent for the Foreign Portfolio Investment (FPI) and an increase of 1.24 percent for other foreign investments such as loans and other claims. It is observed that other foreign investments (which recorded $268.77 million in 2016Q2) have displaced Portfolio investment (estimated $245.32 million) as the largest component of capital importation in 2016Q2. These dynamics made other foreign investments to account for 41.53 percent of total capital importation, compared with 37.91 percent and 20.56 percent of FPI and FDI, respectively. This development suggests that FPI has been the most hit by the recent economic events and less profitable portfolio investment opportunities, which may be as a result of uncertainty surrounding exchange rate policy which may have deterred investors. Most importantly, the weakness in the oil and gas sector and the decision of the CBN to prevent further depreciation of the Naira by imposing strict measures on revenue repatriation by foreign investors has been having negative impact on the business operation of foreign firms in Nigeria. This has caused unforeseen exit of some firms, particularly in the aviation sector (*see Sections 4.5, 4.8*). The CBN may need to revisit the policy restraining the repatriation of revenue by foreign investors in order to prevent further foreign investment outflow, enhance confidence in potential foreign investors and eventually boost FDI and FPI inflows in nearest future.

Figure 24: Foreign investments (Million $US)



Source: *NBS Database and NBS Capital Importation Report*

Table c. Capital importation by sector (Million $US)

	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2
Agriculture	2.68	0.05	95.1	0.5	0.2	1.5
Banking	114.89	360.92	244.24	193.49	107.58	90.24
Construction	4.3	3.24	11.1	9.38	10.16	22.13
Consultancy	0.7	0.1	0.23	9.56	0.14	0.3
Electrical	0.83	73.39	0.58	137.52	70.15	8.84
Financing	763.49	46.54	35.15	13.71	42.57	0.29
IT services	1.4	5.75	2.02	3.61	1.02	0.94
Oil and gas	9.47	4.86	2.21	13.22	20.83	8.09
Production	118.36	51.2	162.42	91.72	77.77	92.62
Servicing	6.29	12.83	65.64	115.71	55.05	130.98
Hotels			1.15		0.75	0
Telecomms	336.87	138.4	369.49	93.37	13.44	77.54
Trading	28.54	91.57	6.66	40.77	55.08	4.45
Total Capital importation	**2672**	**2666**	**2748**	**1557**	**711**	**647**

Source: NBS 2016Q2 Report

The sector with the largest amount of capital importation in 2016Q2 is servicing with $130.98 million, which represents about 20.24% of the total capital importation. This is followed by production, banking and telecommunication sector recording $92.62 million, $90.24 million and $77.54 million, respectively.

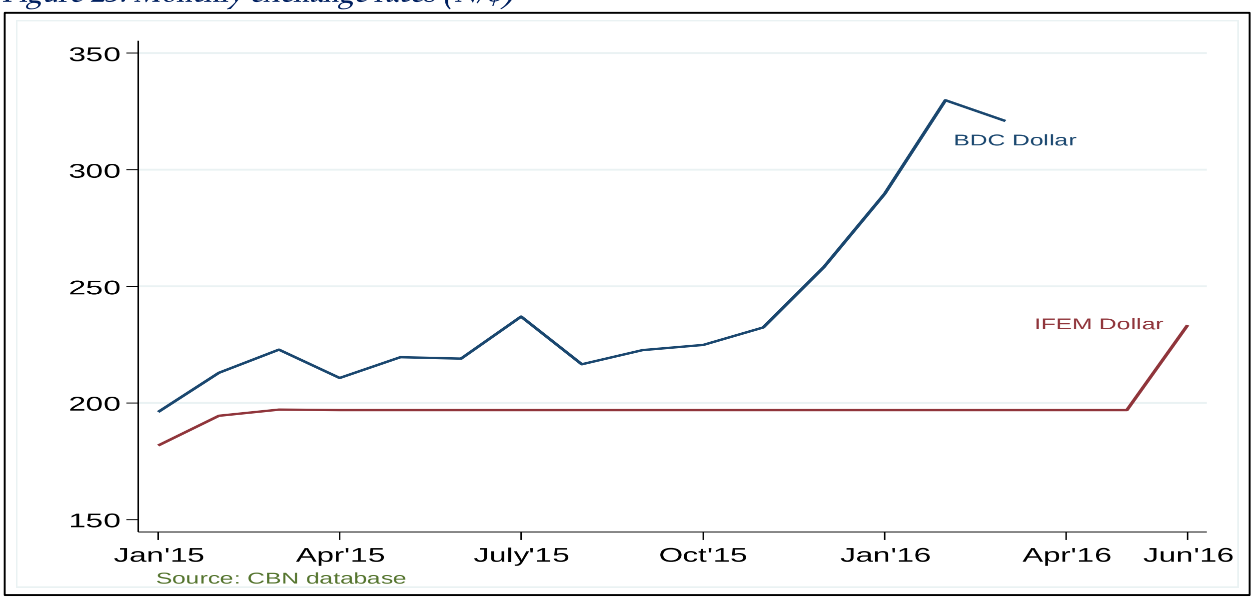
While sectors such as agriculture, telecommunication and services grew by 650.0 percent, 476.93 percent and 137.93 percent between 2016Q1 and 2016Q2 respectively; others such as hotels, financing and trading shrank by 100 percent, 99.32 percent and 91.92 percent respectively between the same quarters. Needful to mention that between 2016Q1 and 2016Q2, capital importation in oil and gas sector also shrank by 61.16 percent while agriculture and production grew by 650.0 percent and 19.09 percent respectively. This is an indication that efforts at diversifying the economy is already having some desired effects. Hence, the policy to float the exchange rate should be complemented with other policies that protect domestic producers against its contractionary effects, given that most of their inputs are also imported. With complementary policies, floating exchange rate will be beneficial in improving foreign investors' confidence thus attracting foreign investment, while domestic production will also not suffer.

3.2 Exchange Rate

The Naira depreciates considerably as Nigeria floats its exchange rate

Exchange rate represents the price of one currency in terms of the other (s). It could be used as trade and monetary policy tool. The adoption of the floating exchange rate system by the CBN in the 2016Q2 made the interbank exchange rate to depreciate by 18.48 percent from N197/$1 in the preceding quarter to N233.42/$1 as at June, 2016 (*figure 25*). With the floating exchange rate regime, both interbank rate and the bureau de change (BDC) exchange rates have continued to depreciate persistently due to the import demand pressure orchestrated by overseas summer holiday rush and huge demand for refined petroleum products, especially with increased share of private marketers to import for the purpose of easing the scarcity of refined petroleum products. To ease the pressure on the exchange rate, there is an urgent need to put refineries in shape. One of the ways in which this can be achieved is to leverage on public-private participation and also encourage private investors in the refining business. Also, intensifying efforts at enhancing locally-produced goods and services will ease the excessive demand for dollars and reduce the gaps between official and parallel market exchange rate.

Figure 25: Monthly exchange rates (N/$)



3.3 External Reserves

External reserves further deplete as the CBN makes efforts to stabilize the Naira amid low forex earnings

External reserves are a means by which a nation can manage its exchange rate and also act as a guarantor for external debt. There has been steady decline in Nigeria's external reserves since 2015Q3 from an average of $30.58 billion to about $26.54 billion in the 2016Q2 *(figure 26a)*. Between 2016Q1 and 2016Q2, foreign reserves declined by 3.51 percent. The continuous decline in external reserves is an indication that the country is not generating enough foreign exchange from crude oil exports, being the major source of the nation's foreign exchange earnings. This is connected to the oil installation vandalization activities of militants in the Niger Delta region. Hence, there is need to ensure that the peace talk in the region to halt vandalization of oil installation facilities is achieved, while the country employs more proactive measures at diversifying its productive base.

Figure 26a: External Reserves (US$ Million)

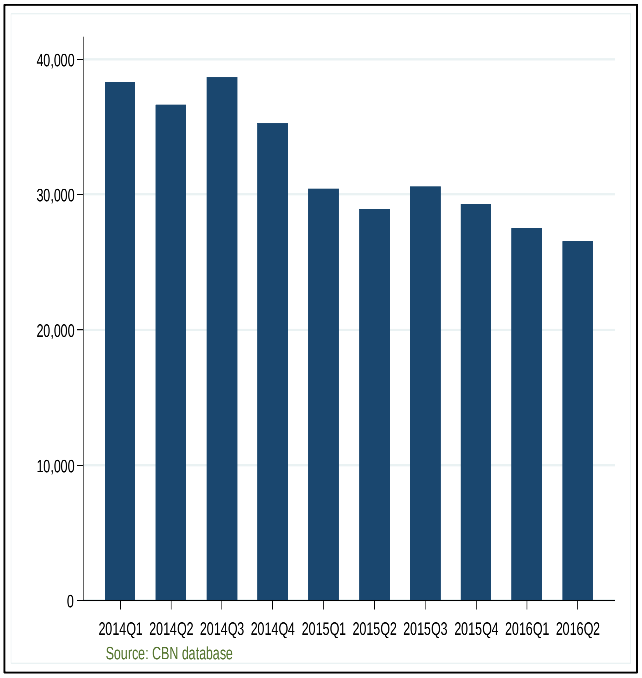
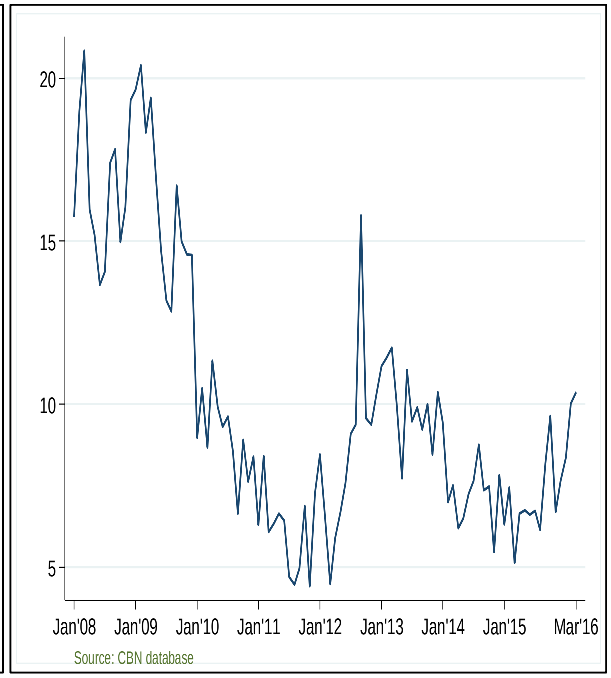


Figure 26b: External Reserves/Import (FOB) Ratio



Besides, the external reserves-imports ratio of 6.4 as at May, 2016 is an indication that foreign reserves can only finance about 6 months imports in the country *(figure 26b)*. This shows that there is a problem of short-term liquidity in the economy to meet up her debt obligations and also indicates low credit-worthiness of the country. Hence, the recent move to finance budget deficits from domestic sources such as treasury bills and other domestic debt instruments could be regarded as a justifiable move. This is not only because financing budget deficits from domestic sources are more reliable with less conditionality but also because it has a way of reducing excessive import demands.

4. SECTORAL PERFORMANCE

This section examines the performance of key sectors of the Nigerian economy, with focus on the second quarter of 2016 (2016Q2). It investigates the factors driving sectoral real GDP growth, as well as sectoral and sub-sectoral contributions to economy-wide real GDP in the quarter. The last part of the section features a summary of key findings and presents a number of policy recommendations.

4.1 Agriculture Sector

Early harvest activities and increased credit drive positive agriculture sector performance.

The general slowdown in economic activities which was evident in virtually all aspects of the economy (including the agricultural sector) in 2016Q1 persisted, in Q2. The agricultural sector however, experienced significant improvement. Particularly, agriculture sector real GDP growth rate increased by 1.44 per cent up from the 3.09 per cent growth in preceding Q1. This growth was driven mainly by growth of 6.32 per cent and 4.72 per cent in livestock and crop farming sub-sectors respectively *(figure 27)*. At 22.55 per cent, agriculture sector contribution to real GDP increased quarter-on-quarter as well as year-on-year by 2.07 per cent and 1.43 per cent respectively; making the agriculture sector the highest contributing activity sector to economy-wide real GDP in the second quarter of 2016 *(figure 28)*

Figure 27: Agriculture Sector Real GDP Growth Rate (%)

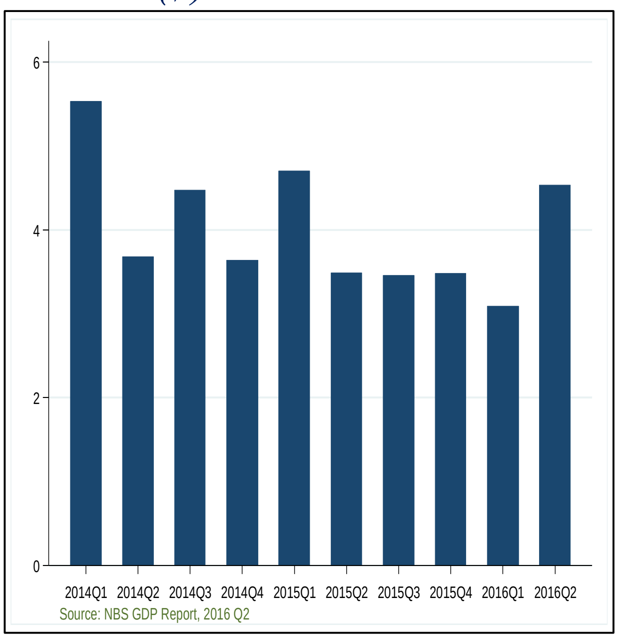
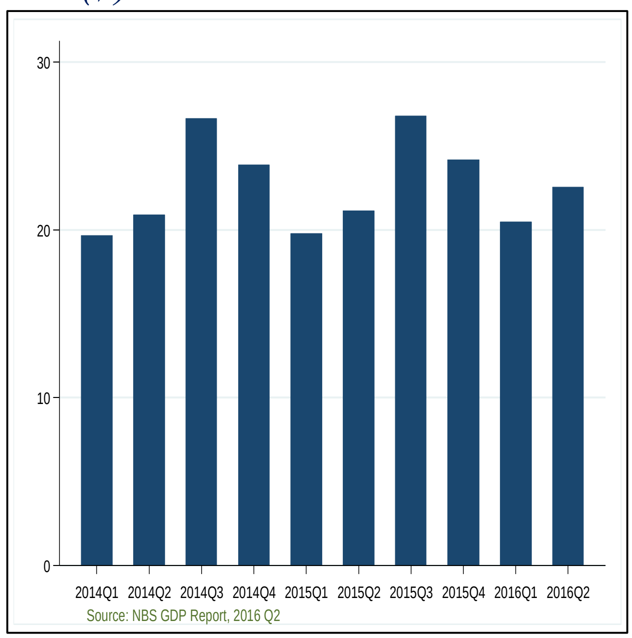


Figure 28: Agriculture Sector Contribution to Real GDP (%)

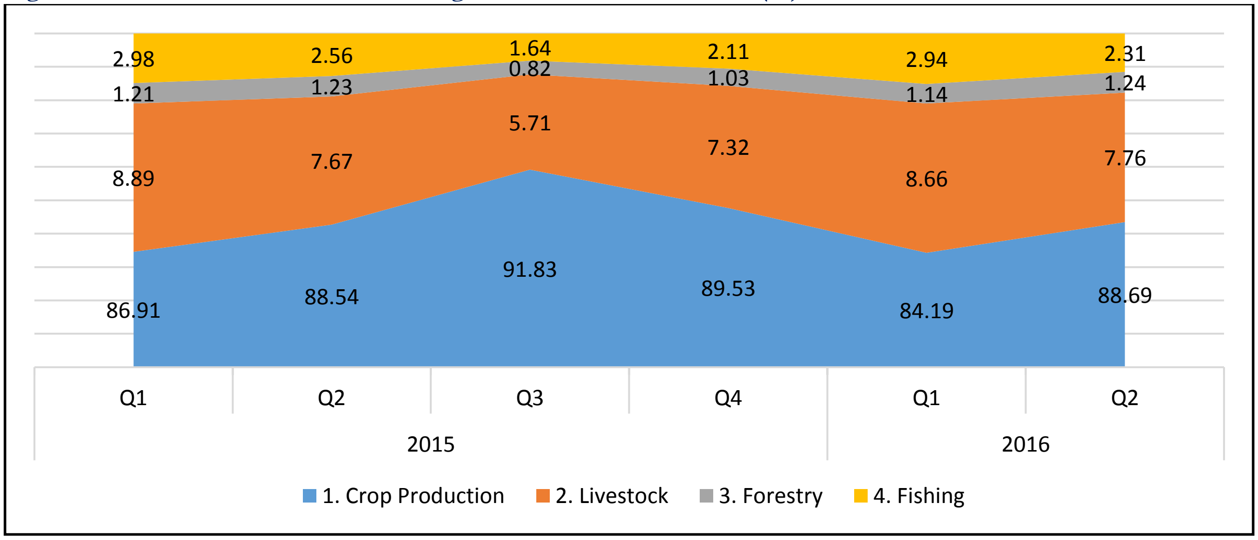


A marginal decline in agricultural sector performance in the first quarter was attributed to lower crop output and lower productivity from dry season pre-planting farming activities; given the rain-fed nature of Nigeria's agriculture. The improvements experienced in the agriculture sector in Q2 on the other hand, were driven basically by early harvest activities as well as increase in agricultural credit. With the diversification of Nigeria's economic base still ranking as a top priority area of the current government, and rising emphasis on the agricultural sector, the federal government through the Central Bank of Nigeria (CBN) continued to guarantee credit for small-holder farmers through the Agricultural Credit Guarantee Scheme (ACGS). Compared to 2016Q1, CBN's total credit guarantee to farmers increased from N1.64

billion in 2016Q1 to N1.993 in Q2, representing an increase of 21.52 per cent. Also, the number of farmers guaranteed under the ACGS increased slightly (about 9 per cent) from 11,369 to 12,405[18].

Sub-sectoral trends show that, crop farming still contributed the highest to agriculture sector real GDP (*figure 29*). However, livestock farming experienced the highest sub-sector growth rate (the second highest real GDP growth rate across all sectors and sub-sectors of the economy[19].

Figure 29: Sub-sector contribution to Agriculture Sector real GDP (%)



Source: NBS 2016

The improvements in the agriculture sector though marginal, seem to align with Nigeria's policy objective of becoming food self-sufficient in the next few years. Overall, however, the limited use of improved agricultural inputs, including technology, land use practices, as well as new seed varieties, have continued to constrain productivity in the agriculture sector. It is likely that the improvements in the agriculture sector will be sustained, and even amplified in 2016 Q3 and Q4 as the harvest season continues. Also, the increased attention being given to the sector by the government especially by making credit available to farmers and other participants in the agriculture value chain through the CBN, and the Bank of Industry is expected to yield more results and further impact on the performance of the sector.

Furthermore, it can be observed that most of what is needed to develop the sector is largely outside the sector – non-farm elements of Agriculture. This is in the sense that factors such as the limited access to capital, limited access and use of improved agricultural inputs – including technology, improved seed varieties –, poor land use practices, and inadequate infrastructure, among others, have continued to constrain productivity in the sector. The government needs to fully step-up in its role of creating an enabling environment, especially in the area of infrastructure development, to enable private sector players invest in the sector.

[18] CBN report of activities under the Agricultural Credit Guarantee Scheme (various issues)
[19] NBS Nigerian Gross Domestic Report Quarter Two

4.2 Construction Sector

Prolonged shortfall in government revenue, late signing and slow implementation of the 2016 Appropriation Bill drive significant real GDP contraction in the construction sector

Construction sector real GDP growth rate continued its downward decline, however marginally by 0.91 percentage points from -5.37 percent in 2016Q1 to -6.28 per cent in 2016Q2. The real GDP growth in the second quarter showed a negative year-on-year difference of 12.7 percentage point from the growth in the sector in 2015Q2 *(figure 30)*. Given that construction in Nigeria is largely public sector driven, substantial shortfalls in revenue of government (federal and state) was the key driver of the sector's poor performance, as most government projects including road and building construction, have been put on hold since the second half of 2015. Furthermore, the late signing of the 2016 Appropriation Bill[20] and the slow implementation of the budget has seen the further contraction of the sector.

Meanwhile, marginal increase in the Construction sector's contribution to real GDP in 2016Q2 (by 0.17 per cent) relative to 2016Q1 (as was the case in 2016Q1 relative to 2015Q4) is largely a reflection of the fall in relative contribution of other sectors of the economy to real GDP (including the Oil and gas sector, the financial services sector and the manufacturing sectors) in the quarter under review *(figure 31)*.

Figure 30: Construction Sector Real GDP Growth Rate (%)

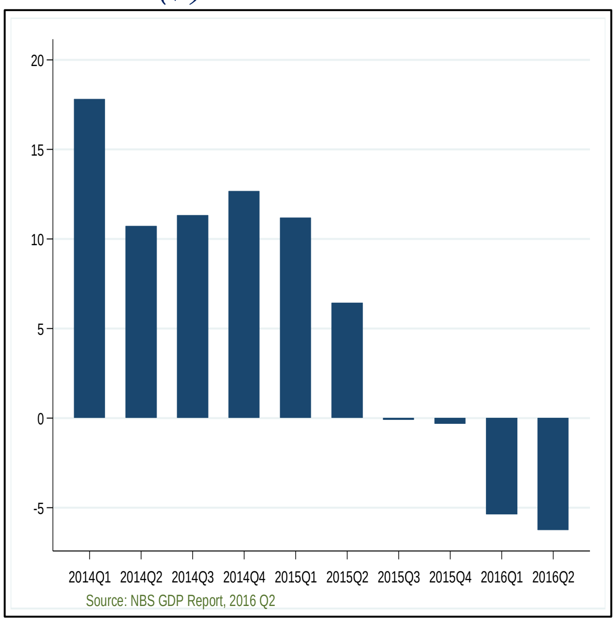
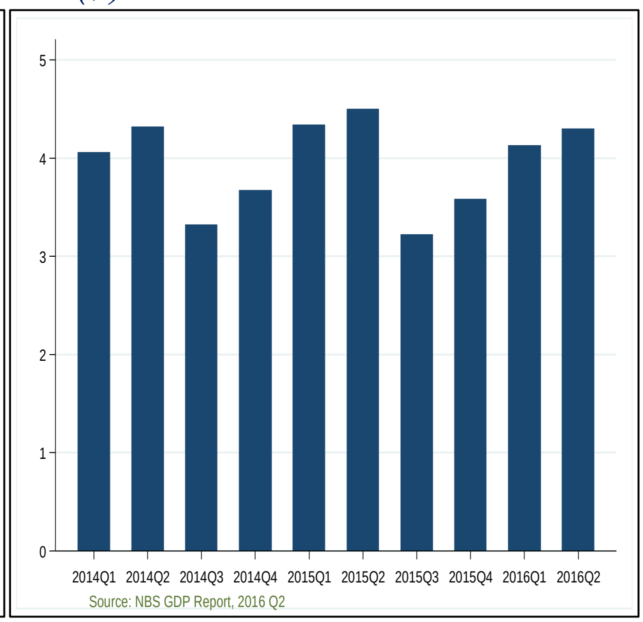


Figure 31: Contribution of Construction Sector to GDP (%)



Considering the slow implementation of the budget which is largely due to heavy fiscal constraints being faced by the government, not much improvement is expected in the construction sector in Q3 and perhaps Q4. This is more so the case as there are indications that much of the funds to be mobilized for construction may be needed to offset a huge backlog of construction contract debts.

The continuous downturn in construction sector activity has significant implications for both infrastructural development as well as youth employment in Nigeria. It is therefore imperative for government to speed up the process of implementing the 2016 budget. In face of the downturn in oil revenue accruing to government, there is the urgent need for more concerted efforts at plugging fiscal

[20] The 2016 Appropriation bill was signed in May 2016

leakages while also exploring alternative income sources; particularly increased efficiency in tax administration. This will considerably revamp economic activities across all other sectors, including infrastructural development and jobs creation.

4.3 Financial Sector

The impact of the TSA and further depreciation of the naira continued to contract the financial sector's performance.

After more than a decade of positive growth and high performance, the negative growth witnessed in the financial sector 2016Q1 continued to persist in Q2, with very marginal improvement of 0.46 per cent from the -11.28 per cent growth rate recorded for the sector in Q1 *(figure 32)*. In face of the negative real GDP growth recorded by the sector in 2016Q2, year-on-year and quarter-on-quarter comparisons showed marginal decline in the contribution of the sector to real GDP of 0.30 per cent and 0.08 per cent respectively *(figure 33)*. The contribution of the insurance sub-sector increased by 3.62 per cent from the 13.10 per cent recorded in 2016Q1 relative to the contribution of other financial services in the same period *(figure 34)*.

Figure 32: Financial Services Real GDP Growth Rate (%)

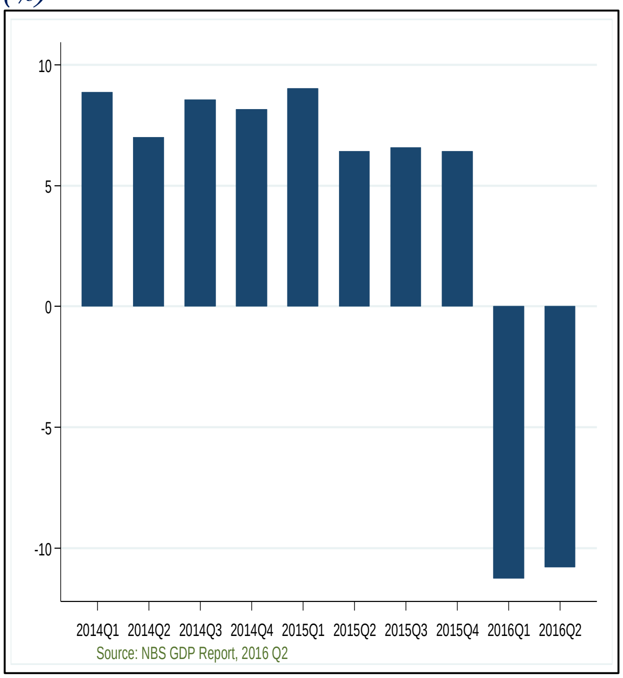


Figure 33: Financial Services Contribution to GDP (%)

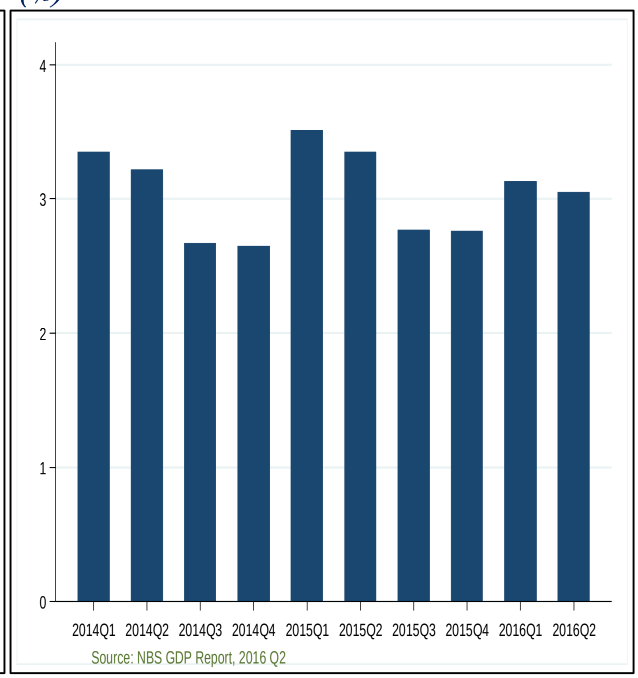
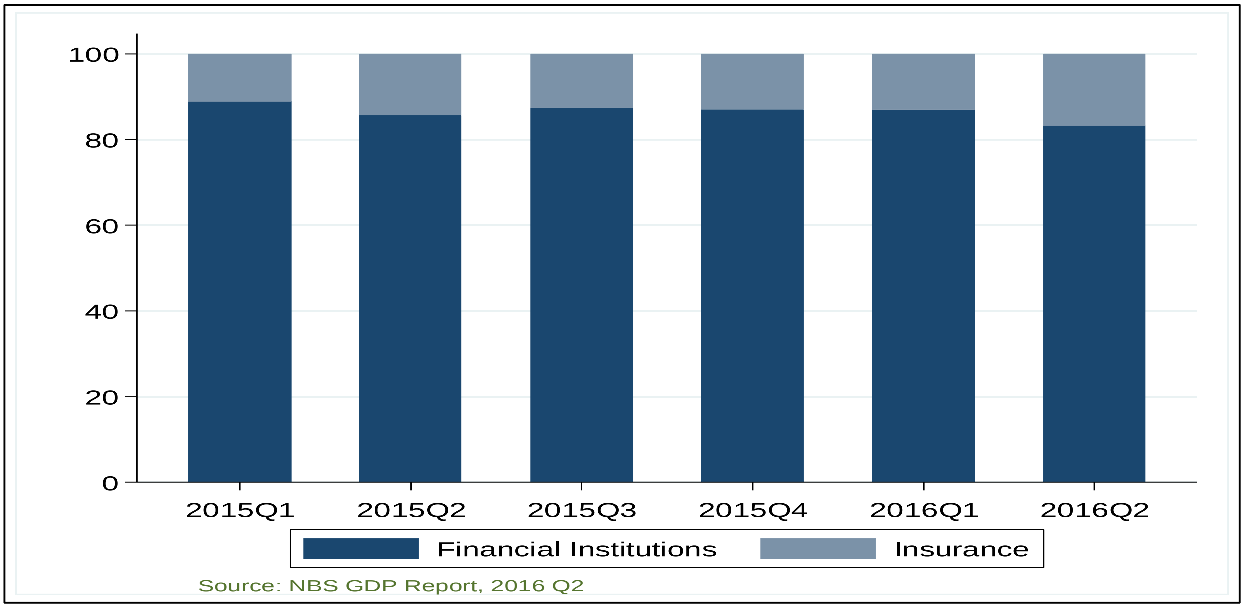


Figure 34: Sub-sectoral Contribution to Financial Sector Real GDP (%)



The poor performance in the sector was basically driven by a challenging macroeconomic environment characterized by declining bank deposits and lending, and a tighter credit system, given rising loan impairment charges. More so, implementation of the Treasury Single Account (TSA) from 2016Q1 significantly reduced banking sector liquidity and hampered the cash flow and profitability of deposit money banks. This adds to the contractionary impacts of declining net foreign asset holdings in the banking system given the continuous depreciation of the naira relative to the dollar.

Looking forward, it can be expected that the sector will experience slight improvements as it adjusts to the shocks from the implementation of the TSA and also as the monetary policy adjustments initiated by the Central Bank begin to set in. This may however be on the heels of active cost-cut strategies by the players in the sector.

4.4 Information and Communication Sector

The ICT sector declined in performance significantly on the account of weak performance in telecommunications and information services, broadcasting activities as well as Motion Pictures, Sound recording and Music production.

In real terms, Information and Communications Technology (ICT) sector GDP growth rate declined in the second quarter of 2016 by 2.72 percentage points to 1.35 per cent from the 4.07 per cent experienced in 2016Q1. The sector's growth rate has continuously declined since 2015Q1 *(figure 35)*. Meanwhile, the contribution of the ICT sector to GDP has remained quite significant, despite slight fluctuations in growth rate. Its contribution to economy-wide GDP again increased marginally in 2016Q2 by 0.70 per cent from the 11.98 per cent contribution in the previous Q1 *(figure 36)*.

Figure 35: ICT Real GDP Growth Rate (%)

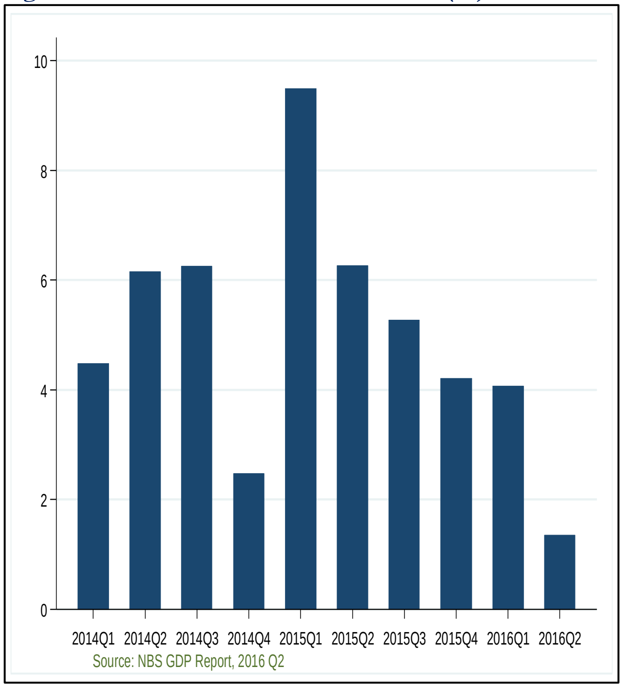
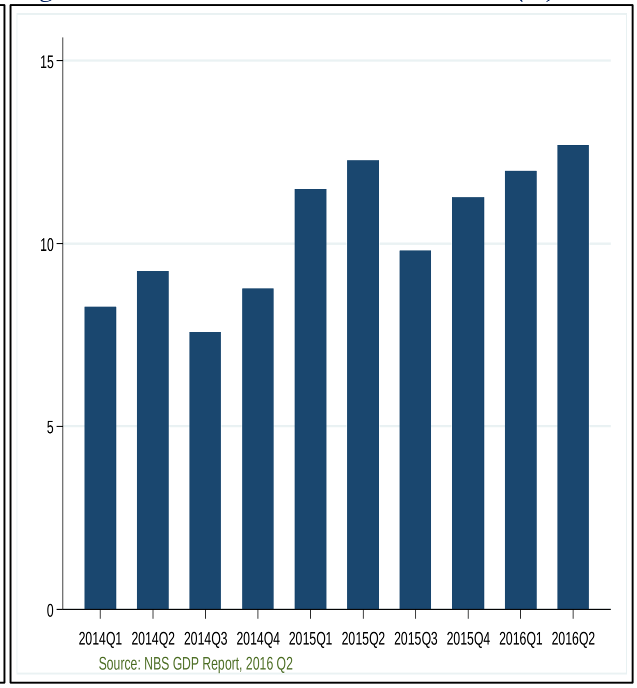


Figure 36: ICT Sector Contribution to GDP (%)



Overall, the weakening growth performance of the sector is attributable to weak performance across the various sub-sectors. While it is expected that the passage of 2016 budget in the quarter should boost performance in the sector; given significant budgetary allocation to the sector, the slow implementation of the budget and other fiscal revenue constraints dwarfs this expectation in the short term. Again, the policies for the sector may need to be broadened to accommodate the expanding sector.

4.5 Transport and Storage Sector

The sector's real GDP growth declined dramatically after an unprecedented increase in Q1, as PMS prices were adjusted

The transportation and storage sector recorded its highest decline in real GDP growth rate from an all-time high of 14.73 per cent in 2016Q1 to -5.34 per cent (20.07 per cent decline) *(figure 37)*. Disaggregated data of the sector indicates that this decline was driven by sharp decline in post and courier services as well as road transport services. Particularly the growth rate in the courier and postage sub-sector declined by 76.25 per cent (from 8.37 per cent in 2016Q1 to -67.88 in Q2)[21]. There was also a marginal decline in the contribution of the sector to economy wide real GDP quarter-on-quarter (0.01 per cent) and year-on-year (0.04 per cent decline) *(figure 38)*.

[21] NBS Nigerian Gross Domestic Report Quarter Two

Figure 37: Transport and Storage Sector Real GDP Growth Rate (%)

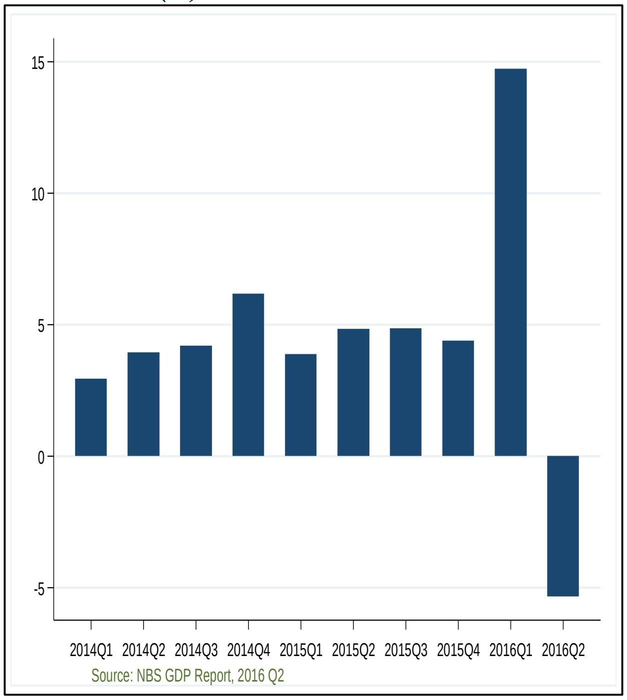
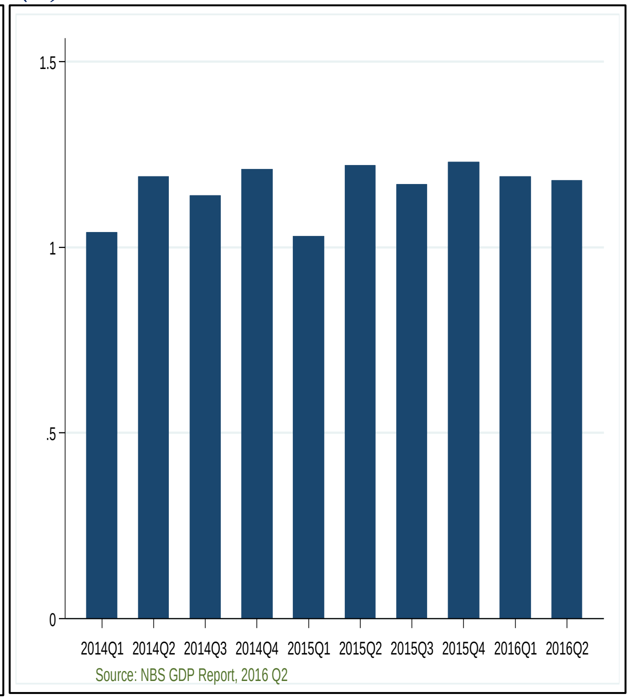


Figure 38: Transport Sector Contribution to GDP (%)

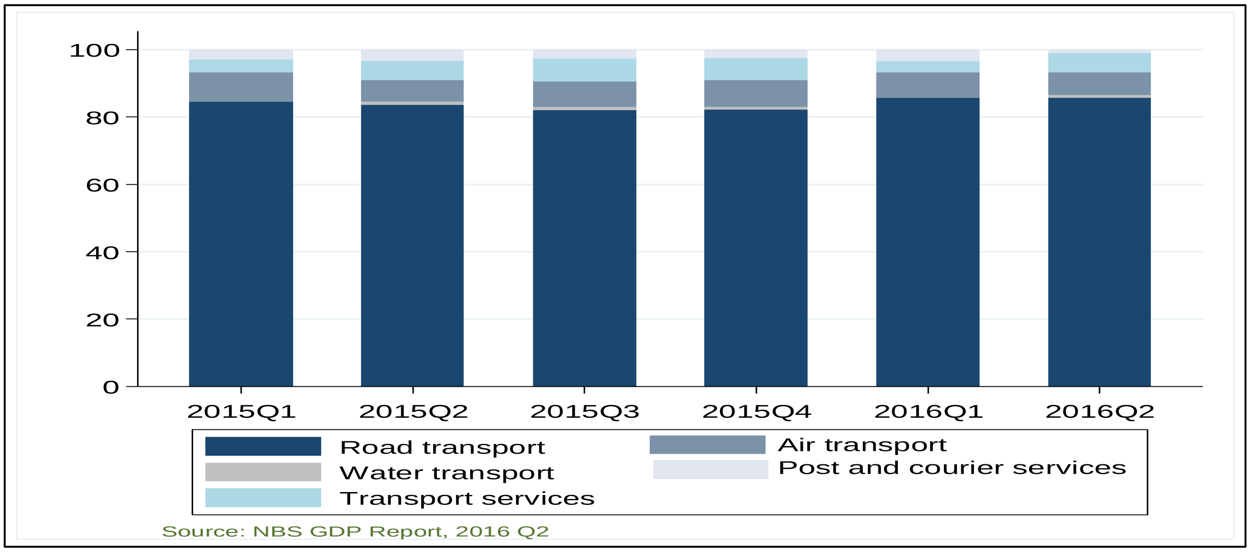


Meanwhile, the road transport sub-sector continued to contribute the highest (85.59 per cent) to the overall transport and storage sector real GDP, followed by air transport which contributed a mere 6.78 per cent *(figure 39)*. The low level of performance in the sector, particularly in post and courier services is not unrelated with the spiked rise in prices in the sub-sector. Particularly, aviation sector operators discontinued cheap fares and cut capacity with a number of operators pulling out of the Nigerian market. Air transport was affected by the change in foreign exchange regime in the month of June from pegged to managed float coupled with crises in the oil and gas sector. Again, the review of the Petroleum Product Pricing and Regulatory Agency (PPPRA) pricing template for PMS which led to 60 percent rise in the official pump price from N86.50 per litre to N145 per litre increased cost of transportation. Economic activities declined in other critical areas of the transportation and storage sector as well. Transportation via pipelines was adversely affected due to reoccurring vandalization of oil pipelines and renewed militancy attacks on gas and petroleum pipeline installations in the oil rich Niger Delta region.

The outlook for the sector remains bleak, as foreign exchange challenges and the Niger Delta crisis persists in the country. The impact could worsen in the aviation sub-sector in which most of the operating costs and expenses are denominated in the foreign currency. Meanwhile there might be some quick wins in the road transport sector as the forces of competition slightly drives down the pump price of petroleum products across the country.

Going forward, considering the high level of investments required for the physical components of the sector, government needs to encourage increasing private sector activity in the sector by putting in place the necessary policies, particularly by giving concessions for the construction, operation and maintenance of critical transport infrastructure. Critically, the government should link loans to particular infrastructure projects across the country.

Figure 39: Sub-sectoral Contribution to Transport and Storage Sector Real GDP (%)



4.6 Manufacturing

Adverse macroeconomic policy environment continue to constrain manufacturing sector performance and productivity.

The role of a strong and resilient manufacturing sector in spurring economic growth, and increasing the value additions of factors of production, including labour, cannot be overstated. In Nigeria, even though the manufacturing sector has not been a key contributor to the economy, its performance has constantly declined, more so in recent years. The trend of negative real GDP in the manufacturing sector continued (apart from a short-lived positive growth of 0.38 per cent in 2015Q4). Real GDP growth rate in the sector while still negative, increased by 2.64 per cent from the -7 per cent experienced in 2016Q1 *(figure 40)*. Contribution of the sector to real GDP declined marginally by 0.08 per cent to stand at 9.44 per *cent (figure 41)*. As in the previous quarter, the size of the sector's contribution to real GDP, amidst persistent negative growth rate, reflect reductions in the contribution of other sectors of the economy.

Figure 40: Manufacturing Sector Real GDP Growth Rate (%)

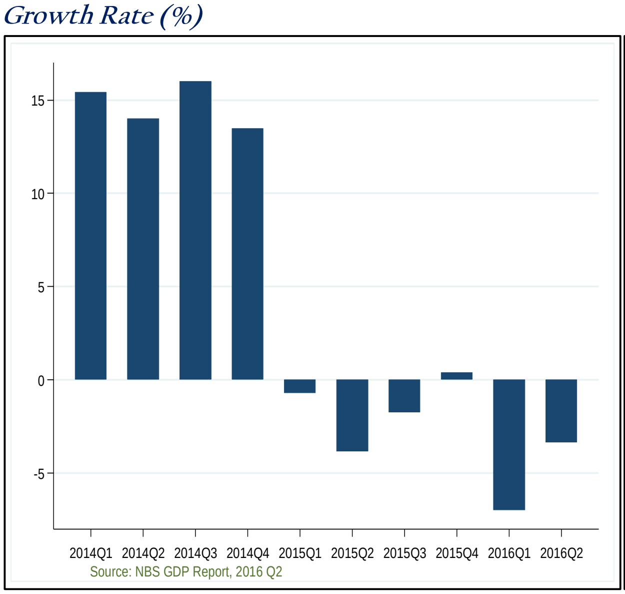


Figure 41: Manufacturing Sector Contribution to GDP (%)

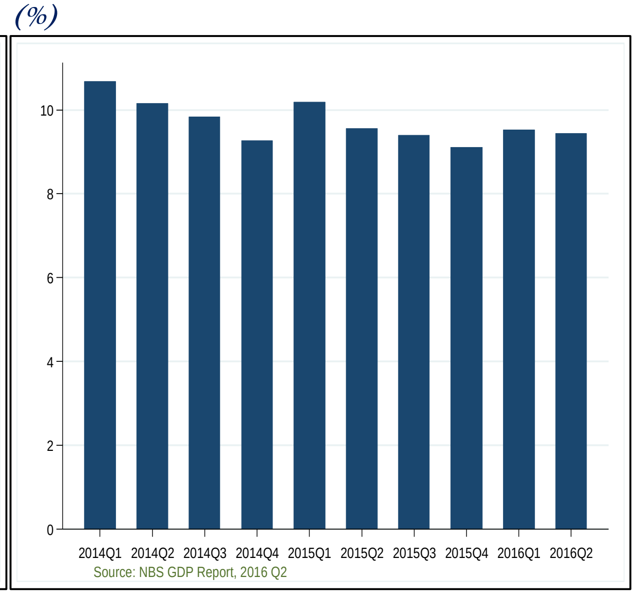
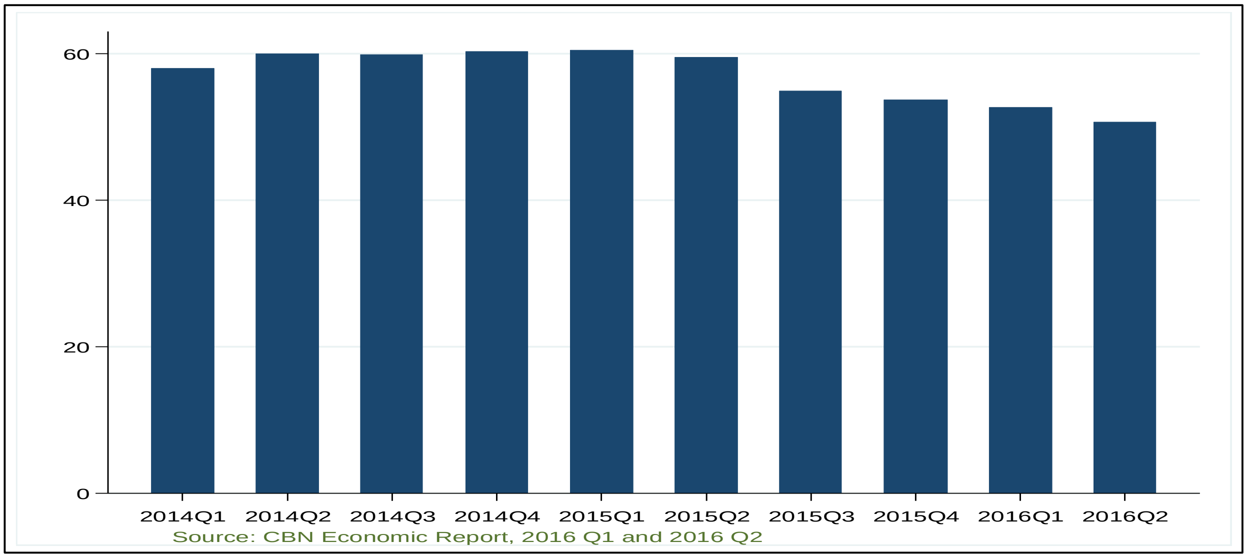


Figure 42: Manufacturing Sector Capacity Utilization (%)



Expectedly, manufacturing capacity utilization rate continued its downward trend in 2016Q2. Specifically, the sector's capacity utilization rate further declined from approximately 53 per cent in 2016Q1 to 51 per cent in 2016Q2 *(figure 42)*.

The contraction recorded in the manufacturing sector while not surprising, has been driven by several factors including persistent power outages, low investor confidence, scarcity of petroleum products, and unfavourable macroeconomic policy stance; especially in regards to capital and forex controls. Monetary policy controls regarding forex continued to undermine productive activities in the sector as it constrains access to foreign exchange with which to import required raw materials and machineries. This is added to Central Bank regulation restricting the allocation of forex for import of certain products – which serve as manufacturing raw material. Meanwhile, a downward review of the Monetary Policy Rate (MPR) by the Central Bank as well as a careful reconsideration of the 41 items which are not allowed access to forex to cater for the short-term manufacturing sector input needs, would go a long way to ease up the current constraints in the sector. Also, special consideration should be given to manufacturers under the current exchange rate regime, so as to enable them access foreign exchange for imports of much needed plant, machineries and raw materials.

The response of the Federal Government to the large-scale attacks on oil facilities in the Niger Delta in the next few months will determine the extent of activities in the oil production and refining subsector going forward. But then, irrespective of government's means of engagement in the Niger Delta (dialogue or military operation), the recent upsurge in attacks on upstream facilities in the petroleum sector is expected to delay new investment decisions and limit production activities, given higher risks and uncertainties.

4.7 Solid Minerals

Growth in the solid mineral sector further contracted in 2016 Q2 due to sustained decline in quarrying activities and limestone mining occasioned by weakened demand in the construction sector

Growth rate of the solid minerals sector had plummeted in the first quarter of 2016 from 5.73 percent in 2015Q4 to -73.63 per cent, representing a decline of over 1300 percent. In the second quarter however, the sector gained some momentum and recorded positive real GDP growth of 2.64 per cent *(figure 43)*. The contribution of the sector to GDP also increased from 0.04 per cent to 0.15 per cent *(figure 44)*. The slight improvement in the sector was majorly driven by increase in quarrying activities; for which gross domestic product increased by over 700 per cent between 2016 Q1 and Q2[22].

Figure 43: Solid Minerals Sector Real GDP Growth Rate (%)

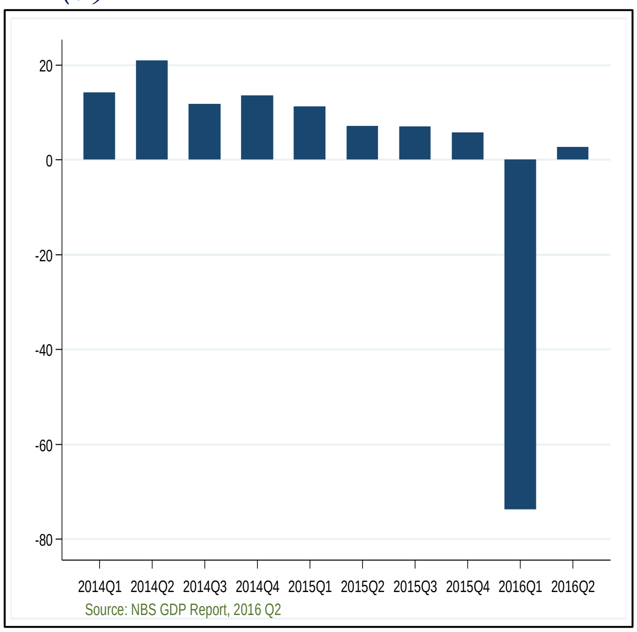
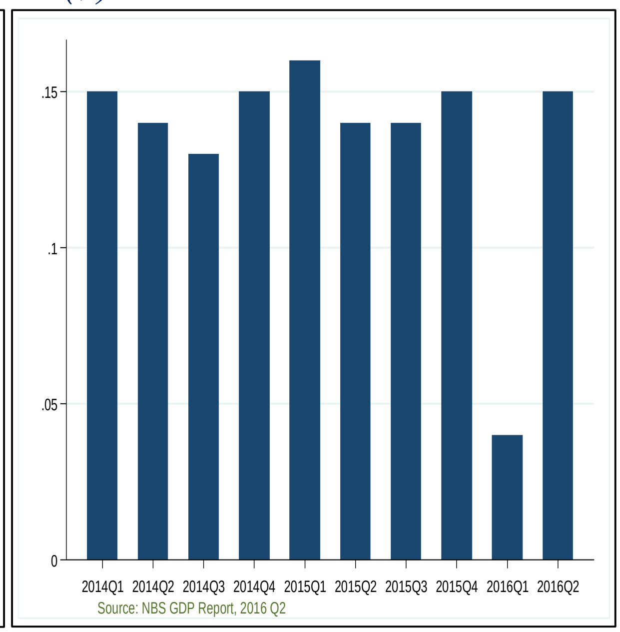


Figure 44: Solid Minerals Sector Contribution to Real GDP (%)



The low level of solid mineral sector growth performance can be linked to low performance in the construction and manufacturing sectors. Furthermore, the sector is characterized by a high percentage of informal sector activities (comprising of illegal miners and artisanal) and heavily constrained by deficiencies in infrastructure (particularly transport and power sector. This would explain its weak contribution to GDP.

While there may be no quick wins in the solid mineral sector considering the low level of engagement of the sector over the years, government needs to be more proactive in creating the necessary policy environment to signal some level of activity and to attract the required investments in the sector in the medium and long term.

[22] NBS, 2016

4.8 Oil and Gas

Growth in the oil and gas sector contracted further on the account of continued attacks on oil and gas infrastructures.

Fuel scarcity in the quarter had a particularly debilitating effect on economic activity. The growth rate of the oil and gas sector remained negative and dropped significantly to -17.48 per cent in 2016Q2 *(figure 45)*. Contribution of the oil and gas sector to real GDP decreased by 2.03 per cent from the 10.29 per cent in 2016Q1 to 8.26 per cent in Q2. On a year-on-year basis, the sector's growth in 2016Q2 was lower than the growth performance recorded in 2015Q2 *(figure 46)*.

Figure 45: Oil and Gas Sector Real GDP Growth Rate (%)

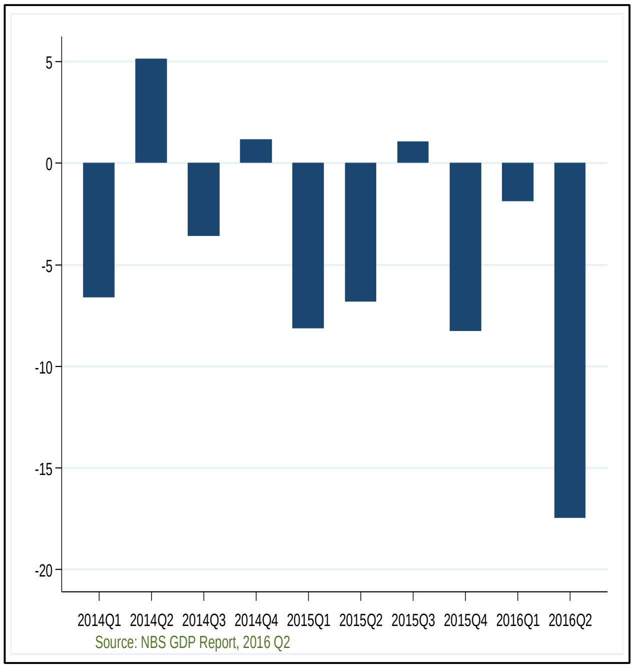
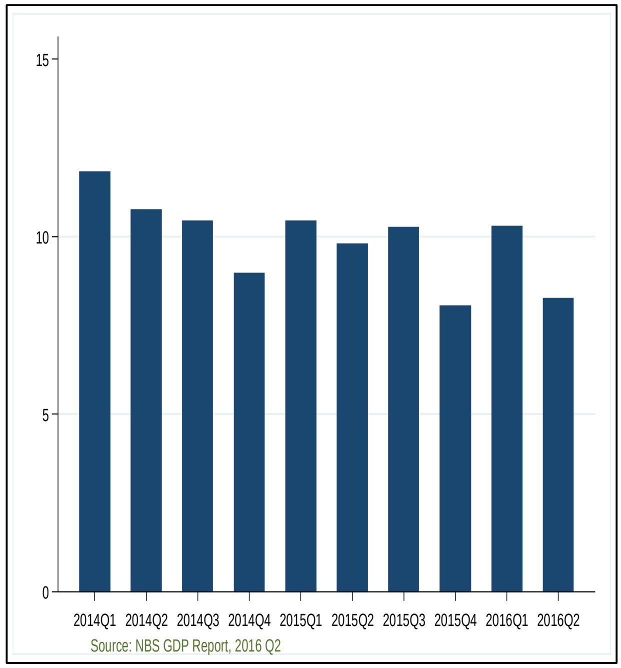


Figure 46: Oil and Gas Sector Contribution to Real GDP (%)



Data from CBN shows that Nigeria's reference crude oil – bonny light – appreciated significantly by 35 per cent, from US$34.39 in 2016 Q1 to US$46.44 in 2016Q2. However, oil production fell from 2.11 million barrels per day (mbpd) in 2016Q1 to as low as 1.69mbpd in 2016Q2[23]. Also, there was a decline of 20.4 per cent in Crude oil export which stood at 1.09 mbpd compared with 1.37 mbpd, recorded in the preceding 2016Q1.

To this extent, the oil sector contributed 8.26 per cent while the non-oil sector contributed the remaining 91.74 per cent to total GDP compared with 10.29 per cent and 89.71 per cent respectively in 2016Q1. Meanwhile, the poor performance of the oil sector, also had its impact on government oil revenue; which accounted for 46.3 per cent (N537.19 billion) of the total revenue; 6.3 per cent less than its 52.5 per cent contribution in preceding 2016Q1. Despite the decline in oil and gas revenue, it still remained the largest contributor to the pool of government revenue. Oil revenue declined by 19.36 per cent between 2016Q1 and Q2, while non-oil revenue increased by 3.22 per cent.

The crises performance in the sector has been mainly as a result of the resurgence of attacks on upstream oil and gas infrastructures in the Niger Delta region. On the other hand, the substantial increase in the

[23]NBS Nigerian Gross Domestic Report Quarter Two

price of crude oil was exogenously determined by the demand and supply dynamics in the international oil market. Since the price of crude oil is exogenously determined, the federal government needs to hasten efforts to engage with stakeholders in the Niger Delta to resolve ongoing crises and thereby see to increased crude oil production and exports.

Overall, key sectors of the Nigerian economy underperformed in 2016Q2 on the account of persistent macroeconomic challenges and weak consumer demand. The manufacturing, transport and storage, and financial services sectors were most severely hit by FOREX challenges and the depreciation of naira. There were however slight improvements in the Agriculture and solid minerals sectors. Particularly, the contributions of the Agricultural sector increased considerably, and it remained the second highest contributor to overall GDP growth, following the services industry as a whole. The contributions of the ICT, construction and solid minerals to GDP also increased but more so as a result of decreased performance in other sectors. Sectoral performance is expected to improve in medium term, given the federal government's commitment to infrastructural development as depicted in the capital expenditure for 2016 budget. Lastly, key sectors of the economy are likely to continue to underperform in the subsequent quarter of 2016.

In terms of outlook, further improvements can be expected in the Agriculture sector as the harvest season continues to set in. Not much is expected for the construction and ICT sectors owing largely to the slow implementation of the 2016 budget. The transport sector is likely not going to experience any significant improvements in the near term as the foreign exchange and Niger Delta crisis continue to bite hard on the economy. Meanwhile slight improvements can be expected in the financial sector as it continues to adjust to the shocks from the implementation of the TSA. There is also the expectation that most of the operators in the financial sector may begin to embark on cost-cut measures to drive improvements in the sector performance.

Going forward, there is the urgent need for government to speed up the process of implementing the 2016 budget. In face of the downturn in oil revenue accruing to government, there is also the need for more concerted efforts at plugging fiscal leakages while also exploring alternative income sources; particularly increased efficiency in tax administration. This will considerably revamp economic activities across all sectors. Government needs to fully step-up in its role of creating an enabling environment especially in the area of infrastructure development, to enable private sector players make the required investment decisions. More so, considering the high level of investments required across the various sectors of the economy, government needs to embrace and encourage increasing private investment by putting in place the necessary policies. In the transport sector particularly, concessions should be given for the construction, operation and maintenance of critical, much needed transport infrastructure. Also, government needs to be more deliberate in borrowing to finance infrastructure by tying its borrowings to particular infrastructure projects across the country.

Considering the centrality of the manufacturing sector to improving the economic fortunes of the country, special consideration should be given to manufacturers under the current exchange rate regime, so as to enable them access foreign exchange for imports of much needed plant, machineries and raw materials. Furthermore, while there may be no quick wins in the solid mineral sector considering the low level of engagement of the sector over the years, government needs to be more proactive in creating the necessary policy environment to signal some level of activity and to attract the required investments in the sector in the medium and long term. In addition, the Federal Government needs to speed up its response to the large-scale attacks on oil facilities in the Niger Delta. In the next few months this will determine the extent of activities in the oil production and refining subsector as well as will determine the amount of funds available for implementing the budget. But then, irrespective of government's means of engagement in the Niger Delta (dialogue or military operation), the recent upsurge in attacks on upstream facilities in the petroleum sector is expected to delay new investment decisions and limit production activities, given higher risks and uncertainties.

5. SPECIAL FEATURE ARTICLE

Stagflation in 2016: Policy dilemma for the policymakers?

The combination of rising inflation and a declining output of the recent experience, no doubt, presents a huge challenge especially to policymakers. The monetary authority has been tackling inflation challenge since the second half of 2015 with no clear indication of containing the problem. As the economy also plunges into a recession, the orientation now focuses on effecting policies that can jump-start growth. However, this may not be an easy decision given the challenge in selecting policy instruments that could lead to simultaneous achievement of price stability and economic growth through demand-management measures. Tackling recession by stimulating aggregate demand via expansionary monetary and fiscal policy is at a cost of further rise in price level. Also, containing inflation through contractionary measures will lead to more economic stagnation. The present challenges obviously present a policy dilemma to policymakers. Can policy direction be focused on addressing recession at the expense of inflation or vice versa? Is demand-management approach an effective response to the current challenges? Are there alternative policy options more pragmatic to address the challenges?

Episodes of stagflation were first recorded in the 1970s in developed economies such as USA, Britain, and France following the negative global oil supply shocks which brought about a four-fold increase in oil prices. This led to higher costs of production in these developed economies and consequently brought about a sharp increase in the price of manufactured goods. The period also witnessed negative growths associated with higher unemployment. The event was at odds with the widely held Phillips-curve evidence that shows an inverse relationship between inflation and unemployment. Prior to the 1970s, most macroeconomists agreed on the trade-off between inflation and unemployment and that shocks to the economy are better managed through demand-management measures. Even Keynes prescriptions to the 1930s great depression were largely hinged on Phillips-curve relation. However, with the event of the 1970s which saw the break-down of Phillips-relation and the inappropriateness of the demand-management measures in tackling the challenges, economists began a new investigation and found the cause to be a supply shock rather than a demand problem. The central argument was that stagflation can be better managed through shifting aggregate supply by tackling challenges to production, work incentives, as well as savings and investment decisions. Supply-side economists focus on determinants of long-run growth rather than causes of cyclical fluctuations in output.

In Nigeria, the present challenge is seen largely as a demand-side problem that could be addressed by demand-management measures. This could be partially true given that the 2014 global oil glut which caused a crash in crude oil prices directly affects components of aggregate demand in terms of causing large shrinkage in government revenue which ultimately led to fiscal crisis. Low export earnings fall short of import spending and consequently lead to trade deficits and balance of payments problem. This put a downward pressure on external reserves and has resulted in the current low international value of the Naira. Given the country's high dependence on importation, continuous depreciation of the Naira led to a rise in the cost of import items which has further resulted to higher cost of intermediate and final goods and consequently put upward pressure on domestic prices. Government reforms in the energy sector which leads to higher gasoline and electricity prices combined with higher importation costs also contribute to an upscale in the costs of production. This coupled with deficient demand (a result of low aggregate income) causes large scale downturn in operation by firms with its attendant higher unemployment; and the economy gradually slumps into recession with sharp and continuous rise in price level.

Given the present reality, the economy could benefit from restrictive monetary policy stance. In fact, this represents the best response from the monetary authority to address the ongoing inflationary and foreign exchange pressure. The CBN can raise monetary policy rate (MPR) and maintain full flexibility in the foreign exchange market to enhance investors' confidence. However, in arriving at the appropriate MPR, consideration should be given to the status of inflation vis-à-vis the current nominal interest rate. At present[24], inflation is far above the MPR (given a record of 16.5% on the former as against 12% by the latter) - pointing to a negative real return on especially short-term government securities. To record success in this strategy, there is need to make government investment more attractive especially to the foreign investors in addition to a guarantee of market mechanism that enhances free capital mobility in the economy.

While monetary instruments tackle inflation challenge and foreign exchange pressure, fiscal tools should be directed to activate growth. In this regard, expansionary fiscal stance should be combined with structural reforms that enhance domestic production. Huge spending required to stimulate the economy should be directed towards critical infrastructures such as power, roads, and housing. Massive investment in infrastructure is critical to the success of robust and effective economic diversification agenda. This should be complemented by reforms in the labour market and capital market. Reforms that promote work effort by ensuring remuneration is tied to productivity should be encouraged especially in the public sector. In addition, savings should be mobilized to enhance job creation in the economy. These combined with good governance and efficient functioning of the market system constitute the remedies towards economic self-reliance in the medium term.

However, record of a meaningful success towards tackling the ongoing recession hinges on how the government addresses its fiscal challenges. On one hand, there is a huge shortfall in revenue mobilization at the current period. This critically constrains the ability of the government to activate growth through huge spending. Revenue from both oil and non-oil source is still low albeit marginal improvement from the non-oil sector. Despite a gradual rebound in the oil price in the international market[25], the country is yet to benefit from the opportunity due to disruption of oil production in major oil producing areas in the Niger Delta. Revenue shortfalls from the oil sector largely constrain the implementation of the 2016 budget. Alternative option to satisfy some of the items in the budget at the moment is for government to borrow. This however, comes with an added challenge. Indicators of economic performance are presently not favourable and this might impinge on the country's loan negotiation and bargaining power. The likelihood of getting required loan at desired concessional rates is low. Therefore, in the absence of improvement in oil revenue performance in the near term, an outlook for a quick economic recovery is bleak. On the other hand, adherence to fiscal rule and efficient utilization of public funds is still low especially at the sub-national level of governance. The implementation of the Treasury Single Accounts (TSA) by the Federal Government promotes efficiency in the administration of public funds. This however, is yet to enjoy full adoption by all the sub-national governments.

[24] i.e. June 2016
[25] As at May 2016, oil prices averages $50 per barrel in the global market

As part of remedies to the ongoing fiscal crisis and a way to enhance budget implementation, there is need to reiterate that improvement in oil revenue presents the pragmatic financing strategy in the interim. Alternative budget financing such as loan or tax increase has economic costs with lots of distortion. Therefore, government should leverage on the recent improvement in oil price by putting necessary measures in place to resolve crisis to oil production in the Niger Delta oil producing region in Nigeria. While recognizing there is no quick fix to the present challenge, efforts should be geared towards instituting effective fiscal rule and ensuring strict adherence to fiscal responsibility measures especially at the sub-national level of governance. The Fiscal Sustainability Plan[26] (FSP) agreed on by the federal and state government needs be given full implementation. The plan articulates action and implementation plan in order to improve public revenue and expenditure efficiency and effectiveness at all tiers of governance.

In summary, an appropriate response to the current economic quagmire requires a policy mix that combines expansionary fiscal stance with monetary tightening. Fiscal easing that targets growth in the real sectors is sine qua non to quick economic recovery and output growth in the medium term. Also, monetary restraint would serve a twin purpose of checking inflation and easing foreign exchange pressure. Given the plausibility of the policy option in addressing the current situation, however, it should be accompanied with other appropriate initiative(s). For example, government can grant special (tax) concessions or allowance to business ventures that utilize local raw materials as major source of inputs. This, among other policy reforms that remove bottlenecks to domestic production would in no small measure safeguard the economy from the current challenges.

[26] http://newsdiaryonline.com/wp-content/uploads/2016/05/Fiscal-Sustainability-Plan-FINAL-1.pdf

6. OUTLOOK AND RECOMMENDATIONS

For the global economy, growth may continue to underperform in the next quarter given, as many oil dependent economies have embarked on austerity measures with negative implications for trade, investment, consumption demand and output for both oil-exporting and oil-importing countries. However, oil prices may increase in the fourth quarter of the year if the objective of the proposed meeting of oil producers is achieved.

For Nigeria, the domestic economy is expected to continue to underperform throughout the rest of the year as major issues, such as crude oil production shortages and FOREX difficulties, are yet to be addressed effectively. On a sectoral basis, further growth is expected in the Agriculture sector in subsequent quarters of the year due to investments in the sector. Slight improvements can be expected in the financial sector as it continues to adjust to the shocks from the implementation of the TSA. However, the prospects of the Transport, Construction and ICT sectors appear bleak owing largely to the slow implementation of the 2016 budget, foreign exchange difficulties, and Niger Delta crisis.

In reversing the downward trajectory of the economy, a greater onus is on fiscal authorities as the underlying challenges are largely outside the purview of monetary policies. Nevertheless, policy harmonization between the fiscal and monetary policies is critical to improving macroeconomic indicators. Notably, the Nigerian government is taking steps to diversify the nation's revenue base towards agriculture which will potentially improve foreign exchange earnings and ameliorate the nation's economic woes. However, the macro-economic impacts of the investments in the agriculture sector would not surface in the short term. Thus, in the meantime, the government should intensify efforts aimed at addressing the Niger Delta situation in order to improve oil production level. It is also recommended that the fiscal authorities should intensify efforts at mobilizing domestic revenue sources by encouraging voluntary tax compliance amongst citizens. This can be achieved by fostering coordination amongst key revenue-collecting agencies to improve data collection, while tying taxes collection with particular project to enable taxpayer see greater value for their money. In addition, the monetary authorities and government should take steps to address the regulatory constraints to forex liquidity with utmost priority in order to improve access to input materials at lower price by domestic businesses. The monetary authorities could engage Nigerians in diaspora to contribute to forex liquidity with an incentive premium, engage experts around the world to discuss Nigeria's foreign exchange crisis and proffer credible solutions, as well as provide incentives to attract foreign and domestic investors. The monetary authorities also need to improve its monitoring mechanisms to minimize currency hoarding that constrains forex liquidity.

Given the current economic downturn which is likely to continue throughout the year, unemployment rates will likely continue to rise throughout the rest of the year. Although there is job creation in the agriculture and education sectors, other real sectors of the economy are witnessing contraction in job creation on the account of unfavourable business climate. There is a need for massive stimulus directed towards infrastructure projects and social intervention policies, in order to support business growth and increase consumption demands. Both monetary and fiscal authorities should follow through with policies that channel consumption to locally-produced goods to improve domestic consumption. In addition, enactment of policies must be clear, credible, consistent and sustainable in order to boost investor confidence and ensue an injection of private capital. Furthermore, empowering the economically marginalized – representing a major sub-set of the Nigerian population– will also be critical to increasing consumer demand and job creation. More so, new skill acquisition and self-employment remain critical for many youths to participate in the labour force in the remaining part of the year.

Furthermore, given that the structural factors that have led to high energy costs as well as forex liquidity constraints that led to the depreciation of the naira are unlikely to be addressed in the near term, inflation may continue its uptick in subsequent quarters of the year. However, in the absence of further shocks, the pace of inflation is likely to slowdown in subsequent months.

The prospects for oil and non-oil revenues are weak in the short term given the incessant shortfall in crude oil production and weak business performance; thus the federal government is likely to continue to record deficit spending in subsequent quarters. However, there is a need to alter the present state of deficit spending towards capital expenditure, as it does not support Nigeria's growth in the medium term. Critically, fiscal authorities have a greater role to play, as drivers of the present economic downturn are skewed to structural factors largely outside the scope of monetary policy. At this time, investment priority should be given to quick wins such as the reconstruction of dilapidated roads before new projects are commissioned. Given low government revenue, the Nigerian government should work with tax authorities to expand the tax base; by designing and enforcing policies that allow for better coordination amongst non-oil revenue-collecting agencies. In addition, given that Nigeria's trade position is still largely dictated by crude oil and natural gas export, and import of refined petroleum products, concerted efforts towards revamping refineries should be made.

7. CONCLUDING REMARKS

This report presents an overview of the Nigerian economy by examining key macroeconomic indicators, external sector performance and key domestic sector performance in 2016Q2. The evidence presented shows that the internal and external sector performance of the Nigerian economy have been highly unimpressive in 2016Q2 as the stagnated economy slipped into a recession– the first in over two decades. In 2016Q2, GDP growth rate fell to -2.06 percent while inflation, unemployment and underemployment rose consistently. Trade deficit increased, foreign investment declined, foreign exchange earnings remained suppressed, and the value of the naira depreciated significantly. All key sectors of the economy underperformed considerably with the exception of the agriculture sector

While overall domestic performance is alarming, the outlook remained fairly positive as present challenges are surmountable. Nigeria still has the large population, natural resources, trained manpower and demographic dividend to allow the economy do well. More than ever before, the coordination and harmonization of fiscal and monetary policies is crucial. However, a greater onus lies with fiscal authorities to provide the necessary stimulus on infrastructures and tackle persisting structural challenges. At the same time, the CBN should continue to adopt contractionary policies alongside a clear, consistent and strictly implemented foreign exchange management policies.

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