NIGERIA ECONOMIC REVIEW

First Half Report 2014

Centre for the Study of the Economies of Africa

No. 4 Dep Street,
off Danube Street
Maitama District
Abuja
Nigeria
Telephone: +234 (0) 9 8709070
Email: enquiries@cseaafrica.org
Website: www.cseaafrica.org

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Abbreviation and Acronyms

CBN	-	Central Bank of Nigeria
CRR	-	Currency Reserve Ratio
FX	-	Foreign Exchange
GDP	-	Gross Domestic Product
IMF	-	International Monetary Fund
Mb/d	-	Million Barrels per Day
MPC	-	Monetary Policy Committee
MPR	-	Monetary Policy Rate
OPEC	-	Organization of Petroleum Exporting Countries
NBS	-	National Bureau of Statistics
ORBP	-	OPEC Reference Basket Price
PIB	-	Petroleum Industry Bill
SSA	-	Sub-Saharan Africa

1. Summary

- Globally, advanced economies showed strong signs of recovery during 2014H1 despite the adverse effect of the severe winter (especially on the United States' economy) while economic activities slowed and growth was below projection in emerging and developing economies.
- Total federally collected revenue increased to N2.42 trillion in 2014Q1 compared to N2.20 trillion in 2013Q4 as a result of a significant increase in crude oil and gas exports to some countries like India, Malaysia and China. Also, the federal government consistently incurred fiscal deficit from 2013Q1 to 2014Q1; the level of deficit increased drastically in 2013Q4 and was sustained through 2014Q1.
- Inflation rate remained within the Central Bank's target (6 – 9 percent) for 2014 although it ticked up marginally from 7.7 percent in February to 8.0 percent in May. Inflationary pressures are expected in the second half of the year but it is expected that monetary policies and supply-side interventions can be used to cushion the effect.
- Monetary Policy Rate (MPR) was maintained at 12 percent (since October 2011), commercial banks' average prime and non-prime lending rates were high at 16.75 and 25.71 percent respectively while real interest rate trended downwards in 2014H1.
- Rising demand for the dollar brought immense pressure on the naira, leading to substantial depreciation beginning February. This trend was later reversed due to foreign exchange interventions by the monetary authority and subsequent capital inflows in the second quarter.
- External reserves declined substantially from about $42 billion in March to about $36 billion in May due mainly to attempts to stabilize the naira. The rate of decline however leveled-off towards mid-year as the reserve increased gradually in June.
- Nigerian Capital Market performance waned in 2014H1 as market capitalization declined from N13.23 trillion at the beginning of January to N12.07 trillion at the end of April.

- During 2014 H1, the following were observed in the energy sector;
    - Global crude oil prices and output increased.
    - OPEC Reference Basket Price (ORBP) increased while production remained within its monthly nominal ceiling.
    - Nigeria's quarterly crude oil production declined but oil revenue increased.
- Some key domestic sectoral events in the period are;
    - Significant increase in agricultural sector's share of deposit money banks' credit.
    - Reduction in food imports
    - Increase in manufacturing sector contribution to GDP and credit to the sector although industrial production index and capacity utilization have not increased significantly.
    - Launch of Nigeria Industrial Revolution Plan aimed at increasing the contribution of manufacturing to 10 percent over the next five years.
- In terms of outlook for second half of 2014, the economy is likely to sustain its growth momentum and maintain sound macroeconomic fundamentals. However, expected inflationary and foreign exchange pressures will require actions by the monetary authorities to cushion the effects.

2. Global Economic Performance

The International Monetary Fund (IMF) projected that global output growth will be 3.7 percent in 2014, with growth in the advanced economies which is projected at 2.2 percent, expected to be driven by domestic demand. It is expected that growth in emerging and developing economies, estimated at 5.1 percent, will be driven by external demand and foreign investment.[i] So far, actual performances in 2014H1 do not fully bear out these expectations.

Advanced economies showed good signs of recovery during 2014H1 despite the adverse effect of the severe winter (especially on the United States' economy). Business and consumer confidence surveys reveal that business confidence and private spending increased in US, the Euro Area and Japan. For developing and emerging economies, however, economic activities slowed and growth was below projection. According to the IMF, industrial production grew at only 3.7 percent, far below the average of 7.6 percent achieved over (2000-2013).[1] A number of factors account for the performance of developing countries. The El Nino phenomenon affected growth in Latin America and the Caribbean.[2] In Eastern Europe, falling commodity prices and weakening economic activities in Russia (due to sanctions imposed by both the EU and US) have taken their tolls on the economies. Some recoveries were witnessed in 2014H1 in the Middle East and Northern Africa but a wave of pessimism is being driven by the recent crisis in Iraq and political tensions in countries like Egypt. Countries in East Asia and Pacific have maintained their impressive growth even though their outlook depends on China and its tightening monetary policy.

The World Bank projects economic growth of 4.7 percent in the Sub-Saharan African region on account of a generally positive investment outlook. Evidence shows that there has been some expansion of infrastructural investment and agricultural

[1] This performance reflects events in China where capital accumulation has been reined in as part of attempt to correct past misallocation of credit.
[2] The El Nino Phenomenon refers to the adverse effect of warm ocean currents (which cause surface atmospheric pressure anomalies and anomalies of land and sea surface temperatures) on weather and agricultural outputs in many parts of the world.

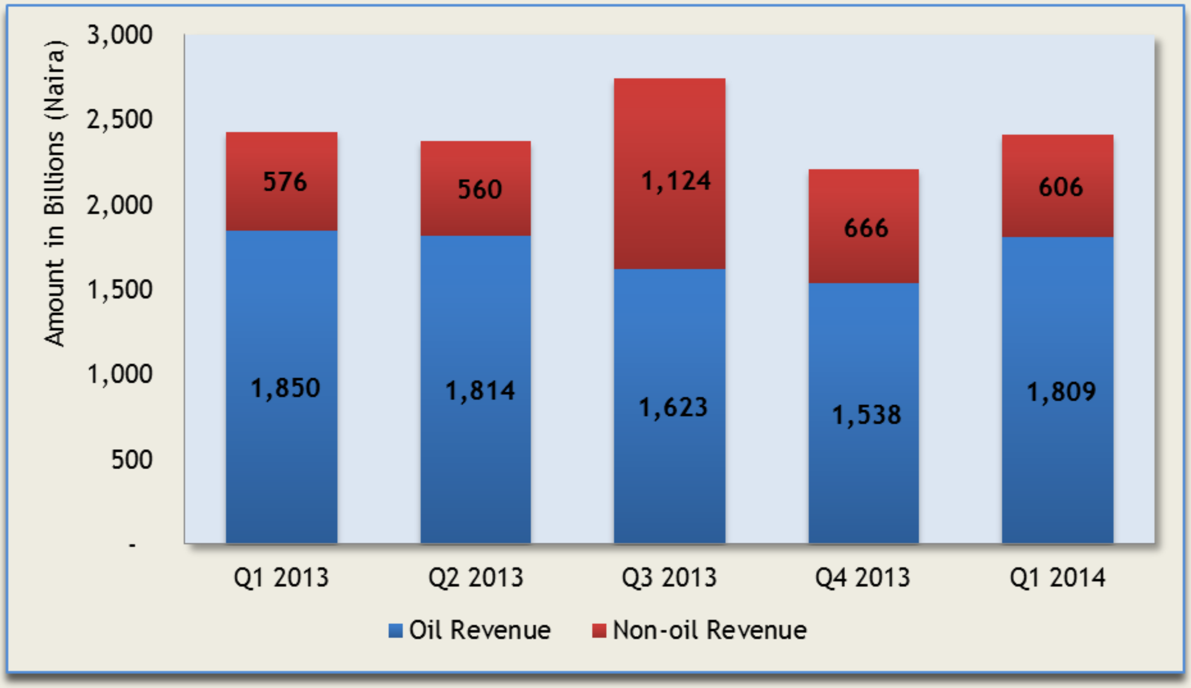
production.[ii] However, there is evidence that both SSA's export performance and capital flows suffered some setbacks as a result of weak global commodity prices and liquidity tightening in 2014H1. Incessant labour strikes led to subdued economic growth in South Africa.

3. Macroeconomic Performance

3.1 More revenue, more deficits.

Recent improvements in revenue generation, especially oil revenue, may be reflective of Nigeria's recovery after shale oil production led to sharp decline in US crude oil imports beginning early 2012. Latest data from the Central Bank of Nigeria (CBN) shows that total federally collected revenue of N2.42 trillion in 2014Q1, of which oil revenue accounted for 75 percent (see Fig 1). On a quarter-to-quarter basis, total revenue increased by 9.6 percent over 2013Q4 as a result of a surge in crude oil and gas exports. As Figure 2 shows, the increase in total federally collected revenue persisted even after the first quarter although there was a decline in oil revenue in April.[iii]

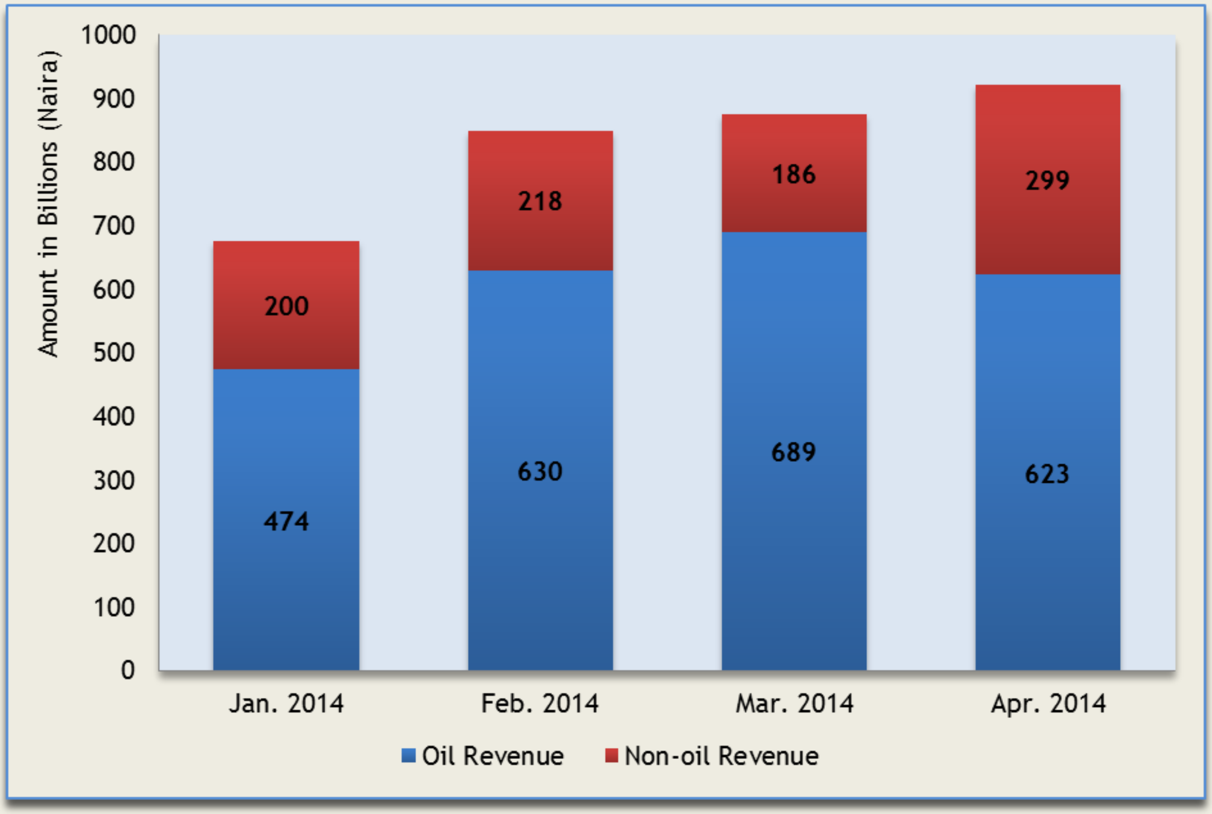
Figure 1: Total Federally Collected Revenue (Q1:2013 to Q1:2014)



Source: CBN 2014Q1 Economic Report

Notably, this period coincided with the improvement in Nigeria's intensive margin of crude oil exports (that is, demand increased from existing buyers). India replaced the United States as the largest importer of Nigeria's crude oil while the share of other Asian countries like China and Malaysia also increased significantly.

Figure 2: Total Federally Collected Revenue (January to April 2014)



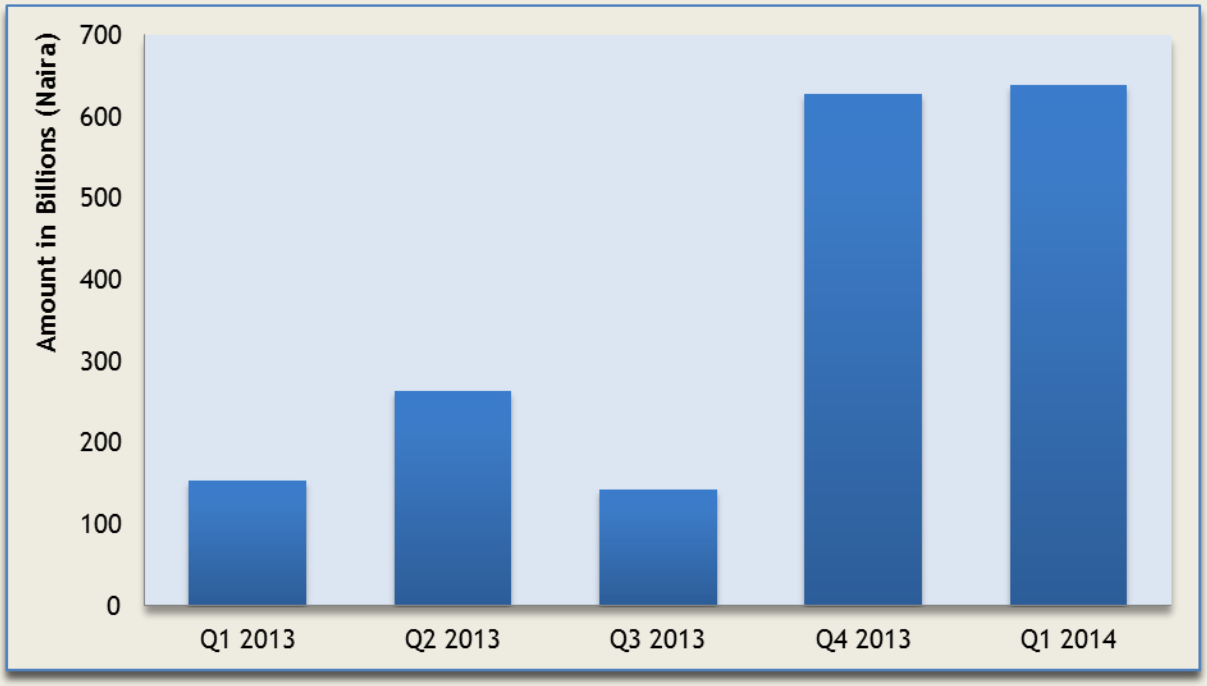
Source: CBN Monthly Economic Report, 2014

It is expected that in the second half performance will improve if policymakers step up efforts in the following directions.

- Government should keep check on the activities of pipeline vandals especially in order to achieve the benchmark revenue.
- Lawmakers should accelerate passage of the Petroleum Industry Bill (PIB) to reduce uncertainties and increase productivity in the oil and gas sector.
- Non-oil revenue-generation agencies (Federal Inland Revenue Service and Nigerian Customs Service) should sustain efforts made toward improving revenue generation from taxes and duties.

On the expenditure side, lack of data at sub-national levels limits analysis to the federal level. As depicted in Figure 3, the federal government has consistently incurred fiscal deficit since 2013Q1; the level of deficit increased drastically in 2013Q4 and was sustained throughout 2014Q1. In the first quarter of 2014, estimated actual expenditure of N1.46 trillion exceeded retained revenue of N823.9 billion, yielding a deficit of N638.4 billion. Further breakdown shows that the increase in deficit between 2013Q3 and 2013Q4 was driven by reduction in retained revenue and increase in recurrent expenditure. The level of deficit persisted in 2014Q1 because retained revenue was yet to recover to its 2013Q3 level.

Figure 3: Federal Government Quarterly Fiscal Deficits



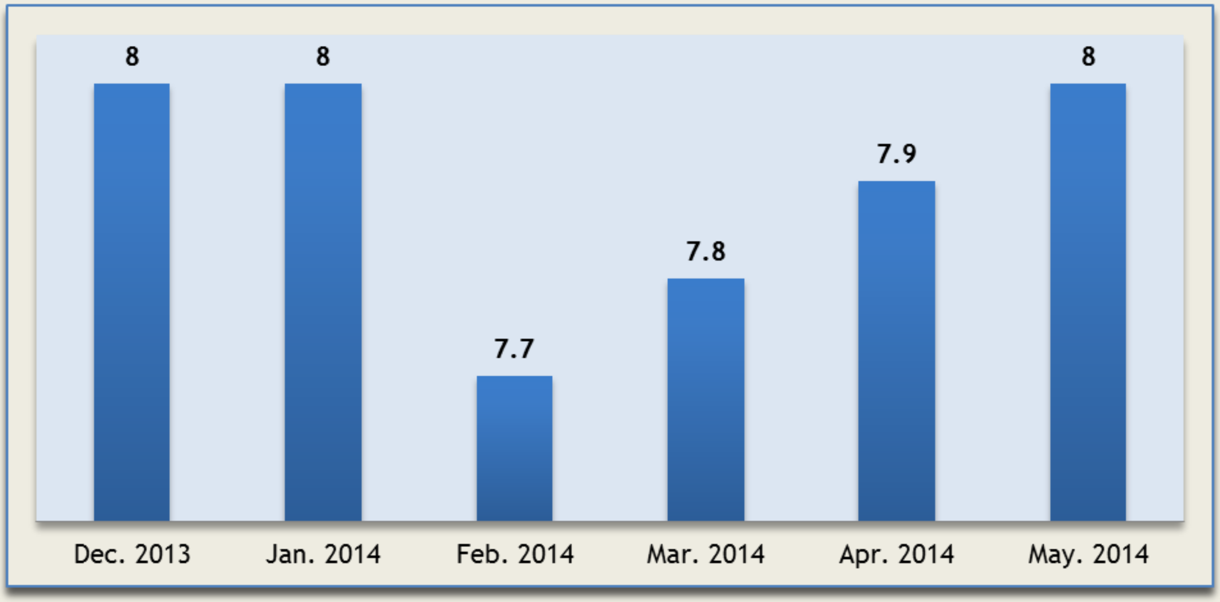
Source: CBN 2014Q1 Economic Report

3.2 Will low inflation persist?

The monetary policy committee of the Central Bank has successfully maintained stable and single digit inflation rate since January 2013. During 2014H1, the Bank consolidated its previous contractionary monetary stance. The Monetary Policy Rate (MPR) was left unchanged at 12 percent and public and private currency reserve requirements of commercial banks were raised to 75 percent and 15 percent in

January and March, respectively. Consequently, headline inflation rate has remained within the 6 – 9 percent band, which is the Bank's target for 2014.

Figure 4: Trend in Headline Inflation Rate (in percentages)



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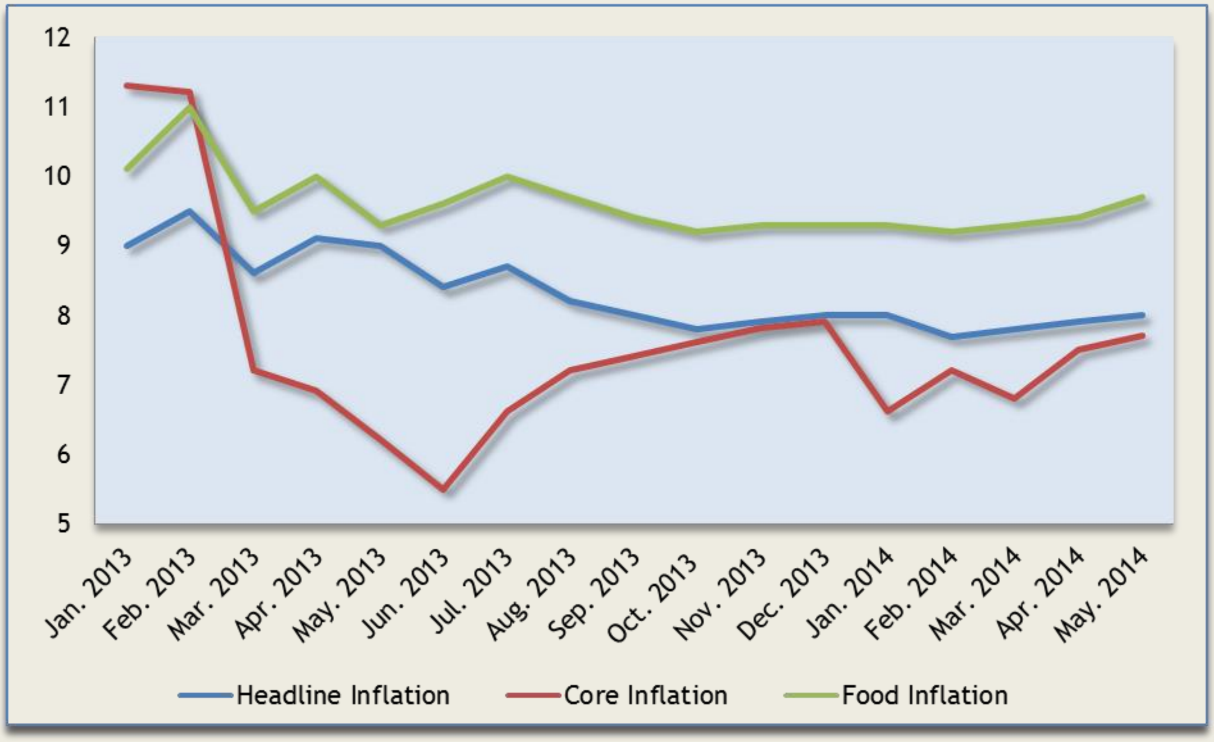
ource: NBS Consumer Price Index Report, May 2014.

Figure 5: Monthly Headline Inflation and its Sub-components



Source: NBS Consumer Price Index Report, May 2014.

However, Figure 4 shows marginal uptick in the headline inflation from 7.7 percent in February to 8.0 percent in May; reversions to the January level when high prices were presumably driven by seasonal factors. The recent marginal increase in headline inflation is driven by increase in the food sub-index. As shown in Figure 5, the food sub-index exerts greater influence on the headline inflation.

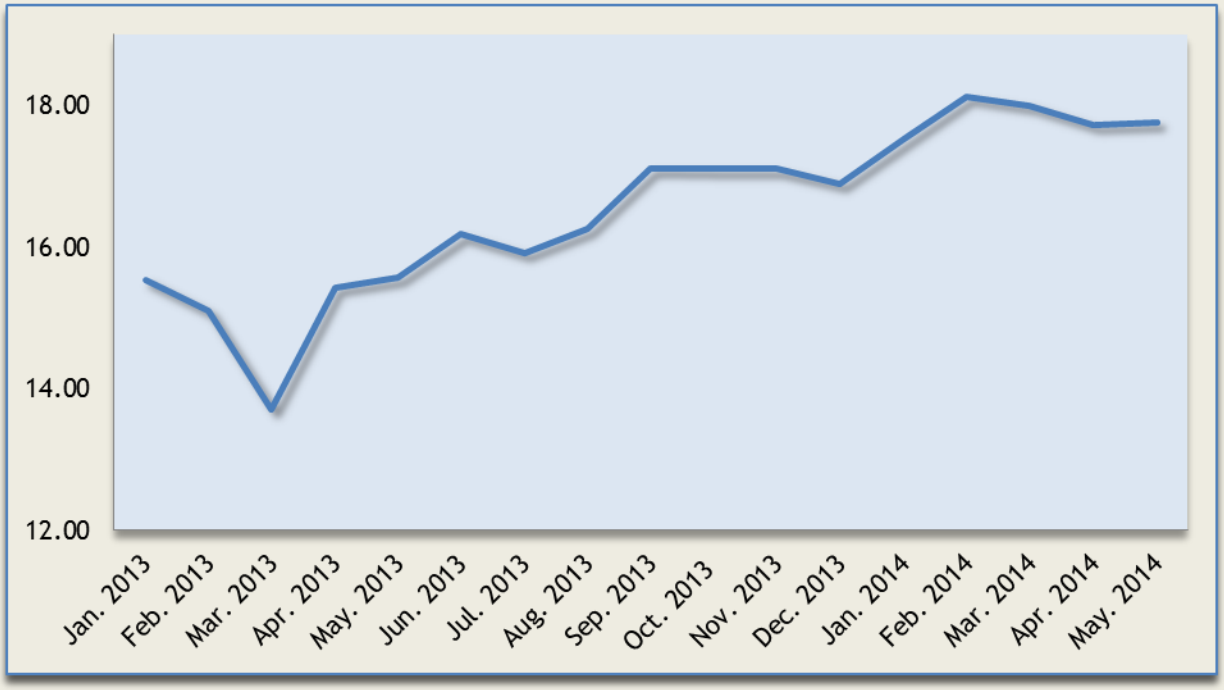
There are justifiable fears that single digit inflation may not persist into the second half of the year. Pre-election spending will pick up in preparation for general elections scheduled for February 2015. The pressure on general price levels might be worsened by the recent passage (in May) of the 2014 budget. The Central Bank Monetary Policy Committee acknowledged these challenges in its last meeting and committed itself to careful monitoring of the fiscal position of the economy to guide subsequent decisions. However, given the present high levels of MPR and CRRs, policy options for dealing with inflationary pressures are limited. More severe contractionary options aimed at inflation targeting might stifle the economy.

In addition to monetary policy instruments, supply-side interventions might help cushion the expected inflationary pressure. Given the strong correlation between headline inflation and the food sub-index in Figure 5, efforts to sustain recent growth of agricultural production coupled with the bumper harvest expected in the second half of the year will be critical to the achieving price stability.

3.3 Interest rate and Investment tradeoff?

Interest rates are anchored on the Monetary Policy Rate (MPR) which is set by the Central Bank’s Monetary Policy Committee (MPC) during its bi-monthly meetings. In 2014H1, the Committee maintained the MPR at 12 percent (in effect since October 2011). Commercial banks’ average prime and non-prime lending rates were high at 16.75 and 25.71 percent, respectively. Real interest rate (non-prime lending rate adjusted for expected inflation) which had been increasing since March 2013 (13.7 percent) peaked at 18.1 percent in February 2014 and seems to be trending downward afterward.

Figure 6: Real Interest Rate in Nigeria



Source: Authors' computation from CBN Statistical Database 2014 and NBS Consumer Price Index Report, May 2014.

While there is consensus that the policy of stabilizing the MPR over a long term, among others, has helped to reduce excess liquidity and maintain price stability in the economy, the private sector has expressed worries about the consequences of high lending rates on domestic investment. The continuous increase in real interest rate since March 2013 reinforces these worries (see Figure 6). Given stable MPR and banks' prime lending rates, the rising interest rate is perhaps attributable to regulations (increases in CRRs and liquidity ratios, erosion of commissions and charges) that erode the rent component of banks' profit margins, which induces the banks to raise the interest component.

Unfolding events provide good reasons to expect that the MPR will not be revised downward in the next half of the year.

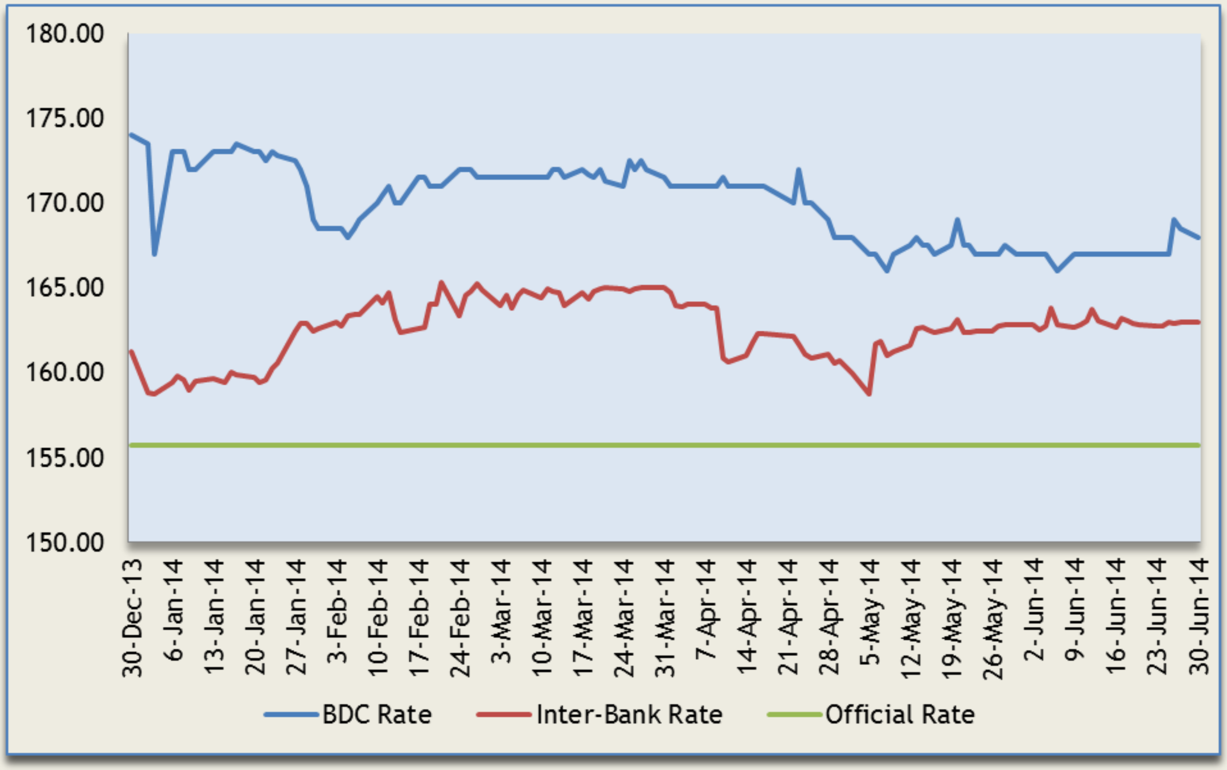
- There are fears that the naira will depreciate against the US dollars (as witnessed earlier in the year between February and April) due to US tapering of its asset purchase program. The unwillingness of CBN to devalue the naira in response limits the policy choice to raising the MPR. Higher interest rates induced by such action can assist in reducing the pressure by attracting portfolio inflows.

- Inflationary pressures associated with pre-election spending will likely spur calls for CBN to raise the MPR.

3.4 Exchange Rate

Rising demand for the dollar associated with reversal of capital flows to advanced economies (US tapering its asset purchases contributed to a large extent) brought immense pressure on the naira, leading to substantial depreciation beginning from February (see Figure 7). While the official FX rate remained stable at around $155.73 ± 0.2, inter-bank and BDC rates depreciated and fluctuated from early February to late April. This trend was later reversed by the monetary authority through the use of Nigeria's FX reserve to stabilize the exchange rate. These efforts were complemented by subsequent capital inflows (and inflow of FX) in the second quarter. By late April, the exchange rate began to appreciate and has since remained stable at around $167.

Figure 7: Naira Dollar Exchange Rate in Nigeria

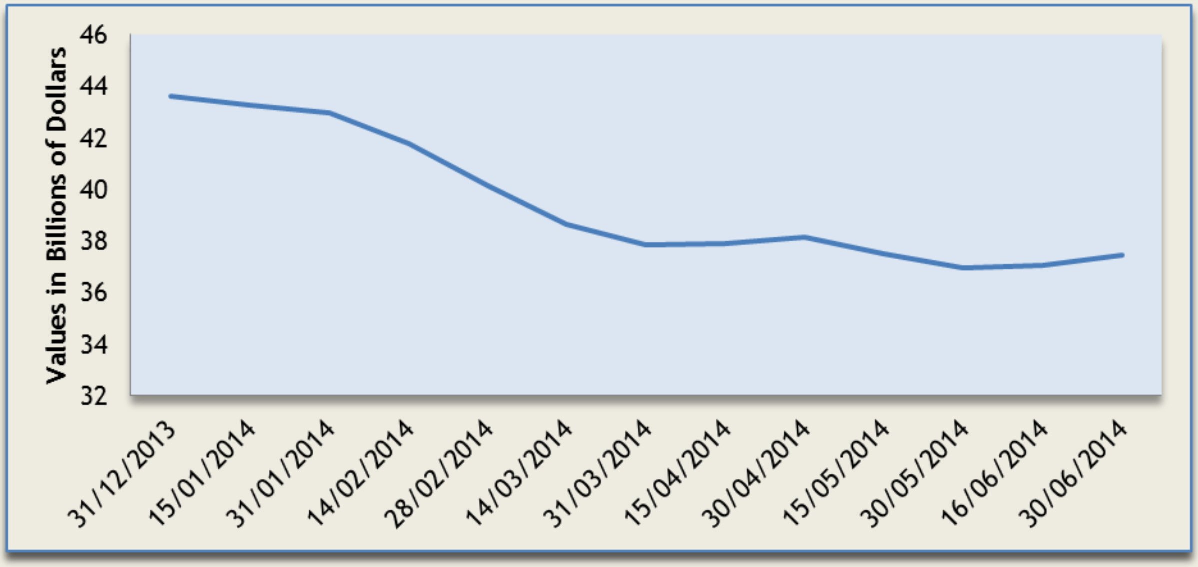


Source: CBN Statistical Database, 2014

3.5 External Reserves

The steady decline of external reserves witnessed at the start of the year had leveled-off towards mid-year. The rate of decline dropped substantially from 13 percent in the first quarter to 0.9 percent in the second quarter. At the current level of US$37.48 billion in June, the reserves can provide 9 months of import cover.

Figure 8: External Reserves, 2014



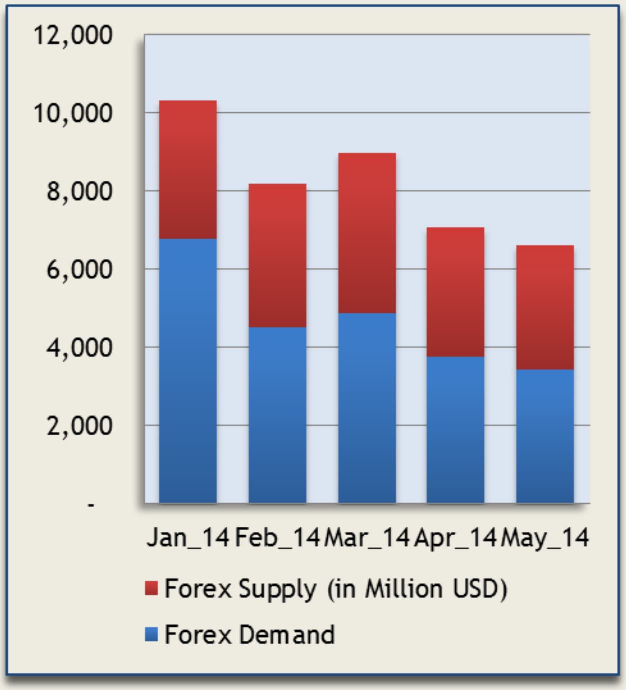
Source: CBN Statistical Database, 2014

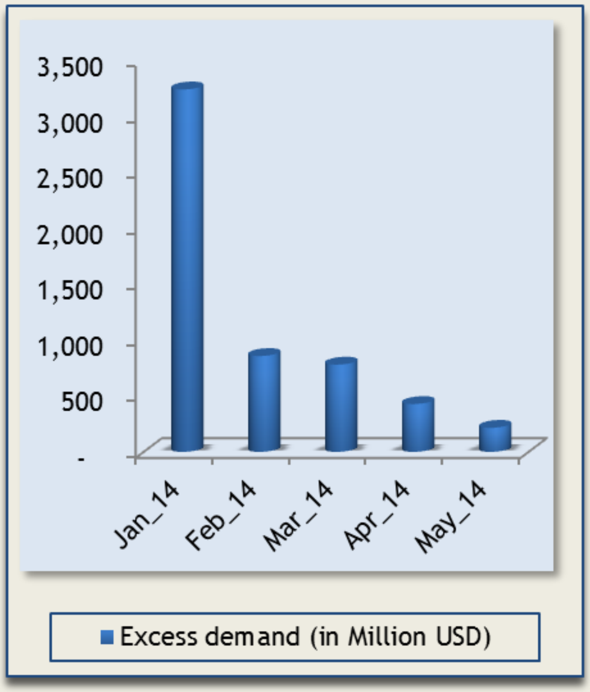
The overall downward trend displayed in Figure 8 is attributable to the increasing role that foreign reserve plays in stabilizing the Naira. Thus, the recent ease in its decline can be attributed to decreasing demand for FX in relation to supply observed from the start of the year.

Excess demand for FX reached a high of US$3.2 billion in January and fell sharply to US$900 million in February (see Figure 9) and gradually to a low of US$200 million in May. The fall in excess demand for FX can be linked to reversal of huge portfolio divestments which occurred towards the end of 2013 and the start of 2014 to a significant rise in short-term investments from March of this year (see Figure 10).[3]

[3] The slight increase in crude oil prices in the second quarter may not have contributed to the ease in depletion of reserves as it was accompanied by a considerable drop in production (see Figure A1). Other factors that can explain the changes in the external reserves such as changes in balance of trade and changes in FX utilization across sectors have not shown any clear trend (see Figure A2 and A3).

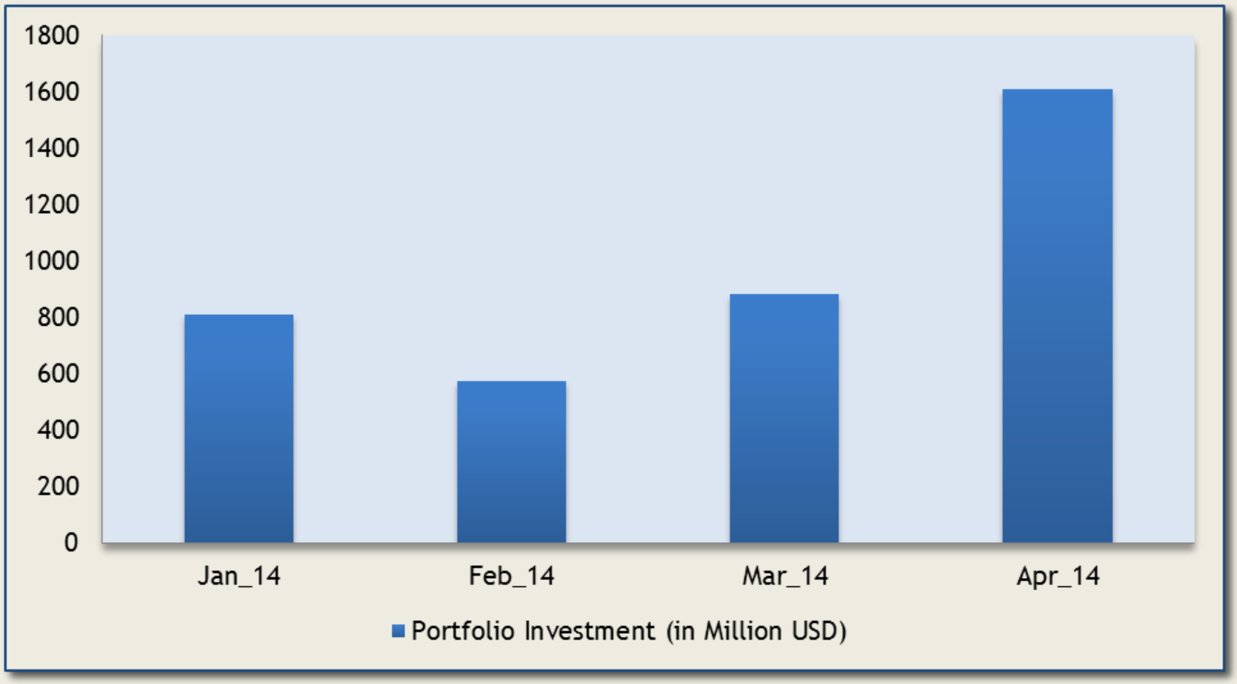
Figure 9: Demand and Supply of Foreign Exchange





Source: CBN Statistical Database, 2014

Figure 10: Foreign Portfolio Investment (US$ Million)



Source: CBN Statistical Database, 2014

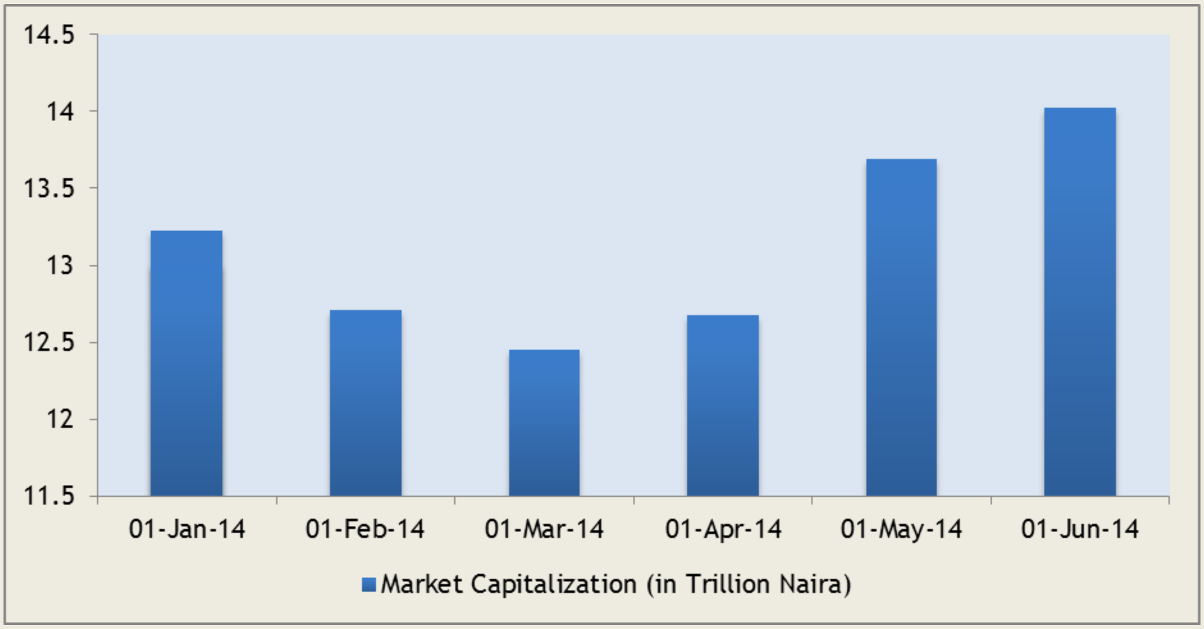
Also, importation of refined petroleum is the highest driver of FX utilization (see Figure A3), highlighting the need to improve domestic refining capacity.

3.6 The Stock Market

In contrast to the clear upward trend witnessed in 2013, the Nigerian stock market capitalization dropped considerably from the start of 2014, up till April. Market capitalization dropped 4.2 percent from N13.23 trillion at the start of January to N12.67 trillion at the end of April.

- Tensions arising from deteriorating security situation and uncertainties on the future leadership of CBN following the suspension of Sanusi Lamido Sanusi may have discouraged investors.
- The first quarter witnessed some decline in foreign portfolio investment as foreign investors exited the market.
- The period also witnessed noticeable declines in the indices for consumer goods, banking, and oil and gas sectors (see Figure A4). However, the trend reversed remarkably towards the end of 2014H1 as investor confidence is being gradually restored.

Figure 11: Nigeria's Stock Market Capitalization



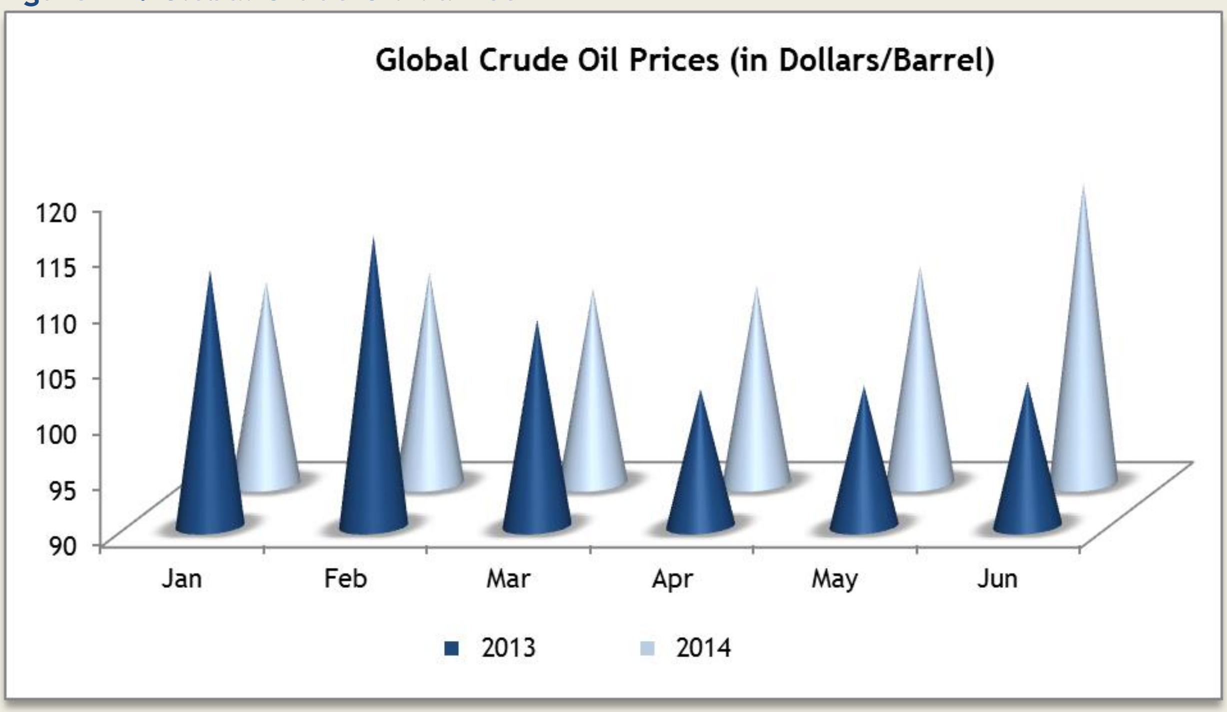
Source: FDHL Analytics Database, 2014

The recent GDP rebasing has particular implications for the Nigeria capital market. The current GDP figures imply that the market capitalization to GDP, which was about 30 percent pre-rebasing, is currently about 16 percent. This places Nigeria way below countries such as South Africa (230 percent), Malaysia (150 percent), and India (69 percent).

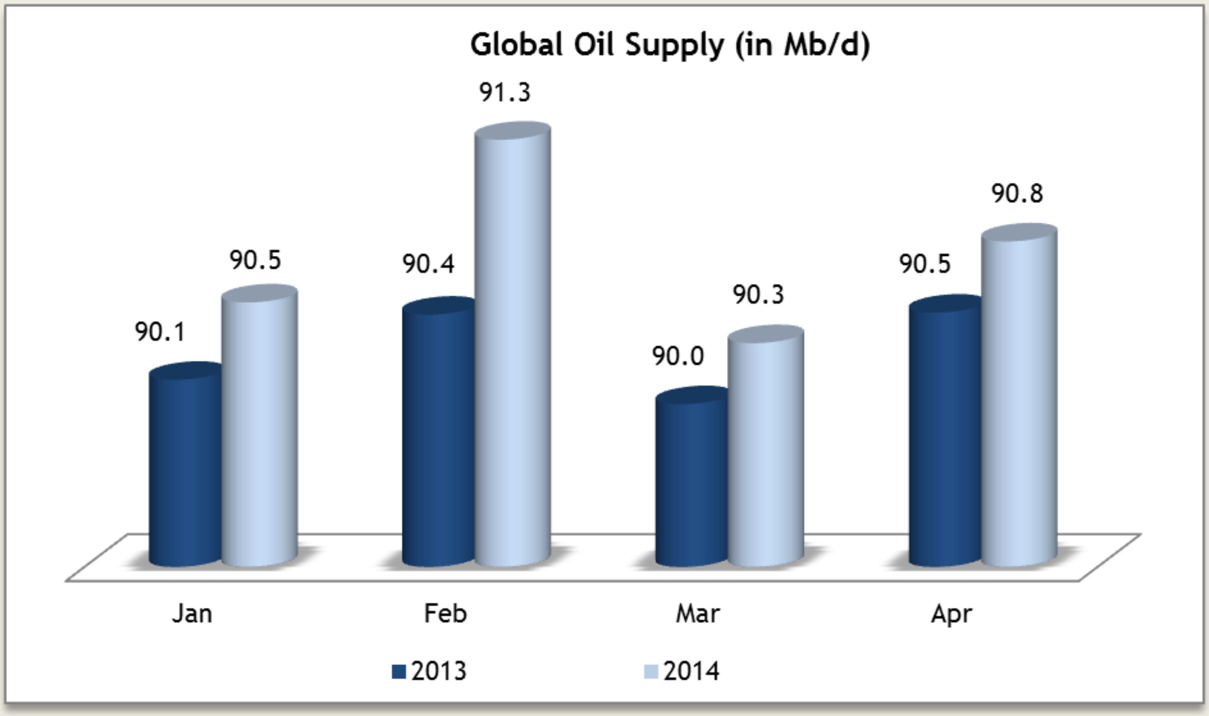
4. Energy Sector Performance

Crude oil contributed 75 percent of federally collectible revenue and 91 percent of external reserves in 2014H1. Crude oil prices for the first six months of 2014 were higher on average than the corresponding period in 2013 (see Figure 12). Prices in 2014Q1 were lower and less volatile than in 2013Q1 despite tensions in Ukraine and the extreme cold winter in North America and Europe that were expected to induce price increases. In contrast, 2014Q2 prices were comparatively higher and more volatile than in 2013Q2.

Figure 12: Global Crude Oil Market



Source: OPEC Monthly Reports, 2014



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urce: OPEC Monthly Reports, 2014

Global production during the half-year was driven largely by fluctuations in OPEC production. Global supply increased from 90.5 mb/d in January to a peak of 91.3 mb/d in February on account of production increase in Nigeria, Iraq and Saudi Arabia. The reversal in March to a low of 90.3 mb/d was attributed to production decline from both OPEC and non-OPEC suppliers.

The twelve-member OPEC accounted for 32.9 percent in 2014Q1, which represents a significant decline from an average of 44.7 percent in 2008. Production fluctuated in 2014H1 with averages of 29.7, 30.1, 29.6 and 29.8 mb/d in January, February, April and May respectively (See figure 13). With the exception of February, OPEC's production remained within its monthly nominal ceiling of 30 million barrels per day.

OPEC's Reference Basket Price[4] (ORBP) has risen over the past decade from approximately $27 a barrel in 2003 to $105.87 in 2013. Nevertheless, since the beginning of 2014, the ORBP has been facing downward pressures due to the increase in non–OPEC supply, especially from the United States. In the first six months of 2014,

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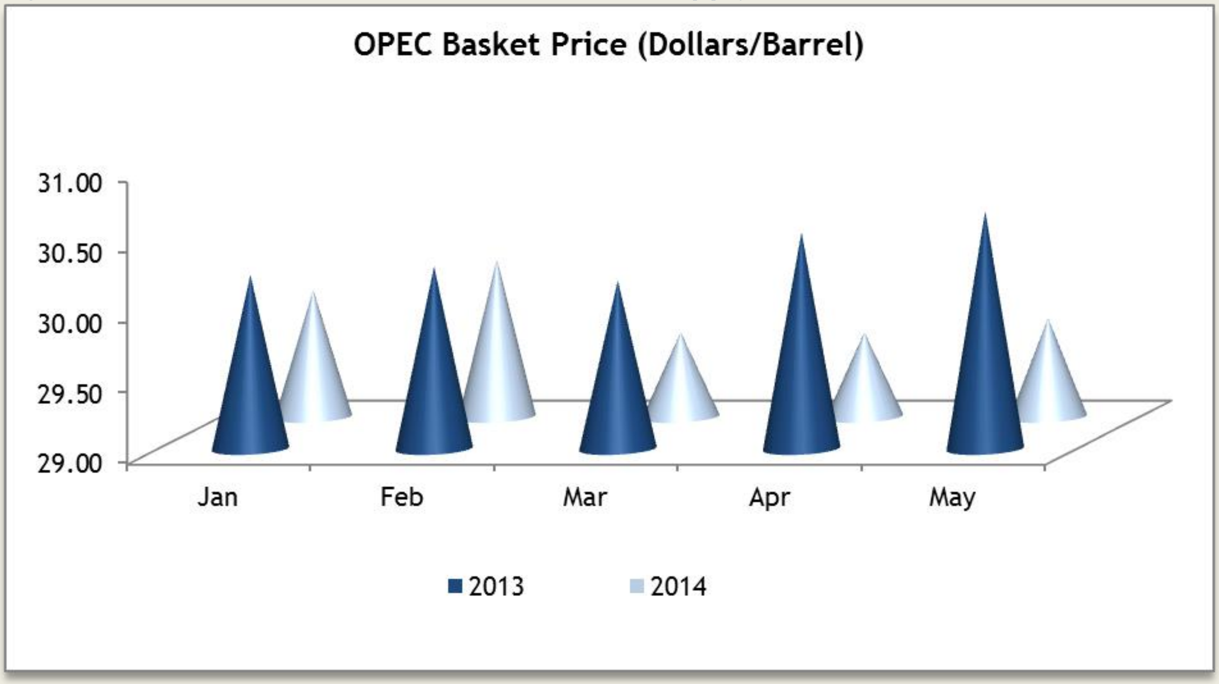
[4] This is referred to as a weighted average of prices for petroleum blends produced by OPEC countries.

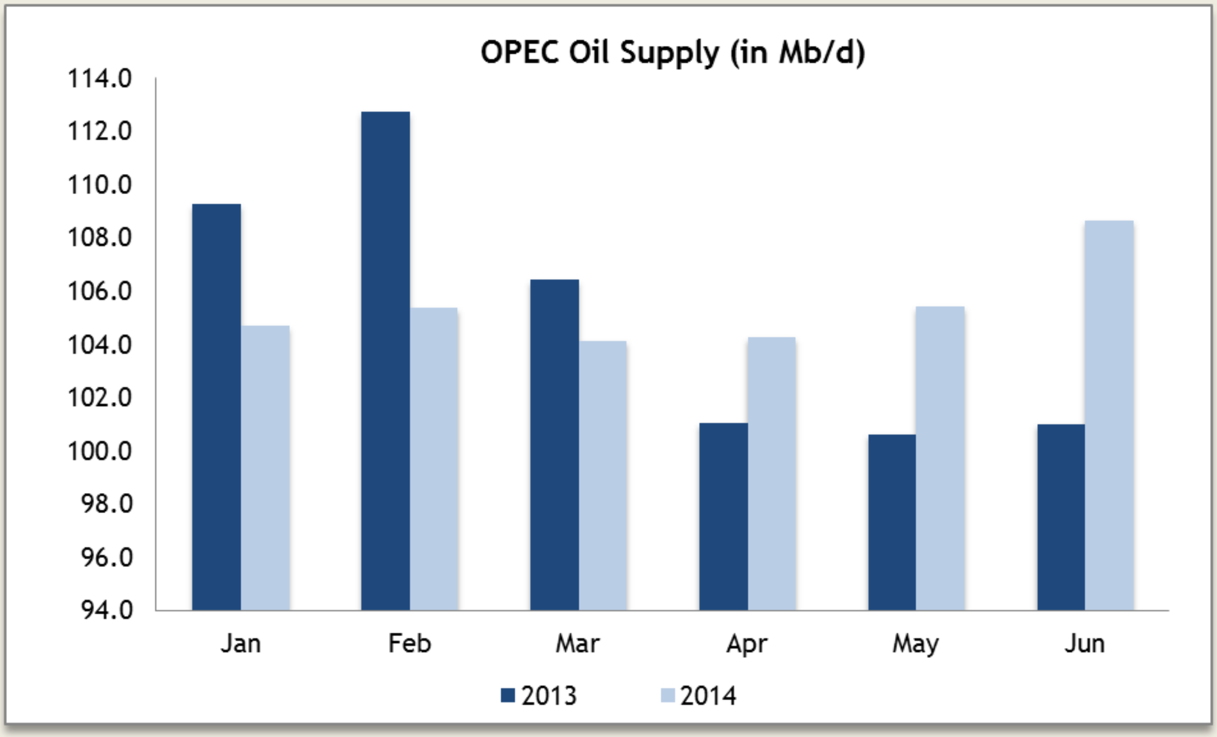
the price fell from $105.4 in February to $104.2 in March, reaching the lowest level since July 2013. The price in March was also lower by $2.29 when compared with March 2013. Factors that impacted on OPEC basket price in March include; concerns over a slowdown of China's economic growth, ample supply availability and reduced demand. Expectations of price increase associated with shutdown of oil fields and increased demand due to extreme weather conditions did not manifest. A stronger counteracting downward effect on the ORBP emanated from sluggish European refining margins, rising Libyan and North Sea production, the soft demand growth of top importer - China, and the higher freight rates for hauling West African cargoes.

Nigeria's production accounted for 2.1 percent of global output and 6.4 percent of OPEC output in 2014, this is an improvement over the 2 percent and 6.0 percent respectively, recorded in 2012 (OPEC, 2013). The crisis in Libya and Iraq explains why Nigeria's output share increased despite local crude oil supply-side constraints. However, average oil production was 1.90 mb/d in 2014Q1 and 1.88 mb/d in 2014Q2, excluding June. In comparison with 2013, these figures represent a decrease from 2.01 mb/d in 2013Q1 and 2.11 mb/d in 2013Q2.

Figure 13: OPEC Basket Price and Crude Oil Supply



Source: OPEC Monthly Reports, 2014



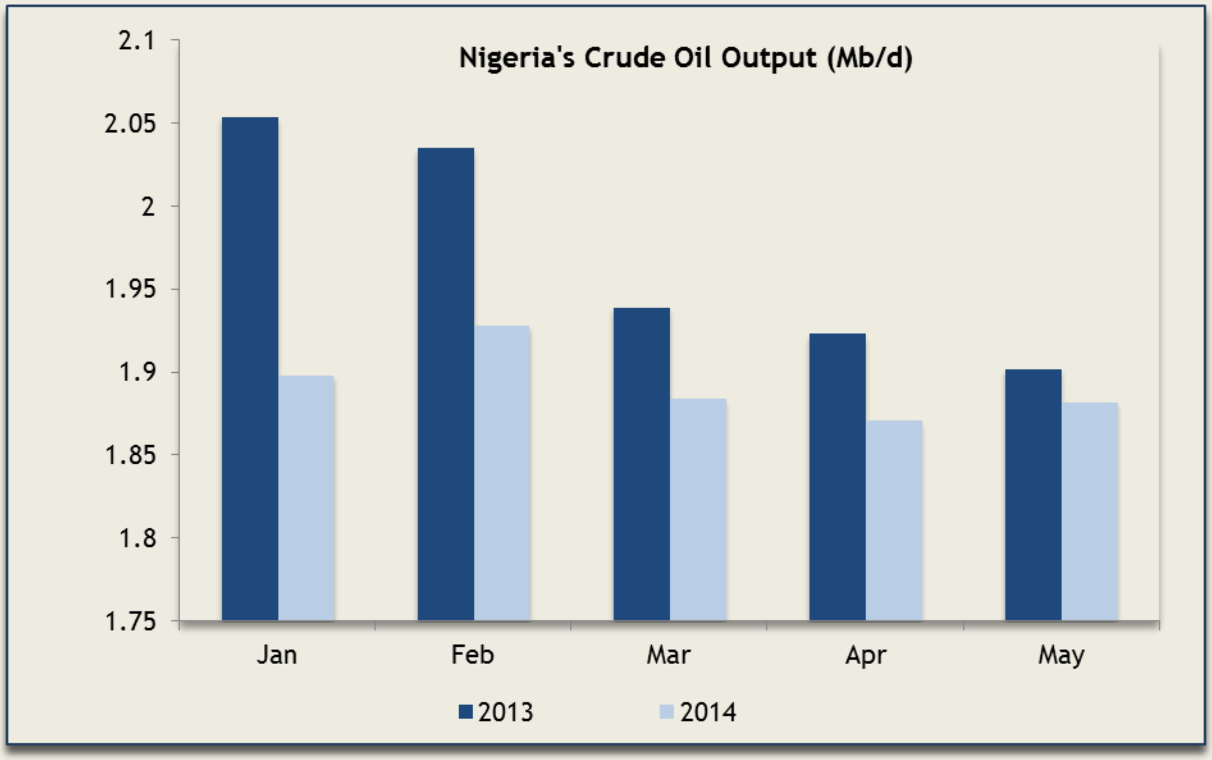
Source: OPEC Monthly Reports, 2014

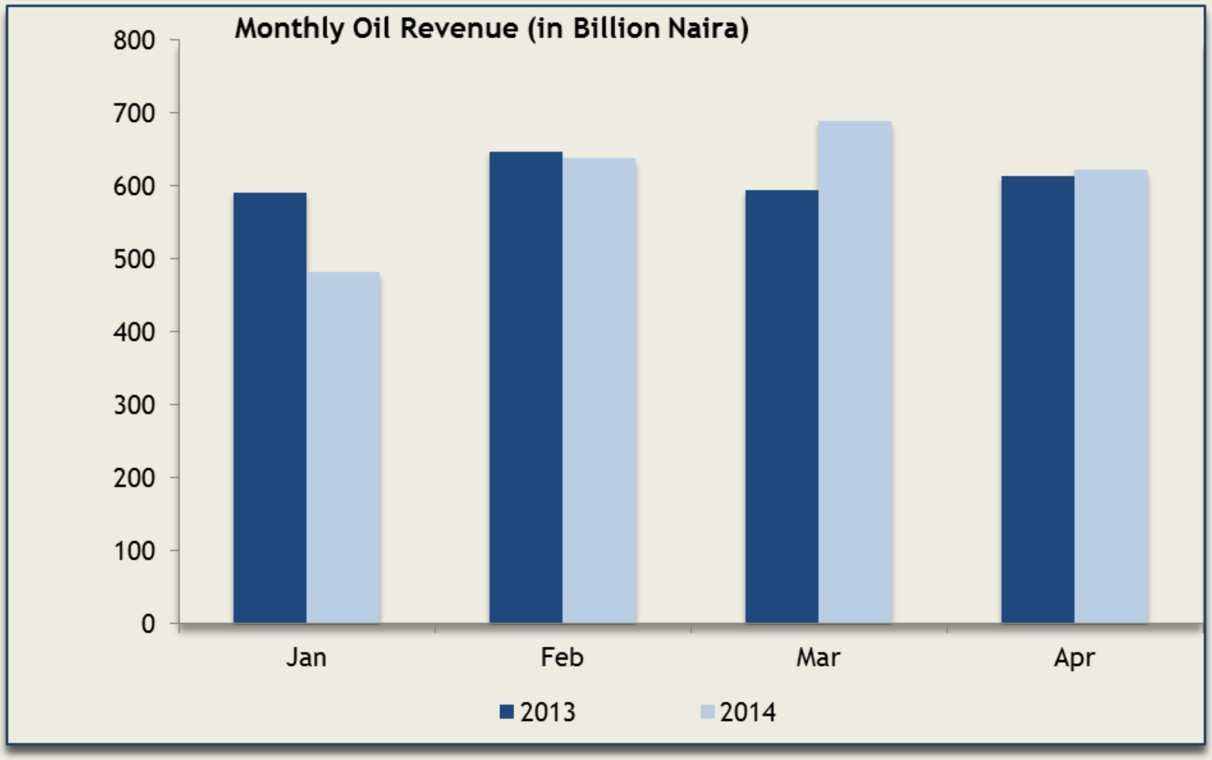
It is expected that the recent policy of legalized (licensed) bunkering will curb oil theft and pipeline vadalization, improve the country's position in the market and stimulate job creation. In addition, if passed into law, the Petroleum Industry Bill (PIB), which is presently in the parliament, will improve production and supplies.

An increase in the global Brent[5] price escalates the energy cost of most countries, but the effect depends on supply or demand structures. In exporting countries with weak refining capacity, such as Nigeria, the effect of price increase depends on whether the extra revenue from exports is sufficient to offset the extra cost of importation. However, since domestic prices are regulated and petroleum subsidies provide a buffer against price movements, the impact of price changes will only be felt in government revenue.

[5] Sarang (2014) defined Brent as "a kind of crude oil produced in the North Sea, off the United Kingdom coast. It is also used as a benchmark price for nearly 66 per cent of world crude traded from Europe, Africa and West Asia".

Figure 14: Nigeria's Crude Oil Output and Revenue





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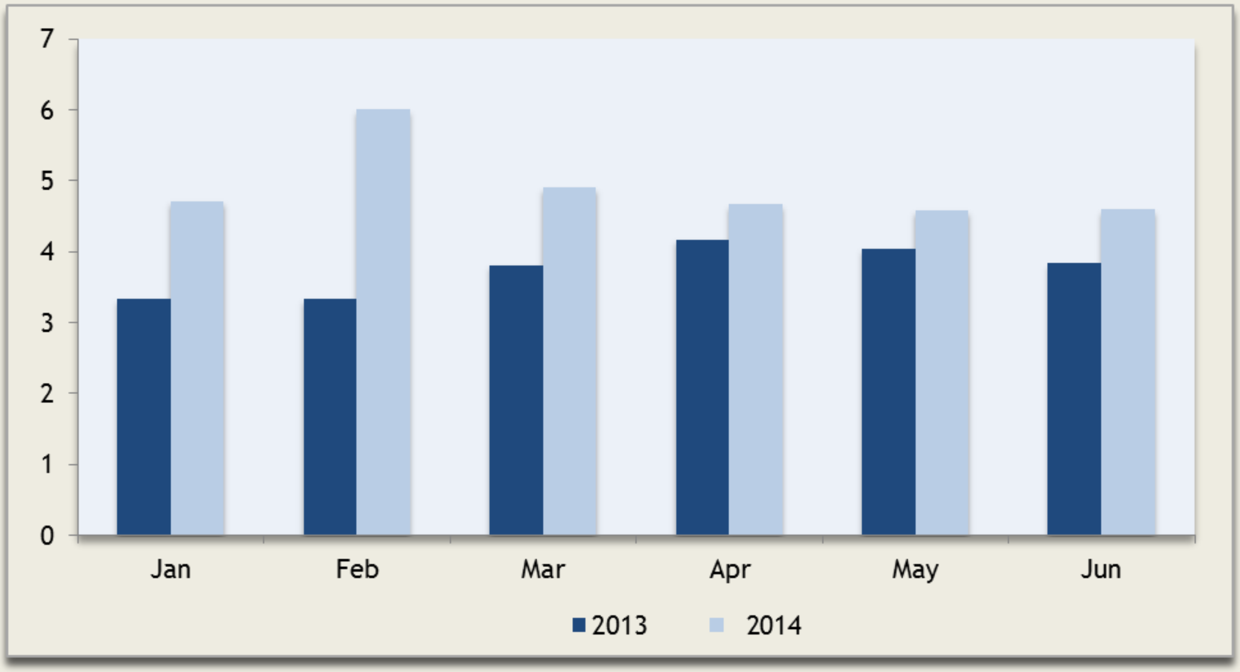
ource: OPEC Monthly Reports, 2014

Figure 15: Global Natural Gas Prices



Source: US Energy Information Agency Database, 2014

Natural gas prices are higher during 2014H1 compared to the corresponding period in 2013, averaging $4.91 per barrel during the former versus $3.91 in the later. Natural gas production averaged 4.83 million barrels per day during the last four years (2010-2013) but it is likely to have increased in 2014 due to increased demand.

There are currently five petroleum refineries in the country of which four are owned by the federal government and the other by Niger Delta Petroleum Resources (NDPR). However, only three, namely; Kaduna Refinery and petrochemical Company (KPR), Warri Refining and Petrochemical Company and Port Harcourt Refinery Company (I & II) are functioning with capacities of 110,000, 125,000, and 210,000 barrels per day respectively. However, in 2013, available data shows that these refineries were substantially underutilized at rates of 29, 7, and 35 percent, respectively.

5. Special Feature Article: *Sustained and Inclusive Growth in the Rebased Nigerian Economy*

The rebased Gross Domestic Product (GDP), based on 2010 prices, valued gross economic activities at N65 trillion ($405 billion) in 2013. At this size, Nigeria surpassed South Africa to become the largest economy in Africa. This improved outlook comes with some advantages. First, the increased GDP is likely to send positive signals to investors, portraying Nigeria as a huge market for investment. Second, public debt indicators have improved. Debt-to-GDP ratio reduced from its pre-rebasing estimate of 19 percent to 11 percent in 2012. Also, in 2013 public external debt[6] became 1.97 percent of GDP, which is well below the international benchmark of 3 percent. This creates room for the country to borrow in order to finance its huge infrastructural deficit.

In terms of structural composition, 35 percent of value added is obtained from primary activities (agriculture–21; mining–14), 12 percent from secondary activities (manufacturing-8; building & construction-4) and 53 percent from tertiary activities (trade-17; services-36). This outlook means that the Nigerian economy transformed directly from a primary (agrarian) economy to a tertiary (services) economy without going through the intermediate stage of industrialization. This atypical transition poses several challenges for sustainability and inclusiveness of economic growth.

In the typical transition, productivity increase in agriculture is associated with increased supply of inputs, both human and material, for processing and value addition activities in manufacturing. Industrial production helps to reinforce productivity in agriculture which, in turn, supplies more materials for industrial processing and leads to value chain developments. Alongside, education and technical experience levels increase in order to provide the labour required in industries. As demand for services intensify due to emerging urbanization and firms in the industrial sector undergo transition from product innovation to process innovation, the services sectors begin to enlarge, leading to completion of the structural transformation

[6] Figures as at September 30, 2013

process. The entire process involves movement of labour and transfer of skills from the primary through secondary to tertiary sectors.

Economies that transit directly from agriculture to tertiary services without going through the intermediate industrial development stage are likely to face unique challenges to inclusive growth namely; shortage of technical skills, possibility that agricultural productivity will not enhance welfare, and the possibility of mass unemployment.

First, the economy could face shortage of technical skills and experience that would have been acquired and deepened during the industrialization stage. This is already a common knowledge in Nigeria. Because these skills are also required in the services sector, productivity growth depends on the speed of production and accumulation of skills. Second, productivity gains in agriculture will be unlikely welfare-improving unless it is accompanied by an aggressive agricultural export strategy or progressive development of value chains. Third, mass unemployment is likely to ensue due to absence of large industries that typically mop up large quantities of labour. This is coupled with the fact that the services sector, which dominates the economy, is not as labour absorptive as the manufacturing sector. This makes the focus on job creation more imperative.

In short, like many countries that transit from being agrarian to services-dominated sector, a large number of potential employment opportunities are lost to foreign manufacturing economies. This situation, as evident in Nigeria, is worsened where there is a high degree of openness, high import propensities and excess demand for manufactured goods and processed outputs.

To achieve sustained and inclusive growth, the economy would require a reverse-transformation, that is, movement of value-addition and labour toward the secondary sector (manufacturing and building & construction). Coincidentally, the manufacturing sector is where labour absorption is highest while building & construction sector is the place where the most significant progress in labour absorption is occurring in the economy. Recent government policies seem to recognize this need as highlighted by the newly introduced Nigerian Industrial Revolution Policy (NIRP) aimed at revitalizing the manufacturing sector and Nigerian mortgage finance company in the housing sector.

However, these policies may not sufficiently address the underlining problems of the secondary sector namely; capital and competition. Many recent surveys of manufacturing sectors in Nigeria including CSEA (2013) overwhelmingly point to access to capital as one of the major challenge. In addition, given the low technical capacity and high cost of doing business, firms in this sector currently have comparative disadvantage to compete in terms of cost and quality of outputs with the foreign firms.

In essence, the key to achieving sustainable and inclusive growth under the present economic structure lies in addressing the two core challenges facing the secondary sector. Nigeria trade policy will also require a more critical evaluation. At present, these policies seem to encourage service oriented activities to the disadvantage of the secondary sector.

6. Domestic Sectoral Performance

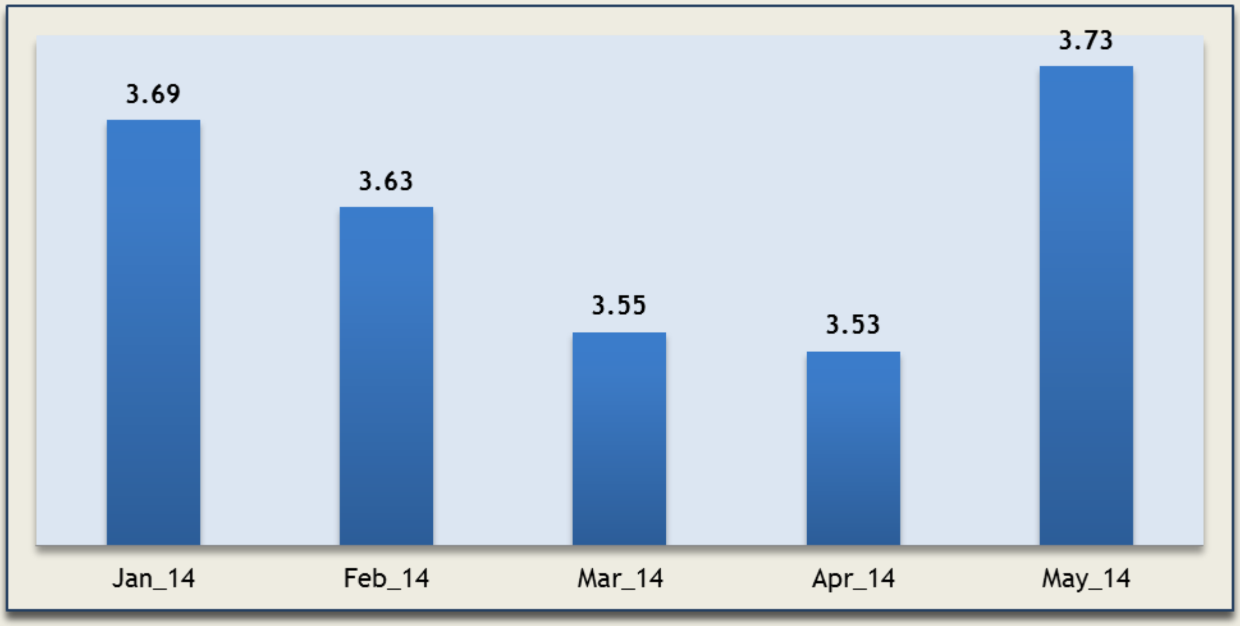
Agricultural Sector

A profound realization from the recent GDP rebasing exercise is that Nigeria is no longer an agriculture-dominated economy but a service-dominated one. To the extent that most development policies of the past three decades were based on the premise that agriculture contributed most to GDP and employment, the direction of policy intervention is likely to reflect the rebased GDP structure in the near future. However, the Agriculture Transformation Agenda remains a priority for the present administration, notwithstanding the reduced share of Agriculture in the economy. The broad objective of accelerating performance of the sector through value chain development initiatives is still on course. Substantial progress has been made in boosting performance in the sector, particularly in providing credit to farmers, and distributing subsidies more efficiently.

Table 1: Key Achievements of Initiatives in Agriculture

Initiative	Aim	Achievement (2014Q1)
Nigeria Incentive-based Risk sharing system for Agriculture (NIRSAL)	An agribusiness initiative aimed at supporting Nigerian financial institutions to provide affordable financial products to farmers	2.19 billion was spent – consists of 1 Credit Risk Guarantee (CRG) od 2 billion, 7 IDP NISAL claims of 57.25, and 61 projects of GES/NISAL IDP of 134.61 million
Commercial Agriculture Credit Scheme (CACS)	To finance large projects along the agriculture value chain by providing credit facilities at a single digit interest rate (9 percent)	A total of 6 projects valued at 1.985 billion = consists of 4 production projects at 985 million and 1 processing project at 1 billion
Agriculture Credit Guarantee Scheme (ACGS)	To guarantee credit facilities to farmers provided by banks up 75% of any outstanding default balance after net of any securities realized.	Guaranteed 17,067 loans valued at 2.62 billion

Figure 16: Agricultural Sector Share of Deposit Money Banks' Credit (in percentage)

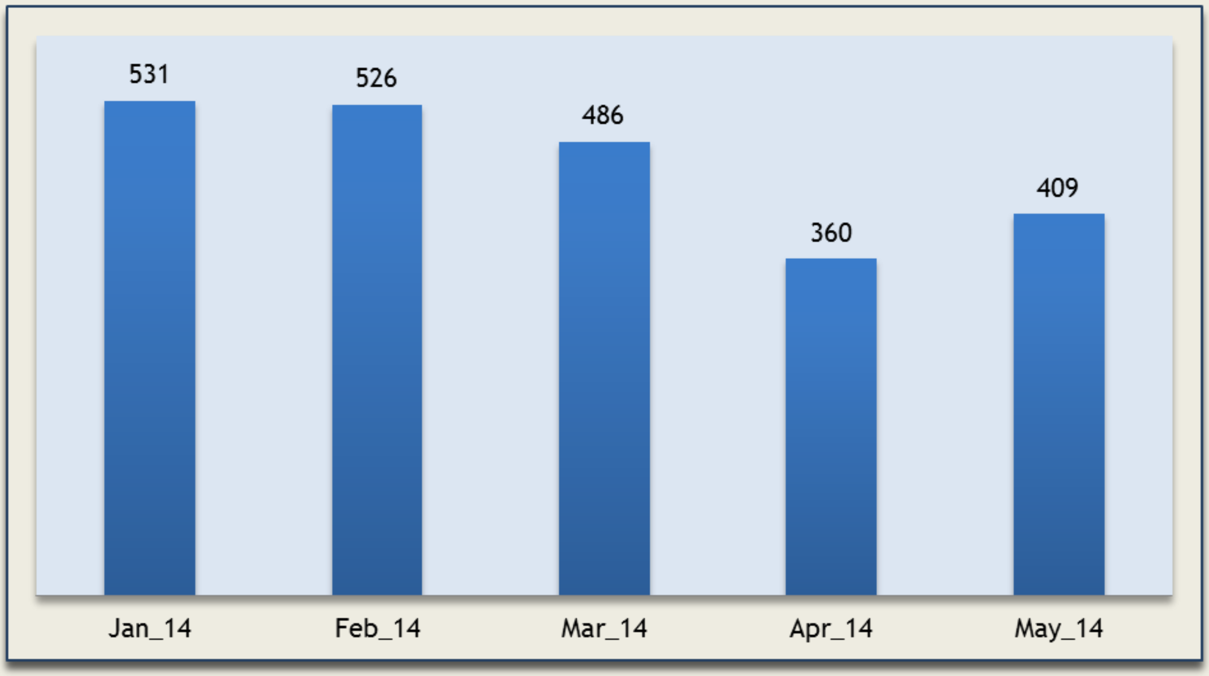


Source: CBN Statistical Database, 2014

Table 1 indicates the key achievements in providing credit facilities to farmers in 2014Q1. While the share of credit to agriculture has grown by more than 100 percent in the past four years, it declined steadily in the first quarter of 2014, up to April, but increased significantly in May (see Figure 16).

Figure 17 shows that FX utilization on food products fell considerable during the first quarter. The drop in import bill on food products was caused by a rise in domestic production of staple foods. However, the volume rose in May, implying that domestic production might have declined.

Figure 17: Foreign Exchange Utilization on Food Products (in Million USD)



Source: CBN Statistical Database, 2014

Manufacturing Sector

The post GDP rebasing estimates show that the manufacturing sector currently contributes 6.8 percent of GDP, up from the pre-rebasing estimate of 4 percent (NBS, 2014). The rise in manufacturing sector contribution to GDP can be attributed to remarkable increases in cement and sugar production, following tax incentives and waivers offered by the government to the sub-sectors. In particular, while Nigeria emerged as a cement exporter in 2013, production is likely to increase in the near future as $ 8 billion investment was attracted to the cement industry in the first quarter of 2014. However, the key measures of manufacturing performance declined slightly in 2014Q1. The index of industrial production dropped from 139.2 to 138.98, while the capacity utilization fell marginally from 58.3 percent to 58.0 percent (CBN Economic Report first Quarter, 2014). Bank lending to the sector rose considerably, while FX utilization on manufacturing products rose sharply in March and May of 2014 (see Figure A5). Thus, while some considerable progress was made in providing credit to manufacturing firms, the import bill on manufacturing products seems to be on the rise as the domestic production of goods are still largely insufficient.

A major policy initiative, the Nigeria Industrial Revolution Plan, aimed at boosting the contribution and performance of the manufacturing sector was launched by the government in the first quarter of 2014. The main goal is to increase the contribution of manufacturing to 10 percent over the next five years, through large-scale industrial initiatives that will focus on areas the country has comparative and competitive advantage. However, the pace and scale of the ambitious plan is likely to be determined by the extent to which the severe infrastructural deficit is corrected. With the persistent electric power shortages and the slow pace of power sector reforms, the cost of doing business is likely to remain high, and thus undermine the viability of manufacturing firms in Nigeria.

7. Outlook for 2014H2

Economic growth is expected to remain robust in the next half of the year, driven by the services and agricultural sectors. Also, if effectively pursued, some of the outcomes of the recently launched Industrial Revolution Plan should begin to reflect.

With sustained increase in demand for Nigeria’s crude oil from diverse sources and improvements in domestic revenue generation, total revenue is expected to increase. Yet, fiscal deficit is also expected to increase as the implementation of the budget continues and pre-election related spending pressure builds up. Although monetary authorities have pledged their commitment to checking the inflationary pressure this might cause, we expect the inflation rate to continue to tick upwards in the coming months. Perhaps the rate will be close to 10 percent by December, except there are further increases in the MPR and the expected agriculture bumper harvest is realized.

Exchange rate and external reserves are expected to continue to face pressures in the second half for at least two reasons. First, the US tapering of its asset purchase is expected to continue albeit at a slower rate thereby putting pressure on the exchange rate. Second, it is normal to expect some level of foreign capital flows reversal from risk-averse investors in the wake of a general election. This is expected to lead to an increase in demand for FX. Consequently, the monetary authority might have to draw on FX reserves to ease the pressure on the naira. Following from the foregoing, the capital market is not expected to return to its peak until around 2015Q2.

Global energy market is expected to remain favorable depending on how the recent crisis in the Middle East and Eastern Europe is managed. Domestically, although oil bunkering remains a challenge, it appears to have waned. It is expected that the recent licensing of bunkering activities will keep the situation under check.

Overall, the major risk to economic performance in 2014H2 is the tendency for economic activities (especially public sector programs and projects) to slow down as the 2015 general election gathers momentum. This is especially the case as the head of the incumbent government is widely believed to be seeking re-election.

8. Concluding Remarks

This report examines the Nigerian economy within the framework of competitiveness that relates external performance to internal conditions of production and consumption. The review shows that macroeconomic performance remains sound in general. Exchange rate movements remain within a comfortable band as FX earnings from crude oil prove resilient despite the US shale oil phenomenon, and excess demand for FX continues on a downward trajectory. These external positions are strengthened by stable single-digit inflation. The impressive economic growth rates recorded in recent years are expected to last into the near future. The stability of tenure of the economic management team and active monetary authorities provide indications that the macroeconomic environment will remain stable in the near future.

However, internal conditions of production remain sub-optimal arising from inefficient resource allocation. The real interest rate is rising, fiscal deficits are rising due primarily to recurrent spending, and unemployment rates are on the increase. Public debt levels are increasing mainly due to domestic borrowing by government, leading to crowding out effect on credit to private sector. Although profits continue to soar in the banking and financial services sectors, lack of access to finance remains a strong impediment to entrepreneurship development and job creation across the country.

Sound external performance will not automatically translate into internal production efficiency and full employment. Economic management teams and monetary authorities need to pay a lot more attention to these issues.

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ENDNOTES

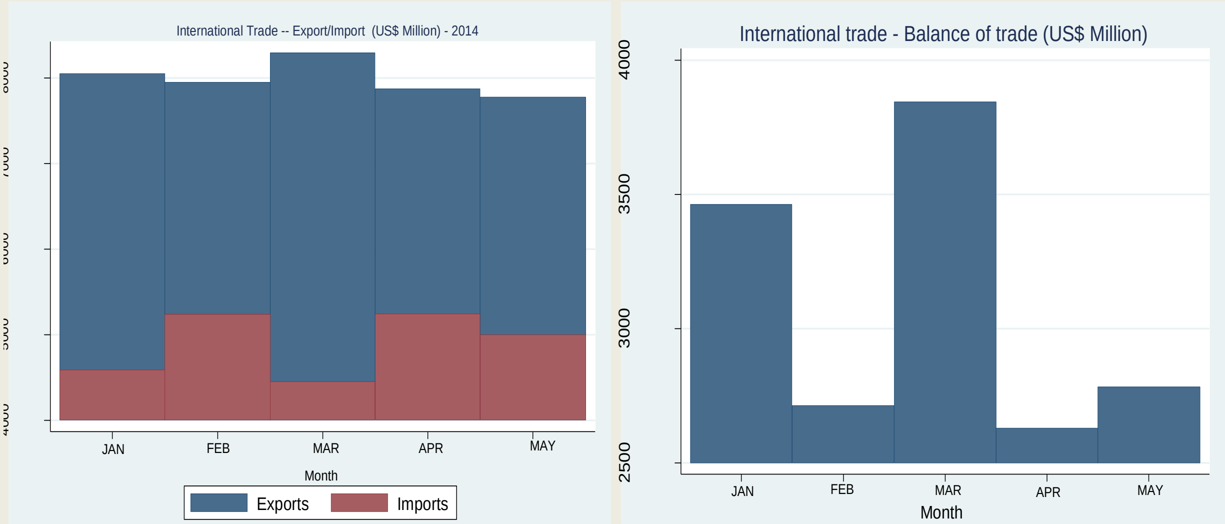
[i] IMF (2014). World Economic Outlook. January 2014 Update.
ii World Bank (2014). Global Economic Prospect, June 2014.
iii The latest report from CBN as at the time of this report was for April, 2014

Appendix

Figure A1

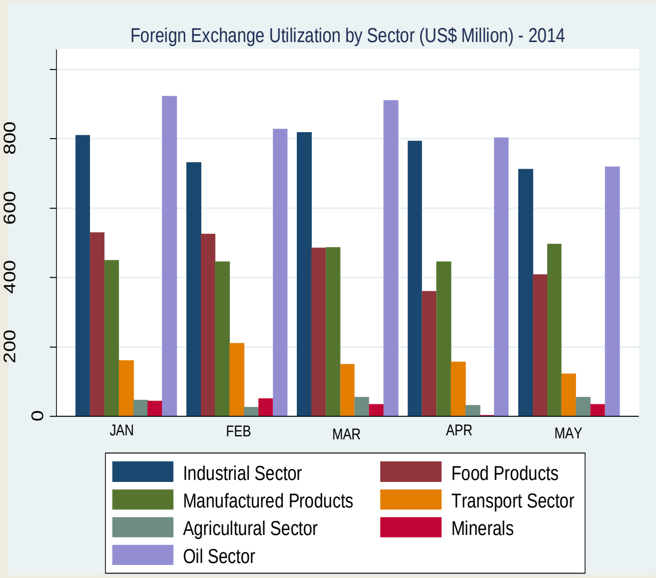
Source: CBN Database

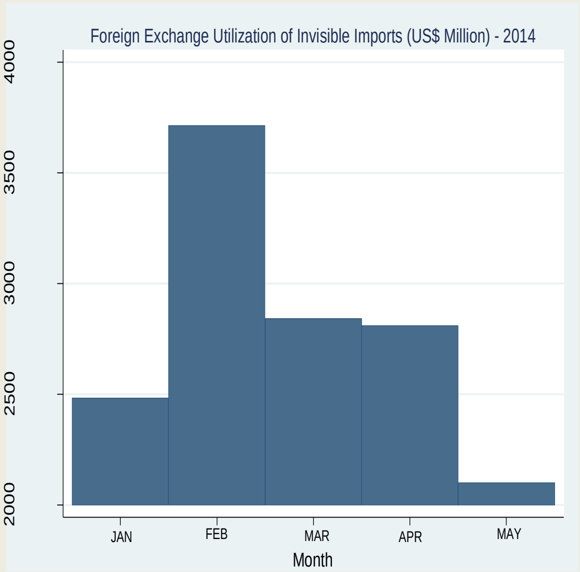
Figure A2



Source: CBN Database

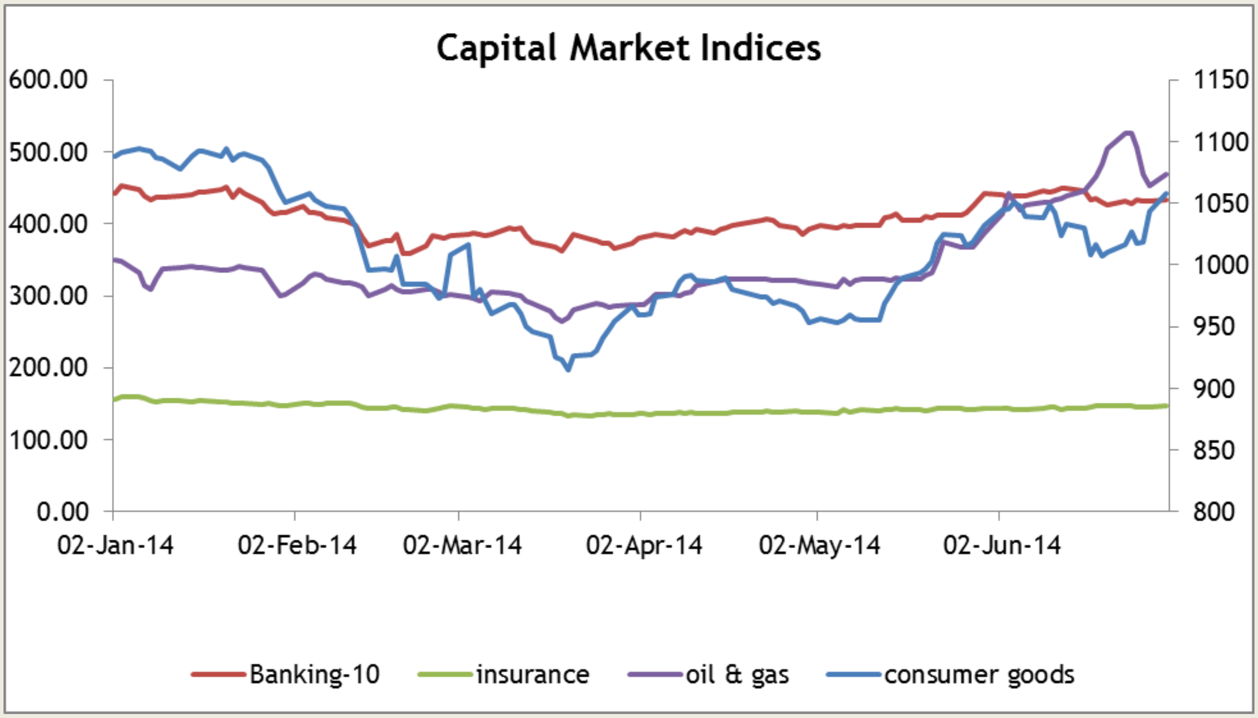
Figure A3





Source: CBN Database

Figure A4



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