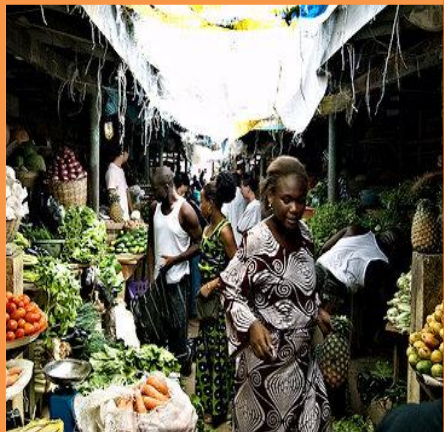


NIGERIA ECONOMIC REVIEW

First Half Report 2015



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Acronyms and Abbreviations

ASI-All Share Index

BDC- Bureau de' change

CBN- Central Bank of Nigeria

CRR- Cash Reserve Ratio

FGN -Federal Government of Nigeria

GDP-Gross Domestic Product

H1- First half of the year

IMF-International Monetary Fund

MPC-Monetary Policy Committee

MPR-Monetary Policy Rate

NBS- National Bureau of Statistics

NSE-Nigerian Stock Exchange

OPEC- Organization of Petroleum Exporting Countries

Q1- First Quarter

Q2- Second Quarter

rDAS- Retail Dutch Auction System

REER- Real Effective Exchange Rate

RGDP-Real Gross Domestic Product

SSA-Sub-Saharan Africa

WEO-World Economic Outlook

Preface

The Nigeria Economic Review is a biannual publication of CSEA, which gives a concise overview of key aspects of the Nigerian economy. It is an attempt to track the developments in the relevant aspects of the economy over a six-month period, and provide valuable insights into the potential drivers of the trend and their implications. The areas of focus are Macroeconomic Indicators, Energy sector performance, and Real sector performance. The report also includes the Special feature article section, which provides deeper insights into a contemporary issue within the period.

The broad aim of the First Half Report (2015) 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 economic and industry policymakers should expect in the second half of 2015. The report relied mainly on data and publications from the Central Bank of Nigeria (CBN), the Nigeria Bureau of Statistics (NBS), and the International Energy Agency (IEA). Considering the quarterly publication timeframe used by these institutions, the biannual report provides analysis on a half-year basis (2015H1), but where necessary, quarterly analysis are used (i.e. 2015Q1).

In writing this report, two main constraints were encountered. The unavailability of the most recent data due to delayed publication of reports by the key government institutions. For instance, at the end of the first half of 2015, the latest economic report published by the CBN was in April, 2015. Similarly, the lack of information completeness in some sectors of the economy constrained the depth and scope of analysis.

Executive Summary

- The modest growth in the global output witnessed in the first quarter of 2015 was driven mainly by advanced economies, particularly the United States. Growth slowed down significantly in emerging and developing economies, primarily natural resource-dependent countries which were adversely affected by falling commodity prices.
- Real Gross Domestic Product (GDP) growth in Nigeria continued to decelerate in 2015H1, with a growth rate of 2.4 percent in the 2015Q2. Non-oil sector remained the driver of growth, in contrast to oil-GDP which witnessed a significant negative growth. The huge drop in global crude oil prices was the main cause of the contraction in Oil-GDP growth.
- The slump in oil prices resulted in a substantial fall in oil revenue by 41.2 percent in 2015Q1. A remarkable increase in non-oil revenue in April dampened the effect of the fall in oil revenue in the first half of 2015. In general, total federally collected revenue increased by 3.4 percent in 2015H1. Fiscal deficits which increased at the start of 2015, was reversed at the last month of 2015Q1, an impact of the austerity measures which has led to a consistent decline in government expenditure.
- Inflation rate rose above the 6.0-9.0 bandwidth set by the Monetary Policy of the Central Bank in 2015H1. Food inflation was the driver of the rise which reflects the exchange rate pass-through occasioned by the depreciation of the naira in 2014H2.
- While Monetary Policy Rate was left unchanged at 13 per cent, the changes in banks' lending rates in 2015H1 were mostly driven by inflation. The harmonization of CRR in public and private sector funds to 31 percent by the CBN was aimed at curbing abusive practices of mostly banks.
- Following the persistent depreciation of the naira in 2014H2, and the start of 2015, the CBN closed the official Retail Auction System (rDAS) forex window in February 2015. The closure moderated the depreciation in both Inter-bank and BDC forex markets.
- External reserves continued to fall in 2015H1, with a considerable reduction in import cover from 2014H2. The sterilized intervention policy implemented by CBN was unable to prevent the depletion, and alternative measures are being pursued.
- Foreign portfolio investment and Stock market capitalization rose significantly after the general elections in April. However, both indicators have declined slightly in June, as uncertainties about the direction of economy increased.

- Crude oil prices rose slightly in the first quarter in 2015. The marginal increase was driven by strong seasonal global demand for refined products and declining crude oil inventory in the United States. However, the moderate rise was not sustained, as prices fell slightly in May 2015. Natural gas prices also declined in 2015H1, reflecting the excess supply conditions in the gas market, which could be related to the shale oil and gas revolution the United States.
- Low crude oil prices adversely affected the profitability of oil majors, which led to a decline in the number of active oil rigs, and thus crude oil production. Persistent volatile security situation in the Niger-Delta Oil producing region which led to frequent cases of pipeline repairs by oil majors contributed to the decline in oil production in 2015H1.
- Agricultural sector remained a major contributor to the GDP, with real growth rates remaining above 3 per cent since 2014Q1. Foreign exchange utilization on food products significantly declined in 2015Q1, as progress was made in local staple crops production. However, the significant gains recorded in the provision of credit to agriculture, diminished in the period.
- Manufacturing sector contracted in the first two quarters of the year, driven by significant declines in the growth of Oil refining and Textiles, Apparel, and Footwear subsectors. However, the period saw a steady rise in inflow of bank credit to manufacturing.
- The services sector remained the highest contributor to GDP, with a share of 54.56 percent. Arts, Entertainment, and Recreation, and the transportation and storage sub-sectors were the main drivers of the increased share of services sector to GDP in 2015H1.
- To minimize uncertainty in the economy, this report recommends that appropriate fiscal policy direction should be considered as part of the policy options to guide expectations on investment decisions.

I. Global Economic Performance

I.1. Background

The global economy grew by 2.2 per cent in the first quarter of 2015, a 0.8 percentage shortfall from the 3 percent growth rate forecasted¹ by the International Monetary Fund (WEO-IMF, July 2015). Advanced economies remain the main drivers of marginal growth, as increased consumption in the United States, and lower petrol prices played a key role. However, the underperformance was due to a slight slowdown in economic activities in North America, in 2015Q1. Adverse weather conditions, port-closures, and massive reduction in oil sector capital expenditure in the United States, which spilled over to Mexico and Canada, were the main factors that contributed to the weak growth witnessed in the first quarter (WEO-IMF, April 2015).

Emerging markets and developing countries witnessed a significant slowdown in growth. The ongoing decline in commodity prices, structural bottlenecks, worsening external financing conditions, and economic slowdown in China economy were the most significant headwinds for output expansion in the region (IMF, 2015b). The economy of the Sub-Saharan Africa (SSA) region grew by 3.5 per cent in 2015Q1, driven by investments in infrastructure and mining, and strong growth in low income countries² (7.4 per cent). However, the growth fell short of expectations as the decline of commodity prices and the Ebola epidemic posed challenges to the region (IMF, 2015c).

Going forward, developing countries, particularly resource-dependent economies in SSA are likely to face the adverse effects of falling commodity prices. Also, domestic risks posed by terrorist groups such as Boko-Haram and Al-Shabaab in West Africa and East Africa remain significant in the region. In general, growth is likely to be driven by advanced economies in the near term, as they continue to reap the benefits of reduced fuel prices. The recent nuclear deal between the United States and Iran is also expected to increase global crude oil supply and thus further exert downward pressure on crude oil price.

¹ See WEO-IMF, April 2015

² Excluding fragile states

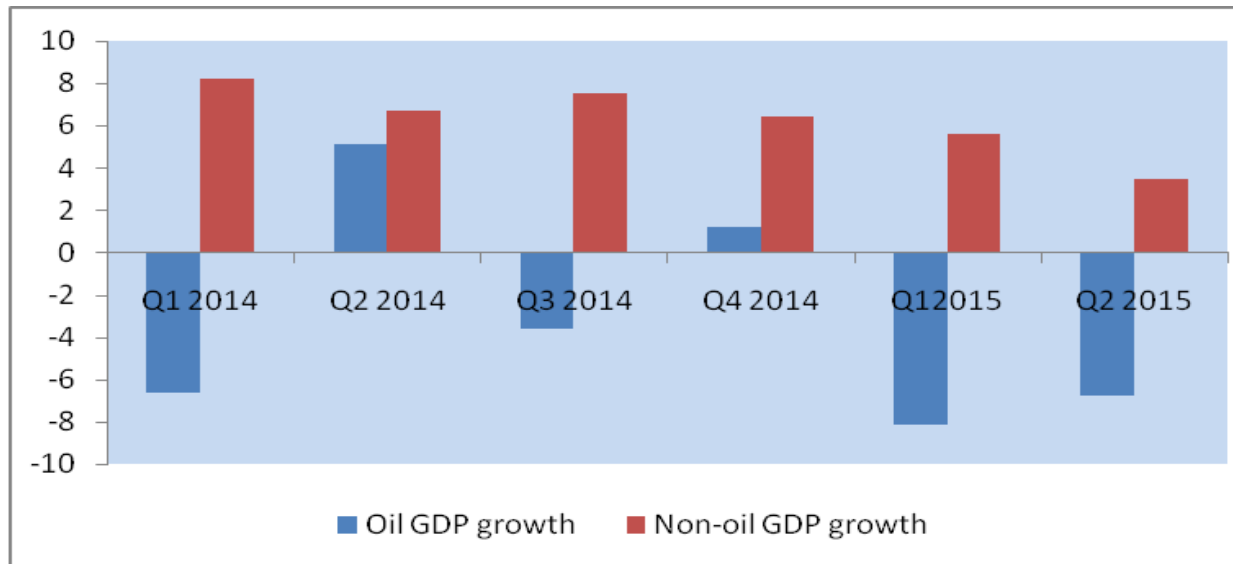
2. Macroeconomic Indicators

2.1 Declining economic growth

The Real Gross Domestic Product (GDP) in Nigeria continued its downward trend in 2015H1, with a 4 percent growth in 2015Q1 and 2.4 percent growth in 2015Q2. The non-oil sector remained the engine of growth in 2015H1, growing by 4.53 per cent in real terms, (year-on-year), albeit witnessing a downward trend from 2014Q3. Figure 1 shows that non-oil GDP has maintained a positive growth rate since 2014Q1, while oil GDP growth has been undergoing mostly negative growth, with a few positive fluctuations within the period. Growth in the non-oil sector in 2015H1 was driven by economic activities in trade, crop production, other services, construction, and telecommunications (NBS, 2015). The huge drop in global crude prices, in addition to volatile security situations in the Niger-Delta oil producing region which hamper oil production, was the main driver of the fall in oil sector's GDP growth.

The persistent deceleration of real GDP growth since 2014Q3, especially in view of unfavorable external economic conditions is a source of significant downside risk. With the persistent low crude prices and growth slowing in Nigeria's major trading partners such as China and the Euro area, growth is likely to remain weak in the near term.

Figure 1: GDP growth: Oil and Non-oil (2014Q1: 2015Q2)



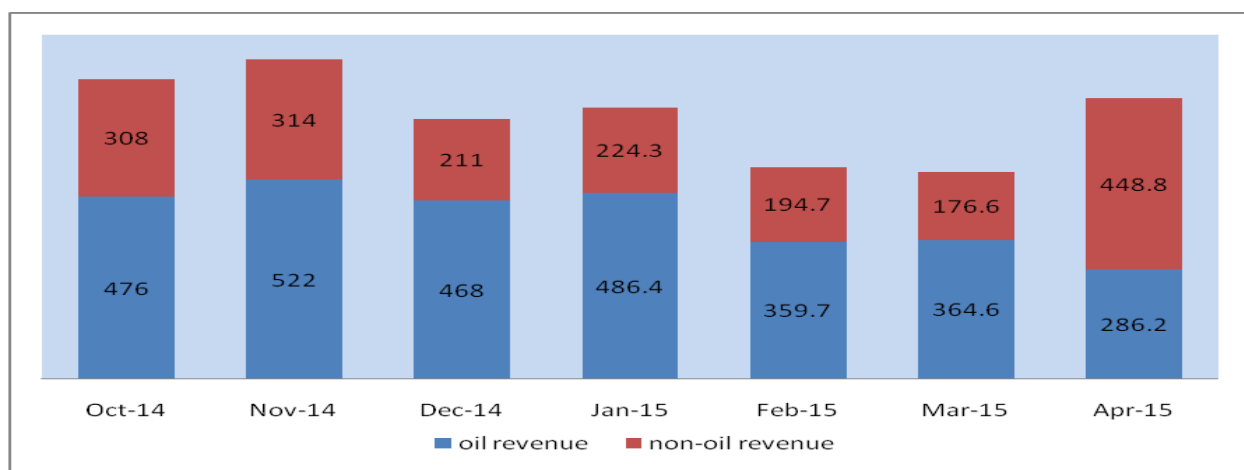
Source: NBS GDP reports, 2015

2.2 Oil Revenue

Against the backdrop of the huge fall in the global crude oil prices from June 2014, Nigeria's total oil revenue declined by 41.2 per cent between January and April 2015. However, figure 2 shows that there was a marginal uptick in oil revenue between February and March, 2015. The reduction in oil revenue was caused by the drop of crude oil prices in the international market, which in turn, led to a fall in crude oil and gas receipts (CBN, 2015).

The effect of the slump in oil prices remained evident, as government revenue witnessed a significant decline in the first half of 2015. While oil revenue maintained a downward trend in 2015, it still accounted for over 50 percent of total federally collected revenue except in April, where non-oil revenue emerged as a higher contributor. Despite some marginal increases in crude oil exports and prices in April, the significant fall in oil revenue in the month was driven by substantial drops in natural gas prices and petroleum profit tax and royalties.

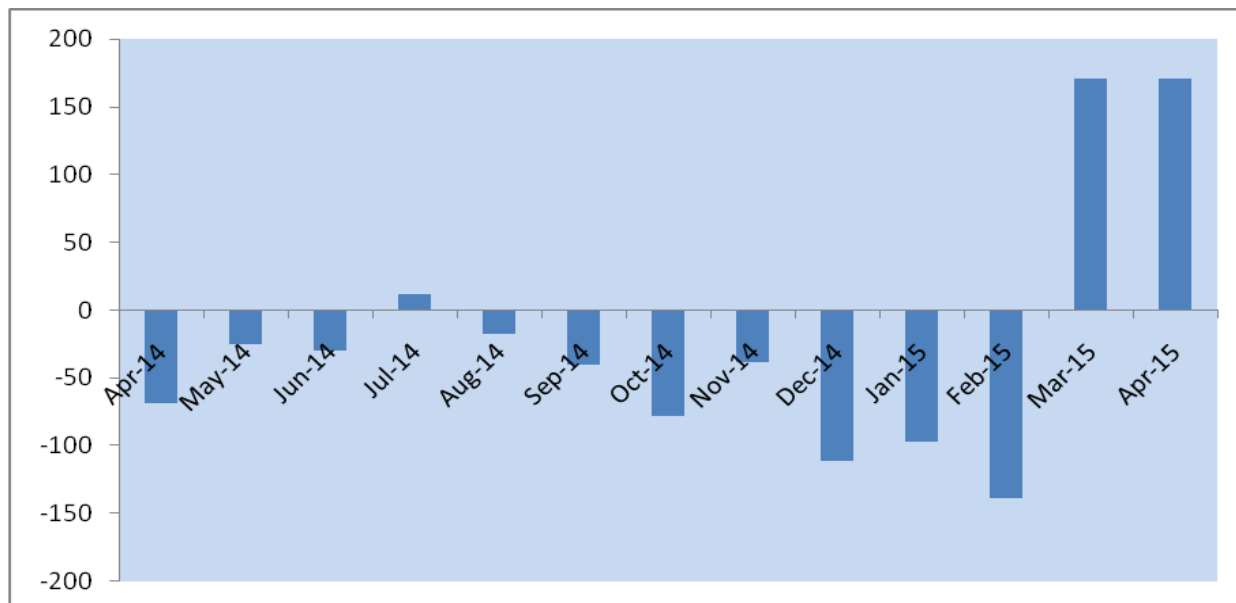
Figure 2: Total Federally Collected Revenue (Billion Naira)



Source: CBN Monthly Report, April 2015

In figure 2, total federally-collected revenue increased by 3.42 per cent in 2015H1. While the trend in the overall total federally collected revenue was essentially driven by that of oil revenue, a huge rise in non-oil revenue witnessed in April dampened the effect of the significant fall in oil revenue in the month. The remarkable increase in non-oil revenue in the month was driven by a sharp rise in FGN Independent revenue: accrues from the operating surpluses of federal agencies and corporations, dividends from federal government's investments in companies and other sundry revenue of federal government. The revenue grew significantly from N7.5 billion to N269.6 billion (59.6% of government revenue) between March and April 2015. However, given that this amount is a shortfall from the projected revenue of 450 billion in the 2015 budget, the dampening effect of the Independent revenue is not likely to be sustained in the near term.

Figure 3: Federal Government Monthly Fiscal Balance (2014-2015) – seasonally adjusted



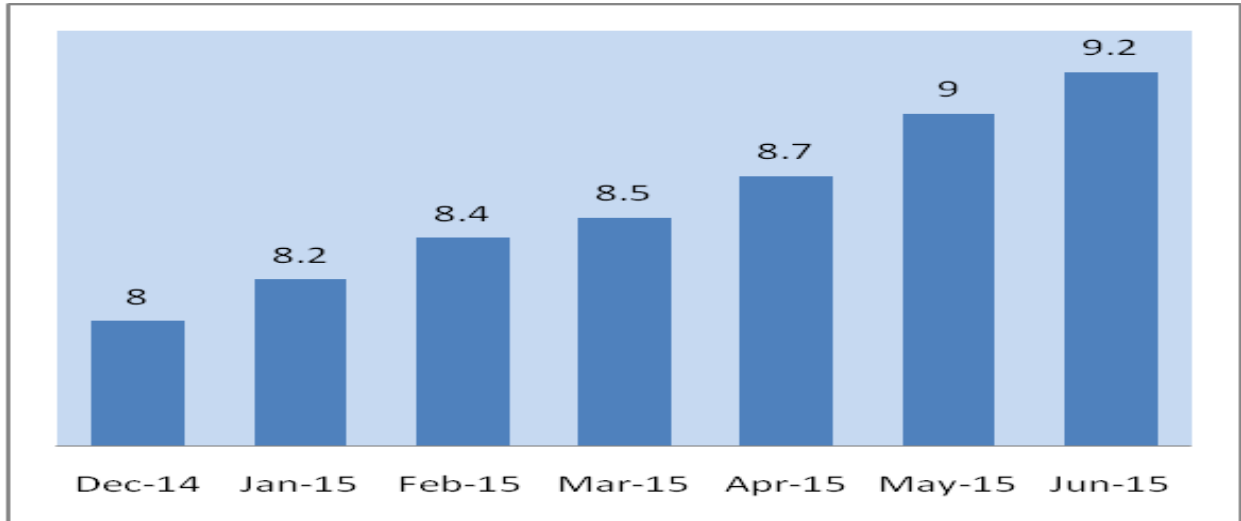
Source: CBN Nigeria Economic Report, 2015

Figure 3 above presents the seasonally-adjusted fiscal balance between April 2014 and April 2015. The figure indicates that fiscal deficits incurred by FGN increased between January and February of 2015. However, the trend was reversed with substantial improvements in retained revenue, as a result of a decline of federal government expenditure in March and April 2015. While there has been continuous decline in government expenditure since July 2014 as a result of the austerity measures instituted by the government to cushion the effects of the plunge in oil price, government revenue has been rising on average, albeit fluctuating. Comparing the seasonally adjusted fiscal balance with the unadjusted counterpart (see Figure A1 in the Appendix), it can be observed that seasonal fluctuation was more pronounced between March and April 2015, while no significant evidence of seasonality was recorded in the other periods i.e. between April 2014 and February 2015. Specifically, the seasonally-unadjusted fiscal balance grossly understated fiscal balance for the month of March 2015 and overstated that of April 2015.

2.3 Rising Prices

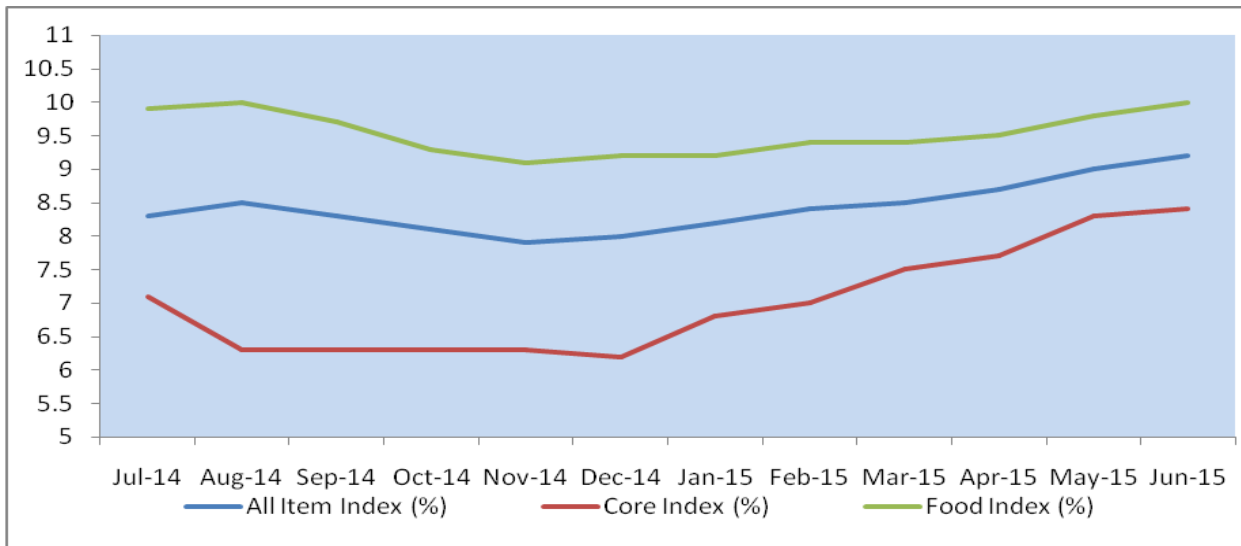
In 2015H1, inflation rate rose above the 6.0-9.0 bandwidth set by the Monetary Policy of the Central Bank (see figure 4). However, headline inflation (year-on-year) remained at the single digit inflation target of the CBN. Figure 4 shows a clear upward trend in headline inflation from December 2014 to June 2015. In particular, year-on-year headline inflation in 2015H1 increased significantly by 1.0 percentage points from 8.2 per cent in January to 9.2 per cent in June.

Figure 4: Trend in Headline Inflation (2014December-2015July)



Source: NBS Consumer Price Index Monthly Reports (January-July, 2015)

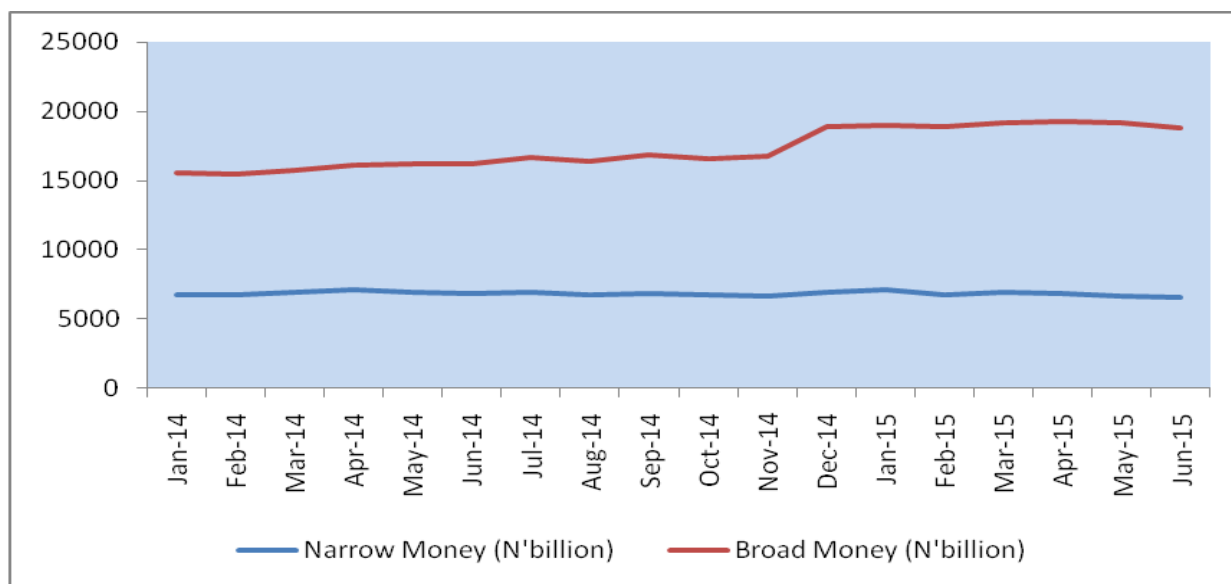
Figure 5: Monthly Headline Inflation and its Sub-components (%)



Source: NBS Consumer Price Index Monthly Reports (July, 2015)

Figure 5 show that the continuous increase in year-on-year headline inflation reflects simultaneous increases in the core and food components of inflation from December 2015. While core index increased by 1.6 percentage points from 6.8 per cent in January to 8.4 per cent in July, food index rose from 9.2 per cent in January to 10 per cent in July, representing a 0.8 percentage increase.

Figure 6: Monetary Aggregates in Nigeria, January 2014-June 2015



Source: CBN Statistical Database, 2015

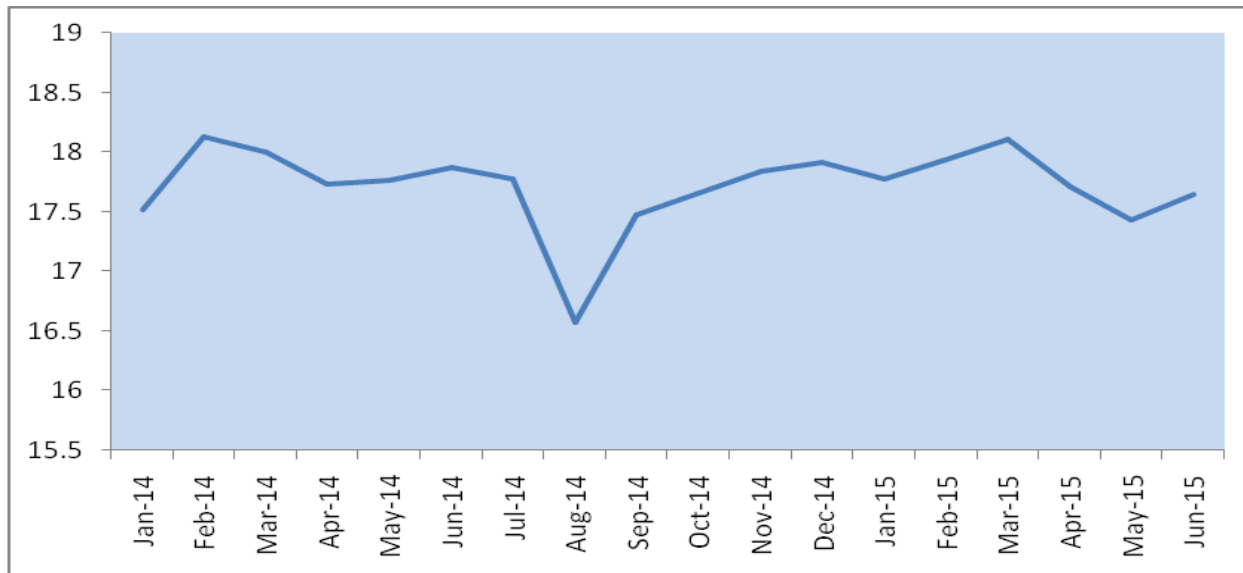
The increase in headline inflation during the early months of 2015H1 reflects the increase in money supply as well as the exchange rate pass-through effects occasioned by depreciation in naira in the second half of 2014. While narrow money has been fairly constant since 2014H2, broad money supply have witnessed marginal increase in 2015H1 compared to 2014H2. From an average of about N17 trillion in 2014H2, broad money supply jumped to an average of N19 trillion in 2015H1, signifying a 12 percent increase (see figure 6). Upsurge in money supply in 2015H1 was not unconnected with the increase in the currency outside banks and quasi-money during the period. Although increase in the price level was expected in the second half of 2014, the price level actually rose significantly in the first half of 2015. Thus there was some considerable lag in the adjustment of prices to the increase in the cost of importation items. This may be attributed to rigidities in the economy which prevent instantaneous adjustment in prices. Furthermore, some other notable factors added pressure to inflation during the period. These include fuel shortages during general elections period which increased transportation costs and thus food prices; and the up-scaled military offensive against the Boko-Haram terrorist group in North-eastern Nigeria continues to further disrupt food supply.

Overall the first half of 2015 was marked by the deviation of inflation rate outside the 6-9 bandwidth, which has been maintained since February 2013. Thus, there is need for the Central Bank of Nigeria to restructure its inflation targeting strategy. Given that fiscal policy could play a complementary role in inflation targeting, the present government should have a clear fiscal policy objective that can assist in that direction.

2. 4 Volatile Interest Rates

The monetary authorities maintained their policy stance on the Monetary Policy Rate (MPR) at 13 percent, and harmonized both the CRR on public and private sector funds to 31 per cent, from their previous rates of 75 per cent and 20 per cent, respectively. The harmonization of the CRR was a CBN measure aimed at curbing abusive practices of private sector participants, particularly banks (CBN-MPC, May 2015).

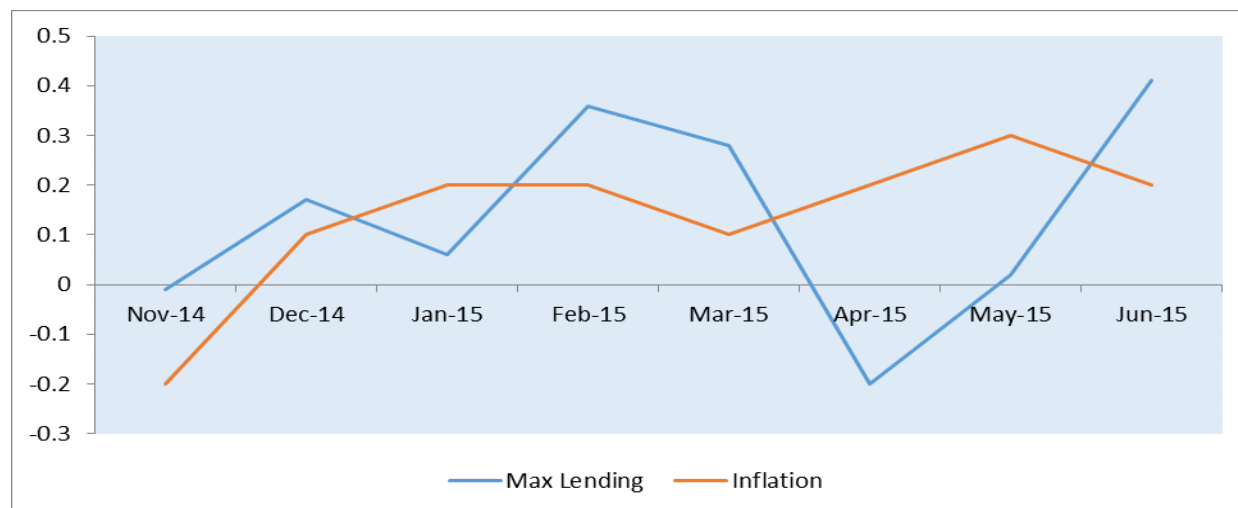
Figure 7: Real Interest Rate in Nigeria



Source: Authors computation from CBN Statistical database, 2015

Figure 7 shows that while real interest rate (non-prime lending rate adjusted for expected inflation) increased from 17.8 per cent in January to 18.1 in March, it however dropped sharply in April and May, albeit a slight uptick in June, 2015.

Figure 8: Changes in Maximum Lending and Inflation Rates (2014 November- 2015 June)



Source: CBN Statistical database, 2015

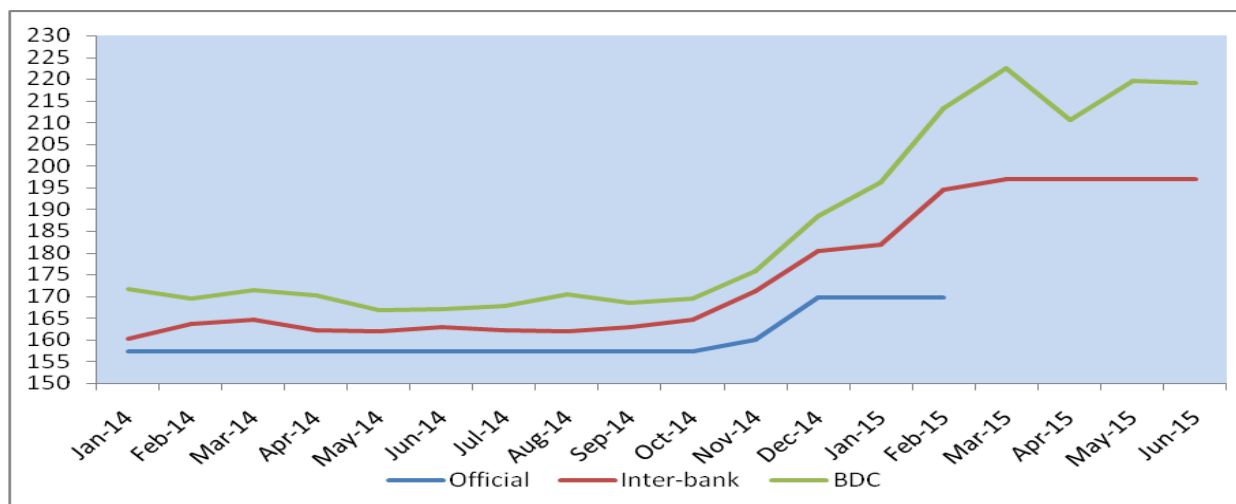
In the 2015H1, there was a noticeable positive relationship between maximum lending rate and inflation, however, the relationship between the two rates were negative in April, a reflection of the expansionary policy of the monetary authorities (see figure 8).³ In spite of the Central Bank's maintenance of a constant Monetary Policy Rate, changes in banks' lending rates in the period were mostly driven by inflation vis-à-vis demand and supply for loanable funds in the credit market. Consequently, it is pertinent that the Central Bank of Nigeria maintains its commitment to price stability and surveillance in the credit market.

2.5 Exchange Rate

The naira depreciated in the Inter-bank and Bureau-de-change (BDC) foreign exchange markets in 2015H1. The persistent pressure observed in the foreign exchange throughout 2014H2 led to further weakening of the naira across all tiers of the forex market in January, 2015. Consequently, the Central Bank of Nigeria closed the official Retail Auction System (rDAS) forex window on February 18, 2015. Despite the moderating effects of the closure, the naira depreciated against the United States dollar in the Inter-bank forex market by 8.33 per cent, from N182/US\$ in January to N196.92/US\$ in June. Also, the naira depreciated in the BDC segment from N196/US\$ in January to N219/US\$ in June, representing a significant decline of 11.65 per cent. The CBN's closure of the rDAS is already reversing the depreciation of the naira in both the Inter-bank and the BDC forex markets. For instance, since March, the naira has appreciated against the dollar by 1.63 percent and 0.08 per cent in the BDC and Inter-bank market, respectively. In the near-term, CBN's closure of the rDAS forex window is expected to stabilize and narrow down exchange rate spreads between the Inter-bank and the BDC forex markets.

³ The Federal Government of Nigeria reopened bonds purchase in April, 2015.

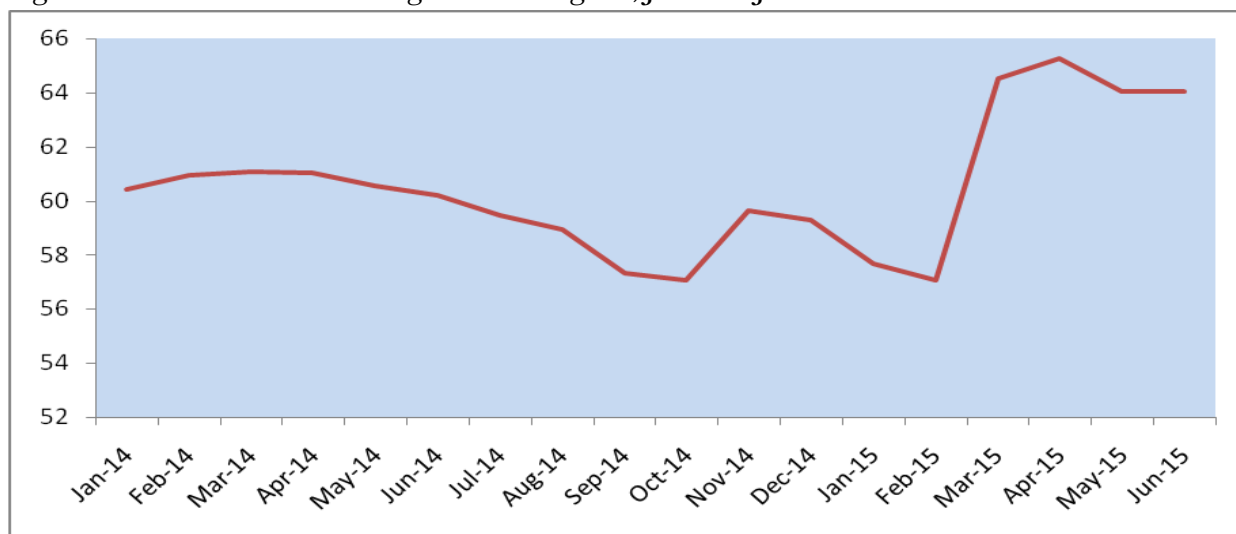
Figure 9: Naira Dollar Exchange Rate in Nigeria (Naira/US\$)



Source: CBN Statistical Database, 2014.

Figure 10 shows the real effective exchange rate (REER) in Nigeria between January 2014 and June 2015. The REER which has been on a downward trend since November 2014 witnessed a sharp rise in March 2015. From index value of 57.09 in February 2015, the REER jumped up by 13% to settle at 64.52 in March 2015, but declined slightly in May and June. On half-year outlook, REER has increased in 2015H1 relative to 2014H2. With the median value of 64 in 2015H1, REER increased by 8% from the median value of 59 in 2014H2. This indicates that an average consumer in Nigeria paid more on imported items in 2015H1 compared to 2014H2. It also signifies that the country has weaker international competitiveness in 2015H1 relative to 2014H1.

Figure 10: Real Effective Exchange Rate in Nigeria, Jan2014-June2015

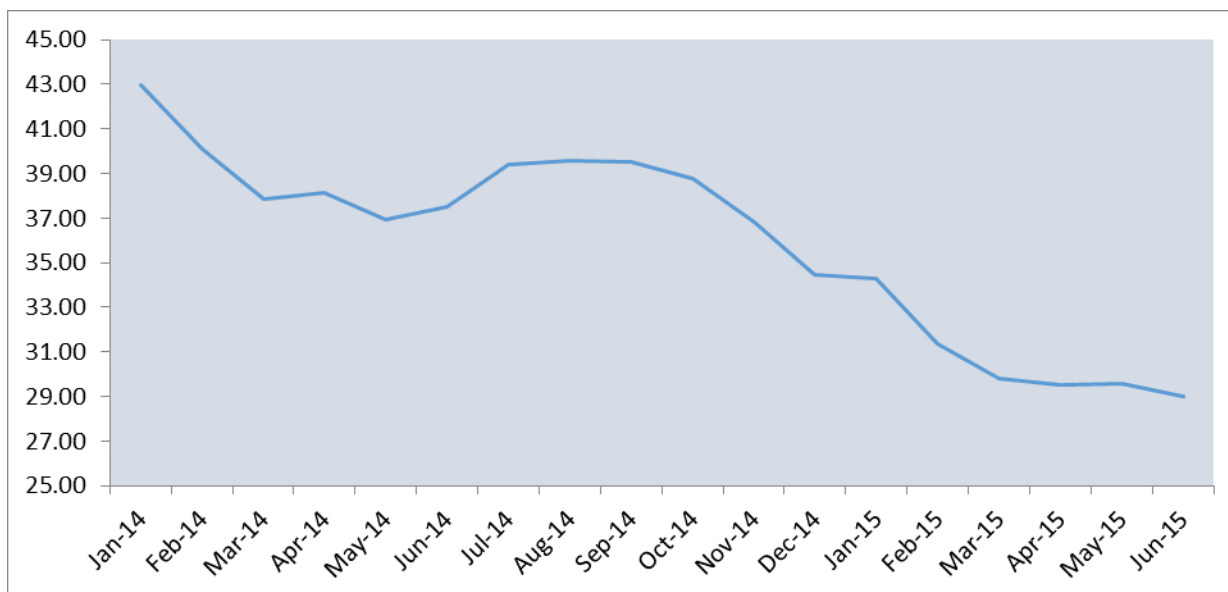


Source: CBN Statistical Bulletin, 2014, 2015

2.6 Declining external reserves

The downward decline of Nigeria's external reserves which started in July (2014), intensified in 2015Q1, particularly with a 14.4 per cent decline between January and March. External reserves significantly declined⁴ by 15.4 per cent from US\$34.28 billion in January to US\$29 billion in June, 2015. However, the decline of external reserves subsided in April, with a marginal uptick of 1.6 per cent - an accretion of US\$0.45 billion to the external reserves. While the current level of US\$29 billion can finance 7 months of imports, above the standard 3 months coverage, it is a considerable reduction in the import cover of 9.1 months and 9.3 months in 2014H2 and 2014H1 respectively.

Figure II: External Reserves (\$ Billion)



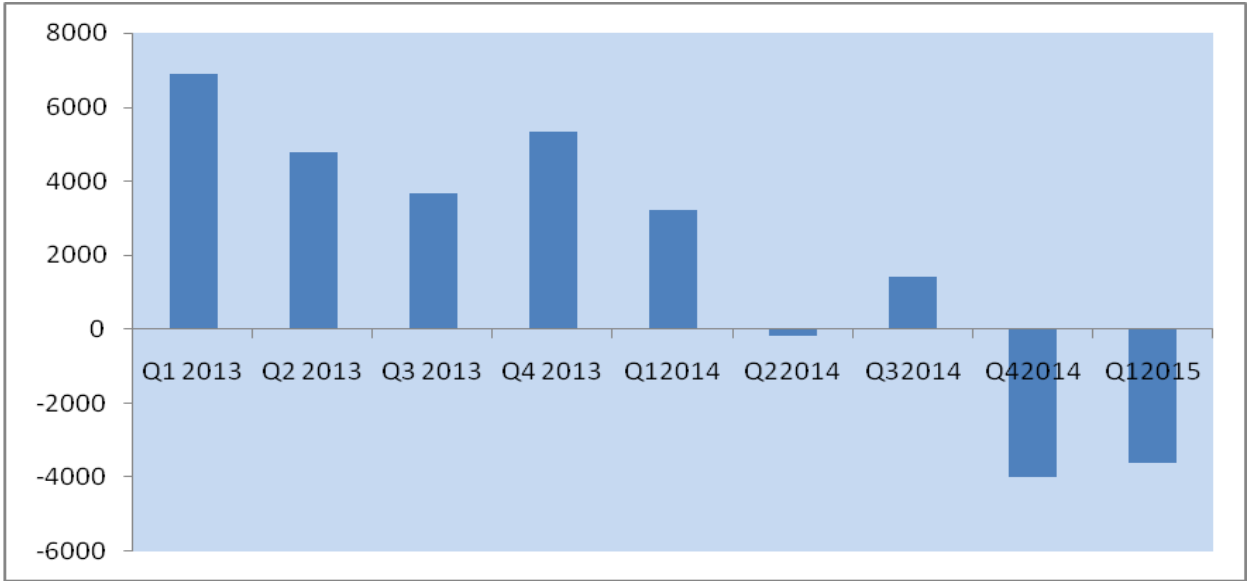
Source: CBN Statistical Database, 2015

The plunge in the oil price that started in the second half of 2014 created trade deficits (see figure 15) and consequently resulted in the depreciation of the naira. Due to the sterilized intervention policy⁵ pursued by the Central Bank of Nigeria (CBN) to prevent continuous fall in the value of naira, excess reserves continue to fall remarkably during the period. In the first half of 2015, pursuing sterilized intervention policy was no longer tenable as the external reserves had already depleted to a low level. Hence, the CBN closure of the retail Dutch Auction System (rDAS) in February 2015 as an alternative measure. This later culminated in pegging of the exchange rate by the apex bank (albeit threat from JP Morgan to remove Nigeria from its EM domestic bond index). Preventing exchange rate to be market-determined tends to inhibit free capital mobility; hence it is considered an act of capital control. The downside risk involved

⁵ Sterilized intervention policy is the Central Bank's response to depreciation of Naira by buying excess Naira in the forex market.

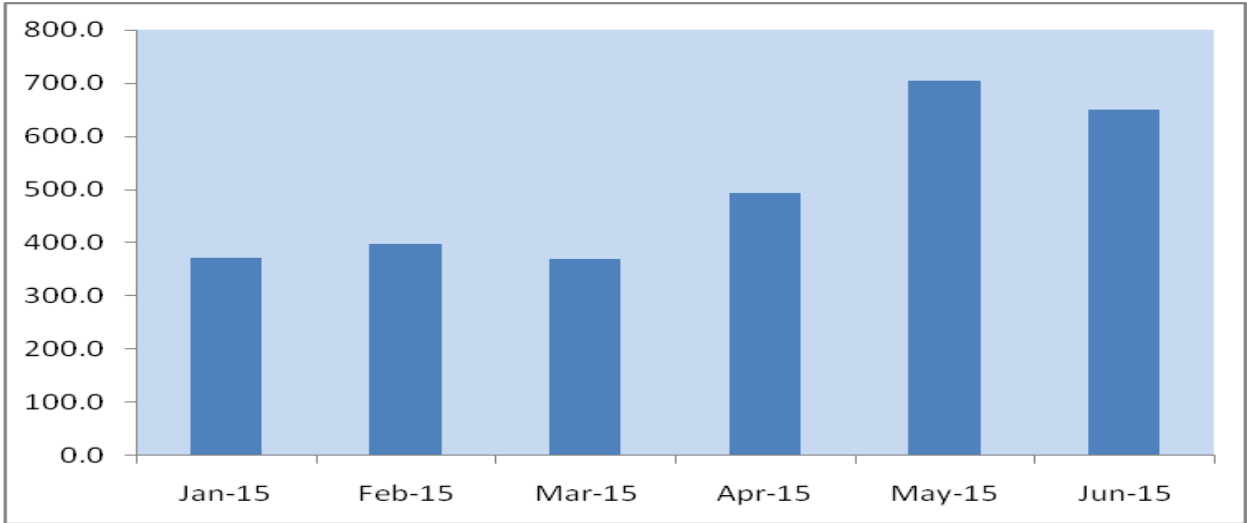
in toeing that line⁶ might affect (negatively) the economy’s international trade and foreign investment. Going forward, more stringent measures are expected to be put in place by the CBN to support the naira.

Figure 12: Nigeria’s Current Account Balance, 2013Q1-2015Q1



Source: CBN Statistical Database, 2015

Figure 13: Foreign Portfolio Investment (\$ Million)



Source: CBN Statistical Database, 2015

In contrast to significant divestments witnessed in 2014Q4, figure 13 shows that foreign portfolio investments increased significantly post-election in 2015H1. Specifically, foreign portfolio investment increased by 74.4 per cent (year-on-year) from US\$372.4 million in January to US\$649.4 million in June,

⁶ i.e. Pegging the exchange rate

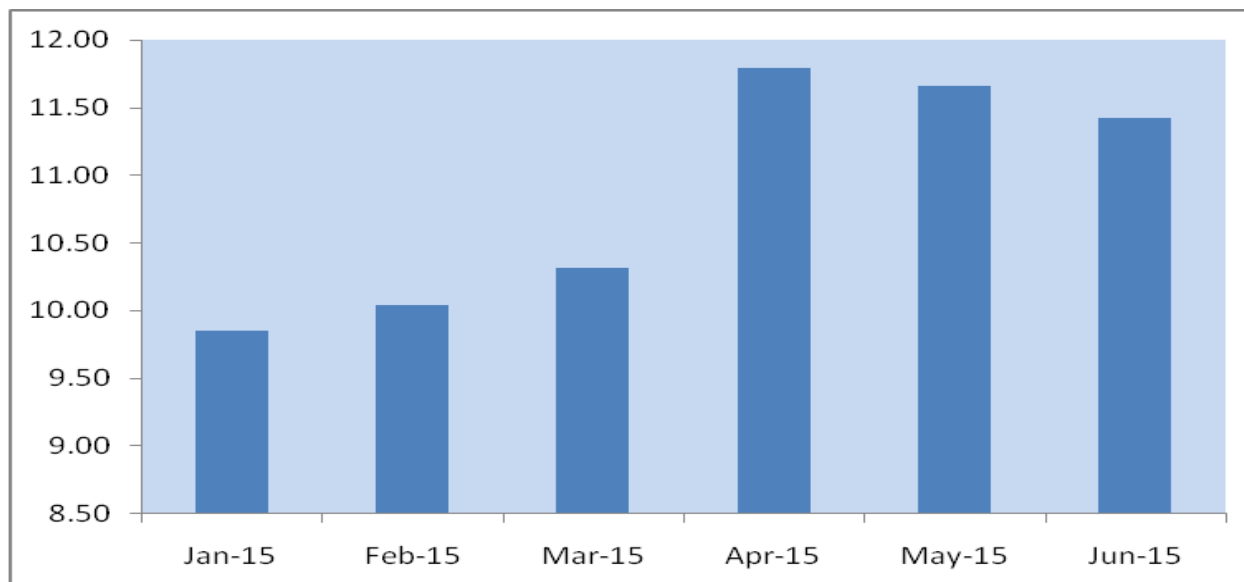
2015. The improved investor confidence and optimism elicited by the violent-free general elections were the likely factors that accelerated investments in the period.

The decline of foreign portfolio investment in June, 2015 may not be unconnected to the lack of clarity of the economic policy direction in the two months after the emergence of a new political administration. A reversal of this trend may be expected in September, as the president appoints a new cabinet and an economic management team.

2.7 The Stock Market

On average, performance indicators in the Nigerian Stock Exchange (NSE) such as the All Share Index (ASI) and the Market Capitalization improved significantly between January and April 2015. The stock market capitalization rose from N9.85 trillion at the start of January to N11.79 trillion at the end of April, representing an increase of 19.7 per cent. However, there was a gradual decline of 3.14 per cent from its value in April to N11.42 trillion in June.

Figure 14: Nigeria's Stock Market Capitalization



Source: The Nigerian Stock Exchange, 2015

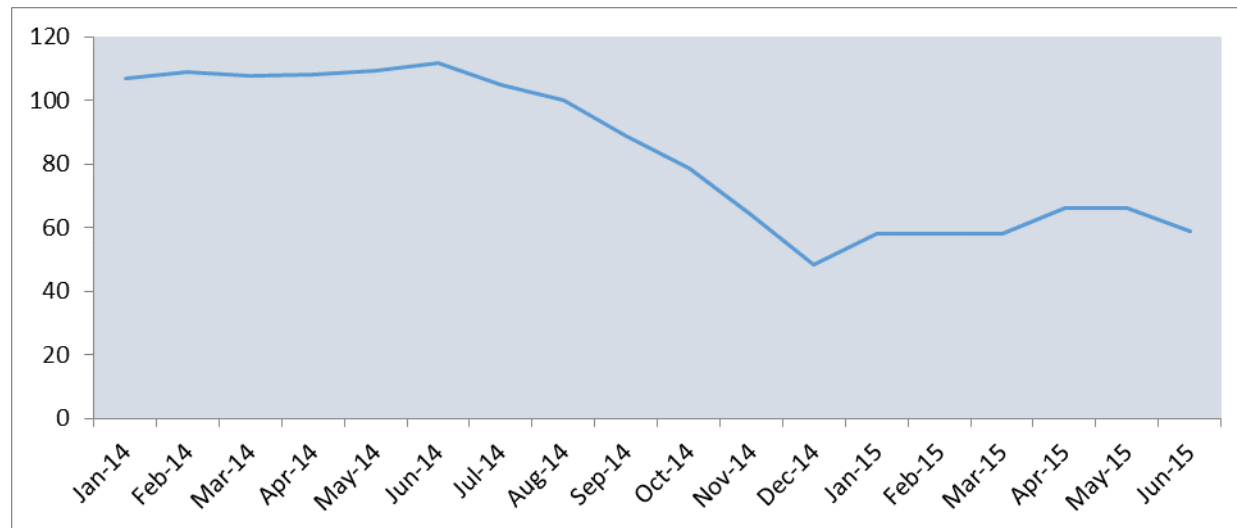
Market Analysts suggests that the emerging bearish conditions may not be unrelated to the uncertainties in Nigeria's economy which is promoting cautious trading among investors in the capital market.⁷

⁷ See Bello (2015) and Asu (2015)

3.0 Energy Sector Performance

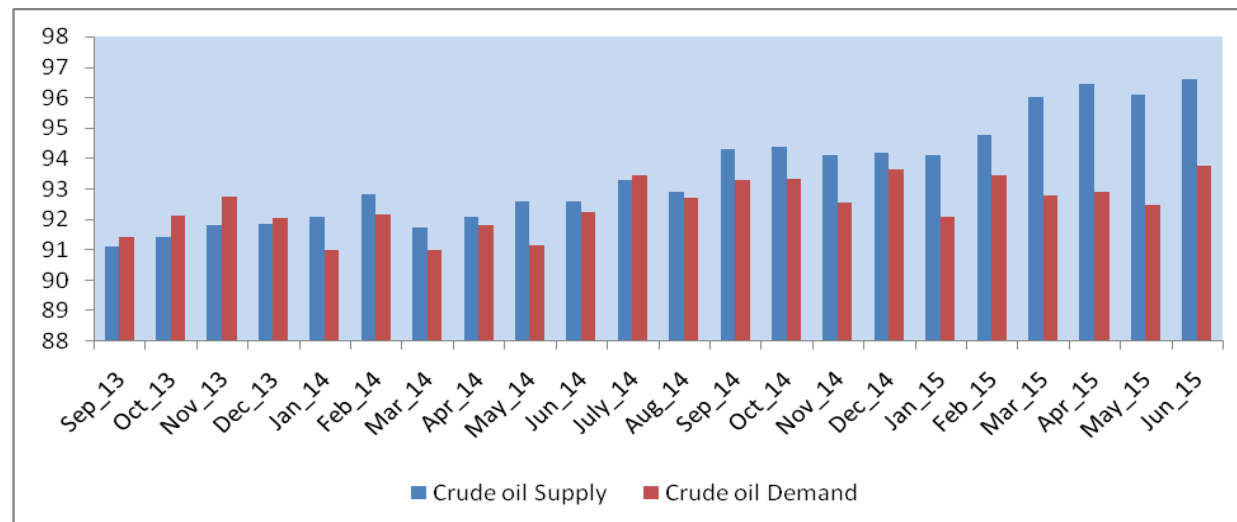
The beginning of 2015 marked an end to the continuous fall in crude oil prices which started in June 2014. Prices increased in January by 20 percent, and a further rise by 14 percent was witnessed in April, before falling slightly to US\$59 in June. The increases were mainly driven by a combination of stronger seasonal demand for refined crude oil products, a drawdown on United States oil inventories in May and an expected decline in the excess supply of oil in the international crude oil market (OPEC, 2015f).

Figure 15: Global Crude Oil (Brent) Market Prices – US\$



Source: US Energy Information Agency Database, 2015

Figure 16: Global Crude Oil Supply and Demand (Million Bpd)

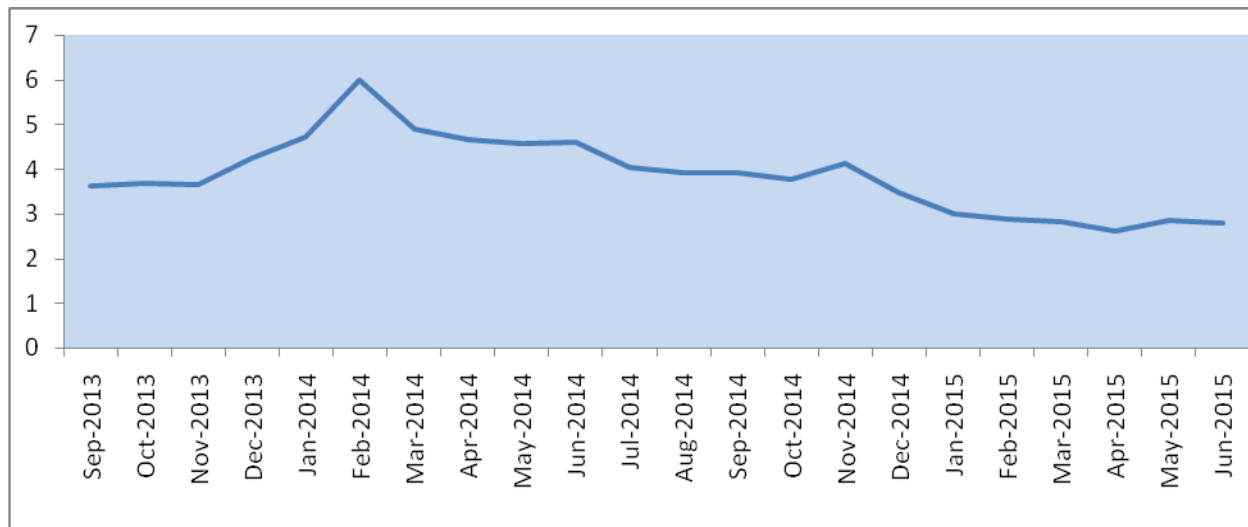


Source: US Energy Information Agency Database, 2015

While excess demand for crude oil could explain the high prices of crude oil in 2013, figure 16 shows that excess supply of crude oil which started from January 2014 did not manifest in lower crude oil prices

until June 2014, reflecting a lag in transmission of the excess supply shock in the crude oil market. The margin of excess supply increased considerably in the 2015H1, while the prices have rather stalled in the period. Thus a further fall in price may be expected in the near term, given the observed lag effect in price adjustment.

Figure 17: Global Natural Gas Prices (Million Btu)



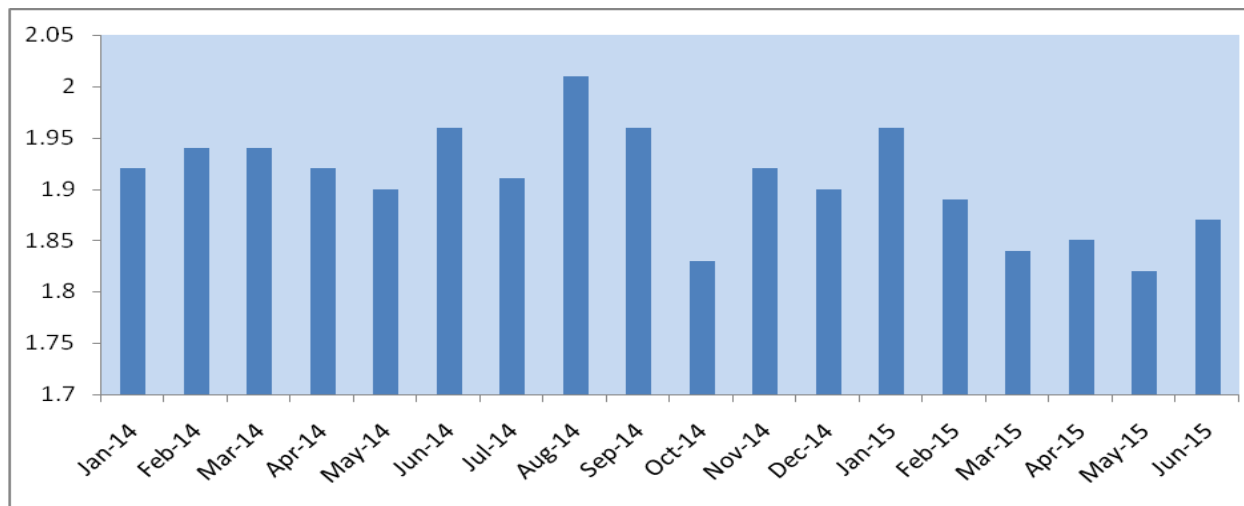
Source: Energy Information Agency 2015

Contrary to the view⁸ that natural gas prices follow the trend in crude oil prices with a 3 -6 months time lag, figure 17 shows that the consistent fall in natural gas prices started in March 2014, 4 months before the fall in crude oil prices. The continuous fall in natural gas prices could reflect the excess supply in the market as a result of the US shale oil and gas revolution. In addition, the resumption⁹ of production in the Gulf of Mexico, which significantly increased global output, may have added further downward pressures on natural gas prices.

⁸ See European Parliament Report on “The Impact of the Oil Price on EU Energy Prices,” 2014.

⁹ Natural gas witnessed shut-in production earlier in 2014 due to storms from the hurricane season.

Figure 18: Nigeria's Crude Oil Output (Million Bpd)



Source: OPEC Monthly Reports, 2015

From Figure 18, while there is no clear trend in the changes of crude oil output, production in 2015 have been generally lower than that of 2014 so far. The following factors contributed to the lower oil output in 2015H1:

- Continuous decline in oil price reduced profitability of oil production, and thus diminished the incentive to prospect for oil. A significant decline in oil rig counts was therefore witnessed in 2015H1 (See Figure A2 in Appendix).
- Persistent volatile security situation in the Niger Delta, unchecked pipeline vandalism, and industrial-scale crude oil theft also contributed significantly to lower crude oil production.
- The force majeure declared by a major oil producer, Shell BP, which led to the shut-down of key oil facilities: Trans-forcados and Nembe creek pipelines.

4. Real Sectoral Performance

4.1 Agricultural Sector

Agricultural sector remain a major contributor of GDP in Nigeria, and has continued to play a key role in the efforts towards the diversification of the economy. Figure 19a shows that the growth rate of the sector has remained above 3 percent since 2014Q1, despite the supply interruptions as a result of the scourge in terrorism in the Northeast within the period. From Figure 19b, post-GDP rebasing values show a continuous drop in its contribution to GDP, up till 2015Q1, with a slight increase in 2015Q2. While Crop production remained the dominant component of Agriculture GDP, marginal increases in the contribution of Livestock was witnessed in 2015H1 (See figure A3 in Appendix).

Figure 19a: Agricultural Sector Real GDP Growth

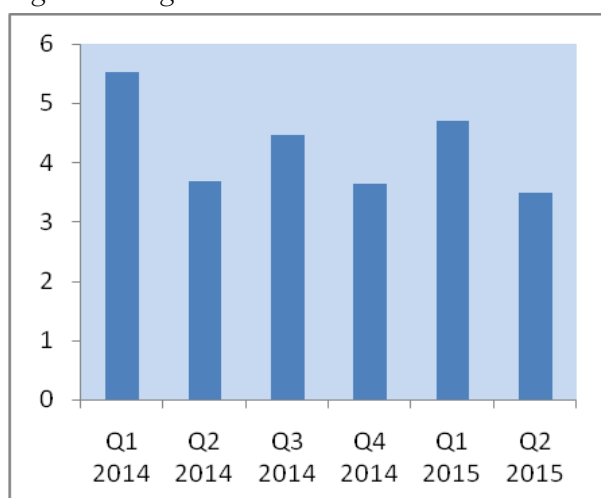
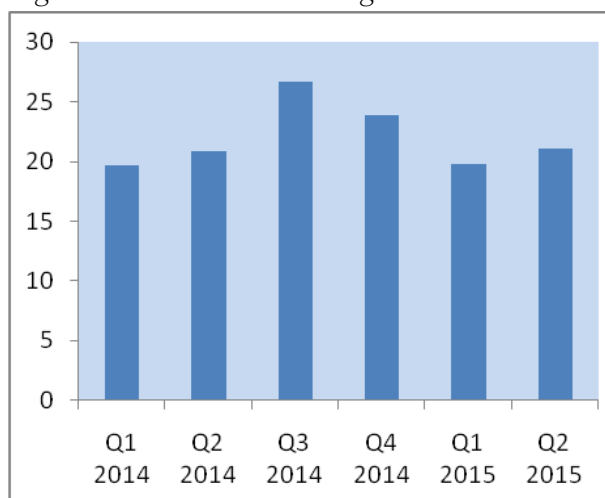


Figure 19b: Contribution of Agriculture to GDP



Source: NBS GDP Report, 2015

The impressive strides gained in provision of credit to agriculture in 2014, have been diminishing in 2015Q1. Figure 20a shows a clear reversal in the upward trend witnessed in the share of agriculture in commercial banks' credit, as a significant decline was witnessed from January 2015. From Figure 20b, foreign exchange utilization on food products declined sharply in 2015Q1. While the decline could be attributed to progresses made in increasing local production of some staple crops, it is more likely to be demand driven, as the largest importer of rice cancelled its importation contracts, following import quota disagreements with the Nigeria Customs Service¹⁰.

¹⁰Olam Nigeria Ltd, the largest importer of rice in Nigeria was not able to reconcile with the Nigeria Custom Service as regards the import quota allocated to it by the Ministry of Agriculture. This led to outright cancellation of rice importation contracts by the company between December 2014 and April 2015.

Figure 20a: Agriculture Share of Deposit Money Banks' Credit

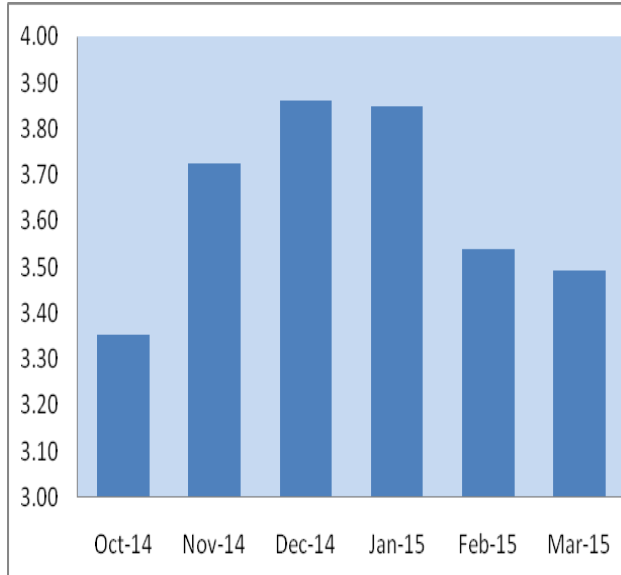
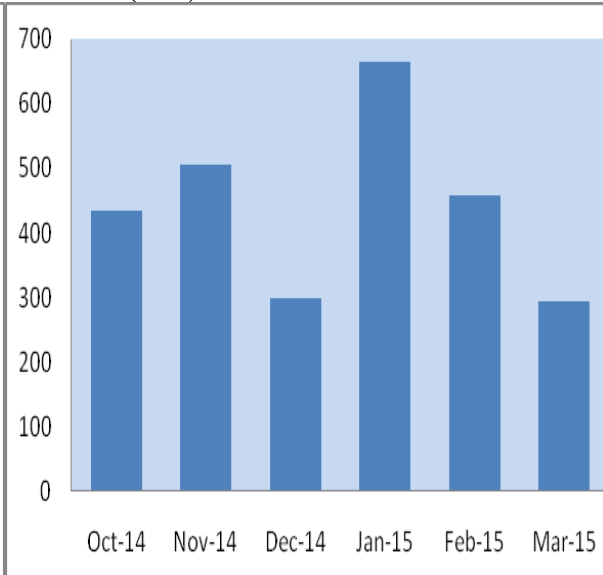


Figure 20b: Foreign Exchange Utilization on Food Products (US\$)

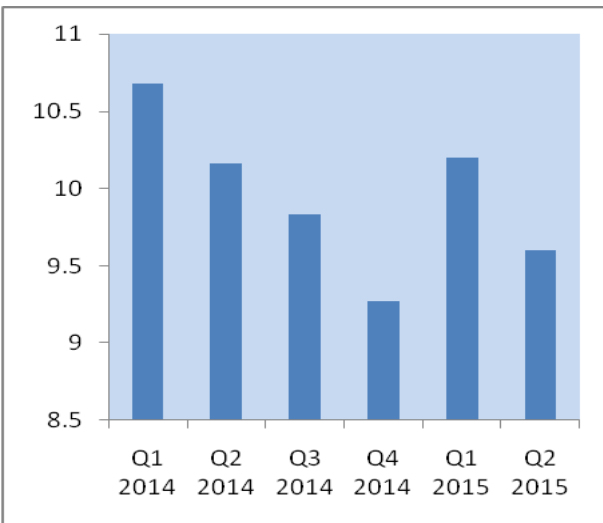
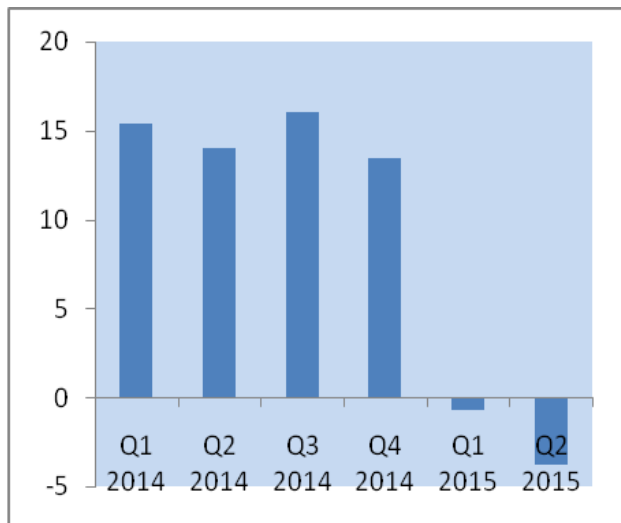


Source: CBN, Statistical Database, 2015

4.2 Manufacturing Sector

The impressive growth of above 10 percent witnessed in the Manufacturing sector all through the quarters of 2014 has reversed remarkably. Figure 21a shows that the sector contracted in the first two quarters of 2015. The negative growth was mainly driven by significant declines in Oil refining (53.85 per cent) and Textile, apparel, and footwear (5.23 percent) subsectors.

Figure 21a: Manufacturing Sector Real GDP Growth Figure 21b: Contribution of Manufacturing to GDP



Source: CBN Statistical database, 2015

The steady decline in the contribution of manufacturing to GDP, reversed sharply in 2015Q1, but declined considerably in 2015Q2. Non-metallic products and Chemicals and Pharmaceutical products were the main drivers of manufacturing contribution to growth for 2015Q1 and 2015Q2 respectively, while Oil refining declined significantly within the period.

In terms of the much-needed provision of credit for manufacturing, it is apparent that progress has been made in 2015H1. From Figure 22a, the share of bank credit to manufacturing has been increasing steadily since January 2015. Figure 22b shows that foreign Exchange utilization in the sector has been fluctuating, with no clear trend.

Figure 22a: Manufacturing Share of Deposit Money Banks Credit (%)

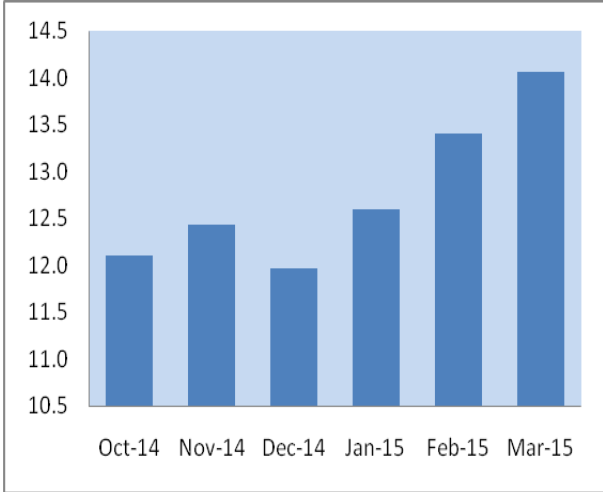
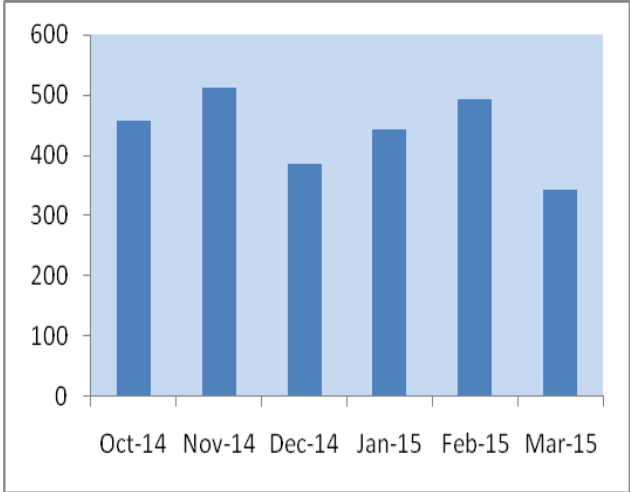


Figure 22b: Foreign Exchange Utilization on Manufactured Products (US\$)



Source: CBN Statistical database, 2015

5.3 Services Sector

The services sector witnessed some considerable growth in first half of 2015, albeit a slowdown of 2.4 per cent in 2015Q2. However, the sector remains the main contributor to GDP in Nigeria post GDP rebasing, and the share intensified in 2015. With a contribution of 54.46 per cent to GDP, the sector was the single highest contributor to Nigeria’s GDP in 2015H1. Arts, Entertainment and Recreation, and Transportation and Storage sub-sectors were the main drivers of the contribution of the sector to GDP.

Figure 23a: Services Sector Real GDP Growth

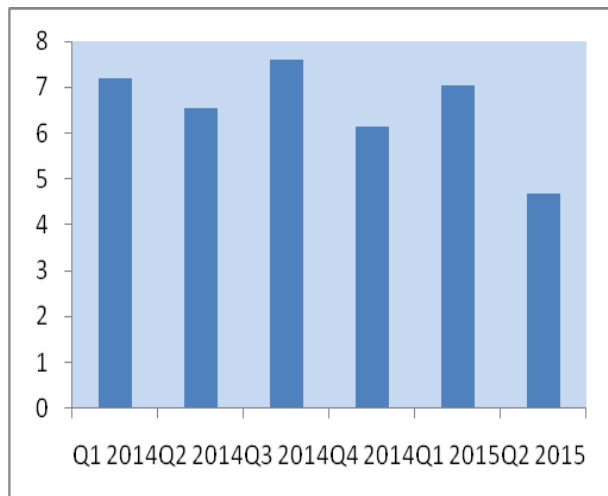
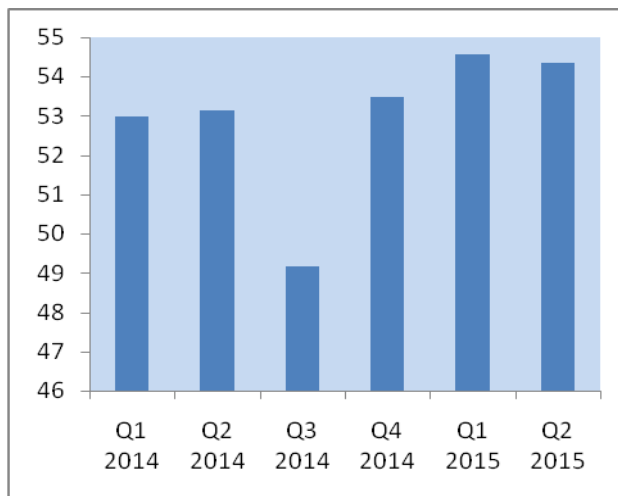


Figure 23b: Contribution of Services to GDP



Source: NBS GDP Report, 2015

From Figure 24a, bank credit to services sector declined significantly between February and March of 2015; while the steady rise in the utilization of foreign exchange in the sector from December 2014, declined considerably in March 2015.

Figure 24a: Services Share of Deposit Money Banks’ Credit (%)

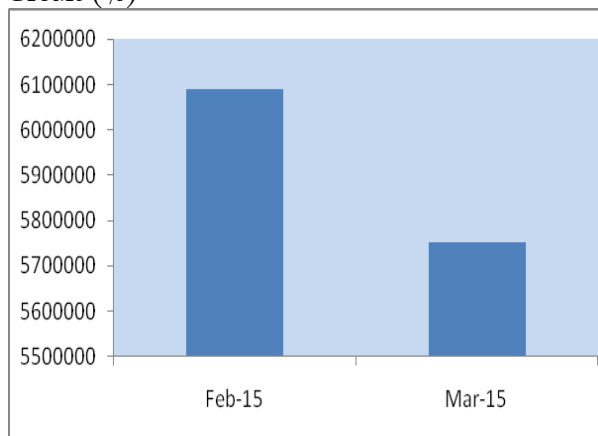
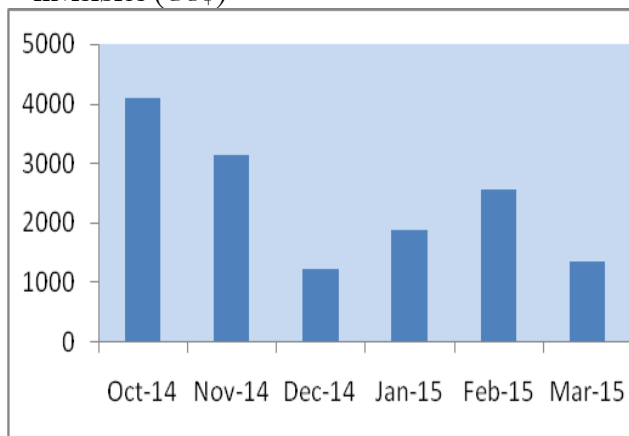


Figure 24b: Foreign Exchange Utilization on Invisibles (US\$)



Source: CBN Statistical database

5. Special Featured Article

Managing the Nigeria's Current Economic Crisis: The Choice between Active and Non-active Stabilization Policy

The negative oil price shock (in the first half of 2014) sparked wide policy debates among policy makers and analysts in Nigeria. The diagnosis of the shock, as well as policy options to remedy its effects has been debated. While it is clear the shock had a direct effect on government revenue, trade balance, and exchange rate, however, selecting the appropriate policy to cushion the effects remains a challenge for policymakers. Given the two prominent economic views to output stabilization, policymakers are apt to choose the one that meet their policy objectives. One line of economic reasoning is for governments to remain passive to output fluctuations - allowing economic adjustment to take place through automatic stabilizers¹¹. But this approach seems to be suitable for countries with improved fiscal system and well-coordinated institutions. An economy with higher Debt-to-GDP ratio may opt for this proposition in order to avoid incurring more debts and ensure fiscal sustainability.

However, the effects of such policy may take long to manifest and this may predispose an economy to a protracted period of high unemployment, low income, low interest rates, etc. The other line of economic thought canvasses active stabilization during recessions. Going by this proposition, pursuing discretionary fiscal policy will correct output fluctuations at a faster rate, albeit at a cost of high inflation and higher debt accumulation depending on the structure of the economy.¹²

In Nigeria, it is apparent that the government is leaning towards a non-active stabilization policy, albeit involuntarily. The long delay in the appointment of ministers has sent different signals to economic agents¹³ in the country. Without a finance minister, household and firms have no clear indication of the fiscal policy direction to guide their expectations. This can create a lot of uncertainty with profound distortions on the macroeconomic aggregates¹⁴.

The economic downturn caused by the fall in oil price in the second half of 2014 transcended to the first half of 2015. Economic indicators in 2015H1 showed a record of high inflation, bearish capital market, erratic exchange rate movement, and dwindling foreign reserves¹⁵. Also the lack of clear direction on fiscal policy has created uncertainty with distortions in expectations among economic agents. Given the continuous depreciation of Naira, the soaring headline inflation figures from 8.2 to 9.2 between January

¹¹Pro-cyclical decrease in transfer or increase in tax revenues.

¹²Note that the two views to economic stabilization is premised on the assumptions that the Monetary Authority pursuing its objectives independent of fiscal policy.

¹³Households and firms

¹⁴Macroeconomic aggregate comprises inflation, unemployment, output, etc.

¹⁵CBN Statistical Database, 2015.

and July 2015 was very well expected¹⁶. The rising inflation is (partly) a result of pass-through effects occasioned by the fall in the value of naira against the dollar. As a consequence, the price of imported items has been rising and this reflected in an overall increase in the price level. But the price level did not adjust instantaneously to exchange rate depreciation. The effect on prices had a lag of six months, which reflects the time for households and firms to adjust their expectation to reflect rising costs of imported items. The rigidities and imperfections in the economy are the most probable causes of the observed lag effect.

Expectations can also explain the erratic movement in exchange rates during the first half of 2015. Uncertainty about future exchange rates manifested in excess demand for dollars during the period. With continuous fall in the value of naira in the international foreign exchange market, the incentive to hold assets in naira has been diminishing. Hence, there was a rush for asset denomination in dollars which led to Central Bank intervention to close the retail Dutch Auction System (rDAS) in February 2015.

In addressing soaring inflation and exchange rate depreciation, the Central Bank of Nigeria (CBN) has been playing key roles in tackling the challenges. Part of its policy was to increase interest rates. By increasing interest rates, capital inflow will increase and exchange rate depreciation will be put to check. But these efforts of the CBN may not be sufficient to safeguard the economy. Government needs to complement the efforts of the CBN by instituting effective fiscal reforms which aims to block leakages and improve revenue generation especially from non-oil sector. Also, government should promote institutional reforms that enhance competitiveness and reduce the costs of doing business in the country. These can be realized through timely constitution of an economic management team.

Overall, government intervention is needed to restore balance in the economy at a faster rate. Relying on automatic stabilizers (which seems rather non-existent in Nigeria) may lead to further distortions and the uncertainty can be inimical to the stability of the economy. Timely responses of governments to economic shocks have played a key role in successfully resolving economic crises in different regions¹⁷ of the world.

¹⁶ NBS Consumer Price Index Monthly Reports (January-July, 2015).

¹⁷ See America recession 2007-2009, Japan recession of the 90s

6. Outlook for 2015H2

The prospects for increased output growth in the second half of 2015 are bleak. Considering the low oil prices and weak revenue, the ability of the government to pursue an expansionary fiscal policy is limited. More so, uncertainty created by lack of policy direction would tend to lower the incentive to invest.

With weak revenue, government is likely to face harder fiscal constraint in the second half of 2015. The rising inflation will reduce the face value of the non-indexed government (bonds) debts. This will impoverish holders of the bonds. Financing government activities through issuing of new bonds may likely be difficult as lenders might exercise restraint in buying government bonds especially in a situation of high economic uncertainty.

With robust fiscal policy intervention to complement existing monetary policy, soaring inflation may be put to check in the second half of 2015. Given the instability of oil price in the world market and declining foreign reserves, exchange rate may be more volatile in the second half. The recent pegging of the exchange rate by the CBN (although effectively stabilized the exchange rate) is unsustainable in the near term considering the threat by JP Morgan to de-list the country from its bond index. The downside risks that may arise from the country's removal from JP Morgan bond's index can lead to more distortion and uncertainty in the economy. The monetary authority should consider other channels to effectively manage the exchange rate depreciation. One of the ways the government can avoid indiscriminate exchange rate depreciation caused by oil price volatility is by hedging¹⁸ future oil contracts.

There is high indication that oil glut in the world market will continue in the second half of 2015. With significant production of unconventional oil in the North American region and the unresolved position of OPEC members to cut down production, the world market would continue to witness increase in oil supply. With no indication of a correspondent increase in the world oil consumption in the near term, oil price may continue to face downward pressure. The implication of this is that the country may face commodity trade deficits in the second half, if imports (especially non-essential items) do not reduce significantly. Therefore, government's plan on attaining self-sufficiency in food production needs more attention. Also, re-oriented efforts should be directed towards establishing agro-allied industries that will make use of primary inputs. These among others will assist in reducing importation on food and industrial inputs.

¹⁸ A hedge is an investment position intended to offset potential losses/gains that may be incurred by a companion investment

In general, volatility in oil prices, inflation, and exchange rate depreciation may still be the major challenges confronting the economy in the second half of 2015. Thus, government should consider designing appropriate policy measures in managing the economic crisis.

7.0 Concluding Remarks

This report presents an overview of the Nigerian economy using key macroeconomic indicators. It examines the performance of the economy both internally and externally. The evidence presented shows that the internal performance in the first half of 2015 has not been impressive. On the production side, there was a continuous decline in the real GDP growth. The fall in GDP growth can be traceable to a combined occurrence of higher interest rates, higher price level, and the shrink in government spending occasioned by low revenue from oil during the period.

Overall economic outlook signifies a struggling economy with weak mechanisms to manage the downturn caused by the plunge in oil price. Therefore, there is need for appropriate policy interventions that will integrate all stakeholders in the economy – monetary authority, government agencies, and corporate institutions. The intervention could come in form of reforms in fiscal, economic, and institutional settings.

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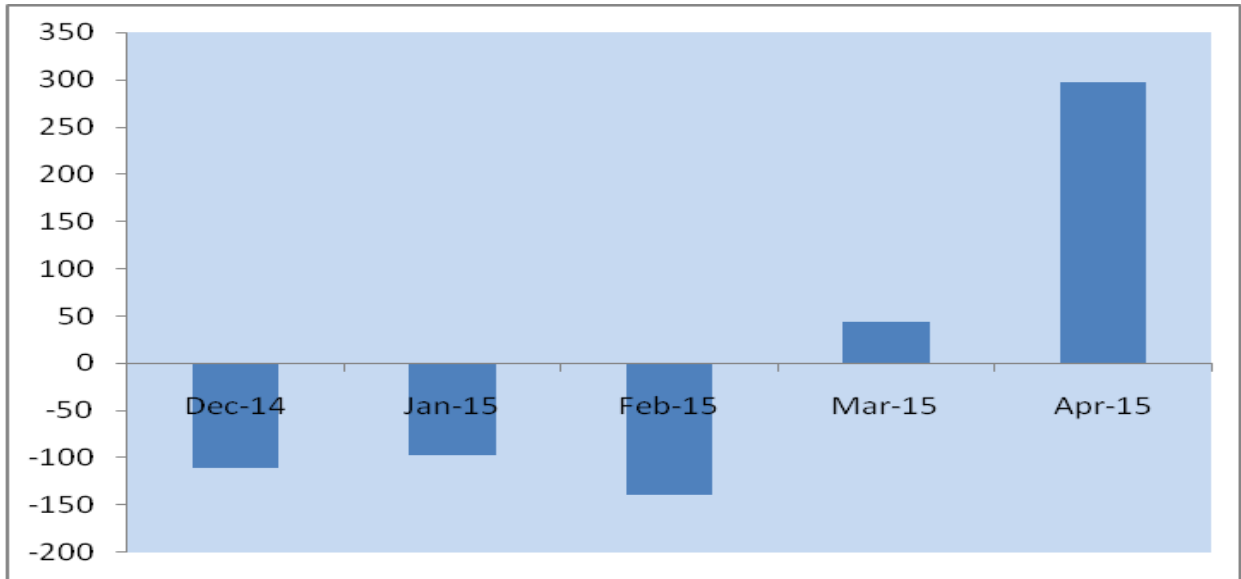
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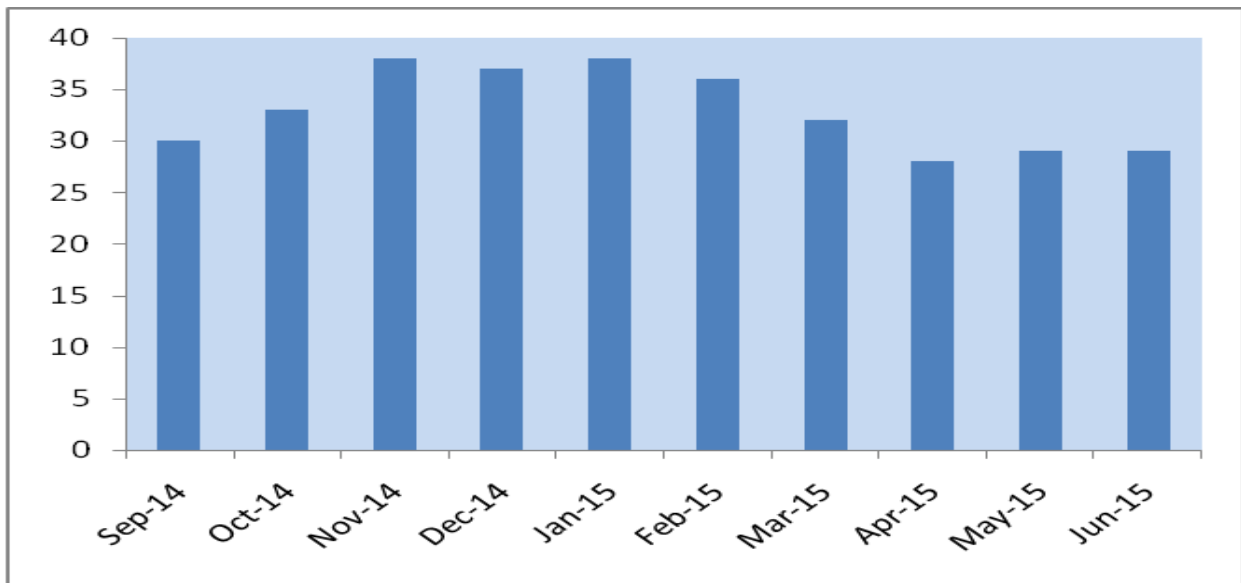
Appendix

Figure A1: Federal Government Monthly Fiscal Balance – Seasonally unadjusted



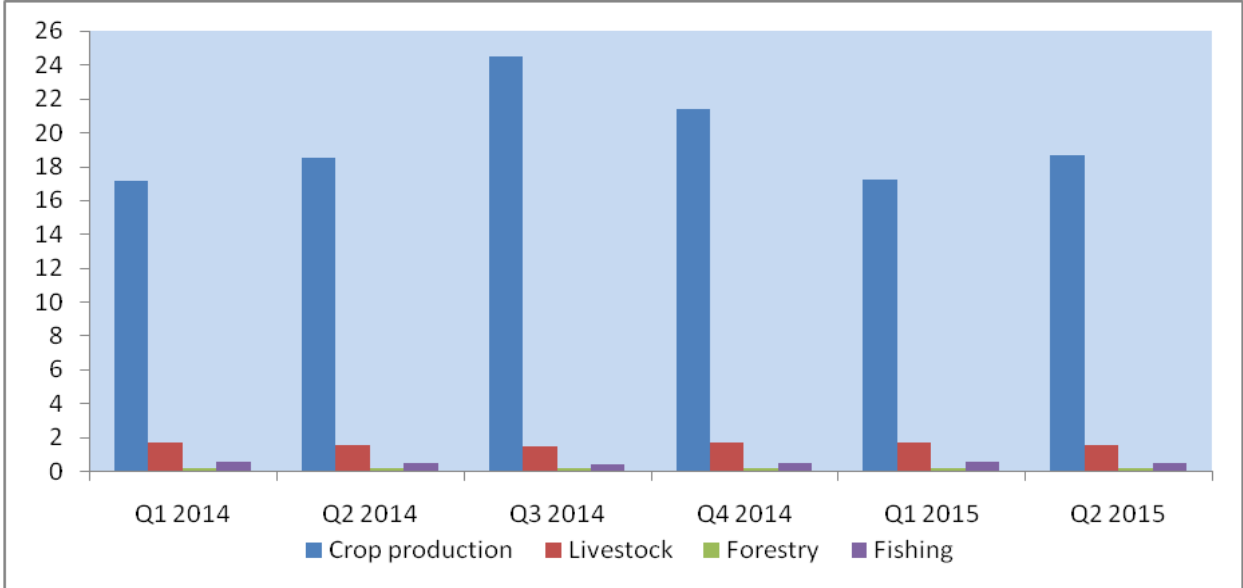
Source: CBN Monthly Report, April 2015.

Figure A2: Oil rig counts



Source: OPEC Monthly Reports, 2015

Figure A3: Components of Agriculture contribution to GDP



Source: NBS GDP reports, 2015