Nigeria Economic Alert

Nigeria - Q1'17 GDP sets the path to recovery

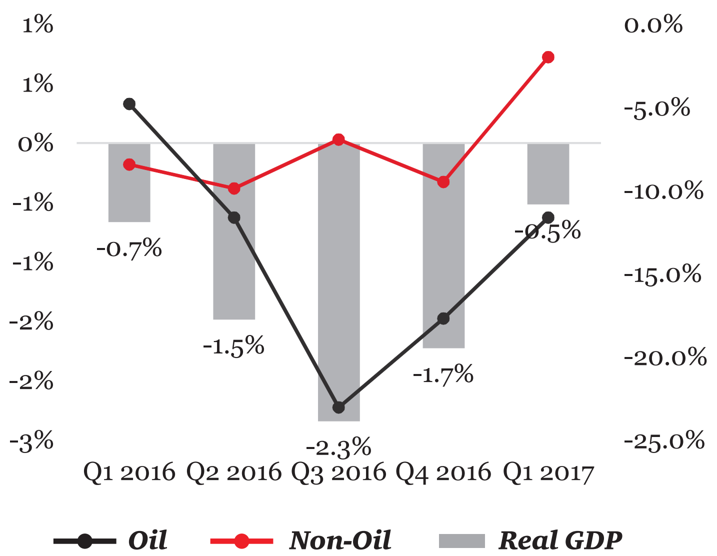
26 May 2017

Economy declines at a slower pace

Real GDP contracted for the fifth consecutive quarter in Q1'17 at 0.5%y/y, as the economy continues to reel from the impact of revenue shortages, owing to the decline in the oil price and production. Nonetheless, an improvement in manufacturing (9% of GDP), offset the impact of the broad based slowdown, a reflection of improved Foreign Exchange (FX) liquidity. Consequently, at -0.5%y/y, economic activities in the first quarter appear to have improved, when compared to -0.7%y/y and -1.8%y/y recorded in Q1'16 and Q4'16 respectively.

The oil sector continues to be a drag on economic growth, contracting 11.6% y/y, a reflection of the first quarter 14.8%y/y decline in crude oil production to 1.8mbpd. Having stated this, we note that this is the sector's best performance over the past four quarters, as the impact of the decline in production was softened by the 53.3% y/y increase in the Bonny Light crude price to $51.1/bbl, and 35.3% y/y depreciation of the NGN/USD to 305.9 in Q1'17. Growth in the non-oil sector turned positive though marginal, expanding by 0.7%y/y, driven by a rebound in activities across Manufacturing, Agriculture and ICT, which together account for 46.1% of GDP.

Figure 1: Real GDP declines at a slower rate



Note: Real GDP and Non-Oil sector growth is represented on the left axis, while Oil sector growth is represented on the right axis on the chart above

Real GDP to expand by 0.7%y/y in 2017

We maintain our 2017 real GDP growth estimate at 0.7%y/y, which suggests the economy will need to expand by at least 1.1%y/y over the next three quarters. This is plausible in our view given our expectation of improvements in oil exports, and an increase in investment flows. The key risks to our outlook stems from the vulnerability of Nigeria's revenue to fluctuations in the oil price and production, as well as any form of inconsistency in the on-going FX reform which could derail investments.

Policy reforms to support growth

Economic growth in Nigeria has been below potential, and is behind other emerging economies largely due to a very low level of investment over the years. We estimate Nigeria's investment to GDP at 12.7%, which is low relative to China's 44.1.% and India's 31.4%. To attain Nigeria's long-term growth rate of 7%, we estimate investment to GDP has to be at least 27%. The most recent capital importation report shows that Q1'17 FDI improved 21.1%y/y to USD 211.4 million. Assuming this is annualized, it would account for less than 5% of Nigeria's annual investment requirement of USD 70 billion. Thus, we view the recent measures on transparency and easing the constraints in the business environment as an important first step to unlocking investment flows which if sustained, would foster inclusive growth.

Improvement in FX liquidity is key to recovery

The Central Bank of Nigeria (CBN) has taken deliberate steps to improve FX liquidity, implementing a number of reforms since the beginning of the year. In our view, improving SMEs access to foreign exchange and the establishment of Investors' and Exporters' FX window have been strong catalysts, with positive spillovers to the real economy and foreign flows. On the downside, multiple exchange rates exist which represent an implicit cost in our view, as the CBN still remains a major provider of liquidity. As such, a collapse in the oil price/production is a key risk to the sustainability of this framework. Ultimately, we would expect that all the exchange rates are harmonized to a market determined rate, but this would depend on the rate of accretion to foreign reserves.

Impact of policy rate to be muted in 2017

The Monetary Policy Committee (MPC), at the end of its last meeting voted to retain the Monetary Policy Rate (MPR) at 14% - the policy rate has been unchanged since July 2016. While policy rate is an important consideration in unlocking domestic investment flows, the challenge of downward sticky lending rates in Nigeria suggest that more sizeable cuts would be required to significantly bring down the cost of private sector borrowing. We estimate that the MPR would need to be cut by at least 400bps to significantly open the credit taps. Given our outlook of a double digit inflation (FY17E: 13.5%y/y) and the need for positive real interest rates, we expect the committee to maintain the policy rate at 14% through the year, even as further tightening could further suppress growth.

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