

Nigeria's Economic Outlook in 2015

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February 5 2015

Abstract

2015 is likely to be a year of contrasts in which a difficult and uncertain start will most probably give way to a promising end, as renewed post-election economic reform efforts to address fiscal, structural, and financial challenges highlighted by low oil price and weak capital inflows on the eve of election will open up new growth and investment opportunities, thereby brightening the outlook. Thus, while the twin external shocks on the eve of general elections had imposed short term challenges and created significant uncertainties about the economic outlook in 2015, they have also beneficially elevated the place of economic and fiscal reforms in the pre-election conversation. A strong consensus for reforms has fortuitously been built among the populace that it makes sense to expect a high pace of reforms after the election. This will brighten the outlook for the second half of 2015 and beyond. Specifically the three big gains within Nigeria's reach are: (a.) Nigeria's fiscal outlook can easily be stabilized by revenue reforms that provides the fiscal space required for growth and stability; (b.) Breaking government monopoly in key potentially large economic sectors and allowing entry of reputable private firms will release fresh growth and investment impetus; (c.) Foreign longer-term financial inflows that will be attracted to the liberalized sectors will reduce Nigeria's dependence on volatile short term capital inflows. Nigeria is clearly coming up with a better contemplation of her economic and financial future, and it should be easier to engage others to come and invest in that future.

Economic Contrasts of 2014

2014 turned out to be a year interesting contrasts for the Nigerian economy, a remarkably favourable first half-year in which oil price reached a peak of US\$115 per barrel and equity market capitalization touched an historic peak of N14 trillion by midyear was followed by a very challenging second half-year in which the economy was buffeted by the twin shocks of global commodity price slump and global liquidity volatility that dwindled both exports income and capital inflows for the county. By yearend, oil price had dipped below US\$50 dollars per barrel, just as market capitalization shrank below N10 trillion, external reserves dropped to US\$34 billion, and the Naira exchange rate had lost a tenth of its value.

Uncertainties about Oil Price

2015 is thus starting on a challenging note for the Nigerian economy. Uncertainties about the oil price loom very large on the global scene, translating to a daunting fiscal challenge for the Nigerian government. In its January 2015 *Commodity Markets Outlook*, the World Bank forecasts oil price of US\$53 for 2015 and US\$57 for 2016. Down from average of US\$95 in 2014, oil exporters are out for a difficult ride in 2015, and the Nigerian government is already bracing up for the challenge by proposing a combination of spending cuts and raising additional revenue from non-oil activities, especially by imposing higher consumption taxes on luxury items.

Uncertainties about Elections

Domestically, general election scheduled for February 2015 adds some uncertainty to the economic outlook, with local and external observers hoping for a peaceful election that will yield an outcome that will be acceptable to all. A peaceful and conclusive election should see a resumption of foreign capital flows to Nigeria as uncertainties about the election must have combined with the fall in oil price to explain the wave of capital outflows from Nigeria towards the end of 2014. Most of the fiscal adjustments are likely to occur after the election, this would

be from March if the polls hold in February as scheduled, but could delay till June if the polls are shifted towards the May 29th date for inaugurating newly elected government.

The Silver Linings

Economic and political uncertainties aside, Nigeria's outlook is brightened by the large and varied opportunities in different sectors of the economy. Over the past decade, Nigeria had unleashed huge growth potentials through the liberalization of its telecommunications sector, which saw the sector grow from less than half a million telephone lines in 2001 to over 130 million in 2014. It is expected that similar liberalization of the generation and distribution segments of the electric power sector towards the end of 2013 will trigger a new wave of growth in the near future, especially if the transmission segment is also liberalized after elections. Complementary liberalization of gas supply, pipelines and refineries after the elections will open up additional investment opportunities that would underpin future growth.

Thus, while the twin external shocks on the eve of general elections had imposed short term challenges and created significant uncertainties about the economic outlook in 2015, they have also beneficially elevated the place of economic and fiscal reforms in the pre-election conversation. A strong consensus for reforms has fortuitously been built among the populace that it makes sense to expect a high pace of reforms after the election. This will brighten the outlook for the second half of 2015 and beyond.

It is therefore reasonable to expect the following key changes after the elections:

Revenue Reforms

- Higher government revenue from increased fiscal transparency and higher non-oil taxes consumption of luxury goods and items of ostentation. Nigeria's Oil GDP of about N10 trillion was just about 13 percent of the N80 trillion GDP that Nigeria was believed to have generated in 2013, the remaining N70 trillion or 87 percent being non-oil GDP. Searching questions have rightly been raised about why oil that is just 13 percent of GDP account for 70 percent of government revenue, and non-oil activities that are 87 percent of GDP. The low oil price regime will push Nigeria to raise more non-oil revenue which is currently about 3.7 percent of GDP and 5 percent of non-oil GDP compared to an average of about 25 percent of GDP in the other African countries with medium-to-large economies such as South Africa, Egypt, Algeria, Angola, and Morocco. Nigeria thus has the potential to raise additional revenue required to run the government from the booming non-oil sectors. Nigeria's Value Added Tax (VAT) rate of 5 percent across the board is low in comparison with South Africa, Egypt, Algeria, Angola and Morocco, which have standard VAT rates of 10 percent but administer much higher rates of 25 or 30 percent on luxury goods. It is better for Nigeria to fix the weaknesses in her revenue generation drive than let fiscal contraction hurt economic growth.

Structural Reforms

- New private refineries, privatization of power transmission, liberalization of gas supply, pipelines, and rail transportation, with concomitant increase in manufacturing and industrial activities. Nigerian government is most likely to do to its rail transport sector what it has beneficially done to its telecommunications sector, and has recently done to its power sector; namely, end government monopoly, carve out the country into zones and allow private firms

to bid for the rights to build and/or operate rail lines under the oversight of a new regulatory body. Not just rail, but pipelines, gas, and refineries. If these are successfully done, manufacturing should be expected to become spontaneously competitive and manufacturing exports should grow. Not just manufacturing will benefit. All other sectors will benefit from the competitiveness and scale that functioning cargo rail transport system will afford. Nigeria's economic activity and growth had hitherto been concentrated in sectors that are being stimulated directly by favourable global commodity prices such as crops, trading, oil & gas, telecoms & communications, and real estate. These are Nigeria's five largest sectors. Manufacturing is sixth, and Food, Beverage, and Tobacco (dominated by Beverage) constitutes 70 percent of it. Food, Beverage and Tobacco contributes nearly five percent of GDP but the other 12 manufacturing sub-sectors remain small, with none individually accounting for up to 0.5 percent of GDP! The manufacturing sub-sectors have not been capable of meeting local demand or compete on the global export market, having been weakened by the absence of domestic cargo rail transportation in Nigeria in particular, and disruptions to energy supply in general. The once vibrant Nigerian manufacturing collapsed in the 80s after the collapse of the once functioning rail transport system in the country.

Financial Reforms

- Higher longer term capital inflows will be attracted to the newly liberated sectors, and government could attract additional medium to long term capital inflows by issuing of medium to long term foreign currency bonds like Diaspora bonds or infrastructure bonds. On the global scene, it seems likely that the quantitative easing planned by the European Central Bank and the Bank of Japan should more than eventually compensate for the end of United States' liquidity injections and ensure a higher level of global liquidity in 2015. Nigeria also has fresh opportunity to reduce the dominance of short term capital inflows to the private sector, often referred to as 'hot money', as sector liberalization measures will boost medium and long term equity and other inflows into new refineries, power transmission, and rail development. Government can also attract longer term inflows by offering strong enough medium and long term value propositions in form of foreign-currency savings-bonds, targeted at Nigerians in Diaspora, or foreign-currency investment-bonds, such as infrastructure bonds, open to anyone looking for attractive long term investment opportunities.

2015 is thus likely to be another year of contrasts in which a difficult and uncertain start will most probably give way to a promising end. Renewed post-election economic reform efforts to address fiscal, structural, and financial challenges highlighted by low oil price and weak capital inflows on the eve of election will open up new growth and investment opportunities, thereby brightening the outlook. Nigeria is clearly coming up with a better contemplation of her economic and financial future and it should be easier to engage others to come and invest in that future.

Ayodele Olalekan TERIBA- Profile



Ayo is the *CEO* of *Economic Associates (EA)* where he provides strategic direction for ongoing research and consulting on the outlook of the Nigerian economy, focusing on: global, national, regional, state, and sector issues. He was a *Member* of the *National Economic Intelligence Committee (NEIC)* from April 2009 to April 2012, where he conducted periodic reality checks on macroeconomic, fiscal and monetary developments in Nigeria. Ayo is well known for articulating his views on Nigeria's economic policy imperatives through articles, interviews and comments in the mass media. Most notably, from 1996 to 1998, he spearheaded the advocacy for re-denomination of Naira notes and coins that led to the successful introduction of N100, N200, N500 and N1000 between December 1999 and October 2005. N50 note was the highest denomination prior to the policy advocacy. His current advocacy research is on what could be done to ensure democratic effectiveness in achieving desirable economic outcomes in Nigeria. Before becoming the CEO of EA in 2004, Ayo worked as Chief Economist and Member of Editorial Board at ThisDay Newspaper Group (2001-2004), Faculty Member at the Lagos Business School (1995-2001), Head of Research at the Lagos Chamber of Commerce (1993-1995), and Company Economist at UAC of Nigeria (1992-1993). He has served as Consultant to a long list of blue chip companies, Federal Ministry of Information, Senate Committee on Banking and Finance, several State Governments, DfID, USAID, World Bank, and was a Visiting Scholar to the IMF Research Department in Washington DC. He has received grants from Ford Foundation and Rockefeller Foundation, and chaired the steering committee of the Money, Macroeconomic and Finance Research Group of the Money Market Association of Nigeria. His prolific research output has included a 400-page annual economic, fiscal and sectoral report on the 36 states & the FCT, plus numerous scholarly publications resulting from his doctoral thesis, research grants, policy advocacy, and consultancy projects. Ayo earned B.Sc. in Economics from the University of Ibadan with Sir James Robertson Prize and Medal, UAC Prize in Economics, and Economics Departmental Prize as the all-round best economics graduate in 1988, M. Sc. Economics from Ibadan in 1990, M. Phil. Economics of Developing Countries as a Cambridge-DfID Scholar at the University of Cambridge in 1992, and Ph.D. in Applied Econometrics and Monetary Economics from the University of Durham in 2003.