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Time Economics Mid-Year Report

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1 Overview

The Nigerian economy is expected to grow in 2017, after experiencing its first full year contraction in 2016, the first such contraction since 1991. The economy is expected to return to growth in 2017, following higher oil prices and output in 2017. Nigeria's dismal economic performance in 2016 was largely due to lower crude oil prices and output compared to previous years, compounded by slow, erratic and indecisive economic policy decisions.

The increase in crude oil prices and production in 2017 in the first half of the year, compared to 2016, is expected to result in higher government revenue and foreign exchange reserves, which in turn will lead to higher government spending, stability in the value of Naira and a reduction in foreign exchange scarcity. Already, in the early months of 2017, the CBN has successfully stopped the fall of the Naira by using its increased foreign exchange reserves to intervene in the forex market and reduce the spread between its official Naira exchange rate and the parallel market rate used by Bureaus de Change (BDCs).

Unemployment data for the fourth quarter of 2016 shows that the unemployment rate in Nigeria increased to 14.2% from 13.9% in the third quarter, while the underemployment rate increased to 21%. This brought the total number of unemployed and underemployed to 28.6 million by the end of 2016, about one sixth of Nigeria's population. Given that the country is still in a recession, we expect that these numbers would have risen further by the time the unemployment report for Q1 2017 is released.

This report looks at how the key economic indicators have fared so far in 2017, following the economic collapse of 2016, and our expectations for the rest of the year. Many of the issues that dragged down growth in 2016 are still present in 2017; however, others are expected to change and we will examine whether the changes will be positive or negative for the country.

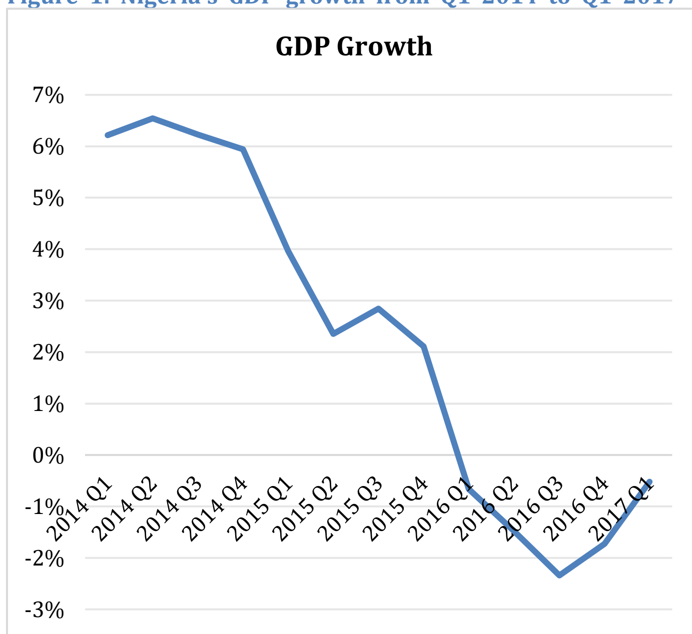
2 The Nigerian Macroeconomic Environment

Most analysts and observers expect growth in the Nigerian economy to be about 1% in 2017 based on expectations of higher oil prices and production. The major reasons for the recession in 2016 were lower oil production due to an insurgency in the Niger Delta region, the fall in global oil prices, and a low level of budget implementation by the government. Higher oil prices in 2017 on the back of an OPEC oil output cut agreement and higher oil production as the government begins to find a solution to the insurgency problem should be enough to see the economy return to growth in 2017.

However, the contraction of the economy in 2016 combined with population growth and the depreciation of the Naira means that the average Nigerian's 2017 income in Dollar terms will not return to the level of 2014 /15 any time soon, even with 1% growth.

2.1 Economic Growth

Figure 1: Nigeria's GDP growth from Q1 2014 to Q1 2017

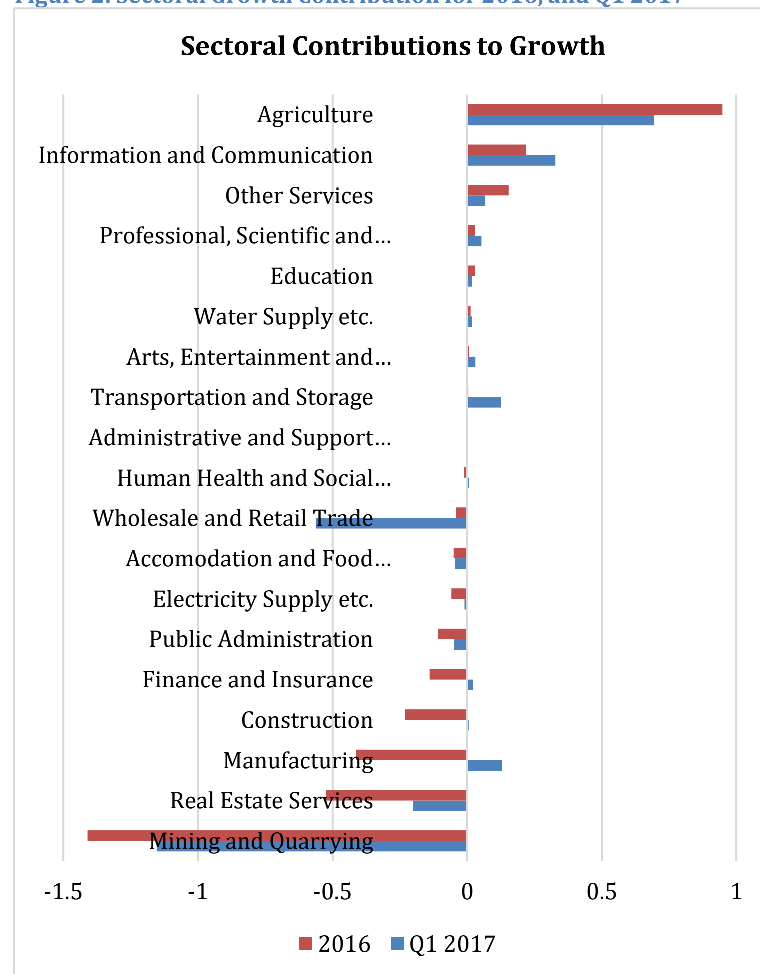


Source: NBS

Growth in the Nigerian economy was -0.52% in the first quarter of 2017 up from -1.73% in the fourth quarter of 2016 (see Figure 1). Although this was Nigeria's fifth consecutive quarter of negative growth, this was the smallest contraction in those five quarters, which is an indication that Nigeria's economy may be on the verge of recovery.

The two largest negative contributors to growth in the first quarter of 2017 were the mining and quarrying sector, which is mostly made up of oil and gas, and the real estate sector which repeated their performances in 2016 (see Figure 2). However, other sectors, which made substantial negative contributions in 2016 such as manufacturing, construction, and finance grew in the first quarter of 2017.

Figure 2: Sectoral Growth Contribution for 2016, and Q1 2017



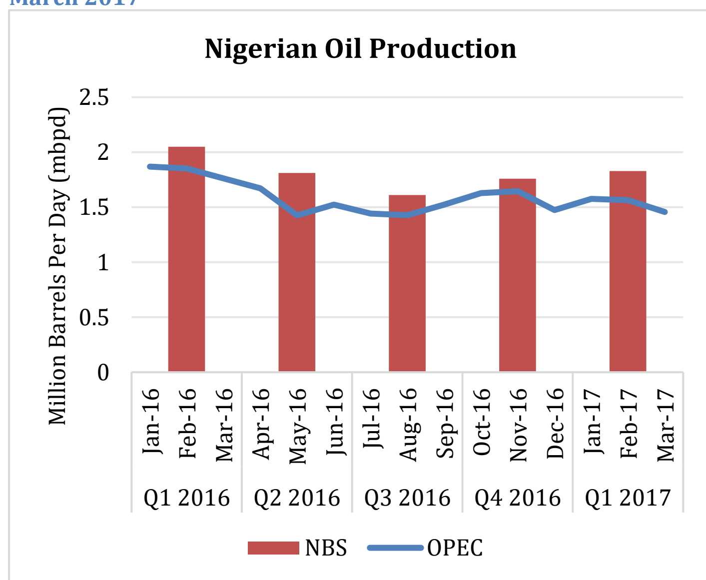
Source: NBS

The performance of the oil and gas sector is due to low production caused by the activities of insurgents in the

Niger Delta, which have affected oil infrastructure in the region. Although oil prices during this period (an average daily price of $53 per barrel) were higher than during the same period last year (an average daily price of $44 per barrel), production was much lower at 1.5 million barrels per day in Q1 2017 compared to 2million barrels per day in Q1 2016 (see Figure 3).

The implication of this is that the oil and gas sector is likely to experience slight growth in Q2 2017 if current oil production levels are maintained – average oil production in Q1 2017 was 1.83 million barrels per day (mbpd) compared to 1.81 mbpd in Q2 2017. Considering that the oil and gas sector has been the largest negative contributor to growth over the past year, a return to growth for the sector is likely to be accompanied by a return to growth for the entire economy. However, it should be noted that this depends on the current oil production levels being maintained or improved upon, and the other sectors of the economy performing similarly to Q1 2017.

Figure 3: Nigerian oil production from January 2016 to March 2017



Source: OPEC & NBS

2.2 GDP Per Capita

Looking at GDP growth gives us a rough idea of how well the economy as a whole is performing. However, to understand how individuals in the economy are impacted by these changes, it is more instructive to look at GDP per capita. The expectation of a return to GDP growth must be put in perspective by examining how it is likely to affect the average Nigerian. When the effects of population growth, which is expected to be around 2.28%, are considered, a GDP growth rate of 1% will mean the average Nigerian's income will be lower in 2017 than it was in 2016. Despite the expected return to growth, most Nigerians will not feel better off in 2017 and the proportion of Nigerians living in poverty will continue to grow.

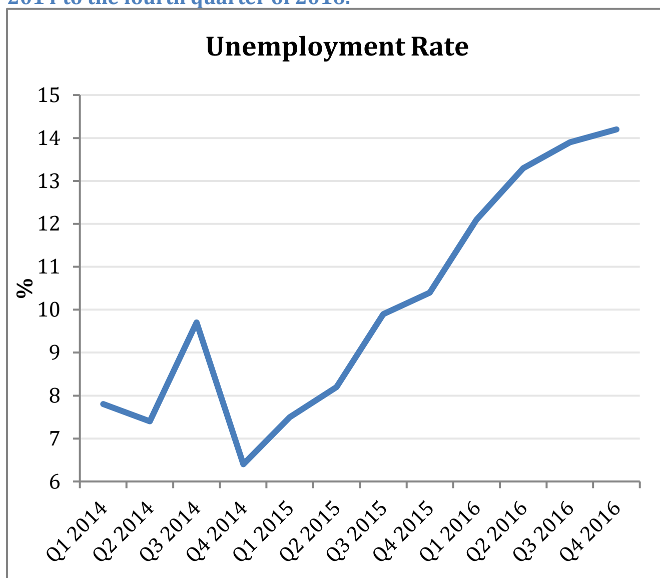
At the end of 2015, GDP per capita was approximately $1900, using an exchange rate of N197/USD and a population of 182.2 million (World Bank). Full year GDP growth for 2016 was -1.58%, and if we assume that Nigeria's population grew by 2.5 %, and use an exchange rate of N305/USD, GDP per capita fell to $1177. This decline in income over a single year is quite substantial but it is even worse when compared to GDP per capita in 2014 which was approximately $2200, a 47% decline in just two years.

If the economy grows by 1% in 2017, and the exchange rate is unchanged at N305/USD, GDP per capita falls further to $1160, again assuming 2.5% population growth. Given the significant reduction in income for the average Nigerian since 2014, and the high rate of population growth, GDP growth will have to be above 5% for a long time for Nigerians to have any chance of regaining their lost income.

2.3 Unemployment

The unemployment rate for the fourth quarter of 2016 was 14.2%, the highest rate recorded since NBS started recording quarterly unemployment data. Youths (those between the ages of 15 and 34) were the worst hit by rising unemployment in the country. Even as the economy is expected to grow in 2017, unemployment is expected to continue increasing with the expected pace of growth below what Nigeria needs to create enough jobs for the large number of people entering its labour force.

Figure 4: **Nigeria's unemployment rate from the first quarter of 2014 to the fourth quarter of 2016.**

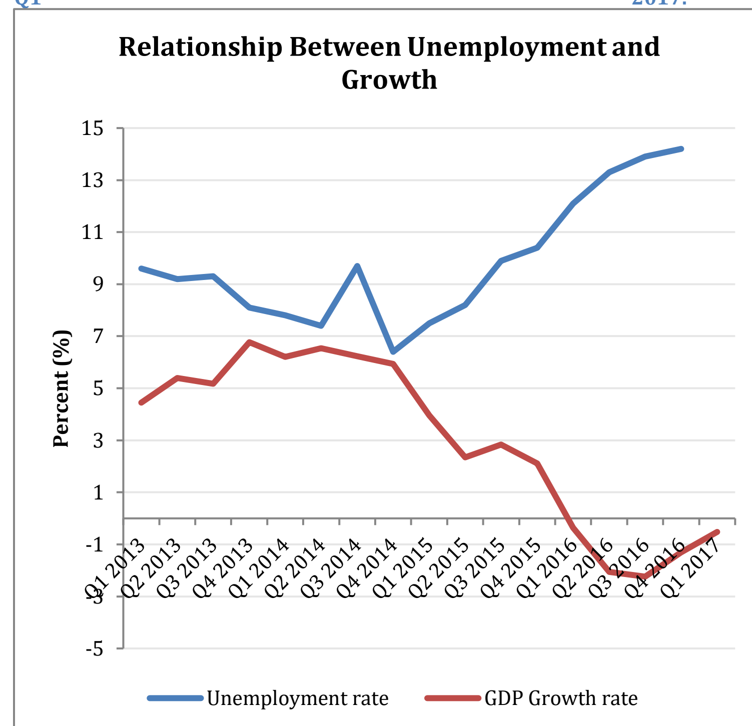


Source: NBS

Historical data has shown that the GDP growth rate has an inverse relationship with unemployment rate. The lower the growth rate, the higher the unemployment rate. The unemployment data for the fourth quarter of 2016 recorded an increase in unemployment to 14.2% from 13.9% in the 3rd quarter. This brings the number of unemployed people in the country to 11.55 million. The situation becomes even worse when the number of underemployed people, people working below 40 hours or engaged in activities that underutilizes their skills, time and educational qualifications, is considered. The underemployment rate increased to 21% from 19.7% in the third quarter of 2016, meaning that 17.03 million were underemployed by the end of the year, bringing the total number of unemployed and underemployed people in the Nigerian labour force to 28.58 million people in Q4 2016.

The unemployment and underemployment situation was worse for persons aged 15-34, which represents the youth population. The unemployment rate increased to 25.2% from 25% in the previous quarter for those aged 15-24 while the underemployment rate for the same age group was 36.5% in Q4 2016. The unemployment and underemployment rates for those aged 25-34 were 15.4% and 22.1% respectively. This brings the total number of unemployed and underemployed people aged 15-34 to 19.3 million or 47% of the youth labour force population. This presents a huge problem for Nigeria as research has shown that high youth unemployment correlates with high incidences of violent crime and other societal ills. This is also a problem for Nigeria's labour force in the future since the labour force is likely to be less skilled over time if a large proportion of the youth are unable to acquire valuable job skills early in their careers.

Figure 5: **GDP growth rate and unemployment rate from Q1 2013 to Q1 2017.**



Source: NBS

The two most important factors in determining the unemployment rate are GDP growth and the growth in the labour force population. We have stated earlier that

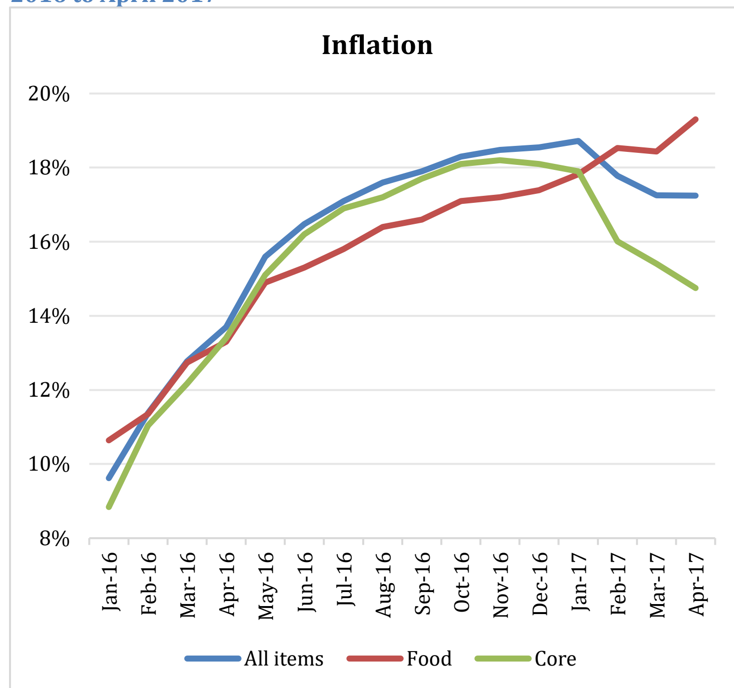
we expect a GDP growth rate of about 1%. If this is correct, we expect the unemployment rate to continue rising. As we can see in Figure 6 even when the GDP growth rate is positive but low, unemployment tends to rise, given the growth in the labour force population. Given the low rate of GDP growth expected, it is unlikely that the economy will create enough jobs for the hundreds of thousands of new entrants into the labour force. Although the number of new entrants into the labour force has fallen from 1.5 million people in Q1 2016 to about 482,000 people in the fourth quarter, this is more likely to be due to workers getting discouraged and leaving the labour force than to any permanent decrease in the number of Nigerians of working age. However, as economic conditions improve and the economy creates more jobs, these discouraged workers are likely to rejoin the labour force, driving the unemployment rate higher even as the economy creates more jobs. Therefore, we expect that the unemployment rate to continue to increase throughout 2017, worsening the unemployment crisis in the country.

2.4 Inflation

Nigeria's inflation declined for the third straight month dropping by 0.02% to 17.24% in April, from 17.26% in March. The slightly lower rate of inflation in 2017 is mostly due to base effects – prices were already high in 2016 so year-on-year increases are smaller in percentage terms – a more stable Naira, and one-time price increases such as higher electricity tariffs no longer being factored into inflation calculations.

After inflation rose to18.72% in January 2017, its highest level since September 2011, inflation fell in February to 17.78% and it continued falling to 17.24% in April. Some of the reasons for the decline in the inflation rate in 2017 are the aggressive intervention by the CBN in the forex market, which forced an appreciation in the Naira to 390 N/$, and a steep decline in the price of diesel from a peak of N260 to N195. Other structural increases such as the higher petrol price or the increase in electricity tariffs were one-time increases and as such have no effect on the year-on-year inflation rate a year after the initial price increase.

Figure 6: Headline, core and food inflation from January 2016 to April 2017



Source: NBS

Another important reason for the decline in the inflation rate is the base effect. The inflation rate for a month in 2017 is measured against the corresponding month in 2016, so since 2016 prices were already quite high, the percentage increase is smaller.

Despite falling headline inflation, food inflation is still rising, reaching 19.3% in April 2017. Given the importance of food to most consumers, particularly the poor who spend a significant portion of their incomes on food, rising food inflation is a worrying trend. The increase in food prices could be because March to May is sowing season for most crops grown in Nigeria while very few crops are harvested during this period. This could mean that the increase in food prices is due to low supply, which should no longer be the case when the harvest season begins around July.

It is too early to determine if the trend of falling headline inflation will continue, but given the reasons for its drop, we expect that inflation will continue to fall. The CBN should be able to keep the value of the Naira stable given

its bolstered reserves and it is highly unlikely that fuel prices or electricity tariffs will be increased again for political reasons.

In addition, if there is a good agricultural harvest, supply will increase and food prices will fall and if there is a disappointing agricultural harvest, food prices could also soar. With weather patterns becoming more erratic due to climate change, the possibility of droughts and other adverse weather events negatively affecting agriculture increases.

However, the ever-increasing Federal Government budget deficits increase the risk of serious inflation in Nigeria. The 2017 budget expects a deficit of N2.36 trillion, worsening the Federal Government's already precarious debt situation which saw debt servicing costs take up 66% of revenue in 2015; a situation which is likely to have gotten worse in 2016 given the plunge in government revenue last year. With debt servicing costs taking up over a third of government revenue, the government has to borrow to pay salaries and undertake capital projects. This increases the likelihood that the government will attempt to pay off its local currency debts by printing money which will lead to higher inflation.

2.5 Oil Outlook

As last year's economic performances have shown, the Nigerian economy depends very much on oil. This might appear surprising given that the oil sector accounts for less than 10% of Nigeria's GDP, a smaller contribution than agriculture and trade.

The explanation for oil's importance to the Nigerian economy is its outsize share of exports and government revenue. In 2015, oil accounted for about 60% of Nigerian government revenue and 87.9% of all Nigerian exports. The implication of this is that when oil revenue suffers, the government is unable to pay salaries on time or spend on capital projects. Since the government, through its many ministries, departments and agencies is a major employer and a direct customer of many businesses, this negatively impacts nearly every sector in the economy.

Reduced foreign exchange inflow due to smaller oil exports exerts downward pressure on the Naira, which increases inflation. The foreign exchange provided by oil is also needed to buy refined fuels, raw materials, machinery, fertilizer and food products among other things. In an example of how foreign exchange scarcity caused by lower oil revenues can affect other industries, the huge contraction of the manufacturing sector was caused in large part by the difficulties manufacturers had in getting foreign exchange to buy equipment and raw materials.

2.5.1 Oil Price

Oil prices have been higher in 2017 – staying within the $50 to $56 range – compared to 2016 where oil prices were as low as $28.94 per barrel in January before rebounding to about $56.82 per barrel in December. The higher oil price in 2017 is mostly due to an OPEC oil output cut agreed among the members of the cartel and a few non-OPEC members including Russia in November 2016.

Despite OPEC's attempts to guarantee consistently high oil prices with its output cut, prices have been slightly volatile, mainly due to increased US shale oil production that has offset OPEC's effort to cut supply, and increased production by members of OPEC such as Nigeria and Libya who were exempted from making cuts. OPEC has failed to ease a supply surplus as US Shale drillers have ramped up output. US output has been about 400,000-500,000 barrels a day more than expected since the OPEC output cuts were agreed.

On the 25th of May, OPEC members and Russia decided for the extension of the cut for 9 months. The motivation for the extension is to remove inventory surplus. US Shale oil still poses as a challenge to the OPEC and Russia deal because they can fill the supply shortfall. The new deal failed to increase prices, rather oil prices fell as markets were expecting deeper cuts rather than a mere extension. However, deeper cuts would have been politically difficult to achieve as most OPEC members would have struggled to comply given the importance of oil revenue to their budgets. Imposing deep cuts on OPEC members would increase their incentive to cheat on the agreement, thereby making it more fragile. Furthermore, there is doubt about how much effect further cuts would have; even if OPEC is able to agree and implement deeper

cuts, US shale oil producers and other non-OPEC producers would likely increase production thus blunting the impact of OPEC's cuts.

Another risk to oil prices comes from lower oil demand. Consumption was forecast to expand this year by about 1.3 million barrels a day; growth has been limited by about 800,000 barrels a day so far in 2017. If demand goes up to the forecast, it will help in increasing prices and reducing the glut but that might take long. There is also concern that demand from China, the second largest oil user, will slow. Independent refiners which account for about a third of the nation's capacity, have received lower import quotas compared to 2016.

2.5.2 Oil Production

According to OPEC, Nigeria's average oil production in Q1 2017 was 1.550 mbpd compared to Q1 2016 that was 1.794mbdp. Though the government has reported production of about 1.8 mbpd, but with the shutdown of Bonga fields for months, which produces about 250,000 barrels per day, the data from OPEC appear more reliable. It is clear that Nigeria's production has fallen from over 2 mbpd at the beginning of 2016 to less than 1.5 mbpd at the end of the first quarter of the year.

The recent uptick in production resulted when the government stepped up peace talks with leaders and youths in the Niger Delta to end militancy in the region and in repairing some destroyed pipelines.

On the 15th of December 2016, the FG announced its decision to exit the Joint Venture Cash Calls – financial contributions the government makes to fund production and exploration for the equity it owns on various oil fields – with Oil companies and replaced it with a system that allows for Cost Recovery. At the point of exit the FG cash-call arrears was $5.1 billion. The companies agreed to a five-year repayment plan of the cash call arrears via incremental production on each of the JV fields. The Federal Government has paid $400 million out of the first tranche of $1.2 billion. The remaining $800 million will be paid in installments within the year.

The agreement is expected to boost exploration and production in the long term, but it has not made a significant impact on production so far, as investments will take a while to materialize and the FG's JV partner also have to source funds to replace the funds contributed by the FG. The implementation is in its early stages, so it is too early to determine what impact it has had. We believe that although the arrangement will benefit the oil and gas industry in Nigeria in coming years, it is unlikely to have any tangible impact on production levels in 2017.

3 Fiscal Policy

The 2017 budget signed into law by Acting President Yemi Osinbajo was the largest budget in Nigeria's history but we expect it to run run into many of the same implementation problems as previous ones. This is evidenced by the preparation, passage, and the imagination of the manner of implementation that will follow a poor and inefficient budget process. In addition, the 2017 budget is predicated on various unrealistic and overly optimistic assumptions.

3.1 The 2017 Budget

The 2017 Appropriation Bill was signed into law on June 12th, 2017 a month after it was passed by the National Assembly, and over 6 months after the budget was presented to lawmakers by the President. The budgeted expenditure in the final version of the bill differed from that in the proposed budget by N143 billion, increased from N7.298 trillion to N7.441 trillion.

The budget is based on a benchmark crude oil price of $44.5 per barrel, oil production of 2.2 mbpd and an average exchange rate of N305/USD. Revenue is expected to be N5.08 trillion of which N1.999 trillion will come from oil, N1.373 trillion from CIT, VAT, Customs and Excise Duties and Federation Account Levies, N807.57 billion from Independent Revenues, N565.1 billion from Recoveries and N210.9 billion from other revenue sources such as mining.

As mentioned earlier, expenditure is budgeted at N7.44 trillion with 29.2% or N2.17 trillion of this budgeted for capital projects. This leaves a projected budget deficit of N2.36 trillion which will be financed mainly by borrowing of about N2.32 trillion of which N1.086 trillion (46%) will be from external sources. An estimated N1.66 trillion will be spent on debt servicing.

3.2 Budget Implementation

Although the budget finally being signed was greeted with much fanfare, there are good reasons to doubt if the budget can be implemented to a satisfactory level. Between 2011 and 2015[1], actual expenditure was below budgeted expenditure by an average of 9%. Since it is difficult to avoid salary or debt servicing payments, the bulk of the shortfall in expenditure comes out of the capital expenditure budget. Actual capital expenditure has undershot budgeted capital expenditure by 29% over the same period. Given the importance of infrastructure development to Nigeria's growth, it is important to determine the likelihood of capital expenditure again being given short shrift during implementation.

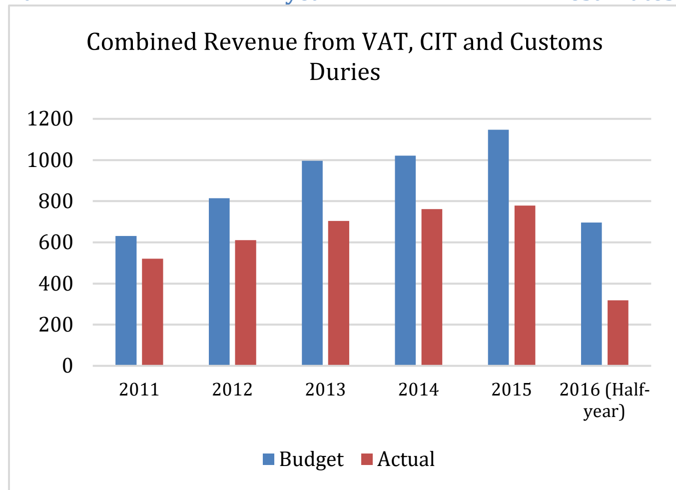
3.2.1 Revenue

In the past, the government's revenue projections have been quite optimistic; actual Federal Government revenues were an average of 17% below projected revenue between 2011 and 2015. Neither oil nor non-oil revenues hit their target in any year during this period. As we discussed earlier, both oil prices and production are likely to be higher this year than in 2016. Barring a total collapse of the OPEC oil agreement, it is unlikely that oil prices will fall below $44.5 per barrel, and while production is still substantially below 2.2 mbpd, this target is achievable considering the lull in militant activity in the Niger Delta. Therefore, we regard the government's projections for 2017 oil revenue as broadly reasonable.

The non-oil revenue projections, on the other hand, are quite unrealistic when viewed in the context of past budgets. The bulk of non-oil revenue is expected to come from VAT, Companies Income Tax and Customs and Excise Duties, revenue sources which underperformed by an average of 26% between 2011 and 2015.

[1] The budget implementation reports for the third and fourth quarters of 2016 are not yet available so we do not yet have complete 2016 data.

Figure 7: Combined Revenue from VAT, CIT and Customs and Excise Duties from 2011 to 2016. The numbers for 2016 are half year estimates.



Source: Budget Office of the Federation.

In 2016, total half year revenues from these sources were 54% below projections. Although the government reduced its expected revenue from these sources from N1.392 trillion to N1.373 trillion, its projection is still quite unrealistic. These revenue sources are dependent on the performance of the economy, which is projected to grow by only 1% from its 2016 level. Therefore, it is extremely unlikely that any increase in the actual revenues realized in 2017 – even after accounting for the growth in the economy and a higher level of tax compliance – will be enough to prevent substantial underperformance in non-oil revenue.

3.2.2 External Borrowing

At an exchange rate of N305/USD, the budgeted external borrowing will be $3.5billion. On the 9th of February, the Federal Government issued a $1billion Eurobond meant to go towards the implementation of the 2017 budget, its first Eurobond offering since 2013. The 15-year Eurobond was offered at 7.875% was nearly 8 times oversubscribed with orders of $7.8billion. In the global low rate environment where many central banks have interest rates below 1% or even below 0, 7.875% is quite high, implying that foreign investors consider investing in Nigerian debt risky.

The government has signaled that it does not want to borrow from the International Monetary Fund (IMF) because of the conditions that would be attached to an IMF loan which means it would have to tap international debt markets again for the remainder of the $2.5 billion of external borrowing it has budgeted. The successful issue of the Eurobond suggests that it is possible for the federal government to be able to borrow this much from foreign lenders, however it will have to offer high interest rates as it did in the Eurobond offering. With the Federal Reserve tightening its monetary policy by increasing interest rates, the Nigerian government might have to offer an even higher rate at its next offering.

3.3 Other Fiscal Developments

As part of efforts to increase the ease of doing business in Nigeria, the FG has established the Presidential Enabling Business Council, which has a mandate to make doing business in Nigeria easier and more attractive. The budget also aims to focus on rapid infrastructural development, especially, rail, roads and power particularly by making use of Public Private Partnerships. The budget also makes provisions for settling long-term debts owed to contractors by the FG in an effort to stimulate the economy. Acting President Yemi Osinbajo signed into law an Executive Order which promotes transparency and efficiency in the business environment designed to facilitate the ease of doing business in the country.

The delay in the signing of the Budget in 2016 and this year hampered capital spending and other operations of the government. To avoid this in future, Acting President Osinbajo signed into law a new executive order which mandates timely submission of annual budgetary estimates by all statutory and non-statutory agencies including companies owned by the Federal Government, the 2018 budget process should be more efficient than in previous years. However, since the delay in the budget was mostly due to the National Assembly, this executive order is unlikely to have much effect on future budgets processes.

4 Monetary Policy

The monetary policy authorities in Nigeria are left with two equally unappealing choices: tighten monetary policy to fight inflation and watch the recession worsen, or loosen policy to stimulate growth and cause runaway inflation. At most of its meetings, the CBN's Monetary Policy Committee (MPC) chose price stability over growth. In 2017, as inflation moderates, the MPC is likely to cut rates to support the economic recovery.

At its 3rd statutory meeting in 2017 which held on the 22nd and 23rd of May, the CBN's Monetary Policy Committee (MPC) noted an unclear outlook especially food production and optimism about the current fall of inflation and also the relative stability in the naira exchange rate, the MPC was reluctant to alter the current policy configuration in any manner. The decision was made to allow the existing policies to fully achieve their intended goals and objectives. This situation put the MPC in a quandary, as any changes to the Monetary Policy Rate (MPR) intended to solve one of these problems would have exacerbated the other.

In addition to inflation and growth concerns, the MPC noted high cost of capital in the economy and is concerned that loosening would exacerbate inflationary pressures. The MPC also considered the need to attract more foreign exchange into the country in the form of foreign portfolio inflows (FPI) to ease the pressure on the CBN's foreign reserves and arrest the fall in the value of the Naira. With inflation at 17.24% and the MPR at 14%, the real interest rate was -3.24%, real interest rate still in the negative territory would have made Nigerian assets less attractive to foreign investors. However, maintaining/raising the MPR would have increased borrowing costs for local borrowers. This presented an additional difficulty for the MPC as it had to balance the conflicting requirements of foreign and local investors.

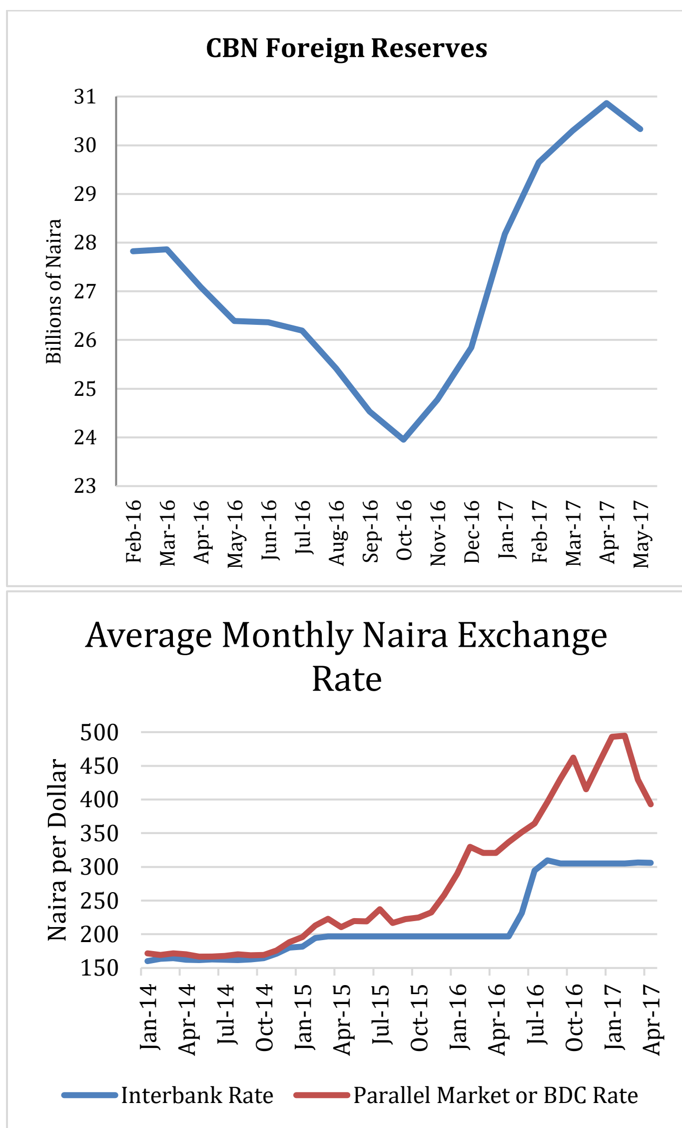
After considering these conflicting requirements, the MPC elected to maintain the MPR at 14%, as well as leaving all other major policy rates unchanged. In his statement announcing the committee's decision, CBN Governor, Godwin Emefiele attributed the downturn in the nation's economy to factors such as forex shortages, low government spending and the failure of the government to settle its debts with domestic companies. Noting that these issues could not be solved directly with monetary policy, the MPC put the onus on the FG to stimulate the economy using fiscal policy. The MPC also took the position that the causes of inflation in the economy are largely structural and so increasing the MPR further was likely to have little effect on the inflation rate.

We believe the MPC followed the best course of action available to it given the conflicting requirements that it had to satisfy. This decision will give the CBN adequate time to monitor the relevant macroeconomic indicators and how they have been affected. On the 13th of April 2017, the National Bureau of Statistics reported that the inflation rate for the month of April dropped to 17.24%. This is the second time that the CPI has declined on year on year basis. We expect inflation to reduce further by Q3 2017. However, with increasing unemployment and positive but still sluggish growth will mean that the MPC is quite likely to reduce the MPR by mid-2017.

5 Foreign Reserves and Currency

The CBN's foreign currency reserves have increased steadily to about $30.3 billion by the end of May 2017. The major reasons for this increase are higher oil prices and higher production levels and increased government external borrowing. Increased oil revenues in 2017 have helped to stabilize Naira against the Dollar.

Figure 8: The Central Bank of Nigeria's Gross Foreign Currency Reserves from January2016 to May 2017 and the official Dollar to Naira exchange rate in the same period.



Source: NBS

From a low of $23.9 billion in October 2016, foreign reserves have increased steadily to about $30.3 billion at the end of May 2016. The major reasons for this increase in reserves are higher oil revenues due to higher oil prices and higher production levels, increased foreign borrowing during the period ($600 million from AfDB and $1 billion Eurobond sale).

The increase in foreign reserves was unsurprising given that Nigeria's main export and therefore its principal foreign exchange earner crude oil increased in production and exported at a higher price. In the face of increasing foreign exchange earnings, the CBN found it easier to maintain its official Naira to USD rate of N305/USD. Foreign reserves increased from $26.1 billion dollars at the start of 2017 to $30.3 billion by the end of May. The increment in foreign reserves is believed to be due to higher oil revenues and higher production levels and increased foreign borrowing. The CBN had instituted strict currency controls, including introducing a list of 41 items for which foreign exchange could not be obtained at the official rate, in order to manage the demand for foreign exchange but this did little to reduce domestic demand for foreign currencies.

On February 20th, the CBN announced a set of new policy actions for the Foreign Exchange market. Under this new policy the CBN will provide FX directly for personal and business travel, medical bills and school fees at a rate not exceeding 20% above the interbank market rate. Additionally, the CBN will no longer impose forex allocation rules on commercial banks, opening of investors and exporters window, SMEs window. This will end the policy under which commercial banks were directed to sell specified percentages of their forex to certain sectors of the economy. In the same week, the CBN sold $500 million worth of forward contracts to provide liquidity to the interbank market. The CBN's intervention in the forex market appears to have been successful as the parallel market Naira rate rose from 520 N/$ per dollar on 20th February to 390 N/$ as at 29th of April.

In addition, the Central Bank of Nigeria on the 21st of April announced a special window for Investors, Exporters and End-Users, with the aim of boosting liquidity in the forex market and to ensure timely execution and settlement for eligible transactions.

It is important to note that a wide gap remains between the official and the parallel market Naira rates. This implies that most investors think the Naira is currently overvalued. As mentioned earlier, a major reason for the persistence of this spread between the two markets, despite the Naira's floatation, is the CBN's continued intervention in the market to stop the Naira from depreciating further. The CBN has been able to keep the Naira relatively stable through its interventions.

While a weak Naira has a positive effect on oil revenue in Naira terms, it will have a negative effect on inflation and external debt servicing costs, which would cancel out some of the effect of the higher revenue. Furthermore, given the fact that a weak Naira would imply low oil revenue in Dollar terms, oil revenue in Naira is likely to still be lower than projections.

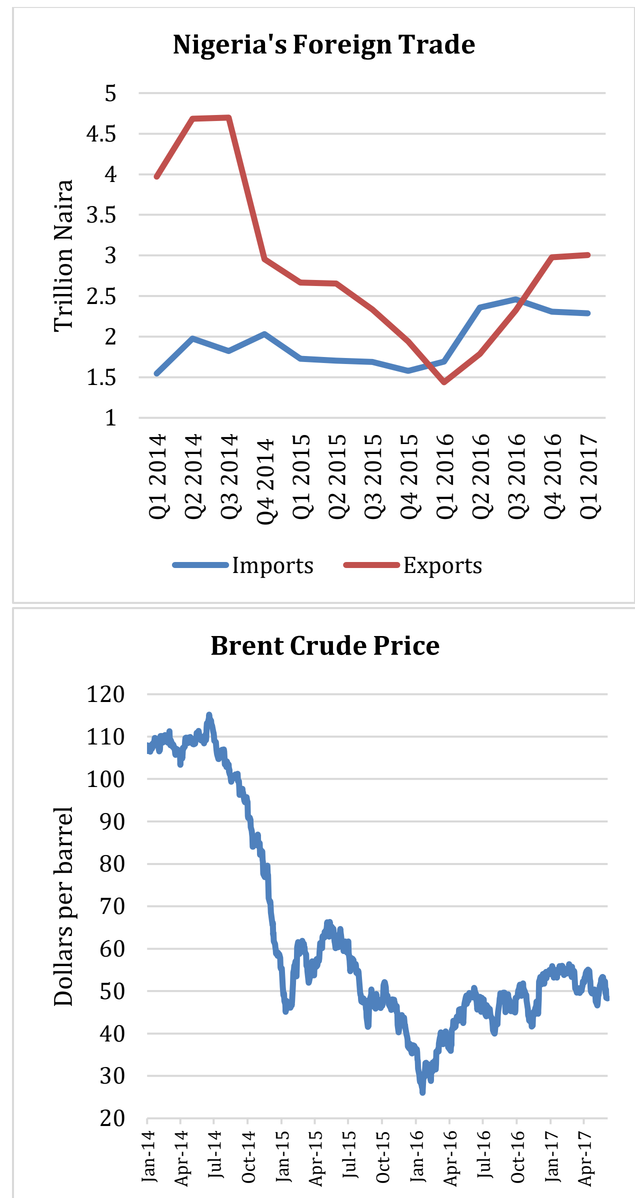
The policies by CBN are not sustainable because it depends on oil. Higher oil prices, more inflow of forex to the bank and to the investors and exporters window.

6 Foreign Trade

Nigeria's exports have continued the upward trajectory they have been on since the second quarter of 2016, mostly due to higher oil prices. Despite the government's rhetoric on diversifying Nigeria's exports, oil continues to dominate Nigeria's exports and is likely to do so for the foreseeable future.

As the oil price fell starting in mid-2014, the value of Nigeria's exports fell along with it (see Figure 9a). Interestingly, despite the devaluation of the Naira that accompanied the fall in oil exports, non-oil exports also fell. In theory, non-oil exports should have increased as the weaker naira made Nigerian goods cheaper for foreign buyers. One of the reasons for the fall in non-oil exports was the recession, which meant that fewer goods were being produced in the country; therefore, even if the same percentage of local production was being exported, the absolute value of exports would still have fallen.

Figure 9: Nigeria's exports and imports from January 2014 to December 2016 and the global Brent Crude price from January 2014 to December 2016

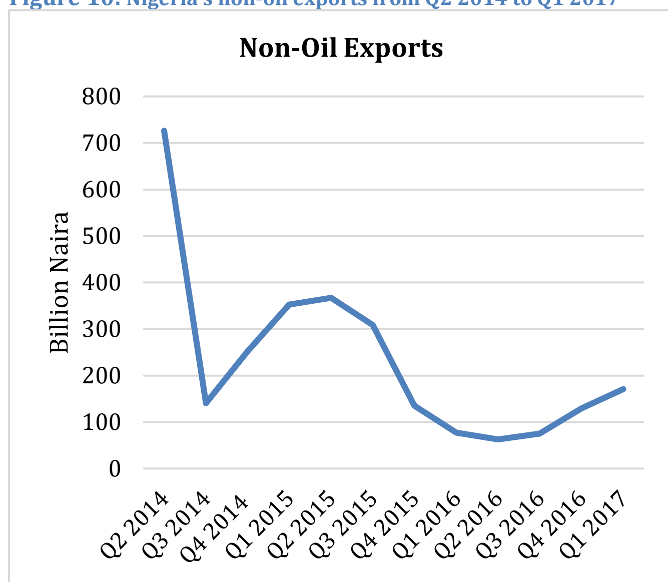


Source: NBS and US EIA

Another possible reason is that as foreign goods became more expensive in Naira terms, Nigerians replaced some foreign consumption with local goods reducing the share of goods produced that was exported. Exports as a share of nominal GDP fell from 18% in 2014 to 10% in 2015 and further to 8% in 2016, indicating that a larger share of the goods produced in the country were being consumed locally.

As oil prices increased at the beginning of 2016 (see Figure 9b) exports also increased, starting in the second quarter of 2016. Although non-oil exports increased too (see Figure 9), their impact was negligible. Non-oil exports fell in Q2 2016 even as total exports rose, and accounted for only 2.3% and 8.3% of the total increase in exports in Q3 and Q4 2016 respectively. In Q1 2017, the increase in non-oil exports was more than the increase in total exports, but in this period, exports only increased by 0.9% over the previous quarter. This again shows the insignificance of non-oil exports to total exports, which is unsurprising given that non-oil exports only accounted for 4% of total exports in 2016. As oil prices increase in 2017, non-oil exports are unlikely to significantly increase their share of exports.

Figure 10: Nigeria's non-oil exports from Q2 2014 to Q1 2017



Source: NBS

7 Capital Markets

The Nigerian Stock Exchange All Share Index (NSE ASI) has been on an increase since the 15th of May. This recovery can be attributed to favourable monetary policies which boosted investors' confidence in the market. However, events in the US and Europe are likely to cause foreign investors to pull their funds out of Nigerian capital markets. Government bond yields increased as inflation is still high and MPR remains stable.

7.1 Equity Markets

The All Share Index (NSE ASI) at the beginning of 2017 was as low as 26874.62, reached its lowest of 24829.59 on March 2nd, its lowest this year. This is attributed to the current economic situations and investors are skeptical about investing into the economy. One of the reasons investors are skeptical is the controlled 'flexible exchange rate' by the CBN, which made investors bearish.

The index rebounded, eventually reaching a high of 28423.70 on May 11th. The index has been volatile but has trended upward. This rebound is attributed to the steady performance of most quoted companies in 2016 and improvement in first quarter 2017 earnings, renewed interest by foreign investors as foreign exchange crises eases off and positive macroeconomic outlook. On the average, most companies are have performed better than they did in 2016. First quarter results released by companies show increased profits and increase in earnings per share. Companies like Eterna, Dangote Sugar Refinery, Medview, PRESCO, Staco Insurance and Grief recorded high profits and have attributed their high performance to increased sales, reduction in production costs, and operating cost. Additionally, the monetary policy changes such as investors and exporters foreign exchange window which allows investors to bring their money at a well-known market determined price is also believed to be one of the reasons for the recent rally in the stock market.

In the remaining part of 2017, we expect Nigerian equity markets to be bullish. As the economy returns to growth, companies should experience rising profits which should

lead to increased enthusiasm among investors. Furthermore, rising oil prices and production should boost oil companies' share prices. As oil companies are some of the biggest companies on the Nigerian Stock Exchange, this will help to lift the broader market. However, we must keep in mind that the ASI lost 6.17% of its value in 2016 and so it will be a while before long-term investors recoup their losses.

The actions of the Federal Reserve in 2017 pose a huge threat to the NSE, as the Fed has raised interest rates to 1%. This is expected to reverse the flow of money from the United States where interest rates have been kept very low for almost a decade to emerging markets that have higher rates of return. Foreign investors are likely to pull their funds out of emerging markets in favour of investing in the United States as interest rates there return to normal. As Theresa May, the British PM has triggered Article 50, there are a lot of uncertainty about whether Britain will remain in the single market, whether its financial institutions will be able to continue operating in the Eurozone among many other concerns. This heightened uncertainty is likely to cause capital to flee from emerging markets such as Nigeria to safer assets in more developed countries since investors prefer safe predictable assets when there is a lot of uncertainty.

7.2 Debt Markets

Yields on Nigerian government bonds have risen consistently this year, indicating increasing borrowing costs for the Federal Government. The continuous rise in yields are because of higher inflation, high MPR, lower government revenue and the poor economic conditions in the country which led to Standard & Poor's, a credit rating agency, cutting Nigeria's sovereign credit rating.

On February 15th 2017, the Nigerian Federal Government issued its first Eurobond since 2013. The 15-year Eurobond offered at 7.875% was nearly 8 times oversubscribed with orders of $7.8 billion. Though the government has pointed to the level of oversubscription as evidence of foreign investors' appetite for investing in Nigeria. However, the high interest rate that had to be offered shows that these investors consider Nigeria debt to be risky. Another $500 million Eurobond was issued on the 29th of March which was consolidated with the $1 billion Eurobond offered at 7.5%.

Inflation rate in 2017 has fallen three times consecutively to 17.24% in February, March and April. As inflation falls, we expect that the MPC would cut the MPR to focus on stimulating economic growth. The combination of lower inflation and a lower MPR would exert downward pressure on bond yields. On the other hand, even though government revenues are expected to be slightly higher due to higher oil prices and production, the FG's increased spending will cause worries among investors about the FG's ability to repay its debts. Since we are not anticipating drastically lower inflation, even in the best-case scenario, yields are unlikely to fall by a significant amount. More likely, yields will continue to increase throughout 2017.

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