Nigeria Development Update

Seizing the opportunity

June 27, 2023
Seizing the opportunity
June 2023 NDU: “Seizing the opportunity” – in a nutshell

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The recently undertaken PMS subsidy & FX reforms are historic:

- NGN 3.9 trn in savings in 2023 alone
- Stops Nigeria from going over a fiscal cliff
- Sets the stage for a new, upward investment, growth, and development trajectory

Inflation impacts should be temporary but will be significant, so provide some timely, temporary and targeted assistance:

- Move to provide quick support: cash transfers can help shield poor and vulnerable HHs
- It can be done affordably relative to the resources getting freed up from the reform, and financing is available
- It can be done based on robust identification of recipients who need help the most, and transparently by digital methods

Beyond the immediate assistance, consider formulating and communicating a new, broader COMPACT around:

- Restoring fiscal sustainability, while also supporting poor and vulnerable HHs to weather the adjustment
- Spending better, to tackle development priorities
- Sustainably spending more, based on mobilizing more revenues

Entrench the new approach to macroeconomic stability and faster growth through continued reforms:

- FX policy: focused on maintaining a unified exchange rate with transparent price discovery based on FX supply and demand
- Monetary policy: focused on price-stability through coherent policies and a revitalized nominal anchor
- Fiscal policy: focused on rebuilding fiscal space, through careful control of total spending, spending better, and mobilizing more revenues
- Trade and structural policies: focused on removing the regulatory bottlenecks and constraints to trade, investment and growth
NIGERIA SEIZING THE OPPORTUNITY TO RISE TO ITS POTENTIAL: RECENT REFORMS CAN BEGIN TO BEND NIGERIA’S DEVELOPMENT PATH UPWARDS

Source: NBS, WDI, and World Bank estimates

Nigeria: rising to potential, with the reforms underway & complementary reforms

Average GDP per capita growth 2002 - 2014: 5.1 percent

Reform reversal

Indonesia’s GDP per capita

Nigeria’s GDP per capita

US$, 2017 PPP
PART 1: UNDERSTANDING THE URGENCY OF REFORMS

NIGERIA’S ECONOMY IN THE FIRST HALF OF 2023
GLOBAL BACKDROP: OIL PRICES HAVE DROPPED SINCE LAST NDU, BUT ARE STILL ABOVE AVERAGE – YET NIGERIA HAS NOT BEEN BENEFITING

Oil prices dropped in H1 2023 but remained above the average price of the last two decades…

… but after recovering from the COVID-19 shock, growth has softened

Sources: CBN

Average 2006-2019 = US$62.8/bbl

Historical average of Real GDP growth 2018-19 = 2.1 percent

Sources: NBS
GLOBAL BACKDROP: CONTINUED TO ADD TO THE PRESSURE ON NIGERIA’S ALREADY HIGH FINANCING COSTS AND INFLATION

Global financial conditions tightened as monetary policy tightened to reduce inflation

The extent of global monetary policy tightening has been unprecedented...

...while commodity prices remain well above pre-pandemic levels

Source: World Bank
GROWTH WEAKENED IN Q1, HAMPERED BY CASH SCARCITY

The naira redesign caused a cash crunch, exacerbating the drag caused by external conditions and – mainly – by other domestic policies.

The naira demonetization reduced GDP growth in manufacturing and services...

...and did not improve either inflation or the FX parallel market rate premium.

Source: NBS, World Bank, FMDQ, and Aboki Rates.
INFLATION CONTINUED INCREASING AND REACHED A 17-YEAR HIGH

Nigeria’s high, structural inflation worsened as monetary and fiscal policy remained loose

In contrast to the global trend, Nigeria’s inflation surged in H1 2023...

...and policy rate increases were ineffective in controlling inflation because the overall policy stance stayed loose

Source: CBN, WDI, FMDQ, World Bank
HIGH INFLATION MEANS THAT MORE NIGERIANS BECAME POOR
Not only did poverty increase, but food insecurity rose too

Inflation pushed an estimated 4 million more Nigerians into poverty in the first 5 months of 2023...

...and average prices of locally produced staples have increased faster than average inflation

What does N1000 buy?

<table>
<thead>
<tr>
<th></th>
<th>April 2022</th>
<th>April 2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yam</td>
<td>1.7 tubers</td>
<td>0.9 tuber</td>
</tr>
<tr>
<td>Bread</td>
<td>2.3 loaves</td>
<td>1.8 loaves</td>
</tr>
<tr>
<td>Kerosene</td>
<td>1.7 liters</td>
<td>0.9 liter</td>
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Source: World Bank estimates based on NBS data
Source: NBS
FOREIGN EXCHANGE DISTORTIONS WERE SEVERE

As CBN rationed supply and attempted to control demand in the FX market

The premium between the parallel and official rate almost doubled in the year through May 2023

FX premium = 63%
FX premium = 37%

...and Nigeria’s FX premium was among the highest in the world

Note: Latest data as of the end of Q1 2023 (May 2023 for Nigeria). Excludes Lebanon and Yemen.

Source: FMDQ, World Bank, Aboki rates
FX RESERVES KEPT DECLINING, DESPITE HIGHER OIL PRICES

As well as the negative impact of previous FX policies, the petrol subsidy also reduced net FX inflows.

Sources: CBN
DETERIORATING FISCAL SITUATION PRIOR TO THE PMS SUBSIDY REFORM

Despite some improvement in non-oil revenues, fiscal and therefore debt dynamics were worsening rapidly.

Revenues remained below 7 percent of GDP (one of the lowest globally) despite the boost in non-oil revenues...

...which led to interest costs surging, crowding out other spending such as capital expenditure.

Sources: BOF and OAGF.

Sources: CBN and OAGF and World Bank estimates.
As a result, public debt increased to 40 percent of GDP

As external markets were closed, the federal government borrowed more mainly from CBN to finance its deficit

In 2022, the FGN was unable to meet its budgeted borrowing targets, resulting in more financing from the CBN...

... and pushing debt service above 100 percent of revenues

Sources: BOF and OAGF

Sources: CBN and OAGF and World Bank estimates.
PART 2: THE REMOVAL OF THE PMS SUBSIDY
THE PMS SUBSIDY REFORM REMOVES AN UNSUSTAINABLE FISCAL BURDEN

In 2022, the petrol subsidy drained 32 percent of Nigeria’s revenues

Petrol subsidy accounted for 0.9 percent and 2.2 percent of GDP in 2021 and 2022

Sources: World Bank calculations based on data from OAGF and NBS
REMOVING THE PETROL SUBSIDY HELPS NIGERIA AVOID A FISCAL CLIFF AND EASES DEBT SUSTAINABILITY RISKS

Source: World Bank estimates based on BOF, DMO, OAGF, and NNPC.

Average fiscal deficit 2015-2019: 3.9 percent of GDP
EVEN WITH THE RECENT REFORMS, FINANCING NEEDS REMAIN ELEVATED

And complementary measures are needed to reduce debt pressures

Gross borrowing is expected to be high, albeit lower than in a no reform scenario...

... and debt servicing will remain a concern despite the increase in fiscal space

Source: World Bank estimates based on data from BOF and DMO
IT IS CRITICAL TO CHOOSE HOW SAVINGS FROM REFORMS WILL BE USED

To maximize the impact of the petrol subsidy reform

Paying off subsidy arrears to NNPC will reduce the fiscal savings for 2023…

…and if the government undertakes large new expenditures the fiscal situation for 2023 could rapidly deteriorate again

Fiscal gains from subsidy removal and FX reforms

Payment of subsidy arrears

Savings for use by the Federation

Fiscal balance

Source: World Bank estimates based on NNPC and BOF data
AVOIDING THE CLIFF, BUT STILL CLIMBING THE MOUNTAIN: BREAKING OUT OF THE LOW REVENUES / LOW SPENDING FISCAL EQUILIBRIUM, AND IMPROVING SPENDING EFFICIENCY

More reforms to strengthen revenues are needed to fund public services and development. On present trends, Nigeria will continue spending less than $20/person/month on non-interest expenditure for the foreseeable future.

Source: World Bank estimates based on data from BOF, DMO, and WEO
PART 2: FOREIGN EXCHANGE MANAGEMENT REFORMS
Multiple windows

- IN THE PAST: 4 official windows, each one with a different price discovery mechanism.
- NOW: All windows were merged into the I&E window.

- IN THE PAST: The rate for government-related transactions was within 2 percent of the NAFEX.
- NOW: The operational rate for all the government-related transactions is the weighted average rate of the proceeding day’s executed transactions at the I&E window.

- NOW: Schemes removed.

Price discovery

- IN THE PAST: Willing buyer willing-seller mechanism was only available at the I&E window, and it was not fully enforced.
- NOW: Willing buyer-willing seller reintroduced.

Transparency and predictability

- IN THE PAST: Not all orders were registered.
- NOW: Order Book reintroduced.

The Central Bank has communicated clearly to the public the operational changes to the FX market.

Source: CBN
THE REFORMS HAD AN IMMEDIATE IMPACT ON THE OFFICIAL FX MARKET

With the IEFX and parallel market rates converging, Nigeria has made rapid progress towards re-establishing a unified, market-reflective FX rate.

The re-introduction of the willing buyer willing seller mechanism has allowed price discovery in the I&E window…

…and the premium between the official and the parallel rates dropped substantially to below 10 percent.

Naira/US$

Sources: FMDQ and Aboki rates

Sources: Aboki rates and World Bank
IMPACTS: INFLATION PASS-THROUGH IS EXPECTED TO BE MODERATE

The parallel market had already passed through domestic prices

The parallel rate moves first (depreciates), and this is followed by a rise in inflation…

In April 2017, the IEFX window is created (an effective devaluation) and the supply of FX improves. With greater ER predictability the parallel rate comes down (appreciates), and this helps to bring down inflation.

Similar dynamics since 2021. The parallel rate and inflation move closely together, but inflation is not as responsive to the IE rate. This implies that a large part of the “passthrough” between inflation and the ER is already accounted for.
IMPACTS: PUBLIC EXTERNAL DEBT IS EXPECTED TO INCREASE DUE TO VALUATION EFFECTS, BUT WILL NOW BE ON A STABLE PATH

Despite the increase in external debt, the improvement in nominal revenues is expected to reduce total borrowing.

Public debt without the subsidy removal and FX reforms would have been higher due to increasing CBN financing.

Sources: DMO, CBN, and World Bank estimates
PART 4: REFORM IMPLICATIONS
WHERE TO FROM HERE TO SEIZE THE OPPORTUNITY TO RISE TO POTENTIAL
THE RECENTLY IMPLEMENTED MACRO REFORMS WILL HAVE A POSITIVE IMPACT ON MACRO STABILITY AND ECONOMIC GROWTH

Growth is expected to increase...

...and while inflation will be higher in 2023, it will be lower in 2024-2025 if the right policy mix is sustained

Source: NBS and World Bank estimates.
FINANCIAL MARKETS ALSO SHOW INCREASED OPTIMISM ABOUT FUTURE ECONOMIC PERFORMANCE

Nigeria’s risk premium has fallen in the international capital market

Eurobond spreads

Source: JP Morgan.
HOWEVER, THE REMOVAL OF THE SUBSIDY WILL TEMPORARILY INCREASE INFLATION

Inflation will increase in H2 2023, before decreasing below 20 percent in 2024...

...as the financing gap, and hence reliance on inflationary CBN financing, decreases

Sources: NBS and World Bank estimates

Sources: World Bank and CBN.
THE NEAR-TERM ADDED PRESSURE ON HOUSEHOLD FINANCES MAKES IT CRITICAL TO ACCOMPANY THE REFORMS WITH A SOCIAL COMPACT

Including temporary cash transfers to help shield poor and vulnerable households. The current coverage of social protection programs (SPPs) is low at 19 percent of the population.

7.1M additional Nigerians would be pushed into poverty by inflation in the absence of any compensation.

**Expected income loss per month per household**

- **Poor**
- **Economically insecure**
- **Others**

**INVEST in a social protection system** that can provide timely, targeted and temporary support to HHs experiencing a shock (like the increase in PMS prices due to subsidy removal):
  - Currently: Nigeria spends only 0.7% percent of GDP on social safety nets (SSA: 1.2%)
  - 19% of the population covered (SSA: 25%)

**Social benefits:**
- Human capital investment
- Education outcomes
- Health outcomes

**Economic benefits:**
- Trust in the government
- Support for and therefore sustainability of reform efforts

Source: 2018/19 NLSS and World Bank estimates.
NIGERIA CAN DELIVER A CASH TRANSFER TO POOR AND VULNERABLE HOUSEHOLDS AS ONE ELEMENT OF A BROADER SOCIAL COMPACT

Using a robust targeting method and transparency based on digital payments

Registries cover 44 percent of all HHs, span across Nigeria, and target the poor... ... and targeting & transparency benefit from digital delivery

Savings from the subsidy can also be used for other pro-poor service delivery (ex. health, education, infrastructure)

Transfers align with CBN's know-your-customer (KYC) requirements

Mobile wallets can be set up for recipients

Biometric verification increasingly used

Percentage of households captured in the registry

Source: World Bank staff based on Smythe and Blumenstock (2022) and administrative registry data from NASSCO.
NSR: National Social Registry, 15.7M households
RRR: Rapid Response Registry: 2.7M households
A POSSIBLE WAY FORWARD: A COMPACT WITH THE NIGERIAN PEOPLE

- **Removal of PMS Subsidies** while ensuring adequate supply and competitive PMS pricing post-deregulation.

- **Unsustainable fiscal burden of PMS subsidies**.

- **Very low expenditures on critical services and investments**: health, education, roads, ...

- **A Spike in Inflation making it harder for millions to meet the cost of basic needs**.

- **A more flexible market-reflective approach to exchange rate management** to dampen the increase in the PMS price and mitigate the impact on inflation.

- **A Large-scale cash transfer program** to provide quick relief to the poor, near poor, and low-income who are most directly affected.

- **A broader compact**—a commitment ex-ante to a set of priority programs that benefit ordinary Nigerians.

- **Possible social unrest** because of hardships in a context of a trust deficit.

- **A public sensitization campaign** of the opportunity costs of PMS subsidies and the alternate uses to which the recovered revenues can be put.

- **Engagement** with critical stakeholders to build the consensus

- **Securing financing** for particular hardship for near poor and low-income who use PMS directly.

- **A large-scale cash transfer program** to provide quick relief to the poor, near poor, and low-income who are most directly affected.

- **A public sensitization campaign** of the opportunity costs of PMS subsidies and the alternate uses to which the recovered revenues can be put.

- **Engagement** with critical stakeholders to build the consensus.
KEY MACRO-FISCAL POLICY RECOMMENDATIONS FOR THE NEXT SIX MONTHS TO KEEP SEIZING THE OPPORTUNITIES

**To sustain and deepen FX policy reform**

- Remove the FX restrictions for the list of 43 items.
- Keep actively communicating and ensuring clarity about the new FX policy with the focus on a unified, market-reflective, transparently-determined rate.
- Reorient monetary policy operations towards achieving price stability, which will help to anchor the exchange rate.

**To tackle inflation**

- Continue reducing subsidized CBN lending to medium and large firms.
- End government borrowing from the CBN.
- Replace import and FX restrictions with tariffs that reflect the ECOWAS Common External Tariff.

**To build on the PMS reform and rebuild fiscal space**

- Sustain the PMS subsidy removal: keep prices deregulated, foster fair competition and curb any commercial malpractice so that efficiency gains are passed onto consumers.
- VAT: increase rate, while allowing for input tax credit on capital and services; remove exemptions on petrol products.
- Improve tax administration to ensure the collection of the newly introduced excises on telecommunication, single use plastics, and high-polluting vehicles.
- Adopt a data-driven approach to tax audit.
- Link residential property with PIT returns.
- Introduce a simple turnover tax on SMEs at state level instead of various existing fees & levies.
Thank You

Feather flakes
By Jimmy Nwanne
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