Nigeria Development Update

Seizing the opportunity

June 27, 2023

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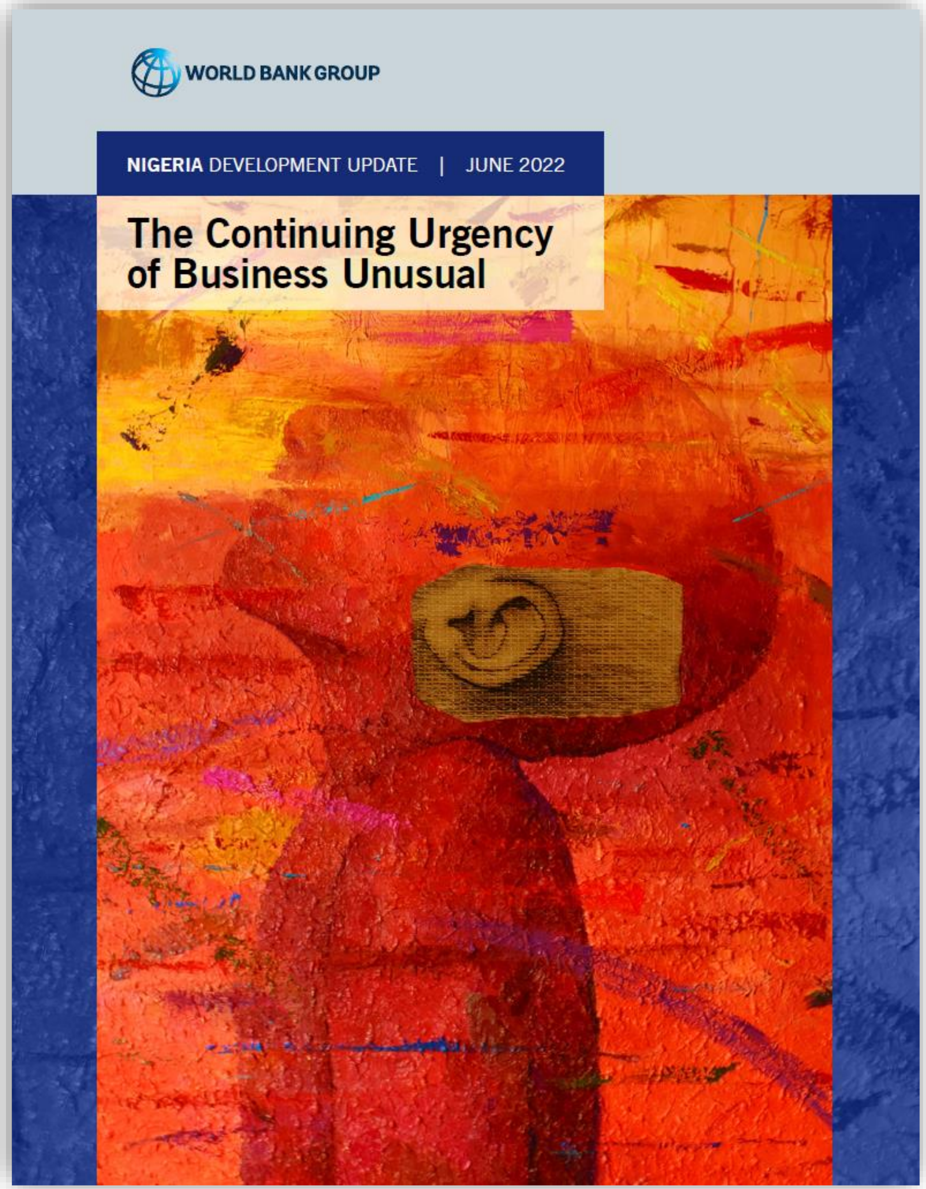
Time for Business Unusual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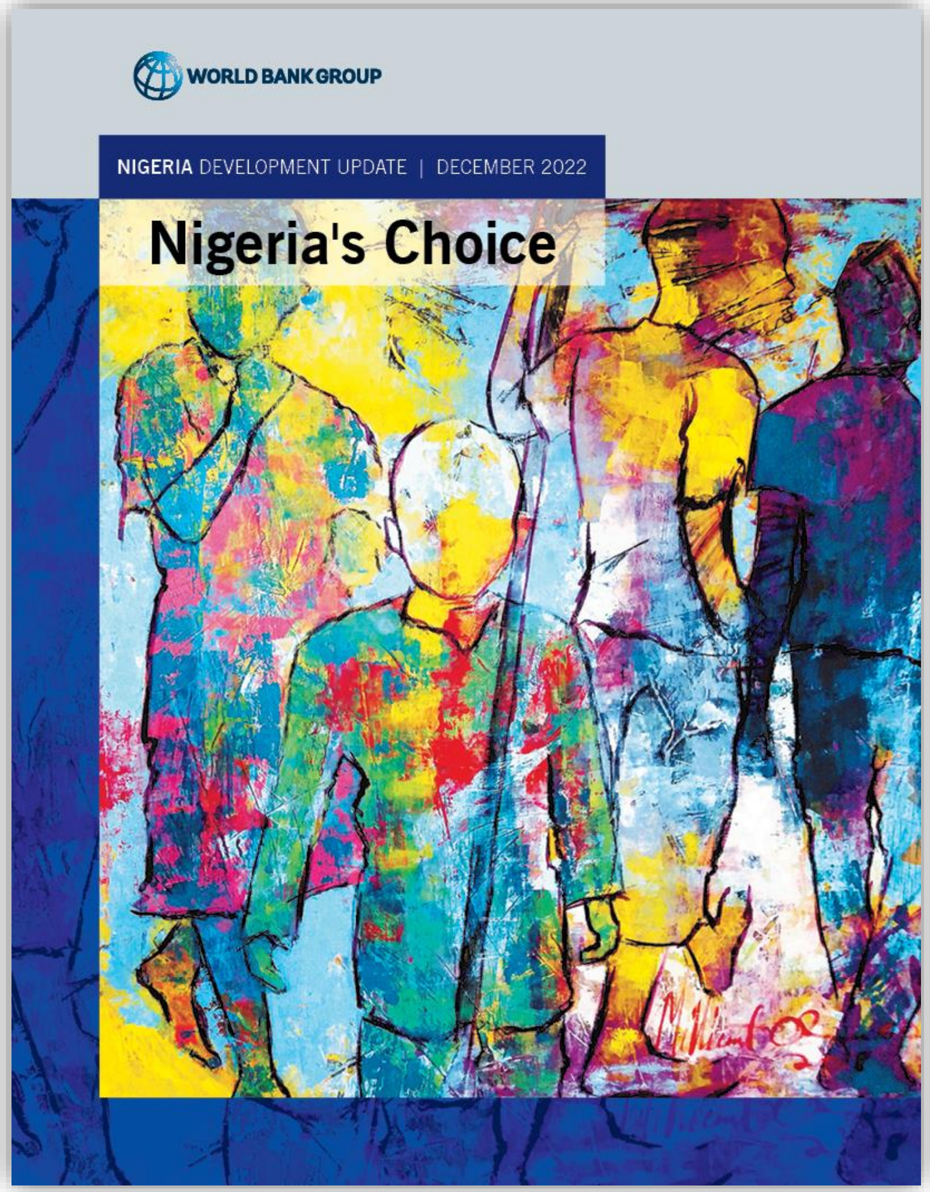
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Seizing the opportunity

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

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:

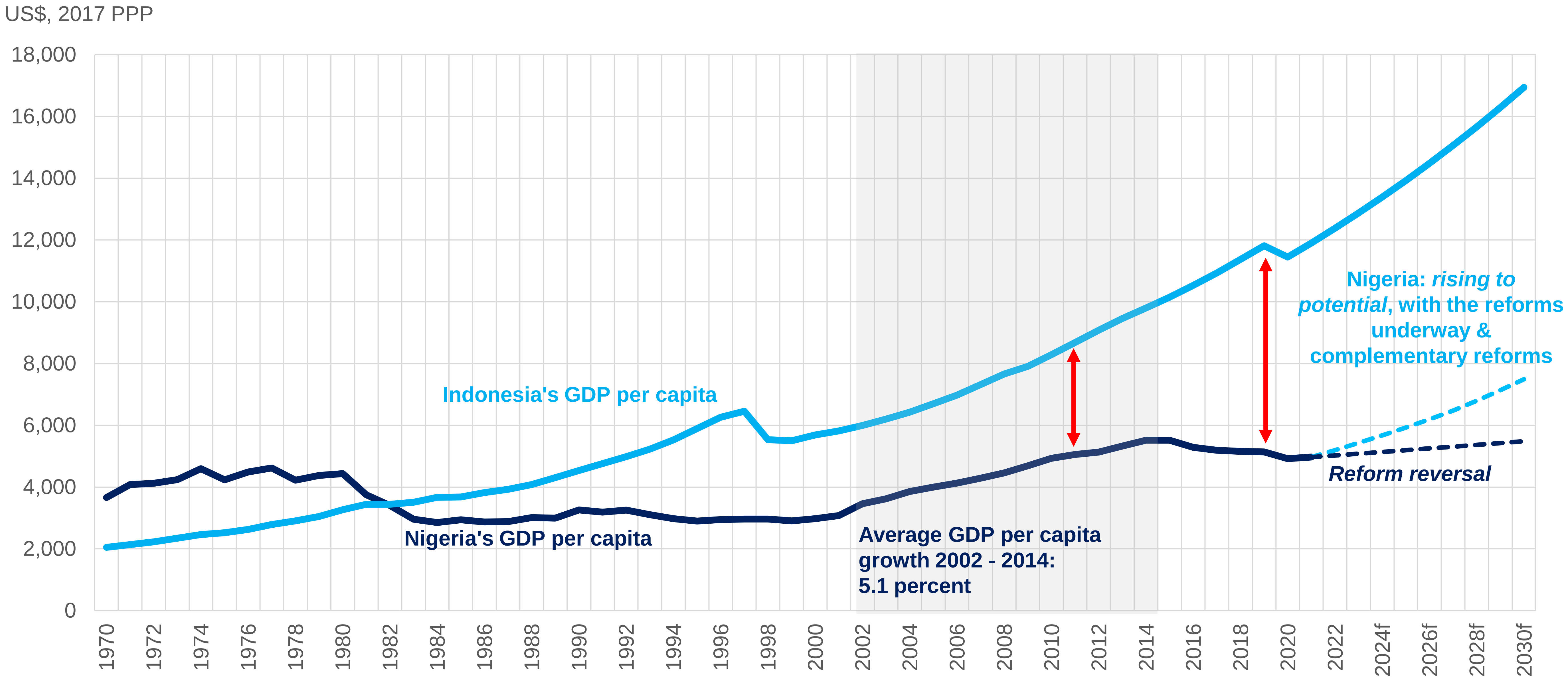
FX policy: focused on maintaining a unified exchange rate with transparent price discovery based on FX supply and demand

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



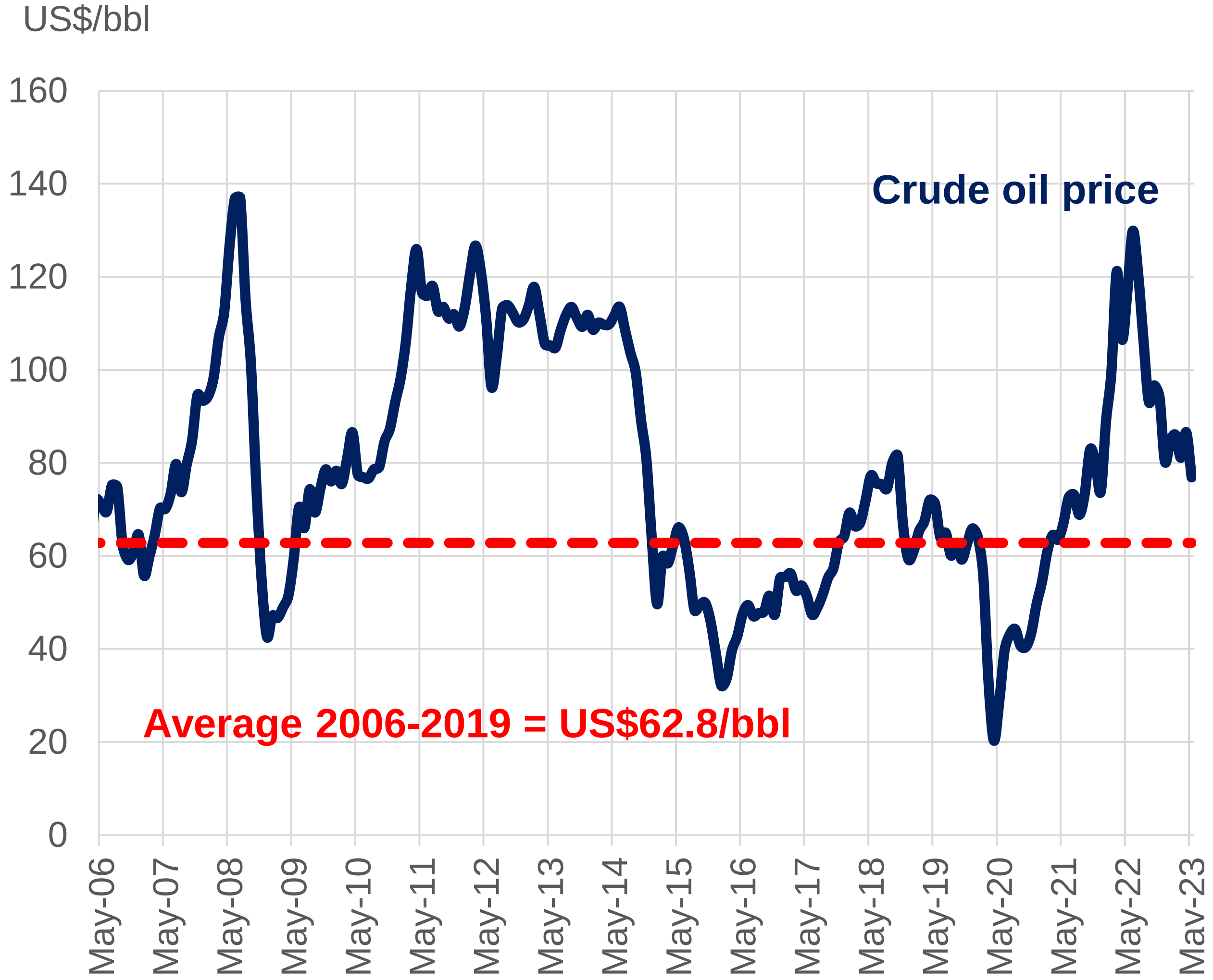
Source: NBS, WDI, and World Bank estimates

PART 1: UNDERSTANDING THE URGENCY OF REFORMS

NIGERIA’S ECONOMY IN THE FIRST HALF OF 2023

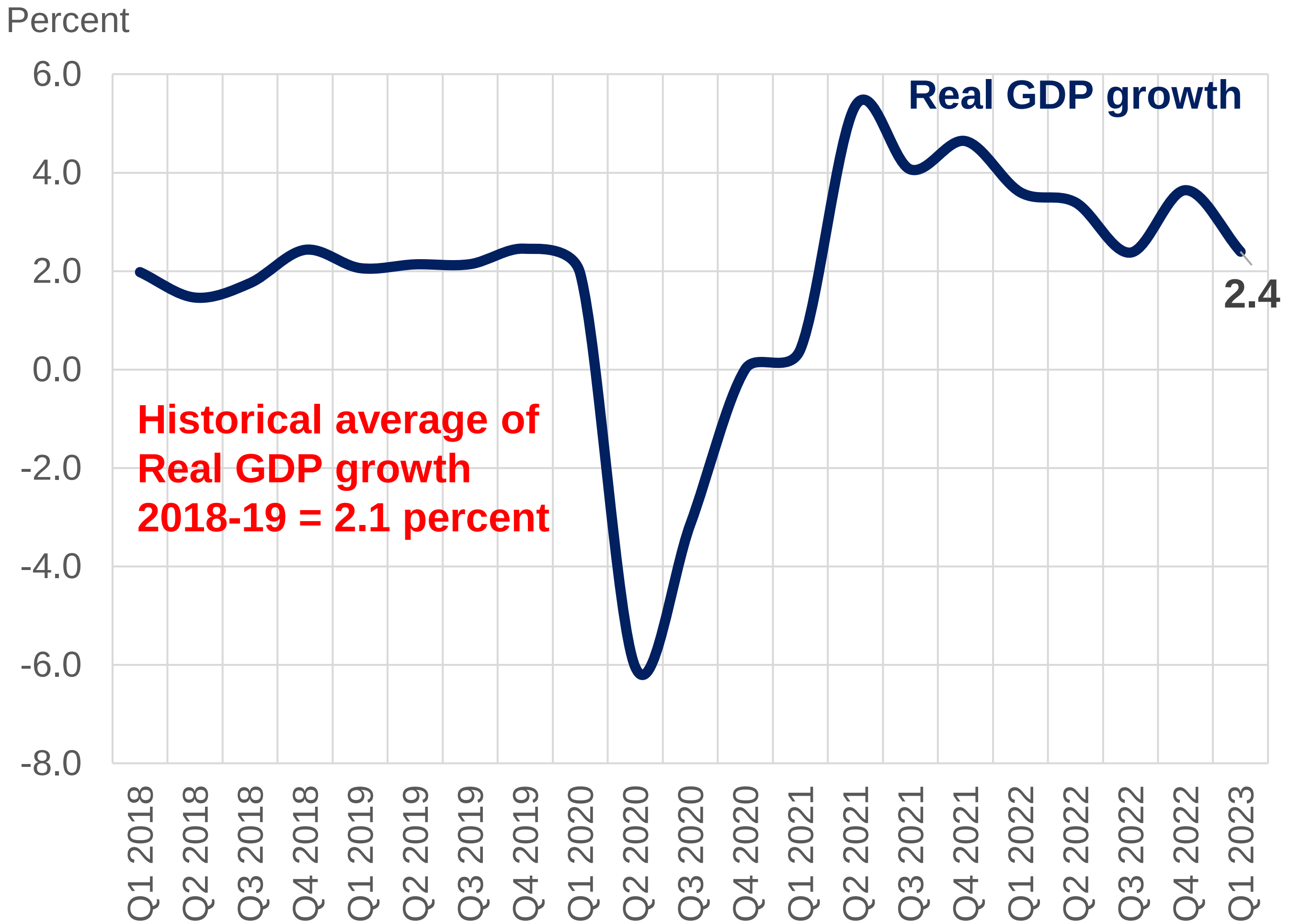
GLOBAL BACKDROP: OIL PRICES HAVE DROPPED SINCE LAST NDU, BUT ARE STILL ABOVE AVERAGE – YET NIGERIA HAS NOT BEEN BENEFITING

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



Sources: CBN

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

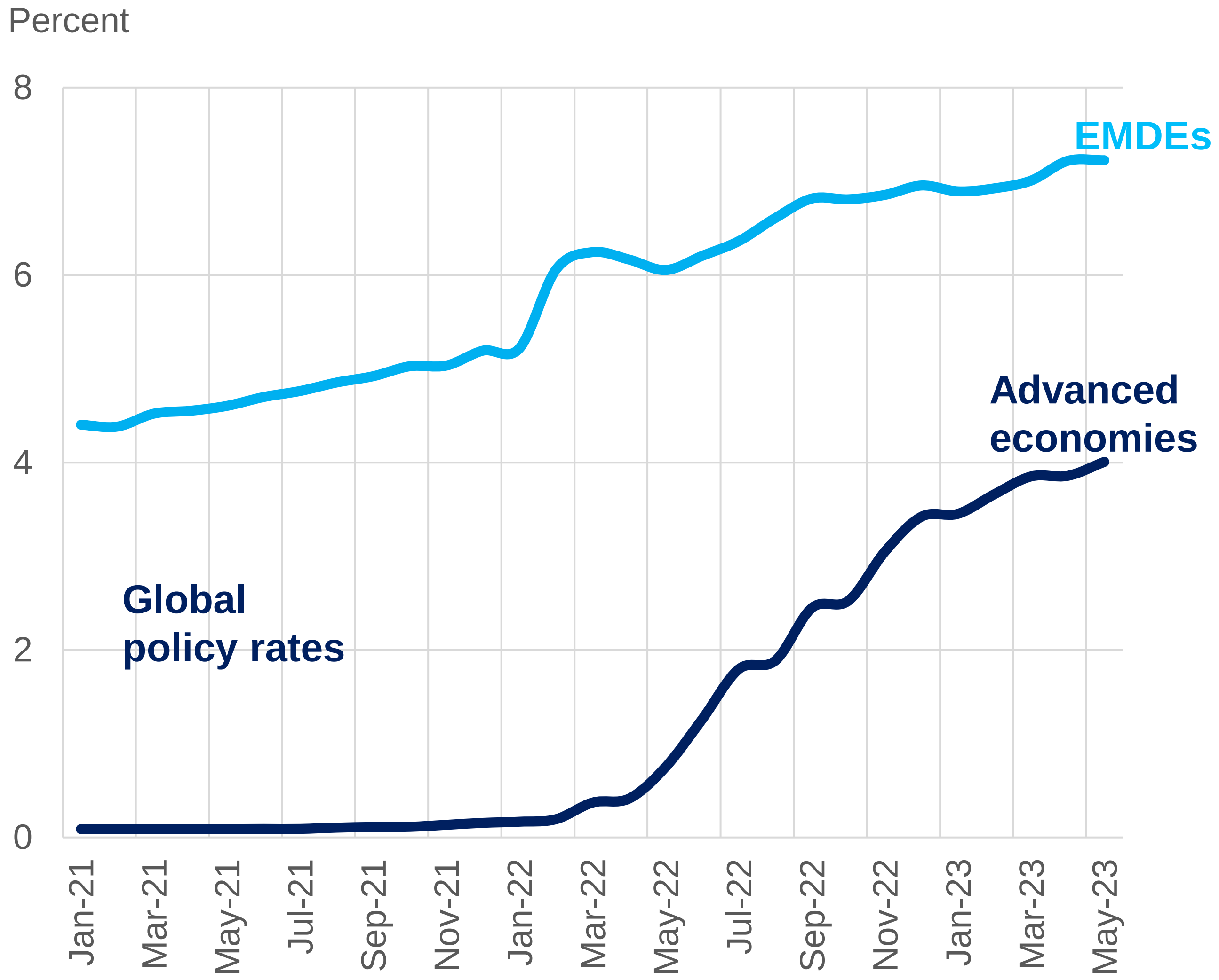


Sources: NBS

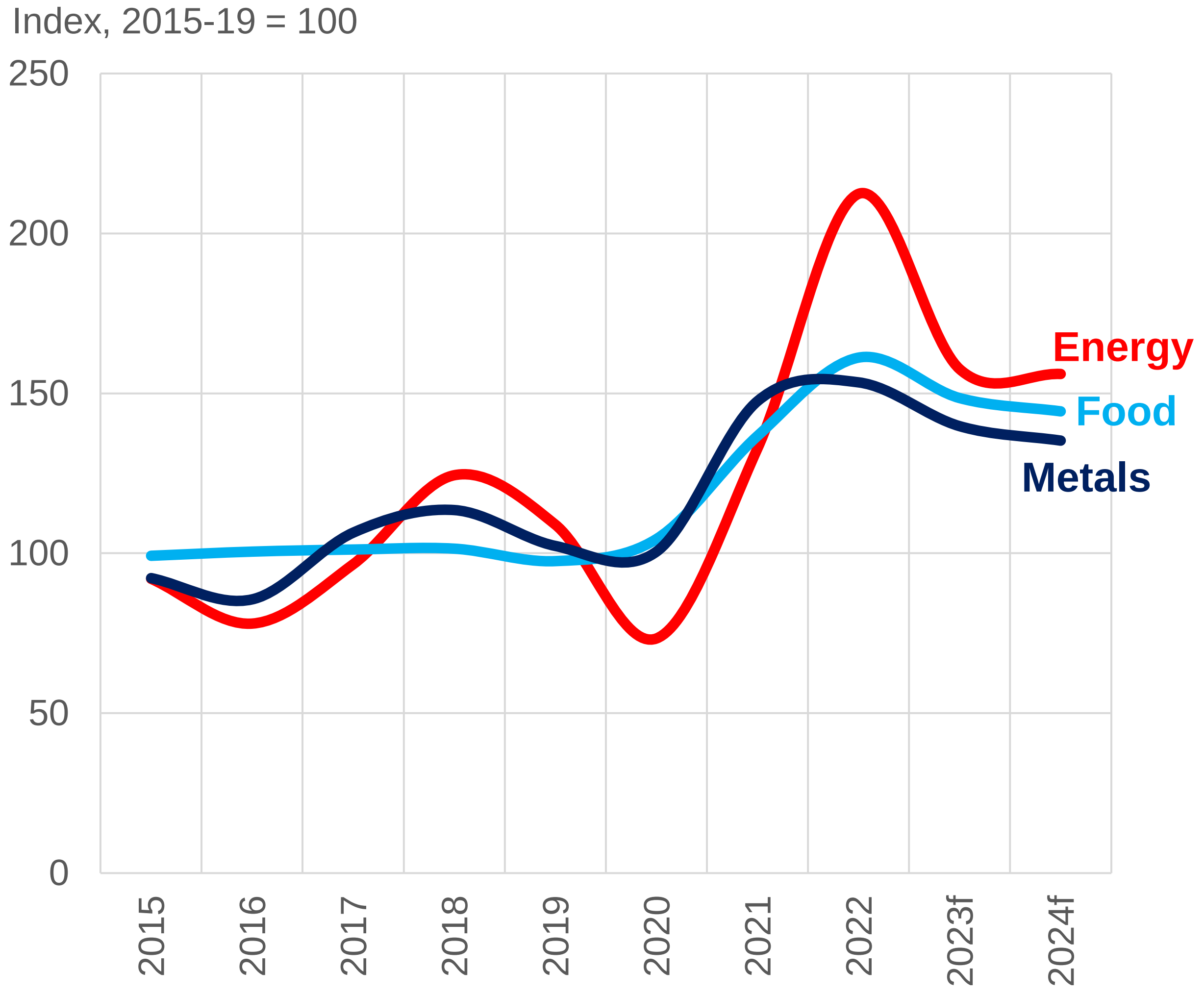
GLOBAL BACKDROP: CONTINUED TO ADD TO THE PRESSURE ON NIGERIA'S ALREADY HIGH FINANCING COSTS AND INFLATION

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

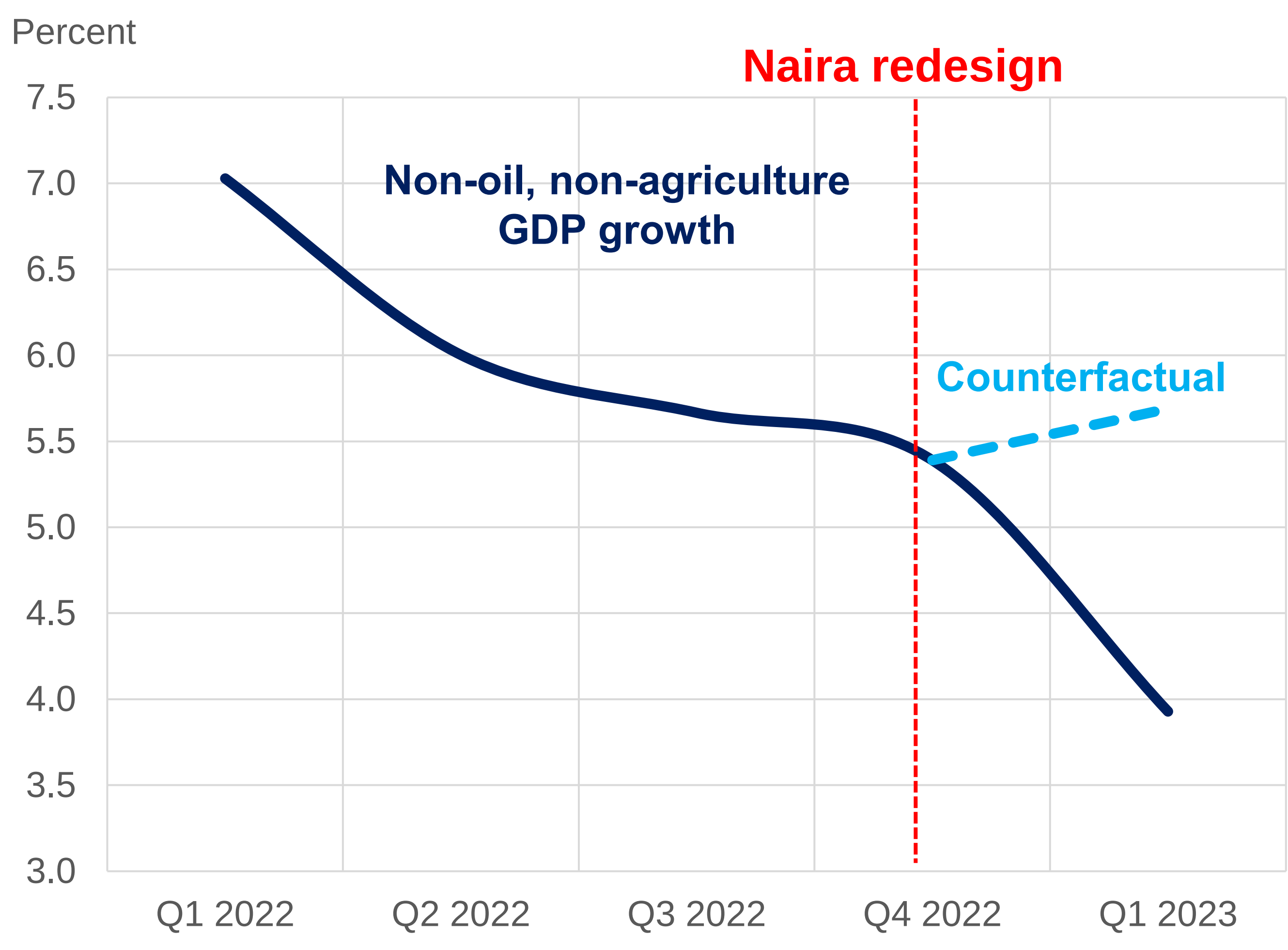


Source: World Bank

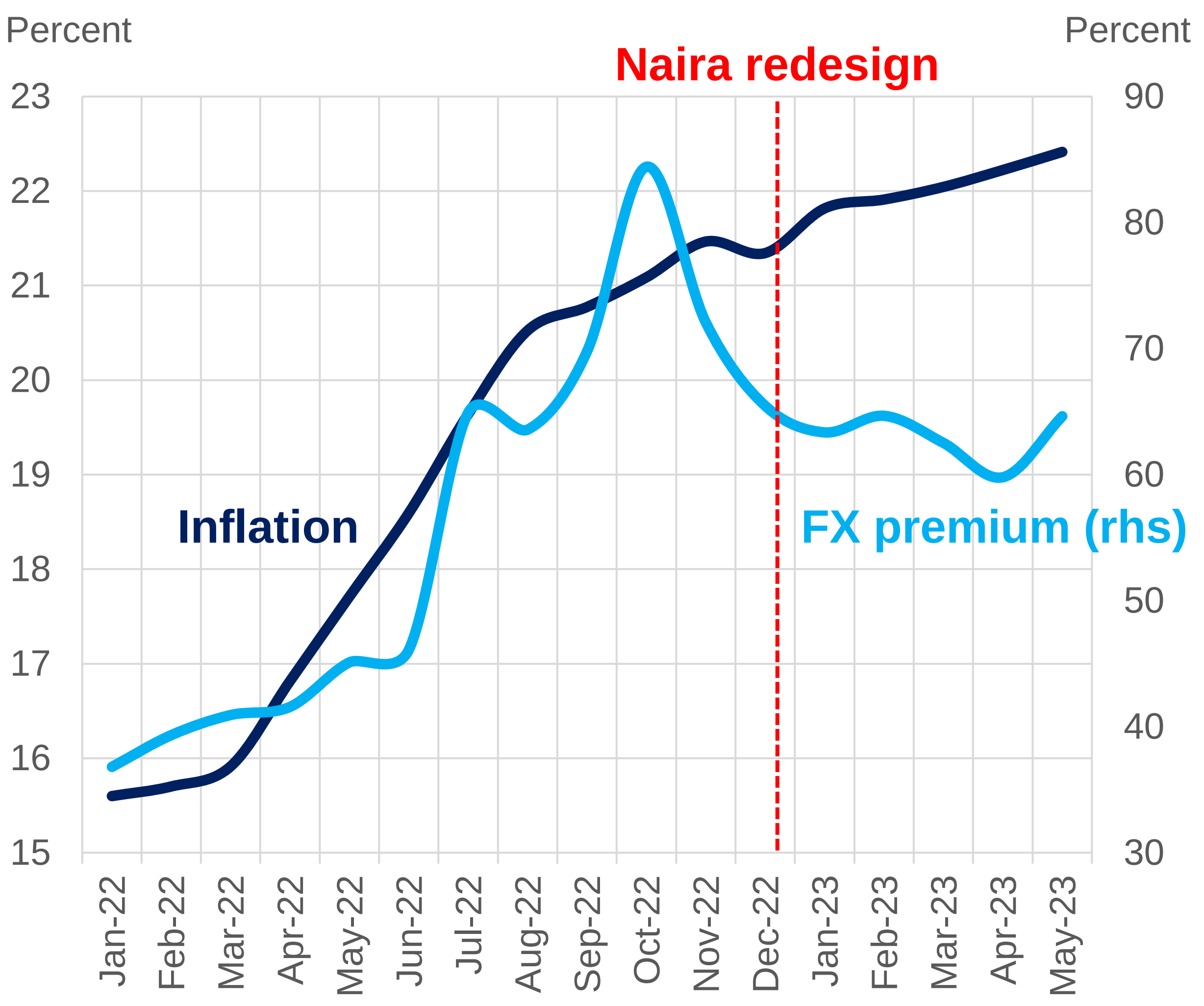
GROWTH WEAKENED IN Q1, HAMPERED BY CASH SCARCITY

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

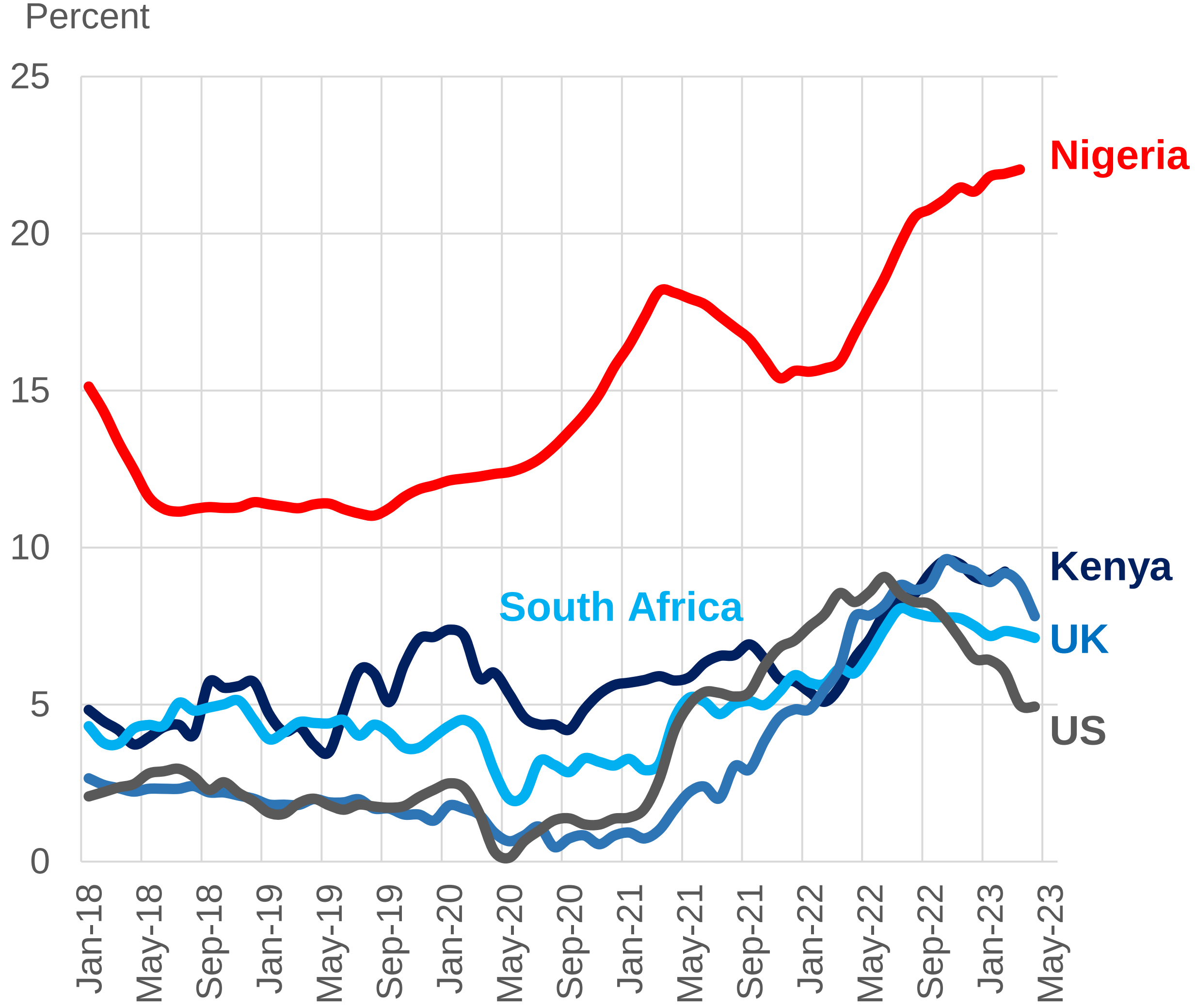


Source: NBS, World Bank, FMDQ, and Aboki Rates.

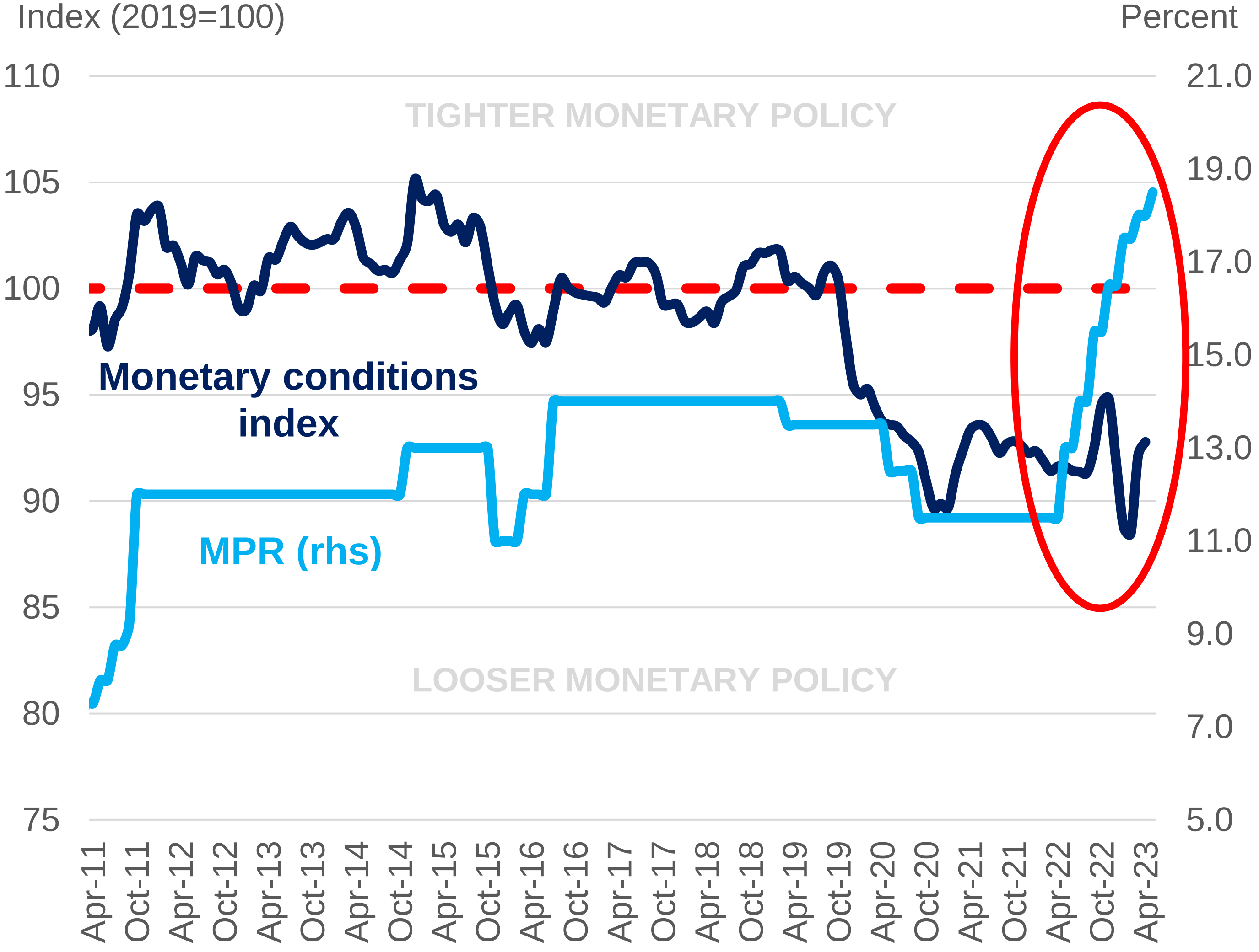
INFLATION CONTINUED INCREASING AND REACHED A 17-YEAR HIGH

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



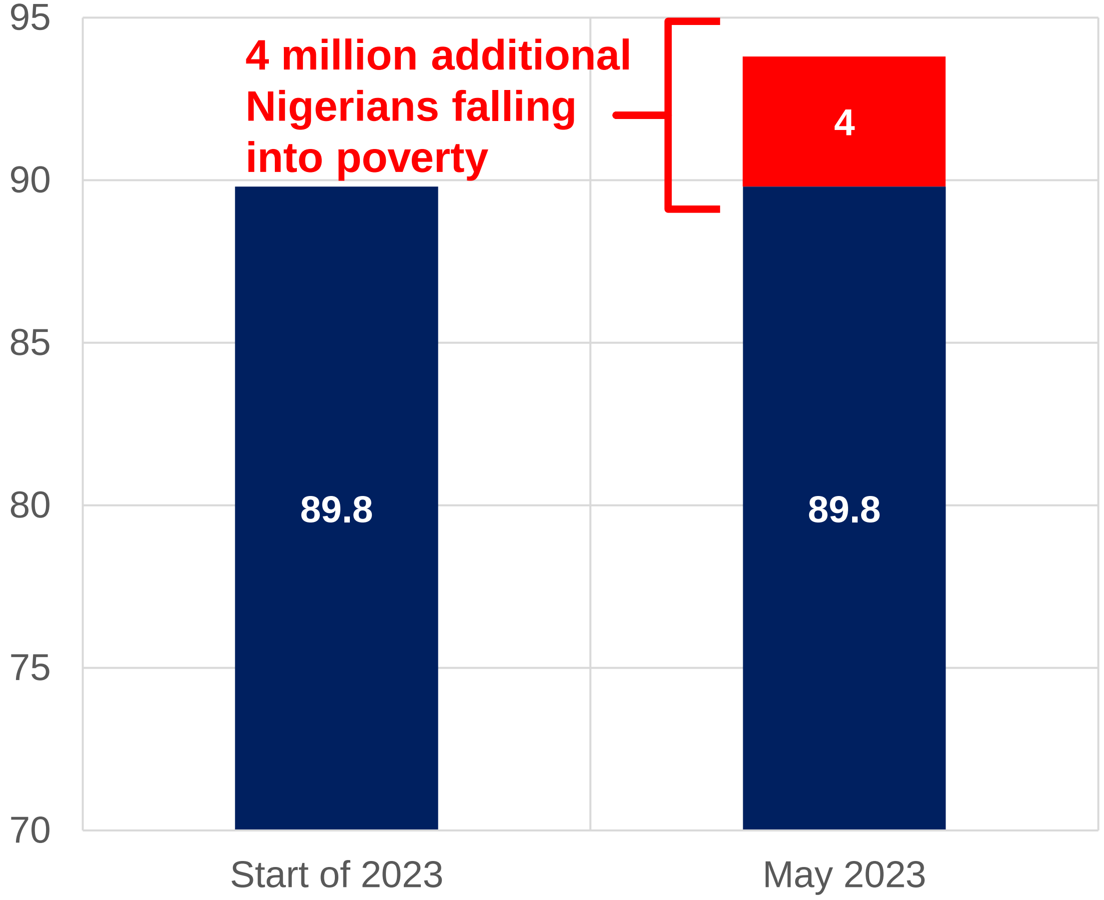
Source: CBN, WDI, FMDQ, World Bank

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…

Number of poor people (millions)

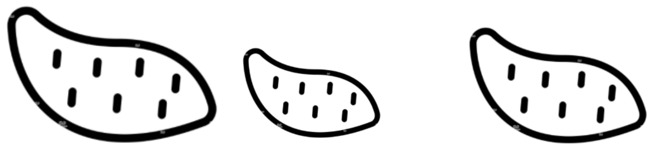


Source: World Bank estimates based on NBS data

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

What does N1000 buy?

	April 2022	April 2023
Yam	**1.7 tubers**	**0.9 tuber**
Bread	**2.3 loaves**	**1.8 loaves**
Kerosene	**1.7 liters**	**0.9 liter**

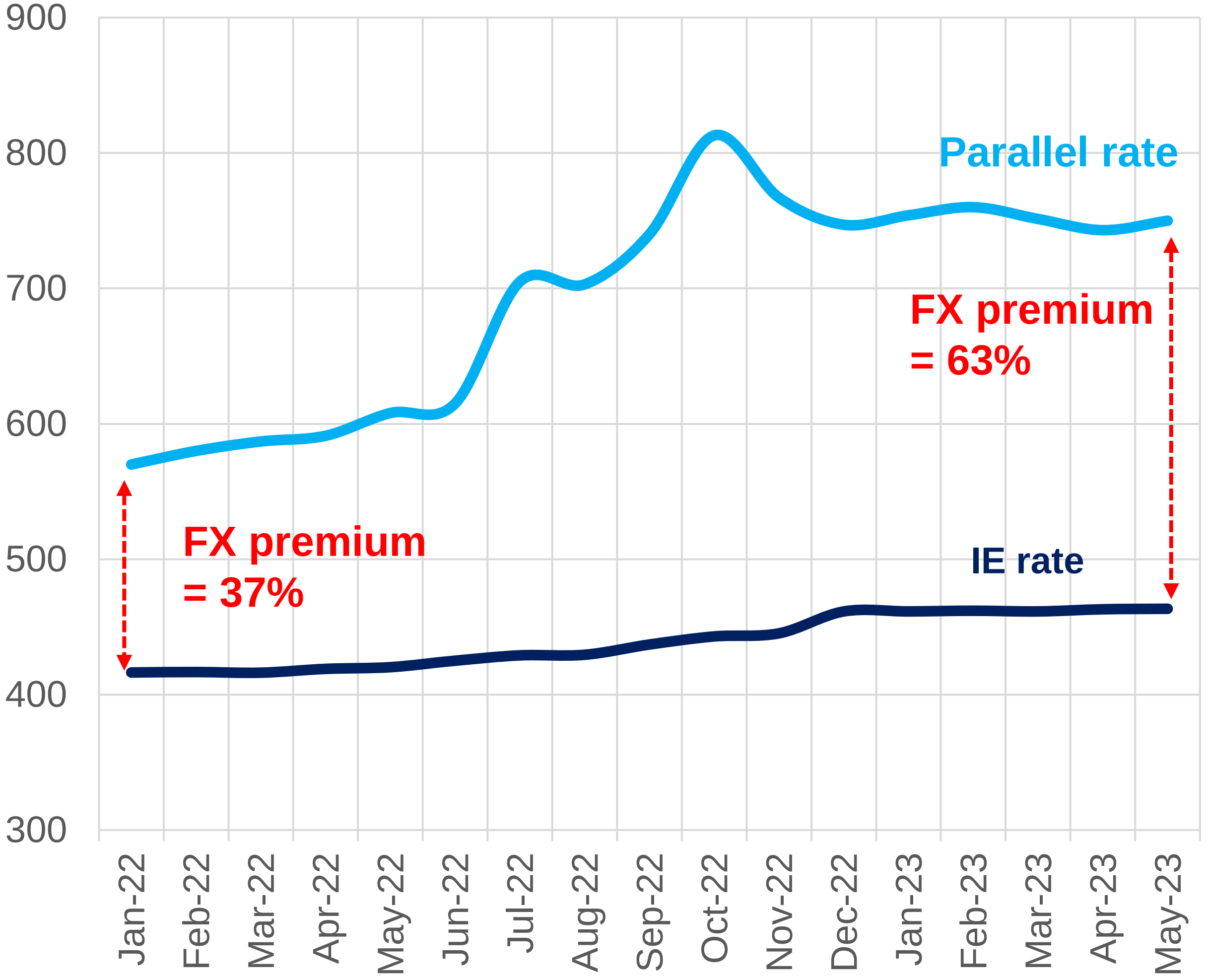


Source: NBS

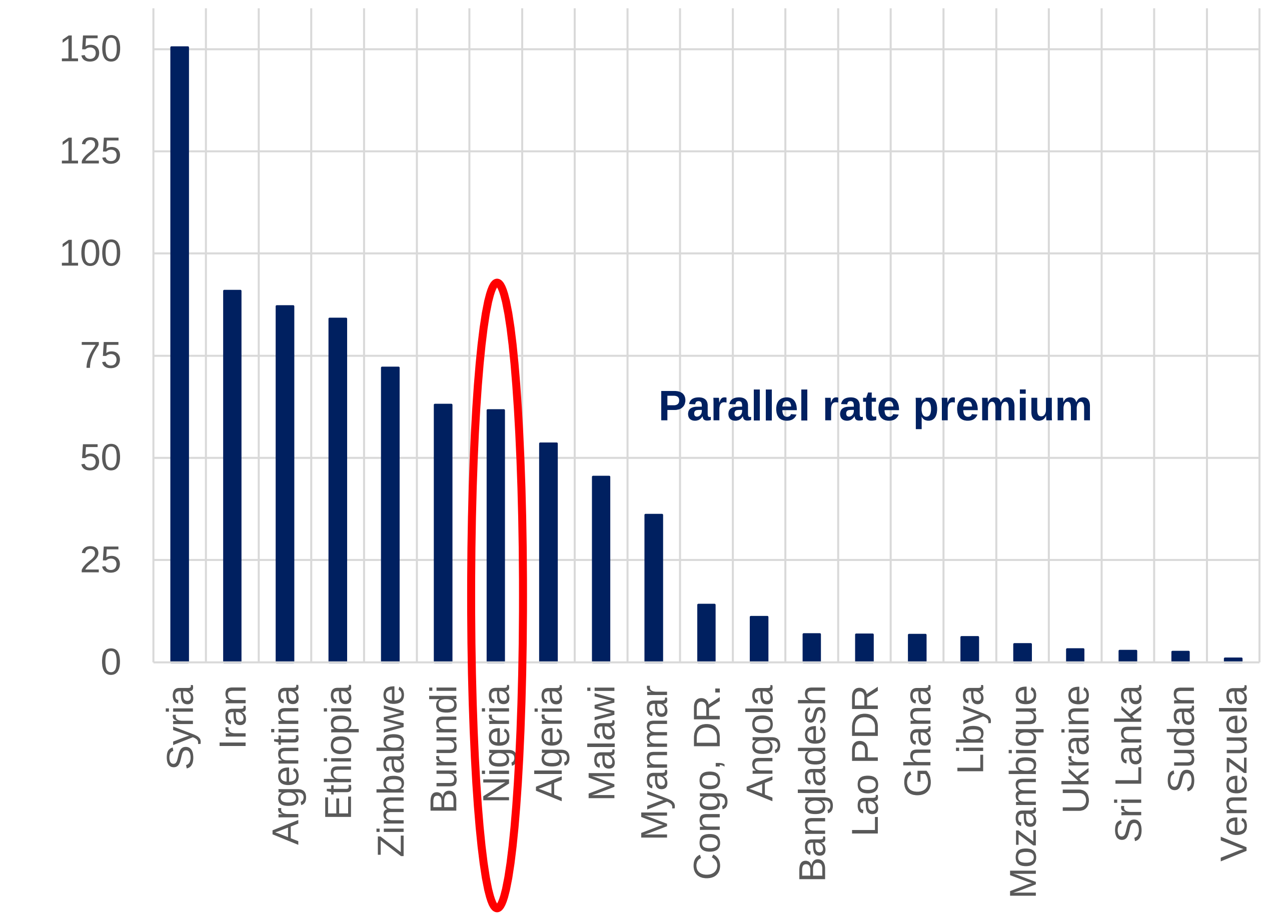
FOREIGN EXCHANGE DISTORTIONS WERE SEVERE

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



…and Nigeria's FX premium was among the highest in the world

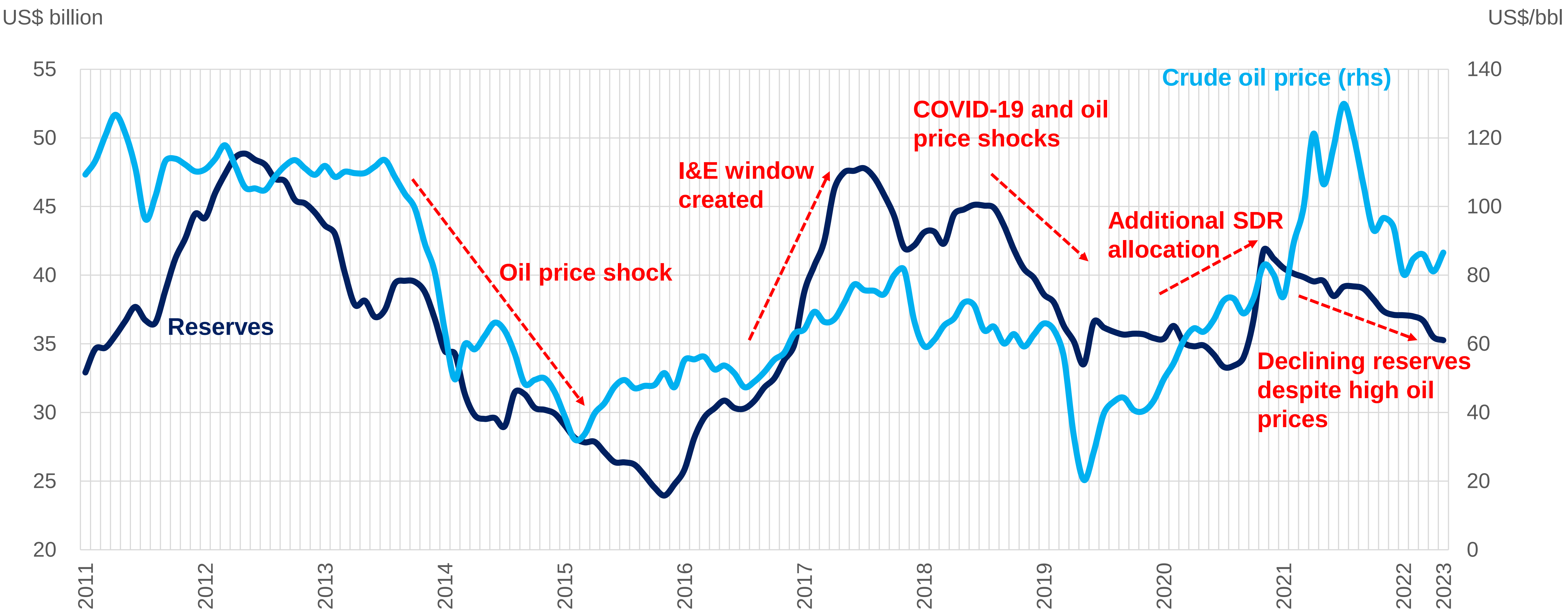


Note: Latest data as of the end of Q1 2023 (May 2023 for Nigeria). Excludes Lebanon and Yemen.

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

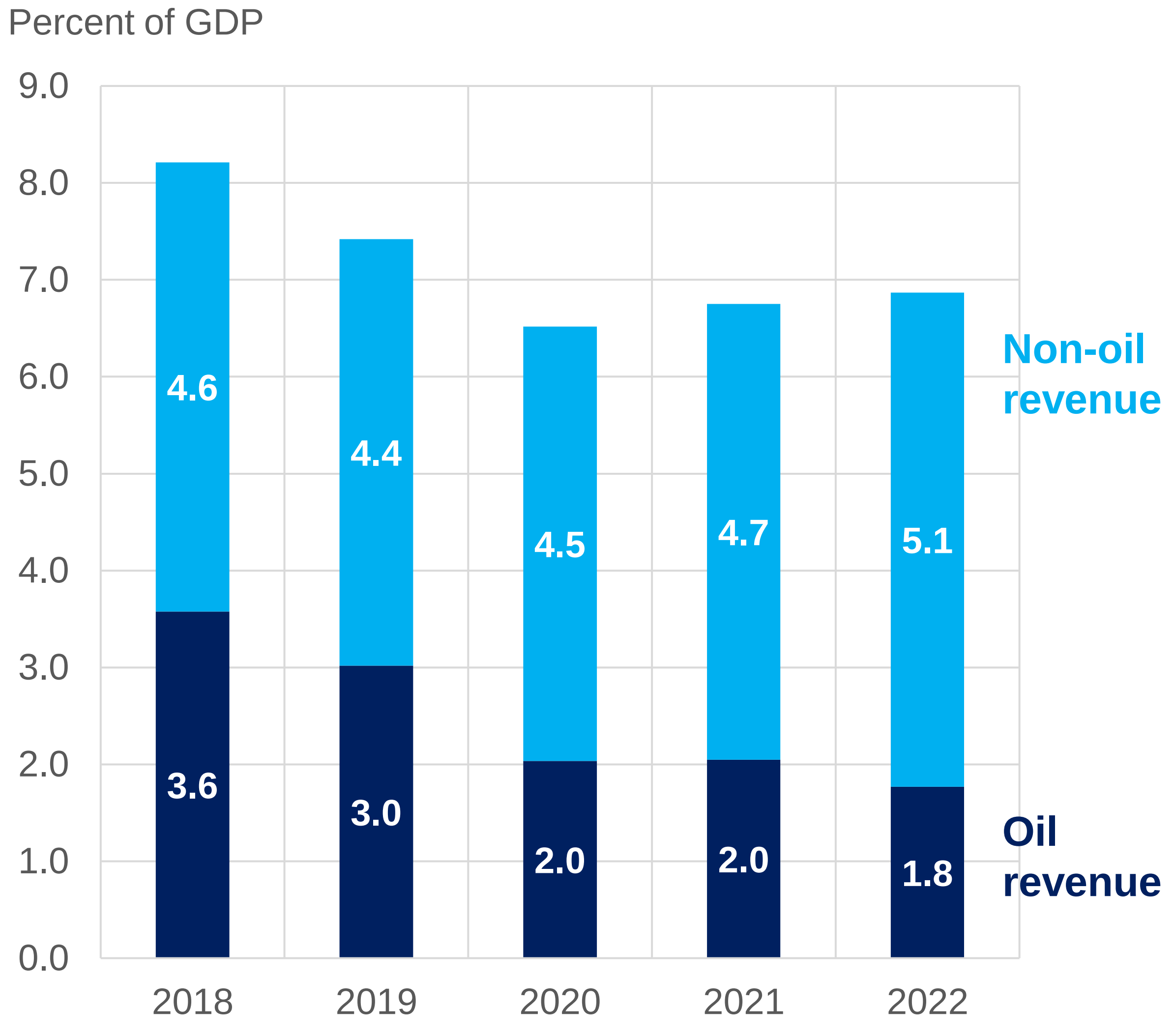


Sources: CBN

DETERIORATING FISCAL SITUATION PRIOR TO THE PMS SUBSIDY REFORM

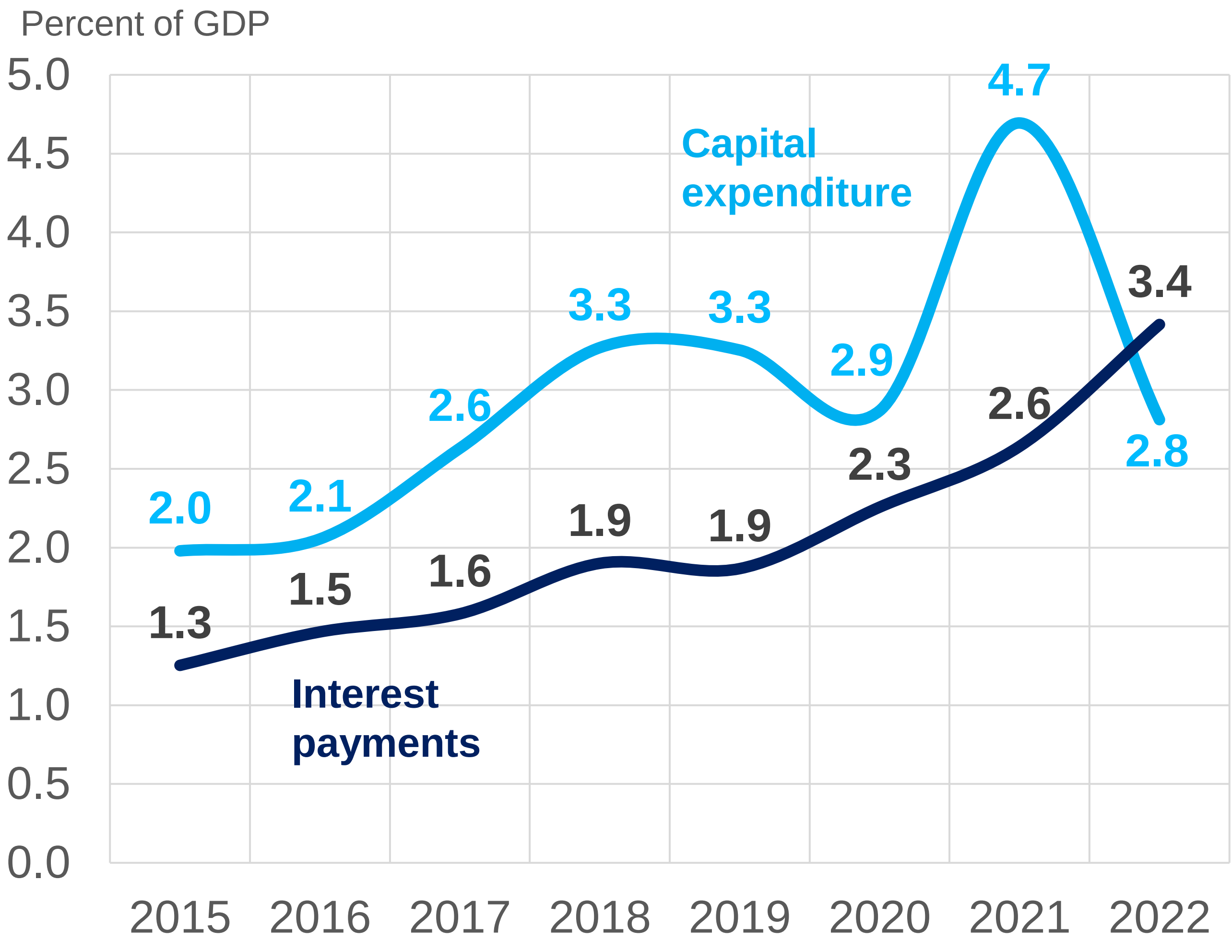
Despite some improvement in non-oil revenues, fiscal and therefore debt dynamics were worsening rapidly

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



Sources: BOF and OAGF

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

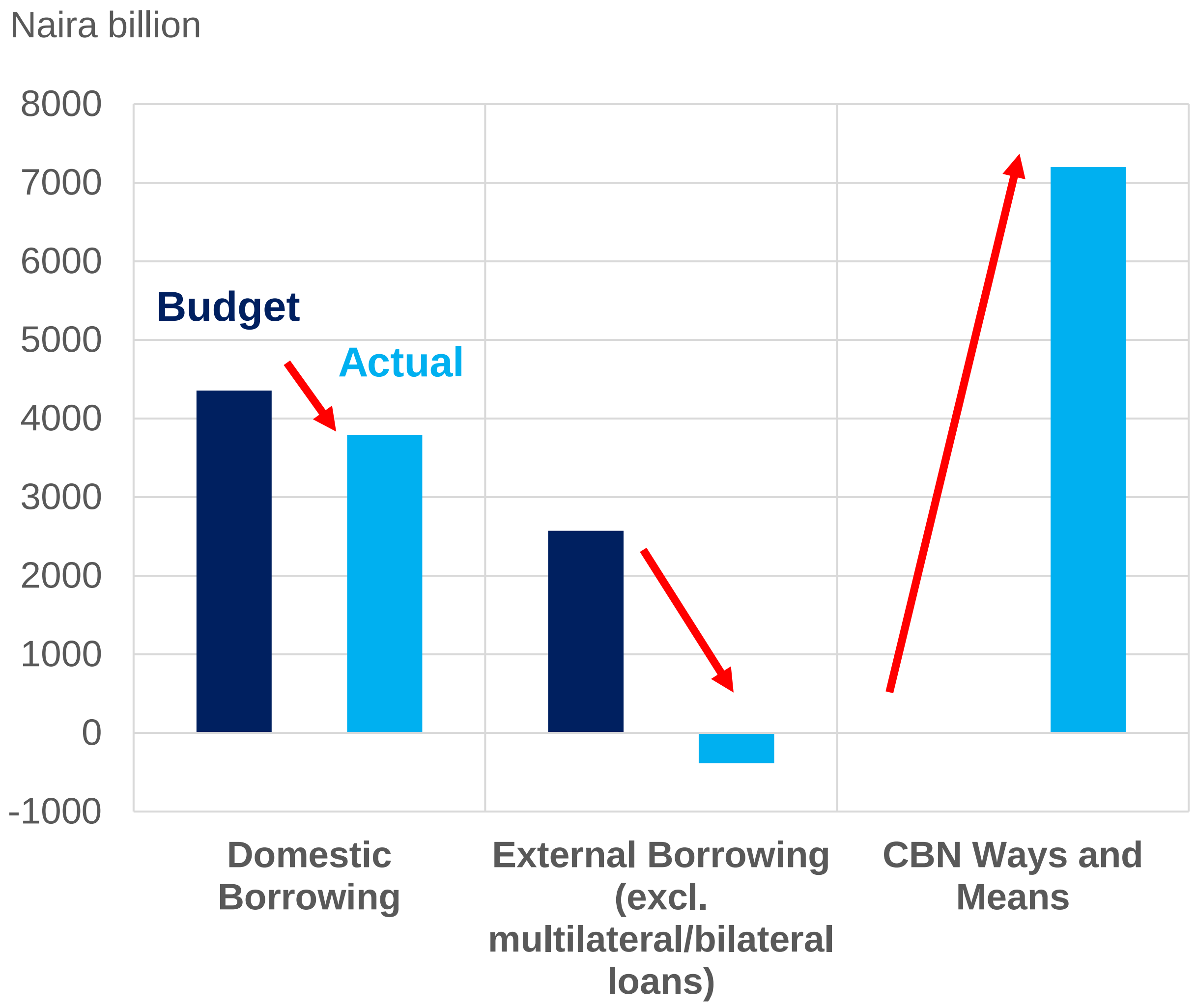


Sources: CBN and OAGF and World Bank estimates

AS A RESULT, PUBLIC DEBT INCREASED TO 40 PERCENT OF GDP

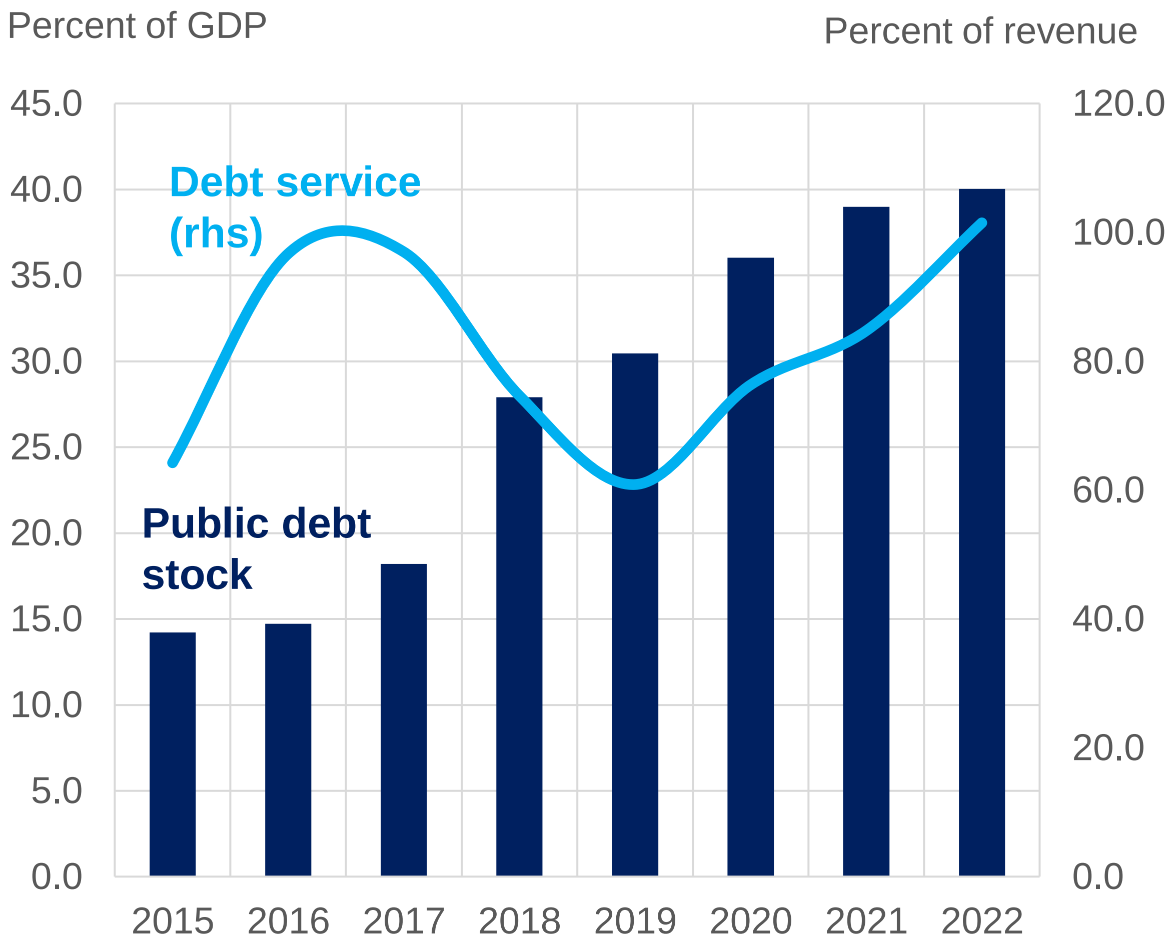
As external markets were closed, the federal government borrowed more mainly from CBN to finance its deficit

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



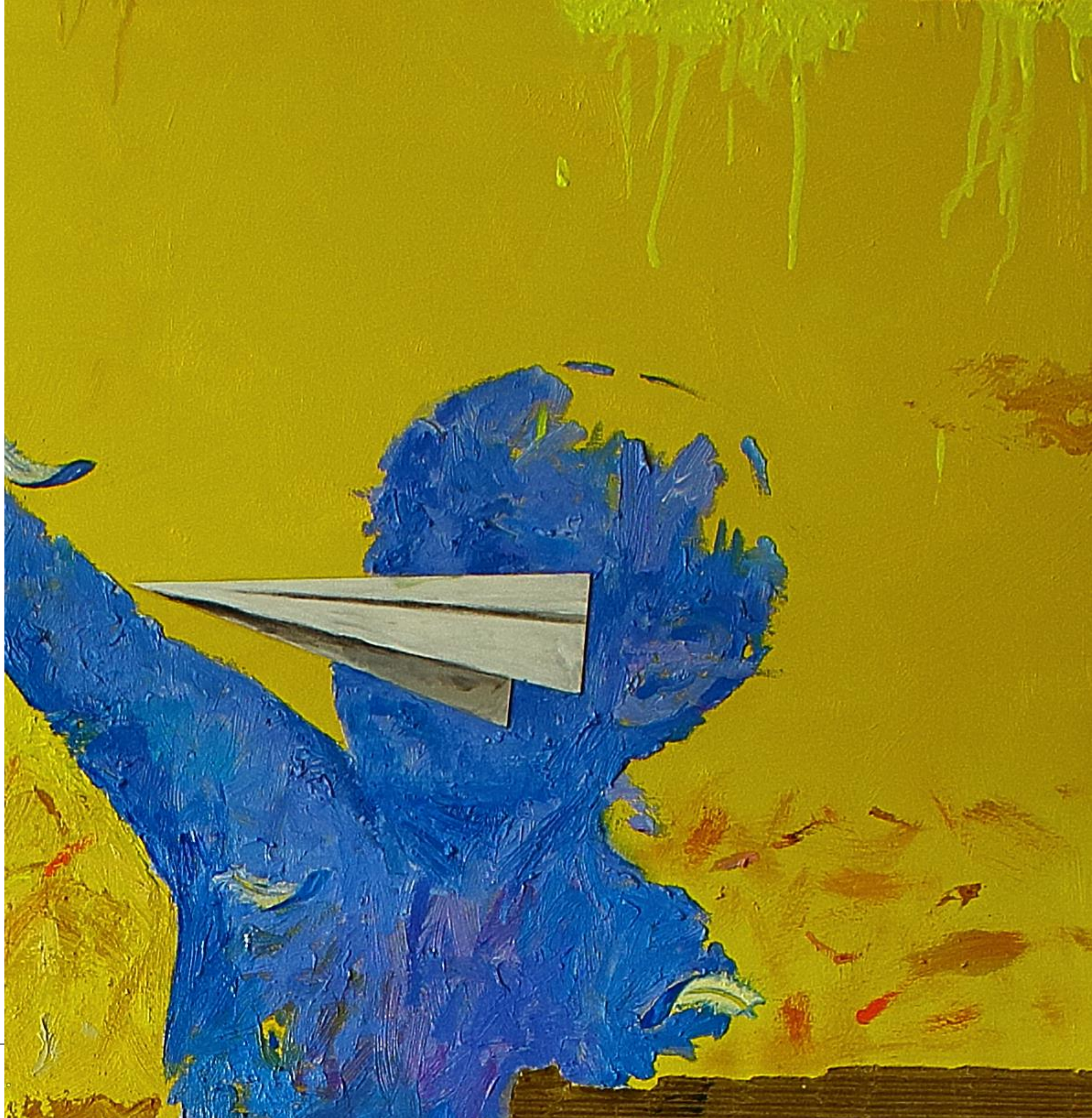
Sources: BOF and OAGF

… and pushing debt service above 100 percent of revenues



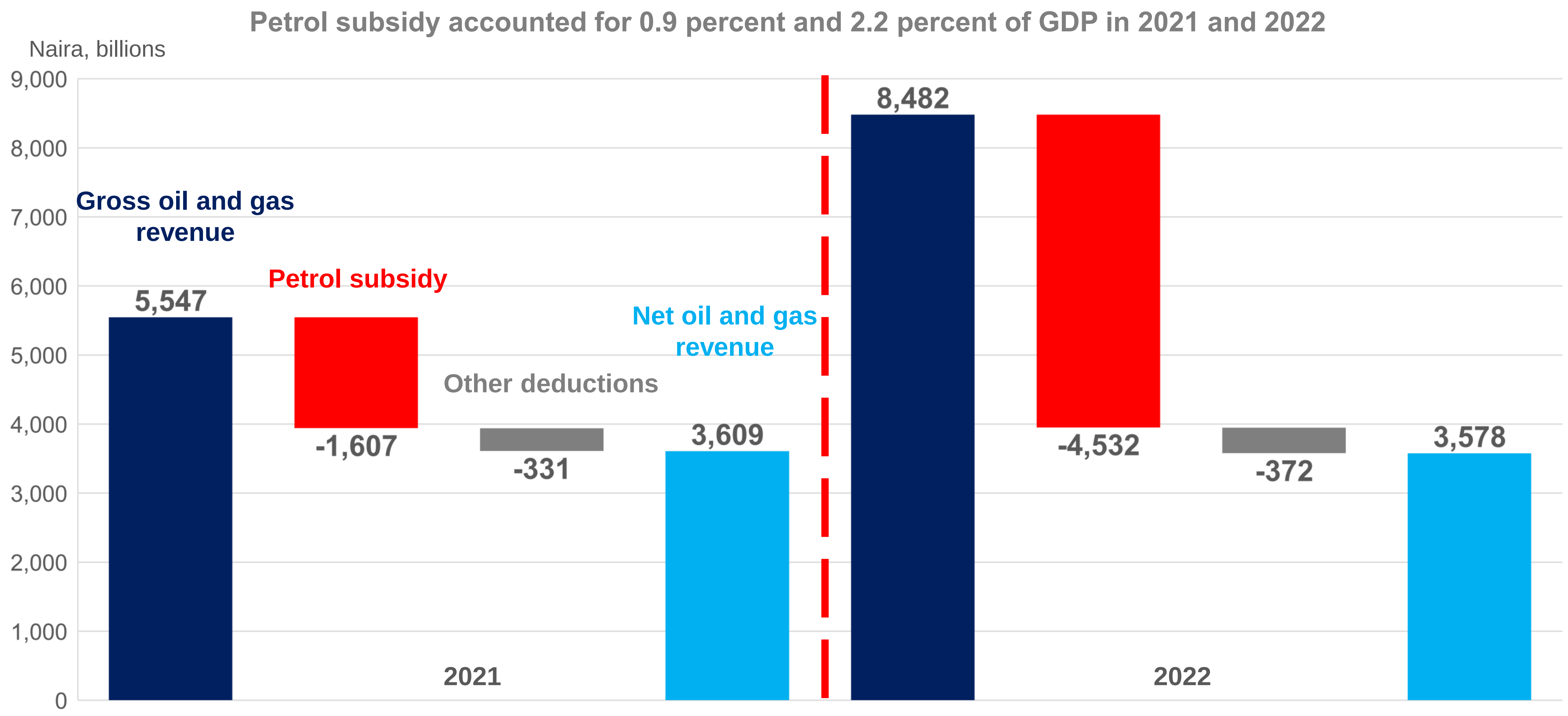
Sources: CBN and OAGF and World Bank estimates.

PART 2: THE REMOVAL OF THE PMS SUBSIDY



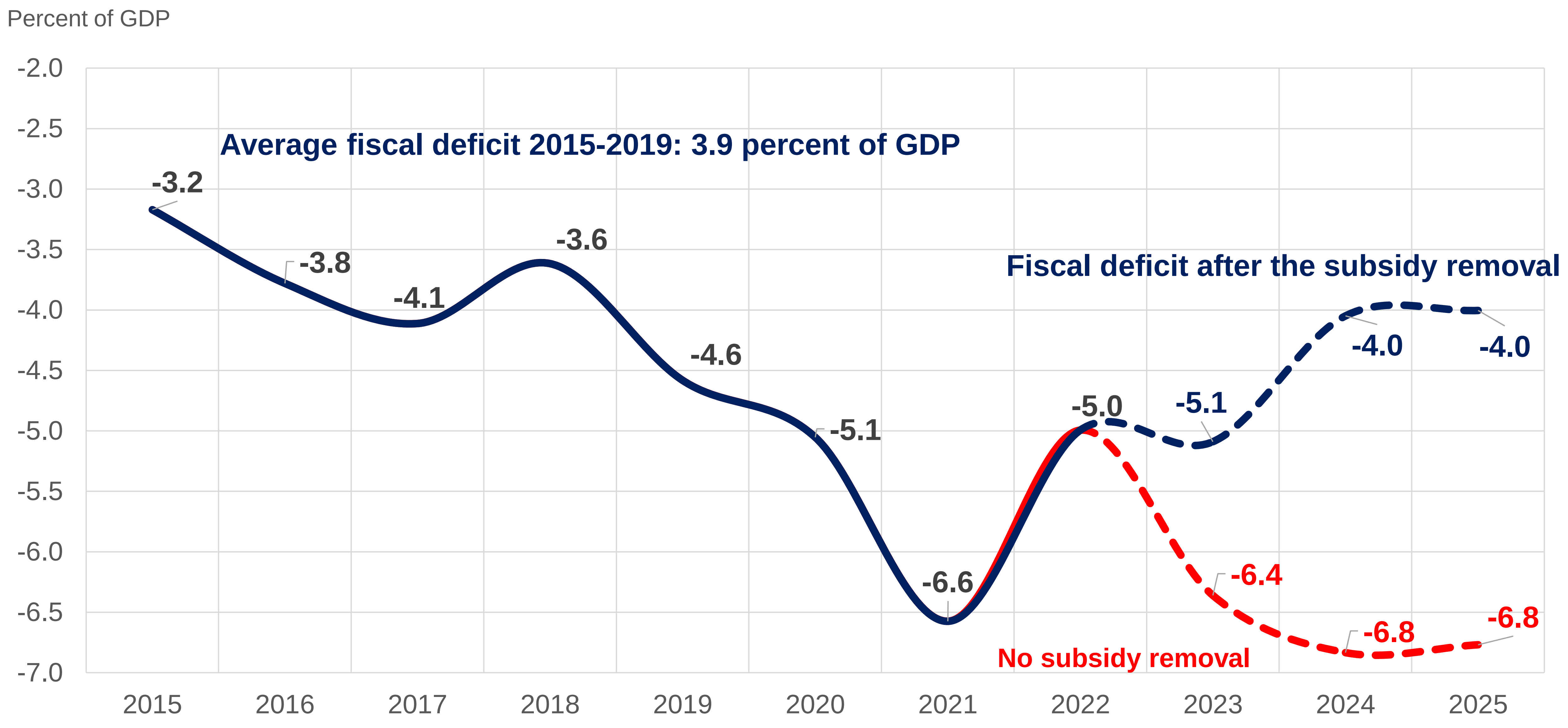
THE PMS SUBSIDY REFORM REMOVES AN UNSUSTAINABLE FISCAL BURDEN

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



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

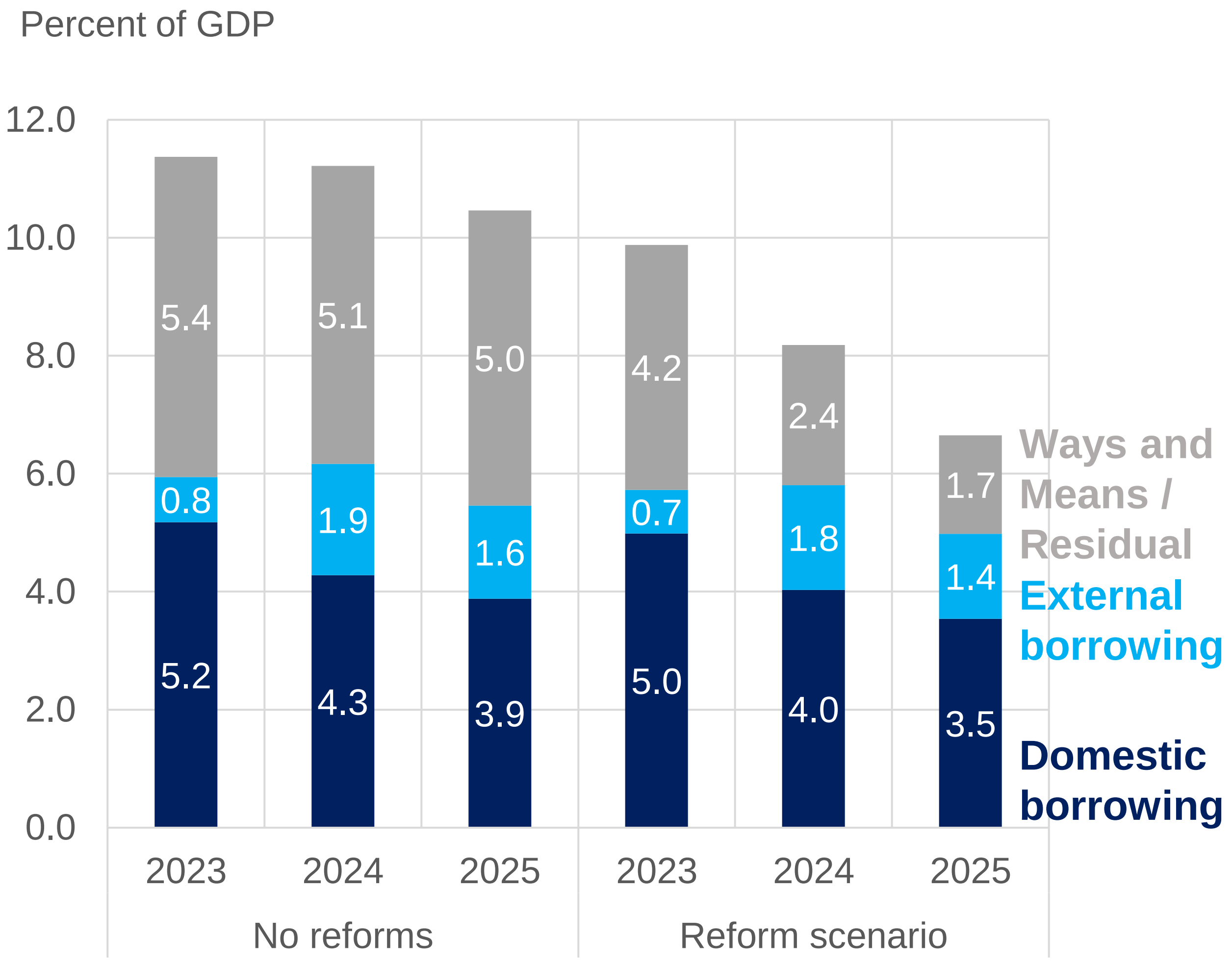


Source: World Bank estimates based on BOF, DMO, OAGF, and NNPC.

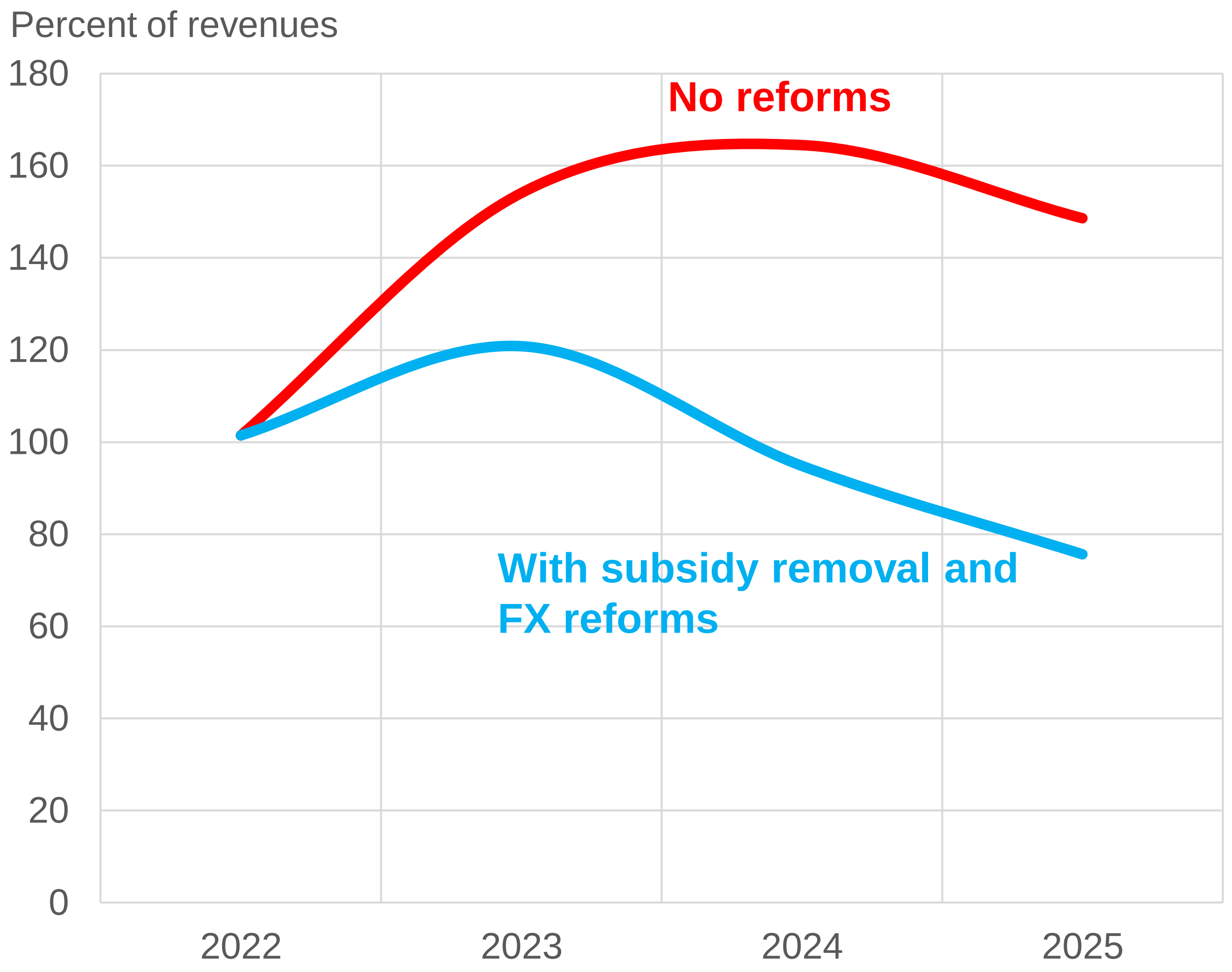
EVEN WITH THE RECENT REFORMS, FINANCING NEEDS REMAIN ELEVATED

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

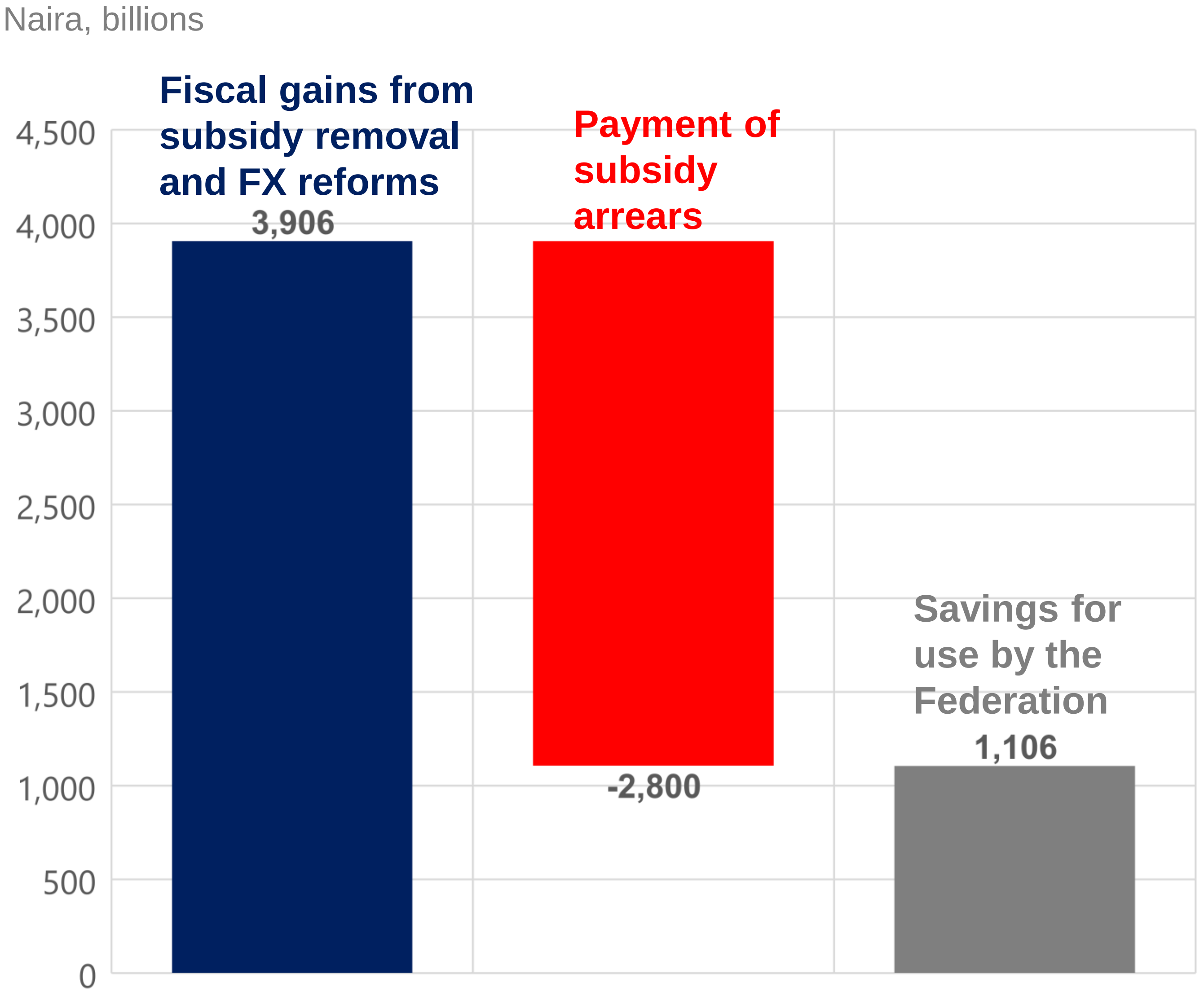


Source: World Bank estimates based on data from BOF and DMO

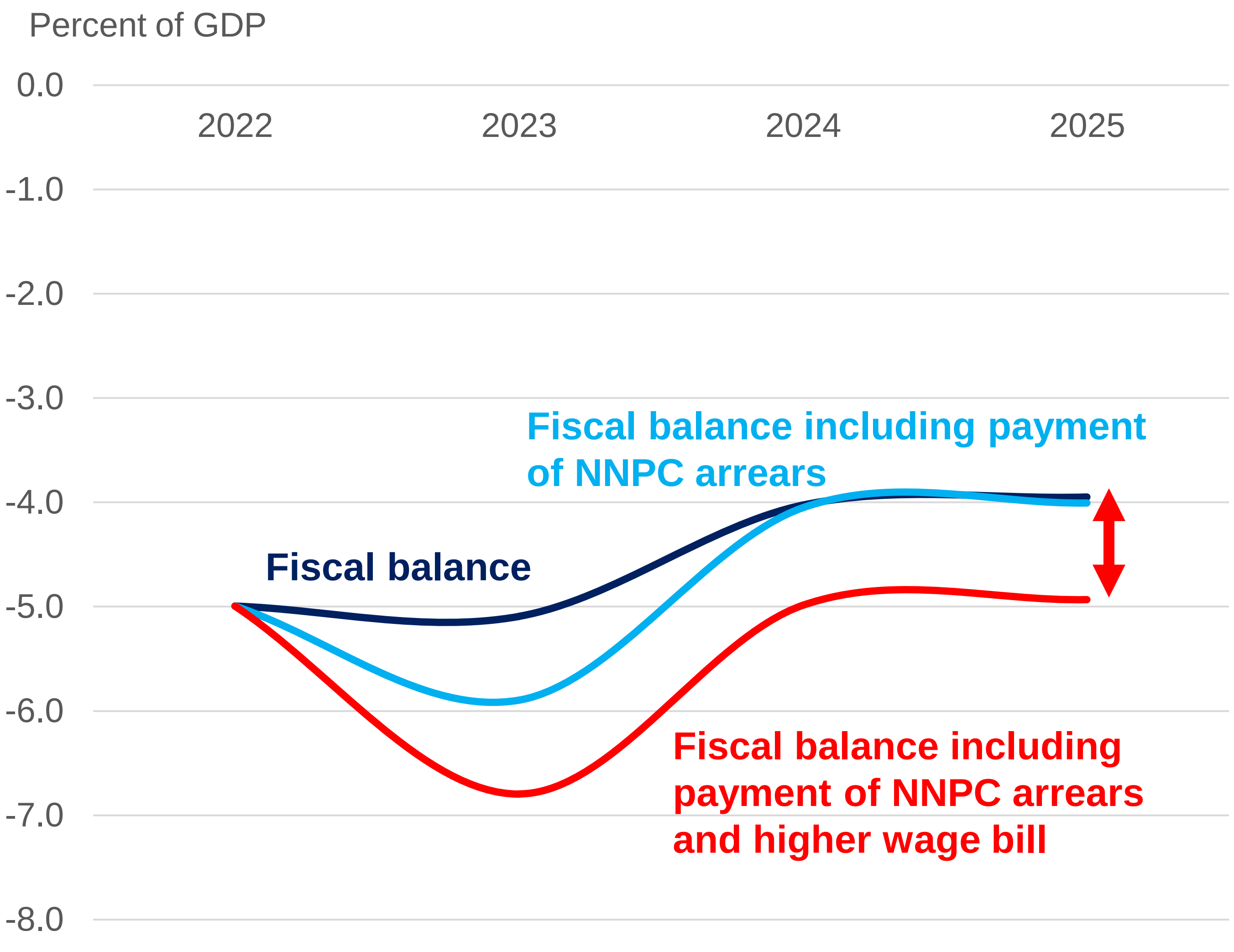
IT IS CRITICAL TO CHOOSE HOW SAVINGS FROM REFORMS WILL BE USED

To maximize the impact of the petrol subsidy reform

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



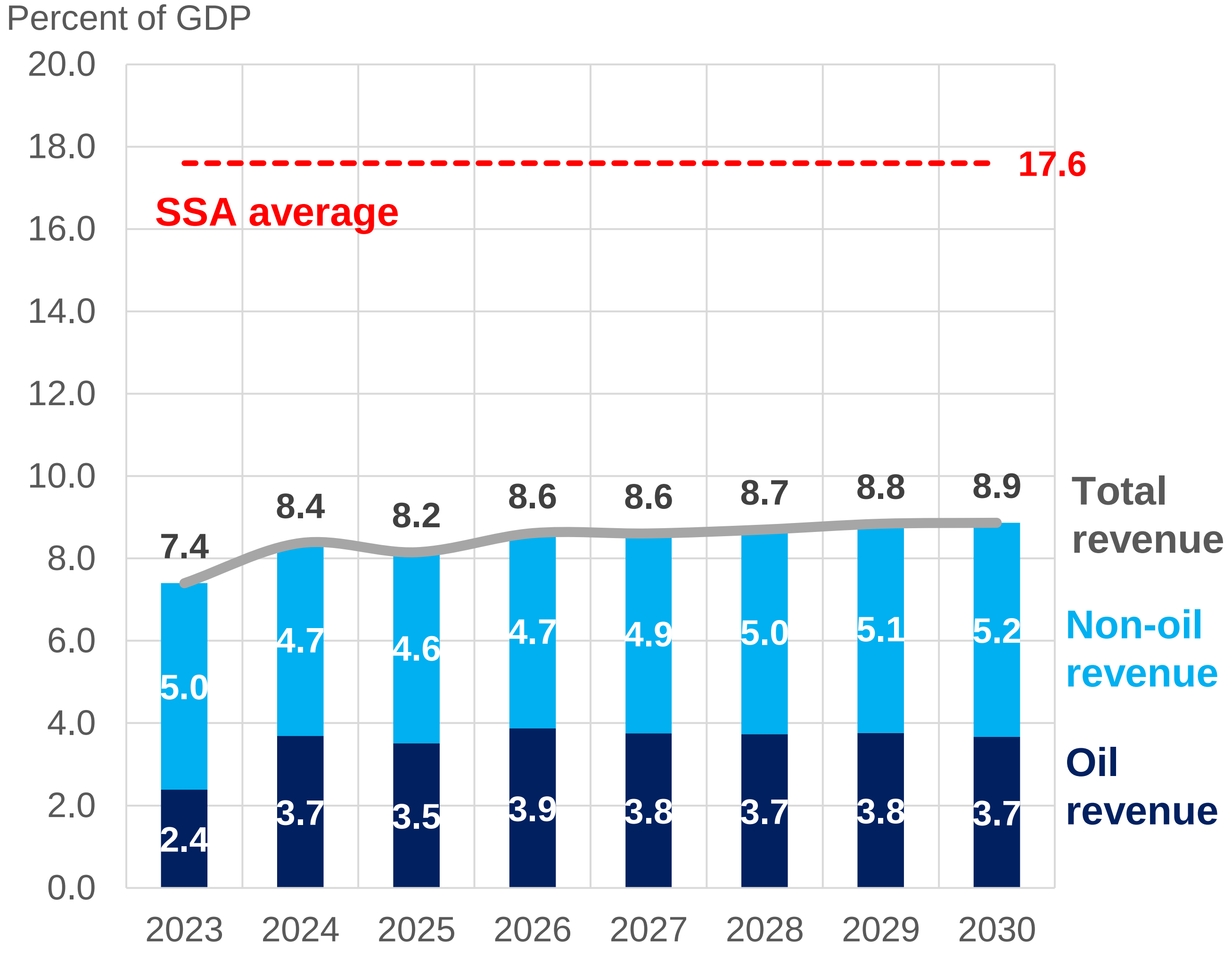
…and if the government undertakes large new expenditures the fiscal situation for 2023 could rapidly deteriorate again

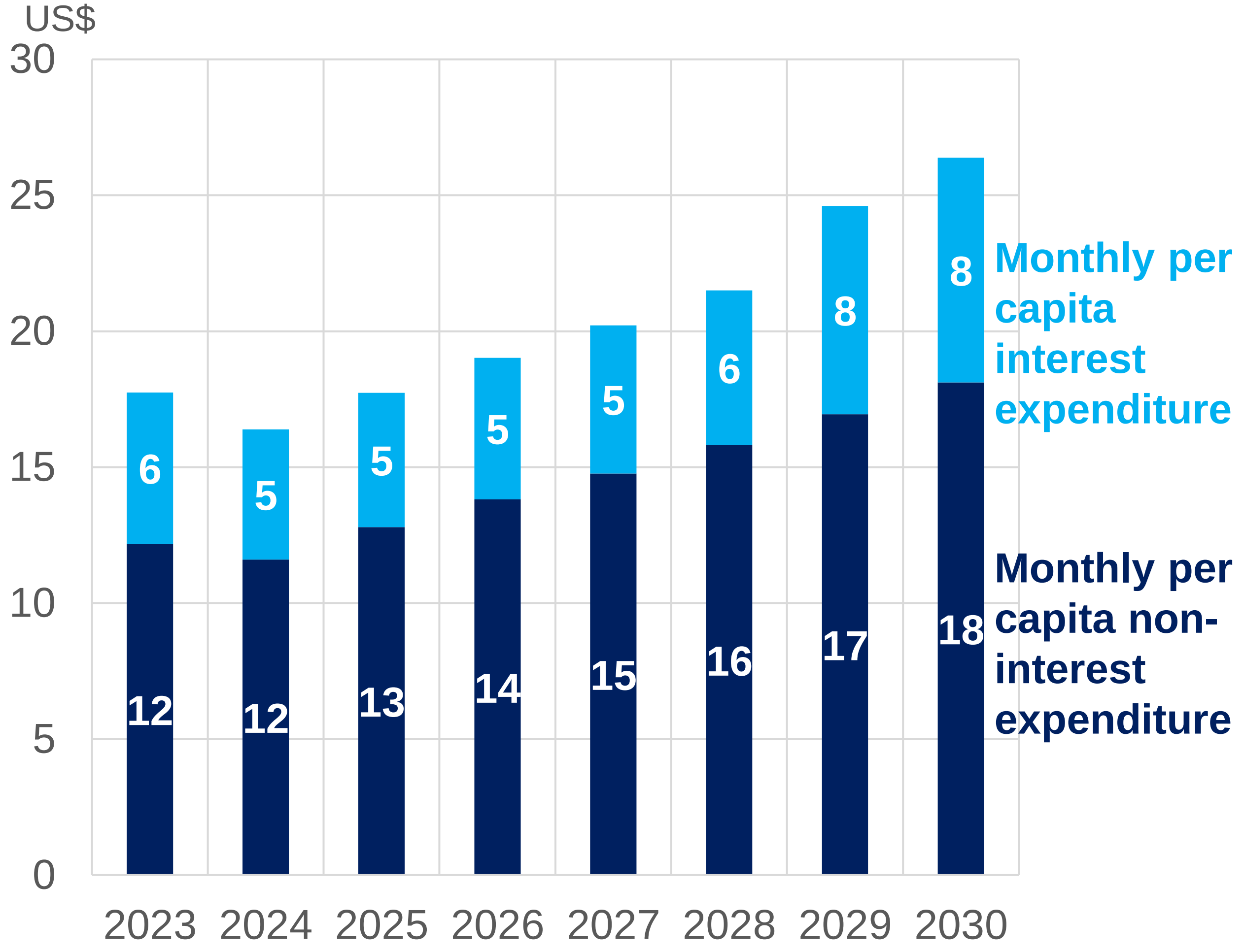


Source: World Bank estimates based on NNPC and BOF data

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

THE CBN UNDERTOOK A SUBSTANTIAL FX REFORM

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.

- **IN THE PAST:** RT 200 and Naira4Dollar Remittance Schemes: costly, subsidized FX windows.
- **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.

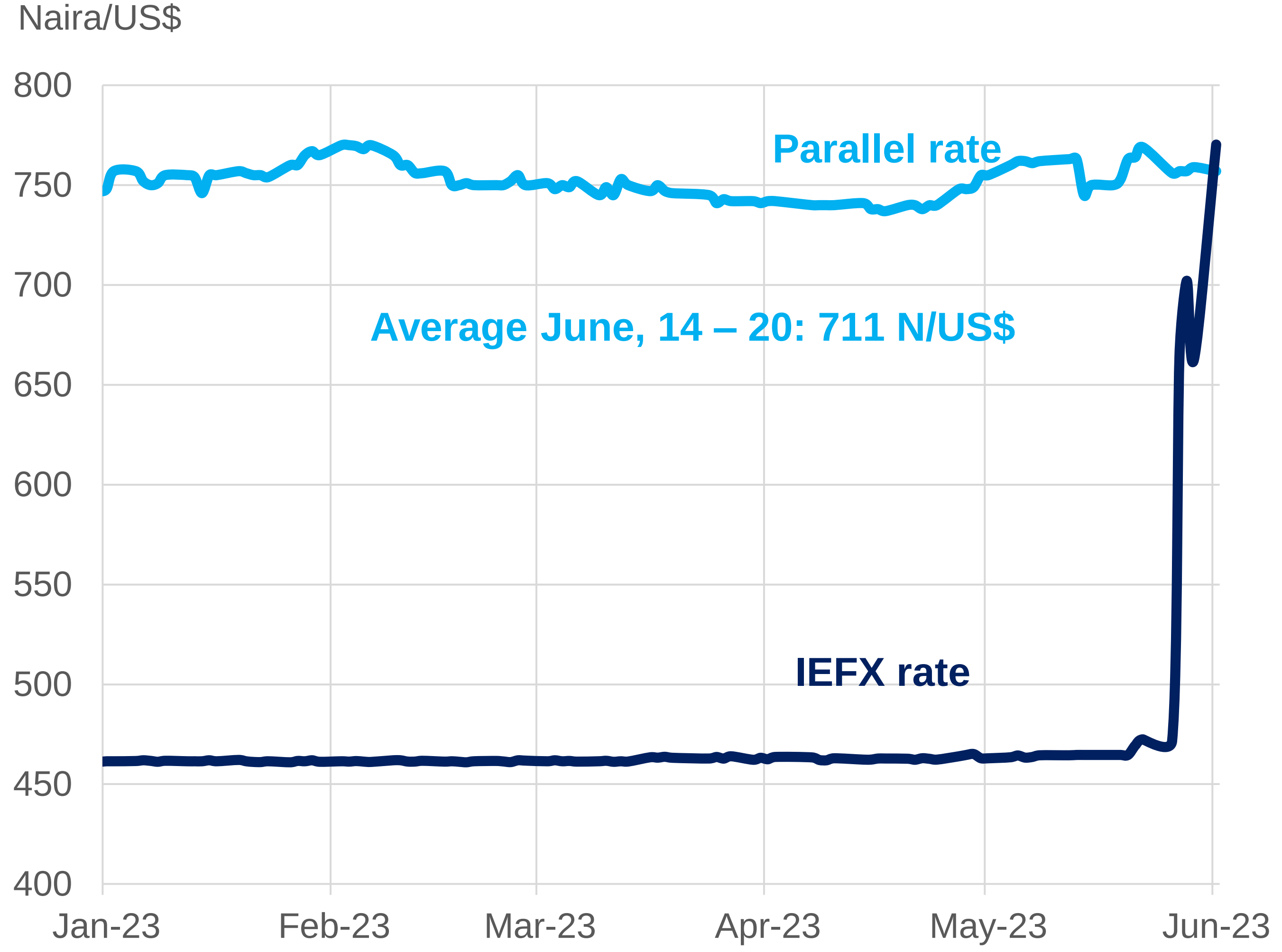
The Central Bank has communicated clearly to the public the operational changes to the FX market.

Source: CBN

THE REFORMS HAD AN IMMEDIATE IMPACT ON THE OFFICIAL FX MARKET

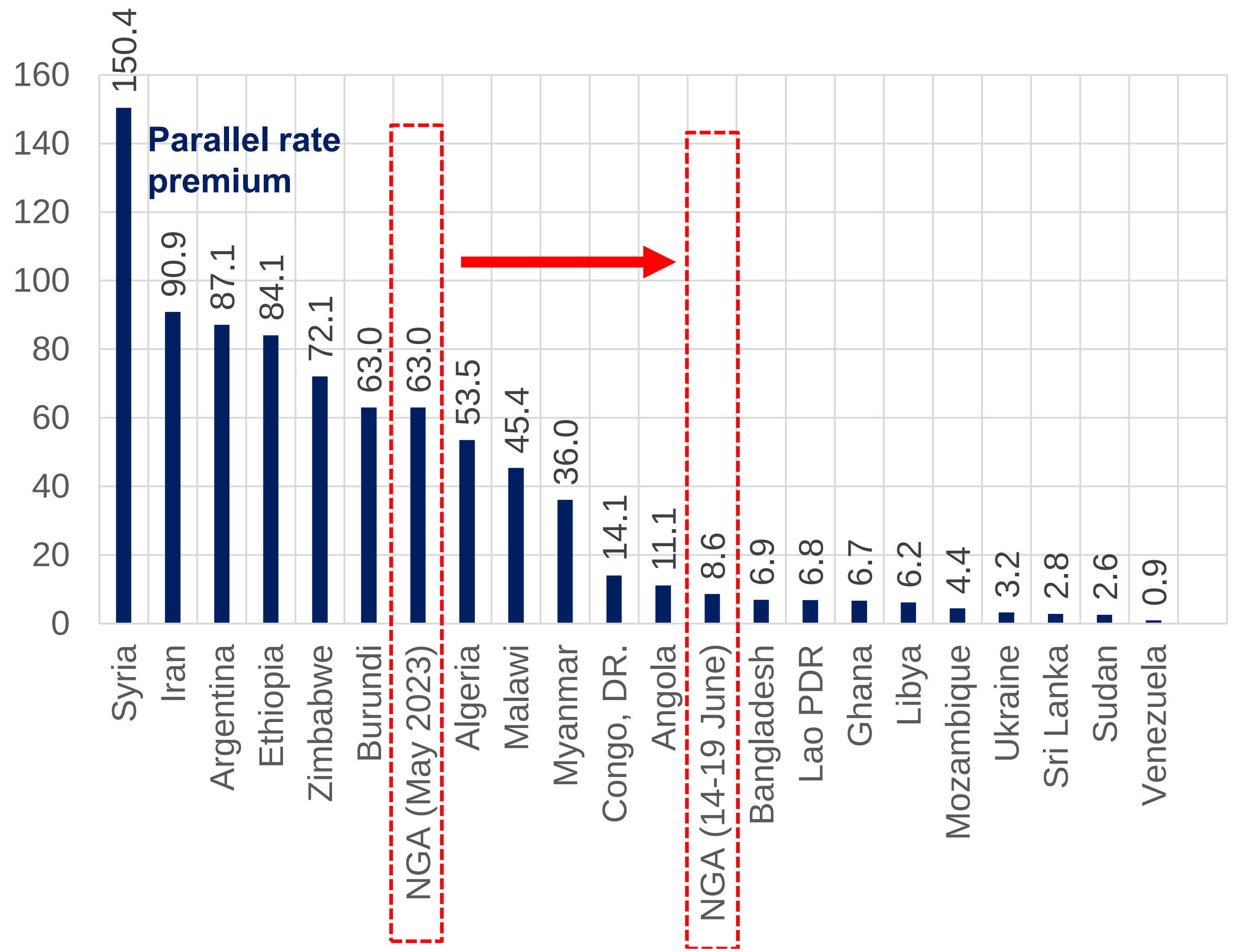
With the IEFX and parallel market rates converging, Nigeria has made rapid progress towards re-establishing a unified, market-reflective FX rate

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



Sources: FMDQ and Aboki rates

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



Sources: Aboki rates and World Bank

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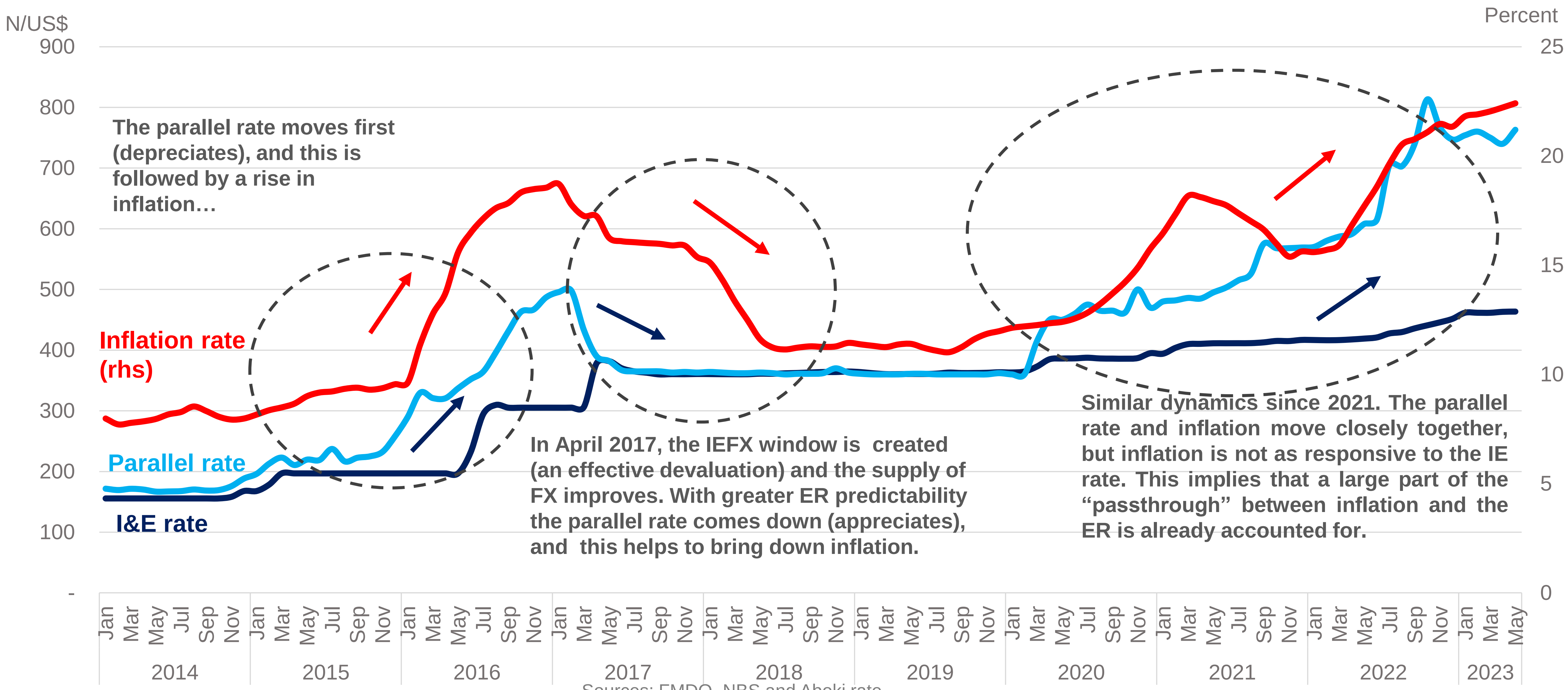
IMPACTS: INFLATION PASS-THROUGH IS EXPECTED TO BE MODERATE

The parallel market had already passed through domestic prices

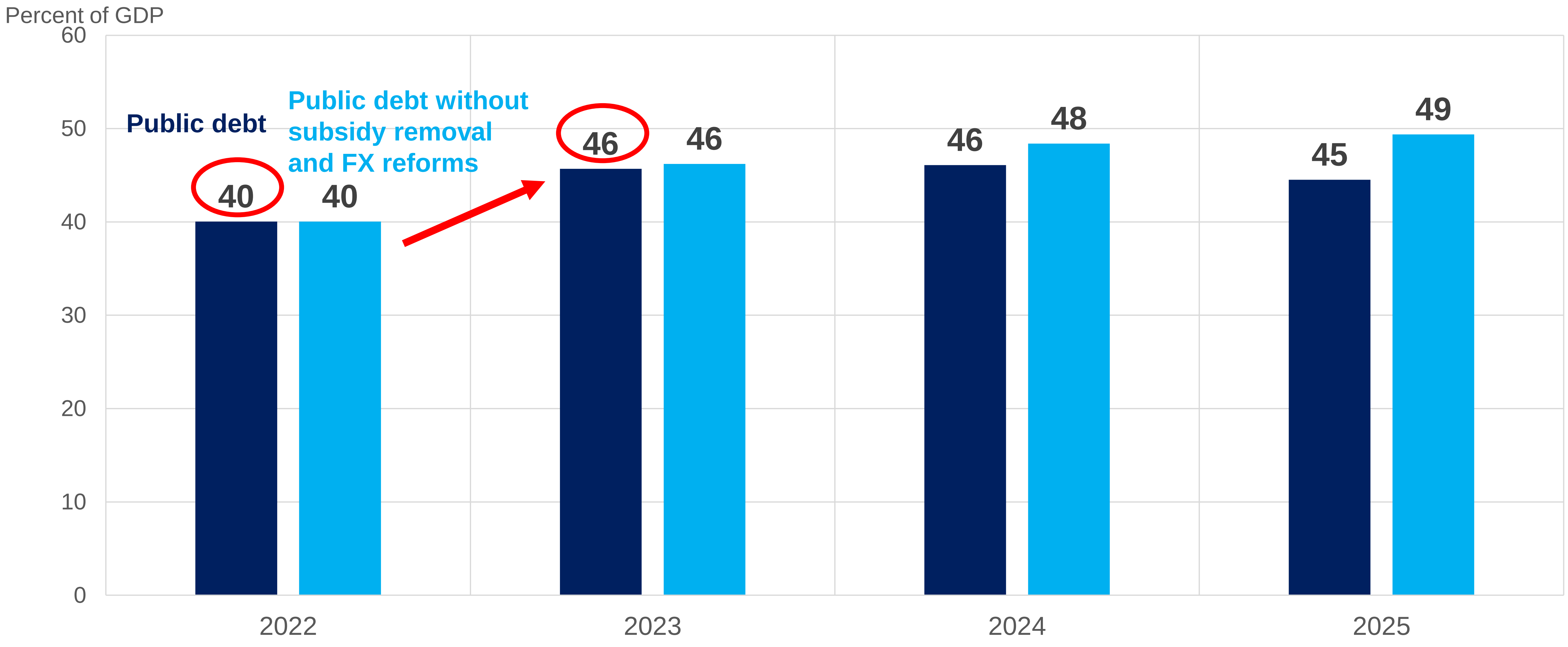


Sources: FMDQ, NBS and Aboki rate

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



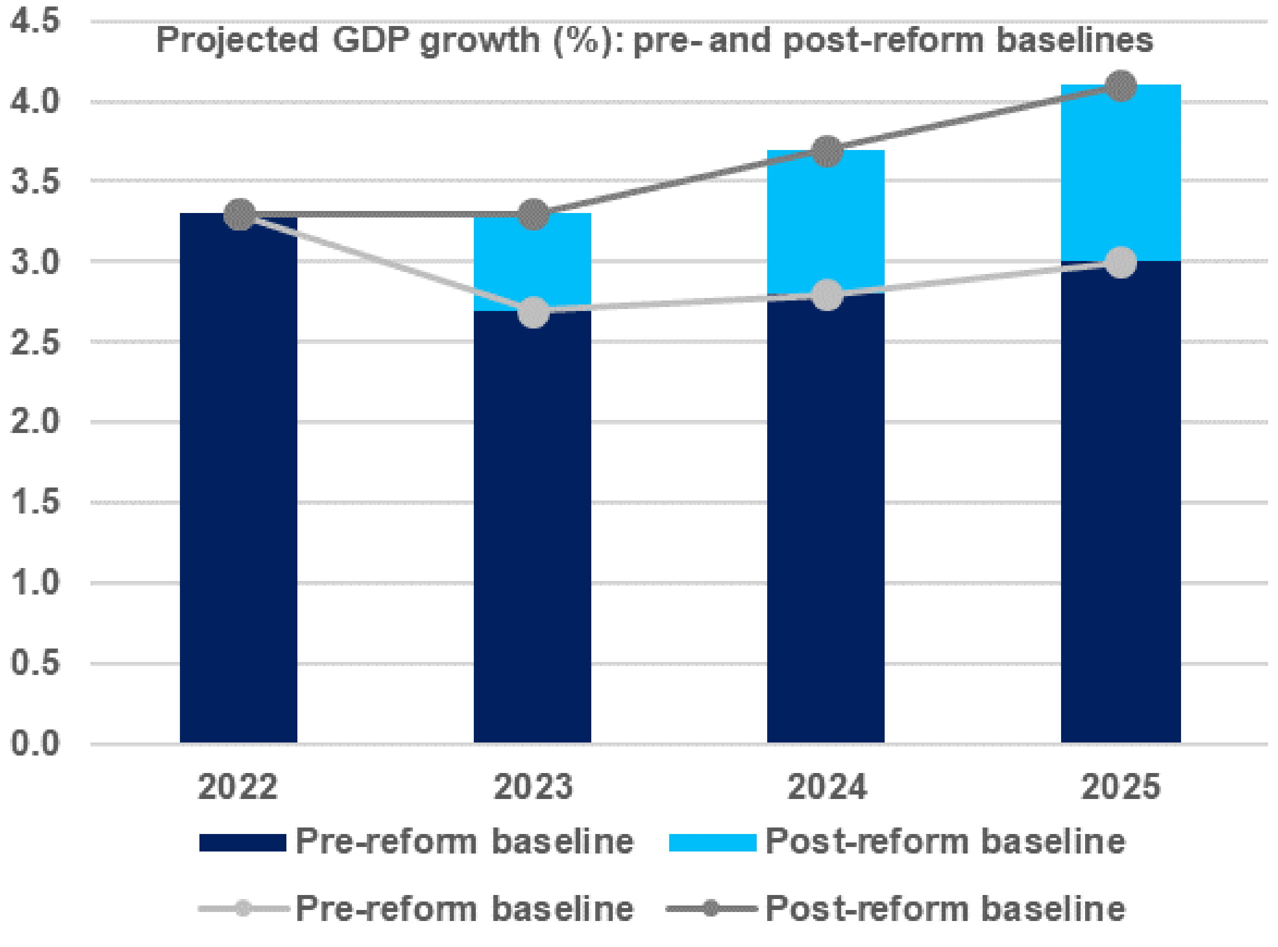
Sources: DMO, CBN, and World Bank estimates

PART 4: REFORM IMPLICATIONS

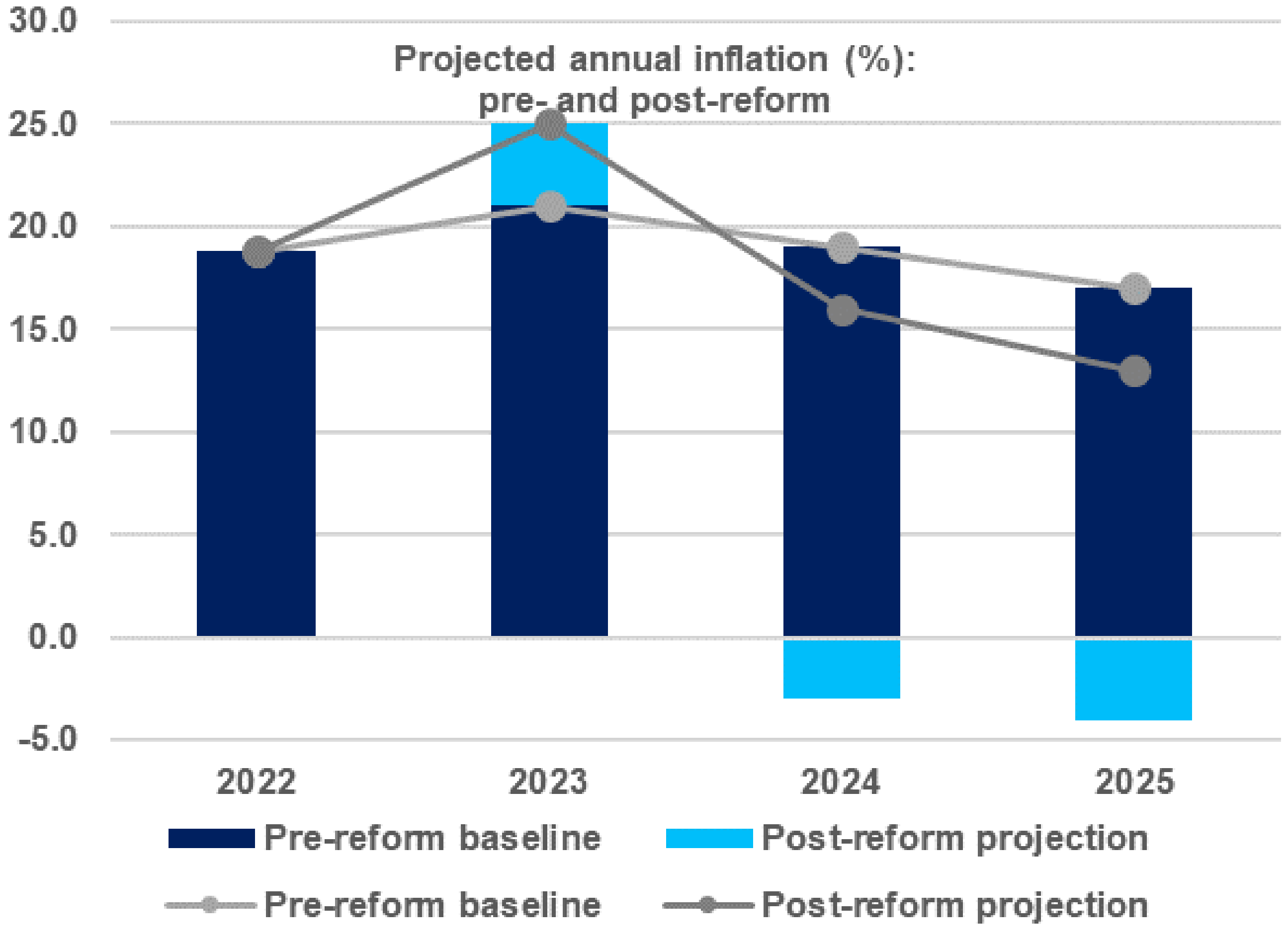
WHERE TO FROM HERE TO SEIZE THE OPPORTUNITY TO RISE TO POTENTIAL

THE RECENTLY IMPLEMENTED MACRO REFORMS WILL HAVE A POSITIVE IMPACT ON MACRO STABILITY AND ECONOMIC GROWTH

Growth is expected to increase…



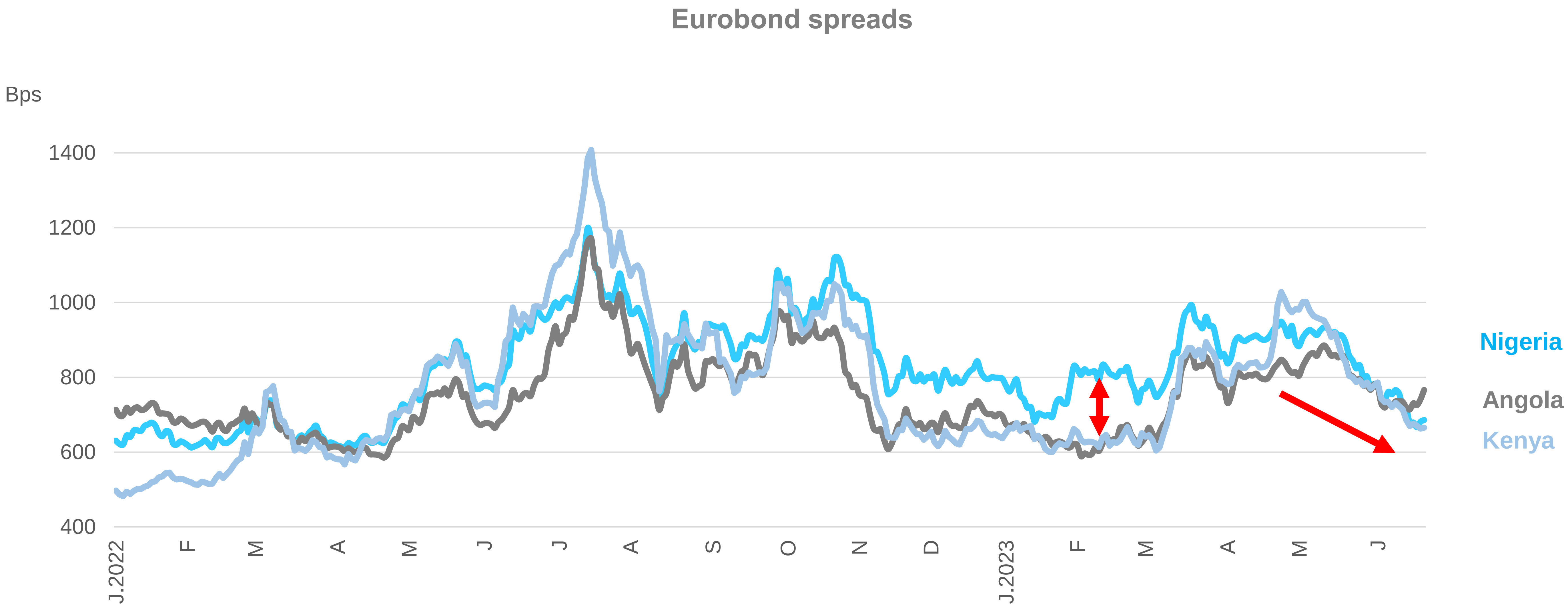
…and while inflation will be higher in 2023, it will be lower in 2024-2025 if the right policy mix is sustained



Source: NBS and World Bank estimates.

FINANCIAL MARKETS ALSO SHOW INCREASED OPTIMISM ABOUT FUTURE ECONOMIC PERFORMANCE

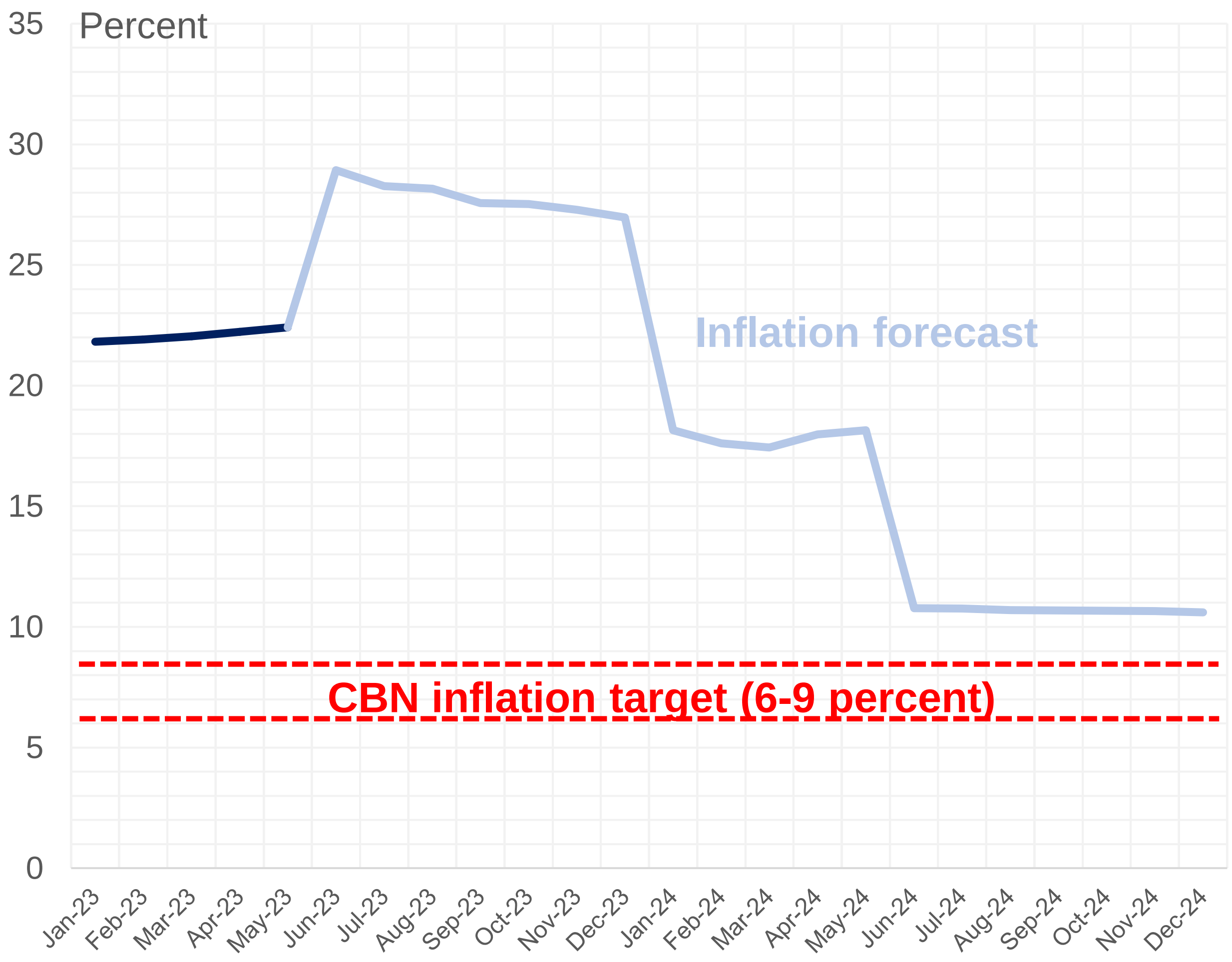
Nigeria's risk premium has fallen in the international capital market



Source: JP Morgan.

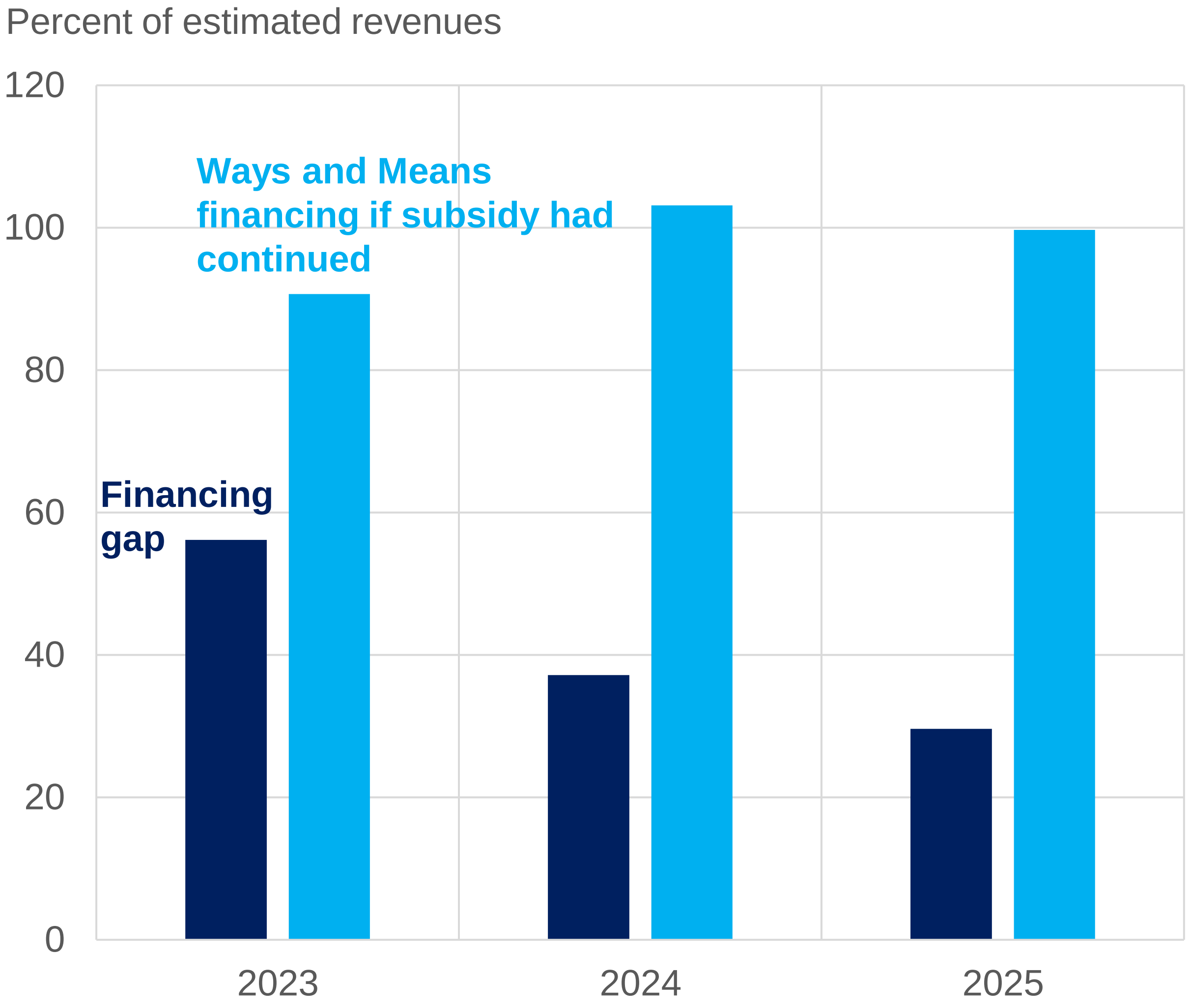
HOWEVER, THE REMOVAL OF THE SUBSIDY WILL TEMPORARILY INCREASE INFLATION

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



Sources: NBS and World Bank estimates

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

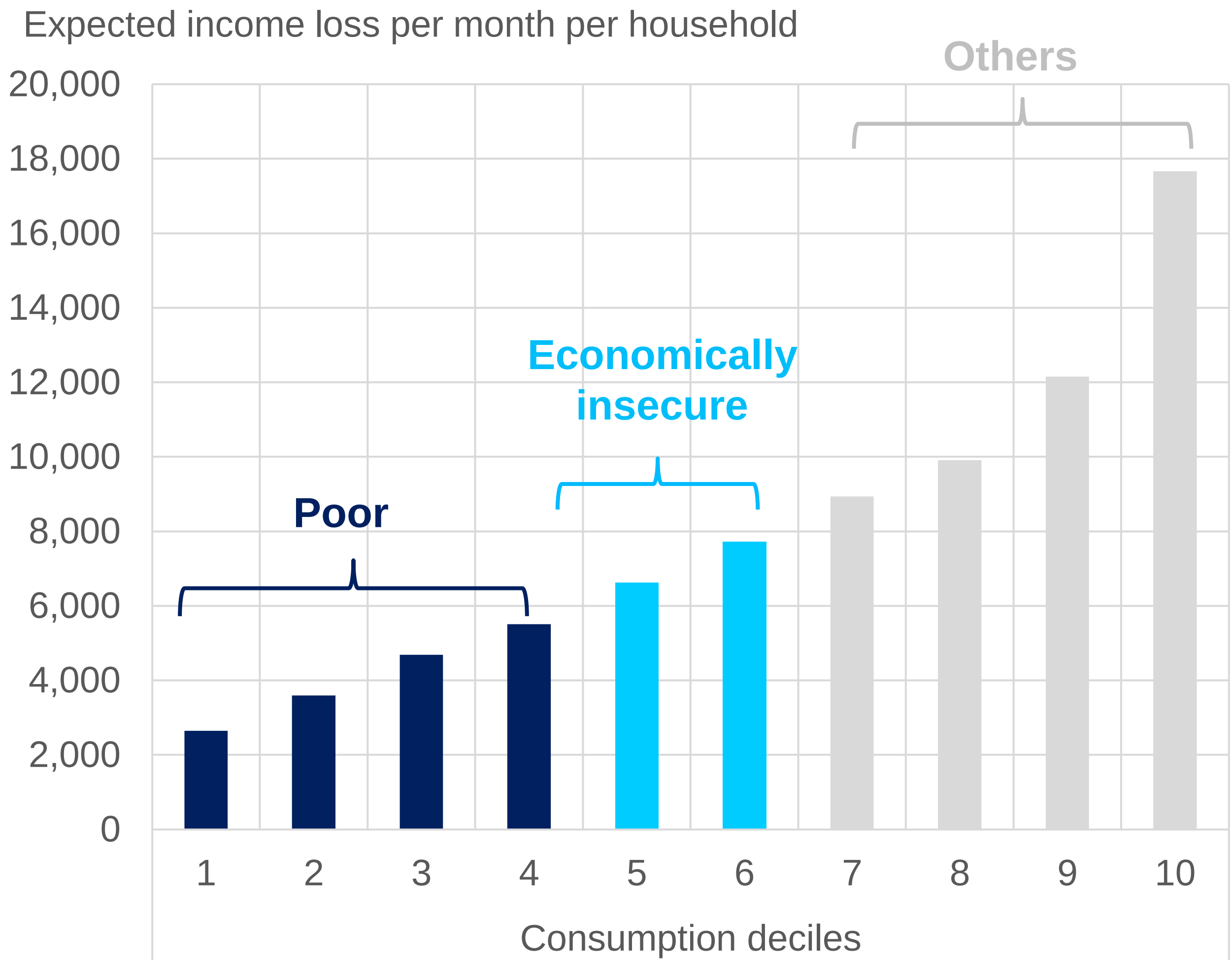


Sources: World Bank and CBN.

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



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:

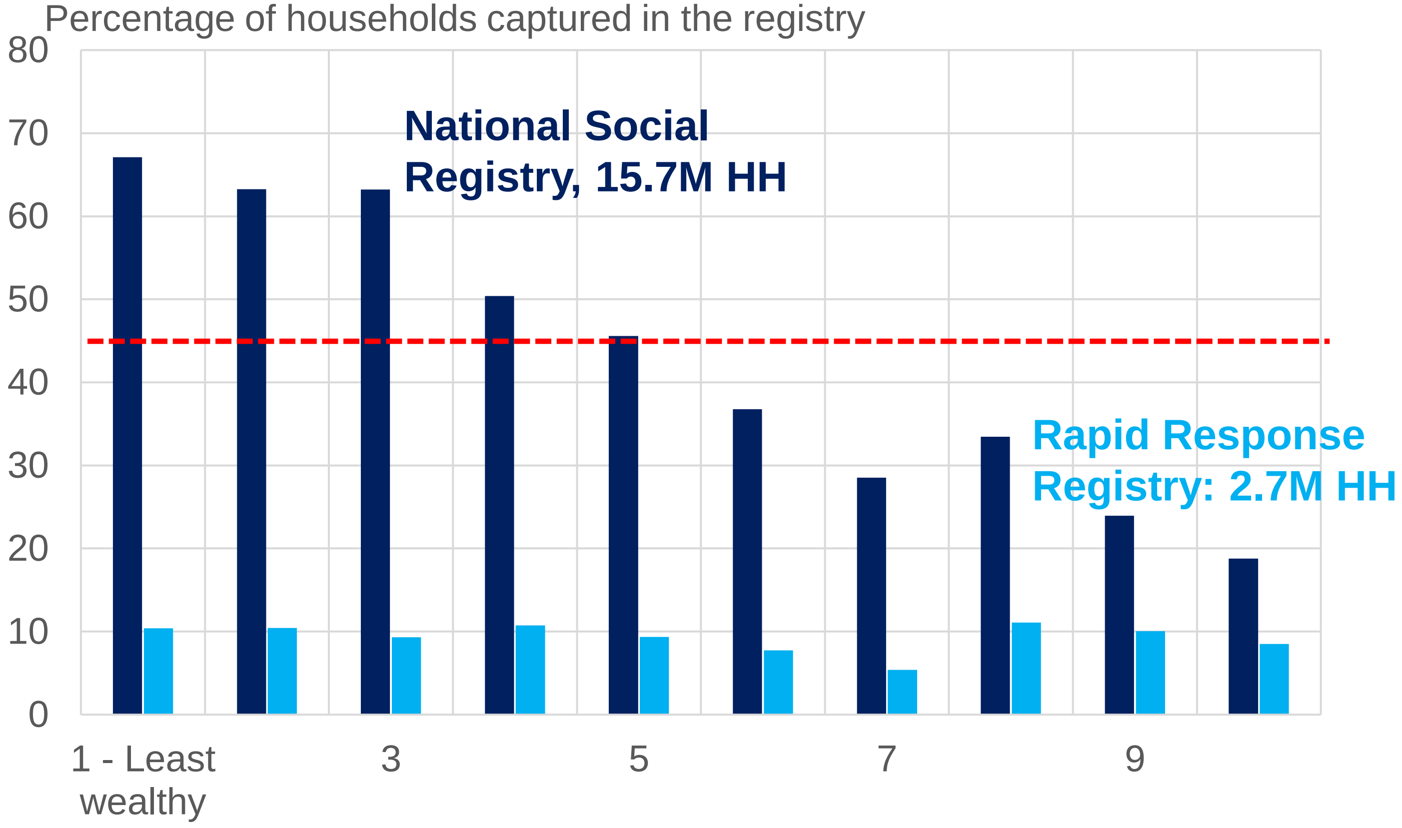
- Trust in the government
- Support for and therefore sustainability of reform efforts

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...



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

… and targeting & transparency benefit from digital delivery

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

Mobile wallets can be set up for recipients

Biometric verification increasingly used

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

A POSSIBLE WAY FORWARD: A COMPACT WITH THE NIGERIAN PEOPLE

UNSUSTAINABLE FISCAL BURDEN OF PMS SUBSIDIES

REMOVAL of PMS SUBSIDIES while ensuring ADEQUATE SUPPLY and COMPETITIVE PMS PRICING post-DEREGULATION

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

PARTICULAR HARDSHIP FOR NEAR-POOR AND LOW-INCOME WHO USE PMS DIRECTLY

POSSIBLE SOCIAL UNREST BECAUSE OF HARDSHIPS IN A CONTEXT OF A TRUST DEFICIT

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 as well as the LOW-INCOME who are most DIRECTLY AFFECTED

A BROADER COMPACT—a commitment EX-ANTE to a set of PRIORITY PROGRAMS that benefit ordinary Nigerians

SECURING FINANCING

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 OPPORTUNITES

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.

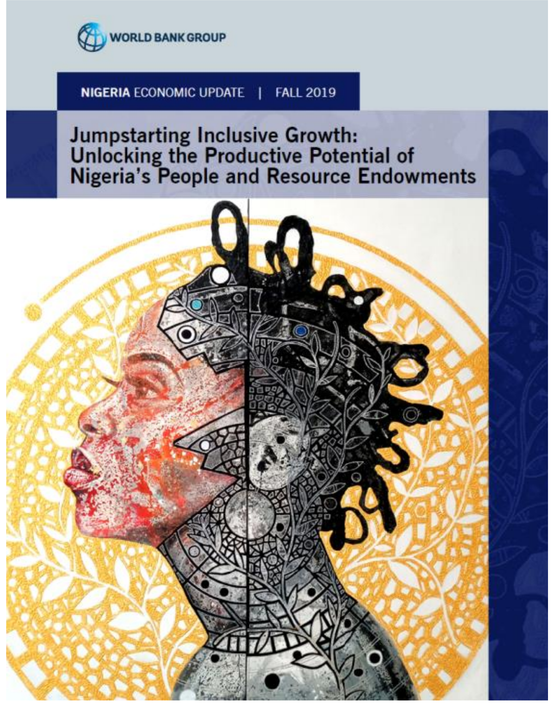
To tackle inflation

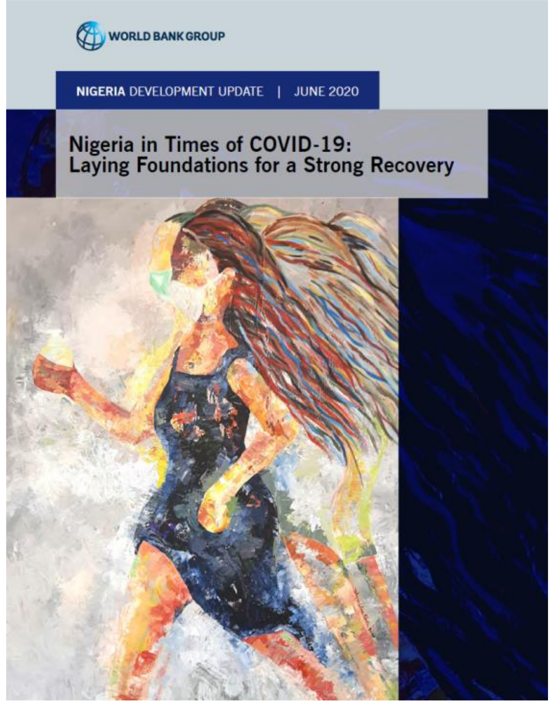
- Continue reducing subsidized CBN lending to medium and large firms.
- End government borrowing from the CBN.
- Replace import and FX restrictions with tariffs that reflect the ECOWAS Common External Tariff.

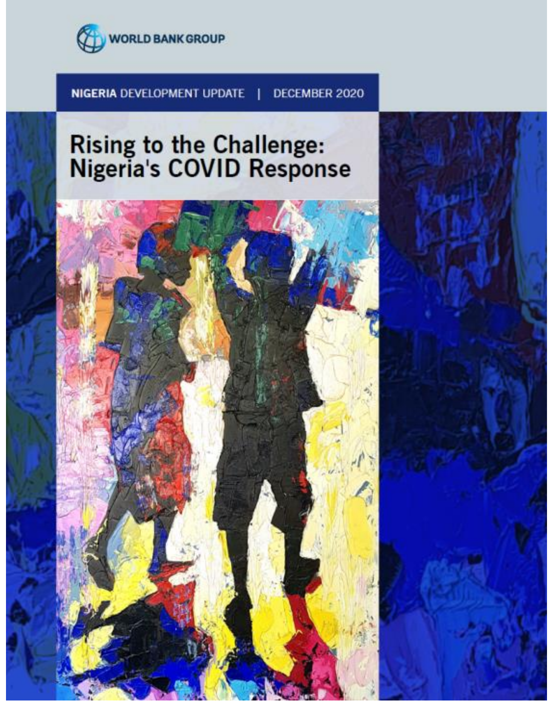
To build on the PMS reform and rebuild fiscal space

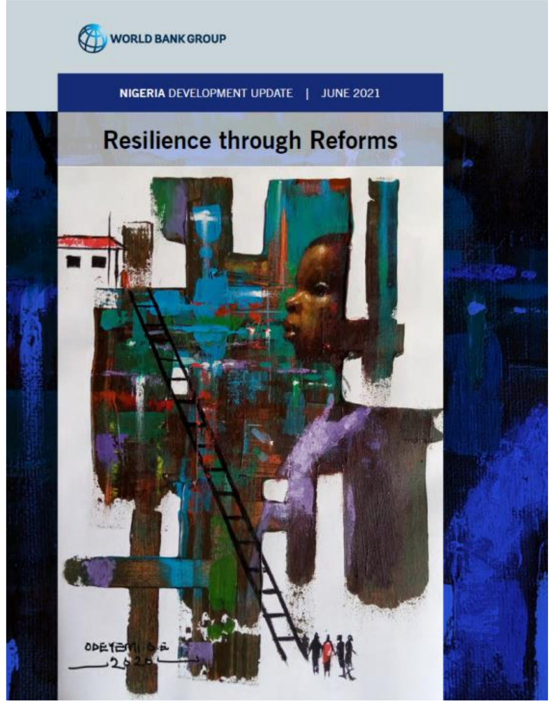
- Sustain the PMS subsidy removal: keep prices deregulated, foster fair competition and curb any commercial malpractice so that efficiency gains are passed onto consumers.
- VAT: increase rate, while allowing for input tax credit on capital and services; remove exemptions on petrol products.
- Improve 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.

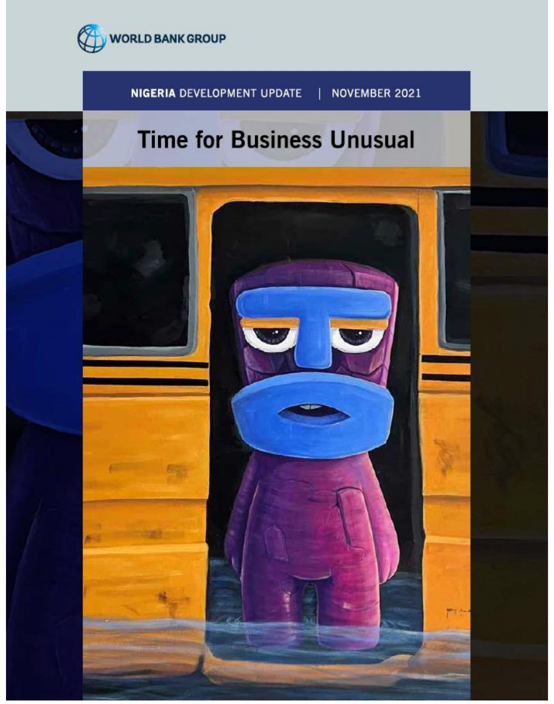
Thank You











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