The Continuing Urgency of Business Unusual

June 14, 2022
NIGERIA’S PARADOX:

FASTER ECONOMIC GROWTH, BUT GREATER CAUSE FOR CONCERN
NIGERIA’S GROWTH IN 2021 WAS BETTER THAN EXPECTED…

…driven by the non-oil sector, while the oil sector is underperforming

Real GDP growth

<table>
<thead>
<tr>
<th>Year</th>
<th>Oil GDP</th>
<th>Non Oil GDP</th>
<th>2021</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>-1.8</td>
<td>2.2</td>
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<tr>
<td>2020</td>
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<tr>
<td>2021 (NDU Nov 21)</td>
<td>2.7</td>
<td>-0.1</td>
<td>3.6</td>
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</tbody>
</table>

Our forecast six months ago

What explains the difference?

Actual GDP growth

AND GROWTH PROSPECTS FOR 2022 HAVE ALSO IMPROVED

Real GDP growth

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<td>2021</td>
<td>2.8</td>
<td>-0.8</td>
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<tr>
<td>2022 (NDU Nov 21)</td>
<td>1.4</td>
<td>3.4</td>
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<tr>
<td>2022f</td>
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HOWEVER, NIGERIA’S MACRO SITUATION HAS WEAKENED

...this is not the case among regional peers or oil producers worldwide.

A macro stability index comprising inflation and external & fiscal balances shows a deterioration
INFLATIONARY, FISCAL, AND FX PRESSURES HAVE INCREASED CONSIDERABLY, LEAVING THE ECONOMY MUCH MORE VULNERABLE

The Nigerian economy is more vulnerable to shocks…

…and the market’s perception of risk has increased.

<table>
<thead>
<tr>
<th></th>
<th>2017-19</th>
<th>2020</th>
<th>2021-22</th>
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<tbody>
<tr>
<td>Inflation (%)</td>
<td>13.3</td>
<td>13.2</td>
<td>16.3</td>
</tr>
<tr>
<td>Overall fiscal balance (% of GDP)</td>
<td>25.3</td>
<td>33.0</td>
<td>35.5</td>
</tr>
<tr>
<td>Debt (% of GDP)</td>
<td>4.9</td>
<td>14.2</td>
<td>29.7</td>
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<tr>
<td>Exchange rate premium* (%)</td>
<td>-4.2</td>
<td>-5.4</td>
<td>-6.5</td>
</tr>
</tbody>
</table>

Source: World Bank, NBS, OAGF, and CBN.

*Note: Exchange rate premium in 2021-2022 is the average difference between the Investors and Exporters (I&E) rate and the parallel market rate between Jan 2021 and May 2022.
INFLATION IS PUSHING MILLIONS OF NIGERIANS INTO POVERTY...

...AND IT’S NOT JUST SHOCKS DRIVING INFLATION, BUT LACK OF CONCERTED ACTION TO REDUCE IT
A COMBINATION OF POLICY DISTORTIONS AND GLOBAL SHOCKS ARE FUELING INFLATION

Suboptimal exchange rate management is fueling inflation due to FX supply constraints and lack of predictability, which is ultimately leading to a rise in the parallel exchange rate which is closely associated with inflation.

The monetization of fiscal deficits by the CBN (Ways and Means) and CBN’s subsidized lending to firms add to inflationary expectations.

Import and FX restrictions reduce the supply of food and key staples, increasing their prices and those of associated goods.

More recently, the war in Ukraine has added to inflation pressures through higher global prices of food and fuels.

The May 2022 increase in the Monetary Policy Rate was a step in the right direction, but the effectiveness of monetary policy is compromised by un-anchored inflation expectations, trade restrictions, and subsidized interest rates.
BEFORE THE WAR IN UKRAINE INFLATION WAS PUSHING MILLIONS OF NIGERIANS INTO POVERTY. WAR-INFLATION WILL PUSH MANY MORE.

By end-2022, 7 million more Nigerians are expected to fall into poverty due to the “inflation shock”

Average prices of locally-produced staples have increased faster than average inflation

Source: World Bank calculations based on NBS data.

Source: NBS.
### Nigeria's Minimum Wage and Inflation

<table>
<thead>
<tr>
<th>Year</th>
<th>Nominal Wage (₦)</th>
<th>Nominal US Dollar (US$)</th>
<th>Real Wage in Naira (₦)</th>
<th>Real US Dollar (US$)</th>
<th>Exchange Rate (Naira/US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>30,000</td>
<td>82</td>
<td></td>
<td></td>
<td>367</td>
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<tr>
<td>2022</td>
<td>22,000</td>
<td>37</td>
<td></td>
<td></td>
<td>600</td>
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</tbody>
</table>

The cumulative inflation between 2019 and 2021 was 35 percent.

Source: NLSS, NBS, CBN, and World Bank calculations.
THE PARALLEL RATE IS DRIVING INFLATION. MORE FLEXIBLE AND PREDICTABLE FX MANAGEMENT WILL HELP REDUCE INFLATION

... the parallel rate is driving inflation even if the volume of transactions in the parallel market is small.

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 in 2020-22. The parallel rate and inflation move closely together, but inflation is not as responsive to the IEFX rate. This implies that a large part of the “pass-through” between inflation and the ER is already accounted for.
THE FISCAL URGENCY:

NIGERIA’S CURIOUS CASE OF THE MISSING OIL REVENUES
NIGERIA’S FIRST-EVER DECOUPLING OF OIL PRICES AND REVENUES BEGAN IN 2021, AND WILL LIKELY EXACERBATE IN 2022

...the reasons are lower oil production, and a larger petrol subsidy which is incentivizing smuggling and eroding oil revenues

In 2021, oil production was the lowest in three decades

Reasons behind the decline in oil production:
- High production costs
- Oil theft and insecurity
- Federation arrears in Joint Ventures (JV cash calls)
- Lack of investment

Source: World Bank calculations based off NNPC annual statistical bulletins for oil production from 1990 to 2019, government oil production reports for 2020 and 2021, and World Bank commodity annual prices for Brent crude oil.
FOLLOWING REVENUE FLOWS
...a primer on Nigeria’s fiscal framework

GROSS OIL & GAS REVENUES

PETROL SUBSIDY

OTHER OIL AND GAS PROJECT EXPENSES

NET OIL & GAS REVENUES

NET NON-OIL NON-VAT REVENUES

MAIN POOL FEDERATION REVENUES

• FGN: 53%
• States: 27%
• LGAs: 20%

NET VAT REVENUES (VAT POOL)

• FGN: 15%
• States: 50%
• LGAs: 35%

TOTAL FEDERATION REVENUES

REVENUES OF STATES & LGAs

FGN REVENUES

Source: OAGF.
DESPITE HIGHER OIL PRICES, OIL REVENUES IN 2022 WILL BE LOWER DUE TO A LARGER PETROL SUBSIDY AND LOWER PRODUCTION

...at a time when fiscal resources are needed to support the economic recovery.

Source: OAGF, NETI, and World Bank estimates.
DESpite higher oil prices, oil revenues in 2022 will be lower due to a larger petrol subsidy and lower production …at a time when fiscal resources are needed to support the economic recovery.

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Oil &amp; Gas Revenues</th>
<th>Other Oil &amp; Gas Project Expenses</th>
<th>Petrol Subsidy</th>
<th>Net Oil &amp; Gas Revenues</th>
<th>Other Oil &amp; Gas Project Expenses</th>
<th>Petrol Subsidy</th>
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<tbody>
<tr>
<td>2020</td>
<td>3,688 Billion naira</td>
<td>-107 Billion naira</td>
<td>-107 Billion naira</td>
<td>2,639 Billion naira</td>
<td>-942 Billion naira</td>
<td>-942 Billion naira</td>
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<td>2021</td>
<td>4,806 Billion naira</td>
<td>-1,430 Billion naira</td>
<td>-1,430 Billion naira</td>
<td>2,742 Billion naira</td>
<td>-634 Billion naira</td>
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Source: OAGF, NETI, and World Bank estimates.
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### Following Revenue Flows

...a primer on Nigeria’s fiscal framework

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<th>Petrol Subsidy</th>
<th>Other Oil and Gas Project Expenses</th>
<th>Net Oil &amp; Gas Revenues</th>
<th>Net Non-Oil Non-VAT Revenues</th>
<th>Main Pool Federation Revenues</th>
<th>Net VAT Revenues (VAT Pool)</th>
<th>Total Federation Revenues</th>
<th>Revenues of States &amp; LGAs</th>
<th>FGN Revenues</th>
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Source: OAGF.
TOTAL REVENUES WILL LIKELY FALL IN 2022, AS HIGHER NON-OIL REVENUES WON’T COMPENSATE FOR LOWER OIL REVENUES

<table>
<thead>
<tr>
<th>Year</th>
<th>NET oil &amp; gas revenues</th>
<th>NET VAT + EML revenues</th>
<th>Other non-oil revenues</th>
<th>TOTAL revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>2639</td>
<td>1371</td>
<td>2196</td>
<td>6207</td>
</tr>
<tr>
<td>2021</td>
<td>2742</td>
<td>1613</td>
<td>2631</td>
<td>6986</td>
</tr>
<tr>
<td>2022f</td>
<td>1637</td>
<td>2098</td>
<td>3025</td>
<td>6760</td>
</tr>
</tbody>
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Source: OAGF, NETI, and World Bank estimates.
IN 2022, ALL STATES EXCEPT ONE WILL RECEIVE LOWER NOMINAL FEDERATION TRANSFERS THAN IN 2021

...as a result, most states will likely experience a decline in total revenues in 2022.

Source: State Budget Implementation Reports 2021, OAGF, and World Bank estimates.
THE URGENCY TO CATALYZE PRIVATE INVESTMENT FOR JOBS AND SECURITY
THE CHALLENGE: JOBS NEEDED FOR A FAST-GROWING LABOR FORCE

300,000 young Nigerians are entering the labor market every month.

23% of girls between the ages of 15–19 are already married

19% are already mothers or pregnant with their first child.

Nigeria has the largest population in Africa, and it will be the 3rd largest country in the world by 2050.
NIGERIA’S FX MANAGEMENT IS DETERRING INVESTMENT

...due to uncertainties firms face in accessing FX and related costs to doing business.

The CBN has reduced its FX interventions...

...and the appetite for investment in Nigeria has declined since 2019.
RATHER THAN BOOSTING DOMESTIC VALUE ADDED, TRADE RESTRICTIONS ARE HURTING NIGERIANS

Import and FX restrictions aimed at promoting industrialization have increased smuggling, reduced revenues, hurt consumers, and raised production costs for firms

- Higher Inflation
- Lower Fiscal Revenues
- Lower Private Investment
RATHER THAN BOOSTING DOMESTIC VALUE ADDED, TRADE RESTRICTIONS ARE HURTING NIGERIANS

Import and FX restrictions aimed at promoting industrialization have increased smuggling, reduced revenues, hurt consumers, and raised production costs for firms.

**HIGHER INFLATION**

- 38% higher prices

Import bans caused the prices of affected goods to increase by 38 percent.

**LOWER FISCAL REVENUES**

- US$1.8bn per year

Import bans make Nigeria lose US$1.8 billion annually (0.5% of GDP) due to tariff evasion.

- US$275m per year

FX restrictions lost Nigeria 1% of total tax revenues between 2015-19.

**LOWER PRIVATE INVESTMENT**

- 14% costlier inputs

The average industry in Nigeria pays 14% more for its inputs than what it would have paid in the absence of trade restrictions.

There are better ways to boost Nigeria’s domestic value added and diversify the economy.
NIGERIA’S CHOICE:
WHAT “BUSINESS UNUSUAL” COULD LOOK LIKE... ESPECIALLY IN AN ELECTION YEAR
GROWING AT 3.2% IS NOT NEAR ENOUGH, THUS NIGERIA HAS A CHOICE

Nigeria: Business-as-usual to rise to potential

Nigeria's GDP per capita

Indonesia's GDP per capita

Average GDP per capita growth 2002 - 2014: 5.1 percent

Source: NBS, WDI, and World Bank estimates.
NIGERIA’S CHOICE: SUGGESTED PRIORITIES FOR THE NEXT MONTHS

1. Reducing inflation
2. Addressing fiscal pressures
3. Catalyzing private investment to boost job creation
HOW TO GET THERE: OPTIONS FOR THE NEXT 6-12 MONTHS

1. Reducing inflation
   - Fully reopen land borders to trade and remove FX and import restrictions on staple foods and medicines
   - Signal the CBN’s commitment to price stability as the primary goal and reduce subsidized lending to medium and large firms
   - Reduce CBN overdrafts for fiscal deficit financing to their legal limit

2. Addressing fiscal pressures
   - Establish a “compact” with the Nigerian people to phase out the petrol subsidy while protecting the poor through targeted and time-bound cash transfers
   - Safeguard oil revenues by eliminating oil in-kind payments and ensuring that all oil revenues are transferred to the Federation account and verified
   - Rationalize tax expenditures granted to agriculture, pioneer, and financial sectors.

3. Catalyzing private investment to boost job creation
   - Establish a single, market-responsive exchange-rate and improve FX access (e.g., well-defined FX auctions)
   - Accelerate power sector reforms
   - Reduce delays in border and port clearance (automating procedures and introducing risk-based customs interventions)
Also, in this edition of the Nigeria Development Update...

- Investing in Adolescent Girls to Defuse Nigeria’s Demographic Timebomb
- The Unintended Consequences of Nigeria’s Trade Policies
- Attitudes Towards the Petrol Subsidy Reform
- Oil Production and Related Revenues
- Bringing Nigeria’s Children Back to School
This and previous editions of the NDU are available at:

worldbank.org/en/country/nigeria
People forge ideas, 
People mold dreams, 
And people create art

Thank You

Transition
By Jimmy Nwanne