

# [Nigerian economy: macroeconomic analysis](https://assignbuster.com/nigerian-economy-macroeconomic-analysis/)

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## Economic Overview

Nigeria's economy is estimated to be worth about $262bn, making it one of the largest economies in Africa.

The estimates and analysis of various indicators is discussed in the later sections. The country has fared better than many other countries during the global economic downturn, but systemic problems in infrastructure and the labor market mean that its position in the Economist Intelligence Unit's global rankings remains towards the bottom during the forecast period, at 75th out of 82 countries. Efforts to create a significantly more attractive businessenvironmentare likely to produce only modest results owing to the slow pace of more fundamental reforms. Nigeria has taken steps to simplify trade by working on its tariff structure.

However, there is still a protectionist sentiment in the country. Cross border smuggling is still a major concern and is liable to remain an important feature of the Nigerian economy. The capacity and efficiency of Nigerian ports (Trade) have improved following the implementation of an ambitious concessioning program that transferred management of terminals to private operators. However, although the reforms have improved port operations and ship turnaround times, there remains the problem of corruption in the customs service, which can complicate and delay the clearance of goods.

## Gross Domestic Product (GDP)

The latest GDP projection data as brought out by World Bank is $ 268. 5 billion (2013 F) and the country population is projected at 175 million translating into a GDP/Capita to 2, 213. The Real GDP Growth for Nigeria has been at 6. 8 %. However, considering the disparity in the country’s infrastructure viz-a-viz other Asian developing nations the growth rate is not enough for substantial improvement.

### GDP Composition

In Nigeria, the Investment component of the GDP as compared to the private consumption and government is very low, hovering at 17 % approximately. A developing market is required to invest around 40 to 50% of GDP in capital investment for successive number of years. However that is not seen with Nigeria. Hence, the prospect of Nigeria as an investment destination appears to be grim in the near future. The graph below gives the GDP contribution - Industry wise for Nigeria. Crude is one of the major contributors to the GDP. Hence, and rate fluctuations in the price of crude oil have added volatility in the Nigerian GDP.

## Inflation

Despite monetary tightening carried out by the CBN in 2011, the forecast for inflation remains negative. Inflation is expected to increase to 12. 7% in 2012. Fiscal laxity by the states is one of the main reasons for this. In addition, the payment of the newly instituted minimum wages and the injection of funds into the bailed out banks, inflationary pressure is bound to continue for the rest of the year. It is expected moderate only in 2014 as a result of moderation in commodity prices. The April 2012 inflation data as obtained shows a Month-on-month inflation to be (0. 13%), Year-on-Year (12. 9%), 12-Month Avg. Chg. (11. 1%). The inflation rate is exceedingly high and is detrimental towards investment in the country.

## Shadow Economy

The untaxed and unregulated revenues - by some estimates - account for between 40% and 45% of gross domestic product (GDP). Nigerians make most of their living, as street hawkers, minibus drivers, moneychangers or market traders. In spite of the abysmal performance of the country’s economy, poor infrastructure and unfriendly business environment Nigeria has huge potentials to be tapped because of its huge deposits of Natural Resources nd population that can be gainfully employed. The black economy accounts for a large part of the Nigerian economy.

## Trade Overview

Nigeria has considerable natural resources such as oils, and the revenue from oil exports forms a major chunk of the Government fund. Nigeria has recently started a sovereign wealth fund and the excess returns from oil exports viz-a-viz projected returns is directed to this sovereign fund. This fund is building up at a slower pace as the revenue is being directed towards meeting government excess spending to meet the countries capital requirement.

The country has been putting efforts to tighten the fiscal policy and the same has been reflected in their medium-term expenditure framework. The country has projected a year-on-year budget deficit of 1% of GDP. However, from the recent trends it appears that Nigeria will be able to sustain a year-on-year budget deficit of 2% given the prices of oil remain stable even though the current European turmoil and a slowdown in china can push oil prices down and lead to further increase in Nigeria’s Fiscal deficit.

Nigeria intends borrowing from the international capital market for meeting its capital expenditure requirement in the near future. The total value of Nigeria's exports in the first quarter of 2012 is at about USD 30 billion, the exports to India has reached USD 4. 2 billion, compared to USD 3. 7 billion credited to the US in the period under review. Nigeria's export to India is mostly crude oil and cashew nuts while India exports pharmaceutical goods, machinery, electronics and rice. The US was trailed by the Netherlands with USD 2. billion, followed by Spain with USD 2. 4 billion and Brazil which recorded USD 2 billion. Nigeria is a member of the WTO and does not impose permanent import restrictions however it has a huge banned list of import goods which coupled with ad valorem tariffs have given rise to increase in smuggled goods. As such the restrictions do not seem to have benefited the local industries. There are specially designated export processing zones which provide benefits from tax, duties, foreign exchange restrictions and import-export restrictions.

The Nigerian Export Credit Guarantee and insurance corporation (Nexim) provides insurance under the government’s export guarantee scheme. This has helped exporters in raising funds at subsidized rates for refinancing. Nigeria figures 133rd on the Doing Business in Index among 183 world economies and 15th among the 46 sub Saharan African economies.

Nigeria and its neighboring African nations have imposed strong continental Trade Barriers which is depriving the continent of new sources of economic growth, new jobs and leading to a sharp fall inpovertyand other factors. However, many African countries are losing several billions of dollars in potential trade earnings every year, because of high trade barriers with neighboring countries. It is easier for Africa to trade with the rest of the world than with itself.

The Policy progress in the nation has been restricted due to political instability and tussle between the presidency and senior economic team. Policies towards changes in exploiting the proceeds from fuel exports are always the concern restricting policy improvements. The country has huge limitation in the power sector and the government has initiated privatization program focused mainly on the power sector, However the progress has been slow as a result of private-sector reluctance, the various vested interests involved and strong union opposition.

This is limiting foreign investments in Nigeria. Nigeria urgently requires Tax reform for attracting investments in the country and this policy reform is high on the political agenda. However due to conflicting interests and the fragile nature of the Nigerian administration reforms are expected to be slow.

## Foreign Debt

Due to the economic slowdown public sector revenue and expenditure has contracted in the past 3 years. As a result of the budget deficit, infrastructure is facing acute shortage which is mostly financed by internal public borrowing while also seeking access to external funding.

The Nigerian government has set on the path of prudent reforms to reduce total spending while improving funding for capital requirements for efficient spending that will translate to long term economic growth. The government also launched a Euro denominated bond in 2011 and expects to return to the international debt capital markets again in the next few years.

## Labor Market & Human Capital

Theeducationsystem of Nigeria is in a poor state unable to meet the educational requirement of the country. There are currently only 46 tertiary institutions in Nigeria providing education covering all functional areas.

Out of the 42m Nigerian children who ought to be in primary school, less than 24m are in school. Out of the 33. 9m children of secondary school age, only 6. 4m are in secondary schools. The pass rate for JAMB examinations is about 20% - indicates poor quality of secondary school graduates. The educational system has not been tailored to meet developmental needs of the nation. Any foreign investment has to transfer both funds and human capital to the country. There are no improvements visible in the near vicinity.

The Nigerian Labor market is marred with constraints and there appears little prospect in the near future of resolving many of the key constraints to improving the labor market in Nigeria. Most of the talented Nigerians prefer to move out of the country and the country is suffering from a ‘ brain drain’. Nigeria has a large number of very capable professional and highly skilled workers in a range of sectors. Unfortunately for the country, large numbers, particularly in the medical profession, live and work overseas, and the restoration of civilian rule in 1999 has failed to bring an end to the brain drain’. Although labor law reform in 2005 weakened the capacity of the unions to organize political or sympathy strikes, the labor movement remains powerful, capable of organizing paralyzing national strikes.

## Population and Income Inequality

The population in Nigeria is growing at a very fast pace, but given the poor state of the countrieshealthcare and educational system, this is only constraining the already dismal state of the country the growth rate is presented below, the high rate of population growth and the deteriorating state of infrastructure is not conducive enough for enticing foreign investment. Poverty in Nigeria remains significant despite high economic growth. Nigeria retains a high level of poverty, with 63% living on below $1 daily, implying a decline in equity. There have been attempts at poverty alleviation, but the inequality has been rising. Income inequality worsened from 0. 43 to 0. 49 between 2004 and 2009. This is correlated with differential access to infrastructure and amenities.

In particular, there are more rural poor than urban poor. This primarily results from the composition of Nigeria's economy. Oil exports contribute significantly to government revenues and about 15% of GDP, despite employing only a fraction of the population. Agriculture, however, contributes to about 45% of GDP, and employs close to 90% of the rural population. This incongruence is compounded by the fact that oil revenue is poorly distributed among the population, with higher government spending in urban areas than rurally.

High unemployment rates have rendered personal incomes even more divergent. The graph below gives a comparison of the population below poverty line in relation to the total Nigerian population.

### Unemployment

According to the '2011 Annual Socio-Economic Report' released by the Nigerian Bureau of Statistics, the total number of unemployed people have increased from approximately 7 million in 2006 to 16 million in 2011. In 2011, approximately 2. 1 million people were newly unemployed.

The report has also predicted the new entrants into the unemployed pool to be around 8. 5 million in 2015. The increase is also interestingly explained by the tendency of Nigerian university graduates to stay away from labor intensive work. They are now ready to wait for a white collar job thus resulting in the entry of new university graduates into the unemployment pool. The total number of employed labor force has remained fairly constant from 2006 to 2011 at around 51 million. However, 10 million new people have been added to the labor force during 2006-2011.

The increase in labor force could be explained by the steady increase in the number of universities, polytechnics and colleges of education. While the enrollment in universities and polytechnics has decreased from around 460, 000 in 2006 to 340, 000 to 2011, enrollment in colleges of education has increased during the same period. Whereas the enrollment in state and federal institutions has decreased during 2006-2011, enrollment in private institutions has increased steadily. According to the report, the increase in unemployment rate has been kept in check by Nigerian government's employment policies.

The unemployment rate in rural areas was 25. 6% and 17. 1% in urban areas. The total national unemployment rate was 23. 9% in 2011. Total unemployment rate amongst males was 23. 5% in 2011 while the same rate amongst females was 24. 3%. The report explains that married women who previously stayed out of the labor force have now started entering the market for jobs due to a raise in claim for financial independence. More women are also now forced to enter the labor market because of the need to supplement the income of males in families.

The unemployment rate has been consistently growing in Nigeria due to lack of industries, political stability and a myriad of other reasons. Unemployment is leading to crime and shadow economy which is further hindering investments in the country.

## Currency

The Central Bank of Nigeria referred as CBN is the sole authority responsible for issuing and maintaining the volume of the currency in the Nigerian economy.

The currency was adopted by Nigeria on 1st Jan 1973 replacing the pound that was being followed since the colonial days.

### Money Supply and Monetary Control

The Central Bank of Nigeria (CBN) is the central bank of Nigeria. Since the global financial crisis of 2008-09, maintaining adequate liquidity and averting a total collapse of the banking system has been the main focus of the CBN. The CBN uses the Monetary Policy Rate (MPR) to anchor short term money market rates and other interest rates in the economy.

Open market operations conducted through the Treasury Bills auction is the major instrument of monetary policy. The CBN also uses discount window operations (including standing lending and deposit facilities, repo and reverse repo operations) and Cash Reserve Ratio (CRR) in monetary management. The banking crisis of 2009 and the subsequent reform initiated in the banking sector has complicated the monetary policy. The central bank also ensures that there is sufficient lending in key sectors such as agriculture.

Since 1977, Nigeria has had an Agric Credit Guarantee Scheme (ACGS) under the management of the central bank. The Central Bank of Nigeria (CBN) is responsible for maintaining a balance between its objective of managing inflation and the government's aim of reducing the cost of borrowing by the private sector to encourage investment in productive activities. The CBN is currently pursuing the former objective, having increased its prime interest rate six times during 2011: the Central Bank is attempting to counter what it sees as high inflationary expectations embedded in the system.

As the forecast period progresses and the inflation outlook improves, the focus of the CBN will return to easing monetary policy and boosting lending to productive sectors. Nevertheless, this has been complicated by the banking crisis of 2009 and the subsequent reform program put in place by the Central Bank, which is likely to mean that risk aversion among the banks persists into the first part of the forecast period at least.

## Fiscal policy

While Nigeria’s fiscal policy during the last half of the decade has been favoring expansive expenditure in the productive sectors, there is growing pressure to introduce tough, unpopular market reforms to tighten the fiscal policy. However it will be difficult to do so considering the different interest groups that the government needs to placate and wider legislature that favors greater government expenditure to counter the crippling infrastructure deficit.

Even as investment in infrastructure remains critical, how the government manages to bring down the share of recurrent expenditures while improving the quality of capital expenditure is the key challenge. Another challenge for the government will be how it manages its dependence on oil prices, the key component of its revenue. A return to recession in Europe or a less than expected growth in China could bring down the oil prices.

### Exchange rates

The Central Bank of Nigeria (CBN) has been responsible for managing the exchange rate and this was being done by auctioning of foreign currencies.

The CBN sets the exchange rate. However, Nigeria’s currency fluctuations is correlated to fluctuations in the oil prices. In 2007, the Naira saw significant appreciation viz-a-viz the dollar due to increase in Global crude prices. Nigeria’s central Bank intends making the Naira exchange rates floating and policy decisions are being formulated towards this objective. The CBN also intends to make the exchange rate independent to the extent possible and aims at intervening only to meet defined policy objectives.

The country has seen a huge depreciation of the Naira in the past 3 Decades, presently owing to the stable and strong crude prices the currency is considerably stable but is forecasted to slip further if the Global Economic crisis continues to deter. Source: http://www. exchangerates. org. uk/

### Interest Rates

The CBN kept its benchmark interest rate at 12%. The CBN will find it hard to balance its objective of managing inflation and the government’s aim of reducing the cost of borrowing by the private sector to boost investment.

Nigeria has seen a slowdown in economic growth in its economy as a result of slackening in global economic activities. As the tight liquidity condition persists, short term interest rates have been rising for the past couple of years. Another cause of concern for the CBN was the slowdown in interbank lending, which prompted the CBN to guarantee placements in the interbank market. This also helped bring down the interest rates in the short term money markets, such as the interbank call rates.

The above table indicates the Monetary Aggregates and Interest Rates as obtained in 2010.

## Foreign Direct Investment

Although the government will continue to welcome foreign direct investment (FDI), the level of FDI outside the oil and gas sector will remain low in relation to the potential size of the market. This reflects the complexities of the local business environment, together with the bureaucracy, corruption, low productivity, poor infrastructure and low income levels that restrict the potential market.

The salient feature of the policy is enumerated. Full foreign ownership is allowed in all sectors apart from banking, although the Central Bank of Nigeria (CBN) has been more relaxed on the issue since the 2009 crisis in the sector and the subsequent need to recapitalize the affected banks. A new bill proposes to outlaw discretionary awards of oil and gas contracts, and stipulates that licenses must be given through " open, transparent and competitive" bidding processes.

Nevertheless, a number of Asian investors, from China, India and South Korea in particular, who have shown keen interest in entering Nigeria on the basis that they concurrently develop local infrastructure, may still find themselves the preferred bidder on new acreage. There is also likely to be a continued bias towards policy favoring local business, as evidenced by the recent local content bill for the oil industry that gives indigenous firms priority in the awarding of oil concessions and requires foreign companies to employ more local staff.

As a result, and with other countries set to improve more rapidly, Nigeria will slip in the global rankings from 67th to 71st out of 82 countries, and from 12th to 13th in the Middle East and Africa region. a Out of 10. b Out of 82 countries. c Out of 17 countries: Algeria, Bahrain, Egypt, Iran, Israel, Jordan, Kuwait, Libya, Morocco, Qatar, Saudi Arabia, Tunisia, UAE, Angola, Kenya, Nigeria and South Africa.

Source: Economic Intelligence Unit| Foreign direct investment, net inflows (% of GDP) in Nigeria was 2. 99 as of 2010. Its highest value over the past 40 years was 8. 28 in 1994, while its lowest value was -1. 15 in 1980.

## Globalization and Comparative Advantage

Nigeria has not benefited considerably fromglobalizationdue to mono-cultural export, inability to attract increased foreign investments and huge indebtedness. And the way forward for Nigeria is to focus towards diversification of exports, debt reduction and expand developmental cooperation. Nigeria got connected to the rest of the world with the arrival of British in the Year 1539 and by the 1800’s Nigeria was under complete control of the British Empire.

And since then Nigeria’s trade has been heavily dependent on British trade. Nigeria has been a country rich in natural resources and traded these resources for weapons and tools. This asymmetric trade is the reason for the wide variance in the distribution of the nation’s wealth. The country received its independence in 1960 and during that time the Farm products was its major export. Post-independence, farm products constituted the major portion of Nigeria’s Trade. The six major agricultural products then were cocoa, rubber, palm oil, groundnut, cotton and palm kernel.

And this constituted 69. 4% of its total GDP for the year 1963/64. The other contributor to exports was oil. However, during that period oil was priced low at $3. 8 per barrel and thus was not much lucrative. The 1970’s saw Nigeria’s fortune turn with the jump in fuel price by almost 4 times. Nigeria had high grade petroleum reserves and these reserves were easier to extract. The petroleum price rose to $14. 7 per barrel by January 1974 and rates continued to soar reaching a high of $38. 77 per barrel in 1981.

Within the same period, total revenue from oil rose correspondingly. By 1978, oil contributed 89. 1% of Nigeria’s export and in the same year contribution from agriculture plummeted to 6. 8% of exports. The overdependence of the country’s economy on oil exports has seriously hindered the development in other spheres. Globalization poses a multitude of challenges on Nigeria. The countries very poorly on education, health, agriculture and industrial development and therefore it is imperative that Nigeria focuses on these area to fundamentally transform the nation.

The country requires focusing on technological development andscience and Technologyare required to be central theme of their Developmental Strategy. The Country also requires focusing on basic Infrastructure such as power supply and telecommunications and these must exist regularly and uninterruptedly. Also, industrialization, including manufacturing and fabrication must be brought in at the center place. There is a need to revitalize agriculture by utilizing the technologies in the field and shifting to mechanized farming.

## Conclusion

There is an element of risk of doing business in Nigeria even though the debt of the country is in a manageable state. A prolonged European crisis and a slowdown in China will lead to dip in oil prices and Nigeria will face difficulties in meeting its deficit requirements. The currency of Nigeria-Naira is currently seen stable and after depreciating by an average of 6. 3% per year in 2012-13 to N174: US$1, the naira is expected to moderate more gently in subsequent years, to N176: US$1 in 2016, though the currency has seen a continuous downslide when data is compared for the last three decades.

After the Banking crisis of 2009, the banking sector is skeptical on lending to private sector, however the confidence is returning. The political risk of the country is seen as high due to factions in the government and the rise in Islamist fundamentalism. Piracy is also a major phenomenon in the Gulf of Guinea which makes Nigeria’s coastline a risky shipping port. Nigeria declared a state of emergency in January 2012 in the northern parts due to a recent spate of terror attacks; however nocivil waror major instability is expected in the short run.

The government has been accused of largely ignoring public grievances like unemployment, poverty, inequality in wealth and corruption. Unless the government steps up to address these issues and establish credibility there is risk of escalation. The President Mr. Good luck Jonathan has recently commissioned investigations into allegations of corruptions in the oil subsidies and replaced the Chief of the Police for failing to root out infiltration by the insurgents into the government offices.

However the effectiveness of these measures will depend on their enforcement. The future of the Nigerian economy therefore depends on stabilizing governance and enabling the parliament to unlock major reforms in the Oil and Gas sector.

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