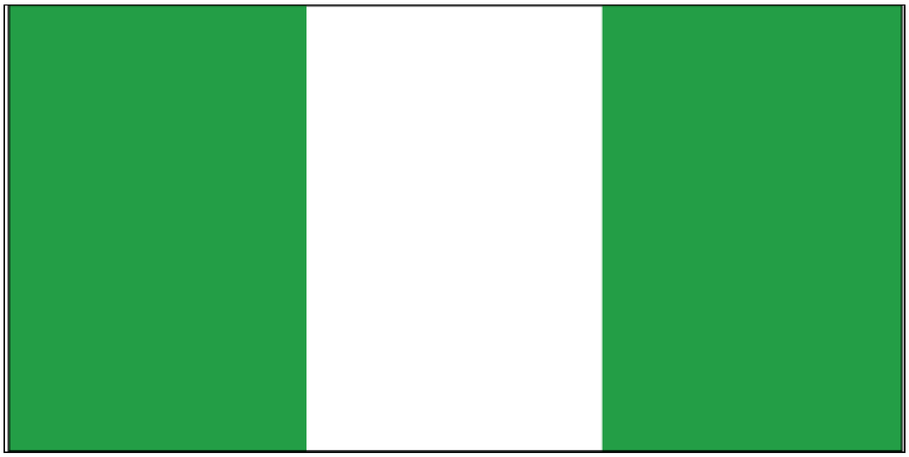
Rabobank

Country report

NIGERIA



Summary

In spite of a growing non-oil economy, Nigeria's economic development is still very much dependent on developments in the oil sector. Since oil revenues account for 89% of total exports, the economy is extremely vulnerable to oil price shocks. Unfortunately, investments and reforms that could strengthen the non-oil economy are likely to take a backseat with the upcoming presidential elections in April 2011. The elections are also expected to fuel existing social tensions, possibly resulting in violent conflict. This would further destabilize an already unstable country. Despite this depressing outlook, we do expect GDP growth to remain above 5%, aided by recovering oil prices. In addition, low debt ratios and large foreign exchange reserves provide some comfort. Nonetheless, high levels of capital flight and Nigeria's poor payment morale remain worrisome.

Things to watch:

- Upcoming presidential elections (April 2011)
- Security issues in the Niger Delta and Jos
- Level of oil production and oil price trends

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Nigeria

National facts		
Type of government	Federal Republic	
Capital	Abuja	
Surface area (thousand sq km)	924	
Population (millions)	152.2	
Main languages	English (offical)	
	Indigenous languages	
Main religions	Muslim (50%)	
	Christian (40%)	
	Indigenous (10%)	
Head of State (president)	Goodluck Jonathan	
Head of Government (prime-minister)	Goodluck Jonathan	
Monetary unit	Naira (NGN)	
Economy	2010	
Economic size	*bn USD*	*% world total*
Nominal GDP	223	0.36
Nominal GDP at PPP	370	0.50
Export value of goods and services	81	0.44
IMF quotum (in mln SDR)	1753	0.81
Economic structure	*2010*	*5-year av.*
Real GDP growth	7.6	6.3
Agriculture (% of GDP)	32	33
Industry (% of GDP)	33	39
Services (% of GDP)	35	29
Standards of living	*USD*	*% world av.*
Nominal GDP per head	1463	15
Nominal GDP per head at PPP	2433	21
Real GDP per head	1012	13

Social and governance indicators	rank / total
Human Development Index (rank)	142 / 169
Ease of doing business (rank)	137 / 183
Economic freedom index (rank)	111 / 179
Corruption perceptions index (rank)	134 / 178
Press freedom index (rank)	145 / 178
Gini index (income distribution)	42.9
Population below $1 per day (PPP)	30%

Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
US	34	China	15
Brazil	10	Netherlands	9
Spain	9	US	8
France	7	South Korea	6

Main export products (%)	
Crude petroleum	89
LNG	6

Main import products (%)	
Manufactured goods	25
Machinery & transport equipment	17
Chemicals	12

Openness of the economy	
Export value of G&S (% of GDP)	36
Import value of G&S (% of GDP)	26
Inward FDI (% of GDP)	2.7

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Economic structure and growth

In many ways, Nigeria is one of the largest countries in Sub-Sahara Africa. For one, it is the most populous nation with a population reaching 150m. Over 15% of the entire Sub-Saharan African population currently live in Nigeria. Secondly, its GDP is among the highest in the region, second only to South-Africa. This comfortable economic position is almost entirely explained by Nigeria's large oil revenues.

As is so often the case, the success of the oil industry nearly destroyed every other export base. Especially manufacturing and agricultural exports have suffered the consequences of an appreciating currency brought on by an inflow of oil revenues. Since the oil industry only employs a limited number of people, many others were forced into poverty or took up a career in crime. Consequently, Nigeria scores poorly on all social development indicators and over 30% of the population live on less than USD 1.25 a day. Another by-product of oil dependency is Nigeria's high corruption rate. The country ranks 134th (out of 178) on the corruption perception index.

The lack of economic diversification is further illustrated by the fact that oil receipts account for 65% of total budget revenues (2010). In addition, oil and gas exports make up 95% of Nigeria's total exports. This leaves the economy vulnerable to fluctuations in global energy prices.

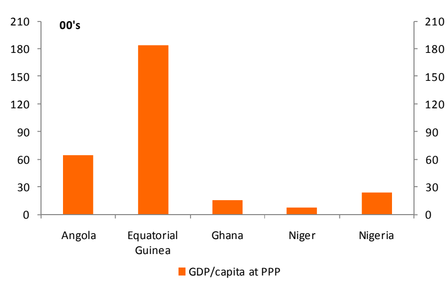
These unfavorable conditions are however softened by the fact that Nigeria maintained a positive growth rate throughout the global crisis. Despite declining oil prices and in spite of the fact that violence in the oil-rich Niger Delta region slowed production, GDP growth never dropped below 6%. In addition, non-oil growth reached 9.5% in 2010. This was largely the result of enhanced productivity in the services and agricultural sectors and increased government spending. In fact, both the agricultural and services sector show great potential for growth. Last year, agricultural growth reached 5.9%, while services expanded by 11% (yoy). For coming years, we expect the non-oil economy to grow further on the back of increased public investment in the mentioned sectors. However, in the short- to medium-term oil revenues will remain the largest source of revenue and will continue to overshadow all other sectors.

Overall growth is expected to remain strong on the back of recovering energy prices and an expected increase in oil production. For 2011 we expect growth at around 6.5%. Nonetheless, for the medium- to long-term, growth prospects are constrained by a number of issues. For one, productivity is limited by an acute dearth of infrastructure. Especially power shortages undermine both industrial and social development. Both are vital for economic growth in the long run. Furthermore, security issues in the Niger Delta, but also in northern parts of the country (especially in Jos), add to operational risks. Last year alone, continued rebel activity in the Niger Delta led to a fall in oil production from the projected 2.3mln barrels a day, to an average of 1.6mln barrels a day. Moreover, productivity is constrained by a lack of skilled personnel. Thirdly, as both cause and consequence, only a small percentage of this population enjoys access to schooling and health facilities. Finally, a lack of transparency and a high level of corruption, both within and outside the government, add to the costs of doing business.

Nigeria's oil sector also dictates the country's trade profile. As mentioned above, oil makes up 86% of all exports. The main recipients of Nigerian oil are the US, Brazil, Spain and France. Oil revenues are mostly held by a small and powerful elite that has taken on an European lifestyle. Consequently, domestic demand for consumption goods is high. Since Nigeria lacks a manufacturing sector, these goods are mostly imported. Together, manufactured goods account for 25% of total imports. In addition, Nigeria imports capital goods and chemicals, most of which are employed in the oil sector. Unsurprisingly, most inward foreign direct investments (FDI) are also directed at the oil industry.

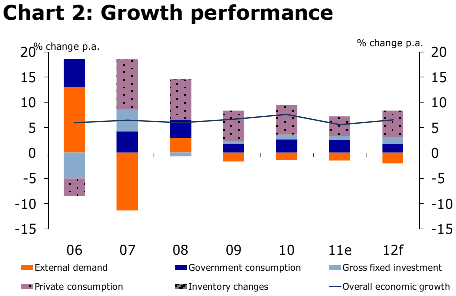
Although the global crisis had little effect on Nigeria's growth rate, it did affect its banking sector. In 2009, the banking sector almost collapsed. Mostly, this near-collapse was the result of overinvestment in oil companies, toxic loans and a lack of confidence among investors. In response to the pending crisis, Nigeria's central bank successfully intervened in all insolvent banks and cleaned up most non performing loans (NPL).

Chart 1: Income level



Source: EIU

Chart 2: Growth performance



Source: EIU

Political and social situation

Last year, president Goodluck Jonathan celebrated Nigeria's 60th birthday by stating that it is nothing short of a miracle that the country still exists. He went on to marvel over the fact that a country as large and diverse as Nigeria, a country destined to fall apart, defied all odds and remained one nation. But despite this success, it is also a nation that is still very much divided. One of the main reasons for Nigeria's stagnated development are the persisting conflicts between ethnic groups, between rebels and the government and between north and south.

One of the oldest conflicts is that between the Islamic north and the Christian south. Although great cultural and ideological differences exist within both regions, they are outweighed by the differences between the regions. On an ideological level, the south fears the Islamic north and the desire of some northern states to install Sharia-law. But the conflict has an economic dimension as well. The south controls most of Nigeria's oil fields and as such its population is richer, better educated and generally more developed. In contrast, most of the population in the northern states relies on agriculture as its main source of income. In addition, the production of oil in the south led to the destruction of many of the manufacturing sectors in the north. These developments reinforced the already deep-seeded mistrust between the two regions.

Aside from the struggle between the two regions, conflicts persist within each region as well. In the north, decades of conflict are the result of a power struggle between the various ethnic groups. The hot spot of this conflict is Jos (a northern city), where violence flairs up on a constant basis. The most recent outbreak in January 2010, killed over 500 people.

In the southern states and especially in the Niger delta, armed rebels routinely attack the oil industry and its infrastructure. In addition, kidnappings and rapes are commonplace. Rebel groups demand a share in the oil receipts and blame both oil companies and the government for their failure to create social development. The fact that even in the southern states oil revenues fail to trickle down to other parts of the economy, bolsters their argument. As does the high poverty rate and the extreme corruption that holds the country in its grip.

Clearly, these conflicts have extensive economic and political ramifications. The economic ramifications are mostly felt in the south, where oil companies were forced to suspend oil production. As mentioned above, continued insecurity reduced oil production by one third. Considering Nigeria's extreme dependence on oil, this is a risky development. Moreover, without hopes that the rebels will lay down their weapons any time soon, companies could be forced to halt investments and even leave the country.

The political ramifications stem mostly from the north-south divide. Indeed, tensions between the two regions continue to dictate Nigeria's political environment. To at least install some balance, parties from north and south agreed to rotate the presidency. Meaning that a president from the southern region should always follow a president from the northern region and vice versa. Each president can stay on for (no more than) two terms. This informal arrangement did ease tensions somewhat, but at the same time reduced the accountability of Nigeria's leaders. Put differently, by allowing the arrangement to stand, it becomes less likely that voters will hold their leaders accountable for past mistakes. Instead, leaders are chosen on basis of their ethnicity and the practice of favouritism is widespread.

Furthermore, recent developments showcase the fragility of this apparent power balance. The balance was threatened when president Goodluck Jonathan announced that he would run in the upcoming elections in April 2011. Former vice president Goodluck Jonathan stepped in as president, after president Yar'Adua died. However, since northerner Yar'Adua only served out one term, the north is entitled to elect another candidate to serve out the remaining second term. By declaring his candidacy, southerner Goodluck Jonathan thus defied the unwritten contract. However, the balance may have been restored now that Jonathan has pledged that, if elected president, he will only stay on for one term.

Despite Jonathan's pledge, we fear the election period will stir up the many tensions addressed above. Not just because of the interests at stake, but also because Nigeria's large population counts a high percentage of young people, many of whom are unemployed. Experiences in both Nigeria and other countries show that a combination of political and social instability and youth unemployment is potentially explosive. This may be especially true for Nigeria, where underdevelopment and corruption obstruct social and economic mobility.

Apart from the many internal conflicts, Nigeria enjoys relative stability externally and is not embroiled in any noteworthy international or diplomatic conflicts. In addition, the country is a member of the G20. Nonetheless, in order to achieve its goal of becoming a regional powerhouse, the country should rid itself of its reputation of being the host of many international crime networks.

Economic policy

After years of neglect, Goodluck Jonathan commenced some major reforms in all key areas. These areas include infrastructure, power supply and the diversification of the economy. For the most part, the reforms focused on privatizing the energy sector in hopes of increasing productivity. In addition, Jonathan has made some strides in securing the abandonment of a costly fuel subsidy and increased investments in infrastructure. The shift in focus is likely to continue if Jonathan survives the elections in April. But as detailed in the previous section, this is not at all certain. Depending on how the elections evolve, we should expect 2011 to become a year of political turbulence, rather than economic transformation.

Nigeria’s fiscal policy centers around a three year medium-term expenditure framework (MTEF). Within the MTEF, expected oil prices function as a benchmark for planned expenditures. Oftentimes, the government is overly optimistic about oil price trends, in which cases a supplementary budget is drafted that allows for additional spending. However, despite the fact that the government often overshoots its budget, funds earmarked for infrastructure and social development are almost never fully employed. This points to a lack of administrative capacity, as well as political will.

In the past two years, high domestic demand, low oil prices, decreased oil production, as well as Nigeria’s banking crisis resulted in budget deficits of 4.4% of GDP in 2009 and 5.7% of GDP in 2010. Despite the fact that oil prices are on the rise, we expect this deficit to remain around this level in 2011, as elections will likely inspire increased spending. The deficit is funded with help of accumulated oil revenues, as well as the recent issue of an 10-year Eurobond. Consequently, public debt levels rose to a still low 14% of GDP in 2010, from 12% of GDP in 2009. We expect a further increase in public debt to 17% of GDP in 2011. Most public debt is held domestically and most public external debt is concessional. In addition to public debt, public guarantees and loans made to illiquid banks by the Central Bank of Nigeria (CBN), present further liabilities. But even when these are directly added to the public debt, debt levels would not exceed 35% of GDP and do not raise any major concerns.

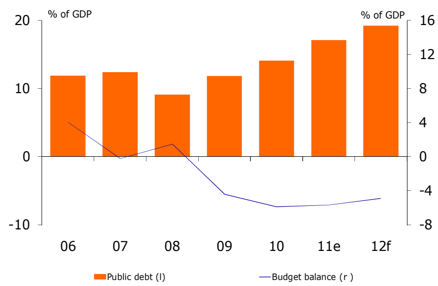
More worrisome however, is the fact that the government continues to make large withdrawals from its Excess Crude Account (ECA). The fund was established with the idea to keep some of the oil revenues outside of the economy, so as to facilitate counter-cyclical spending. Put differently, the fund is to absorb surpluses when oil prices are high and provide additional cash flows when oil prices are low. Now that oil prices are increasing, the government should start replenishing the fund. Instead, the government continues to withdraw from the ECA. In doing so, it actively contributes to the boom-bust cycles that we saw in previous years. In 2011, the government plans to replace the ECA with a new fund, the sovereign wealth fund (SWF). As the ECA, the SWF is set up for three reasons: anti-cyclical spending, providing a fund for future generations and providing a fund for investments in infrastructure.

The banking crisis that held Nigeria in its grip for the better part of 2009 meant that monetary policy mainly focused on preventing major banks from collapsing, while simultaneously reducing the number of non performing loans (NPLs). The Central Bank of Nigeria (CBN) did so by creating the AMCON, which is basically a bad bank that is meant to buy off all NPLs and toxic assets from other (otherwise) healthy banks. In addition, the CBN improved supervision of the banking sector, improved transparency and increased capital requirements.

In addition to dealing with the causes of the banking crisis, the CBN also had to deal with its consequences. In the wake of the crisis, banks became hesitant to hand out new loans, resulting in a credit squeeze. This induced the CBN to implement monetary stimulus measures. However, in 2010, inflationary pressures increased and forced the CBN to raise the interest rate. The higher rate and the fact that banks remain risk averse, continues to constrain private credit. Meanwhile, increasing food prices as well as an expected increase in public spending will keep inflation in double-digits. For 2011, we expect inflation to average around 12% (from 14% in 2010), while credit growth is expected to increase to 30% (from 14% in 2010).

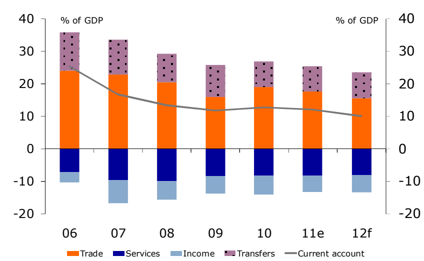
In 2009, the government liberalized the exchange rate system. In theory, this means that the naira is free to float against other currencies. In practice, the government still attempts to manage the rate of the naira against the US Dollar. Nonetheless, between 2008 and 2009 falling exports and increased capital flight weakened the naira against most other currencies (most notably the dollar). For 2011, we expect a strengthening of the naira on the back of higher oil prices.

Chart 3: Public finances



Source: EIU

Chart 4: Current account



Source: EcoWin

Balance of Payments

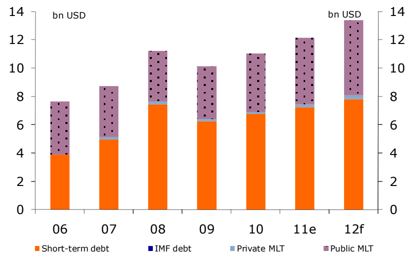
Nigeria suffers from an undiversified export basket and a somewhat inflexible import basket. 95% of all exports are made up of oil and gas. As a result, the inflow of export receipts is highly dependent on energy prices and the performance of one main sector. Imports on the other hand, consist of a wide range of goods including manufactured and capital goods. The inflexibility of the import basket stems from the fact that Nigeria lacks a manufacturing sector and thus has to import almost all of its (non-agricultural) consumption goods. In addition, the oil producing sector requires a steady inflow of capital goods. However, in spite of the strong domestic demand for foreign goods and despite low oil prices in 2008 and 2009, Nigeria's trade balance stayed in the black. For the coming years, we expect the trade surplus to expand on the back of increased oil prices.

The services balance generally reports a deficit. This is the result of large imports of technical and financial expertise by oil companies. Nigeria mostly exports tourism and business services, but both sectors are relatively underdeveloped. The deficit on the income balance is a reflection of the profit repatriation by foreign oil producers. Finally, the surplus on the transfer balance is the result of large remittance inflows from Nigerians living abroad (mostly in industrialized countries). Together, these inflows account for around 10% of GDP.

Overall, Nigeria's current account generally reports a surplus, which stood at 12.7% of GDP in 2010. For the coming years we expect this surplus to remain strong. Inflows of foreign direct investments are stable at 2.6% of GDP (2010). Unsurprisingly, these investment mostly benefit the oil sector.

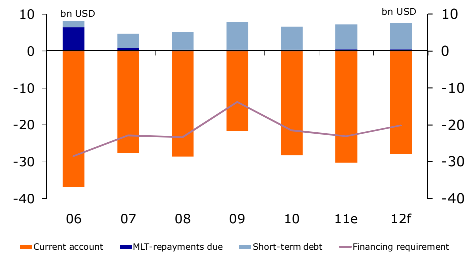
Given these large inflows of foreign capital we should expect large increases in reserves. Nonetheless, in 2008 and 2009 reserves shrunk rather than increased. A likely explanation for this outcome is the large amount of unidentified capital outflows (i.e. capital flight). At 20% of GDP these outflows of capital are substantial. They reflect a general lack of trust in Nigeria's economy among investors and capital owners. Despite the high levels of capital flight, reserves still cover 7.4 months of imports and are expected to increase in 2011.

Chart 5: Foreign debt



Source: EIU

Chart 6: Financing requirement



Source: EIU

External position

Total external debt stands at a low 5% of GDP. Around 37% of this debt is held by the government. As mentioned above, around 94% of all public debt is concessional. Private debt is mostly short-term trade finance. Consequently, the share of short term debt is somewhat high at 61% of total foreign debt. However, we take comfort in the fact that the total debt service due (which includes short term debt) only amounts to 7% of external revenues (2010). This is a reduction from the 10% of external revenues in 2009. Large foreign exchange reserves provide further comfort as they cover 7.4 months of imports and account for 541% of total debt service due.

Although Nigeria is a net creditor, it is hard to find data on foreign assets holdings. The only documented holdings are those with Nigeria's commercial banks. It is estimated that commercial banks' net foreign asset holdings stand at around USD 7,087mln, which is 3% of GDP (2010).

Despite the fact that Nigeria is a net creditor and despite the fact that reserve levels are high and debt levels low, a returning concern regarding Nigeria's external position is the country's payment moral. Both the government and the private sector are notorious for delaying debt payments. Nonetheless, there are no reported principal or interest arrears and the last reported arrears (in 2005) were with official creditors.

Nigeria

Selection of economic indicators	2006	2007	2008	2009	2010	2011e	2012f
Key country risk indicators							
GDP (% real change pa)	6.0	6.5	6.0	6.7	7.6	5.6	6.6
Consumer prices (average % change pa)	8.2	5.4	11.6	11.5	13.9	11.8	10.7
Current account balance (% of GDP)	25.3	16.7	13.4	11.8	12.7	12.0	10.0
Total foreign exchange reserves (mln USD)	42299	51334	53002	44763	35305	39890	44050
Economic growth							
GDP (% real change pa)	6.0	6.5	6.0	6.7	7.6	5.6	6.6
Gross fixed investment (% real change)	-31.3	40.5	-5.4	5.0	8.0	6.5	10.0
Private consumption (% real change)	-5.2	16.7	12.5	8.7	8.3	5.5	7.3
Government consumption (% real change)	35.8	21.4	15.4	7.0	10.5	10.0	7.0
Exports of G&S (% real change)	60.2	-0.8	5.5	0.5	11.0	10.3	11.1
Imports of G&S (% real change)	10.8	39.5	-2.4	5.7	15.7	14.8	15.9
Economic policy							
Budget balance (% of GDP)	4.0	-0.2	1.5	-4.4	-5.9	-5.7	-4.9
Public debt (% of GDP)	12	12	9	12	14	17	19
Money market interest rate (%)	10.0	6.9	8.2	3.8	3.0	5.0	6.5
M2 growth (% change pa)	36	64	53	14	30	25	21
Consumer prices (average % change pa)	8.2	5.4	11.6	11.5	13.9	11.8	10.7
Exchange rate LCU to USD (average)	128.7	125.8	118.5	148.9	150.0	154.7	160.0
Recorded unemployment (%)	1.3	1.2	1.0	0.7	0.4	n.a.	n.a.
Balance of payments (mln USD)							
Current account balance	36815	27644	28646	21659	28210	30280	27880
Trade balance	34947	37748	43743	29042	42225	44230	43130
Export value of goods	56935	66040	83587	59318	78785	86310	90170
Import value of goods	21988	28291	39844	30276	36560	42080	47040
Services balance	-10473	-16220	-21491	-15339	-18506	-20850	-22760
Income balance	-4602	-11747	-12350	-10019	-12909	-12800	-14910
Transfer balance	16943	17863	18744	17976	17399	19700	22410
Net direct investment flows	4832	5564	5131	5647	5750	6250	7380
Net portfolio investment flows	1288	800	-3403	-188	200	230	300
Net debt flows	-3644	892	2538	-998	971	1200	1310
Other capital flows (negative is flight)	-25273	-25865	-31244	-34359	-44589	-33370	-32700
Change in international reserves	14019	9035	1668	-8239	-9458	4580	4160
External position (mln USD)							
Total foreign debt	7634	8696	11221	10141	11031	12130	13370
Short-term debt	3890	4944	7456	6244	6761	7240	7780
Total debt service due, incl. short-term debt	8656	5078	5553	8004	6873	7490	8110
Total foreign exchange reserves	42299	51334	53002	44763	35305	39890	44050
International investment position	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total liabilities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	24.0	22.8	20.4	15.9	19.0	17.5	15.4
Current account balance (% of GDP)	25.3	16.7	13.4	11.8	12.7	12.0	10.0
Inward FDI (% of GDP)	3.3	3.6	2.6	3.2	2.7	2.6	2.8
Foreign debt (% of GDP)	5	5	5	6	5	5	5
Foreign debt (% of XGSIT)	10	10	10	13	11	11	11
International investment position (% of GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	11	6	5	10	7	7	7
Interest service ratio incl. arrears (% of XGSIT)	0	0.4	0.2	0.2	0.2	0.3	0.3
FX-reserves import cover (months)	14.6	13.4	10.0	11.2	7.4	7.3	7.3
FX-reserves debt service cover (%)	489	1011	954	559	514	533	543
Liquidity ratio	253	226	204	200	183	183	176

Source: EIU