THE CFG ADVISORY

NIGERIA Q1 2021

OUT OF RECESSION INTO STAGFLATION

MAY 2021

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Amidst the counter accusations of money printing by the two Godwins, denial by the National Economic Council, and statement by the Nigerian National Petroleum Corporation (“NNPC”) that it will be unable to remit funds into the federation account for several months; several issues started to manifest in my mind concerning the state of the nation.

What is the true state of our economic decline, debt levels and descent into a state of anarchy?

Several social media posts documenting the facts that in the past week alone over 150 Nigerians killed, was particularly depressing. These killings across the nation were related to kidnapping, insurgency and internal strife. The humble fulani herdsman has been weaponized and converted to a tool of insurgency.

This week, the government of the United States of America also upgraded its travel advisory to Nigeria to level three, advising its citizens to reconsider travelling to Nigeria and if they must travel, they should put in place kidnapping protocols and prepare their evacuation arrangements without assistance from American authorities. We are one step off the highest level, level Four, which advises Americans not to travel to Nigeria.

While the dire security situation in Nigeria has not been adequately addressed, the local narrative and official explanation varies depending on who you talk to. The American travel advisory without any ambiguity, defines how the world now views Nigeria.

As a fallout of the money printing saga, I decided to extend my Q1 2021 Nigerian economic report and conduct a more comprehensive review, focusing on the rising debt profile which dates back to 2014, when the economy grew by 6.5% with a GDP of USD569bn, a historic high.

Flashback to an article published by Fitch in January 2021, which warns that Nigeria's deficit monetization may raise macro stability risks. The report stated, that the Central Bank of Nigeria ("CBN") had financed the budget deficit directly with NGN10trn (approximately USD25bn). Fitch also warned that..

*...**Repeated central bank financing of government budgets could raise risks to macro-stability** in the context of weak institutional safeguards that preserve the credibility of policymaking and the ability of the central bank to control inflation. **The CBN's guidelines limit the amount available to the government under its Ways and Means Financing ("WMF") to 5% of the previous year's fiscal revenues**. However, **the FGN's new borrowing from the CBN has repeatedly exceeded that limit in recent years, and reached around 80% of the FGN's 2019 revenues in 2020"**. The report stated further that "the CBN's guidelines requires borrowing under the WMF to be repaid in the year in which it was granted. The government has stated its intention to securitise balances borrowed under the facility, but published statistics indicate that the amounts borrowed have been rolled over repeatedly in recent years.*

In effect the CBN was out of step with its own guidelines and has also not publicly released its audited accounts in a while. In February 2021, the Debt Management Office ("DMO") under the Ministry of Finance confirmed the level of WMF at NGN10tn (approximately USD25bn). They admitted that they had engaged with the CBN in WMF since 2015 to plug the budget deficit. The DMO also announced establishment of a 10-year to 30-year bond issuance program to refinance the WMF, in compliance with the CBN guidelines.

The question that remains unanswered is how the CBN, out of step with guidelines, funded NGN10tn (approximately USD25bn) to finance the budget deficit?

The CBN intervention programs and financing in the local and international capital markets are well documented and require legislative approval. In the absence of published audited accounts, is it not logical to presume that the CBN must have printed to support WMF over the past five years? While the doctrine of necessity allows leeway for central banks in time of economic downturn and crisis to resort to printing money or WMF, the Nigerian situation started in 2015, with the COVID-19 pandemic and ensuing recession, exacerbating the situation.

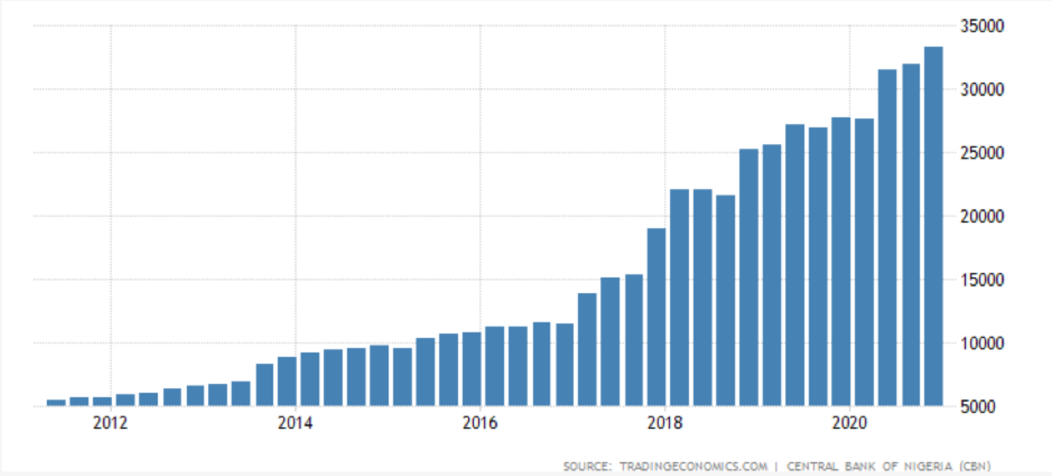
From all accounts, ***the USD25bn WMF has not been accounted for in Nigeria domestic and total debt profile.***

NIGERIA DEBT STOCK EXCEEDS US$100 BILLION

Nigeria Total Debt US$Billions

According to DMO data in 2014, Nigeria's total debt was USD67.7bn with domestic debt accounting for USD57.9bn and foreign debt USD9.7bn. By 2020, Nigeria's total debt increased by 27.5% to USD86.3bn, with domestic debt accounting for USD53.0bn (a decline by USD 4.9bn or 8.5% from 2014 total domestic debt) and foreign debt accounting for USD33.3bn (an increase by USD23.6bn or 243.3% from 2014 total foreign debt). At this level of total debt, 80-90% of government revenue for the Q1 2021 was going towards debt service.

Nigeria Public External Debt US$Billions



A different picture emerges when you include the unaccounted USD25bn WMF in the CBN books. In reality, the total debt stock increased from USD67.7bn in 2014 to a record high of USD111.3bn in 2021 (a 64.4%increase). This directly impacts domestic debt as it rises from USD57.9bn to USD78bn (an increase by USD20.1bn or 34.7% from 2014 total domestic debt). The DMO March 2021 report, when released, should clarify the current position of our total debt profile and how much of the USD25bn WMF has actually been refinanced.

Recently, the National Assembly approved a foreign loan of USD2.5bn. Taking into account the WMF, this will take the total debt stock to US$113.8bn. From the analysis above, it is clear that ***with Nigeria's current debt profile, servicing its debt with over 80 to 90% of its revenue is no longer sustainable.*** As a result of this debt profile and declining revenue situation red flagged by the NNPC pronouncements, ***Nigeria can now be classified technically insolvent.***

A review of the key economic indicators for the Nigerian economy between 2014 to Q1 2021 (the period under review), suggests sub-optimal performance.

In 2014, the Nigerian economy was growing steadily at about 6.5% until policy inconsistencies forced the economy into a self-inflicted recession in 2016. The government responded with an Economic Recovery Growth Plan ("ERGP"). The plan promised, but was unable to stem the economic decline to deliver 7% growth by 2020.

Since the 2016 downturn, the Nigerian economy has not grown beyond 2.5%, considering its population growth rate of 3.5%. Between 2016 and 2020, Nigeria lost USD218bn (approximately 40% of its GDP).

This is equivalent to Portugal's GDP, three times Ghana's GDP and six times Cameroon's GDP. Inflation also hit a 10-year high of 18.7% in January 2017 and the monetary authorities were able to reduce it to 11.9% by December 2019.

Unfortunately, as a result of cost push factors, by March 2021 inflation was up by 18.2%. Food inflation, at just over 22%, is the key driver of inflation, despite a NGN1.5tn intervention by the CBN in the agriculture sector.

The recent hike in utility rates and fuel subsidy removal has done nothing but sustain the upward trajectory of inflation rates. The Naira suffered over 300% devaluation as it moved from NGN160/USD1 to NGN500/$1 in the parallel market under the review period.

The static exchange rate mechanism and multiple exchange rate windows have been a sore point. They remain in place, despite calls for a single window and a market driven rate mechanism.

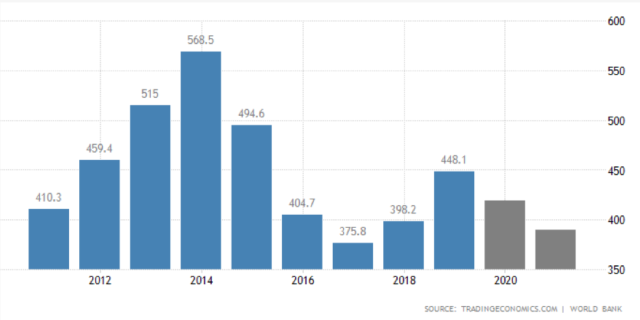
The biggest challenges during this review period were fiscal indiscipline and the perpetual budget deficit the government struggled to finance.

The government admitted in it's 2021 budget presentation, that it is now in violation of the Fiscal Responsibility Act which stipulates a value of 3.5% of GDP as the budget deficit ceiling. Unemployment rate more than tripled from 12% in 2016 to 45% by Q1 2021. Factoring underemployment and youth employment reveal higher numbers.

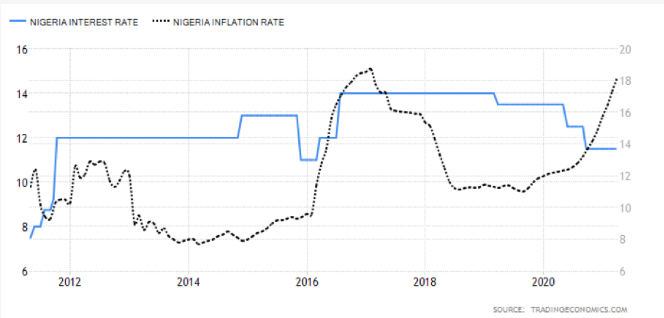
As a result of sub-optimal economic growth and declining GDP, over 100 million Nigerians entered into poverty and ***Nigeria became the global poverty capital***.

Increasingly, our population instead of being an asset with a viable consumer market and aggregate demand of 180 million people is fast becoming unproductive with meagre disposable income and a liability. From the data available, it can be established that self-inflicted policies caused the first recession in 2016.

Nigeria GDP US$Billions

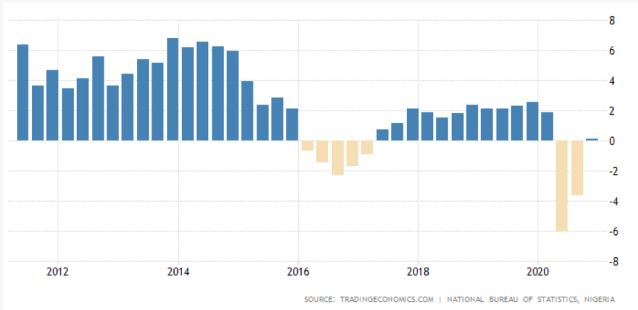


However, the shocks to the economy as a result of the pandemic lockdown and the sharp drop in oil prices caused a downturn in an already fragile economy and tipped it into another recession in 2020. In Q2 and Q3 2020, the Nigerian GDP contracted by -6.10% and -3.62% respectively.



However, by Q4 2020, Nigeria exited recession with 0.1% growth. The irony as with the last recession is that our economic and financial managers did not have sufficient buffers in place to help withstand the shocks.

Nigeria GDP Annual Growth Rate %



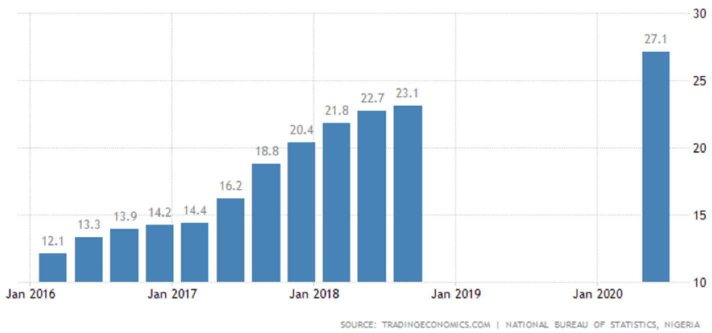
At the onset of the pandemic, the NSIA stabilisation fund had only USD350mn and Excess Crude Account ("ECA") a paltry USD72mn. A sum of USD150mn (approximately NGN57bn) was withdrawn from the NSIA in April 2020 to support a NGN5tn budget deficit. In contrast during the 2009 global financial crisis, the ECA had USD22bn, which saw Nigeria through the crisis.

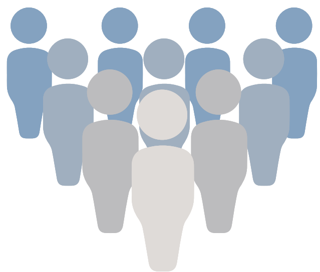
Nigeria Inflation Rate

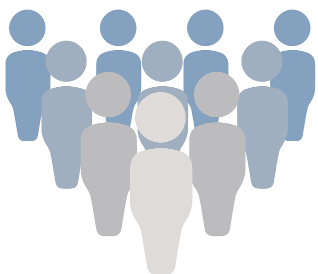
As a response to addressing the impact of the shocks to the Nigerian economy during the period under review, the FGN began to step up its social intervention programs and engage in consultative meetings with stakeholders across all sectors of the economy. While these programs are laudable and pilots have been successful, it is clear that the government cannot fund the program. ***The best way out this quagmire is to grow the economy by over 6.5% to 10.0% on a sustainable basis, lifting the masses out of poverty in the process.***

The CBN also increased its intervention program with additional funding to cover the healthcare and SME sectors, ensuring liquidity and credit to the economy. An ambitious infrastructure fund with over USD20bn is being developed and request for proposals ("RFPs") have gone out for fund managers. Rate cuts were also announced on intervention funds and MPR base rates, giving banks the confidence to continue lending and providing the much-needed stimulus. On the 24th of June 2020, the FGN approved The Nigeria Economic Sustainability Plan ("NESP"). This is in an effort to cushion the adverse effects of the pandemic on Nigerians and define a policy framework and implementation roadmap to economic recovery.

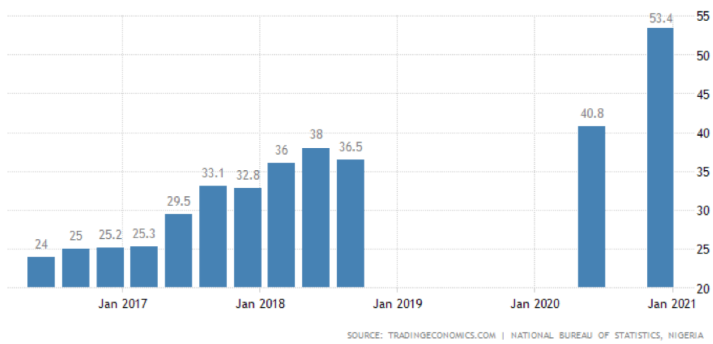
Nigeria Unemployment Rate







Nigeria Youth Unemployment



On the 28th of April 2021, barely a year after the approval of the NESP, the Federal Executive Council approved The National Poverty Reduction with Growth Strategy, prepared by the president's economic advisory council.

We are not sure if this supersedes or compliments the NESP. The CBN MPC meeting held early 2021 maintained the rates as the economy came out of recession earlier than expected.

The results of the NESP are yet to bear fruit as the government is struggling with the 2021 budget implementation and deficit financing.

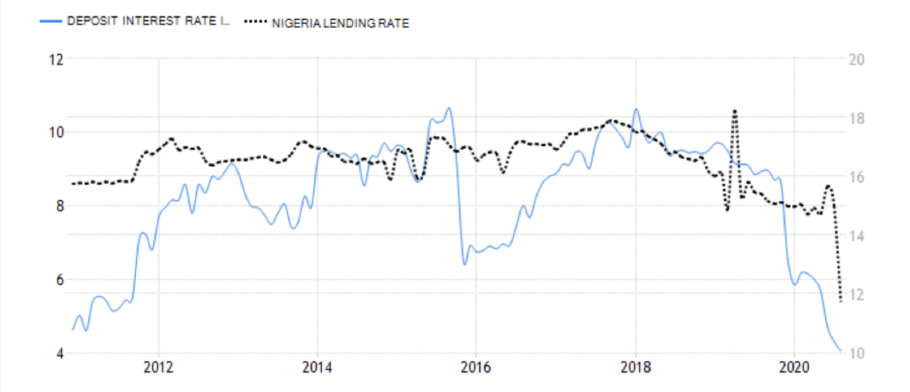
We are now faced with stagflation, a situation more protracted than a recession. It is clear that monetary policy has reached its limits and supply side structural reforms and fiscal discipline are now required to get the Nigerian economy out of the current stagflation quagmire.

The most urgent structural reform is immediate removal of subsidies across the economy in particular the fuel subsidy. NNPC recently announced that it will be unable to remit revenues to the federation account for several months as a result of the subsidy payments. The short fall will put addition pressure on the CBN and the WMF.

In the period under review, we now face the stark reality of stagflation, ***a declining economy that lost USD210bn of its GDP, with 0.1% growth, runaway inflation at 18%, USD113.8bn debt stock with 90% of revenues going to debt service, unsustainable budget deficit, 300% currency devaluation,*** the Nigerian Naira trading at NGN500/$ (based on parallel market rates), 100 million Nigerians in poverty and over 50% youth unemployment.

The security situation also seems not to fair better. Recent headlines from Thisday newspapers reads "*Nation in turmoil, bandits kill two more Kaduna students*" and Nigerian Tribune reads "*Niger gov. raises alarm Boko Haram 2 hour drive from Abuja, hoists flag in Niger*" There seems to be a failure of the intelligence services and lack of coordination between the security agencies and armed forces. The Nigerian president in recent conversation with the US Secretary of State is now requesting for The US Africa Command ("AFRICOM") to relocate from Germany to Africa.

The fundamentals of the Nigerian economy despite these challenges remain strong. The Nigerian economy remains the largest in Africa even with the loss of GDP three times that of Ghana in recent years. It is however time to stem the decline and put in place sustainable policies that will sustain growth and lift the masses out of poverty. The problem has been with policy formulation, fiscal indiscipline, lack of presidential leadership and poor coordination of monetary, fiscal, trade and investment policies.



In September 2015, I published an article in Ventures in Africa which put forward suggestions on policy initiatives to the new government, to help drive the Nigerian economy towards a G-10 ranking. Nigeria had achieved USD570bn GDP and created dollar billionaires business men and women. At the time, the policy suggestions were seeking to drive Nigeria economy to a USD850bn GDP by 2020, with the overall objective of how Nigeria can implement sustainable policies that can help us realize the true potential of a USD1tn GDP economy. Unfortunately as at Q1 2021, Nigeria's GDP is only USD350bn.

Elections are about 20 months away and party primaries start in another 12 months. This administration has to face that fact and set realistic goals as to what it can deliver in the next two years before it hands over to the next administration. It should focus on completion of legacy projects such as the second Niger Bridge, Lagos to Ibadan and Kano rail projects and extensive road rehabilitation projects across the country. The priority for the nation now is an urgent security summit that the president must convene at the local, regional and international level. The support of the USA and French government is critical in the resolution of the security situation. If the security challenges are not resolved the economy might collapse from the weight of turmoil.

Outside the security situation, the fiscal indisciple, inabiltily to optimize revenues, cut cost and right size government are the achilles heel of this administration. There hasn't been a proper coordination of monetary, fiscal, trade and investment policy and singular leadership of the related agencies by the presidency.

This has to be urgently addressed. We welcome the launch of the Strategic Revenue Growth Initiative ("SRGI") and the annual Finance Act to help susustain revenue generation, create new streams and optimize costs. We will also recommend to the government in addition to subsidy removal across all sectors of the economy, the review, update and implementation of the Ornasanye report. There is a significant amount of fiscal structural reforms that needs to be done to jumpstart the economy as monetary policy has reached it limits.

> ***First quarter 2021 The Nigerian economy recorded a paltry 0.5% GDP growth while poulation was growing at 3.5%, Inflation rate eased to 18.12% in April down sligtly from a four year high of 18.17% in March. Unemployment and under employment still over 50%, with monetary policy rates unchanged at 11.5%. The CBN finally consolidated its multiple FX windows in alingement with the Nafex rate. This futher devaluing the naira by about 7% to US$1/410 and sending the parrlel market rates to a record high of US$1/500. Market returns for the ASI shows a fall of 9% for Q1 2021. ASI declined from 5.3% in January to -1.2% in February and further to -3.0 in March. The q12021 numbers confirm an exit from a recession and stagflation taking hold. Feable growth, high unemployment, runaway inflation and unsustainable debt levels now plauge the Nigerian Economy.***

The 2021 budget is focused on repositioning the Nigerian economy on three pillars: Recovery, Growth and Resilience. This cannot be accomplished without political will and leadership from the presidency to drive policy implementation. The president has assembled a sound team of ecomonic policy advisers that report directly to him.

They are aware of the narratives, facts and figures around the declining economic situation. I have no doubt that they have profferd viable solutions to the problems. With contributions from the CBN, MOF, MITI, the president's economic advisory committee and the Nigeria Economic Sustanability plan, we have a viable policy framework in place to reveive the Nigerian Economy.

With two years left with the present adminstration the question we need to ask is this; ***is Mr President willing to muster the political will to restore fiscal disipline and implement policies to jump start the economy, or will he hold back and continue the decline?***

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