NIGERIA BIANNUAL ECONOMIC UPDATE

# Investing in HUMAN CAPITAL for Nigeria's future

COUNTRY FOCUS: NIGERIA

**FALL 2018**

WORLD BANK GROUP

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# PREFACE

The Nigeria Biannual Economic Update is a product of the staff of the World Bank and has three broad aims. First, it reports on the key developments in the Nigerian Economy in the recent past. Secondly, it summarizes the staff's assessment of likely economic outcomes in the short-to-medium term, given the policy developments, and highlights key short-term risks. Finally, the Update provides a more in-depth examination of selected highly relevant economic policy topics.

This edition of the Nigeria BEU was prepared by the World Bank Nigeria Macroeconomics, Trade and Investment (MTI) Global Practice Team, and was led by Gloria Joseph-Raji (Senior Economist) and Emilija Timmis (Economist). Muna Meky (Program Leader) and a team from the Human Development Global Practice (comprising Mistura Rufai, Benjamin Loevinsohn, Sangeeta Pinto, Oluwole Odutolu, Ayodeji Ajiboye, Elina Pradhan, Dina Abu-Ghaida, Aisha Mohammed, Foluso Okunmadewa and Priyanka Pandey) prepared the special topic Chapter. Oversight on the report preparation was provided by Souleymane Coulibaly (Lead Economist), under the overall supervision of Francisco Carneiro (Practice Manager), Indira Konjhodzic (Country Program Coordinator) and Rachid Benmessaoud (Country Director). The report benefited greatly from valuable insights and comments from David Evans (Lead Economist) and Kene Ezemenari (Senior Economist). Joseph Ogebe (Consultant) provided valuable contributions. The World Bank team is grateful to the IMF Senior Resident Representative and Mission Chief, Amine Mati, and his team for valuable comments and for continued dialogue and collaboration.



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# GLOSSARY

| | |
|---|---|
| bbl | Barrels |
| BDC | Bureau De Change |
| BHCPF | Basic Health Care Provision Fund |
| bn | Billion |
| CAB | Current Account Balance |
| CAR | Capital Adequacy Ratio |
| CBN | Central Bank of Nigeria |
| CCT | Conditional Cash Transfers |
| CIT | Corporate Income Tax |
| CPI | Consumer Price Index |
| CRR | Cash Reserve Ratio |
| DMO | Debt Management Office |
| ECA | Excess Crude Account |
| ERGP | Economic Recovery and Growth Plan |
| FAAC | Federation Account Allocation Committee |
| FCT | Federal Capital Territory |
| FDI | Foreign Direct Investment |
| FEC | Federal Executive Council |
| FG | Federal Government |
| FGN | Federal Government of Nigeria |
| FOB | Free on Board |
| FPI | Foreign Portfolio Investment |
| G&S | Goods and Services |
| GDP | Gross Domestic Product |
| GoN | Government of Nigeria |
| Govt | Government |
| H1 | First Half of the Calendar Year |
| H2 | Second Half of the Calendar Year |
| HCD | Human Capital Development |
| ICT | Information and Communications Technology |
| IEFX | Investors and Exporters Foreign |
| IGR | Internally Generate Revenue |
| IMF | International Monetary Fund |
| IOC | International Oil Companies |
| ITN | Insecticide Treated Nets |
| JV | Joint Venture |
| JVCC | Joint Venture Cash Call |
| mb/d | Million barrels per day |
| MDAs | Ministries, Departments, and Agencies |
| MSME | Micro, Small and Medium Enterprises |
| MTDS | Medium Term Debt Strategy |
| NBOR | Nigeria Interbank Offer Rates |
| NEC | National Economic Council |
| NEC | National Economic Council |
| NHAct | National Health Act |
| NLNG | Nigeria Liquefied Natural Gas |
| NNPC | Nigerian National Petroleum Corporation |
| NSE | Nigerian Stock Exchange |
| NSIA | Nigeria Sovereign Investment Authority |
| o/w | Of which |
| OAGF | Office of the Accountant General |
| OMO | Open Market Operations |
| PBOC | People's Bank of China |
| PHC | Primary Health Care |
| PIB | Petroleum Industry Bill |
| PIGB | Petroleum Industry Governance Bill |
| PMS | Premium Motor Spirit |
| PPP | Purchasing Power Parity |
| PPT | Petroleum Profits Tax |
| RSSF | Real Sector Support Facility |
| S&P | Standard & Poor |
| SEZ | Special Economic Zones |
| SG | State Governments |
| SME | Small and Medium Enterprise |
| SOE | State-Owned Enterprise |
| SSA | Sub-Saharan Africa |
| SWF | Sovereign Wealth Fund |
| SWOT | Strengths Weaknesses Opportunities |
| T-bills | Treasury Bills |
| U5MR | Under-Five Mortality Rate |
| USAID | United States Agency for International Development |
| USD | US Dollars |
| VAIDS | Voluntary Assets and Income Declaration Scheme |
| VAT | Value Added Tax |
| WASH | Water, Sanitation and Hygiene |
| yoy | Year on Year |

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# EXECUTIVE SUMMARY

**The Nigerian economy remains dependent on the small oil sector (under 10 percent of GDP) for the bulk of its fiscal revenues and foreign exchange earnings.** This makes Nigeria's balance of payments and government budgets vulnerable to volatilities in oil prices. Indeed, growth and investment in Nigeria have been negatively impacted by repeated oil-price driven boom-bust cycles. The oil price shock of late 2014 and its aftermath pushed the economy into recession and precipitated a major budgetary crisis at the national and state levels which brought to light the longer-term trend of weak domestic revenue mobilization. Nigeria's weak revenue mobilization has major implications for growth and development, including for improving its dire social service delivery outcomes. Thus, the country needs to take concrete steps to break its oil dependency to improve its economic and social outcomes. *The Nigeria Economic Recovery and Growth Plan (ERGP) 2017-2020* aims to achieve macroeconomic stability and economic diversification and there is thus the need to accelerate its implementation progress.

**Nigeria's emergence from recession remains very slow, and sectoral growth patterns are unstable.** Real GDP growth strengthened from 0.8% (year-on-year) in 2017, to 2.0 percent in Q1 2018, but slowed to 1.5 percent in Q2. The oil sector – which pushed the country into recession in 2016 and lifted it back into growth in 2017 - contracted by 4.0 percent in Q2 2018. Usually-resilient agricultural growth slowed significantly to 1.2 percent in Q2, impacted by the insurgency in the North-East and farmer-herdsmen clashes in the Middle-Belt. The conflicts led to the destruction of assets, decreased food security, disrupted economic activity and by April 2018 internally displaced of 1.9 million persons.

**The current account surplus surpassed 4% of GDP in 2018 Q1-Q2, driven largely by a higher oil exports, as oil prices increased while production remained relatively stable.** Oil and gas exports account for about 90 percent of Nigeria's goods and service exports. Oil-imports, which contracted in late-2017 and caused fuel shortages across the country, recovered, as Nigeria National Petroleum Corporation (NNPC) rebuilt inventories (at the same time deducting significant unbudgeted subsidies for fuel imports). There are also widespread reports of fuel smuggling to neighboring countries. NNPC remains the sole fuel importer as pump prices remain capped and below market value. Non-oil imports remain subdued due to slow growth in private demand and central-bank-led import-substitution policies. The steady flow of current transfers (mainly diaspora remittances) also contributed to the positive current account balance. Levelling at US$ 48 billion at end-June, the external reserves started declining in July with the slowing, and then reversal of short-term capital inflows, as domestic yields declined, and emerging market volatility increased; as well as with the repayment of US$500 million maturing Eurobonds. Despite sustained efforts to improve the business environment, FDI inflows stagnated, likely reflecting low consumer demand and election-related uncertainty.

**A relatively tight monetary stance kept the exchange rates stable and helped control inflation, which reached a two-year low of 12.5 percent (yoy) in April.** The headline inflation declined further to 11.1 percent in July 2018. However, with declining inflation, the CBN began to cut back on its liquidity-draining operations from March 2018. In August, inflation increased slightly to 11.2 percent, on account of increasing food inflation. The recent ease in liquidity and partially-improving health of the banking sector did not however stimulate private sector lending, due to persistent risk aversion, stagnating consumer demand, and still high government security yields. The central bank maintained key exchange rates (particularly, the official and IEFX) stable through direct intervention and greater convergence was achieved between the interbank wholesale and retail rates on the one hand and the IEFX rate on the other hand. However, the still-existing divergence in rates remains distortionary, creating a complex scheme of implicit subsidies and distorting national accounting.

**Oil revenues are recovering with increasing oil prices, but distributions to the tiers of government are constrained by the unbudgeted fuel subsidy and other deductions.** The fuel subsidy, no longer an explicit first line deduction from oil revenues, mostly benefits the affluent and it is also widely-known that a portion of Nigeria's imported petrol is smuggled out to neighboring countries where petrol is more expensive. The constrained net oil revenues, combined with non-oil revenues that are constrained by limited tax policy reforms and are thus stagnated (relative to GDP), limit overall revenue realization, thus constraining budget execution and the build-up of fiscal buffers. The growth in the public debt stock between the first half of 2017 and the first half of 2018 was mainly attributable to the increased Eurobond issuances, some of which were used to liquidate costlier domestic short-term debt.

**Nigeria is in a pre-election period, and fiscal and inflationary pressures are increasing.** The agriculture sector outlook remains weakened due to ongoing conflicts, despite targeted government support (import restrictions and subsidized financing schemes). Oil production is projected to remain relatively stable, but below the government's ambitious targets. The growth in non-oil non-agriculture sector – the biggest share of the economy – will remain limited by a slow recovery in private demand, but with its momentum likely strengthening by the election-related public and private spending in the second half of 2018 and early 2019. Overall annual growth is expected to be around 1.9% in 2018, undermined by the slowdown in agriculture and oil sector growth, gradually rising in the medium-term with reduced political uncertainty and returning consumer confidence. The central bank is expected to closely control the level of liquidity in the economy to maintain the exchange rates stable. Inflation is expected to increase slightly towards end-2018, averaging about 13% over the year, declining slowly in the medium-term.

**The fiscal deficits will likely widen in 2018 due to increased pre-election spending and sustained revenue shortfalls.** The 2018 budget implementation is expected to be assertive, with a rush to complete projects before elections. Spending will normalize post-election, limited by a lack of revenue growth. Over-optimistic budget revenue targets, combined with delayed approval of external borrowing plan will likely increase the reliance (and the cost) on domestic borrowing. Public debt will rise steadily but remain relatively low (under 25% GDP). The current account balance is expected to remain positive, benefitting from a rising value of oil exports and limited growth of non-oil imports. The capital account faces significant uncertainty, as external portfolio investors may seek safety elsewhere during the upcoming elections, despite rising domestic security rates.

**The risks to the outlook are tilted to the downside and exacerbated by the upcoming elections.** Current monetary and external policy solutions remain fragile to external and domestic shocks. As oil remains a crucial driver for growth, any negative shocks to oil production or price could affect the fiscal revenues, external balance, and banking sector stability. Resulting exchange rate instability could translate into capital flight, which could further be amplified by any political uncertainty surrounding the election period.

**Given the clearly challenging economic backdrop, certain key policy reforms would be important to support macroeconomic resilience for Nigeria.** Amongst these are the following:

- Acceleration of the economic diversification agenda;
- Upholding of a stronger counter-cyclical fiscal policy stance to guard against oil price shocks;
- Reform of the petrol subsidy regime to improve the fiscal space;
- Improvements in the domestic revenue (particularly non-oil) mobilization drive to reduce volatilities in government revenues and expand fiscal space; and
- Unification of all exchange rates in the economy.

**The special focus topic for this report is on human capital development in Nigeria.** Studies show that between 10 and 30 percent of the differences in per capita income between countries can be attributed to human capital. The economic burden of malaria alone in Nigeria, accounting for direct and indirect costs excluding mortality, is estimated at 13.5 percent of GDP. However, in the quest for sustainable growth, Nigeria, like many other countries, has underinvested in human capital. While physical capital remains critical, it does not fully account for improvements in growth.

**Recognizing the importance of human capital outcomes for social and economic well-being of all countries,** the World Bank launched the Human Capital Project (HCP) in October 2018 to help countries improve their education, health and social protection systems to raise the next generation of well-equipped and healthy people. The Human Capital Index (HCI) is one of the key pillars of the HCP and it measures how human capital contributes to productivity. It captures three main indicators, namely: survival, education and health. Despite some progress against some of the indicators, Nigeria is lagging in all three components of the index, partly because it spends too little and inefficiently on human capital.

**The Government of Nigeria acknowledges that bold actions are required to address years of underinvestment in human capital.** To bring attention to the alarming human capital outcomes in Nigeria and prioritize financing for high-impact interventions, the Nigerian government has established a human capital working group. The working group is made up of key agencies of the government at the national and state level, the private sector, non-governmental actors, and development partners. On October 3, 2018 the steering committee of the human capital working group held its inaugural meeting. The meeting was chaired by the Vice President. Governors, Ministers of key sectors, the private sector, and development partners were in attendance.

**The meeting closed with a call for action.** The Government requested all stakeholders including community service organizations, the private sector, traditional leaders and development partners to partner with them; calling for action in the following areas required to unlock the potential of Nigeria's people:

- **National dialogue:** Foster a national dialogue to find country-led solutions to critical Human Capital challenges including demography, stunting, and education.

- **State-led solutions:** Empower States to identify and implement programs that will allow its citizens to access the health, education, and other services required to live productive lives; while also holding States accountable to deliver results at scale and provide program funding based on performance.

- **Commit to equity:** Enhance support to the poorest by disaggregating the human capital outcomes thematically and by state; improving the national and state level statistics to fill in data gaps; and identifying key drivers of the poor human capital outcomes. Thus, allowing for appropriate targeting and resource allocation.

- **Innovate:** Continue to use disruptive technologies to create jobs and improve efficiency and transparency in service delivery.
- **Whole society approach:** Non-state providers including the private sectors and community organizers to work closely with the Government to improve service delivery and enhance social accountability. The partnership to also include tribal leaders, imams and churches leaders for advocacy and support in critical challenge areas.

- **All lives matter/ the current human capital stock:** Support interventions that lift the young and old out of poverty enabling them to access social services and be empowered. Provide young people the vocational skills required to make a living and be productive

- **Financing:** Increase domestic non-oil revenues to meet the Human Capital spending needs will remain a government priority. This will include structural tax policy and administration measures, reallocations, as well as improved efficiency of existing programs.

# KEY DATA SNAPSHOT

| *Economy* | 2015 | 2016 | 2017 | 2018f | |
|---|---|---|---|---|---|
| **Real GDP Growth (% yoy)** | 2.7 | -1.6 | 0.8 | 1.9 | *The growth outlook is weakened by slowdown in agriculture* |
| Nominal GDP (US$ bn) | 487 | 405 | 376 | 408 | *The nominal GDP in US$ has not recovered to pre-crisis levels yet, partly because ER depreciation* |
| Oil Production (mb/d) | 2.1 | 1.8 | 1.9 | 2.0 | *Oil production stabilized but remains below government targets* |
| Oil Price (US$/bbl) | 54.2 | 45.2 | 54.8 | 73.5 | *Oil price has increased, the outlook is flat, but subject to shocks* |
| Inflation (%yoy, average) | 9.0 | 15.6 | 16.5 | 13.1 | *Inflation has declined but remains in double digits* |

| *Nominal GDP Composition (%):* | | | | | |
|---|---|---|---|---|---|
| Agriculture | 20.6 | 21.0 | 20.8 | 21.4 | *Agriculture constitutes about a fifth of GDP but employ over half of the population.* |
| Oil industry | 6.3 | 5.2 | 9.0 | 11.6 | *Oil sector is small, but key for forex and fiscal revenues.* |
| Non-oil industry | 13.9 | 12.9 | 13.3 | 13.5 | *Non-oil industries, while small, are expected to grow* |
| Services | 58.1 | 59.8 | 55.8 | 52.4 | *Services alone represent more than half of the economy.* |

| *Real sectoral growth (%, yoy)* | | | | | |
|---|---|---|---|---|---|
| Agriculture | 3.7 | 4.1 | 3.4 | 2.1 | *Agricultural growth slowed down due to persistent conflicts in the North East and the Middle-Belt* |
| Oil industry | -5.4 | -14.4 | 4.7 | 5.5 | *Oil industry is recovering with production, but the contribution to growth is small due to sector's small size.* |
| Non-oil industry | 0.1 | -5.0 | 0.6 | 2.1 | *No-oil industry growth is recovering, led by the cement industry.* |
| Services | 4.8 | -0.8 | -0.9 | 1.2 | *Service sector recovery is driven by ICT and transportation.* |

| *External Sector* | 2015 | 2016 | 2017 | 2018f | |
|---|---|---|---|---|---|
| Exchange rate - official (N/US$, average) | 196 | 253 | 306 | 306 | *The official exchange rate remains stable, but only applied to restricted transactions.* |
| Exchange rate - parallel (N/US$, average) | 223 | 381 | 397 | 363 | *The parallel exchange rate is expected to remain stable in the short-term, in line with IEFX window rate.* |
| Current Account Balance (US$ bn) | -15.4 | 2.7 | 10.4 | 21.7 | *The current account balance is improving with rising value of oil exports.* |
| Current Account Balance (%GDP) | -3.2 | 0.7 | 2.8 | 5.3 | |
| Exports of Goods and Services (US$ bn) | 49 | 38 | 51 | 70 | *Export growth is primarily driven by oil export value due to higher oil price.* |
| o/w oil and gas exports | 42 | 32 | 42 | 60 | |
| Imports of Goods and Services (US$ bn) | 72 | 47 | 51 | 59 | *The growth in imports are driven by increasing value of imported fuel.* |
| Remittances (net, US$ bn) | 19 | 19 | 22 | 22 | *Remittances strengthened with economic recovery.* |
| External Reserves (US$ bn, end of period) | 29 | 26 | 39 | n/a | *External reserves grew rapidly, with oil export receipts and investment inflows. Their growth has stalled and reversed in mid-2018.* |
| Equivalent months of imports of G&S | 4.8 | 6.6 | 9.1 | n/a | |

| ***Fiscal*** | **2015** | **2016** | **2017** | **2018f** | |
|---|---|---|---|---|---|
| ***Federation*** | | | | | |
| ***General Govt. Expenditures (WB)*** | **10.7** | **9.7** | **10.6** | **12.3** | *Public spending is recovering with slowly increasing oil revenues and pre-election spending* |
| ***General Govt. Revenues (WB)*** | **7.5** | **5.9** | **6.7** | **8.3** | |
| Net federally collected revenues (%GDP) | 5.6 | 4.2 | 4.9 | **6.5** | *Federally collected revenue growth is driven by oil and gas revenues, although they are growing slower than oil price due to increasing deductions (including the fuel subsidy).* |
| Oil and gas (%GDP) | 3.2 | 2.0 | 2.6 | 4.2 | |
| Non-oil (VAT, CIT, Customs) (%GDP) | 2.3 | 2.2 | 2.3 | 2.3 | *Non-oil federal revenue collection stagnates as share of GDP due to lack of tax policy reforms* |
| Total Public Debt (% GDP) | 14. | 17 | 19 | 21 | *Public debt is growing with continued deficits, but remain low by international standards* |
| ***Federal Govt. (FGN)*** | | | | | |
| Total FGN Expenditures (Actual, %GDP) | 5.0 | 4.7 | 5.6 | 6.0 | *FGN expenditures are growing with increasing recurrent spending.* |
| Total FGN Revenues (Actual, %GDP) | 2.7 | 2.0 | 2.4 | 3.0 | *The revenue growth is driven by oil revenues.* |
| FGN Debt (%GDP) | 10.8 | 13.1 | 14.7 | 16.4 | *The growth is FGN debt drives the growth in total public debt.* |
| FGN Debt (% FGN Revenues) | 395 | 654 | 622 | 541 | *FGN needs to increase revenue to ensure debt sustainability.* |
| FGN interest-payments-to-revenue ratio (%) | 39 | 61 | 57 | 47 | *FGN's interest-payments-to-revenue ratio remains high but is slowly decreasing with growing revenues.* |
| ***States Govt. (incl. FCT; excl. Local Govt.)*** | | | | | |
| States Expenditures (%GDP) | 4.0 | 3.6 | 3.3 | 4.2 | *States expenditures leveled off (and deficits decreased in 2017) but are expected to increase with rising revenues and election spending.* |
| States Total Revenue and Grants (%GDP) | 3.0 | 2.5 | 2.7 | 3.2 | |
| State IGR in Total States revenues (%) | 25 | 33 | 31 | 25 | *States IGR is growing, but slower than oil revenues.* |
| State Debt (%GDP) | 3.3 | 4.2 | 4.3 | 4.8 | *States' collective public debt is expected to grow with increasing deficits.* |
| States interest-payments-to-revenue ratio (%) | 6.4 | 9.8 | 9.9 | 8.6 | *States' interest-payments-to-revenue remain low and decreasing with growing revenues.* |

| ***Investment Climate*** | **2017** |
|---|---|
| *Doing Business 2018* ranking | 145 |
| *DB 2018* Distance to the frontier | 52.0 |
| Net credit to the government (%GDP) | 3.2 |
| Growth of net credit to the government (% yoy) | -25.3 |
| Net credit to the private sector (%GDP) | 19.6 |
| *compared to SSA average of* | *32* |
| Growth of net credit to the private sector (% yoy) | 1.4 |

| ***Banking industry*** | **H12016** | **H12017** |
|---|---|---|
| NPL to Gross loans | 10.7 | 15 |
| Capital Adequacy Ratio | 14.7 | 11.5 |
| Return on Assets (%) | 2.3 | 2.6 |
| Return on Equity (%) | 17.8 | 21.6 |
| Sectoral concentration of credit (%) | | |
| Oil and Gas | 28.83 | n.a |
| Manufacturing | 13.76 | n.a |
| General | 8.82 | n.a |
| Information and communications | 4.94 | n.a |
| Government | 8.53 | n.a |
| Others | 35.12 | n.a |

# CHAPTER 1:

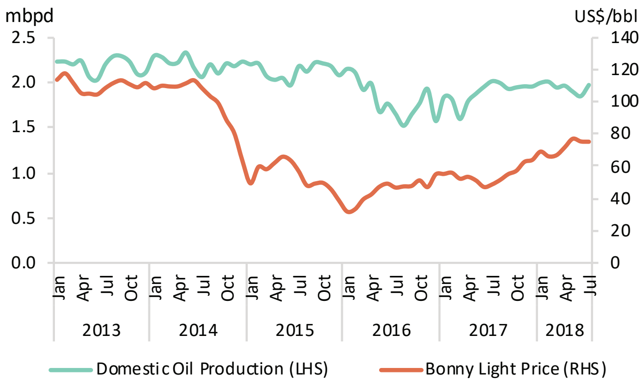
# Context

1. **The Nigerian economy remains dependent on oil, despite its diminishing contribution to growth.** In recent decades, oil and gas accounted for over 90 percent of Nigeria's exports and over 70 percent of general government revenues. This makes Nigeria's balance of payments and government budgets vulnerable to volatilities in oil prices. Growth and investment have been negatively impacted by repeated oil-price driven boom-bust cycles. While Nigeria still has substantial untapped oil reserves, their widespread exploitation would require significant new investments. The oil sector has exhibited slow—and at times, negative—growth in recent decades. Furthermore, current oil output potential in recent years has not been actualized due to insurgency in the oil-producing region of the country. Combined with the expansion of other sectors in Nigeria, this has steadily reduced the size of the oil sector to under 10 percent of GDP since 2015.

2. **The oil price shock of late 2014 and its aftermath pushed the economy into recession and precipitated a major budgetary crisis at the national and state levels.** The drop in the price of oil, combined with weakened output, had major spill-over effects on the non-oil sector, as the authorities did not allow the exchange rate to adjust in line with market pressures. They instead instituted a set of administrative restrictions on access to foreign exchange, particularly for imports, which, as subsequently acknowledged by the government itself, had a negative impact on economic growth, as many firms struggled to access foreign exchange to import necessary inputs for production. Thus, GDP growth decelerated from 6.3 percent in 2014 to -1.6 percent in 2016. The oil price and output shock also had a significant impact on national and sub-national finances resulting in the contraction of already low public expenditures and bringing to light the longer-term trend of weak domestic revenue mobilization (Nigeria's non-oil revenue-to-GDP is only around 5 percent). Overall, Nigeria's dependence on oil has led to volatile and low average growth, a weak non-oil tax system, and limited economic diversification.

**FIGURE 1.1:**

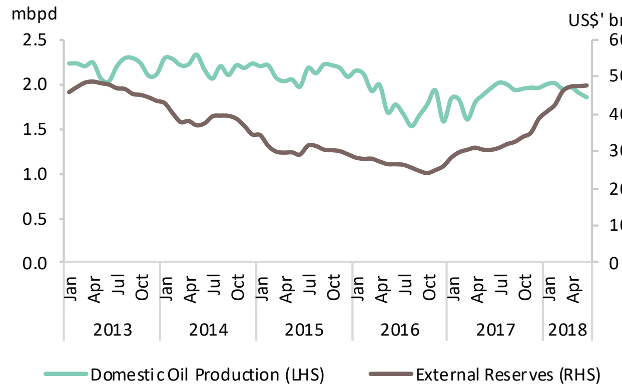
Volatility of Oil prices and Nigeria's Oil Output




*Source: NNPC*

**FIGURE 1.2:**

Nigeria's External Reserves have moved in tandem with Oil Prices




*Source: NNPC, CBN*

3. **Nigeria's weak revenue mobilization has major implications for its growth and development, including for improving its dire social service delivery outcomes.** Poverty remains high in Nigeria and access to basic social services is not universal. In 2016, the World Bank estimated poverty at 38.8 percent of the population using the national poverty line. But by the international poverty line of PPP-corrected $1.90 per capita per day, an estimated 49.2 percent of the population lived below poverty in 2017. With 9 million children out of school, Nigeria has the highest number of out-of-school children of primary school age in the world; with over 90 percent of them in the North. Vaccination coverage rates in Nigeria have changed little over the last 25 years, in sharp contrast to other West African countries which have made more rapid progress even though they started from higher levels. Nigeria will overtake India in 2021 as the country with the most under-five deaths in the world. More children die of malaria in Nigeria than in any other country in the world.

4. **Nigeria therefore needs to take concrete steps to break its oil dependency in order to improve its economic and social outcomes.** Diversifying the revenue and foreign exchange base beyond oil will require necessary investments (public and private) in infrastructure and an enabling business environment to support expanded private enterprise. It would however deliver a needed boost to currently-low revenues that could support the necessary expansion of social service delivery in Nigeria.

5. **As one of its three broad strategic objectives, the Nigeria Economic Recovery and Growth Plan (ERGP) 2017-2020 aims to restore growth by focusing on achieving macroeconomic stability and economic diversification.** It identifies agriculture, energy, manufacturing and services as key sectors to achieve economic diversification as well as job creation. The plan thus signals the government's own view that the country needs a new economic model that moves away from heavy dependence on oil. Very importantly, too, ERGP aims to tackle the obstacles hindering the competitiveness of Nigeria's private sector, notably infrastructure facilities and the business environment. A first wave of ERGP focus labs were set up by the federal government in March 2018 as closed-door investment platforms to identify and accelerate key strategic and high-impact priority projects with significant potential impact on GDP growth through investments and job creation. The initial labs focused on agriculture and transportation, manufacturing and processing, power and gas. These labs helped identify 164 priority projects with an investment requirement of US$22.5 billion. Concerted effort to unlock the private capital necessary to catalyze public sector action for achieving ERGP's objectives can therefore not be over-emphasized at this time.

2

CHAPTER 2:

# Recent Economic Developments

*The Nigerian economy emerged from recession, but the recovery remains slow and fragile. Higher oil prices and stable output in the first half of 2018 contributed to a stronger fiscal and external position. Foreign capital inflows which began to strengthen in 2017 have slowed in 2018. The federal government continues to rebalance its debt portfolio towards external borrowing. Commercial banks remain risk-averse and credit to the private sector remains weak.*

## 2.1 The Nigerian economy continues to emerge from recession, but sectoral growth patterns are unstable

6. **Nigeria's recovery from recession has been slow. Its initial return to positive growth in Q2 2017 was helped mainly by the recovery of the oil sector and continued resilient growth in agriculture.** However, in the second quarter of 2018, oil output growth slowed in nominal terms (and contracted in real terms) as base year effects wore off and the sector suffered a series of production downtimes during the period. Furthermore, new investments in upstream oil and gas have been limited. Agricultural growth also weakened significantly due to the accumulated impact of conflict, mostly in the northern parts of the country where a substantial proportion of crop production takes place. Whereas the non-oil, non-agriculture sub-sectors (over a half of the economy) contracted in 2017, these sub-sectors contributed to keeping growth afloat in Q2. Overall real GDP growth averaged 1.7 percent in the first half of 2018.

7. **Nigeria's growth began to lag behind the growth in comparator[1] countries in 2015 when oil price and production shocks hit the country.** Prior to 2015, real GDP growth in Nigeria compared favorably with growth in peer countries and was even significantly higher than growth in structural

1. Three sets of comparator country groups are used to benchmark Nigeria's economic outcomes: i) structural, ii) aspirational and iii) regional peers.
   i) **Structural peers** include countries that resemble Nigeria in the key economic structure and performance indicators: these are lower middle income countries with nominal lower-middle countries with nominal income per capita of at least 50% that of Nigeria's, and/or upper-middle income countries with nominal income per capita less than double that of Nigeria's; with natural resource share in total exports of 20% or more (Indonesia, Algeria, Egypt, India, and Iran) and large populations.
   ii) **Aspirational peers** are countries that Nigeria can potentially improve to match its economic performance: upper-middle income countries with nominal income per capita at least double that of Nigeria's; with natural resource share in total exports of 20% or more, and population of over 30 million (Brazil, Russian Federation, Mexico, Malaysia, Colombia, Peru and South Africa).
   ii) Regional comparators are geographically close countries that exhibit similar economic characteristics (Tanzania, Uganda, Ethiopia, Kenya, Senegal, Cameroon, Cote D'Ivoire, Ghana and Angola).

and aspirational countries. Between 2013 and 2014, growth in Nigeria averaged 6 percent, but fell to 2.7 percent in 2015 and -1.6 percent in 2016. Even with the recovery in 2017, Nigeria's growth is yet to meet up with its peers (Figure 2.3).

8. **The agricultural sector's real growth rate of 1.2 percent in Q2 2018 was the lowest in recent history.** The impact of direct government interventions in the sector could not robustly counteract the effects of conflicts which have led to the destruction of agricultural farmlands, insecurity, disrupted economic activity, decreased food security; and by April 2018, 1.9 million internally displaced persons. Overall, in the first half of 2018, agriculture grew by 2.1 percent in real terms, also the lowest half-year growth rate in recent history (see Table 2.1).

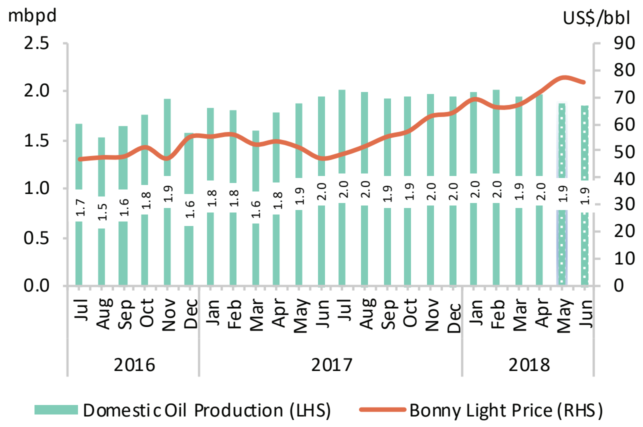
9. **The oil sector contracted by 4.0 percent in Q2 2018 after growing robustly from Q2 2017 up till Q1 2018.** The 2017 recovery in the oil sector benefited from the price recovery, restoration of relative calm in the oil-producing Niger Delta region as well as the government's efforts to clear joint venture (JV) payment arrears and improve payments to joint venture partners in 2017[2]. However, with various force majeure episodes declared by oil companies during the first half of the year, output has not increased as envisaged by the government (Medium Term Fiscal Framework and Federal Government Budget 2018 projected 2.3 mb/d for 2018) but has remained relatively stable in 2018 at an estimated average of 2.0 mb/d up to June 2018. Moreover, there have been limited new investments in the sector (as important legislations capable of unlocking new investments continue to stall).[3] Thus, despite the strengthening of oil prices (the price of Nigerian crude, Bonny Light, increased to an average of US$71.3 per barrel, compared to US$52.8 in H1 2017), the sector fell back into contraction in Q2. Overall, in the first half of the year, the oil sector grew by 5.0 percent in real terms (see Table 2.1).

2. Joint Venture cash call payments refer to payments made by the Nigerian National Petroleum Company (NNPC) to International Oil Companies (IOCs) with which it operates in joint venture as its contribution to the costs associated with upstream oil operations.

3. A comprehensive Petroleum Industry Bill (PIB) was first drafted in about 2008 and underwent several years of legislative deliberations. It was subsequently broken up into four component bills to enable potentially easier legislative processing. The first of the four - the Petroleum Industry Governance Bill (PIGB) - has been approved by both chambers of Nigeria's National Assembly and harmonized in March 2018 but remains to be assented by the President. The other component bills are on the fiscal regime, downstream oil and gas administration, and petroleum host community development. These are yet to be approved. The current version of the PIGB envisages restructuring NNPC and the Ministry of Petroleum Resources with the stated purpose of promoting transparency and accountability in the petroleum industry. While indeed it could move the Nigerian petroleum industry a step forward on the path to greater transparency and efficiency, the fiscal and petroleum host community development bills can have more significant effects on future investments in the sector.

**FIGURE 2.1:**

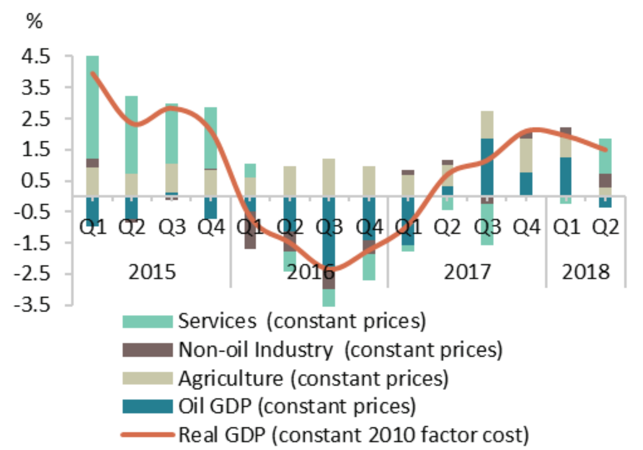
Oil Price Increased, and Production Remained Stable in H1 2018.




***Source: NNPC***

**FIGURE 2.2:**

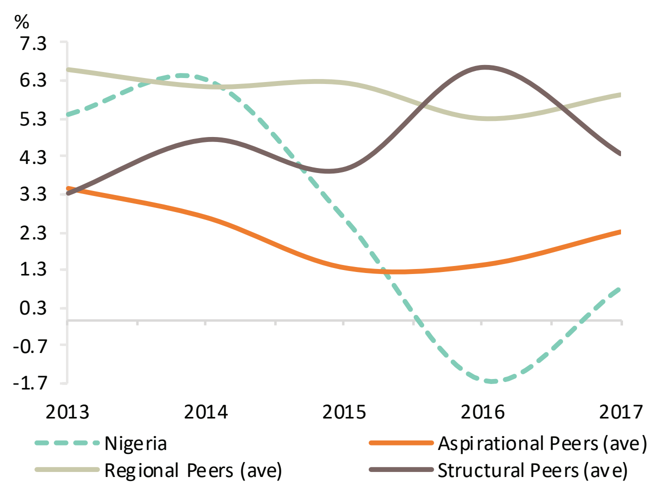
Services and Non-Oil Industry Contributed the Most to GDP Growth in Q2 2018




***Source: NBS***

**FIGURE 2.3:**

Real GDP Growth in Nigeria lags Growth in all Peer Countries Since 2016




***Source: World Development Indicators***

**10. The non-oil economy, in aggregate, grew at a faster rate of 2.0 percent in Q2 2018, as non-oil industry and services' growth strengthened.** Whereas, manufacturing growth slowed significantly to 0.7 percent, compared to 3.4 percent in Q1, the construction sub-sector picked up significantly, growing by 7.7 percent after a contraction of 1.5 percent in Q1. This was likely due to the increase in road and rail construction across the country. Following prolonged weakness of the services sub-sector, growth picked up to 2.1 percent in 2018 Q2, mainly due to significant pick-up in information and communications technology (ICT); other service sub-sectors remained in decline. The growth in internet data consumption may be responsible for the growth in ICT. Despite the strengthening of overall non-oil sector growth in Q2, there have been no discernable growth trends or patterns within the sector, post-recession, and it remains very weak relative to pre-recession. The key goal of the federal government's Economic Recovery and Growth Plan (ERGP) is to drive economic growth, diversification and job-creation with a special focus on the real sectors of agriculture, manufacturing (including MSME-led manufacturing), and energy; as well as key services. The central bank has further expanded its development finance interventions to increase the flow of credit to the real sector, as commercial bank credit to the private sector remains muted, despite looser liquidity conditions since March 2018 (see Section 1.3 for more detail). However, the impact of previous similar initiatives is not fully discernable.

11. **While expenditure side GDP data for H1 2018 are yet to be released, it is deducible that aggregate demand remained weak in the period.** This is because real incomes continued to dwindle in light of still high inflation and high unemployment (unemployment data available only up to Q3 2017). Furthermore, the CBN consumer expectations survey reports for Q1 and Q2 2018 showed that consumers' overall confidence in the economy worsened in both quarters, as more consumers were less optimistic in their outlook.[4] Consumers generally indicated that their economic conditions were worse due to deteriorating economic conditions and family financial situation. The overall 'buying index' was low, indicating that consumers did not reckon that both quarters in review were good periods to purchase major consumption or investment goods.

**TABLE 2.1:** Real GDP Growth by Sector and Selected Sub-Sectors (percent, year-on-year)

| ACTIVITY SECTOR | ANNUAL | | | QUARTERLY | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 | Q1 2018 | Q2 2018 |
| Total GDP (2010 market prices) | 2.7 | -1.6 | 0.8 | -1.0 | 0.8 | 1.2 | 2.1 | 2.0 | 1.5 |
| Total GDP (2010 basic prices) | 2.8 | -1.6 | 0.8 | -0.9 | 0.7 | 1.2 | 2.1 | 2.0 | 1.5 |
| **Agriculture** | 3.7 | 4.1 | 3.4 | 3.4 | 3.0 | 3.1 | 4.2 | 3.0 | 1.2 |
| **Industry** | -2.2 | -8.9 | 2.1 | -5.8 | 2.2 | 7.7 | 4.9 | 6.9 | 0.4 |
| Oil and Gas | -5.4 | -14.4 | 4.7 | -15.6 | 3.5 | 23.0 | 11.2 | 14.8 | -4.0 |
| Manufacturing | -1.5 | -4.3 | -0.2 | 1.4 | 0.6 | -2.9 | 0.1 | 3.4 | 0.7 |
| Construction | 4.4 | -5.9 | 1.0 | 0.1 | 0.1 | -0.5 | 4.1 | -1.5 | 7.7 |
| **Services** | 4.8 | -0.8 | -0.9 | -0.4 | -0.8 | -2.7 | 0.1 | -0.5 | 2.1 |
| Trade (wholesale and retail) | 5.1 | -0.2 | -1.1 | -3.1 | -1.6 | -1.7 | 2.1 | -2.6 | -2.1 |
| ICT | 6.2 | 2.0 | -1.0 | 2.7 | -1.2 | -4.5 | -1.5 | 1.6 | 11.8 |
| Finance and Insurance | 7.1 | -4.5 | 1.3 | 0.7 | 10.5 | -6.0 | 0.2 | 13.3 | 1.3 |
| Real Estate | 2.1 | -6.9 | -4.3 | -3.1 | -3.5 | -4.1 | -5.9 | -9.4 | -3.9 |
| Public Administration | -12.3 | -4.6 | -0.4 | -2.1 | 1.6 | -0.7 | -0.5 | -1.7 | -5.2 |
| **Oil GDP** | -5.4 | -14.4 | 4.7 | -15.6 | 3.5 | 23.0 | 11.2 | 14.8 | -4.0 |
| **Non-Oil GDP** | 3.7 | -0.2 | 0.5 | 0.7 | 0.4 | -0.8 | 1.5 | 0.8 | 2.0 |
| **Non-oil industry** | 0.1 | -5.0 | 0.6 | 1.1 | 1.3 | -1.8 | 1.7 | 2.2 | 3.1 |
| **Non-Oil, Non-Agriculture** | 3.8 | -1.7 | -0.6 | -0.1 | -0.4 | -2.5 | 0.4 | 0.1 | 2.3 |

***Source: NBS***

4. The CBN overall consumer confidence index is computed as the average of the three indices, namely: economic conditions, family financial situation and family income.

**TABLE 2.2:** Sector and Selected Sub-Sector Shares in Nigeria's real GDP (percent)

| ACTIVITY SECTOR | ANNUAL | | | QUARTERLY | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2015 | 2016 | 2017 | Q1 2017 | Q2 2017 | Q3 2017 | Q4 2017 | Q1 2018 | Q2 2018 |
| Total GDP (2010 basic prices) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| **Agriculture** | 23.1 | 24.4 | 25.1 | 21.4 | 22.9 | 29.2 | 26.1 | 21.7 | 22.9 |
| **Industry** | 23.7 | 22.0 | 22.2 | 22.9 | 23.4 | 22.4 | 20.5 | 24.0 | 23.2 |
| Oil and Gas | 9.6 | 8.3 | 8.7 | 8.5 | 9.0 | 9.8 | 7.3 | 9.6 | 8.6 |
| Manufacturing | 9.5 | 9.3 | 9.2 | 9.8 | 9.4 | 8.8 | 8.9 | 9.9 | 9.3 |
| Construction | 3.9 | 3.7 | 3.7 | 4.2 | 4.3 | 3.0 | 3.5 | 4.0 | 4.5 |
| **Services** | 53.2 | 53.6 | 52.7 | 55.7 | 53.6 | 48.4 | 53.3 | 54.3 | 54.0 |
| Trade (wholesale and retail) | 16.9 | 17.2 | 16.9 | 17.8 | 17.1 | 15.9 | 16.7 | 17.1 | 16.5 |
| ICT | 11.2 | 11.6 | 11.4 | 12.5 | 12.4 | 9.6 | 11.2 | 12.4 | 13.6 |
| Finance and Insurance | 3.1 | 3.0 | 3.0 | 3.2 | 3.3 | 2.7 | 2.8 | 3.5 | 3.3 |
| Real Estate | 7.6 | 7.2 | 6.9 | 6.3 | 7.2 | 6.8 | 7.0 | 5.6 | 6.8 |
| Public Administration | 2.4 | 2.3 | 2.3 | 2.3 | 2.5 | 2.1 | 2.3 | 2.2 | 2.3 |
| **Oil GDP** | 9.6 | 8.3 | 8.7 | 8.5 | 9.0 | 9.8 | 7.3 | 9.6 | 8.6 |
| **Non-Oil GDP** | 90.4 | 91.7 | 91.3 | 91.5 | 91.0 | 90.2 | 92.7 | 90.4 | 91.4 |
| **Non-oil industry** | 14.1 | 13.6 | 13.6 | 14.4 | 14.4 | 12.5 | 13.2 | 14.4 | 14.6 |
| **Non-Oil, Non-Agriculture** | 67.3 | 67.2 | 66.2 | 70.0 | 68.0 | 60.9 | 66.5 | 68.7 | 68.6 |

***Source: NBS***

## 2.2 Higher Oil Prices and Stable Output as well as Portfolio Inflows Have Boosted Nigeria's External Position in 2018

12. **The current account surplus increased to 4.8 percent of GDP in the first half of 2018, from 2.7 percent in the first half of 2017.** This was driven mainly by higher oil prices, as production remained relatively stable. Oil and gas exports account for about 90 percent of Nigeria's Goods and Services' exports. The services and income components of the current account remained negative while current transfers (mainly diaspora remittances) remained stable, even strengthening slightly, at US$12.7 billion in H1 2018. Without the steady current transfers, the current account balance would be negative.

13. **Nigeria's current account balance(CAB) in recent years has compared more favorably with the CAB of peer countries** (Figure 2.5). The CAB of each of Nigeria's peers was negative in the period 2013 – 2017, whereas Nigeria's Current Account went into deficit only in 2015 at the height of its oil price and production shock. Nigeria's CAB returned to positive territory in 2016 and has been improving since.

14. **Short-term capital inflows strengthened significantly in H1 2018, relative to H1 2017, resulting in a stronger financial account balance.** The institution of the convertible Investors and Exporters' Foreign Exchange window (IEFX) in April 2017 engendered stronger investors' confidence and contributed to a restoration of short-term capital flows into the country. This was in addition to the high yields on domestic debt instruments (treasury bills, CBN liquidity management bills, and FGN bonds) which significantly boosted foreign portfolio inflows (FPI). Net FPI in H1 2018 (at 4.8 percent of GDP) was over 500 percent higher than in H1 2017. However, in Q2 2018, there was a slowing and then declining of FPI inflows as domestic yields declined, and emerging market volatility increased. The strengthening of the United States Dollar due to the tapering of the quantitative easing policy also contributed to the change in investors' stance towards emerging market economies like Nigeria. Foreign direct investment (FDI) inflows on the other hand, remained low in H1 2018 (at 0.3 percent of GDP) and even declined relative to H1 2017, despite government's sustained efforts to improve the business environment and attract long term investments.[5] This was likely due to long-term policy and regulatory uncertainties, including uncertainties related to upcoming general elections.

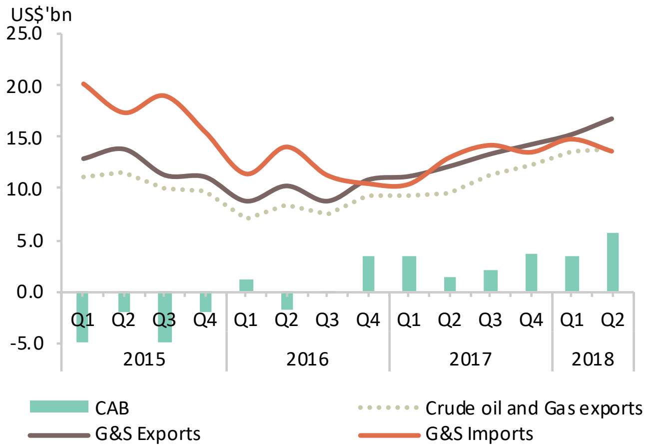
15. **The external reserves spiked to a new high of US$46.3 billion at the end of March but subsequently grew only gradually to US$47.8 billion at the end of the June 2018.** The reserves declined to US$47.1 billion in July and US$45.8 billion in August (representing about nine months of import coverage). The sharp growth in reserves in March was supported not only by the increasing oil exports, improvements in portfolio inflows (linked to the stability in the IEFX window rate), and diaspora remittances; but also, proceeds from the successful US$2.5 billion Eurobonds issued in February provided a further boost. The slowing of reserves accretion from April was due to the change in investor stance and consequent deceleration of portfolio inflows; and the decline in July was additionally due to the repayment of US$500 million maturing Eurobonds (five-year bonds issued in 2013). Investor sell-offs continued to exacerbate the pressure on reserves in August.

16. **The Central Bank of Nigeria (CBN) continues to intervene in the different foreign exchange windows to adjust foreign exchange liquidity and keep the rates stable.** The official rate (mostly for government operations and the oil sector) stayed in the range of N305-N307/US$, the interbank (wholesale and retail) intervention rate achieved greater convergence with most other rates as it has depreciated to the range of N340 – N345/US$ (although some banks were able to access limited quantities of foreign exchange at the interbank at the CBN official rate); the invisibles and SME rates remained at N360/US$. The CBN also began to intervene more assertively in the IEFX window, to keep the rate stable in the region of N360/US$. In April, the CBN executed a bilateral currency swap deal with the People's Bank of China (PBoC) to the tune of Renminbi 16 billion (US$2.5 billion), making the Renminbi directly available to Nigerian importers and investors for imports from, and investments in China.

5. The Government executed three 60-day National Action Plans with a series of specific actions and result targets for improving the business environment.

**FIGURE 2.4:**

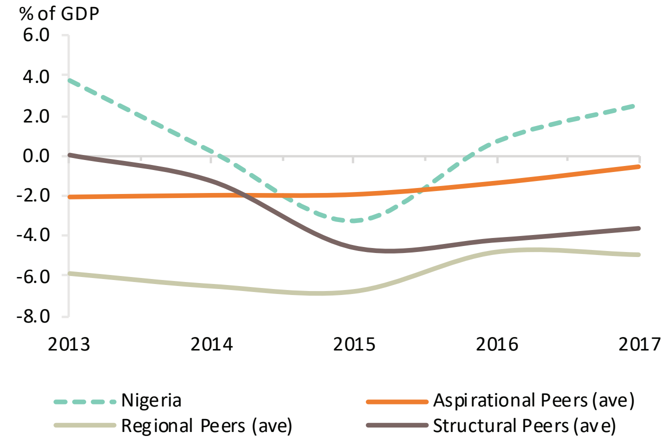
The Current Account Balance Improved, as Oil Exports Improved




*Source: CBN. 2018 Q2 data preliminary*

**FIGURE 2.5:**

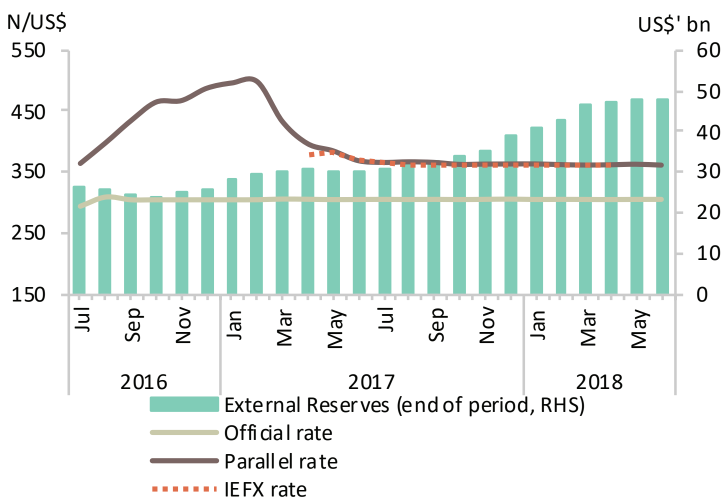
Nigeria's Current Account Balance Generally Compares more favorably with Peer Countries




*Source: World Development Indicators*

**FIGURE 2.6:**

External Reserves Increased up to June; IEFX, BDC Rates Convergence was Sustained




*Source: CBN, Aboki FX*

**TABLE 2.3:** Real GDP Growth by Sector and Selected Sub-Sectors (percent, year-on-year)

| ACTIVITY SECTOR | ANNUAL | | | QUARTERLY | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2015** | **2016** | **2017** | **Q1 2017** | **Q2 2017** | **Q3 2017** | **Q4 2017** | **Q1 2018** | **Q2 2018** |
| **CURRENT ACCOUNT BALANCE** | -15.4 | 2.7 | 10.4 | 3.4 | 1.4 | 2.0 | 3.7 | 3.5 | 5.7 |
| Trade Balance | -6.4 | -0.5 | 13.1 | 2.3 | 2.0 | 3.4 | 5.5 | 5.9 | 8.4 |
| Exports (fob) | 45.9 | 34.7 | 45.8 | 10.0 | 10.8 | 12.0 | 13.1 | 14.5 | 15.6 |
| o/w Crude Oil and Gas | 42.4 | 32.0 | 42.3 | 9.3 | 9.6 | 11.3 | 12.2 | 13.5 | 13.8 |
| Imports (fob) | -52.3 | -35.2 | -32.7 | -7.7 | -8.8 | -8.6 | -7.6 | -8.6 | -7.3 |
| o/w Oil and Gas | -8.5 | -9.0 | -8.2 | -2.4 | -2.2 | -2.2 | -1.3 | -2.5 | -1.2 |
| Services(net) | -16.5 | -8.0 | -13.2 | -1.5 | -2.8 | -4.3 | -4.7 | -5.4 | -5.2 |
| Income(net) | -12.7 | -8.6 | -11.5 | -2.3 | -3.3 | -3.0 | -3.0 | -3.2 | -3.8 |
| Current transfers(net) | 20.2 | 19.9 | 22.0 | 4.9 | 5.4 | 5.8 | 5.9 | 6.3 | 6.4 |
| **FINANCIAL ACCOUNT BALANCE** | -6.7 | 0.7 | 7.9 | 3.3 | 3.2 | -1.0 | 2.3 | 8.2 | 2.3 |
| Net Direct Investment | 1.6 | 3.1 | 2.2 | 0.5 | 0.6 | 0.5 | 0.6 | 0.5 | 0.1 |
| Outflows | -1.4 | -1.3 | -1.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.4 |
| Inflows | 3.1 | 4.4 | 3.5 | 0.9 | 0.9 | 0.8 | 1.0 | 0.8 | 0.4 |
| Net Portfolio Investment | 0.9 | 1.7 | 8.5 | 0.4 | 1.0 | 3.3 | 3.8 | 5.1 | 4.2 |
| Outflows | -1.7 | -0.2 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Inflows | 2.5 | 1.9 | 8.5 | 0.4 | 1.0 | 3.3 | 3.8 | 5.1 | 4.2 |
| Net Other Investment | -9.2 | -4.2 | -2.8 | 2.4 | 1.7 | -4.7 | -2.1 | 2.6 | -2.0 |
| Outflows | -10.3 | -3.1 | -8.7 | -0.7 | -0.3 | -5.6 | -2.1 | -6.4 | -4.5 |
| Inflows | 1.0 | -1.1 | 5.9 | 3.1 | 2.0 | 0.8 | 0.0 | 9.0 | 2.4 |
| **CHANGE IN RESERVES** (positive sign indicates reserve spending, i.e. reduction in reserves) | 5.9 | 1.0 | -12.2 | -3.0 | -0.3 | -2.8 | -6.2 | -7.3 | -0.5 |
| **NET ERRORS AND OMISSIONS** | 16.3 | -4.4 | -6.1 | -3.8 | -4.3 | 1.8 | 0.2 | -4.4 | -7.5 |

***Source: CBN. Note that 2018 Q2 figures are provisional***

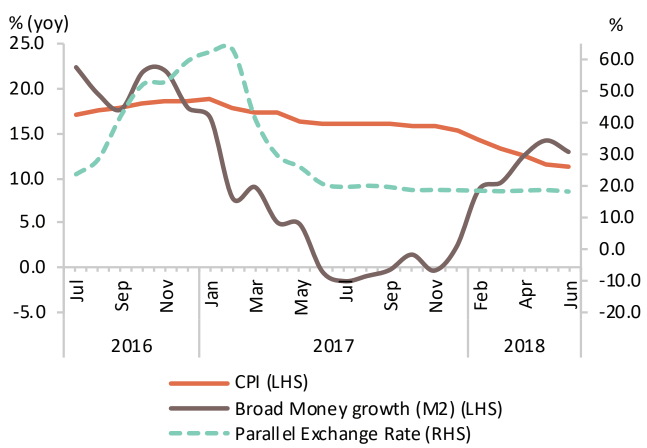
## 2.3 Monetary Policy Became Less Tight, But Private Sector Credit Remained Weak

17. **Following significant monetary tightening in 2017, the Central Bank began to loosen its stance in early 2018.** The relatively tight monetary stance in 2017 and into 2018 helped control inflation, which reached a two-year low in April. However, with persistently declining inflation, the CBN began to cut back on its liquidity-draining operations from March 2018. Broad money growth thus increased from 2.3 percent at end-December 2017 to 12.9 percent (yoy) at end-June 2018 and money market rates began to decline. One to six-month Nigeria Interbank Offer Rates (NBOR) declined from a range of 15.1 – 18.4 percent at end-March to 13.2 – 15.6 percent at end-July. Treasury bill (T-bill) rates and Nigeria government bond yields also declined in similar vein. The lower T-bill and bond rates have contributed in part to the weaker investor sentiment in the fixed income market. The CBN has however kept its policy rates unchanged - monetary policy rate at 14 percent since July 2016; cash reserve requirement at 22.5 percent and liquidity ratio at 30 percent since March 2016 - but continues to target liquidity through its open market operations (OMO).

18. **Year-on-year inflation continuously declined since early 2017 in response to monetary tightening and exchange rate stability.** Base year effects from the major electricity and fuel price increases of 2016 also contributed to the slowing of inflation in 2017. The headline inflation declined continuously from 18.7 percent in January 2017 to 11.1 percent in July 2018. The core and food components of inflation on a year-on-year basis have also declined in 2018. However, in August, inflation increased slightly to 11.2 percent, on account of increasing food inflation. The month-on-month headline measure however slowed marginally in August after accelerating in previous months.

**FIGURE 2.7:**

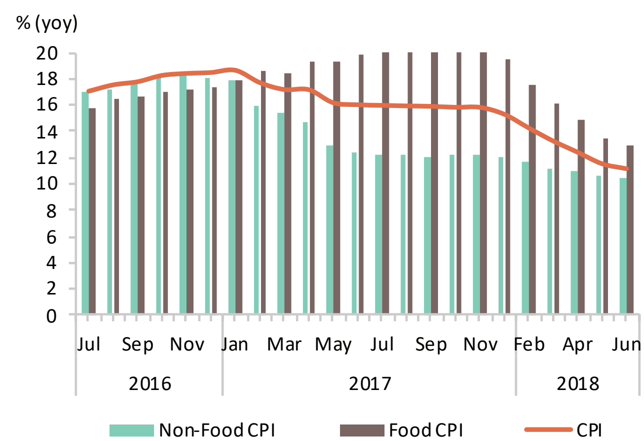
Broad Money Has Grown Faster




*Source: CBN, NBS, Aboki FX*

**FIGURE 2.8:**

Year-on-Year Inflation Continued to Decline




*Source: NBS*

**19. The recent ease in liquidity has not stimulated private sector lending, due to continued risk aversion on the part of banks, as well as stagnating consumer demand.** Despite the expansion in the money supply in recent months and declining yields on government securities, credit to the private sector remains weak; declining by 1.4 percent in June (y-o-y), similar to its levels at the start of the year. For this reason, the CBN at its July Monetary Policy Committee meeting instituted a Real Sector Support Facility (RSSF) to increase the flow of credit to the real sector of the economy. Under this facility, banks wishing to provide credit to employment-intensive sectors of agriculture and manufacturing can apply for release of funds from their Cash Reserve Requirement (CRR) deposits with the CBN for this purpose. The loans are to be in form of long term (minimum tenor of seven (7) years and two (2) years moratorium) bank credits at 9 per cent rate of interest. This is not the first initiative of its kind geared towards stimulating real sector lending, and it is uncertain that the RSSF would unlock credit to the real sector. Indeed, risk aversion rather than liquidity seems to be the main constraint for lending to the real sector.

**20. Banking sector performance has partially improved, but vulnerabilities persist.** Helped by rising oil prices, and a recovering economy, the level of non-performing loans (NPLs) as a percentage of total loans — mostly loans in the oil, gas and power sectors - declined from 15 percent in June 2017 to 11 percent in April 2018. The aggregate capital adequacy ratio (CAR) has however fallen further from 11.5 percent in June 2017 to 10.2 percent in December 2017.

**TABLE 2.4:** Monetary and Financial Indicators

| | H1 2017 | H1 2018 |
|---|---|---|
| **Monetary & Financial Sector Indicators (% change, end of period)** | **YoY** | **YoY** |
| Broad Money | -0.4 | 12.9 |
| Narrow Money | 7.1 | 5 |
| Net Foreign Assets | 19.2 | 116.5 |
| Net Domestic Credit | 10.6 | -6.1 |
| o/w to the Federal Government (Net) | 65.6 | -37.4 |
| o/w to the Private Sector (Net) | 1.8 | -1.4 |
| | **H2 2017** | **H1 2018** |
| Monetary Policy Rate (absolute rate, end of period) | 14 | 14 |
| Liquidity Ratio (absolute rate, end of period) | 30 | 30 |
| Cash Reserve Requirement (absolute rate, end of period) | 22.5 | 22.5 |
| **Exchange Rates (end of period)** | | |
| Exchange rate (LCU/$US) | 306.3 | 305.9 |
| Real effective exchange rate index (Nov 2009=100) | 84.4 | 77.2 |
| **Financial Market Indicators (end of period)** | | |
| Stock Market (NSE) Index | 38,243 | 38,279 |
| Fitch Sovereign Long Term Foreign Debt Rating | B+ | B+ |
| Moody's Sovereign Long Term Foreign Debt Rating | B2 | B2 |
| S&P Sovereign Long Term Foreign Debt Rating | B | B |

***Sources: Central Bank of Nigeria, Securities & Exchange Commission, Fitch, Moody's, S&P.***

## 2.4 Oil Revenues Have Picked Up, but So have Deductions; Undermining Net Revenue Distributions

21. **Federally-collected revenues were higher in the first half of 2018 than in the corresponding period of 2017.**[6] Both the oil and non-oil revenue components surpassed their levels in H1 2017 in nominal terms. The increase in net oil and gas revenue collections were particularly significant at 140 percent, mainly on account of higher oil prices in 2018, relative to 2017 (average of US$71.3 per barrel, compared to US$52.8 in H1 2017). In percent of GDP, the net oil revenues were also higher. All the non-oil revenue components (corporate taxes, customs revenues and VAT) increased nominally relative to 2017 (corporate taxes the most) but remained flat relative to GDP. The oil and non-oil revenues were however lower than the government's targets. While the oil price was higher than the budgeted price (US$71.3 compared to the conservative oil benchmark price of US$51 per barrel), oil output came in lower than the target (an estimated actual production of 2.0 mb/d, compared to 2.3 mb/d budgeted). Furthermore, deductions from gross oil revenues were higher than planned. The various prior deductions by the NNPC from oil sales (including 'cost under-recovery' for unbudgeted petrol subsidies) contributed to net oil revenues in H1 being 34 percent below budget.[7] The state governments continued to challenge the NNPC deductions and the Federation Account Allocation Committee (FAAC) meeting in the month of June 2018 was deadlocked and revenue-sharing across the three tiers of government was delayed. The plan by the federal ministry of finance to raise as much as US$100 billion through a voluntary assets and income declaration scheme (tax amnesty) that opened in July 2017 and closed in June 2018 was less successful than expected as only 8 percent of this target was realized in cash by the cut-off date.

22. **Available data indicate that NNPC deductions from crude oil sales revenue for petrol subsidies in the first three months of 2018 exceeded the deductions for the whole of 2017**.[8] The deductions for 2017 totaled N107.3 billion, while for January to March 2018 alone they totaled N139.3 billion. Landing and transportation costs for imported petrol continue to be higher than the capped domestic pump price, giving rise to 'cost under-recoveries' by the NNPC. Independent oil marketers have stopped importing petrol since 2016 for this reason. The volume of petrol imported by NNPC in 2018 has been higher than in any other year. During the first three months of 2018, NNPC imported more than half of what it had imported in the whole of 2016. The need to shore up fuel inventories may have contributed to this, but there have also been widely reported cases of fuel smuggling to neighboring countries where pump prices are higher than the subsidized price in Nigeria.

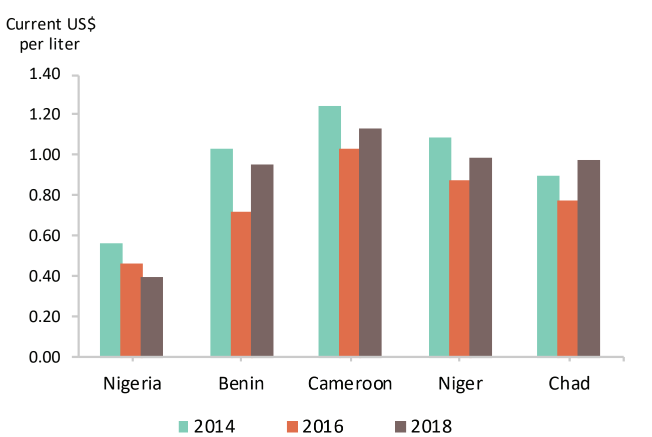
6. This refers to the net measure of federation and VAT accounts revenues (i.e. revenues net of revenue-collection agencies' costs of collection, cost recoveries on oil and gas sales (including petrol subsidy deductions), government's contribution to cost of oil production and costs of other federally-funded upstream projects). It is the net revenue that is distributed to the three tiers of government, in line with the existing revenue -sharing formulae.
7. Other NNPC deductions include those for: crude losses, product losses, pipeline management and repairs. Joint venture cash call transfers are also deducted before remittance to the federation account.
8. NNPC Financial and Operational Reports are available only up till March 2018.

**23. The government indicated, since 2017, that it will introduce a new funding mechanism for the joint venture cash call payments (JVCC), allowing for cost recovery by the international oil companies (IOCs).** However, cash call transfers still continue to be made by NNPC from gross oil sales revenue, despite the JVCC not being budgeted for. The government also indicated through its 2018 budget plans to restructure its ownership (equity) in joint venture oil assets to reduce the joint venture costs to the Nigerian government. It is not clear how much progress has been made on this front.

**24. Net accrual to the Excess Crude Account (ECA) in H1 2018 was negative.** This was despite the fact that actual oil prices were higher than the budget oil price benchmark (i.e. the assumed oil price used to prepare the federation revenue framework) of US$51 per barrel. The ECA was established on the basis of Section 35 of the federal Fiscal Responsibility Law which stipulates a commodity (oil) price-based fiscal rule requiring that savings should accrue to the ECA if the price exceeds the budget benchmark.[9] However in recent past, accruals have not been realized because in practice, compensations are made for oil output shortfalls. Furthermore, the NNPC deductions are charged first to oil revenues before considerations for the ECA. In H1 2018, there was also a US$496 million withdrawal from the ECA for the purchase of fighter aircrafts for anti-terrorism operations. Thus, apart from a US$80.6 million that accrued to the account in May, there were no other accruals (besides investment income) and the account which opened at US$2.2 billion in January 2018, had a balance of US$1.9 billion at the end of June.

**FIGURE 2.9:**

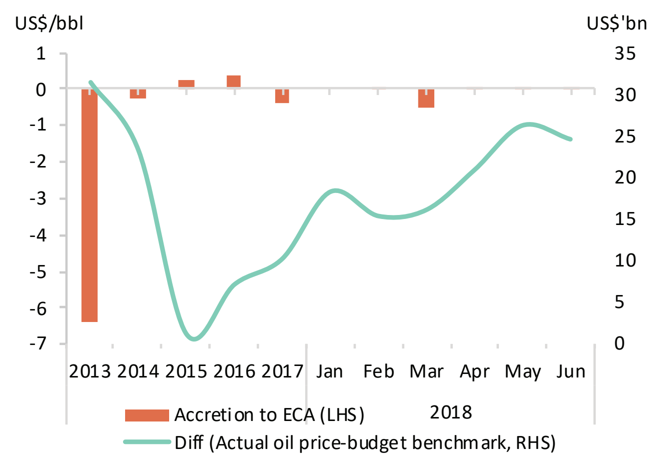
Nigeria's Gasoline Pump Price has usually been lower than her neighbors'




***Source: World Development Indicators (WDI); World Bank Staff Estimates***

**FIGURE 2.10:**

Nigeria's Oil Price-Based Fiscal Rule Has Not Been Very Effective




***Source: FGN***

9. Savings in the ECA have been variously challenged (including in the courts) on the basis that Section 35 of the FRL is at variance with the Constitutional provision that allows for all revenues accruing to the federation account to be distributed among the tiers of government.

**TABLE 2.5:** Net Federation Account Revenues (in percent of GDP)

| Net Federation Account Revenues | 2017 | | | 2018 | | |
|---|---|---|---|---|---|---|
| % GDP | Budget (full year) | Budget (Jan-June) | Actual (Jan-June) | Budget (full year) | Budget (Jan-June) | Actual (Jan-June) |
| **Total Federation Account Net Revenues** | **8.2** | **4.1** | **2.0** | **8.3** | **4.2** | **2.8** |
| **Oil and Gas (Net) /1** | **4.4** | **2.2** | **0.9** | **5.3** | **2.7** | **1.8** |
| **Other Extractives-related revenues and inflows /2** | **0.3** | **0.1** | **0.3** | **0.0** | **0.0** | **0.0** |
| **Non-oil Revenues (Net)** | **3.5** | **1.8** | **0.9** | **3.0** | **1.5** | **1.0** |
| Corporate | 1.4 | 0.7 | 0.3 | 1.3 | 0.6 | 0.4 |
| Customs | 0.6 | 0.3 | 0.2 | 0.6 | 0.3 | 0.2 |
| VAT | 1.5 | 0.8 | 0.4 | 1.1 | 0.6 | 0.4 |

*Notes: /1 After first line deductions, but before derivation. /2 Includes Solid Minerals, NLNG Dividend, and Signature Bonus; unbudgeted oil revenues (exchange rate difference, excess PPT); excludes NNPC Refund and Special ECA distribution (not revenue). Not all of these items are budgeted thus budget performance is not assessed. 2018 GDP estimate is as projected by the World Bank staff.*

***Source: Office of the Accountant-General of the Federation (OAGF), WB staff computations***

25. **The federal government's 2018 budget was enacted only on June 20, 2018, nearly six months after the start of the fiscal year.** However, the revenues already began to accrue since January and based on constitutional provisions, the federal government began to implement recurrent expenditure plans (subject to the limits of the 2017 budget under each category of expenditure). Because the 2017 capital budget was still under implementation up till June, no capital expenditure from the 2018 budget took place by June. The federal government's realized revenues in H1 2018 were 57 percent higher (in nominal terms) than in the same period of 2017. All categories of revenue came in higher, but the FGN's oil revenues from the federation account and its independent revenues exceeded their H1 2017 levels.[10] In percent of GDP, oil revenues and independent revenues grew relative to 2017, but the FGN non-oil revenues relatively stagnated. All categories of revenues fell short of their pro-rated targets for the period. The independent revenues that have in the past two years fallen far short of targets was only 15 percent short in H1 because of a spike in May and more realism in the 2018 budget projections. While recurrent spending (2.2 percent of GDP) was 97 percent executed relative to the 2018 half-year budget, only capital spending under the 2017 budget was executed up till June (constituting 0.6 percent of 2018 projected GDP).

10. FG Independent revenue consists of SOE surpluses, income taxes of the Military, Police and staff of the Foreign Service, as well as revenues accruing to FGN ministries, departments and agencies (MDA) e.g. from service fees and charges. SOE surpluses however constitute the bulk (at least 65 percent).

**TABLE 2.6:** FGN Fiscal Accounts (In percent of GDP)

| FGN Fiscal Accounts | 2017 | | | 2018 | | |
|---|---|---|---|---|---|---|
| % GDP | Budget (full year) | Budget (Jan-June) | Actual (Jan-June) | Budget (full year) | Budget (Jan-June) | Actual (Jan-June) |
| **Total FGN Revenue** | **3.9** | **1.9** | **1.0** | **3.9** | **2.0** | **1.4** |
| Oil and Gas | 1.8 | 0.9 | 0.4 | 2.3 | 1.1 | 0.8 |
| Non-oil Revenues | 1.2 | 0.6 | 0.3 | 0.9 | 0.5 | 0.4 |
| Corporate | 0.7 | 0.4 | 0.1 | 0.5 | 0.2 | 0.2 |
| Customs | 0.3 | 0.1 | 0.1 | 0.3 | 0.1 | 0.1 |
| VAT | 0.2 | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 |
| FGN Independent Revenues | 0.7 | 0.4 | 0.1 | 0.6 | 0.3 | 0.3 |
| Other Inflows/1 | 0.1 | 0.1 | 0.2 | 0.2 | 0.1 | 0.0 |
| **Total FGN Expenditures /6** | **6.4** | **3.2** | **2.7** | **6.9** | **3.4** | **3.0** |
| Recurrent Expenditures (excl. Statutory Transfers) | 4.1 | 2.1 | 1.9 | 4.3 | 2.2 | 2.2 |
| Capital Expenditures/3 | 1.9 | 0.9 | 0.5 | 2.2 | 1.1 | 0.6 |
| Statutory Transfers | 0.4 | 0.2 | 0.2 | 0.4 | 0.2 | 0.1 |
| Other Outflows/4 | 0.0 | 0.0 | 0.1 | n/a | n/a | n/a |
| **Fiscal Balance** | **-2.5** | **-1.3** | **-1.7** | **-3.0** | **-1.5** | **-1.6** |

*/1 Other inflows include Mineral revenues, NLNG Dividend, Exchange rate difference, and Excess oil PPT; but excludes Balances in Special Accounts, Mopped up capital, TSA Pool Account and Paris Club overdeduction. /2 Interest rate component estimated using DMO debt service 2017 Jan-Sep data /3 The total capital expenditures for the 2016 budget carried out by May 2017 aamount to N 1.1 trn (abotu 1 percent of GDP). /4 Other Outflows include Refund to MDAs and Banks, ECA Loan Deduction, but* exclude *Settlement of State Coupon Payment, Mopped up Capital Refunded, Reimbursement of Paris Club overdeduction. /6 Total Revenue differs from FGN's computations due to World Bank excluding irregular items considered revenue by FGN but financing by the World Bank. Expenditure also differs from FGN's computations as the World Bank excludes principal repayments from debt service expenditure and considers it as amortization of existing debt.*

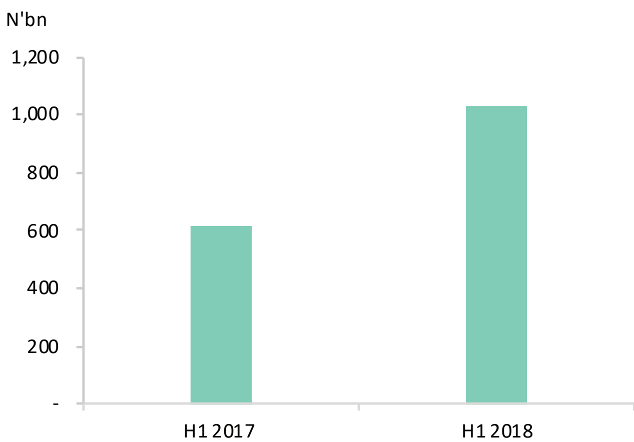
***Source: OAGF, World Bank Staff Calculations***

26. **The share of federally collected revenues accruing to the state governments were almost 70 percent higher in the first half of 2018, relative to the first half of 2017.** However, they were 33 percent lower relative to projections in the federation revenue framework. The higher federally allocated revenues were predominantly due to the much higher federation oil revenues and provided much-needed relief to many states. The state governments' efforts at generating revenue internally, while improving in some states (aggregate internally-generated revenue of states grew in nominal terms by over 20 percent annually in 2015-2017), remain low overall and the federal transfers still constitute the bulk of most states' revenues.

**27. Consolidated government revenues in Nigeria are strikingly low when compared to peer countries.** At 6.7 percent of GDP in 2017, Nigeria's fiscal revenues are much lower than those of its regional peers (average of 17.5 percent), its structural peers (average of 20.3 percent) and its aspirational peers (average of 25.7 percent). As such, public spending on necessary social and infrastructural needs are constrained; primarily financed by borrowing. At the federal level in the first half of 2018, total recurrent expenditure (2.2 percent of GDP) exceeded total revenue (1.4 percent of GDP).

**FIGURE 2.11:**

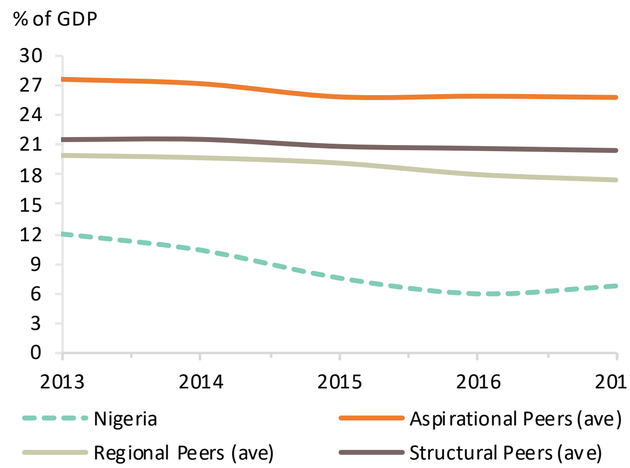
Federally-Collected Revenue Transfers to States were Higher in H1 2018




*Source: OAGF*

**FIGURE 2.12:**

Revenue (% of GDP)




*Source: WDI; WB Staff estimates*

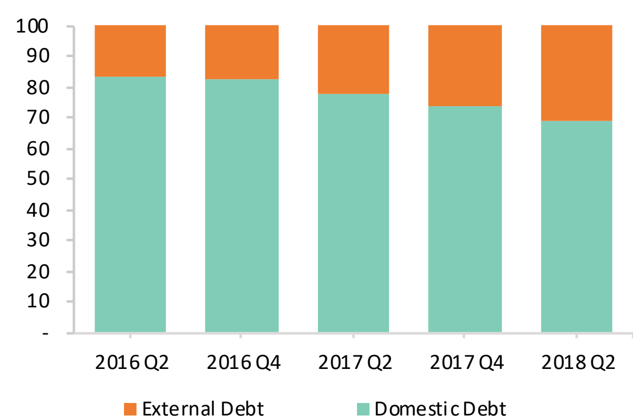
## 2.5 Federal Government's Implementation of its Debt Strategy Increased the share of External Borrowing and Lowered Domestic Interest Rates

**28. Nigeria's public debt has grown nominally by 14 percent between H1 2017 and H1 2018.** Most of this growth emanated from the external debt component and was contracted by the federal government (FG). The total consolidated government external debt grew by 47 percent, with the FG portion growing by 61 percent and the state government (SG) portion, by 8 percent. Domestic debt on the other hand, grew in aggrregate by only 4 percent, with the FG portion growing by 1 percent and the SG portion by 16 percent. Most of the growth in SG domestic debt was due to the FG financial assistance loans to many SGs starting in 2015 and which continued into 2017.

**29. The FG continues to implement its strategy to rebalance its debt portfolio composition.** This strategy includes rebalancing the domestic/external mix from 84/16 at end-2015 to 60/40 by end-2019.[11] It also involves changing the domestic debt mix from 69/31 long-term/short-term debt to 75/25 over the same span of time. The FG external debt growth numbers highlighted in the previous paragraph are in line with this strategy. The FG's interest payments-to-revenue ratio has grown significantly in recent years (estimated at 57 percent at end-2017), and constitutes a significant burden on the budget, underscoring the FG's effort to replace the more expensive short-term domestic debt with longer term external debt. Moreover, the government seeks to reduce its dominant participation in the domestic money market, giving more space for private sector credit growth. In 2017, the FGN raised US$4.5 billion from Eurobonds (with tenors ranging from 10 to 30 years) and US$300 million from diaspora bonds (5-year tenor). This reduced the amount of new domestic instruments issued by the FGN. Also, of the US$4.5 billion Eurobonds, US$0.5 billion was used to liquidate short-term treasury bills that matured in December 2017. This eased pressure on the domestic debt market. Nonetheless, the FGN's domestic borrowing remained elevated overall, and this, coupled with monetary tightening by the CBN and deteriorating asset quality in the banking system meant that the private sector remained crowded-out. In February 2018, the FGN successfully raised an additional US$2.5 billion in Eurobonds, primarily to replace short-term domestic treasury bills. Furthermore, in March 2018, the FGN, through its Debt Management Office (DMO) announced plans to cut back on domestic bond issuance, with total borrowings for 2018 to be 30 percent lower than in 2017. This has contributed to the declining interest rates prevailing in the money market.

**FIGURE 2.13:**

The Share of Domestic Debt in the Total FGN Debt is Declining




***Source: DMO***

11. Specified in Nigeria's 2016-2019 Medium Term Debt Strategy (MTDS).

CHAPTER 3:

# Economic Outlook and Policy Options to Restore Macroeconomic Resilience

*Entering the election period, Nigeria is facing higher fiscal and inflationary pressures, and increased policy and economic uncertainty. At the same time, oil-sector risks, policy uncertainties, and persisting conflicts remain a constant backdrop. Policymakers would do well to implement or accelerate policy measures to foster greater macroeconomic resilience.*

## 3.1 The oil sector is not expected to be the main source of growth, but the sector's stability is integral to non-oil economy's pick-up

30. **The World Bank projects a relatively stable oil production and price over the 2018-2020 period.** The oil price outlook remains rather favorable, over US$ 70/bbl for Nigeria's crude. While marginal increments - up to 2.2 mb/d by 2020 - in oil production are realistic (though still below government's aspirational targets), the small oil sector's share in the Nigerian economy implies that the sector will contribute less to the economic growth than in 2017, when the sector exhibited high growth rates due to base effects from 2016 production shocks.

31. **Stability in the oil sector is an important enabler of the non-oil economic recovery.** As demonstrated during 2016 recession, the performance in the oil sector can impact the non-oil economic growth through several indirect channels. Firstly, oil and gas exports – which still represent around 90 percent of Nigeria's goods and services exports – are one of the key source of foreign exchange earnings, with direct impact on the monetary and exchange rate policy decisions. Secondly, the oil revenues are still the largest single source of government revenues. With stagnating (as a share of GDP) non-oil revenues, and the link between the level of external reserves and exchange rate stability, as well as movements in inflation, oil production and price shocks can have significant impact on both the real and nominal sides of the economy. While international oil price volatility is beyond Nigerian authorities' control, continued government efforts to prevent militant activity in the Niger delta can limit negative shocks to oil production, while serious governance reforms are needed to secure oil sector investments needed to counteract the natural production decline.

## 3.2 Non-oil economy outlook remains blurred by unstable recent sectoral growth patterns combined with election-related uncertainty

32. **The agriculture sector outlook weakened due to ongoing conflicts, despite targeted government support.** Agriculture performance is expected to be unusually weak in the second half of 2018, due to the base effects: the sector saw some government-encouraged (through import restrictions and subsidized financing schemes) investments whose levels were not matched in 2018. In the meantime, the efforts to contain and limit the impact of the farmer-herdsmen conflict in the Middle Belt and the insurgency in the North East achieved less than expected results. However, with the sector attracting more than half of the labor force and identified as one of the ERGP priorities, continued government support is expected, which will most likely improve the sector's growth in the medium-term horizon.

33. **The non-oil non-agriculture economic outlook is positive but with some likely continued quarterly quivers.** The growth of non-oil non-agriculture sector – the majority of the economy – will remain limited by a slow recovery in private demand, but with its momentum likely strengthened by the election-related public and non-public spending in the second half of 2018 and early 2019. Non-oil industry contribution to growth is expected primarily from the construction sector, moving in tandem with cement production, with a further positive contribution from food and beverage industry. Dominated by MSMEs, the growth of the service sector (which represents over half of the economy) is constrained by a subdued demand and limited lending. Indeed, the banking sector is still risk-averse and will continue to remain enticed by the safety and high-yields of the government securities. First nudged by the election-related public and private spending in late 2018-early 2019, and then teased-out by slowly recovering private demand, the growth is expected to accelerate, though remaining below the pre-oil shock levels.

## 3.3 The medium-term growth outlook depends on the implementation of structural reforms

34. **Overall annual growth is expected to be around 1.9% in 2018.** The slight downward revision from the previous World Bank forecast is due to the slowdown in agriculture and oil sector growth, gradually rising in the medium-term with reduced political uncertainty and returning consumer confidence.

35. **Nigeria's growth trajectory depends on the implementation of significant structural macroeconomic, fiscal, and sectoral reforms; and establishing sound macroeconomic policies.** Nigeria's public sector is small – among the smallest globally – and marred with inefficiencies and coordination problems, so the medium-term growth trajectory depends on the private sector development. However, the government still has a crucial role to play in creating a conducive environment for the private sector to thrive through a coherent and stable macroeconomic framework, reliable power sector, and ensuring an educated, healthy and connected population able to participate and add to employment opportunities.

**TABLE 3.1:** World Bank Medium-term Macro-Fiscal Projections

| | 2015 | 2016 | 2017 | 2018 f | 2019 f | 2020 f |
|---|---|---|---|---|---|---|
| **Real GDP growth, at constant market prices** | 2.7 | -1.6 | 0.8 | 1.9 | 2.2 | 2.4 |
| Private Consumption | 1.5 | -5.7 | -1.0 | 0.6 | 1.3 | 1.9 |
| Government Consumption | -11.9 | -15.1 | -8.0 | 8.3 | 1.8 | 0.6 |
| Gross Fixed Capital Investment | -1.3 | -4.8 | -3.0 | 4.3 | 4.7 | 3.8 |
| Exports, Goods and Services | 0.1 | 11.5 | 8.7 | 3.9 | 2.7 | 2.7 |
| Imports, Goods and Services | -25.7 | -10.4 | 4.8 | 5.7 | 1.9 | 2.4 |
| **Real GDP growth, at constant factor prices** | 2.8 | -1.6 | 0.8 | 1.9 | 2.2 | 2.4 |
| Agriculture | 3.7 | 4.1 | 3.4 | 2.1 | 3.1 | 3.4 |
| Industry | -2.2 | -8.9 | 2.1 | 3.5 | 2.4 | 2.4 |
| Services | 4.8 | -0.8 | -0.9 | 1.2 | 1.7 | 1.8 |
| **Inflation (Consumer Price Index)** | 9.0 | 15.7 | 16.5 | 13.1 | 12.5 | 11.7 |
| **Current Account Balance (% of GDP)** | -3.2 | 0.7 | 2.8 | 5.3 | 4.5 | 4.0 |
| **Fiscal Balance (% of GDP)** | -3.2 | -3.8 | -3.9 | -4.0 | -3.6 | -4.0 |
| **Debt (% of GDP)** | 14.2 | 17.3 | 19.0 | 21.4 | 23.4 | 24.5 |
| **International poverty rate ($1.9 in 2011 PPP)**[a,b] | 46.8 | 48.4 | 49.1 | 49.3 | 49.4 | 49.5 |
| **Lower middle-income poverty rate ($3.2 in 2011 PPP)**[a,b] | 72.9 | 73.9 | 74.5 | 74.7 | 74.8 | 74.9 |
| **Upper middle-income poverty rate ($5.5 in 2011 PPP)**[a,b] | 89.7 | 90.2 | 90.4 | 90.5 | 90.5 | 90.6 |

***Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.***

*Notes: e = estimate, f = forecast.*
*(a) Calculations based on 2009-LSS. Actual data: 2009. Nowcast: 2010-2018. Forecast are from 2019 to 2020.*

## 3.4 The central bank is expected to closely control the level of liquidity in the economy to maintain the exchange rates stable

36. **The downward trend in inflation is expected to revert in the second half of 2018, declining again afterwards slowly towards the central bank's target rate, in the absence of significant shocks.** An increase in inflation is expected in late-2018 and early-2019 as the base effects wear off, and the election related spending, public and otherwise, picks up. However, the central bank is expected to monitor closely the liquidity in the system, including from increasing fiscal oil receipts, primarily to maintain the exchange rates stable and moderate the outflows of short-term portfolio investments. The central bank is expected to continue to rely on policy instruments beyond the standard policy signals, such as Monetary Policy Rate (MPR) and Cash Reserve Ratio (CRR), in favor of the issuance of central bank bills.

37. **Multiple exchange rates will continue creating a complex scheme of implicit public subsidies and distort national accounting.** Although most of the private sector operates in the IEFX window, some priority pockets of the economy continue to enjoy preferential rates, reducing market transparency. Furthermore, it creates accounting distortions as different rates are used: to close various banks' books; for national or public accounting (e.g. evaluation of Naira value of exports in the national accounts of for custom revenue collection or expressing public debt in single currency). Application of official rate for public finances subsidizes the public debt servicing, fuel imports, and central bank operations, but reduces the domestic currency value of dollar denominated (including oil) revenue receipts. Although the convergence among the various forex windows is expected to continue, full exchange rate unification and allowing it to move with the market fundamentals remains less likely. The central bank is expected to prioritize exchange rate stability in the IEFX market, through direct intervention, especially with the increasing outflows in the face of election uncertainty and increasing emerging market volatility. The post-election exchange rate management will depend on broader future macroeconomic and fiscal developments.

38. **Private sector lending is expected to remain subdued and increase only slowly in the short-to-medium-term.** Despite the improving financial sector health, the commercial banks remain risk-averse, especially with relatively high yields still available from the government securities and low private sector demand.

## 3.5 The current account balance is expected to be positive and relatively high with rising value of oil exports and constrained import growth

39. **The current account surplus is vital at the time of increasing portfolio outflows and increasing cost of external financing.** The value of oil exports is expected to remain in line with the 2018 H1, given the high and stable oil price expectation and relatively stable production. The non-oil exports, although their value is relatively low compared to the oil exports, are expected to sustain the growth momentum, albeit from a low base. The value of oil imports is expected to level off in the second half of 2018, as NNPC has rebuilt the reserves, and fluctuate primarily with the oil price. However, with the substantial fuel subsidy and resulting oil smuggling to neighboring countries, the fuel imports may have to remain elevated to avoid domestic fuel shortages (authorities' drive to estimate the actual domestic fuel consumption would shed light on the volume of these unofficial re-exports). In the medium term, the new domestic refinery would provide an alternative source of fuel to Nigeria, but its net effect would depend on various parameters which remain undisclosed. Non-oil imports are expected to continue to exhibit relatively low growth: given low consumer demand, imports both of intermediary/investment and consumer goods are expected to be subdued.

40. **Nevertheless, the positive current account balance is unlikely to be sufficient to maintain the external reserves level.** The capital account balance face significant uncertainty, as external portfolio investors, already nudged out by the volatility in the emerging markets and strengthening US dollar, may seek safety elsewhere in the upcoming elections, further increasing net outflows. However, the potentially increasing domestic security yields – both the federal government's and central bank's - may entice them to stay.

The sovereign Eurobond issuances may decline in volume, as the yields are increasing (both because of increasing US interest rates, and potentially increasing spread due to higher emerging market volatility and election-related uncertainty). Furthermore, the 2018 external borrowing plan remains unconfirmed, and the passing of the 2019 one is likely to be similarly, if not more, delayed.

## 3.6 The fiscal deficits will likely widen in 2018 due to increased pre-election spending and sustained revenue shortfalls

41. **Although the revenues are increasing, largely due to higher oil prices, the actual revenues will fall below the budget targets in 2018.** The oil revenues will continue to underperform both relative to the budget targets and their realistic potential due to the unbudgeted fuel subsidy (NNPC 'cost under-recovery'), lack of clarity over the JVCC exit process, and the dollar-naira conversion using an exchange rate lower than that prevailing in the convertible IEFX window. These impediments are, unfortunately, unlikely to be resolved before the elections due to their political sensitivities. Domestic market fuel price deregulation would present a policy opportunity to reduce the fiscal leakages – amplified by the uncertain volume of domestic consumption vis-à-vis the amounts smuggled to neighboring countries – and to target public spending explicitly towards pro-poor, human-capital-enhancing areas, which could increase the long-term growth potential and sustainability and improve the population's wellbeing.

42. **Federation non-oil revenue collection will also fall below targets, however less so than in 2017, and the performance varies across the revenue sources.** The corporate taxes, whose performance improved with the recovering economy and from the Voluntary Assets and Income Declaration Scheme (VAIDS), are expected to perform fairly in line with the budget target – which has also been reduced compared to 2017, to commendably reflect more realistic government expectations. The VAT, whose target was also slightly revised downwards, is expected to face about a 30 percent under-collection in 2018, as despite administrative improvements the nominal growth of the receipts has failed to significantly exceed the level of inflation. The customs revenues are expected to be largely on target as in 2017, although federation account levies collection may again underperform. The states are expected to continue improving their IGR collection, with the growth in independent federal government revenues expected to be slower.

43. **The growing revenues and election-pressures will fuel higher spending; however, full capital budget implementation is again unlikely due to revenue shortfalls and external financing uncertainties.** Recurrent federal expenditures are expected to accelerate with budget passing, to catch up with the overall annual nominal expenditure growth envisaged in the budget.[12] The capital budget implementation (scheduled for one year from the budget passing) is expected to be assertive and frontloaded – availability of funds permitting -, with a rush to complete projects before the elections. Over-optimistic budget revenue targets, combined with delayed approval (and increasing cost) of external borrowing plan will likely increase the reliance (and the cost) on domestic borrowing. The state government public expenditures

12. The non-capital expenditures in the first half of the 2018 had to comply with the lower 2017 budget pro-rated ceilings, until 2018 budget was passed.

are expected to follow a similar pattern, however, with more reliance on commercial bank rather than public borrowing. Nevertheless, the public authorities are expected to largely comply with the deficit ceiling: explicit 3 percent of national GDP for the federal government, and implicit collective 1 percent of national GDP for the states' governments. Overall public debt will rise steadily but remain relatively low (under 25 percent of GDP).

### 3.7 The cautiously non-negative outlook – if constrained and below-potential –is subject to numerous risks

44. **The risks remain high, as current monetary and external policy solutions are fragile to external and domestic shocks.** As oil remains a crucial driver for growth, any negative shocks to oil production or price could affect the fiscal revenues, external balance, and banking sector stability. In the short-run, the resulting exchange rate instability could translate into capital flight, which could further be amplified by any political uncertainty surrounding the election period. The lack of non-oil revenue reform continues to make the government over-reliant on the volatile oil revenues, whose future trajectory remains uncertain not only due to inherent international oil price volatility, but also due to lack of transformative oil sector governance and management reforms.

### 3.8 Nigeria's macroeconomic performance would benefit from implementation of the key planned policy reforms

45. **Given the clearly challenging economic backdrop, certain key policy reforms would be important to support macroeconomic resilience for Nigeria.** Amongst these are the following:

- **Acceleration of the economic diversification agenda:** Continued high oil dependency for fiscal revenues by all tiers of the Nigerian government and for foreign exchange earnings will continue to keep the economy at risk of macroeconomic instability. It was in recognition of this that the federal government in early 2017, articulated its *Economic Recovery and Growth Plan (2017-2020)* with a vision to restore macroeconomic stability and set the economy on a path of diversification. The diversification plan aims to ensure that the revenue and export base of the economy would be broadened beyond oil. It identified agriculture and manufacturing as key sectors to achieve economic diversification as well as job creation.

- **Upholding of a stronger counter-cyclical fiscal policy stance to guard against oil price shocks:** The commodity (oil) price-based fiscal rule established by the federal Fiscal Responsibility Act (FRA, 2007) has been variously challenged as not binding on the federal government, and the lack of corresponding fiscal responsibility laws establishing rules on states and local governments' public finances. The Nigeria Sovereign Investment Authority (NSIA) Act (2011) provided for a Sovereign Wealth Fund (SWF) to be funded monthly by "residual funds above the budgetary smoothing amount". Despite an annual budget oil benchmark, neither provisions of the FRA or NSIA Act is upheld and neither the ECA nor the SWF is growing in value as originally envisaged. To avoid further boom-bust fiscal cycles as is still the case for all tiers of governments, a stronger counter-cyclical fiscal policy stance needs to be upheld.

- **Reform of the petrol subsidy regime to improve the fiscal space:** Several studies and analyses have shown that the petrol subsidy regime in Nigeria (explicit or implicit) not only constitutes a significant drain on fiscal resources of the three tiers of government, but is inherently regressive, allowing larger and richer consumers to capture most of the benefits. Moreover, the subsidy extends to citizens of neighboring countries. The intention of the petrol subsidy by successive governments is to provide benefits to the population in the form of lower fuel prices, which can directly affect welfare through savings in the purchase of fuel, as well as bring indirect benefits through lower costs of transportation. However, while this is certainly a very valid objective, the regressive nature demands that subsidies be better targeted. For example, compensatory measures to protect the poor and vulnerable could be introduced instead.

- **Improvements in the domestic revenue (particularly non-oil) mobilization drive to reduce volatilities in government revenues and expand fiscal space:** Given the macro-vulnerabilities arising from unstable (mostly) oil revenues, securing non-oil revenue mobilization and its effective and efficient allocation through the three tiers of government is essential. Nigeria's fiscal space is limited by the severely low revenue levels. Thus, stronger and more effective tax policies and tax administration would be required. Current efforts are not yet yielding the level of returns that could boost the fiscal space and enable substantial increases in productive and priority fiscal expenditures.

- **Harmonization of all exchange rates in the economy:** As earlier highlighted, multiple exchange rates continue to create a complex scheme of implicit public subsidies and distort national accounting. Thus, full exchange rate convergence across the various exchange rate windows (at a market-convertible rate, as the IEFX) is essential, including to increase transparency and confidence for all market participants, with a flexible exchange rate regime as a consideration for policy direction.

4

CHAPTER 4:

# Human Capital in Nigeria

*Human capital can be defined as the sum of a population's health, skills, knowledge, experience, and habits, and forms the basis for individual and societal well-being. It enables people to realize their full potential, and is the primary factor driving nations' economic growth.*

## 4.1 Nigeria Under-Invests in its Human Capital

**46. Nigeria has an immense potential to invest in its human capital.** Nigeria accounts for 20% of the population of Sub-Saharan Africa (SSA), and as per current population projections will be the 3rd most populous country in the world with over 400 million people by 2040. A healthy, well-nourished, well-educated and skillful population not only provides the foundation for a productive life and enables future workers to compete in the dynamic labour markets of the emerging digital economy; it gives citizens a stake in their community and country, helping to build greater stability and reducing the drivers of conflict. This is particularly important for Nigeria. As Africa's largest and most populous economy, a stable and prosperous Nigeria is critical for regional stability and faster poverty reduction in West Africa. Not investing in human capital has implications. Poor education and health outcomes dim the prospects of sustained growth and poverty reduction. Studies show that between 10% and 30% of the differences in per capita income between countries can be attributed to human capital.[13] The low levels of human capital in Nigeria, if not addressed, have consequences beyond its borders. The country's high fertility rate, explosive population growth and conflict in the North East, coupled with chronic underinvestment in health and education and high unemployment have dangerous implications for global pandemics, migration and further conflict.

13. Hsieh, Chang-Tai, and Peter J. Klenow. 2010. "Development Accounting." American Economic Journal: Macroeconomics 2 (1): 207–23

## 4.2 Nigeria Has Very Poor Human Capital Outcomes

47. **Recognizing the importance of the human capital outcomes for both individual and societal (social/economic) wellbeing, the World Bank launched the Human Capital Project (HCP) in October 2018.** The HCP seeks to build commitment for effective reforms and investments that will transform human capital outcomes for the greater good of both people and economies. As a first step, a Human Capital Index (HCI) was developed to assess the relative human capital outcomes across countries. The HCI provides an entry point into discussing the economic payoffs of investing in human capital (Box 1).

Specifically, the HCI measures how human capital contributes to the productivity of the next generation of workers based on health, quantity and quality of education and prospects of what a child born today will achieve by the age of 18. It captures three main human capital outcomes that contribute to productivity: survival, education, and health. Human capital, of course, is broader than the three components in HCI, also including, for example, socio-emotional skills and job-specific skills, digital literacy, and other aspects of health. However, the current index design is meant to be a starting point for analyzing the importance of human capital to economic growth and productivity.

In this chapter, discussion and data on human capital are presented in accordance with the HCI definition. Figure 4.1 shows Nigeria's ranking for the different indicators of the HCI. The figure demonstrates Nigeria is lagging behind most other countries in all three components of the index.

## BOX 1:

***Human Capital Index and its components***

The Human Capital Index (HCI) measures the amount of human capital that a child born today can expect to attain by age 18. It conveys the productivity of the next generation of workers compared to a benchmark of complete education and full health. It is constructed for 157 countries, and Nigeria is one of them.

The index presently includes three components that are closely linked with Sustainable Development Goal targets for health, education, and nutrition:

***Survival:*** Will children born today survive to school age?

***School:*** How much school will they complete and how much will they learn?

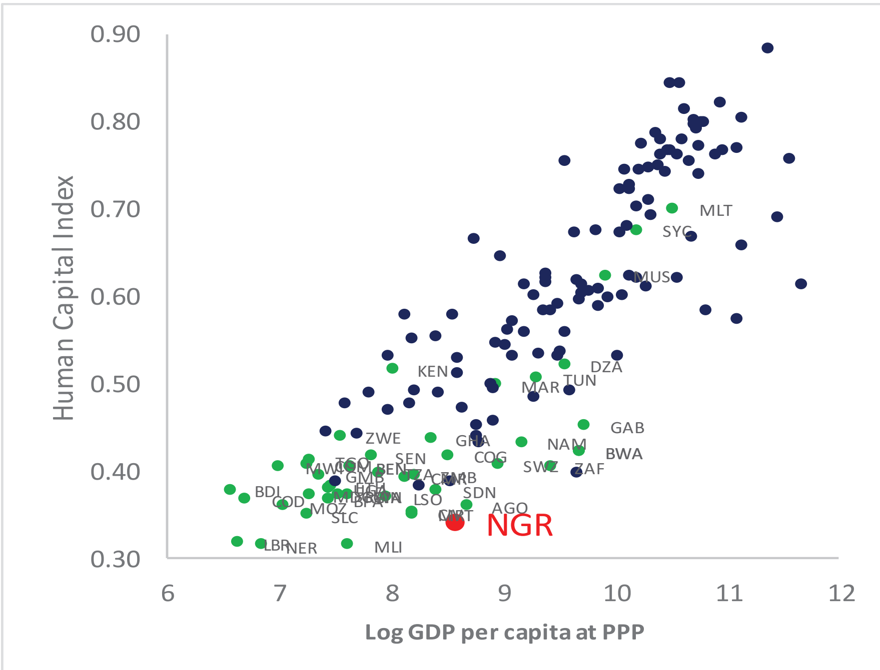
***Health:*** Will they leave school in good health, ready for further learning and/or work?

To measure progress in these components, the HCI is made up of five indicators: the probability of survival to age five, a child's expected years of schooling, harmonized test scores as a measure of quality of learning, adult survival rate (fraction of 15-year olds that will survive to age 60), and the proportion of children who are not stunted.

**FIGURE 4.1:**

Nigeria (Red dots represent Nigeria, green Sub Saharan Africa, black all other countries)

**Nigeria: Overall HCI**

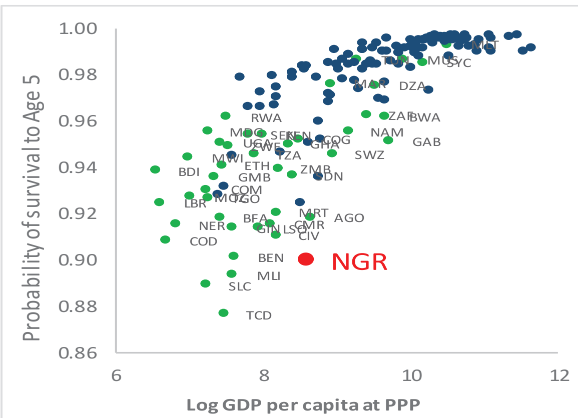


## FIGURE 4.1:

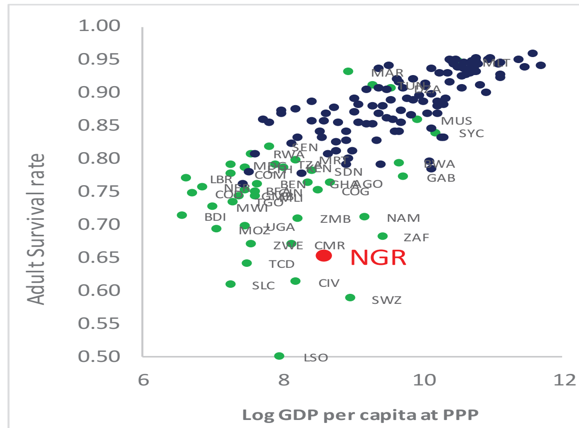
Nigeria (Red dots represent Nigeria, green Sub Saharan Africa, black all other countries) (continued)

### Components of the HCI

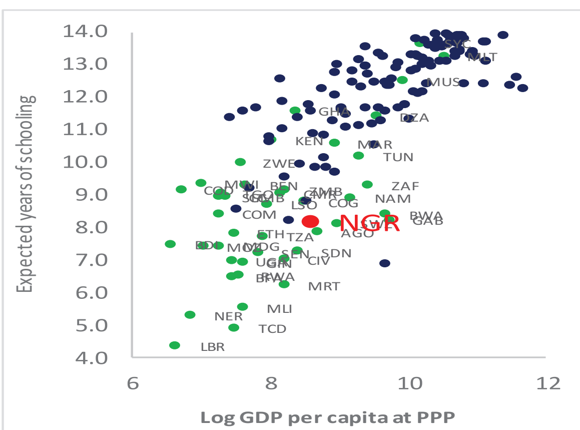
***Probability of survival to Age 5***



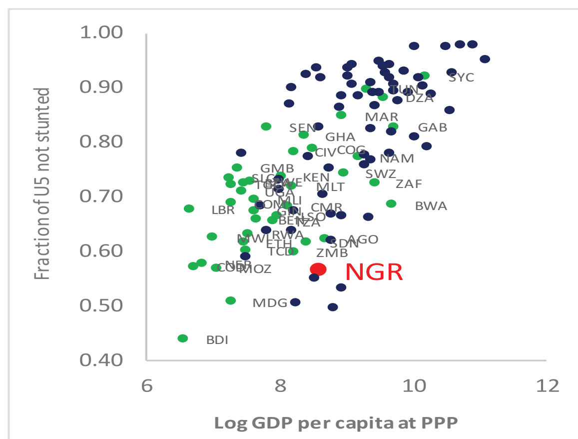

***Adult survival rate***



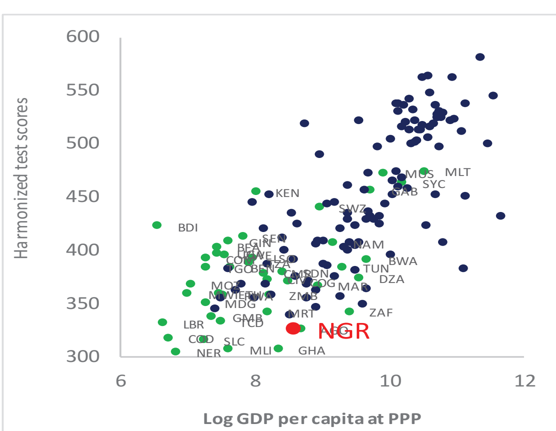

***Expected years of schooling***




***Fraction of U5 not stunted***




***Harmonized test scores***

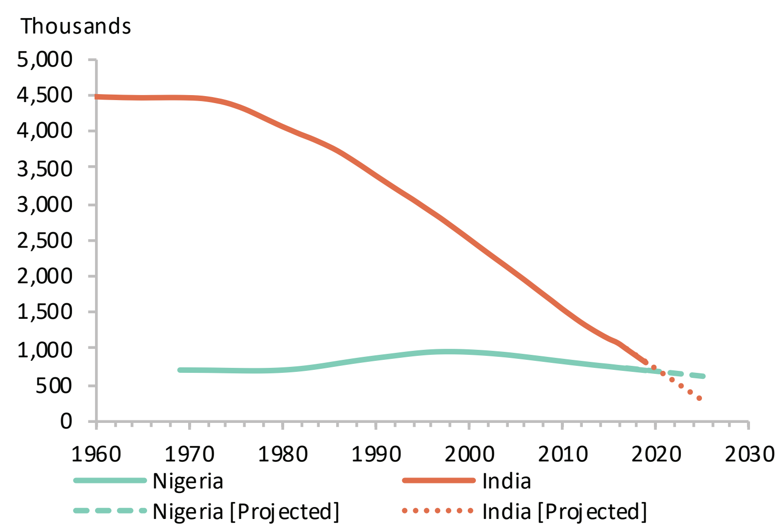


## Survival of children:
## Will children born today survive to school age?

**48.** **In Nigeria, the under-five mortality rate (U5MR) is reducing but not fast enough.**[14] With an U5MR of 107 per 1000 live births in 2017[15], Nigeria is projected to overtake India in 2021 as the country with the most underfive deaths in the world (figure 4.2). Children dying early is not only a tragic loss for families and societies, but also associated with enormous economic and social cost. U5MR in Nigeria is among the highest in Sub-Saharan Africa (figure 4.3), thus among the highest in the world. It is also unequal both across states (figure 4.4) and income groups. The rate of child mortality (between ages 1 and 5) is eight times higher among the poor than the rich.[16] Vaccination coverage rates, an important cause of U5MR, vary dramatically across states and regions (figure 4.5) and have changed little in Nigeria over the last 25 years. This is in sharp contrast with other countries in West Africa such as Cameroon, Ghana, or Senegal, which have made more rapid progress on immunization even though they started from higher levels of coverage (figure 4.6).

**FIGURE 4.2:**

Projected U5MR in Nigeria and India:



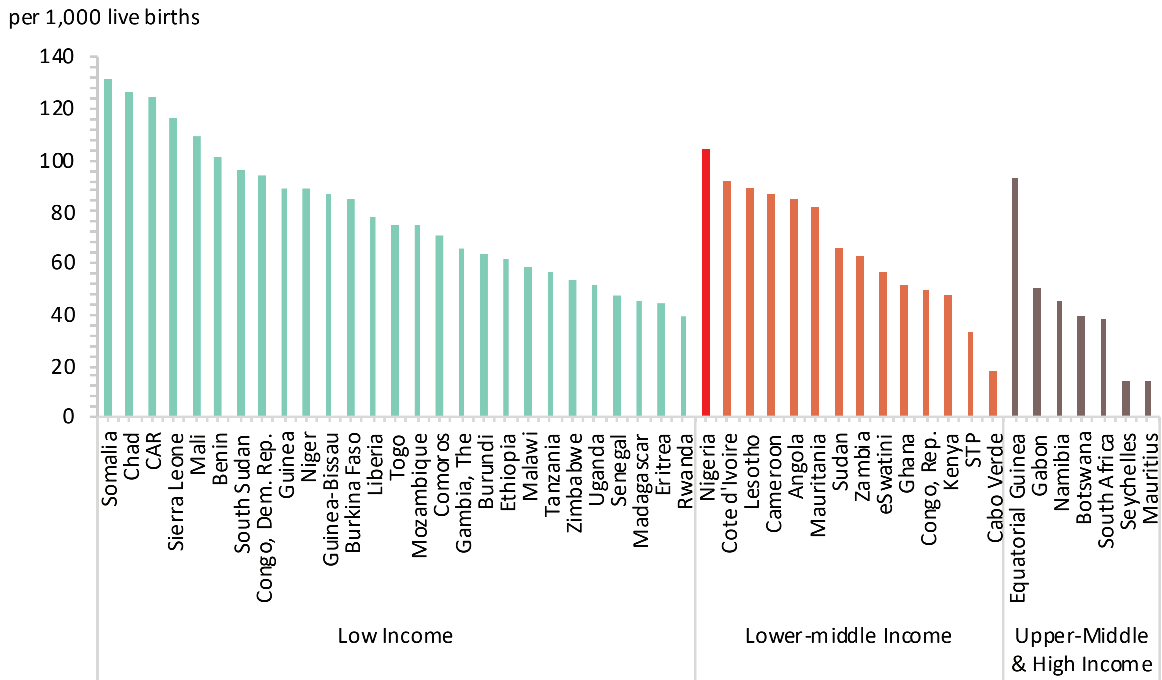

***Source: The UN Inter-agency Group for Child Mortality Estimation(UNICEF, WHO, World Bank, UN DESA***

***Note: The projection assumes the rate of decline in both countries is the average decline seen since 2000.***

14. Nigerian Demographic and Health Surveys 2003-2016, NPopC and Multiple Indicator Cluster Survey (MICS) 2016-17.
15. World Bank, 2017. https://data.worldbank.org/indicator/SH.DYN.MORT?locations=NG
16. MICS 2016 -17.

**FIGURE 4.3:**

Under-5 Mortality in Sub-Saharan Africa by income group




***Source: World Development Indicators, 2017***

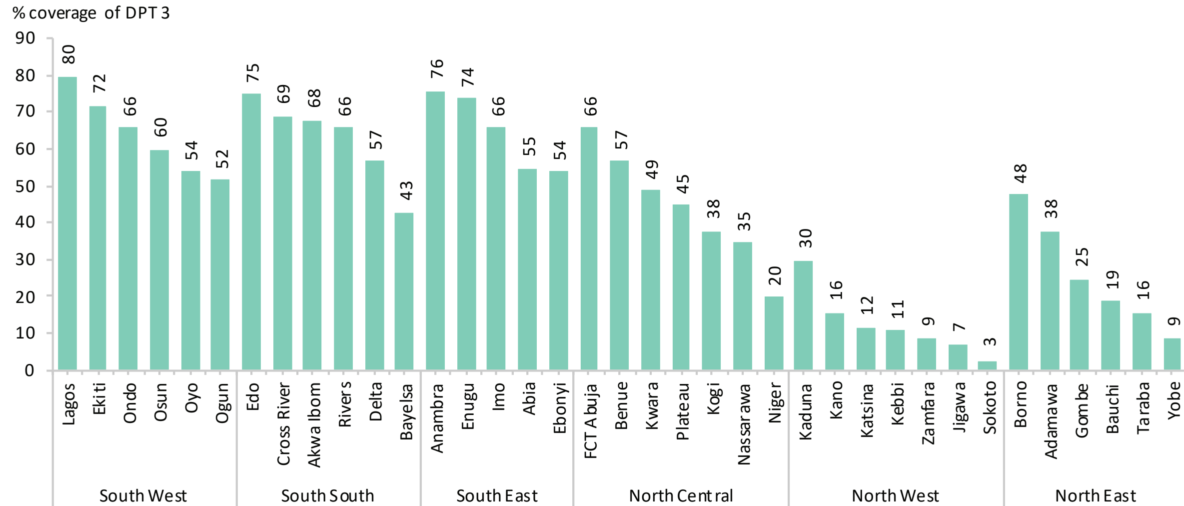
**FIGURE 4.4:**

Under-5 Mortality across states


***Source: Multiple Indicator Cluster surveys***

**FIGURE 4.5:**

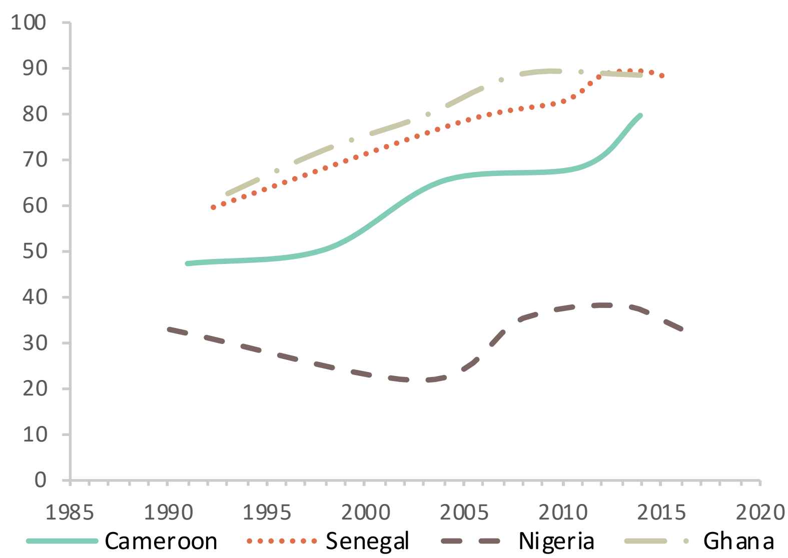
Immunization coverage by State




***Source: Various DHS and MICs surveys, Note: Coverage of DPT3 shown.***

**FIGURE 4.6:**

Immunization Coverage in Cameroon, Senegal, Nigeria and Ghana




***Source: Demographic and Health Surveys and MICS 2016***

49. **A large amount of post-neonatal mortality can be tackled by addressing a handful of diseases.** Malaria accounts for 30% of post-neonatal U5MR deaths and diarrhea and pneumonia account for 26% and 18%, respectively. Another 13% of deaths are caused by the vaccine-preventable diseases measles, pertussis and meningitis.[17] More children die of malaria in Nigeria than any other country in the world.[18] Cost-effective and evidence-based prevention and treatment interventions exist for the three major killer diseases, such as vaccines for pneumonia and diarrhea, adequate water supply, sanitation and hygiene (WASH) coverage for diarrhea, and insecticide treated bed nets and behavior change communications for malaria, but their coverage and utilization are very limited in Nigeria.

## Schooling:
## How much school will children born today complete and how much will they learn?

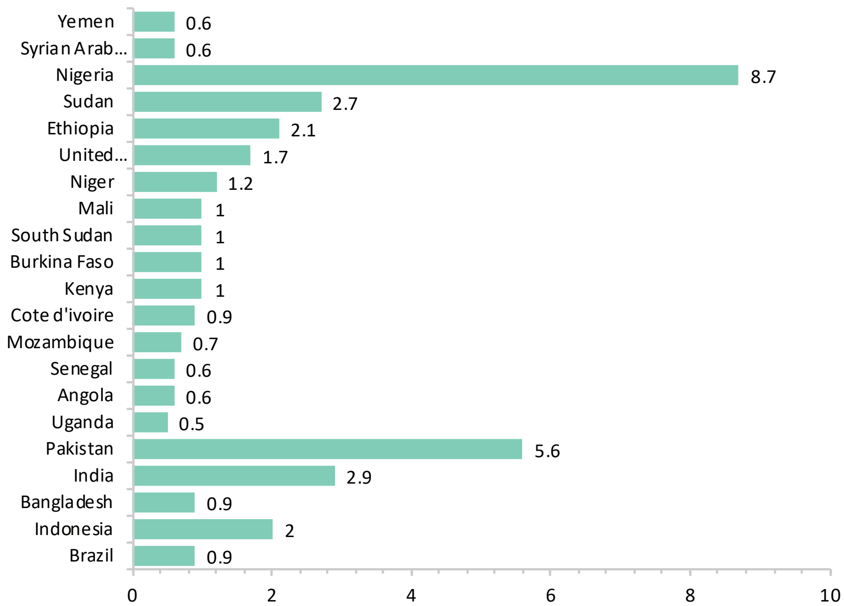
50. **Education comes with high social and economic benefits.** In Nigeria, the average return to one extra year of school is 10%.[19] Education also benefits societies by way of greater social participation, trust and cohesion. In Nigeria the large cohort of children who finished primary school after introducing universal primary education in the mid-1970s were years later more likely to pay close attention to the news, speak to their peers about politics, attend community meetings, and vote.[20] Studies have also observed strong results related of increasing educational outcomes of females. Educated women tend to have better health, lower fertility and greater bargaining power within the family, leading to higher investment in the health and education of their children.[21] Each additional year of junior or secondary education is associated with lower risks of being married as a child and having a child before age 18. Earning gains are also larger for women with junior or secondary education; women with primary education earn 14-19% more whereas those with secondary education earn almost twice as much as those with no education.[22]

51. **Years of schooling: With approximately 9 million children out of school, Nigeria has the one of the highest number of out-of-school children of primary age in the world (figure 4.7); over 90% of these are in the North.** While globally out-of-school rates have decreased,[23] in Nigeria, the rate has increased in recent years, going up from 24% in 2010 to 27.2% in 2016/17. This is partly a result of rapid population growth among the poorest, who have the lowest access to education. Access is also highly unequal across states (see figure 4.8) and among the poorest (72 percent for the poorest quintile vs. 3 percent for the wealthiest). In the North, out-of-school rates among girls are highest (1 girl to 3-4 boys in school).[24] Children of nomadic

17. A Verbal/Social Autopsy Study to Improve Estimates of the Causes and Determinants of Neonatal and Child Mortality in Nigeria, Johns Hopkins University, 2016.
18. An estimated 193,263 Nigerian children under-five died from malaria in 2016.
19. Psacharopoulos, G. and Patrinos, H.A. 2002. Returns on Investment in Education: A further update. Policy Research Working Paper (WPS) 2881. The World Bank, Latin America and the Caribbean Region, Education Sector Unit, September, 2002
20. Larreguy, Horacio and John Marshall. 2016. The Effect of Education on Civic and Political Engagement in Non-Consolidated Democracies: Evidence from Nigeria.
21. Pradhan E. & Canning D (2015) "The Effect of Schooling on Teenage Fertility: Evidence from the 1994 Education Reform in Ethiopia." Program on the Global Demography of aging At Harvard University, Boston, M.A.
22. Wodon, Q, Montenegro, C., Nguyen, H and Onagoruwa, A., 2018. Missed Opportunities: The High Cost Of Not Educating Girls. The World Bank Group, Washington DC.
23. UNESCO Institute for Statistics - UIS. 2018. One in five children, Adolescent and Youth is out of school. Fact sheet No.48, February, 2018.
24. World Bank, 2017. Better Education Service Delivery for All (BESDA), Project Appraisal Document.

## FIGURE 4.7:

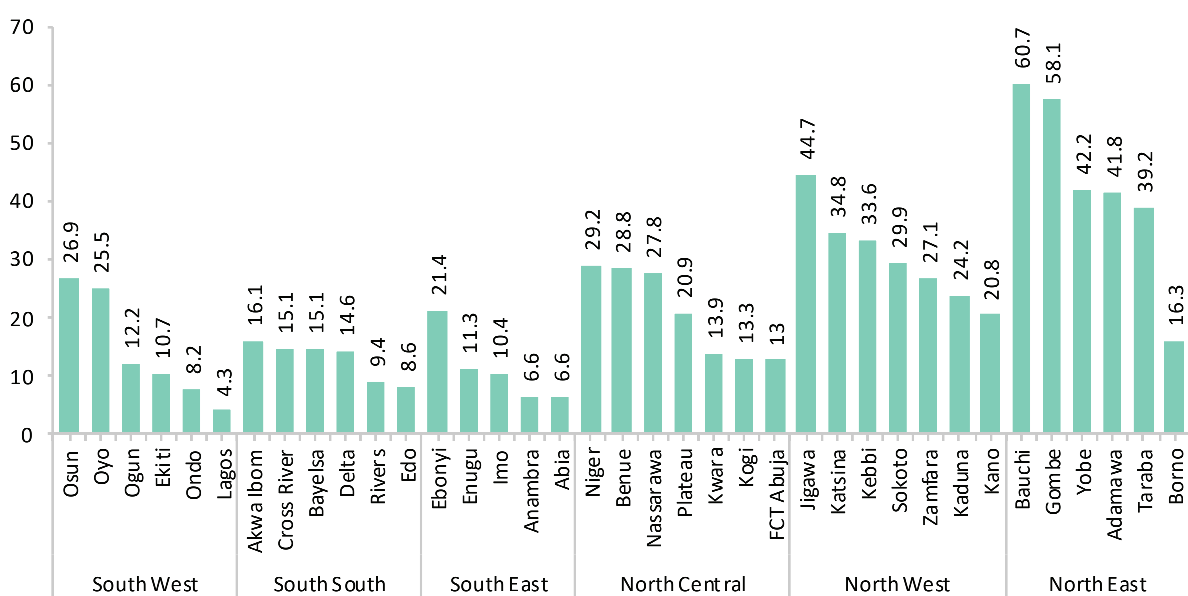
Number of out of school children (millions)




***Source: UNESCO. July 2016. Leaving no one behind: How far on the way to universal primary and secondary education?***

## FIGURE 4.8:

Percentage of out-of-school children by state for Nigeria (Primary)




***Source: Multiple Indicator Cluster Surveys 2016 Data.***

pastoralists throughout the country are less likely to be in school, as are children in the North East whose families were displaced by the Boko Haram insurgency.[25]

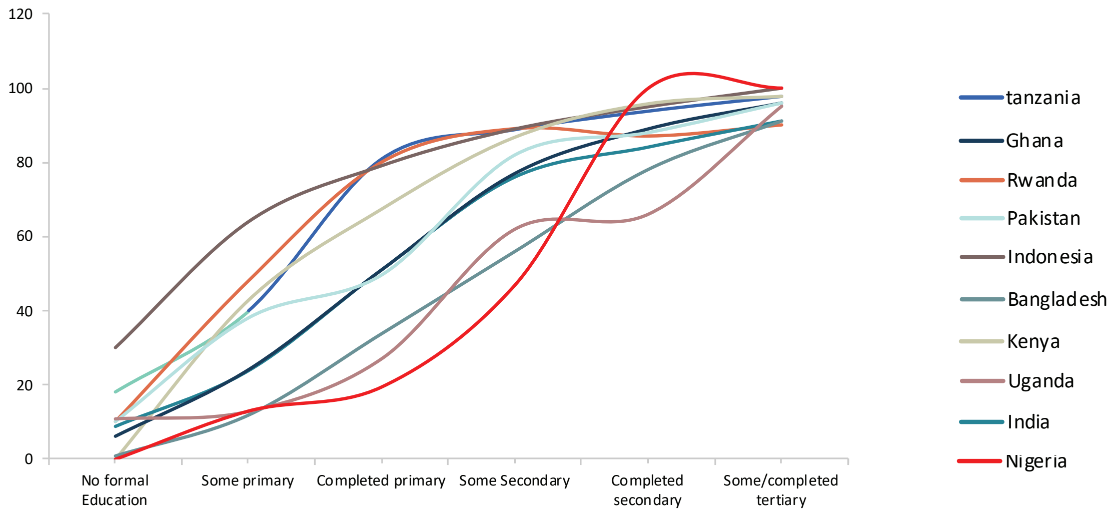
52. **Education quality: Completing the unfinished agenda of universal basic education is essential but being in school alone is not enough.** Increasing access to education without ensuring its good quality will not improve learning. Only 20% of Nigerian adults between 18-37 years who completed primary school can read, compared to 80% in Tanzania (Figure 4.9).[26] Children in Nigeria can expect to complete 8.2 years of pre-primary, primary and secondary school by age 18. However, when years of schooling are adjusted for quality of learning, this is only equivalent to 4.2 years: a learning gap of 4 years (Figure 4.10).

For schooling to translate to learning, children need to arrive at school motivated and prepared to learn, but almost half of the children under 5 are stunted implying they do not have adequate brain development to learn in school.[27] High quality school inputs, including adequate infrastructure and teaching and learning materials, are important but in short supply all over the country. However, no single factor is as critical for learning as the quality of teachers.[28],[29],[30] Alarmingly, many teachers do not have adequate content and pedagogy knowledge.[31] A 2017 study showed that only 24% of teachers had the minimum knowledge in language and 31% had the minimum knowledge in mathematics (Table 4.1). Just 1% of teachers had the minimum pedagogy knowledge while none had the minimum knowledge to assess students. Improving the quality of public education could also help address the conundrum of religious education that does not integrate the core formal subjects. A recent survey of community leaders found that households' preference for religious education results more from state failure in providing a "credible alternative", i.e. quality public education, than from cultural or social attitudes.[32]

25. UNESCO Institute for Statistics - UIS. 2018. One in five children, Adolescent and Youth is out of school. Fact sheet No.48, February, 2018.
26. Pritchett, Lant and Michelle, Kaffenberger, 2017. "More Schooling or More Learning? Evidence from Learning Profiles from the Financial Inclusion Insights Data." Research on Improving Systems of Education, Working paper, 17/012, May 2017
27. UNICEF/WHO/World Bank Joint Child Malnutrition Estimates: Stunting. May 2018
28. Hanushek, Eric and Steven, Rivkin. 2010."Generalizations about Using Value-Added Measures of Teacher Quality". American Economic Review: Papers & Proceedings, 100. 267–271.
29. Hanushek, Eric and Steven, Rivkin. 2012. "The Distribution of Teacher Quality and Implications for Policy". The Annual Review of Economics, 4:131–57.
30. Rockoff, Jonah (2004). "The Impact of Individual Teachers on Student Achievement: Evidence from Panel Data". American Economic Review, Vol. 94(2).
31. Bold et. Al. 2017. "What Do Teachers Know and DO? Does It Matter? Evidence from Primary Schools in Africa," Policy Research Working Paper 7956, World Bank.
32. Antoninis M., 2014, "Tackling the Largest Global Education Challenge? Secular and Religious Education in Northern Nigeria," World Development.

## FIGURE 4.9:

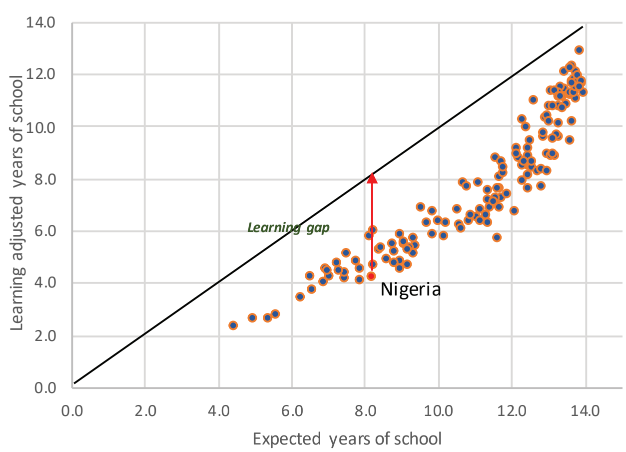
Literacy rates at successive education levels




**Source: Pritchett, Lant and Michelle, Kaffenberger, 2017.**

## FIGURE 4.10:

Learning Gap




**Source: Human Capital Project. 2018**

## TABLE 4.1:

Teacher Knowledge (Percent of teachers who score at least 80 percent on a test of grade 4 material)

| | Average | Kenya 2012 | Mozambique 2014 | Nigeria 2013* | Tanzania 2014 | Togo 2013 | Uganda 2013 |
|---|---|---|---|---|---|---|---|
| **Equivalent to student** *language curriculum* | 61 | 66 | 77 | 24 | 41 | 54 | 90 |
| **Equivalent to student** *mathematics curriculum* | 56 | 82 | 26 | 31 | 62 | 24 | 55 |

***Source: Bold and others 2017. *Data based on 4 states in Nigeria (Anambra, Bauchi, Ekiti, and Niger)***

## Health:
## Will children born today leave school in good health, be ready for further learning and/or work?

Health is a broad concept and in the absence of a widely-accepted single metric to capture it, the HCI measures overall health in a country by two proxies, the rate of stunting and rate of adult survival.

53. **Two out of every five children under five years of age (44%) suffer from chronic malnutrition, among the highest in the world.** This translates into 14.5 million Nigerian children at risk of either dying or not developing to their full potential. This is a huge loss of potential as children who escape stunting are more likely to survive, stay in school and learn better due to proper brain development. Without stunting, children are 33% more likely to escape poverty as adults and become productive individuals earning incomes that are up to 50% higher than those of their stunted peers.[33] Again, the national stunting rate masks immense regional disparities (figure 4.11). Stunting in the North West has been consistently *increasing* between 2008 and 2015 whereas the states of the South West and South East have recorded consistent decreases.

54. **Most of the largely irreversible damage from chronic malnutrition in Nigeria, as in other countries, happens during the "first 1000 days," which is the period from conception to the child's second birthday.** Chronic malnutrition in Nigeria is the result of three main categories of factors: (i) inappropriate caring practices and poor unhygienic environments for young children, and for women during pregnancy; and (ii) insufficient and poor-quality food; and (iii) inadequate access to nutrition and health services, including family planning services. For example, only 30% of children with diarrhea were taken to a health facility or health provider and 21% of children received no treatment at all (Box 2).[34] In most cases, poor feeding practices are not primarily caused by food insecurity because the quantities of food required by young children are small. It is rather a question of inadequate knowledge and beliefs about how children should be fed and cared for and particularly ensuring that the diets of children 6-24 months are diverse and micronutrient-rich.

33. World Bank, 2017. An Investment Framework for Nutrition: Reaching the Global Targets for Stunting, Anemia, Breastfeeding, and Wasting. Washington, DC.
34. Demographic Health Survey, 2013.

## BOX 2:

### Nigeria's Nutrition Crisis – Some Facts

The persistent high rates of stunting in Nigeria indicate a long-term nutrition crisis. Poor maternal, infant and young-child feeding practices are prevalent. Only 23.7% of children are exclusively breastfed and 16.5% of children aged 6-23 months have minimal dietary diversity and meal frequency. Utilization of preventive maternal and child health care, especially by the poorest two quintiles and beneficiaries from rural areas, has been dismal. Only 26.7% of children under-five with diarrhea were sought treatment, of which only 18.5% were treated appropriately with oral rehydration salts and zinc therapy. Only 22.9% of children aged 12-23 months were fully vaccinated against vaccine preventable diseases. An overwhelming 31.6% of pregnant women received no antenatal care during their last pregnancy. An estimated 30% of Nigerian children and 20% of pregnant women are vitamin A deficient, while 76% of children and 67% of pregnant women are anemic. A negligible proportion of Nigerians have access to community-based programs to improve practices related to infant and young child nutrition, such as breastfeeding support and counseling and education on age-appropriate complementary feeding in young children. Along with promoting a diverse diet for young children, micronutrient powders can provide essential vitamins and minerals to complement foods, but these are virtually unavailable in Nigeria. Only 2.4% of households in Nigeria have access to piped drinking water in their homes and 23.5% of the households practice open defecation (MICS 2016-17). The high total fertility rate (5.83) coupled with early child bearing (28% of women aged 18-22 years have their first child before the age of 18), has also driven the inter-generational cycle of stunting, with bodies of adolescent mothers competing with their developing fetuses for nutrition (DHS 2013).

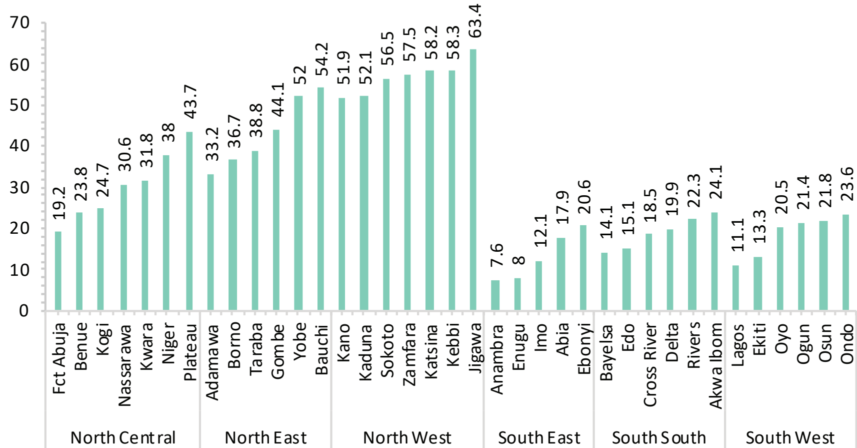
55. **This significant nutritional risk can be reduced by focusing on a set of well-proven interventions,** notably appropriate infant and young child feeding (e.g., early, exclusive and continued breastfeeding, especially during childhood illness, complementary feeding), healthy sanitation behaviors (e.g., hand washing before preparing meals and feeding children), prevention and, when necessary, appropriate treatment of diarrhea, and ensuring adequate intake of essential vitamins and minerals through natural or fortified foods and supplementation. These inexpensive and cost-effective interventions can be scaled-up relatively rapidly, boosting children's chances of survival and enabling them to fully develop cognitive functions and prepare them to be active learners and contributors to economic growth.

56. **Adult Survival:** Reductions in mortality have been shown to account for some 11% of recent economic growth in low and middle-income countries based on national income accounts.[35] Using a more encompassing measure of growth based on "full income," Jamison, Summers and others argue that 24% of the growth observed between 2000 and 2011 in full income was due to mortality reduction. Data from the Institute of Health Metrics and Evaluation for 2016 (Global Burden of Disease) indicate the largest causes of mortality in the age group 15-49 years in 2016 were communicable, maternal and nutrition diseases at 69%, with HIV/AIDS contributing to 40% of the mortality, followed by diarrhea/lower respiratory infections and other communicable infections at 12%, maternal disorders at 7% and tuberculosis at 5%.[36,37]

35. Jamison DT, Summers LH, et al: Global health 2035: a world converging within a generation. Lancet: 2013, 382: 1898-955
36. Jimoh, A. (2010). The Economic Burden of Malaria in Nigeria and Willingness to Pay. In *Handbook of Disease Burdens and Quality of Life Measures* (pp. 1443-1458). Springer New York.
37. Note that most mortality data except for maternal and under-five mortality since 2006 has been modeled using the standard global burden of disease methodology because vital registration system is not functional yet.

**FIGURE 4.11:**

Stunting in Children under 5 years of age by state




***Source: Multiple Indicator Cluster Surveys 2016 Data***

**57. The prevalent causes of adult mortality in Nigeria are preventable, treatable and curable.** Typical access reasons for low health care coverage seen in other parts of SSA do not fully explain the challenges in Nigeria. About 85% of the population lives within a one-hour travel of a health facility and 67% live within a 30-minute walk of a facility. Similarly, the health worker to population ratio is twice the SSA average. Thus, neither a shortage of infrastructure nor human resources alone can explain the low coverage of services. Additional explanations that need further investigation include weak management, poorly incentivized health workers, limited accountability mechanisms as well as user fees (even in the public sector), which can act as financial barriers to care.

## 4.3 Nigeria will benefit from better prioritization of Human Capital spending as well as service delivery reform

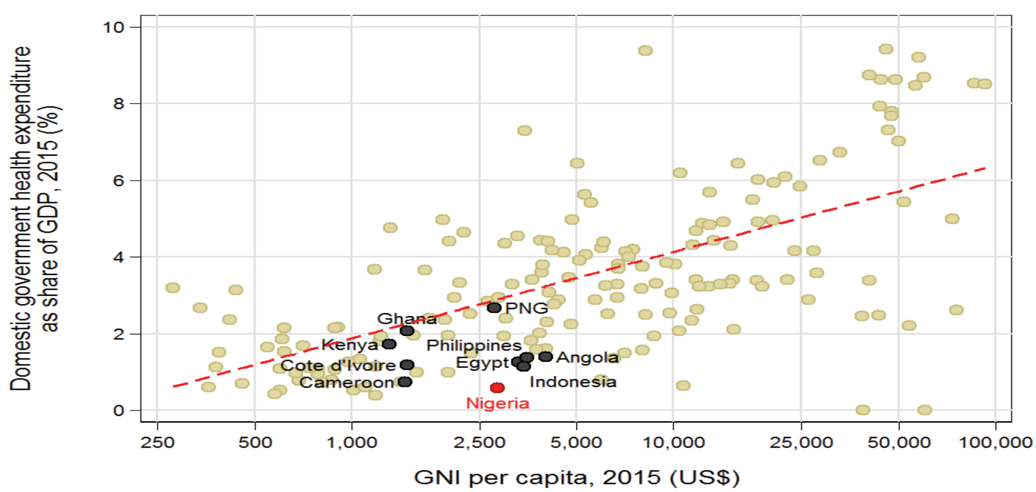
**58. In Sub Saharan Africa, economic growth driven by natural resources has not translated into improved human capital outcomes.** SSA's natural-resource-rich countries, including Nigeria, have higher per capita incomes than other countries in the region.[38] But controlling for per capita income, resource-rich (especially oil-rich) SSA countries have systematically worse education and health outcomes compared to non–resource-rich SSA countries, including lower school participation, higher infant mortality, lower vaccination rates, and higher stunting rates. Nigeria, specifically, has struggled to transform its non-renewable natural capital into poverty reduction and productive people. Between 2004 and 2016, for every one percent increase in GDP per capita, the poverty rate declined by only half a percent, or less than one-quarter of a percentage point. This elasticity is among the lowest globally.[39] It is partially due to the fact that Nigeria has the second-lowest general government revenue relative to GDP in the world.[40] In 2016, revenue accounted to only 5.9% of GDP.

38. World Bank, 2015. From Mines and Wells to Well-Built Minds: Turning Sub-Saharan Africa's Natural Resource Wealth into Human Capital.
39. The growth elasticity for Nigeria was estimated at -0.5 versus -1.1 for Sub-Saharan Africa and -2.0 for the rest of the world.
40. World Bank. 2018. Federal Government of Nigeria Public Expenditure Review. Draft paper.

**59. Public spending for human capital development is extremely low in Nigeria.** The Nigerian government spends less on health than any other government in the world. In 2016, as a percentage of GDP, public health spending was 0.6% of GDP (figure 4.12). Spending on health is also very low as a share of government expenditure (figure 4.13) Most of the spending is on tertiary and secondary hospitals leaving little for primary and preventive health care. Health care is mainly financed by household out-of-pocket health expenditures, which account to about 70%. This is one of the highest levels in the world (comparing to 58% and 34% in low-to-middle income countries and upper-to-middle income countries, respectively) placing the poor at a very high risk.[41] Private out-of-pocket spending at the point of service delivery causes financial distress, especially for the poor. It can tip households into poverty or deepen existing poverty. Nigeria allocates only 0.2% of its budget to nutrition-specific and -sensitive interventions.[42] While the Federal Government has a budget line for nutrition within the FMOH, this is poorly financed and focused mainly on relatively small-scale capacity building activities. Some State governments have started investing own resources, but this financing remains far from sufficient, and it is used mainly to address crisis situations. With some exceptions, most of the financing to date has focused on addressing the most visible "tip of the iceberg" emergency nutrition through the treatment of severe acute malnutrition.

**FIGURE 4.12:**

Health Expenditure as a share of GDP

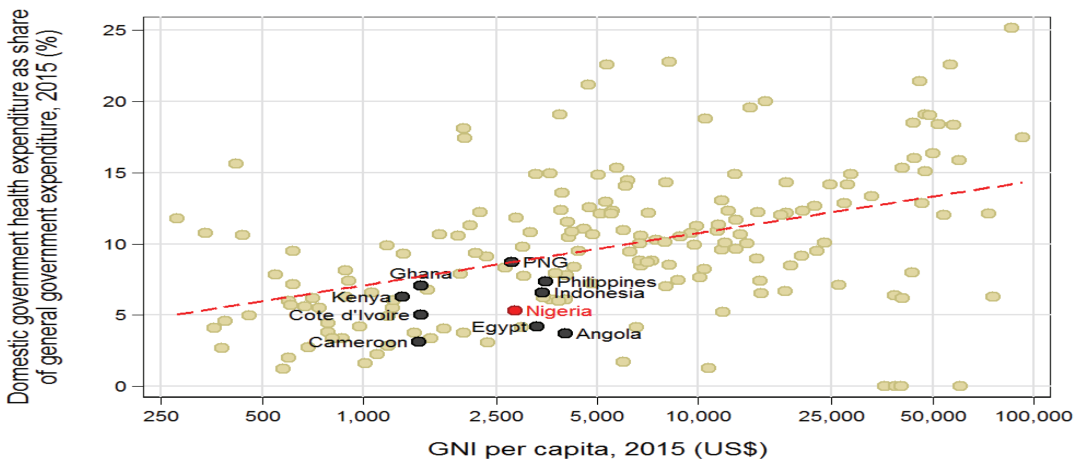



***Source: IMF World Economic Outlook***

41. Reem Hafez, 2018. "Nigeria Health Financing System Assessment," Discussion Paper, World Bank.
42. Global Nutrition Report, 2016.

**FIGURE 4.13:**

Health expenditure as a share of government expenditure




***Source: IMF World Economic Outlook***

60. **Public spending on education is slightly better, but still just 1.7% of GDP compared to 4.7% average for SSA.**[43] Low levels of public spending are present also in other dimensions that help building human capital, such as social protection, water supply, sanitation and hygiene (WASH), or skills development. With 47% of the population being poor, Nigeria has the highest poverty rate amongst its peers. Yet it has the lowest public spending, 0.3% as percentage of GDP, on social protection (figure 4.14-4.15). The coverage of programs specifically targeted to poor and vulnerable households is limited, meeting only a small fraction of national needs. Similarly, although there are no recent estimates, government spending on WASH sector was just 0.42% of GDP between 2006 and 2010.[44]

43. World Bank, 2015. Governance and Finance Analysis of the Basic Education Sector in Nigeria. Washington DC.
44. World Bank, 2017. A Wake Up Call. Nigeria Water Supply, Sanitation, Hygiene (WASH) Diagnostic.

**FIGURE 4.14:**

Government Spending (of all tiers) on Social Assistance Programs, % of GDP, Latest Year Available

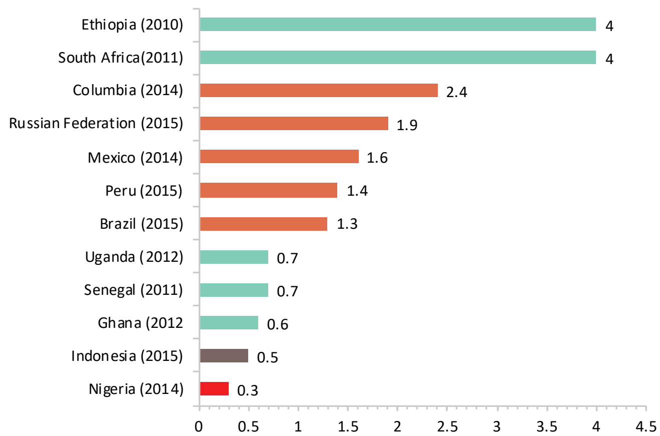
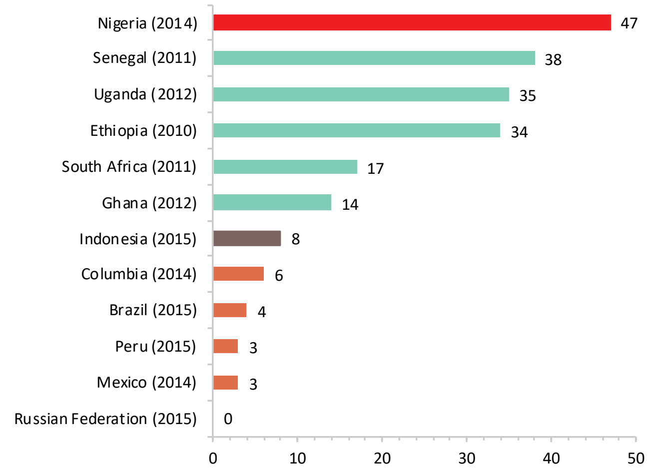



**FIGURE 4.15:**

Poverty Rate at $1.90 a Day (2011 PPP), % of Population, Latest Available Year



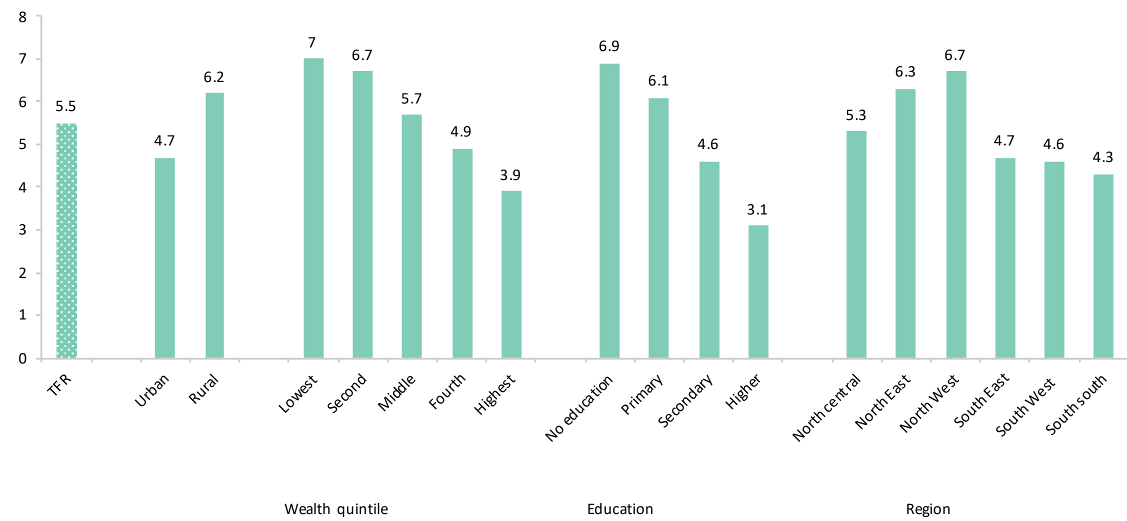

***Source: World Bank ASPIRE Database for Government Expenditure on Social Assistance; World Development Indicators Database and World Bank Nigeria (for Nigeria value only) for Poverty Rate. World Bank Public Expenditure Review draft report.***

61. **Nigeria's high fertility rate may hinder its growth prospects and scope for a significant increase in human capital development spending.** Population growth exacerbates the demand for social services and outstrips the capacity of the economy to generate jobs. Nigeria's total fertility rate (TFR) of 5.8 children per woman in 2016 has changed little since 1990, when it was 6.0. Fertility rates are substantially higher in the North-West and North-East regions (figure 4.16).[45] Adolescents make up a substantial 23 percent of Nigeria's population, and the already large number of adolescents is expected to more than double in the upcoming decades from 41 million to 84 million in 2050 (under a medium fertility scenario), posing challenges for the provision of health, education, and job skills development services. Considering patterns of early marriage and early childbearing, it will also have implications for the next generation. Children born to adolescent mothers are at higher risk of mortality, malnutrition, and illness compared to children of older mothers.

45. Hasan, Rifat, Benjamin Loevinsohn, Corrina Moucheraud, S. Amer Ahmed, Israel Osorio-Rodarte, Emi Suzuki, Sara Troiano, Michael Sexton, Fatimah Abubakar Mustapha. 2017. Nigeria's Demographic Dividend? Policy note in support Of Nigeria's EGRP 2017–2020. World Bank: Washington, D.C.

**FIGURE 4.16:**

Total Fertility Rate in 2013, national and disaggregated




***Source: Demographic Health Survey 2013***

62. **While the Government of Nigeria needs to spend more, and more efficiently, on human capital to address it's lagging human capital indicators, increased financing is not sufficient.** In addition to resource mobilization, effective budget prioritization and efficient spending, a purposeful reform process is required to strengthen service delivery. Successful experiences of other countries in improving human capital outcomes show that critical features of such a reform include the following:

- **Targeting key outcomes and sustaining political commitment over time.** Countries that have made progress in specific outcomes of human capital development aligned support around reform in specific areas. Malawi, one of the poorest countries in the world, reduced stunting by 10 percentage points in six years. Senegal reduced stunting significantly by 10 percentage points in a mere five years. Sustained political commitment and targeting specific outcomes were key to success for both countries.

- **Measuring outcomes.** Repeated measurement can be used to gather political support for change as well as to evaluate, which interventions are working. Measurement allows the government and civil society to monitor progress towards goals. In India, ASER Centre, a civil society organization, used learning data from a citizen-led assessment of learning in children to advocate for education reform. In Tanzania, the non-governmental organization Twaweza published assessment results of children showing poor learning, while another survey showed teacher absenteeism and incompetence. Together they led to the start of the government initiative to improve learning "Big Results Now in Education".

- **Acting on evidence to improve human capital outcomes for everyone.** Evidence-based interventions include: demand-side approaches that enable poor and vulnerable populations to access services; supply-side approaches to build capacity and skill of service providers, and strengthen resource management; and result-based financing approaches to improve performance incentives. Peru made use of all of these to reduce stunting. Information on stunting and its consequences was provided to parents to affect behavior change. Conditional cash transfers (CCTs) were given to poor families to strengthen incentives for families to access nutrition and health services. Coverage of maternal and child nutrition services was expanded as was the coverage of improved water and sanitation. Results-based financing was used to hold service providers accountable for specific service delivery outcomes such as the number of poor children enrolled in CCT, number of child-growth checkups and nutrition counseling sessions to poor families in targeted communities.

- **Aligning actors to make the whole of society work to improve human capital outcomes.** Non-state actors can be leveraged especially where service delivery gaps persist and governments face barriers to improvement. A "whole of society" approach in Bangladesh played an important role in a substantial reduction of the total fertility rate (TFR) from 6.3 in early 1970s to 2.2 at present. In addition to a sustained commitment over more than 40 years and strong political and policy leadership, religious leaders and communities were involved, and mass media were used to effect change in attitudes about family size.

### 4.4 Moving Forward - Nigeria's Human Capital Working Group

***Successes DO exist:***

63. **Nigeria has made real progress in reducing the burden of malaria and is on the cusp of eradicating polio.** Malaria control has rapidly increased the share of children under 5 using insecticide treated nets to 49% in 2016 compared to 1% in 2003 (although still below the average of 57% for SSA). The success of the polio program indicates that the country is one year away from being certified as having eradicated wild polio. This would be an important accomplishment as the last polio cases were found in the conflict-stricken North-East states of Borno and Yobe. A strong government commitment, coupled with careful attention to data and use of community-based approaches and non-traditional service providers, has been key to these successes.

64. **In response to the poor health outcomes, the Government of Nigeria has enacted a potentially transformative National Health Act (NHAct), operationalized through the Basic Health Care Provision Fund (BHCPF).** The BHCPF, if implemented as envisioned in the Act, will mobilize substantial new financing for primary health care. In addition to more funding for PHC, the BHCPF builds on some of the successes Nigeria has achieved under the Nigeria State Health Investment Program (NSHIP)39, which involve results-based and decentralized approaches. Thus, the BHCPF represents "more money

and smarter money." The BHCPF engenders approaches that could alter the long-term trajectory of the Nigerian health system, because: (i) the government will use its own resources to purchase services not inputs; (ii) the government will buy services from both public and private providers using a level playing field; (iii) it establishes a system of accreditation to improve quality of care; (iv) it will finance a rigorous system of verification that helps ensure value for money; (v) it creates robust payment systems via electronic transfer to providers, that reduces the chances of corruption; and (vi) it demonstrates long-term government commitment to using public funds to subsidize the cost of services for the poor.

65. **The Government of Nigeria has taken steps to set up the foundations of the national social protection system with the ratification of the Social Protection Policy in 2017** and the creation of a Social Registry of Poor and vulnerable Households at State and National level. GON also increased budget allocation especially at the Federal level to social protection activities as part of a specialized social investment program. From 2015 to date. The program is mainly targeted to the poor and vulnerable and include cash transfer, school feeding, microcredit to women and traders and skills acquisition and job opportunities for unemployed youths. More than 1.5 million Nigerians are currently beneficiaries of these interventions as stated by the Federal Government.

66. **Improving learning at the scale needed in Nigeria requires a reorientation of the education systems.** This includes adopting innovation and new approaches, such as measuring and tracking student learning outcomes, acting on the substantial evidence available on what works for all learners, aligning educational contents with the skills needed in the labour market, and developing a sense of urgency among key actors to address the changes needed.[46] Some steps are already being taken along these lines. With the intent to make better use of evidence to inform policy, the Federal Ministry of Education has committed to implementing a new technically rigorous student learning assessment that will provide invaluable data on student learning both at the national as well as state levels.[47] A major investment to improve the relevance of skills development in the country is under preparation. Notably some states have started to take bold actions to improve education outcomes and female participation rates (Box 3).

46. World Bank. 2018. "Learning to Realize Educations Promise." Washington D.C: The World Bank.
47. The World Bank is supporting these efforts through the Better Education Service Delivery for ALL (BESDA) project.

## BOX 3:

**Examples of State-level Initiatives to Improve Educational Outcomes**

The **Lagos** state government adopted the use of the e-reader: a low-cost digital device with large amounts of stored learning materials for students in the primary and secondary levels of the public-schools system. The portable devices have had a significant impact on the reading outcomes of students who did not have access to text-books and other learning materials.[48]

To improve the outcome of the education sector in **Kaduna** State, the state government embarked on mass training of teachers in 2015, following assessments that revealed low competency. In 2018, the trained teachers were reassessed by the state through a curriculum-based test for primary-4 students. Out of the 33,000 teachers that took the test, only 11,200 teachers passed. As a result, the state government replaced those who failed the test with others who were literate and numerate. The state has also used competency-based testing to appoint the head teachers from this crop of new teachers, and education secretaries who manage education at the local government education authority level.

The state of **Kano** piloted a conditional cash transfer (CCT) program in 2010 to improve the transition of girls to secondary schools. The cash transfers were conditional on regular attendance. An impact evaluation of a randomized control trial built into the pilot found increased attendance and transition of girls to secondary schools in treatment schools compared to control group. Results show that CCTs can help address cultural and financial constraints to female schooling.[49]

### *Call for Action :*

On the new presentation "Human Capital Development Index (HCI)" by the World Bank where Nigeria ranked low - 44% of stunting; and some other lows recorded against us. While these results are disheartening and depressing, we are nevertheless not discouraged, rather we see this as a wakeup call. We admit that this pervasive action was due to long years of under-investment in Human Capital, which we have before now realized and for which we have been addressing. (excerpt of statement made by Zainab Shamsuna Ahmed, Honorable Minister of Finance, Nigeria at the 2018 WB-IMF Annual Meetings in Bali). **(excerpt of statement made by Zainab Shamsuna Ahmed, Honorable Minister of Finance, Nigeria at the 2018 WB-IMF Annual Meetings in Bali)**

67. **To bring attention to the alarming human capital outcomes in Nigeria and prioritize financing for high-impact human capital interventions, the Nigerian government has established a human capital working group.** The Nigerian National Economic Council (NEC), chaired by the Vice President, held a Special Session on March 22nd, 2018 on the "role of Human Capital Investment in supporting pro poor programs and long term economic growth". The meeting offered an opportunity for government leaders and the development community to call for bold leadership and strategic interventions that will harness the power of Nigeria's greatest assets for economic growth, its people. A major outcome of the event was the

48. Habyarimana, J and Sabarwal, S. 2018. "Re-Kindling Learning: eReaders in Lagos," Draft, The World Bank.
49. Shwetlena Sabarwal et. al. 2011. "Kano Conditional Cash Transfer Program for Girls' Education," Evaluation Note, The World Bank.

formation of the human capital working group comprising key agencies of the government at the national and state level, private sector, non-governmental sector, and development partners with a mandate to develop a unified vision for human capital development and to drive implementation of interventions that complement the ongoing efforts in health and education under the Economic Recovery and Growth Plan (ERGP) pillar, 'investing in our people'. The working group's mandate stretches beyond the World Bank's HCI components to also incorporate issues related to productive people and jobs.

68. **On October 3, 2018, the steering committee for the human capital working group held its inaugural meeting.** The meeting was chaired by the Vice President. Governors, Ministers of key sectors, the private sector, and development partners were in attendance. The meeting closed with a call for action. The Government of Nigeria requested that all stakeholders including community service organizations, the private sector, traditional leaders and development partners to partner with them on the following critical actions required to unlock the potential of Nigeria's people:

- **National dialogue**: Foster a national dialogue to find country-led solutions to critical Human Capital challenges including demography, stunting, and education.

- **State-led solutions:** Empower States to identify and implement programs that will allow its citizens to access the health, education, and other services required to live productive lives; while also holding States accountable to deliver results at scale and provide program funding based on performance.

- **Commit to equity:** Enhance support to the poorest by disaggregating the human capital outcomes thematically and by state; improving the national and state level statistics to fill in data gaps; and identifying key drivers of the poor human capital outcomes. Thus, allowing for appropriate targeting and resource allocation.

- **Innovate:** Continue to use disruptive technologies to create jobs and improve efficiency and transparency in service delivery.

- **Whole society approach:** Non-state providers including the private sector and community service organizations to work closely with the Government to improve service delivery and enhance social accountability. The partnership to also include tribal leaders, imams, and churches leaders for advocacy and support in critical challenge areas.

- **All lives matter/ the current human capital stock:** Support interventions that lift the young and old out of poverty enabling them to access social services and be empowered. Provide young people the vocational skills required to make a living and be productive

- **Improve Financing:** Increase domestic non-oil revenues to meet the human capital spending needs will remain a government priority. This will include structural tax policy and administration measures, reallocations, as well as improved efficiency of existing programs.

69. **Moving forward the human capital working group will work closely with all Nigerian stakeholders to turn this call for action into tangible policy changes and execution realities.** The working group will use this critical window of opportunity, where there is increased international and national focus on human capital, to support the government to develop innovative and sustainable solutions. In the immediate future, the working group will focus on identifying high-impact policies and interventions to make dramatic progress in improving human capital; while also beginning to lay the foundation for addressing more complex challenges that require sustained long-term efforts including demography, out-of- school children, learning quality, under five child mortality, youth employment, and women empowerment. As a member of the human capital working group, the World Bank stands ready to support the Government of Nigeria in its bold steps to improve the human capital of its people.

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