Emerging Markets Spotlight

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Strengthening Nigeria as a business location – a Herculean task for the new government

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Economic situation

Real growth	good
Private consumption (y-o-y)	neutral
Inflation rate	weak

Economic performance is not driven by oil wealth alone

Nigeria's current drivers of growth are manufacturing and services. Nonetheless, Nigeria owes its ascent to middle-income country status to its oil wealth. The fallen oil price will probably enable only weak growth of 4 % in 2015. Private consumption is sustaining growth but poverty and inequality remain very pronounced. The 9 % inflation rate is at the upper limit of the central bank's target range.

Growth financing

Public debt / GDP	very good
Current account balance / GDP	neutral
Forex reserves	very weak

Budget and foreign trade not critical but heavily oil-dependent

Oil and gas revenues are crucial to the country's budget and balance of payments. Thus, the oil price decline of 2015 has pushed the current account balance into negative territory for the first time and caused the budget deficit to rise. Both trends, however, are manageable. Foreign direct investors are holding back. Forex reserves have been lowered substantially in the course of exchange rate support operations since autumn 2014.

Growth resources

Investment ratio	very weak
Manufacturing contribution	very weak
Labour market participation	very weak

Insufficient investment and use of the factor labour

Both the state and the private sector are investing far too little. Manufacturing is growing strongly, as mentioned, but its share of GDP (10 %) is comparatively small. Labour market participation is relatively low. Poor local employment prospects force 1.2 million Nigerians to work abroad, many even in poorer countries such as Benin or Mali.

Economic relations with Germany

German share of goods exports	neutral
German share of goods imports	very weak
FDI inflows from Germany	very weak

Bilateral trade is comparatively low

Trade is subject to strong fluctuations and of little importance to both countries. German imports from Nigeria are almost exclusively oil, while exports to Nigeria are more than 50 % machinery, vehicles and chemical products. German direct investment in Nigeria is very modest, with a value of less than EUR 100 million (2013).

Legend (see p. 4 for detailed explanation of methodology)

very good | good | neutral | weak | very weak

Investment climate – assessment by our local experts

Nigeria is Sub-Saharan Africa's biggest economy. The large domestic market, abundant labour supply and as yet relatively low wages make the country an interesting production location and trading partner. However, the critical security situation, serious infrastructure deficiencies and inefficient state administration hamper economic activity. Nigeria is suffering from the low oil price. The government of newly elected President Buhari wants to substantially improve the overall economic conditions but is facing an enormous challenge.

Continued on p. 2

Focal theme: banking sector has successfully managed the crisis but still has weaknesses

Following the acute banking crisis of 2008/2009, comprehensive reforms have considerably strengthened the sector and made it one of Nigeria's major assets today. Since mid-2014, however, the oil price decline and currency depreciation have highlighted the banks' vulnerability, although without provoking another major crisis. In order for the banking sector to be able to fulfil its important economic role, a number of weaknesses need to be eliminated.

Continued on p. 2

Investment climate – assessment by our local experts

Nigeria is Sub-Saharan Africa's largest economy and becoming increasingly diversified. Its 174 million inhabitants (regional share 19%) and GDP of USD 1.1 trillion (regional share of 32% measured in purchasing power parities), make Nigeria Sub-Saharan Africa's biggest economy. As a result, the large domestic market with growing demand for high-quality products is also regarded as one of the country's assets. Nigeria has been able to more than quadruple its economic output since 1990 (average annual growth 6.3%). The root of this development is its oil wealth, but not only that. Oil and gas are a crucial component of state revenue (around two thirds) and commodity exports (> 90%). But manufacturing and the services sector have also been growing strongly for several years. The manufacturing industries with strong momentum are textile production, leather articles, food, the automobile industry and others, while the dynamic service industries are telecommunications, trade and banking (see focal theme below). As a production location, Nigeria is benefiting from still relatively low wages and a large pool of labour. Currently 44% of the population is under the age of 15. Creating employment for these young people in the future is both an opportunity and a challenge.

A new political beginning amid major challenges. The presidential elections of February 2015 are regarded as a political milestone. The victory of opposition candidate Buhari was not questioned and, fortunately, the elections and transfer of power were peaceful. President Buhari is seen as a beacon of hope, as he has announced his intention of tackling the country's major problems head-on. There are plenty of them: the critical security situation (particularly in the north-east) caused by terror acts of Boko Haram, the still widespread poverty (despite the sustained economic boom, 54% of the population, or 85 million people, survive on less than USD 1.90 day while the average for Sub-Saharan Africa is 43%); the accompanying extreme inequality in income distribution (Gini coefficient is a high 0.43); the significant environmental damage not just from oil prospecting in the Niger Delta but elsewhere as well (inadequate sanitation and waste disposal, air pollution etc).

Further location problems from the perspective of domestic and foreign investors: Businesses are complaining about infrastructure bottlenecks (traffic jams, power blackouts etc.), inefficient state administration and corruption. The budget constraints caused by the low oil price currently leave the government little scope to implement costly reforms. However, a number of measures do exist that cost little but could improve efficiency and help the budget. These include improvements to tax administration, the elimination of pointless fuel price subsidies or more rigorous compliance with environmental regulations.

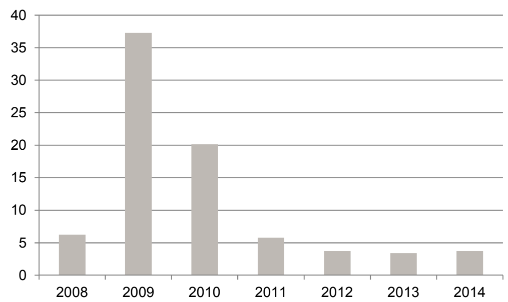
Conclusion: Really interesting possibilities do exist for doing business with and in Nigeria. However, without an intensive analysis of the political and socio-economic realities, the risk of unpleasant surprises is high. The new government of President Buhari is facing a Herculean task.

Based on an interview conducted with Martin Mainz (DEG Accra Office Director) und Ikenna Mbaekwe (DEG staff member Lagos) on 9 November 2015. ■

Focal theme banking sector: comprehensive restructuring since the acute crisis of 2008/2009, but weaknesses remain

The turbulent years since 2008. Today the banking sector is one of Nigeria's strengths. But that has not always been the case. A serious banking crisis developed in 2008/09. Debt-financed share purchases created a stock market bubble. When Nigeria was faced with falling oil prices and a massive devaluation of the Naira in the wake of the global financial crisis, this bubble burst, pushing the supposedly robust banking sector to the edge of a precipice. Almost 40% of the loan portfolio had to be classified as at risk of default (Figure 1). The Nigerian Government and the Central Bank of Nigeria (CBN) then granted the banks financial assistance but placed some under state supervision and created a bad bank that took over toxic assets. The government and the CBN also quickly promised a deposit guarantee and subsequently secured it by establishing a deposit insurance system. After the banking crisis the sector also introduced Basel II/III reporting standards, improved the risk management and initiated the organised supervision of systemically relevant institutions.

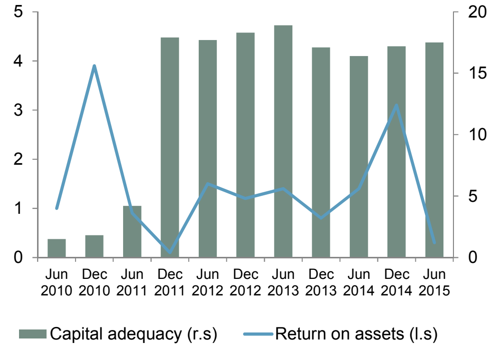
Figure 1: Non-performing loans ratio (commercial banks, in per cent) [a)]



a) Loans overdue > 90 days in relation to gross loan volume

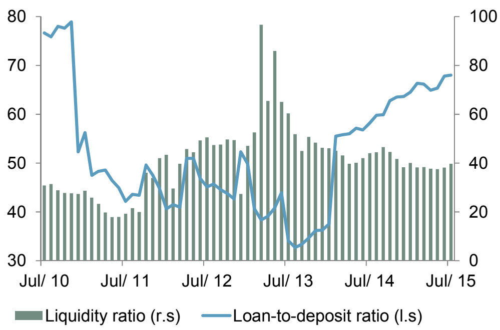
Source: World Bank

Figure 2: Capitalisation and profitability of Nigerian banks (per cent)



Source: CBN.

Figure 3: Key liquidity figures of Nigerian banks (per cent)



Source: CBN.

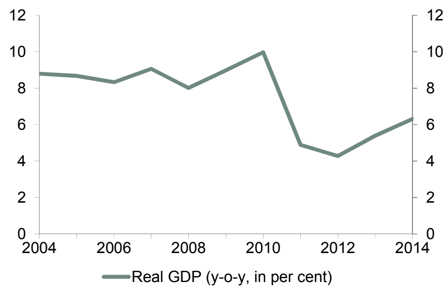
The banking sector is now deemed healthy, profitable and well capitalised. Nigeria currently has 21 commercial banks (ten years ago it had 89), six specialised state promotional banks and a number of regulated and unregulated microfinance institutions. Foreign banks are hardly represented in Nigeria. The NPL quota has fallen since 2009 (Figure 1) because the bad bank took over bad loans, but also as a result of the systemic improvements previously mentioned. Capitalisation is sufficient with an adequacy ratio of 17.5% (equity in relation to risk-weighted assets) and is above the regulatory standard (Figure 2). The return on assets increased to a sound level up to 2014 (higher than in South Africa but lower than in Ghana and Kenya), but has since declined (Figure 2). The banks base their refinancing very much on customer deposits which make up 75% of their liabilities, so accordingly, their dependence on the money market is low. On average, the banks have sufficient liquidity (regulatory standard is at least 30% in relation to customer sight deposits). The relatively low loan-to-deposit ratio of around 70% attests to a prudent lending policy (Figure 3).The CBN's banking supervision is effective.

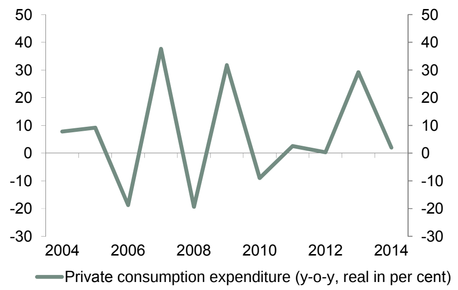
Current economic trends harbour risks for the banks. Forty per cent of the loan portfolio is in foreign currency. The Naira devaluation and the oil price decline since mid-2014 are creating problems for borrowers and, thus, for the banks, which in addition have issued foreign-currency bonds. The recent deterioration of their earnings position is likely to be related to this situation. However, the fact that many borrowers also have foreign-currency earnings somewhat mitigates this problem.

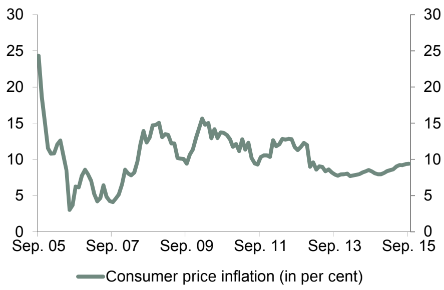
Further deficits of the banking sector in the development process: Small and medium-sized enterprises (SMEs) have virtually no access to bank loans. Since 96% of bank deposits run for a term of less than one year, banks for the most part are able to offer loans with only short maturities, which hampers the financing of durable capital goods. Further indicators underscore the weak financial intermediation in Nigeria: only one third of adults has a bank account, the density of branch networks and number of ATMs are comparatively low, and 40% of the population has no access to any financial services whatsoever. The newly founded Development Bank of Nigeria aims to improve the supply of credit for SMEs. All in all, Nigeria is still far from having a fully functioning banking sector that simplifies the processing of business transactions, provides incentives to form deposits and directs these funds to the most productive investments. ■

Overview of figures

Economic situation

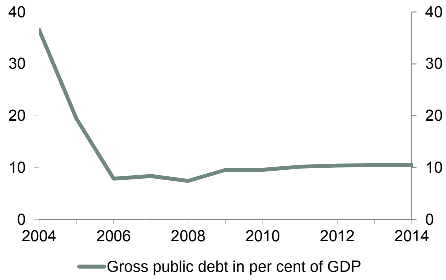


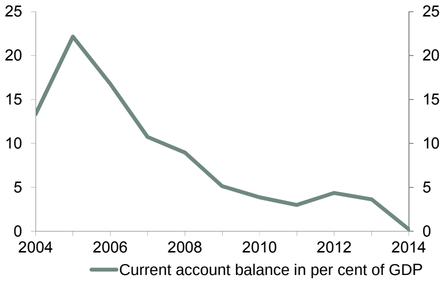


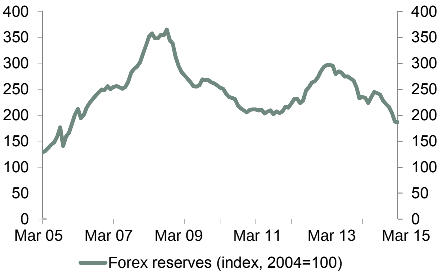


Source: Datastream; IMF, Worldbank, National Bureau of Statistics Nigeria; own calculations.

Growth financing

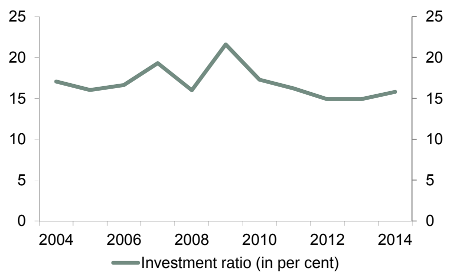


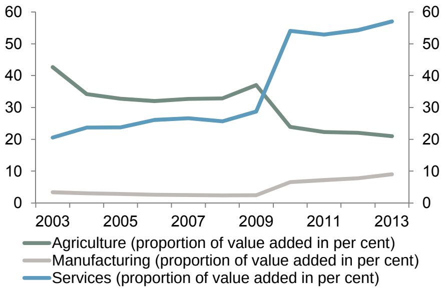


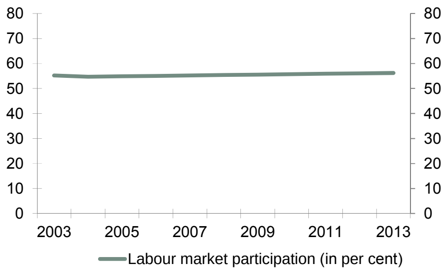


Source: Datastream; IMF, Worldbank; own calculations.

Growth resources

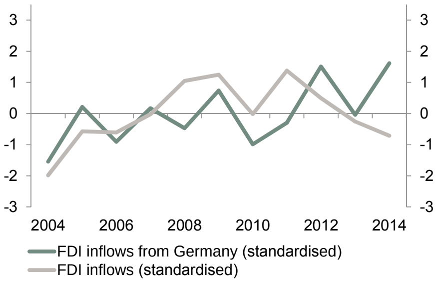






Source: Datastream; Worldbank.

Economic relations to Germany



Source: Deutsche Bundesbank; Datastream; IMF; UNCTAD; own calculations.

Methodology

In the Emerging Markets Spotlight, a selected country is analysed based on various macroeconomic indicators. These indicators are grouped into four categories: economic situation, growth financing, growth resources and economic relations with Germany.

The indicators are used to compare the country's situation with its peers. The group comprises Brazil, China, India, Indonesia, Mexico, Russia, South Africa and Turkey. The comparison is based on a quintile ranking in five categories, which are labelled in different colours:

Quintile 1
Quintile 2
Quintile 3
Quintile 4
Quintile 5

The country is assigned to a quintile of the country group for each indicator analysed. The best quintile may be different for each indicator. For example, higher growth rates are better, so here the upper quintile is coloured dark green, but higher debt rates are a negative factor, so here the upper quintile is coloured dark red.

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