FDC Economic Bulletin

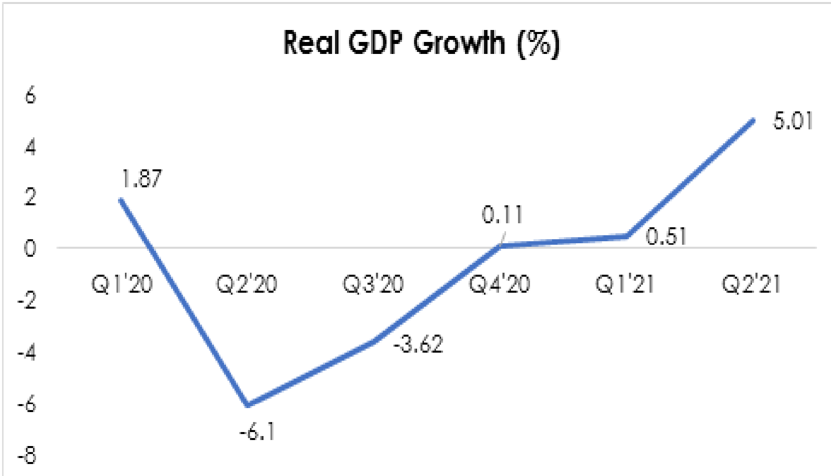
August 26, 2021

GDP great numbers but limited impact as base year effects mask vulnerabilities

The long anticipated Q2 GDP growth data was released on schedule today. The growth of 5.01% in Q2 when compared with the growth rate at the corresponding quarter in 2020 was strong but surprisingly it was much sharper than analysts and investor expectations. The primary reason for the surge was due to base year effects. It is interesting that the release coincided with the rebasing of the South African economy (the second largest economy in SSA), which cosmetically magnified the size of its GDP by 11% to $369bn. This brings it neck and neck with Nigeria.

It was in the second quarter of 2020 that there was an unprecedented lockdown. Domestic and international flights were shut down, intercity travels were restricted and markets were shut. This resulted in the sharpest contraction of the economy in decades to -6.1%. Therefore, it is not surprising that the economy grew by gangbusters when compared to that period. The fastest growing sectors in Q2 2021 when compared to the shut sectors like transport, trade, services were to be expected. The H1'21 growth is now 2.70%. Therefore, to achieve the target growth of 2.5%-3.0% for 2021, Nigeria will need to achieve an average growth of 2.5% per quarter in the next two quarters. This is possible but will be a tall order when you compare the activity levels with Q3 when the re-opening and relaxation started and the Economic Sustainability Plan (ESP) and palliative stimulants were in play.

The impressive growth trajectory will only be sustained if complemented with strategic investment and increased stimulus in the job elastic sectors while reducing leakages emanating from misaligned exchange rates and subsidies. According to Okun's law, real GDP must grow 2% faster than the growth of potential GDP to achieve a 1% decline in unemployment. However, the new wave of COVID-19 is a major threat to these projections.



[1]

Nigeria is more oil production sensitive than price

Oil has remained a major source of government revenue and foreign exchange earnings in Nigeria. In Q1’21, it accounted for 66.38% of total export earnings. However, it is yet to have a significant impact on output growth. The sector’s contribution to GDP fell to 7.42% in Q2’21 from 9.25% in Q1’21 and 8.93% in Q2’20. Despite the 12.47% increase in oil prices in the quarter ($69.02pb), the sector contracted further to –12.65% from -2.21% in Q1’21 and -6.63% in Q2’20. This was largely due to lower oil production. Domestic oil production declined to 1.61mbpd in Q2’21 from 1.72mbpd in Q1’21 and 1.81mbpd in Q2’20. This suggests that the Nigerian economy is more sensitive to oil production than price.

Broad-based sector performance – 34 expanded, 8 slowed and 4 contracted

The breakdown of the report showed a broad-based improvement in sector performance, particularly in the non-oil sector. This suggests that the various government interventions, stimulus packages and economic reforms are beginning to yield the intended impact. The non-oil sector grew by 6.74% in Q2’21, 5.95% higher than 0.79% in Q1’21 and 12.8% above -6.05% in Q2’20. The non-oil sector’s contribution increased to 92.58% of GDP, from 90.75% in Q1’21 and 91.07% in Q2’20.

Of the 46 activities tracked by the NBS, 34 expanded, 8 slowed and 4 contracted. The expanding sectors comprised of activities that are labour-intensive and those that have the potential to boost productivity and stimulate output growth.

[1] NBS, FDC Think Tank

Expanding Sectors	Q1'21 Growth Rate (%)	Q2'21 Growth Rate (%)	Rationale	Impact on the Economy
Electricity	8.66	78.16	* Increased commercial consumption	* Boost in productivity
Transportation	-21.89	76.81	* Increased demand as more	* Boost in productivity
Trade	-2.43	22.49	* Border re-opening, increased economic and business activity levels	* Labour-intensive (employs about 16% of the labour force)
Construction	1.42	3.70	* Increased government investment especially in road infrastructure. Private construction still limited by low disposable income	* Boost in productivity and labour intensive
Manufacturing	3.40	3.49	* Boost in economic activities * Forex scarcity remains a major threat	* Labour intensive (employs 8.3% of the labour force)
Accommodation	-21.89	76.81	* Gradual re-opening of hotels	* Less labour-intensive (employs 1.6% of the labour force)
Entertainment	-1.13	1.22	* Gradual re-opening of event centres	* Less labour-intensive (employs 0.8% of the labour force)

Some of the slowing and contracting sectors are:

Slowing & Contracting Sectors	Q1'21 Growth Rate (%)	Q2'21 Growth Rate (%)	Rationale	Impact on the Economy
Agric	2.28	1.30	* Planting season effect * Benefitted from govt interventions * Insecurity a major threat	* Labour-intensive (employs 54.7% of the labour force)
ICT	6.31	5.50	* Increased commercial usage but reduced personal usage due to low purchasing power * Impact of removal of SIM ban delayed till Q3	* Sector is a growth booster
Mining & quarrying	-2.19	-12.29	* Lower oil production	* Nigeria is more sensitive to oil production than price

Okun's law – Nigeria's real GDP growth yet to move the needle

While the continued expansion in economic growth is a positive development, it is yet to have a significant impact on socio-economic conditions. More people are living below the poverty line. According to the World Bank, 7mn people fell into extreme poverty in 2020, bringing the total number of people living below the poverty line to approximately 96mn. Also, unemployment is projected to increase towards 40% from 33.3% in Q4'20. According to Okun's law, to achieve a 1% decline in unemployment, real GDP must grow 2% faster than the growth of potential GDP. The EIU estimates Nigeria's potential growth at 8.3% for 2021.

Strategic investment and stimulus in productive sectors

Economists believe that investment is a catalyst for growth. Keynes also opined that countercyclical fiscal policy (increased government spending) will stimulate growth during periods of economic downturns. However, the impact of these on the economy largely depends on the multiplier effect. It is important that these investments and stimulus packages are targeted at the productive sector of the economy to unlock idle resources and spur output growth whilst eliminating leakages emanating from misaligned exchange rates and subsidies. It is also important that the major challenges to investment are addressed – policy inconsistency and uncertainty, insecurity and regulatory bottlenecks.

Outlook

We expect the positive growth momentum to continue in the third quarter on further boost in economic activities. Q3 is the peak of the harvest season, hence we expect the agric sector performance to improve albeit slightly as insecurity heightens. Also, Nigeria's oil production is likely to increase in line with its new OPEC quota (1.83mbpd). However, real GDP could fall slightly to 3.5% as base effects gradually wane. The manufacturing sector performance will be limited by forex challenges and higher production costs.

Impact on policy decisions

The sustained moderation in inflation (17.38%) and the spike in GDP (5.01%) increases the likelihood of a nominal cut in the MPR by 50 basis points to 11.0%p.a. in September if inflation drops again.