NIGERIA

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

December 16, 2020

KEY ISSUES

Context. The Nigerian economy is at a critical juncture. A weak pre-crisis economy characterized by falling per capita income, double-digit inflation, significant governance vulnerabilities and limited buffers, is grappling with multiple shocks from the COVID-19 pandemic. Real output is projected to contract by 3.2 percent in 2020, with a weak recovery likely to keep per capita income stagnant and no higher than the 2010 level in the medium term. Policy adjustment and reforms are urgently needed to navigate this crisis and change the long-running lackluster course.

Key policy recommendations. In the short run, the recommended policy mix is heavily tilted toward exchange rate adjustment given constrained capacity on the monetary and fiscal fronts. In the medium term, revenue mobilization is a top priority.

Fiscal Policies. In the short run, fiscal policy should address economic and health impact of the pandemic in a transparent and efficient manner. Significant revenue mobilization will be needed in the medium term to reduce fiscal sustainability risks arising from low debt servicing capacity**.** With high poverty rates, revenue mobilization will need to rely on progressive and efficiency-enhancing measures, with higher value added and excise tax rates awaiting a firm economic recovery.

Exchange Rate Policies. A more transparent and market-based exchange rate policy is imperative to instill confidence. Staff recommends establishing a market-clearing unified exchange rate with the near-term focus on allowing greater flexibility and removing the backlog of requests for foreign exchange.

Monetary and Financial Sector Policies. The accommodative monetary stance is appropriate but may need to be tightened if balance of payments pressures intensify. In the medium term, the monetary policy operational framework should be reformed to establish the primacy of price stability. The banking sector has been resilient thanks to the ample pre-crisis buffers. Continued vigilance and, if necessary, prompt corrective actions are needed to contain stability risks.

Structural Policies. Significant reforms are underway in the fuel and power sectors as well as in governance and business regulations. Steadfast implementation in these areas along with broad market and trade reforms to open up the economy are needed to usher in a job-rich growth.

Approved By
David Owen and Maria Gonzalez

Discussions took place virtually during November 3-17, 2020 with some technical meetings on October 30. The team comprised Ms. Rahman (Mission chief), Mr. Aisen (Resident Representative), Messrs. Ree, Yao (both AFR), Mr. Chai (FAD), Mr. Wezel (MCM), and Mr. Lundback (SPR). Ms. Mangga, Ms. Bonet, and Mr. Okafor (Resident Representative office) assisted the mission. Messrs. Odonye and Ekeocha (both OED) and Mr. Saldarriaga (The World Bank) participated in most meetings. The mission held discussions with Finance, Budget and Planning Minister Ahmed, Central Bank of Nigeria Governor Emefiele, and other senior government officials. The mission also met with parliamentarians and representatives of financial institutions, private sector, development partners, and civil society. Ms. Kiggundu, Ms. Pilouzoue, and Ms. Synak provided excellent assistance for the preparation of this report.

CONTENTS

FIGURES

TABLES

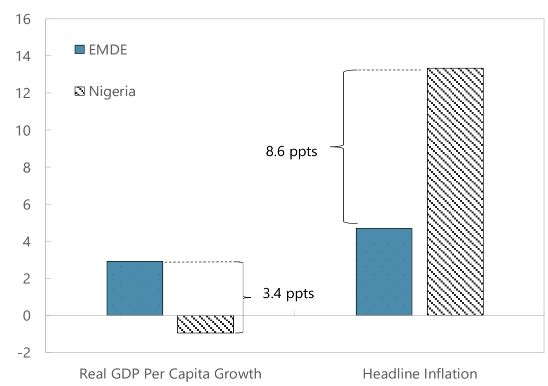
ANNEXES

BACKGROUND

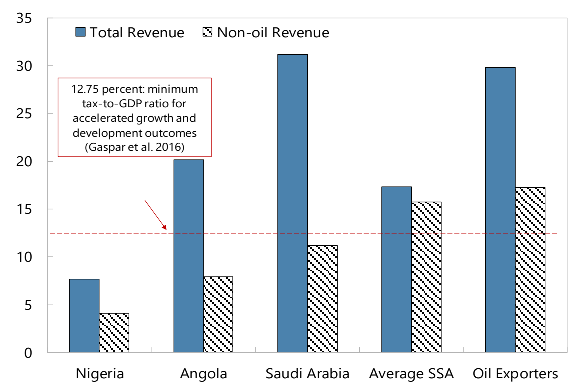
1. Nigeria's economy is at a critical juncture. An economy that was already weakened by falling per capita income, double-digit inflation, limited buffers and significant governance vulnerabilities has been hit hard by the global pandemic. Plunging oil prices and sharp capital outflows in 2020Q1 significantly increased balance of payments (BOP) pressures which, together with the pandemic-related lockdown in 2020Q2, have caused a historic output contraction. With the consolidated government revenue-to-GDP ratio at 8 percent in 2019, among the lowest in the world, there is limited policy space to respond to the current crisis. In April 2020, Nigeria received IMF financial assistance amounting to $3.5 billion under the Rapid Financing Instrument (RFI) in the wake of the oil price shock.

Nigeria: Pre-COVID-19 Context and Economic Impact of the Pandemic

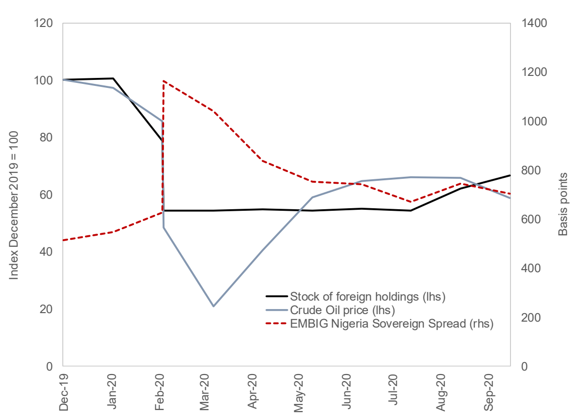
GDP per Capita Growth and Inflation, 2017-19
(percent)



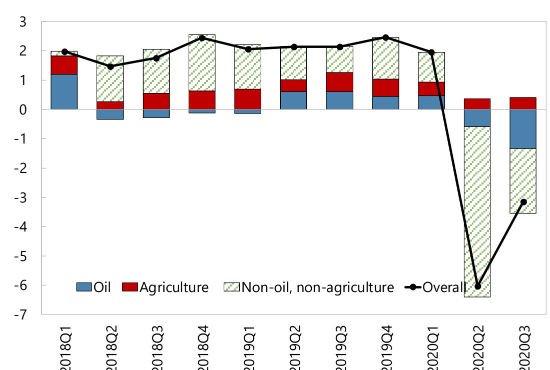
Consolidated Fiscal revenues, 2019
(percent of GDP)



Oil Price, Foreign Capital Holdings and Sovereign Spreads
(units as indicated)



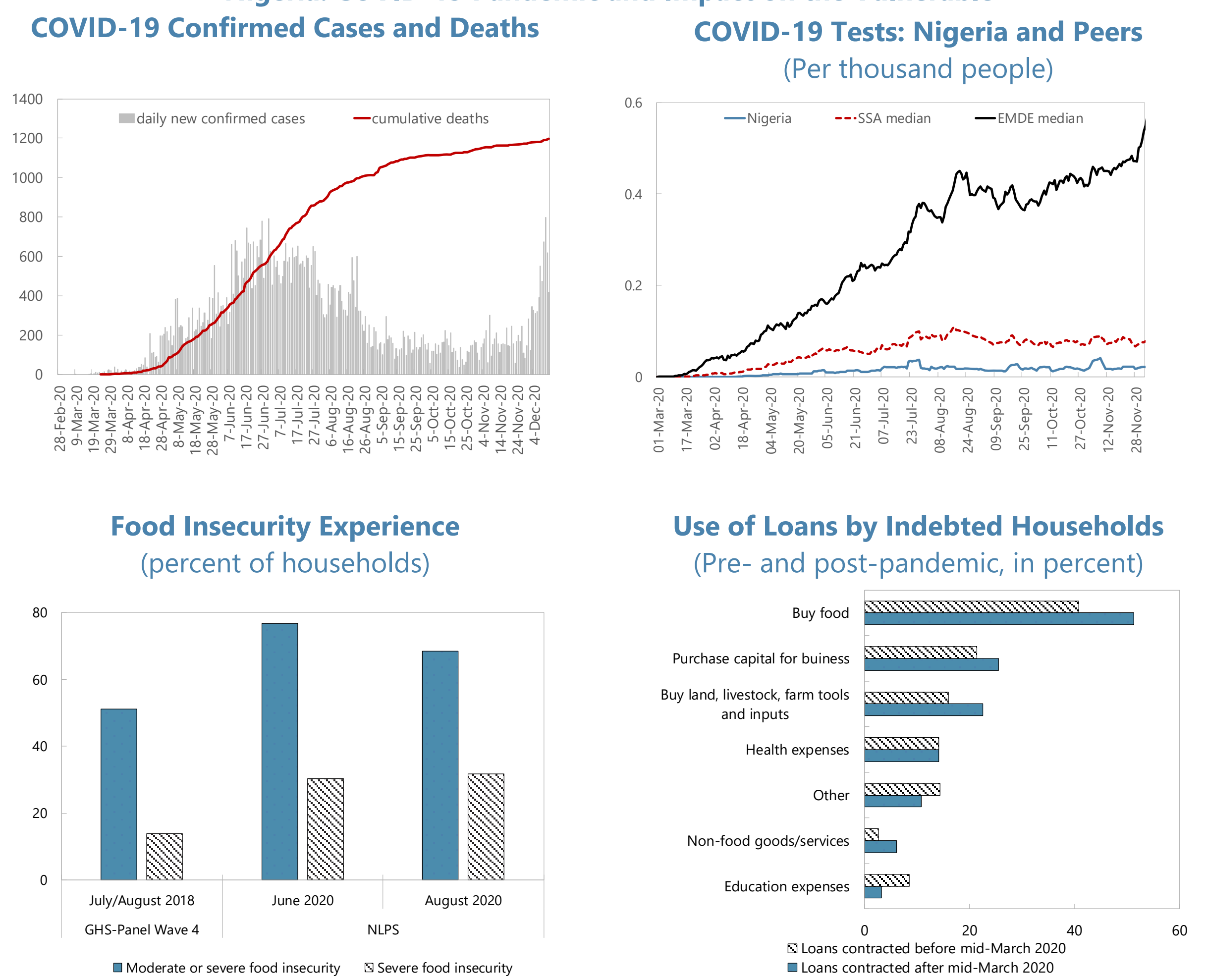
Quarterly Real GDP Growth and Contribution
(percent)



Note: EMDE includes a set of 155 emerging market and developing economies (WEO classification).
Sources: WEO, Bloomberg, CBN, custodian data, Haver and IMF staff calculations.

2. The authorities have undertaken commendable and timely measures to counter the pandemic's impact on lives and livelihood. These encompassed palliative measures, a strict lockdown, removal of fuel and electricity subsidies as well as fiscal and monetary policy support for the health sector and the economy, including higher subsidies on Central Bank of Nigeria's (CBN) credit intervention facilities and regulatory forbearance measures to ease debt service (Annex 1). Daily confirmed new cases of COVID-19 peaked in June and July and have remained mostly below 200 since September before starting to surge more recently, with the cumulative reported death toll around 1200 as of December. With limited testing, there are uncertainties regarding the extent of the health impact. Nigeria is working with the World Health Organization on the COVID-19 vaccine access. However, a plan is yet to be developed for purchase, distribution and administration of the vaccine and potential funding gaps could emerge.

Nigeria: COVID-19 Pandemic and Impact on the Vulnerable



Sources: Our World In Data and IMF staff calculations; Nigeria COVID-19 National Longitudinal Phone Survey (COVID-19 NLPS) 2020 Fourth Round by National Bureau of Statistics (NBS).

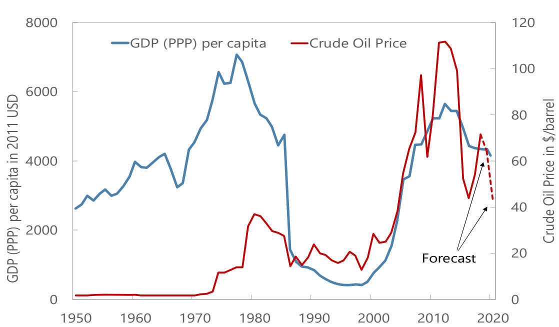
Note: Nigeria COVID-19 NLPS 2020 Fourth Round was conducted in August 2020. Sample included 1,789 households who were interviewed on all questions. The data are representative at the national level and survey weights were calculated to adjust for non-responses and under coverage.

3. Socio-economic conditions have significantly deteriorated. In October, mass protests against police brutality started under the ENDSARS movement. Social discontent has widened since the beginning of the crisis with rising food inflation, elevated youth unemployment and high social inequality. Headline inflation reached 14.2 percent in October 2020, a 30-month high, while the unemployment rate reached 27 percent in 2020Q2, with youth unemployment increasing to 41 percent (Figures 1 and 4). Surveys conducted by the Nigerian authorities also show a significant economic impact on the vulnerable, including a precarious food security condition.

4. A fundamental policy reset is needed to durably exit this crisis. A large number of countries around the world have been battered by the global pandemic, experiencing output contractions. What set Nigeria apart are its weak pre-crisis fundamentals that threaten to turn a temporary crisis into a slump with more lasting consequences for employment and living standards. Long-running inward-looking policies have been stepped up in recent years through increased import restrictions, a partial border closure, administrative control of foreign exchange (FX) allocation and capital flow measures (CFMs).[1] These protectionist measures are yet to deliver a job-rich growth as the economy remains heavily dependent on the oil sector, through direct and indirect exposures, and vulnerable to periodic commodity shocks. Past IMF advice to pursue broad market reforms, including recommendations for unification and greater flexibility of the exchange rate that the authorities committed to under the RFI, have seen limited traction (Annex II). The current crisis provides a unique opportunity to break away from the past. This year's consultation focuses on near- and medium-term policies needed to alter Nigeria's lack-luster economic course.

Nigeria: Growth and Oil Dependence

GDP per Capita and Oil Price



Oil and the Nigerian Economy

Share of oil in total (2010-2019 average unless otherwise indicated)	
GDP	
oil and gas	11%
oil and gas related	30-35%
Exports	93%
FGN revenue	48%
banking sector loans (2015-2019 average)	29%
Revenue of publicly listed companies	
oil and gas	23-41%
oil and gas related	44-58%
Correlation with oil price (2010-2019)	
Non-oil GDP growth	0.82
EMBIG spread	-0.73

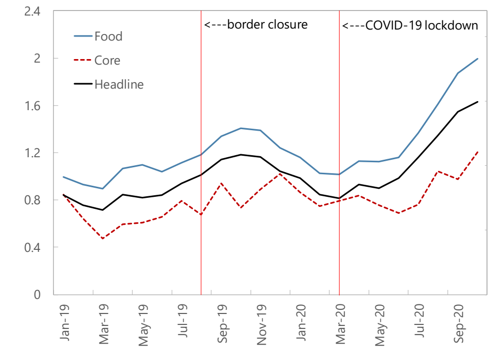
Sources: Penn World Tables, World Bank, Nigerian authorities, CBN, NBS, Bloomberg and and IMF staff calculations.

[1] Introduced in August 2019, the partial border closure prevents goods trade across land borders with intentions to address smuggling and security concerns and help boost domestic production. CFMs include the prohibition of FX purchases in the official market for foreign currency bond and equity instruments, and payment limits on naira-denominated credit and debit cards for overseas transactions. In addition, export proceeds must be repatriated within 90 days of the date of shipment for oil exports and 180 days for non-oil exports.

RECENT MACROECONOMIC DEVELOPMENTS

5. **The economy has been hit hard**. Following a modest expansion in the first quarter, real GDP declined by 6 percent (y/y) in the second quarter driven by declining oil prices, which together with the COVID-19 related lockdowns, severely impacted the non-oil economy. The economy continued to contract in the third quarter albeit at a slower pace. Despite weak domestic demand, both headline and core inflation rates have been on an upward trend amidst supply shortages resulting from the lockdown, border closure and import restrictions (text chart, Box 1).

Nigeria: Seasonally Adjusted Inflation
(m/m percent change)

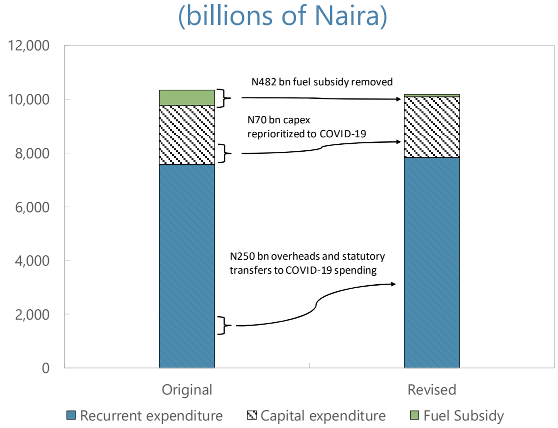


Sources: NBS and IMF staff calculations.

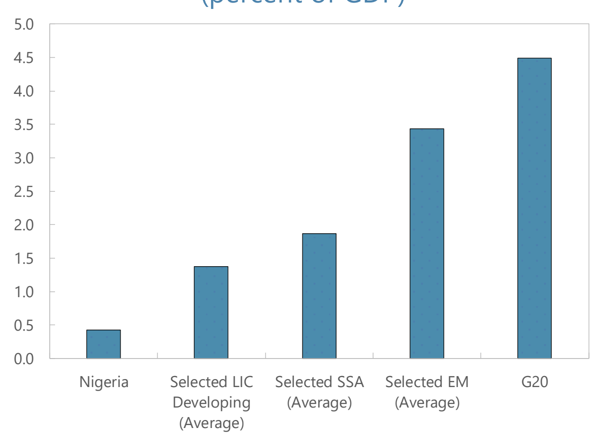
6. **Fiscal developments in the first nine months of 2020 show underperformance relative to the revised budget.** The Federal Government (FGN) adopted a revised budget in July 2020 in response to the pandemic, which removed fuel subsidies, prioritized spending to make room for a N500 billion (0.3 percent of GDP) support package and adjusted the budget oil price to \$28 per barrel (from \$57 in the original budget). The fiscal support package is small when compared to peer countries but reflects Nigeria's constrained policy space. The year-to-date FGN fiscal outturn shows sizable underperformance in non-oil revenues, while oil revenues outperformed slightly thanks to recovering prices. Deficit financing has relied on external borrowing, including the disbursement under the RFI, and domestic bond issuance taking advantage of ultra-low interest rates and higher borrowing limits (Figure 2).

Nigeria: 2020 Budget Revisions and COVID-19 Support

2020 Original and Revised Budgets
(billions of Naira)



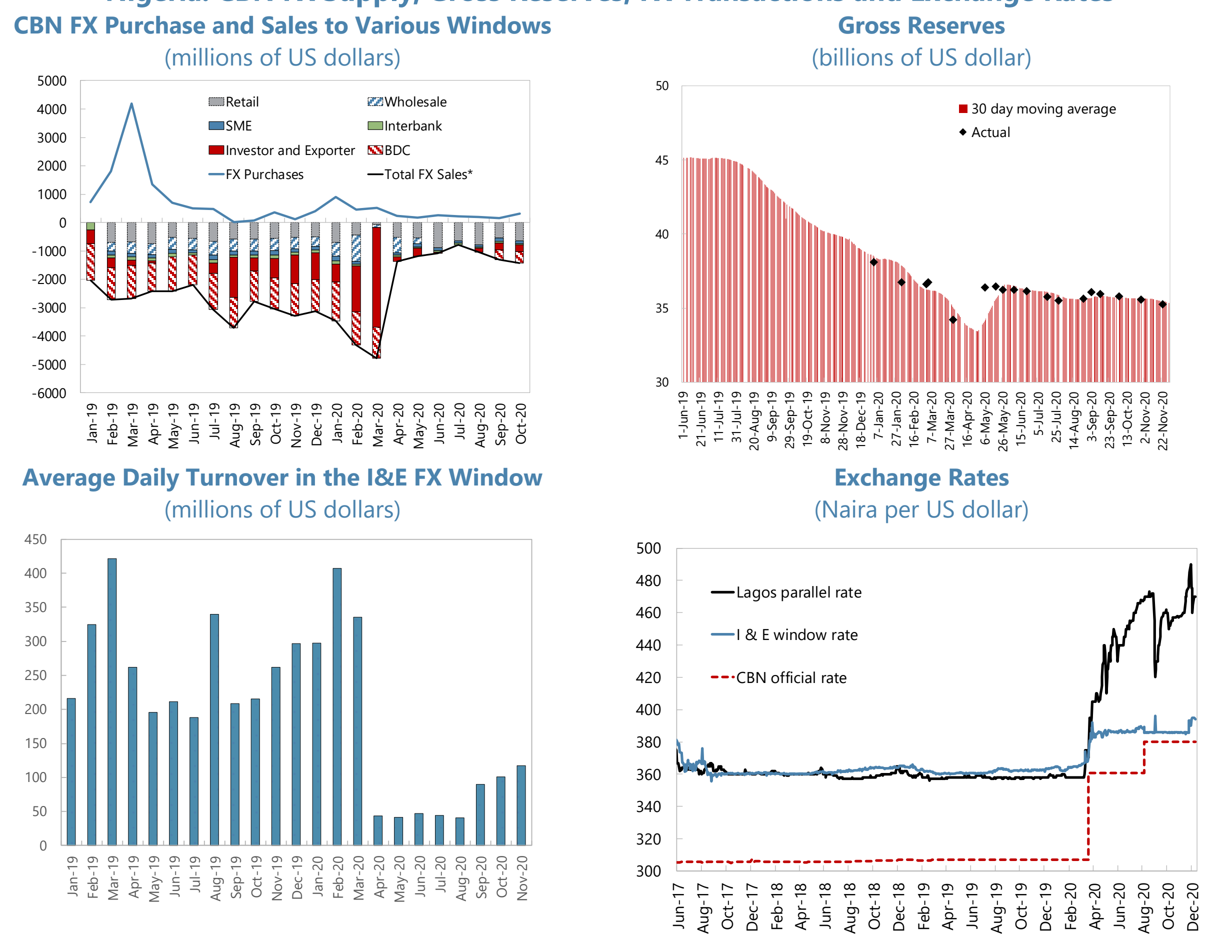
COVID-19 Fiscal Support Package
(percent of GDP)



Sources: Nigerian authorities, Fiscal Monitor April 2020 and IMF staff calculations.

7. The external sector came under intense pressures in 2020H1. After a significant worsening in 2019, the current account (CA) remained in deficit in 2020H1 despite a large contraction in imports (Figure 3). Sharp declines in exports and capital outflows put pressure on the exchange rate. The authorities responded by adjusting the official exchange rate by 18 percent in March and 6 percent in August, although the Investors' and Exporters' (I&E) window rate, considered "the market rate" before the pandemic, moved by only 5 percent. In addition, they stepped up administrative controls by increasing the number of goods under import restrictions, enforcing existing requirements for export repatriation and reducing FX supply to various windows. While these policies have stopped capital outflows and kept gross reserves stable, confidence is weak and, in the absence of fresh capital inflows, transactions in the I&E window remain well below pre-pandemic levels. The private sector reported significant FX shortages during discussions with staff, which are being met by a combination of delayed payments, use of own FX funds and purchases in the parallel market, where premiums relative to the official exchange rate have ranged between 13-31 percent since April. In addition, there is also an estimated $2 billion backlog of requests for FX from divestment by foreign portfolio investors (FPI) of Naira assets, which are being gradually cleared by the CBN using a combination of spot and forward allocation.

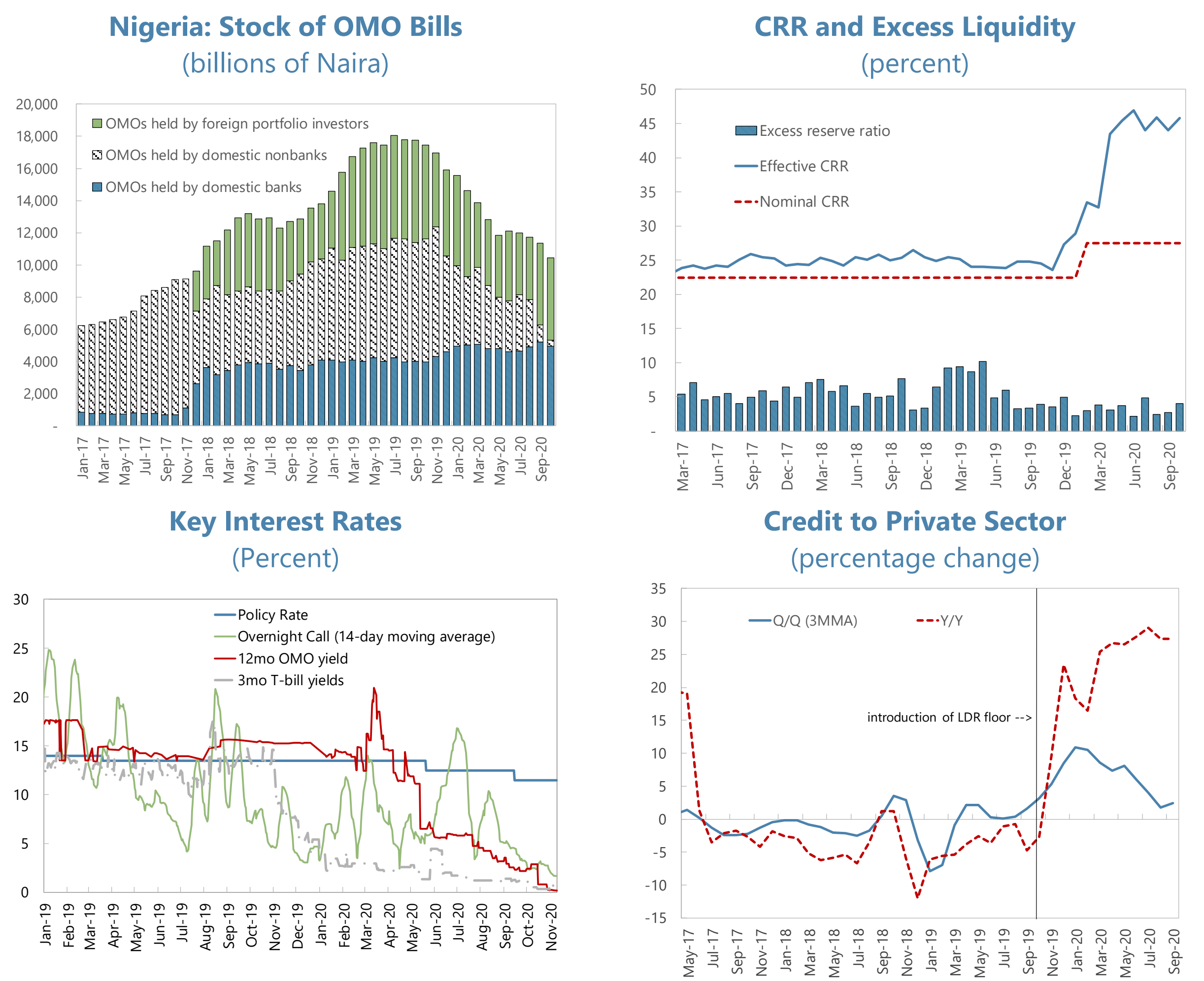
Nigeria: CBN FX Supply, Gross Reserves, FX Transactions and Exchange Rates



Sources: CBN, Haver and IMF staff calculations.
*/ FX sales are shown in negative amounts.

8. Monetary policy has on balance been accommodative mostly benefiting fiscal financing. In October 2019, the CBN adopted a policy prohibiting domestic nonbank institutional investors from reinvesting in Open Market Operations (OMO) bills. The significant liquidity released from maturing OMO bills held by these investors has mostly found its way into the government debt market which has driven interest rates to record low levels. Given the strict cash reserve requirement (CRR)-based liquidity management in the interbank market, the effective CRR ratio recently rose to 46 percent despite a nominal ratio of 27.5 percent reflecting the CBN's discretionary and out-of-cycle debits. The authorities also reduced the monetary policy rate (MPR) twice in May and September by a cumulative 200 basis points, which has put downward pressure on the lending and borrowing rates. A highly liquid domestic financial market has mostly benefited fiscal financing, while credit to the economy has slowed considerably in recent months after rising strongly due to the administrative push from the minimum loan-to-funding ratio (LDR) introduced in mid-2019.

Nigeria: Key Interest Rates and Credit Growth



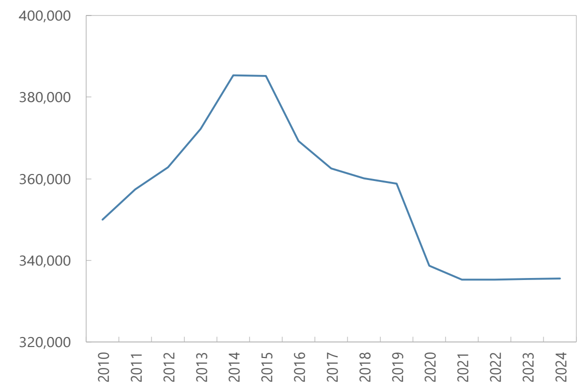
Sources: CBN, FMDQ and IMF staff calculations.

9. The authorities have introduced transparency measures to facilitate tracking and reporting of emergency spending.[2] New budget lines have been created with monthly expenditure information on emergency funding posted on the Ministry of Finance's Transparency Portal, although users have found it difficult to access the data on the portal.[3] The Bureau of Public Procurement has issued guidelines on COVID-19 emergency fund use, and the Nigeria Open Contracting Portal has been publishing related procurement contracts, although some contract details on beneficiary ownership are yet to be completed.[4]

OUTLOOK AND RISKS

10. Under current policies, the recovery is expected to be weak and drawn-out. Real GDP is projected to contract by 3.2 percent in 2020 with growth turning positive in 2021 at 1.5 percent (Table 1). Over the medium term, a subdued global recovery and decarbonization trends are expected to keep oil prices low and OPEC quotas in place, keeping oil-related activities, fiscal revenues and export proceeds contained. Non-oil growth would also remain sluggish, reflecting inward-looking policies and regulatory uncertainties. Real GDP is expected to recover to its pre-pandemic level only in 2022, implying several more years of stagnant living standards. Inflation would gradually come down with the easing of food prices but stay in double digits absent monetary policy reforms. The CA deficit is projected to improve slightly on the back of recovering oil prices, although capital flows will remain subdued without a more transparent and market-based exchange rate policy (Table 2).

Nigeria: Real GDP Per Capita
(2010 Naira)



Sources: NBS and IMF Staff calculations.

11. The near-term outlook faces significant downside risks while there are some upside risks in the medium term (Annex III). A global and domestic resurgence of the pandemic, which might prompt a sharp drop in oil prices, a renewed domestic lockdown, a fall in remittances and a surge in borrowing costs, poses the largest risk. Staff estimates show that in such a scenario, real

[2] The authorities committed to the following in the letter of intent for the RFI (i) creating specific budget lines to facilitate the tracking and reporting of emergency response expenditures and report funds released and expenditures incurred monthly on the transparency portal; (ii) publishing procurement plans, procurement notices for all the emergency response activities—including the names of awarded companies and of beneficial owners—on the Bureau of Public procurement website; and (iii) publishing no later than three to six months after the end of the fiscal year the report of an independent audit into the emergency response expenditures and related procurement process, to be conducted by the Auditor General of the Federation—who will be provided the resources necessary and will consult with external/third party auditors.

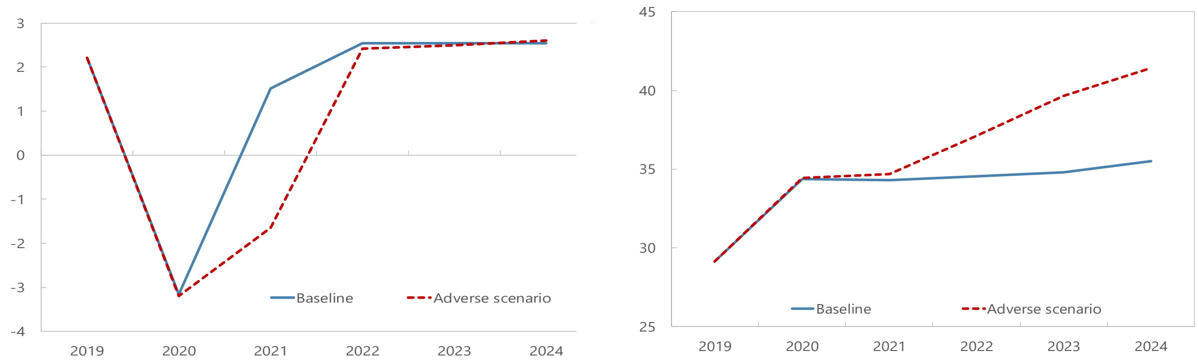
[3] See http://www.opentreasury.gov.ng/

[4] See link to Nigeria Open Contracting Portal - https://nocopo.bpp.gov.ng/ContractReportCovid19.aspx and Bureau for Public Procurement Guideline on COVID-19 Procurement - https://www.bpp.gov.ng/wp-content/uploads/2020/05/BPP-Guideline-on-COVID-19-Procurements-1.pdf

GDP could contract by 1.7 percent in 2021, pushing back recovery, with public debt rising by almost 7 percentage points of GDP in the medium term absent consolidation measures (Box 2). The impact on the real economy could be further exacerbated by the risks of disorderly BOP adjustment and ongoing ENDSARS protests. Capital outflow risks remain considerable with record-low interest rates and still sizable foreign holdings of short-term OMO bills. On the upside, the Dangote refinery, if commencing production in 2022 as planned, could meet the full demand for domestic consumption of refined petroleum products—which are almost all imported at present—thereby improving the CA balance. With crude oil for local refining not subject to the OPEC quota, the refinery also has the potential to catalyze more domestic crude oil production and boost GDP growth.

Nigeria: Downside Risks from COVID-19 Pandemic

Real GDP (Annual percentage change) | **Public Debt** (percent of GDP)



Sources: The calculations are done using a dynamic general equilibrium model, DIGNAR-19 (Melina and Zanna, 2020), combined with an epidemiological multigroup susceptible-infectious-removed (SIR) model (Cugat, 2020). See Box 2 for more details.

Note: The following simultaneous shocks are applied to capture a global and domestic pandemic resurgence: (1) a health shock, which affects the labor force and government expenditures; (2) a commodity price shock affecting the oil and nonoil economy (due to its dependence on the oil price), exports and government revenues; and (3) external finance shocks causing a fall in remittances and a surge in borrowing costs.

Authorities' Views

12. While acknowledging high uncertainties, the authorities also expect negative growth for 2020, albeit lesser than in staff's projection, and a slow recovery. They project that real GDP growth may turn positive as early as in 2020Q4 but could also take until mid-2021 in light of continued financial strains faced by a large part of the population coupled with supply-side shocks, including floods affecting agriculture and the ENDSARS movement on top of the logistical challenges posed by the pandemic. The authorities highlighted strong actions taken in the aftermath of the pandemic which could help a resilient recovery. Inflation could reach as high as 16 percent by year-end with upward pressures from fuel and electricity price increases. The agricultural harvest in late 2020 is expected to increase supply and ease upward pressures on food prices.

POLICY DISCUSSIONS

13. Staff recommended policies to support recovery and contain BOP pressures in the short run followed by priority reforms to lift growth and employment. The near-term policy mix is heavily tilted toward exchange rate adjustment given constrained policy space on the monetary and fiscal fronts and the need to cushion health and economic impacts of the pandemic. With economic recovery taking root, the authorities should pursue the following policy mix in the medium term: (i) a revenue-based fiscal consolidation through tax policy and revenue administration measures; (ii) a clear exchange rate policy with a unified, market-clearing exchange rate and greater flexibility; (iii) a reformed monetary policy framework to provide a credible anchor for price stability; and (iv) structural policies to reduce protectionism and decisively improve governance and the business environment. Financial sector vigilance to monitor credit, liquidity, FX and money-laundering risks will be important in the near and medium term. Sustained implementation of these policies could lift growth above 4 percent compared to 2½ percent under the baseline and create higher buffers and policy space (Table 10).

A. Fiscal Policy: Reduce Sustainability Risks through Revenue-Based Consolidation

14. The authorities expect a significant increase in revenues as the economy starts to emerge from the pandemic. Based on the partial information available to staff, the draft 2021 Finance Bill includes proposals to reduce import duties and levies and to provide targeted tax relief and exemptions. The 2021 draft budget targets a roughly unchanged overall FGN deficit, as a strong bounce-back of oil and non-oil revenues is expected to finance a significant scaling up of public investment. Some savings in current spending are also expected from lower interest payments. In the medium term, stable revenues and expenditures in percent of GDP are expected to keep the overall FGN deficits roughly at the projected 2020 level.

Nigeria: Authorities' Budget and Medium-term Fiscal Forecasts

Macroeconomic Assumptions

	2019	2020	2021	2022	2023
Oil Price (US$ per barrel)	67.2	28	40	40	40
Oil Production (mbpd)	1.96	1.80	1.86	2.09	2.38
Exchange rate (Naira/USD)	305	360	379	379	379
Real GDP growth (%)	2.3	-4.2	3	4.7	3.9

FGN Budget Projections
(percent of authorities' projected GDP)

	2020	2021	2022	2023
Revenues	3.8	4.6	4.4	4.6
Expenditures	7.1	7.8	7.7	7.6
Overall fiscal balance	-3.3	-3.2	-3.3	-3.0

Sources: Ministry of Finance.

Note: The detailed policy measures underlying the authorities' 2021 budget and medium-term projections were not available, hence are not incorporated in staff's baseline projections. FGN projections exclude government owned enterprises and project-tied loans.

15. Under staff's baseline projections, fiscal deficits and debt-servicing risks are projected to stay elevated. Reflecting sharp revenue declines, the General Government (GG) deficit is projected to widen to 5.9 percent of GDP in 2020 and drop below 5 percent thereafter driven by higher non-oil revenues from full impact of the value added tax (VAT) increase implemented by the authorities in 2020 (from 5 to 7½ percent), and some improvement in administration, and expenditure savings from removal of power sector subsidies and COVID-19 related emergency support (Tables 3-6). Public debt is projected to increase sharply to 34 percent of GDP in 2020 and rise moderately to around 36.5 percent in the medium term, helped by favorable interest rate-growth dynamics (Annex IV: Public Debt Sustainability Analysis). Liquidity-based indicators, such as the interest payments and gross financing needs will continue to constitute a high share of government revenues, putting Nigeria's fiscal space at risk and making its low debt-to-GDP ratio highly vulnerable to macroeconomic shocks.

Nigeria: Staff's Fiscal Projections for the General Government under the Baseline

(percent of GDP)

	2019	2020	2021	2022	2023	2024	2025
	actual	projections					
Total revenue	7.9	5.9	6.9	7.0	7.1	7.1	7.1
o.w. non-oil	4.2	3.9	4.5	4.8	4.9	5.0	5.1
Total expenditure	12.6	11.8	11.7	11.8	11.6	11.8	12.0
o.w. COVID-19 related		0.3					
o.w. electricity subsidy	0.4	0.3	0.1	0	0	0	0
Overall fiscal balance	-4.8	-5.9	-4.7	-4.8	-4.5	-4.7	-4.9
Public debt	29.1	34.4	34.3	34.6	34.8	35.5	36.4
Memorandum items							
FGN revenue	3.1	2.2	2.6	2.5	2.5	2.4	2.4
FGN expenditure	7.6	7.5	6.7	6.6	6.4	6.7	6.8
FGN fiscal balance	-4.6	-5.3	-4.0	-4.1	-3.9	-4.3	-4.4
GG interest to revenue ratio	20.5	35.2	23.0	24.3	24.8	28.0	31.9
FGN interest to revenue ratio	52.6	92.6	60.8	67.7	69.7	81.3	94.1

Source: Staff Calculations.

16. To ensure sustainability, staff emphasized the need for additional revenue-based fiscal consolidation. In light of high poverty, staff recommended revenue measures that are progressive and efficiency-enhancing, drawing on previous IMF technical assistance recommendations (text table). These include increasing the VAT rate to at least 10 percent by 2022 and 15 percent by 2025, rationalizing the pioneer status system and other tax exemptions and customs duty waivers, increasing rates for excises and broadening the base, developing a high-integrity taxpayer register, and improving on-time filing and payment. A significant increase in non-oil revenue is critical to balance the negative revenue impact of the global decline of demand for oil in the long run.

Nigeria: Adjustment Scenario: Recommended Fiscal Measures

(Cumulative Impact, 2021–25, Percent of GDP)

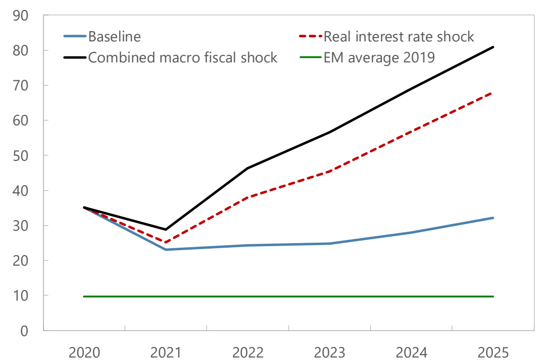
Total	7.1
VAT	2.2
Increase rate to 15 percent	1.0
Remove exemptions and improve compliance	1.2
CIT and custom duties	1.2
Rationalize tax incentives	0.2
Improve efficiency	0.7
Exchange rate depreciation	0.3
Excises (rate increase and base broadening)	2.1
Property tax	0.4
Oil revenue (exchange rate depreciation)	1.1

Source: IMF staff estimates.

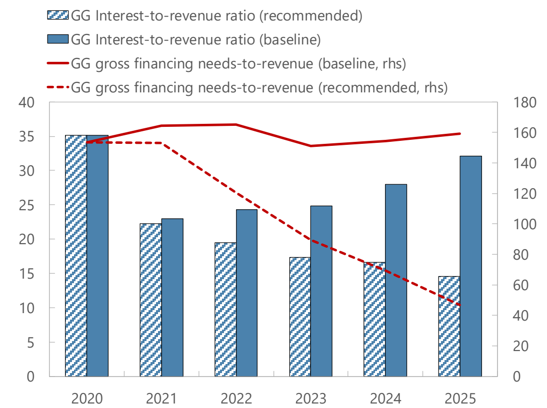
Nigeria: Fiscal Sustainability Risks from Low Revenues

GG Interest Payments, Baseline and Stress Tests

(Percent of GG Revenue)



GG Interest Payments and Gross Financing Needs: Baseline and Recommended Scenarios



Sources: Nigerian authorities and staff calculations.

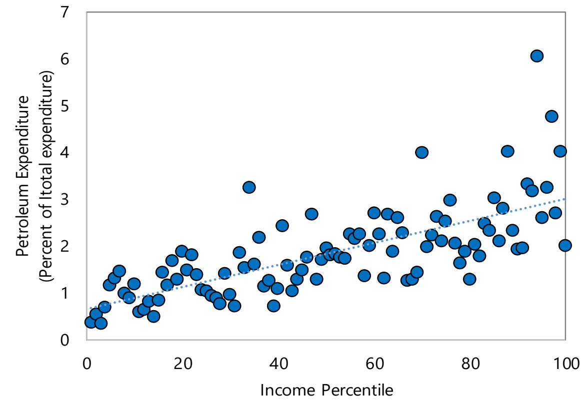
Note: The interest rate shock is calibrated to cause the average rate to reach historical maximum in the medium term (this implies a 687 bps increase in the real interest rate using the maximum in the past decade); the combined macro-fiscal shock assumes a combination of reduced growth, higher expenditure, higher interest rate, and currency depreciation. See Annex IV for details.

17. The combined gains from these measures could increase revenues by 7 percent of GDP during 2021-25. Staff recommended using part of the additional revenues, up to 2 percent of GDP, for well-targeted social spending leaving overall cumulative fiscal consolidation to be around 5 percent of GDP. Under this scenario, the GG interest payments-to-revenue and gross financing needs-to-revenues ratios would decline significantly, bringing them closer to the emerging markets and developing economies (EMDE) averages and also putting public debt on a downward trajectory. The 2021 consolidation is expected to take place mainly through revenue gains from the impact of further exchange rate adjustment (see next section) and strengthened tax administration, which would include enhanced use of third-party information and digital infrastructure. As the recovery takes root and tax compliance improves, efforts will need to focus on raising tax rates and broadening the tax base to deliver the recommended consolidation.

18. Staff advised a re-composition of fiscal financing away from CBN overdrafts. Elevated fiscal financing needs in the absence of adequate revenues have hinged heavily on CBN borrowing in recent years. The increasing reliance on CBN overdrafts has come with negative consequences. The financing is costly for the federal government at interest rates of MPR plus 300 basis points, and for the CBN, with sterilization done through issuance of OMO bills. Staff recommended reducing dependence on CBN overdraft through the following measures: (i) improved budget planning, including through greater flexibility to secure financing from domestic markets, (ii) enhanced PFM practices, including better integration of cash and debt management, and (iii) more effective use of FGN's idle cash balances in the Treasury Single Account (TSA). A complete removal of central bank financing of fiscal deficits will require higher domestic revenue mobilization.

19. Staff stressed the importance of well-targeted and adequate social policies to protect the poor from negative impacts of ongoing and recommended reforms. Nigeria's social safety net suffers from limited coverage, poor targeting and inadequate monitoring. While the fuel and electricity subsidies were untargeted, largely benefiting the well-off, some negative impacts on the poor from the removal of energy subsidies can be expected. It is essential to improve targeting under the existing social safety nets and increase coverage, including from future VAT increases. Staff's previous analysis shows that any negative impact on the poor from subsidy removal and VAT increases can be countered by additional social spending that would cost a fraction of the fiscal savings from these measures (SM/18/34).

Nigeria: Expenditure on Fuel Products by Income Quintiles



Sources: National Bureau of Statistics, IMF staff estimates

20. Staff welcomed the recent submission of the Petroleum Industry Bill (PIB) to the Parliament. The Fiscal Framework chapter of the bill appropriately rebalances the government take in onshore/offshore production. The fiscal regime should ensure a fair share of revenues to the government while remaining attractive to investors. The bill also addresses the issue of separating the commercial and regulatory functions with proposals to replace the current state-owned NNPC with NNPC Limited, which would carry out only commercial activities, and set up two regulators with considerable independence. Going forward, striking the right balance between independence and accountability, while ensuring data and information sharing between regulators and relevant ministries and agencies, will be essential. For transparency and accountability purposes, adhering to the principle that all petroleum sector revenues, including royalty, taxes, government profit oil share and dividends, should flow through the Federation Account will be important and help reduce vulnerabilities to corruption.

Authorities' Views

21. The authorities concurred on the need for a revenue-based fiscal consolidation. While they reiterated their commitments to achieve a medium-term target of GG revenue-to-GDP ratio of 15 percent, the plans are yet to be firmed up. They are confident that budgeted revenue increases would materialize, including from oil license renewals, stamp duty, and FGN independent revenues. They recognized the importance of improving fiscal monitoring and reporting. Gaps and inconsistencies in fiscal data and misclassifications in fiscal reporting have hampered their capacity for proper fiscal analysis and projections. They reiterated the request for technical assistance to improve the quality of fiscal reporting and appreciated the IMF's consideration of their request for a resident advisor to help implement the agenda on domestic revenue mobilization.

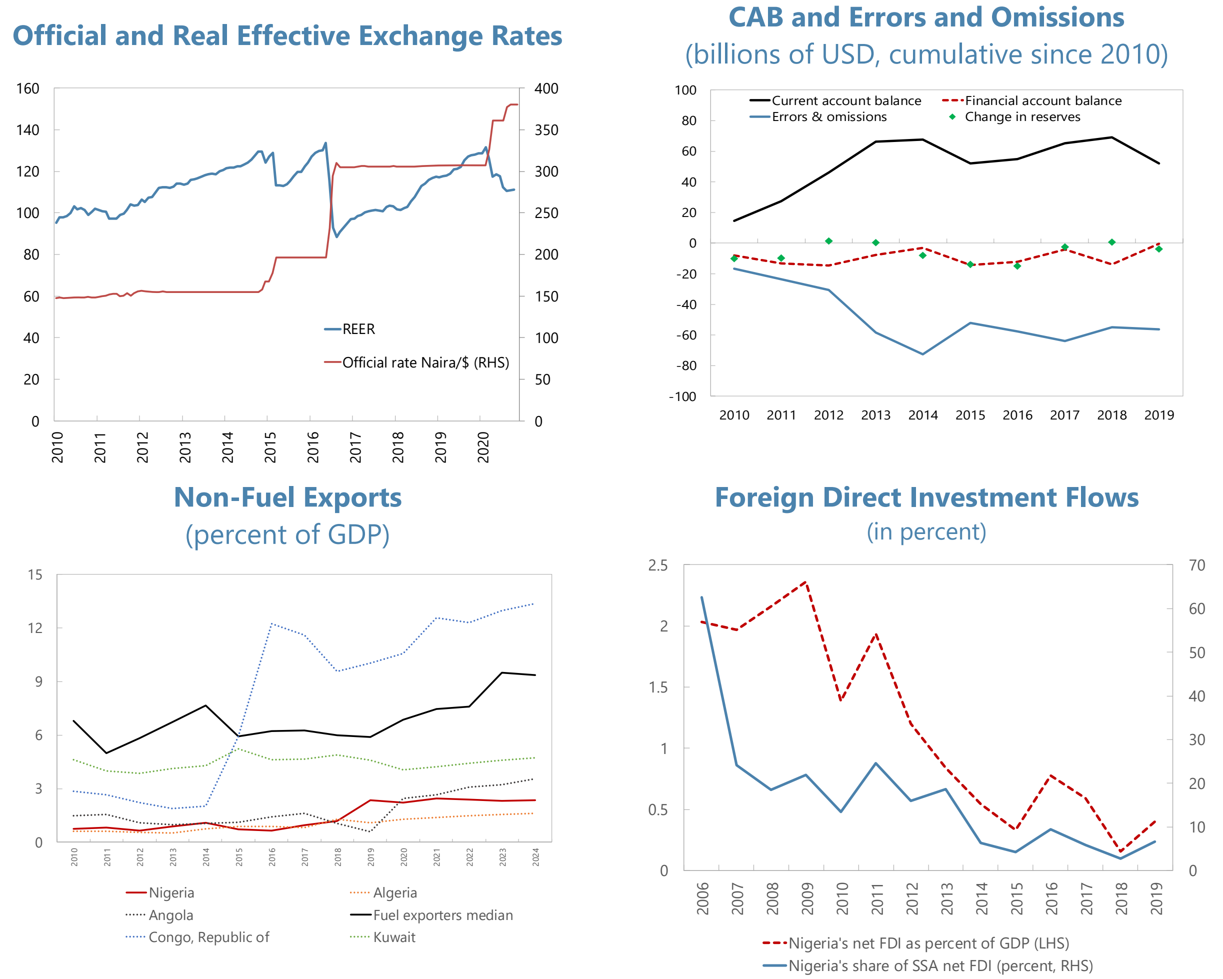
22. The authorities highlighted important recent reforms undertaken despite a difficult macroeconomic environment. They expressed strong commitment to prevent fuel subsidies from resurfacing and to fully eliminate electricity tariff shortfalls by mid-2021. They believe that lifeline tariffs and other relief measures are adequate to protect poorer households from increases in electricity prices and highlighted the benefits from higher and more predictable availability. The authorities expect the PIB to be approved by parliament by 2021Q1 and are confident that the ensuing reforms will significantly boost investment in the oil sector as well as generate sizable positive spillovers for the non-oil economy.

B. Exchange Rate Policy: Allow Greater Flexibility and Unification to Address BOP Pressures

23. The long-running policy of a stable exchange rate has produced limited benefits. The stabilized exchange rate policy, combined with administrative control of imports, has led to periods of real effective exchange rate appreciation interrupted by episodes of forced large adjustments. Staff's latest estimates suggest an overvaluation of the real effective exchange rate (applied on the current level of the official exchange rate) of 18½ percent, with the external position assessed as substantially weaker than what is consistent with fundamentals and desirable policy settings (Annex V: External Stability Assessment). Exports remain highly undiversified. Past current account surpluses resulting from commodity price booms have made limited contributions to the build-up of buffers as sizable unrecorded outflows have continued. Gross reserves levels are significantly below the IMF's ARA metric and projected to remain so in the medium term. External financing is projected to rely on Foreign Direct Investment, issuance of Eurobonds and some drawdown of reserves as portfolio flows are expected to only gradually recover over the medium-term.

24. A clear exchange rate policy is needed to instill near-term confidence and bring long-term gains. The current system, with its multiple windows and untransparent rules of FX allocation, creates uncertainties for the private sector. The unification of various rates into one market-clearing rate, including the dismantling of the legal, institutional and operational underpinnings of the various windows, is needed to establish policy credibility and a decisive break from the highly interventionist regime. It would also eliminate existing Multiple Currency Practices (MCPs, see Informational Annex). An appropriately valued exchange rate would foster domestic industrialization more effectively than through a system of FX rationing where winners are chosen and protected, and relative prices do not move. A clear exchange rate policy would also help attract larger capital inflows, including foreign direct investments, which have significantly dropped in recent years.

Nigeria: External Sector Developments

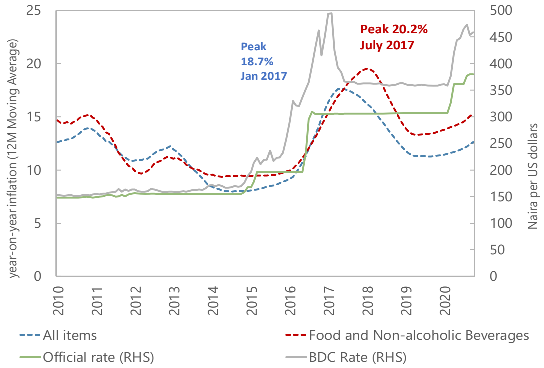


Sources: CBN, Haver and IMF staff calculations.

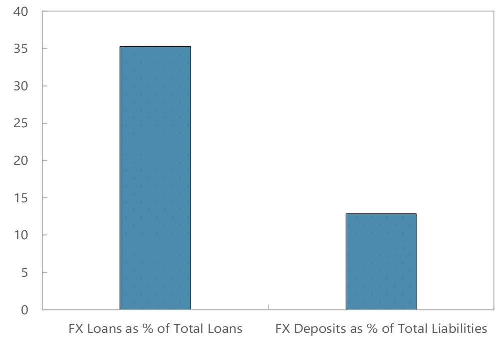
25. Exchange rate flexibility may have short-term negative impacts, particularly on inflation, which should be mitigated. Staff's estimates suggest that a 10 percent devaluation could push the inflation rate up by up to 2.5 percentage points, but the impact could be less if the parallel market rate is already reflected in the prices of imported goods (Box 1). Experience from other countries that have undergone exchange rate adjustment generally shows less pass-through and often a more transient impact on inflation (Box 3). Some targeted support is likely needed to minimize the impact on the poor. The corporate sector and possibly the banking sector could also face significant impact given that a third of banking sector loans are denominated in FX. Strict and pro-active enforcement of existing prudential measures to limit FX loans to only those with FX earnings should limit this impact.

Nigeria: Exchange Rate, Inflation and Banking Sector Dollarization

Consumer Price Index and Exchange Rates
(monthly, units as indicated)



FX Loans and Deposits – 2020Q3
(percent)



Sources: Central Bank of Nigeria, INS database, World Economic Outlook, NBS, staff calulcations.

26. Staff recommended a multi-step approach to exchange rate unification and flexibility. While such an approach carries some implementation and credibility risks, it seems appropriate given the need for monetary policy to support the economy and steps needed to move from the current system to a well-functioning exchange rate system. At the same time, it will be crucial to follow through with reforms without delays and not to backtrack, to ensure maximum effect. Likewise, clear and timely communications of the FX strategy to the private sector are also important to instill confidence.

- ***Immediate steps.*** Greater adjustment in the exchange rate should be allowed to facilitate CA adjustment (mostly through import compression in the very near term due to limited non-oil exports), eliminate the parallel market premium, remove and prevent further build-up of the FX backlog, and increase non-CBN participation in the I&E market window. To prevent excessive overshooting, the authorities should be prepared to increase interest rates if needed. Higher interest rates will also be needed if inflation accelerates.

- ***Near-term steps*****:** All exchange rates should be collapsed into one well-functioning market exchange rate *with* the CBN conducting FX auctions through a pre-announced schedule following the immediate steps. This should be accompanied by a gradual removal of import restrictions and export repatriation requirements and the phasing out of CFMs. The process of the phasing out of CFMs should be state dependent and commence with the stabilization of the external position while paying due regard to the reserve adequacy and orderly macroeconomic adjustment——in line with the IMF's Institutional View on Liberalization and Management of Capital Flows.

- ***Medium-term steps*****:** The CBN should step back from its role of main FX intermediator in the country, limiting interventions to smoothing market volatility and allowing banks to freely determine FX buy-sell rates.

27. Staff advised contingency planning to address large downside risks. Further BOP pressures, through renewed capital outflows and/or weaker oil prices, will make exchange rate

flexibility and unification even more urgent. In such a situation, it may be inevitable to temporarily tighten monetary policy to temper possible overshooting of the exchange rate. Securing external fiscal financing including through borrowing from international financial institutions and issuance of Eurobond would bolster foreign exchange reserves. All available policy options should be considered to support macroeconomic stability and adjustment.

Authorities' Views

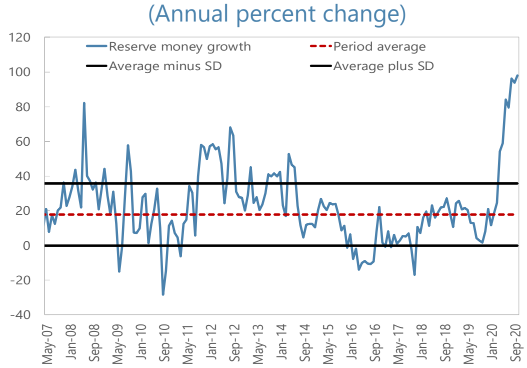
28. The authorities did not agree with the need for additional exchange rate adjustment. They explained that the major burden of macroeconomic adjustment does not need to be borne by the exchange rate, as current pressures are not related to the exchange rate per se but rather reflective of global developments. In their view, investors exited most emerging markets at the onset of the pandemic and will only return when the public health crisis has waned, and global economic activity has picked up. The authorities, furthermore, emphasized that Nigeria's stable exchange rate has contributed significantly to price stability, one of the most enduring objectives of macroeconomic policy. Allowing further depreciation would add to rising inflation. They also emphasized that they are addressing the FX backlog and noted that turnover in the I&E window is on an upward trend.

C. Monetary Policy: Establish Primacy of Price Stability

29. Multiple, often conflicting, objectives have undermined Nigeria's price stability. Staff's analysis shows that the pursuit of multiple objectives, namely price and exchange rate stability, credit growth, domestic industrialization, and fiscal financing, have resulted in a pro-cyclical monetary policy stance, resulting in the CBN's inability to rein in inflation expectations. While the de jure regime is monetary targeting (MT), the volatility of both reserve money and interest rates would suggest the authorities are yet to establish a credible nominal anchor.

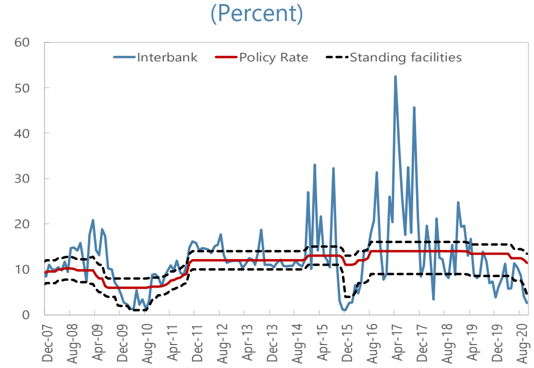
Nigeria: Monetary Targeting Regime

Nigeria: Reserve Money Growth
(Annual percent change)



Source: Central Bank of Nigeria.

Policy and Interbank Rates
(Percent)



Sources: Central Bank of Nigeria and FMDQ.

30. On balance, the accommodative monetary stance remains appropriate in the near term. With fiscal space at risk, and large financing needs, monetary policy will need to support the economy in the near term. However, if BOP pressures intensify, there might be a need to withdraw

liquidity or raise rates to prevent an excessive overshooting of the exchange rate in its phased move toward full flexibility (¶27). Given the weak transmission channels and record low levels for all key rates, further cuts in the MPR are unlikely to provide additional support to the economy.

31. In the medium term, the monetary operational framework should be strengthened along with clear communications of the policy strategy. A move to a market-determined exchange rate requires a rules-based monetary policy regime that provides a clear nominal anchor. Staff recommended the following measures.

- ***Establish primacy of price stability.*** The 2007 CBN Act should be modernized as also recommended by the ongoing safeguards assessment, to establish primacy of price stability and to strengthen central bank autonomy and governance arrangements. Staff recommended reforming the MT regime through implementing a flexible (i.e., allowing for period averaging) reserve money growth target, complemented by interest rate targeting within a band.[5] For this, the CBN's current interest rate corridor will also need to be revised by removing access restrictions on standing lending and deposit facilities.

- ***Recalibrate of tools***. Staff recommended using OMO bills of shorter maturity (e.g., 14-30 days) and/or T-bills as the main liquidity management instrument rather than the CRR, which has been used in a discretionary manner varying the rates between banks. The CRR itself should be reset to eliminate asymmetry, level the playing field among banks and reduce financial repression. The use of OMO bills should be reserved for liquidity management only including by limiting OMO tenors to shorter maturities.

- ***Eliminate CBN financing of the federal government budget.*** Staff welcomed the decision to convert the outstanding stock of the CBN's credit to the government into FGN bonds which should be followed by eventual divestment of these bonds. Going forward, domestic borrowing requirements should be adequately budgeted and met, in principle, by marketable debt instruments (¶18). The CBN's should also phase out quasi-fiscal operations.

- ***Reconsider the LDR policy.*** Staff recommended the minimum LDR policy be reconsidered because of the risk to financial stability associated with pushing credit possibly to higher-risk clients. Instead, financial deepening should be pursued through targeted inclusion measures.

Authorities' Views

32. The authorities felt that high unemployment and limited fiscal space justify a monetary policy that is not narrowly focused on price stability. They stressed that the growth-inflation trade-off in the face of the COVID-19 crisis is not a Nigeria-specific issue; and the CBN is obliged, by law, to maintain exchange rate stability—which they see as a core element of price

[5] A flexible monetary targeting is recommended when legal and economic preconditions for an inflation targeting is missing with such a regime helping to put in place these preconditions. See IMF (2015), "Evolving Monetary Policy Frameworks in Low Income and Other Developing Countries", IMF Policy Paper and "Nigeria: Strategy for a Monetary Policy Reset", forthcoming SIP for a fuller discussion.

stability. While acknowledging that inflation was approaching their tolerance limit, the authorities expect that the current monetary policy focus on supporting domestic production, including of food, will help dampen inflationary pressures in the medium term.

33. The authorities viewed their heterodox monetary policy tools as appropriate. They plan to continue with the discretionary use of CRR as the main tool for liquidity management. They felt that the shift from OMOs to CRR had significantly reduced CBN's costs of liquidity management and arbitrage activities by banks and, along with the minimum LDR policy, had boosted credit growth effectively. They noted that the MPR remained a signaling tool and a reference for market interest rates, with the monetary aggregate as the intermediate target. They deemed the current negative real interest rates to be warranted in light of the weak economy and capital outflow risks to be manageable considering large outflows to date, ongoing normalization of the FX market, and low interest rates abroad.

D. Banking Sector: Contain Stability Risks from the COVID-19 Economic Fallout

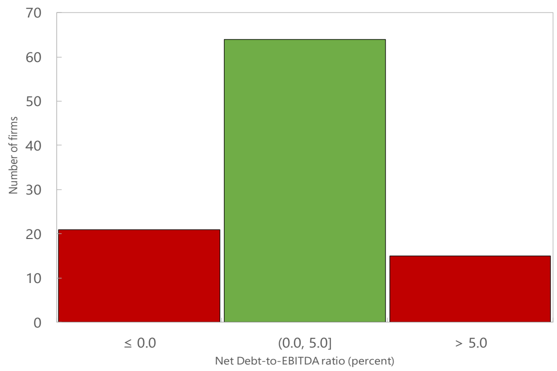
34. Overall, the banking sector has been resilient thanks to the ample pre-crisis buffers. Banks entered the crisis with adequate capital buffers and profitability, which they are now tapping into. The system's NPL ratio has remained stable at 6 percent, albeit with noticeable variations across sectors. Impaired loans, which include stage 2 loans under the International Financial Reporting Standard (IFRS) 9, account for 24 percent of total loans with banks engaging in forward-looking provisioning in line with IFRS 9. Overall, capital adequacy ratios (CAR) have remained resilient so far, although a few large banks are close to the required minimum and high profitability has come under pressure since the onset of the pandemic. Spillovers from difficulties at foreign subsidiaries are noticeable in individual banks, in some cases requiring support measures, including recapitalization.

35. There are risks of worsening adverse macro-financial linkages with respect to the corporate sector. The pre-pandemic fundamentals of large Nigerian firms showed a steady deterioration between 2014 and 2019, with decreasing revenue-to-asset and pre-tax income-to-asset ratios. Corporate leverage relative to income also worsened, putting the debt of a third of the large firms at sustainability risks.[6] The COVID-19 shock is likely to aggravate these fragilities, particularly considering that relief is currently being sought for 40 percent of loans through CBN's forbearance measures and a surge in NPLs was experienced following the 2014-15 oil price shock. Beyond credit risk, banks are experiencing some disintermediation as large firms increasingly turn to direct market financing, taking advantage of pension funds' search for yield in the low interest rate environment.

[6] See "Nigeria—Corporate performance, investment and financing", forthcoming Selected Issues Paper.

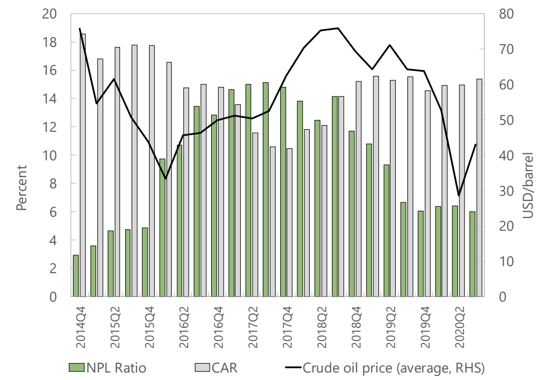
Nigeria: Corporate Debt Sustainability and Credit Risks

Net Debt-to-Operating Income (EBITDA) Ratio, end-2019 (100 largest firms)



Oil price, NPL ratio and Capital Adequacy Ratio

(as indicated)



Sources: Bloomberg and IMF Staff Calculations.

Note: Net debt is defined as interest-bearing liabilities less cash holdings, and operating income is measured by EBITDA as earnings before interest, taxes, depreciation and amortization. The ratio reflects the number of years that a firm would take to repay debt from operating income. Using the typical average sustainability threshold of five years and including the firms whose income is negative (denoted by a negative ratio), more than one third of the large firms may face debt sustainability risks.

36. **Banks face significant FX and solvency risks.** Although banks are long in overall FX exposure, FX risks arise from a relatively limited short-term net FX liquidity position and lending to borrowers with incomplete currency hedges, which have prompted some banks to convert FX exposures into naira lately. Moreover, recent CBN's stress tests show that the system's CAR would drop below the required minimum of 10 percent should 25 percent of the loan portfolio that is still unrestructured become non-performing. The CBN currently does not conduct liquidity or FX stress tests.

37. **Continued vigilance and corrective actions are needed to prevent an increase in stability risks.** The CBN's framework for granting forbearance, requiring debt relief measures to be time-bound and limited to clients in good standing, is appropriate, and non-compliance with restructured terms should trigger proper reclassification. To contain stability risks, staff recommended to (i) closely monitor exposures to vulnerable clients, e.g. independent oil and gas producers, and safeguard timely loan loss recognition; (ii) strictly limit FX lending to clients who are fully hedged by FX cash flows; and (iii) strictly enforce FX open position limits for all banks, requiring banks to observe a minimum FX liquidity ratio, and conduct FX stress tests.

38. **Progress with regulatory reforms and asset recovery has been mixed during the pandemic.** Work on the implementation of the Basel III reform package and macroprudential instruments has not progressed much. Given rising systemic risks, staff discussed considerations for additional instruments, including measures for capital conservation and countercyclical buffers, and a debt (service)-to-income ratio. Asset recovery by the public asset management company (AMCON) has improved slightly, but on current trends will likely be incomplete by the scheduled sunset date of end-2023.

39. The mission welcomed progress in reaching financial inclusion objectives and recommended further measures. Notable progress has been made in narrowing gender and regional gaps in access to financial services, including through fostering financial literacy, agency banking and use of fintech technology. The CBN has started approving the new license of payment system bank to support electronic and mobile banking services. Further progress could be made by fully implementing the cashless strategy by augmenting access points and by approving the pending applications of large telecommunications operators already serving a significant share of the financially excluded population.

40. Staff recommended strengthening the CBN's operational framework. A safeguards assessment is currently in progress in connection with the RFI approved in April 2020. The analysis of the CBN Law reconfirmed the need to modernize the legal framework by enshrining price stability as the CBN's primary objective, strengthening central bank autonomy and governance, limiting credit to the government, and phasing out of quasi-fiscal operations. There is also scope for improving the CBN's financial reporting for closer alignment with international best practices and strengthening internal controls based on external auditor observations.

Authorities' Views

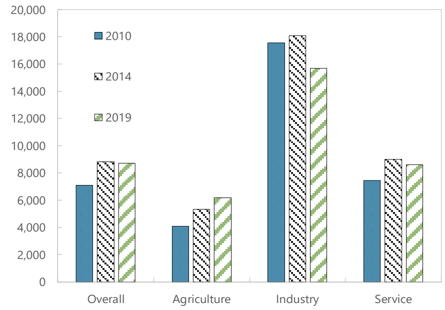
41. The authorities viewed the banking sector to be resilient to the current crisis and regulations to be adequate. They acknowledged elevated credit risks as evidenced by the stress test results but also pointed to mitigating factors, notably the loan forbearance measures and standing regulations to rein in NPLs. They felt that the current capital regulation requiring an additional five-percentage point buffer for international banks was sufficient at the current juncture, lessening the need for introducing the Basel III capital buffers. They took note of staff's recommendation to develop selected macroprudential instruments and tighten regulations to limit FX risks for future consideration. They also noted that the recent amendment to the Banks and Other Financial Institutions Act will promote financial stability by empowering the CBN and the deposit insurance corporation (NDIC) to establish a bank resolution fund.

E. Structural Policies: Embrace Broad Market Reforms to Promote Diversification and Employment

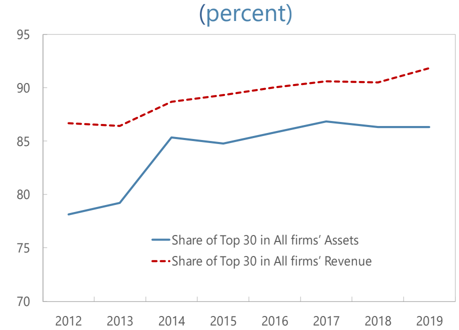
42. Decades of import substitution policies have yielded limited results. Quantitative import restrictions were intensified in the aftermath of the 2014-15 commodity price shock with import restrictions now covering more than a third of agricultural and industrial products. Despite such protection, the economy remains heavily dependent on oil. Labor productivity has been stagnant since 2014. The corporate sector has become more concentrated, with protectionist policies benefiting large firms disproportionately. The top 30 firms now account for around 90 percent of large firms' assets and sales, and the four largest firms alone account for about half of total sales by large firms.

Nigeria: Labor Productivity and Corporate Sector Concentration

Labor Productivity
(value added per worker, 2010 constant USD)



Largest Firms: Assets and Sales Concentration
(percent)



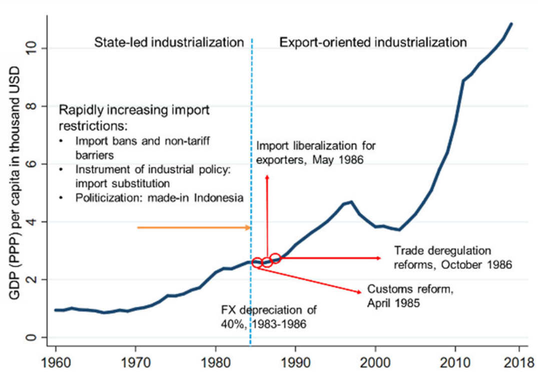
Sources: Nigeria National Bureau of Statistics, United Nations Department of Economic and Social Affairs, World Development Indicators database, Bloomberg and IMF staff calculations.

Note: Output per worker uses ILO-modelled estimates. Largest firms include 30 largest (defined by asset size) companies listed on Nigerian Stock Exchange.

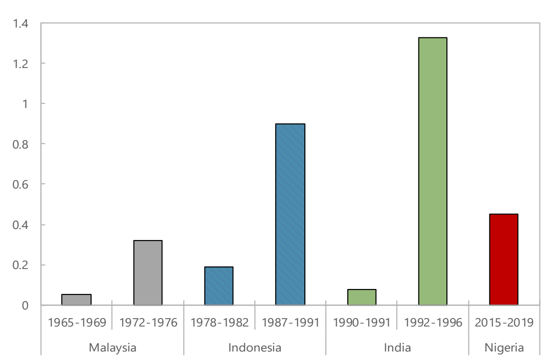
43. **Cross-country experience shows that successful economic diversification requires trade openness and competitive discipline**. Malaysia and Indonesia, with heavy dependence on natural resources in their early stages of development and similar inward-looking policies as in Nigeria today, moved decisively toward export-oriented industrialization after facing an economic crisis. Over time, these countries have far surpassed Nigeria in GDP per capita. The defining aspects of reforms undertaken were the emphasis on exposing domestic firms to international competition and ensuring knowledge accumulation (Box 5). Similarly, India, after liberalizing its industrial and import licensing regime, also saw per capita income soar and overtake that of Nigeria in the 1990s. These policies have also significantly increased FDI inflows along with productivity and employment gains.

Nigeria: Economic Diversification: Cross-Country Experience

Economic Diversification: Indonesia's Journey from Import Substitution to Export Promotion

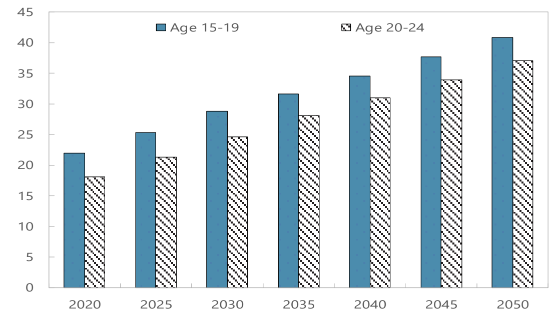


Net Foreign Direct Investment, Pre- and Post-Reform
(billions of US dollars, annual average)



Sources: "Diversification of the Nigerian Economy", Forthcoming Selected Issues Paper.

Nigeria: Labor Market Entrants
(Millions of people)



Sources: Nigeria National Bureau of Statistics, United Nations Department of Economic and Social Affairs, ILOSTAT and IMF staff calculations.

44. Nigeria needs to embrace more open trade and competition policies to rejuvenate growth. To absorb its projected 54 million new entrants in the labor force over the next decade, Nigeria will need to create at least 5 million new jobs each year compared to nearly 2 million job losses each year on average in the last five years. This will require much higher growth relying much more on labor-intensive manufacturing (e.g., light manufacturing and agro-processing) and services sectors (e.g., IT and digital economy). The recently ratified African Continental Free Trade Agreement (AfCFTA) holds huge prospects for job-rich growth through regional trade and economic integration. But to unlock such potential, follow up actions are needed. Keeping borders open, while stepping up measures to address security concerns including smuggling, is not only critical to ensuring the flow of goods and services that enables price stability and growth but is expected to have a positive signaling effect on the business environment in Nigeria. Implementing trade enabling reforms, such as speeding up customs clearing time, and removing regulatory bottlenecks, are key to improving Nigeria's international competitiveness.

45. Nigeria continues to face systemic challenges in effectively combatting corruption, and money laundering and terrorism financing. Recent efforts to strengthen the anti-money laundering and anticorruption frameworks are welcome. These include i) passing the Companies and Allied Matters Act (CAMA) to introduce beneficial ownership disclosure requirements, ii) enhancing engagement with the non-financial sector to improve compliance with AML/CFT preventive measures, and iii) the tabling of Proceeds of Crimes and Whistleblower Bills to strengthen confiscation powers and protect whistleblowers. Staff recommends focusing efforts on i) swiftly adopting and implementing the aforementioned statutes; ii) strengthening institutions involved in the combating of corruption, including the role of the Office of the Auditor General, and enhancing the asset-declaration framework, (iii) fully implementing the risk-based approach to anti-money laundering/anticorruption supervision, iv) including lawyers as reporting entities and enhancing compliance of other professions (e.g., real estate, dealers in precious metals and stones); v) implementing the CAMA Act by properly verifying, recording and ensuring the transparency of beneficial ownership information, and vi) ensuring effective implementation of the Mutual Legal Assistance in Criminal Matters Act of 2019.

Authorities' Views

46. The authorities agreed with the need for diversification, which is high on their policy agenda. They emphasized that weak institutions and lack of collective knowhow are key obstacles to Nigeria's path toward to a more diversified economy. Highlighting the success of Dangote Cement as an example, they believe import substitution remains the way forward for Nigeria's

industrialization. They also noted that there is no global standard for development strategies and Nigeria is unique in various ways. Current policies should be steadfastly implemented to strengthen domestic industries before moving to a more open and export-oriented economy.

OTHER SURVEILLANCE ISSUES

47. Data provided is adequate for regular surveillance, but there are gaps. The breakdown of FX reserves, large errors & omissions in the BOP, limited data on private sector external debt repayments and sub-national government finance, and a significant lag in availability of demand-side GDP components hamper a more-intensive monitoring of risks and vulnerabilities. The recent completion of the National Household Living Standards Survey is welcome. Consistent funding remains important for timely completion of key ongoing projects, including National Census of Industry and Business and agricultural census.

STAFF APPRAISAL

48. COVID-19 is exacting a heavy economic toll on Nigeria. The economy is grappling with multiple shocks from the COVID-19 pandemic, including sharp declines in oil prices and large capital outflows. These shocks, together with the pandemic-related lockdown, are projected to cause a significant output contraction in 2020, followed by a weak and protracted recovery that could keep per capita income below the 2010 level for several years.

49. The authorities have undertaken commendable and timely measures to save lives and livelihoods. The Central Bank of Nigeria took a series of measures to support the health sector and the broader economy, including higher subsidies on credit intervention facilities and regulatory forbearance to ease debt service. The Federal Government adopted a revised budget in July and prioritized spending to make room for a support package for the pandemic. These measures have helped contain the pandemic's impact.

50. However, a fundamental policy reset is needed to durably exit this crisis. Despite recovering oil prices and improving sovereign risk perception, the economy continues to face significant balance of payments pressures which are currently being managed mostly through administrative measures. Without broad market and exchange rate reforms, the external sector is likely to stay under pressure, and the economy on a lackluster growth path.

51. A clearer exchange rate policy is a top priority. To instill confidence, a unified exchange rate with greater flexibility is imperative. Exchange rate rigidity and uncertainties regarding FX access have put the burden of adjustment disproportionately on the real economy. Staff recommends a multi-step approach to establishing a market-clearing exchange rate, with the near-term focus on allowing for greater flexibility in the rate and removing the FX backlog. In the medium term, the CBN should step back from foreign exchange intermediation, limiting interventions to smoothing excessive volatility.

52. Notable reforms are underway in the fiscal sector. The authorities removed fuel subsidies earlier this year and took courageous steps to start implementing cost-reflective tariff increases in

the power sector, both of which are expected to create fiscal space. The subsidies largely benefitted better-off households; nonetheless, targeted support may be needed to dampen the negative impacts on the poor. The recent submission of the Petroleum Industry Bill (PIB) to the Parliament is welcome. To ensure envisaged economic gains, the fiscal regime should ensure a fair share of revenues to the government while remaining attractive to investors. Measures to increase fiscal transparency are positive. Going forward, the transparent planning, execution, monitoring, and reporting of COVID-19-related spending should continue with improved data access. These measures should help reduce vulnerabilities to corruption.

53. Significant revenue mobilization will be needed to reduce fiscal sustainability risks. Tax policy and administration reforms are required to reduce fiscal risks and allow for an increase in priority social spending. With high poverty rates and current economic weaknesses, revenue mobilization will need to rely on progressive and efficiency-enhancing measures, with higher VAT and excise rates awaiting a more sustained economic recovery. Improved social safety nets through better targeting and higher coverage is essential to cushion the negative impacts on the poor from VAT rate increases and removal of fuel and power subsidies. It is also essential to eliminate the dependence of budget financing on CBN's overdraft facility by improving budget planning and public finance management practices, ensuring effective use of the federal government's idle cash balances in the Treasury Single Account, and significant and steadfast revenue mobilization in the medium term.

54. The accommodative monetary stance remains appropriate in the near term. Owing to the constrained fiscal space, large fiscal financing needs and strained sovereign external market access, an accommodative monetary policy is appropriate. However, if BOP and inflationary pressures intensify, there might be a need to withdraw liquidity further or raise interest rates. Given weak transmission and record low market interest rates, further cuts in the Monetary Policy Rate are unlikely to provide additional support to the economy. In the medium term, the monetary policy operational framework should be reformed to establish the primacy of price stability along with clear communication of the policy strategy.

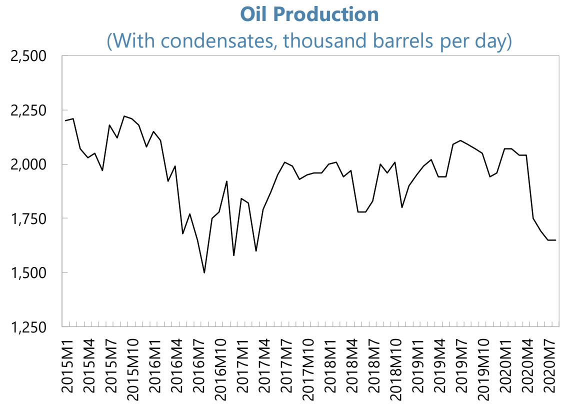
55. The banking sector has been resilient thanks to the ample pre-crisis buffers, but stability risks remain. Vigilance by banks and their supervisors is needed to contain financial stability risks arising inter alia from loan impairment and FX exposures. In this context, debt relief measures for bank clients should remain time-bound and limited to those with good pre-crisis fundamentals. The notable progress on financial inclusion objectives is welcome, though additional measures fostering digital payments are recommended.

56. There has been notable progress in structural reforms, and continued implementation is warranted. The approval of the power sector recovery program financing plan 2020, the passage of the CAMA act, and the ratification of the African Continental Free Trade Area are important steps. Going forward, strengthening anti-money laundering/anticorruption institutions and implementing trade-enabling reforms, including lifting border closures, are necessary to tackle governance weaknesses and unleash a more robust job-rich growth.

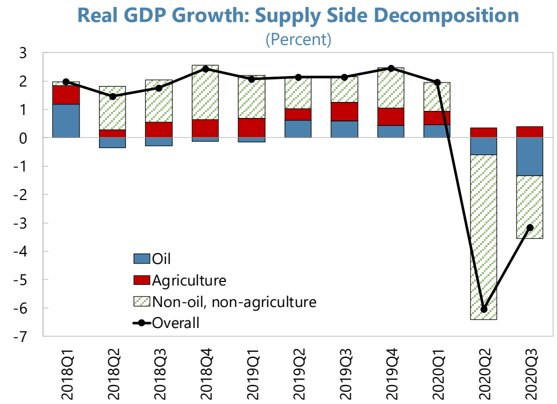
57. It is recommended that the next Article IV consultation with Nigeria take place on the standard 12-month consultation cycle.

Figure 1. Nigeria: Real Sector Developments

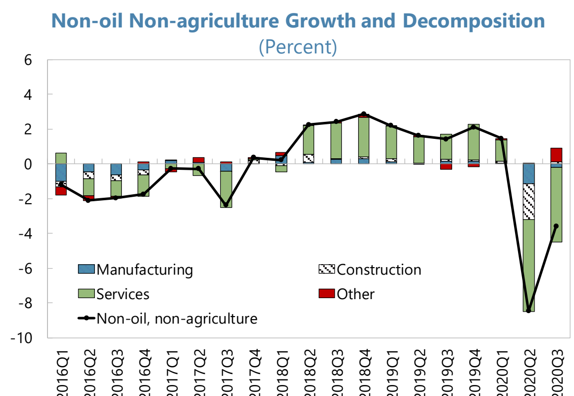
Oil production continues to fall amid low oil prices.



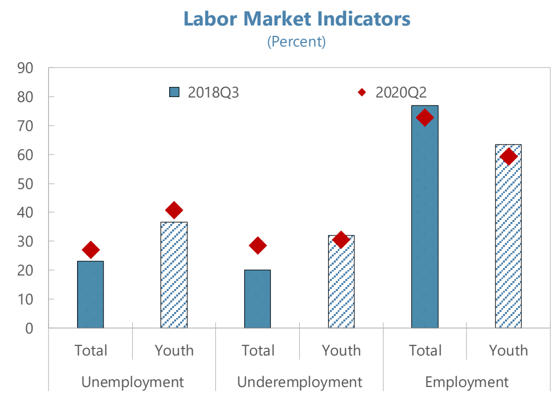
Real GDP contracted by 6.0 percent in 2020 Q2, the sharpest in decades …



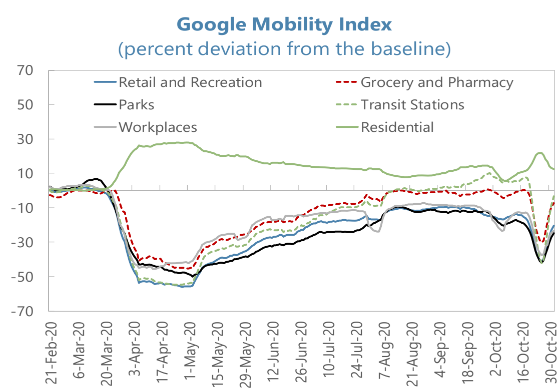
… with services and construction sectors hit hard.



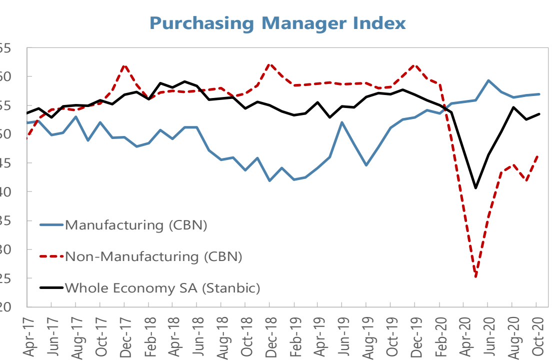
Unemployment, particularly youth unemployment, has risen sharply



High frequency indicators show mobility normalizing,..



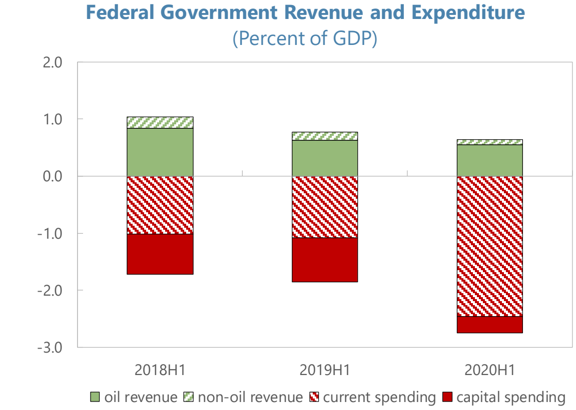
..and PMI improving.



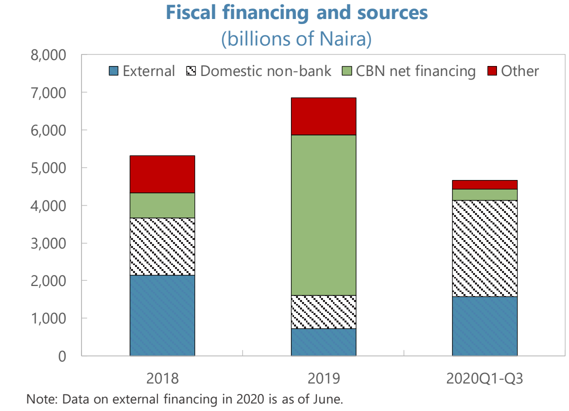
Sources: Central Bank of Nigeria, National Bureau of Statistics, Nigerian National Petroleum Corporation, World Economic Outlook, Google Mobility Report, Haver and IMF staff calculations.

Figure 2. Nigeria: Federal Government Revenue and Expenditure Developments

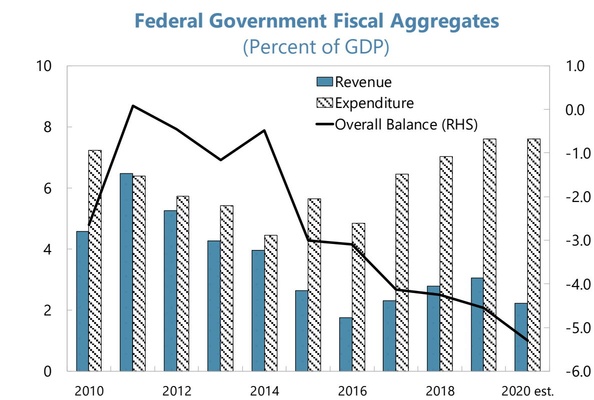
Fiscal outturn for 2020H1 shows underperformance in non-oil revenues and under-execution of capital spending



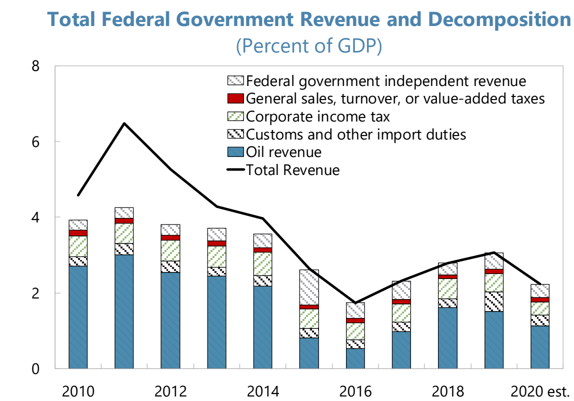
Deficit financing has relied on IFI loans and domestic borrowing.



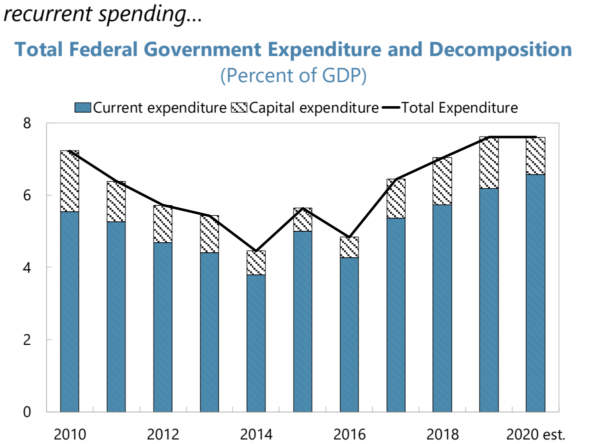
Low revenue mobilization has kept deficits high…



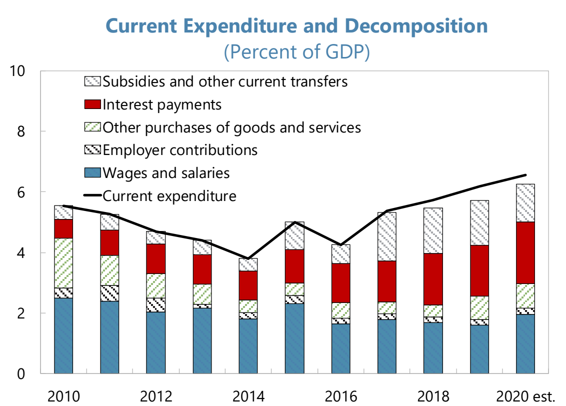
…reflecting structurally low non-oil revenues



Expenditures have increased in recent years driven by recurrent spending…



… with interest and wage bill constituting two thirds of current spending.

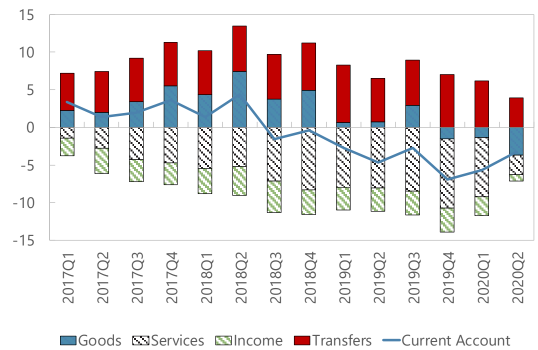


Sources: Central Bank of Nigeria, Debt Management Office, and IMF staff calculations.

Figure 3. Nigeria: External Sector Developments

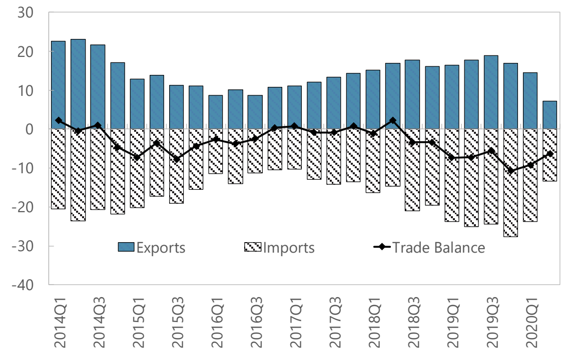
The current account deficit remained in the negative in 2020Q2…

Current Account
(Billions of U.S. dollars))



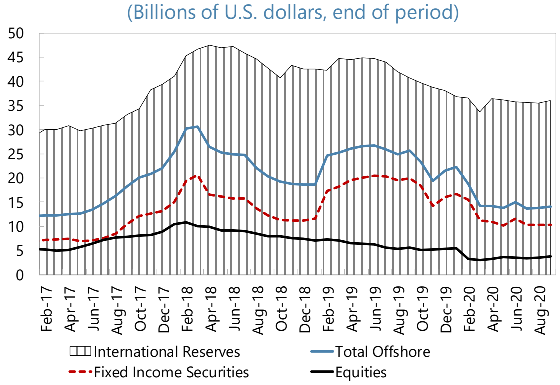
…despite large import contraction as export revenues also dropped sharply.

Trade Balance
(Billions of U.S. dollars)



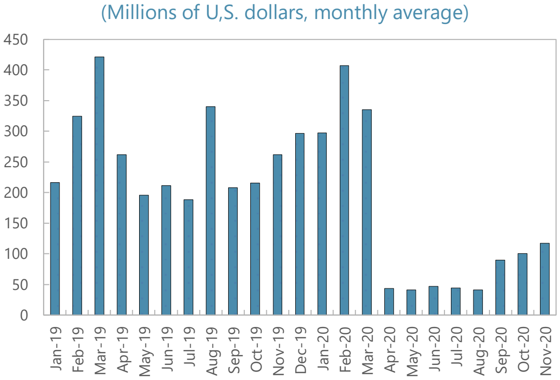
Capital outflows halted since Q2 with investors not being able to receive FX from assets redeemed earlier this year…

International Reserves and Portfolio Investment Stock
(Billions of U.S. dollars, end of period)



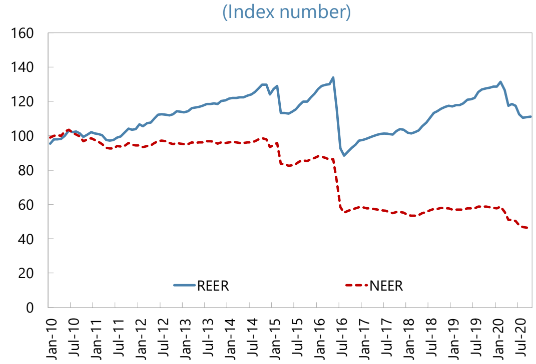
…as transactions significantly dropped in the I&E market window.

I&E Window Daily Turnover
(Millions of U,S. dollars, monthly average)



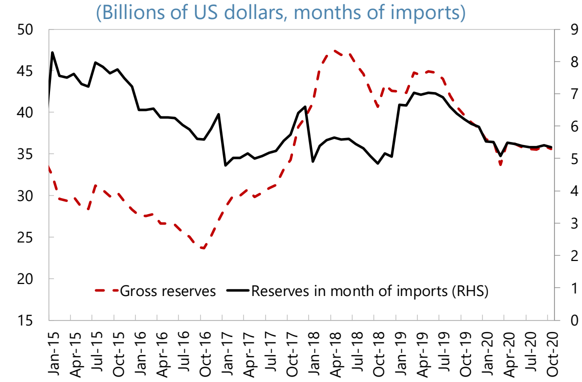
Exchange rate has seen limited adjustment…

Real and Nominal Effective Exchange Rate
(Index number)



..and gross reserves have fallen.

International Reserves
(Billions of US dollars, months of imports)

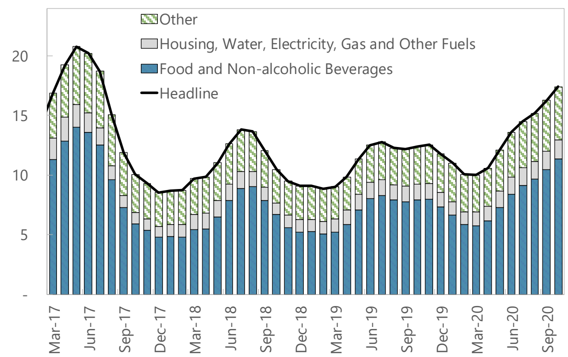


Sources: Central Bank of Nigeria, custodian data, Haver and IMF staff calculations.

Figure 4. Nigeria: Inflation and Monetary Sector Developments

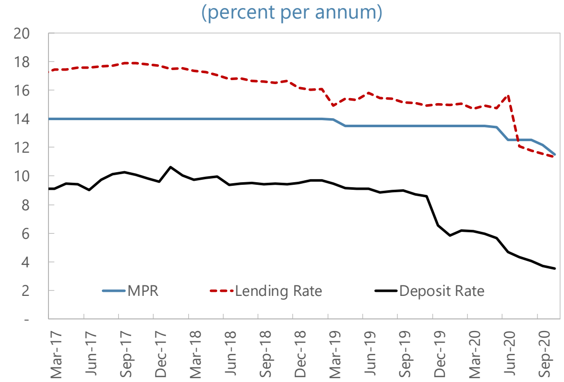
Headline inflation has risen to 14.2 percent, its highest level since February 2018

Contribution to Inflation
(Percent, 3M Moving Average Annualized)



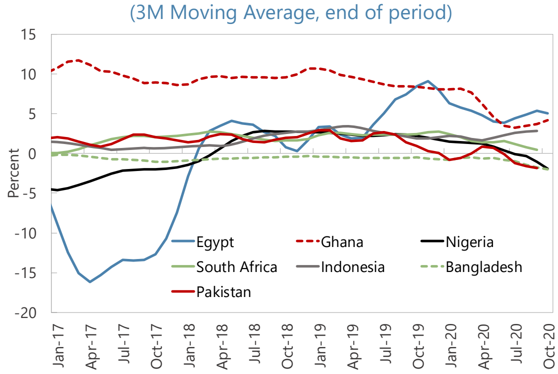
Recent cuts in MPR have put downward pressures on lending and deposit rates

MPR and Lendng & Deposit Rates
(percent per annum)



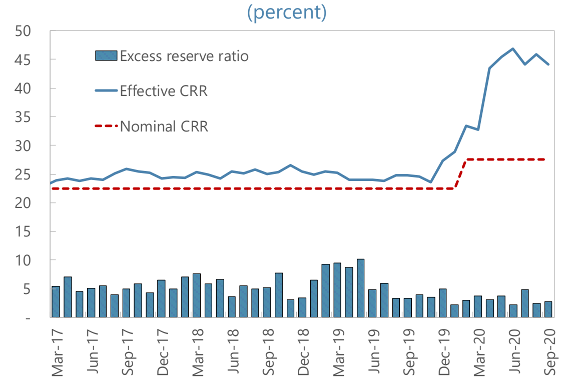
Real policy rate is now negative and lower than peers.

Real Policy/Official Interest Rate
(3M Moving Average, end of period)



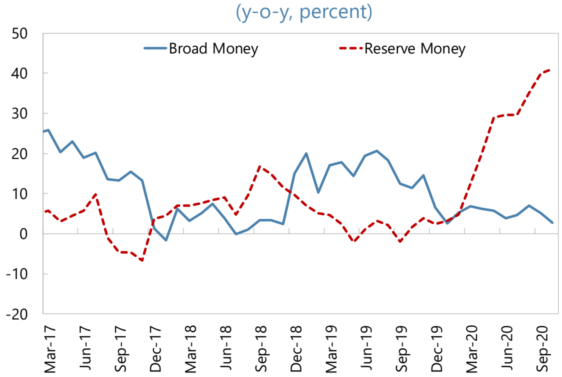
The authorities have used CRR to keep interbank excess liquidity constant…

Cash Reserve Requirement Ratios
(percent)



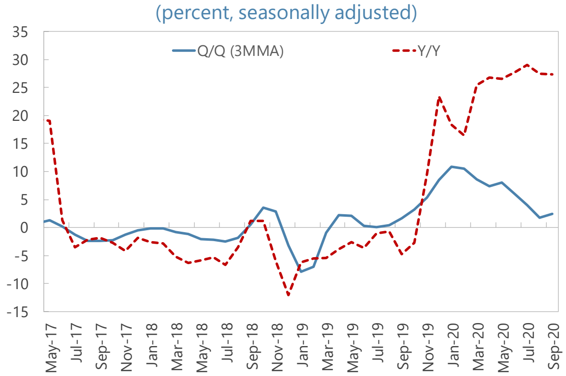
Reserve money growth picked up significantly while broad money growth slowed amidst OMO redemptions

Monetary Growth
(y-o-y, percent)



Despite administrative push, credit growth slowed reflecting a weak economy.

Private Sector Credit Growth
(percent, seasonally adjusted)

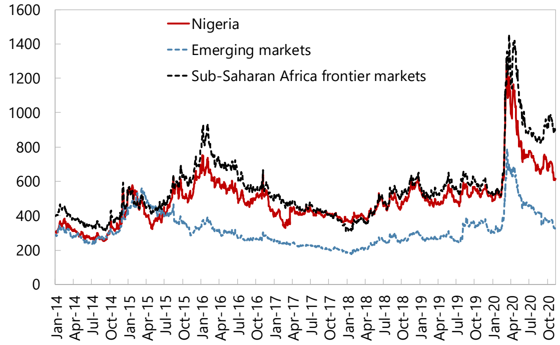


Sources: Central Bank of Nigeria, Haver, CEIC Data.

Figure 5. Nigeria: Financial Sector Developments

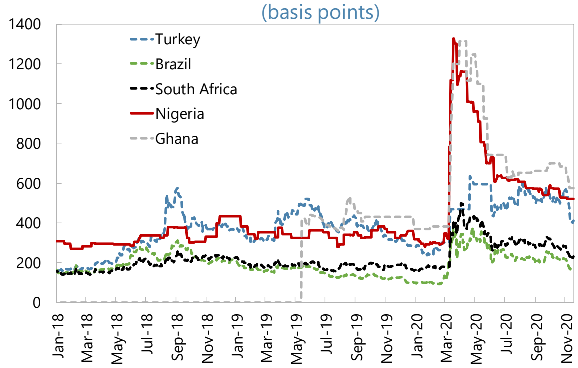
External financing conditions were hit hard by the crisis…

Sovereign Bond Spreads
(Basis points)



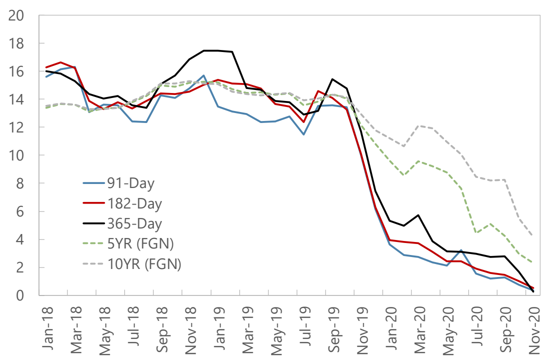
..although spreads have come down since.

CDS Spreads
(basis points)



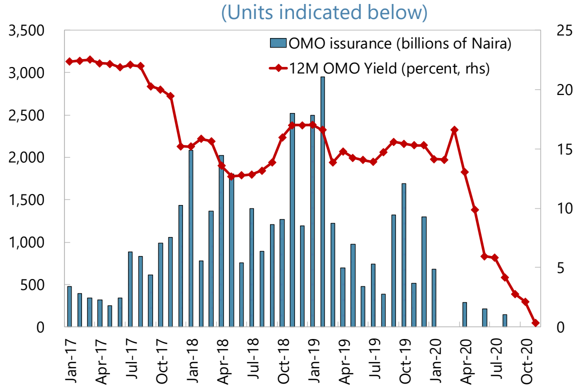
Domestic yields have fallen sharply as institutional investors sought to reinvest proceeds from maturing OMOs.

Treasury Bill and Bond Yields
(Percent)



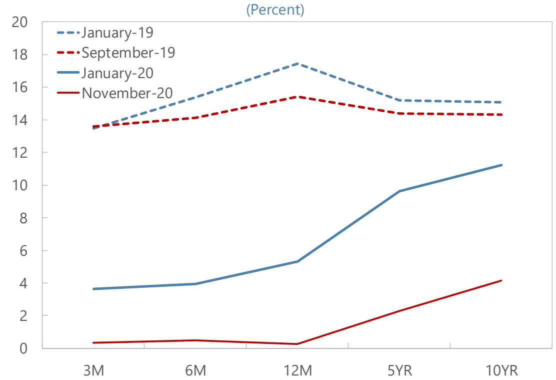
OMO yields also slid as the CBN steeply cut back rollovers.

Open Market Operations
(Units indicated below)



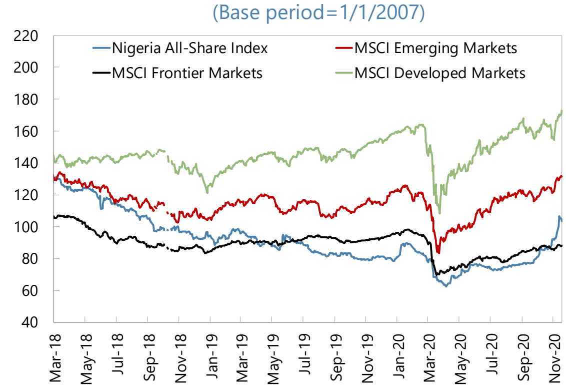
The yield curve steepened significantly.

Domestic Yield Curves
(Percent)



Stock market has recovered.

Equity Price Developments
(Base period=1/1/2007)

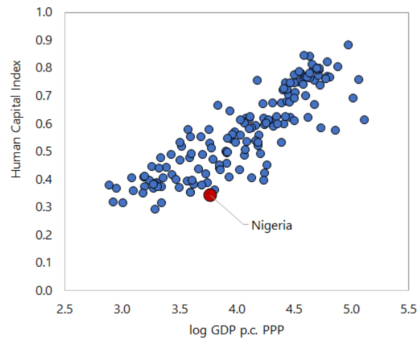


Sources: Bloomberg, Central Bank of Nigeria, and IMF staff calculations.

Figure 6. Nigeria: Human Development Indicators

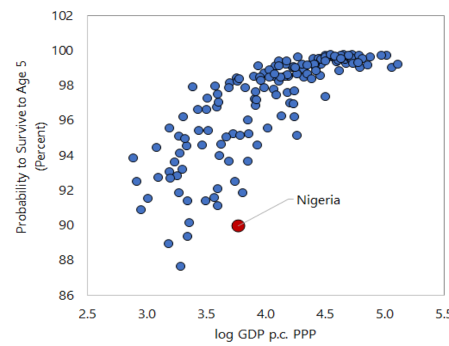
Human capital index has been weak compared to peers…

GDP per Capita (PPP) and Human Capital Index



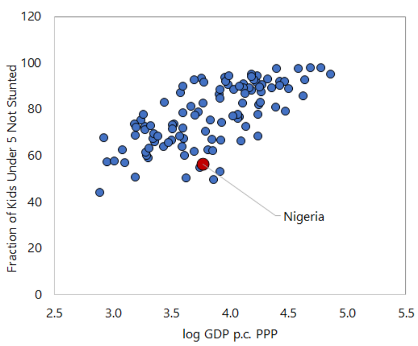
…with child mortality among the highest worldwide…

GDP per Capita (PPP) and Child Mortality



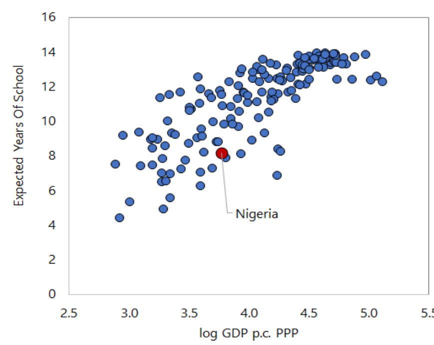
…and almost half of children suffering from stunting.

GDP per Capita (PPP) and Stunting



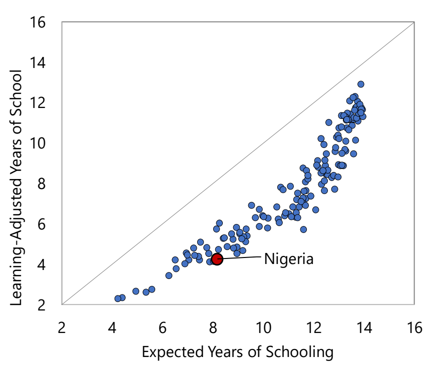
Nigeria is behind peers in schooling…

GDP per Capita (PPP) and Years of Education



…and education quality.

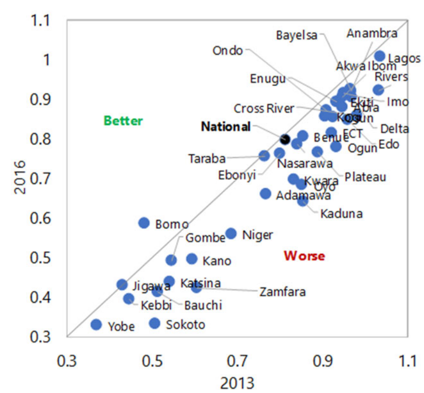
Expected Years of Education and Quality Adjusted Years of Learning *(Years)*



Education varies significantly across states.

Education Index

(Higher =better)



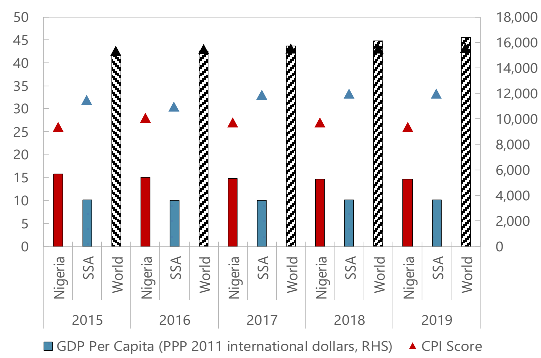
Sources: Nigeria National Bureau of Statistics; World Bank Human Capital Project.

Note: Expected Years of School measures the number of years of school a child progressing through the current pattern of enrollment rates can expect to obtain by the age of 18, up to a maximum of 14 years.

Figure 7. Nigeria: Governance and Transparency

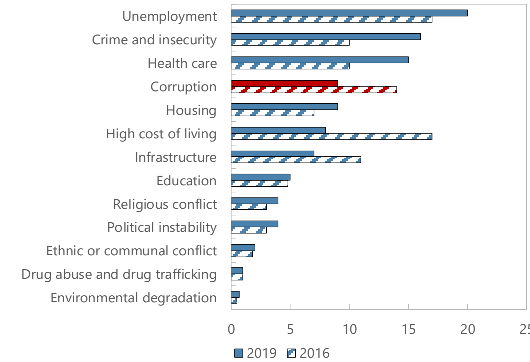
Nigeria is perceived as one of the more corrupt countries in the region…

GDP per Capita and Perception of Corruption[1]



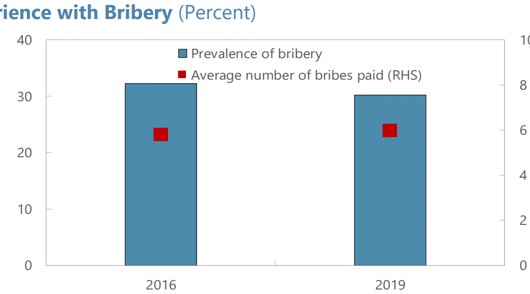
…with corruption ranking among the top problems in surveys.

Share of Population Considering Selected Issues to be the Most Important Problem Affecting Nigeria (Percent)



Bribery has been prevalent…

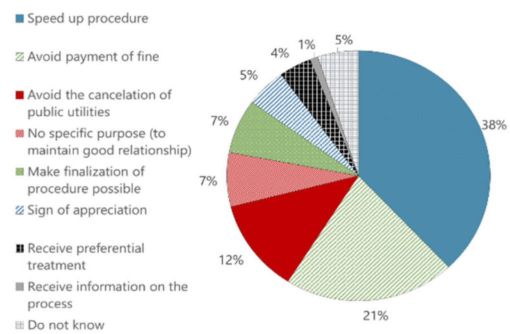
Experience with Bribery (Percent)



Note: The prevalence of bribery is calculated as the number of adult Nigerians who had at least one contact with a public official and who paid a bribe to a public official, or were asked to pay a bribe by a public official, on at least one occasion in the 12 months prior to the survey, as a percentage of all adult Nigerians who had at least one contact with a public official. The average number of bribes refers to the average number of bribes paid by all bribe-payers, i.e., those who paid at least one bribe in the 12 months prior to the survey.

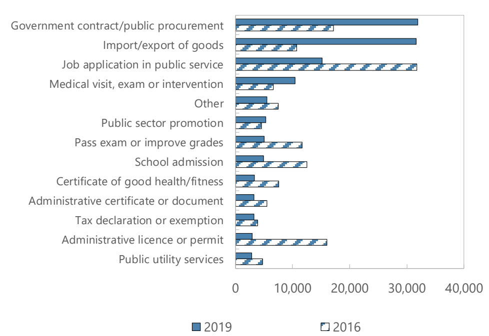
…often to speed up procedures and avoid fines…

Reasons for Paying the Bribe (Percent)



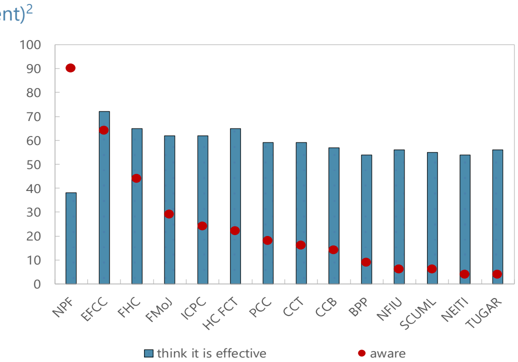
…in the course of pursuing government contracts, clearance, or services.

Average Size of Bribes Paid by Service Sought (Naira)



Anti-corruption bodies are still developing public awareness and trust.

Awareness and Perceived Effectiveness of Anti-corruption agencies (Percent)[2]



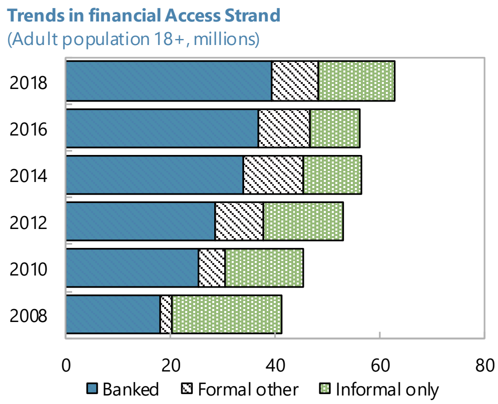
Sources: National Bureau of Statistics; UNODC (2019); Transparency International.

[1] Note: The use of these indicators should be considered carefully, as they reflect perceptions-based data. CPI stands for Corruption Perceptions Index and indicate whether a higher CPI score is better.

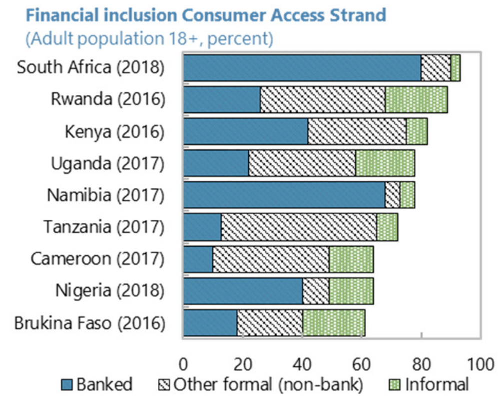
[2] BPP = Bureau of Public Procurement, CCB = Code of Conduct Bureau, CCT = Code of Conduct Tribunal, EFCC = Economic and Financial Crimes Commission, FHC = Federal High Court, FMoJ = Federal Ministry of Justice, HC FCT = High Court of the Federal Capital Territory, ICPC = Independent Corrupt Practices Commission, NEITI = Nigeria Extractive Industries Transparency Initiative, NFIU = Nigeria Financial Intelligence Unit, NPF = Nigeria Police Force, PCC = Public Complaints Commission, SCUML = Special Control Unit Against Money Laundering, TUGAR = Technical Unit on Governance and Anti-Corruption Reform.

Figure 8. Nigeria: Financial Inclusion

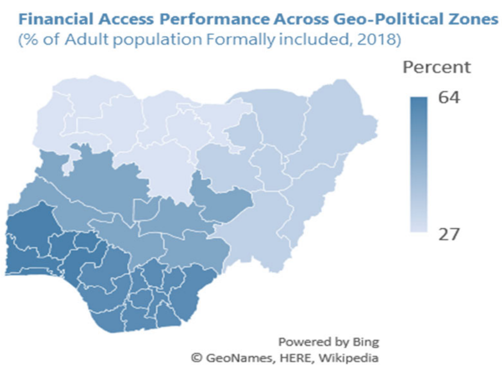
Nigeria managed to significantly increase financial inclusion..



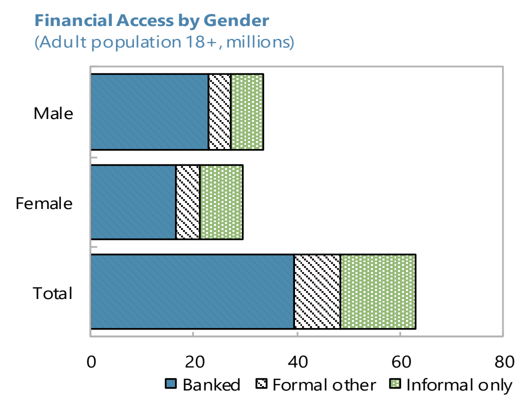
...but remains behind peers



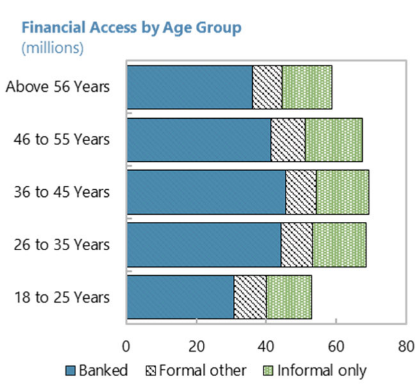
In lockstep with geographic disparity in poverty, the North lags behind...



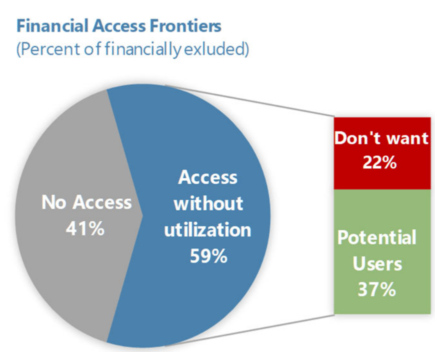
...a financial inclusion gap feeds a cycle of gender inequality.



...and reinforces economic exclusion of youth.



While 41 percent of the excluded lack access (e.g. mobile phones), 37 percent only require enabling hookup support.



Source: Enhacing Financial Innovation and Access Report, 2019

Table 1. Nigeria: Selected Economic and Financial Indicators, 2017–25

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Projections					
National income and prices	(Annual percentage change, unless otherwise specified)								
Real GDP (at 2010 market prices)	0.8	1.9	2.2	-3.2	1.5	2.5	2.5	2.5	2.6
Oil and Gas GDP	4.7	1.0	4.6	-10.5	3.0	6.5	6.0	4.6	2.2
Non-oil GDP	0.5	2.0	2.0	-2.5	1.4	2.2	2.2	2.4	2.6
Non-oil non-agriculture GDP	-0.6	2.0	1.8	-4.0	1.2	1.8	1.8	2.0	2.3
Production of crude oil (million barrels per day)	1.89	1.93	2.00	1.80	1.84	1.95	2.06	2.14	2.20
Nominal GDP at market prices (trillions of naira)	114.9	129.1	145.6	157.7	183.4	212.0	242.9	276.5	313.5
Nominal GDP per capita (US$)	1,969	2,033	2,230	…	…	…	…	…	…
GDP deflator	11.1	10.2	10.4	11.8	14.6	12.7	11.8	11.0	10.5
Consumer price index (annual average)	16.5	12.1	11.4	13.2	14.8	13.1	12.3	11.7	11.1
Consumer price index (end of period)	15.4	11.4	12.0	15.2	13.8	12.6	12.0	11.4	10.8
Investment and savings	(Percent of GDP)								
Gross national savings	18.2	20.8	22.4	21.8	21.8	22.5	22.8	23.1	23.2
Public	-0.5	0.7	0.4	-1.3	-0.2	-0.1	0.2	0.3	0.2
Private	18.8	20.1	22.0	23.1	22.0	22.7	22.6	22.8	23.0
Investment	14.7	19.0	25.4	24.6	23.5	23.7	23.6	23.5	23.5
Public	3.3	3.0	3.0	2.4	2.7	2.8	2.8	2.8	2.8
Private	11.5	16.0	22.4	22.2	20.7	20.9	20.8	20.7	20.7
Current account balance	2.8	1.0	-3.8	-3.7	-2.2	-1.7	-1.2	-0.9	-0.7
Consolidated government operations	(Percent of GDP)								
Total revenues and grants	6.6	8.5	7.9	5.9	6.9	7.0	7.1	7.1	7.1
Of which: oil and gas revenue	2.6	4.6	3.7	1.9	2.2	2.1	2.1	2.0	1.9
Total expenditure and net lending	12.0	12.8	12.6	11.8	11.7	11.8	11.6	11.8	12.1
Overall balance	-5.4	-4.3	-4.8	-5.9	-4.7	-4.8	-4.5	-4.7	-5.0
Non-oil primary balance	-6.7	-7.2	-6.8	-5.9	-5.6	-5.4	-5.0	-4.8	-4.7
Non-oil revenue	4.0	4.0	4.2	3.9	4.5	4.8	4.9	5.0	5.1
Public gross debt[1]	25.3	27.7	29.1	34.4	34.3	34.5	34.7	35.5	36.5
Of which: FGN debt	22.4	25.0	26.5	31.0	30.7	30.7	30.7	31.2	32.1
Of which: External debt	5.0	6.4	6.2	8.4	7.7	7.2	6.6	6.1	5.6
FGN interest payments (percent of FGN revenue)	58.4	60.7	52.6	92.6	60.8	67.7	69.6	81.1	93.9
Interest payments (percent of consolidated revenue)	20.5	19.9	20.5	35.2	23.0	24.3	24.8	27.9	32.0
Money and credit	(Change in percent of broad money at the beginning of the period, unless otherwise specified)								
Broad money (percent change; end of period)	-1.2	15.0	6.4	9.7	17.3	18.1	17.1	16.4	15.7
Net foreign assets	10.8	3.0	-18.0	2.1	-7.9	-2.8	-1.4	-0.3	0.3
Net domestic assets	-12.0	12.0	24.5	7.7	25.2	20.9	18.5	16.7	15.4
o/w Claims on consolidated government	-1.0	5.1	16.2	7.4	15.6	15.2	14.5	15.7	16.6
Credit to the private sector (y-o-y,%)	-1.8	-11.9	23.5	15.6	19.3	9.8	8.3	7.5	2.6
Velocity of broad money (ratio; end of period)	3.8	3.5	3.8	3.9	3.8	3.8	3.7	3.6	3.6
External sector	(Annual percentage change, unless otherwise specified)								
Exports of goods and services	32.3	29.9	5.9	-32.4	17.3	9.6	8.5	8.0	6.6
Imports of goods and services	8.4	40.6	40.7	-24.0	4.2	6.9	6.2	7.1	6.8
Terms of trade	9.4	12.4	-5.1	-18.2	6.5	1.3	0.8	0.2	0.2
Price of Nigerian oil (US dollar per barrel)	54.4	71.1	64.0	42.8	48.0	49.6	50.9	52.0	53.0
External debt outstanding (US$ billions)[2]	94.8	99.2	112.4	105.5	107.6	112.6	117.4	122.4	128.0
Gross international reserves (US$ billions)	39.5	42.8	38.1	29.5	21.8	18.8	17.2	17.6	19.2
(equivalent months of imports of G&Ss)	6.6	5.1	6.0	4.4	3.1	2.5	2.1	2.0	2.0

Sources: Nigerian authorities; and IMF staff estimates and projections.

[1]Gross debt figures for the Federal Government and the public sector include overdrafts from the Central Bank of Nigeria (CBN) and AMCON bonds.

[2]Includes both public and private sector.

Table 2. Nigeria: Balance of Payments, 2017–25
(Billions of U.S. dollars, unless otherwise specified)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Projections					
Current account balance	10.4	3.9	-17.0	-16.1	-10.8	-9.3	-7.9	-6.3	-6.0
Trade balance	13.1	20.5	2.9	-10.0	-4.6	-4.7	-4.8	-5.6	-7.4
Exports	45.8	61.2	65.0	42.5	50.5	55.7	60.6	65.7	70.2
Oil/gas	42.3	56.6	54.5	32.5	38.9	42.9	46.5	49.4	51.5
Other	3.5	4.7	10.5	10.0	11.6	12.8	14.2	16.3	18.7
Imports	-32.7	-40.8	-62.1	-52.5	-55.1	-60.4	-65.4	-71.4	-77.6
Oil/gas	-8.2	-11.6	-11.0	-7.1	-8.0	-8.3	-8.4	-8.5	-8.7
Other	-24.5	-29.2	-51.1	-45.4	-47.1	-52.2	-57.0	-62.8	-68.9
Services (net)	-13.2	-26.1	-33.8	-19.4	-19.8	-19.8	-19.8	-20.1	-20.3
Receipts	5.0	4.8	4.9	4.7	4.9	5.1	5.3	5.5	5.8
Payments	-18.3	-30.9	-38.7	-24.1	-24.6	-24.9	-25.1	-25.6	-26.0
Income (net)	-11.5	-14.7	-12.5	-8.2	-10.4	-10.7	-10.2	-9.6	-9.8
Of which: Interest due on public debt	-0.3	-0.3	-1.0	-1.3	-1.2	-1.2	-1.2	-1.2	-1.2
Transfers (net)	22.0	24.1	26.4	21.5	24.0	25.9	26.9	29.0	31.4
Capital and Financial account balance	8.2	-9.8	13.6	-8.7	3.2	6.3	6.2	6.8	7.6
Capital Account (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial Account (net)	8.2	-9.8	13.6	-8.7	3.2	6.3	6.2	6.8	7.6
Direct Investment (net)	2.2	0.6	1.8	0.6	1.9	2.2	2.5	2.9	3.3
Portfolio Investment (net)	8.5	-2.3	9.0	-10.3	0.7	3.1	3.1	3.8	2.8
Other Investment (net)	-2.5	-8.1	2.8	0.9	0.6	0.9	0.6	0.1	1.5
Errors and omissions[1]	-6.3	9.2	-1.3	12.7	0.0	0.0	0.0	0.0	0.0
Overall balance	12.4	3.2	-4.7	-12.1	-7.7	-3.0	-1.6	0.4	1.6
RFI Disbursement				3.5					
Net international reserves (increase -)	-12.4	-3.2	4.7	8.6	7.7	3.0	1.6	-0.4	-1.6
Memorandum items:									
Gross official reserves, end-of-period	39.5	42.8	38.1	29.5	21.8	18.8	17.2	17.6	19.2
In months of next year's imports of goods and services	6.6	5.1	6.0	4.4	3.1	2.5	2.1	2.0	2.0
Current account (percent of GDP)	2.8	1.0	-3.8	-3.7	-2.2	-1.7	-1.2	-0.9	-0.7
Exports of goods and services (percent of GDP)	13.5	16.6	15.6	10.8	11.5	10.9	10.3	9.8	9.2
Imports of goods and services (percent of GDP)	13.6	18.0	22.5	17.4	16.5	15.3	14.2	13.3	12.6
Public external debt[2]	32.2	28.5	30.2	36.0	38.1	41.1	43.3	45.4	47.3
In percent of GDP	8.6	7.2	6.7	8.2	7.9	7.4	6.8	6.2	5.7
In percent of exports of G&S	63.3	43.2	43.2	76.1	68.7	67.6	65.7	63.7	62.3
In percent of consolidated fiscal revenues	129.7	84.1	85.8	139.8	113.5	105.2	96.0	87.7	81.0
Private external debt	54.5	60.2	65.8	61.5	61.5	63.5	66.0	69.0	72.7

Sources: Nigerian authorities; and IMF staff estimates and projections.

[1]The 2020 number reflects outturn for 2020H1 and assumes 0 for H2.

Table 3. Nigeria: Federal Government Operations, 2017–25
(Billions of Naira)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
						Projections			
Total revenue and Grants	2,665	3,602	4,458	3,509	4,818	5,330	6,106	6,760	7,571
Oil revenue	1,132	2,076	2,209	1,285	1,946	2,001	2,257	2,316	2,448
Non-oil revenue	1,533	1,526	2,249	2,131	2,518	3,045	3,565	4,160	4,839
Import and excise duties	283	318	758	378	448	522	599	692	797
Companies' income tax	562	666	695	683	912	1,164	1,408	1,690	2,023
Value-added tax	129	147	160	197	324	395	455	520	593
Federal government independent revenue	559	395	637	873	834	963	1,104	1,257	1,425
o.w. special accounts				300					
Grants	0	0	0	93	355	284	284	284	284
Total expenditure	7,406	9,082	11,087	11,843	12,231	14,092	15,662	18,496	21,893
Recurrent expenditure	6,164	7,400	9,002	10,236	9,736	11,209	12,358	14,735	17,628
Personnel	2,278	2,417	2,596	3,364	3,905	4,533	5,219	5,969	6,804
Overheads	437	517	1,131	1,224	1,421	1,650	1,899	2,172	2,476
of which COVID-19 fund				214					
Interest	1,557	2,186	2,347	3,251	2,930	3,610	4,253	5,482	7,107
Transfers[1]	1,842	1,948	2,147	1,946	980	916	988	1,112	1,241
of which electricity subsidies	252	272	524	600	200	0	0	0	0
of which net transfers to SLGs[2]	1,150	1,220	1,195	880	291	362	366	418	470
of which COVID-19 fund				150					
Arrears Clearance	50	331	686	450	500	500	0	0	0
Capital expenditure	1,242	1,682	2,084	1,607	2,494	2,883	3,304	3,761	4,264
of which COVID-19 fund				200					
Overall balance	-4,742	-5,480	-6,628	-8,334	-7,413	-8,763	-9,556	-11,736	-14,322
Financing	4,742	5,480	6,628	8,334	7,413	8,763	9,556	11,736	14,322
External	2,183	2,142	725	2,795	796	1,149	860	773	731
Borrowing	1,521	1,423	556	2,039	846	1,084	1,126	1,171	1,217
of which RFI				1,324					
Amortization	-26	-176	-60	-125	-301	-297	-537	-641	-717
of which RFI							-338	-677	-339
Net External Lending to SLGs	687	573	228	880	291	362	366	418	470
Domestic	1,158	3,168	6,735	5,539	6,617	7,613	8,696	10,963	13,591
Bank financing	-791	1,204	5,170	1,999	4,186	4,835	5,993	7,819	9,818
CBN	-12	656	4,876	2,821	3,932	4,525	5,601	7,337	9,227
Commercial Banks	-779	548	294	-821	254	310	392	482	591
ECA financing	-151	-42	-199	-176	0	0	0	-380	-392
Nonbank financing	1,898	1,526	878	2,964	1,828	2,195	2,620	3,144	3,773
Promissory notes	50	331	686	450	500	500	0	0	0
Asset Disposal	0	107	0	126	103	84	82	0	0
Statistical discrepancy	1,401	171	-831	0	0	0	0	0	0
Memorandum items:									
FGN Total Debt	25,767	32,232	38,536	48,847	56,296	65,100	74,574	86,310	100,632
Domestic[3]	19,989	24,018	29,541	35,535	42,188	49,843	58,457	69,420	83,011
Foreign	5,778	8,214	8,995	13,312	14,108	15,257	16,117	16,890	17,621
Price of Nigerian oil (US dollar per barrel)	54.4	71.1	64.0	42.8	48.0	49.6	50.9	52.0	53.0
FGN overall balance (percent of GDP)	-4.1	-4.2	-4.6	-5.3	-4.0	-4.1	-3.9	-4.2	-4.6

Sources: Nigerian authorities; and IMF staff estimates and projections.

[1] Includes earmarked spending for National Judicial Council, Universal Basic Education, Niger Delta Development Corporation,

[2] Net transfers to SLGs include Paris Club refunds, Budget Support Facility, and on-lending by the FGN.

[3] Gross debt figures for the Federal Government and the public sector include overdrafts from the Central Bank of Nigeria (CBN), promissory notes and AMCON debt.

Table 4. Nigeria: Consolidated Government, 2017–25

(Billions of Naira)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Projections					
Total revenue and Grants	7,593	10,991	11,452	9,232	12,738	14,837	17,156	19,656	22,196
Oil revenue	2,993	5,879	5,378	3,025	4,063	4,468	5,075	5,628	5,953
Of which: implicit fuel subsidy	146	623	561	89	0	0	0	0	0
Non-oil revenue	4,599	5,112	6,074	6,115	8,320	10,085	11,797	13,744	15,959
Import and excise duties	628	705	837	839	994	1,156	1,327	1,535	1,768
Companies' income tax	1,206	1,430	1,637	1,467	1,959	2,501	3,023	3,631	4,346
Value-added tax	957	1,090	1,172	1,463	2,412	2,939	3,384	3,870	4,412
Other (education tax and customs levies)	312	331	482	410	516	631	745	880	1,035
Federal government independent revenue	559	395	637	873	834	963	1,104	1,257	1,425
SLGs independent revenue	936	1,160	1,309	1,063	1,607	1,894	2,214	2,571	2,973
Grants	0	0	0	93	355	284	284	284	284
Total expenditure	13,797	16,550	18,379	18,598	21,435	25,083	28,151	32,602	37,883
Federal government	6,256	7,862	9,892	10,963	11,940	13,730	15,296	18,078	21,422
of which COVID-19 fund				414					
State and local government	5,096	7,029	7,316	6,958	8,460	10,095	11,640	13,142	14,894
of which COVID-19 fund				150					
Extrabudgetary funds, ECA and implicit fuel subs	774	1,658	1,173	678	1,034	1,258	1,215	1,383	1,567
Extrabudgetary funds [1]	628	768	610	493	1,034	1,258	1,215	1,383	1,567
Spending from Excess Crude Account	0	267	1	96	0	0	0	0	0
Implicit fuel subsidy	146	623	561	89	0	0	0	0	0
Overall balance	-6,204	-5,559	-6,927	-9,366	-8,696	-10,246	-10,994	-12,947	-15,687
Non-oil primary balance	-7,641	-9,251	-9,958	-9,233	-10,185	-11,388	-12,101	-13,377	-14,817
Financing	6,204	5,559	6,927	9,366	8,696	10,246	10,994	12,947	15,687
External	2,182	1,820	725	2,795	796	1,149	860	773	731
Borrowing	2,221	2,078	812	2,977	1,235	1,582	1,644	1,709	1,777
o.w. RFI				1,324					
Amortization	-38	-258	-87	-182	-439	-433	-784	-936	-1,046
Domestic	1,541	3,377	6,661	6,571	7,901	9,097	10,134	12,174	14,956
Bank financing	-408	1,413	5,096	1,757	5,470	6,319	7,432	9,030	11,183
CBN	371	865	4,802	1,547	3,932	4,525	5,601	7,363	9,253
Commercial Banks	-779	548	294	210	1,537	1,794	1,830	1,667	1,930
Nonbank financing	1,898	1,526	878	2,964	1,828	2,195	2,620	3,144	3,773
Other financing	50	331	686	1,724	500	500	0	0	0
Asset Disposal	0	107	0	126	103	84	82	0	0
Statistical discrepancy	2,482	361	-458	0	0	0	0	0	0
Memorandum items:									
SLGs External Financing	687.5	573.4	228.3	880.5	290.6	362.0	365.9	418.4	470.4
Budget oil price (US dollar a barrel)	44.5	47.0	64.0	42.8	48.0	49.6	50.9	52.0	53.0
Overall balance (% of GDP)	-5.4	-4.3	-4.8	-5.9	-4.7	-4.8	-4.5	-4.7	-5.0

Sources: Nigerian authorities; and IMF staff estimates and projections.

[1] Includes spending of customs levies and education tax; transfers to FIRS and NCS; spending from the ecology, stabilization, development of natural resources accounts; and FCT spending.

Table 5. Nigeria: Government Operations, 2017–25

(Percent of GDP)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
						Projections			
Consolidated Government									
Total revenue	6.6	8.5	7.9	5.9	6.9	7.0	7.1	7.1	7.1
Oil revenue	2.6	4.6	3.7	1.9	2.2	2.1	2.1	2.0	1.9
Of which: implicit fuel subsidy	0.1	0.5	0.4	0.1	0.0	0.0	0.0	0.0	0.0
Non-oil revenue	4.0	4.0	4.2	3.9	4.5	4.8	4.9	5.0	5.1
Total expenditure	12.0	12.8	12.6	11.8	11.7	11.8	11.6	11.8	12.1
Federal government expenditure	5.4	6.1	6.8	7.0	6.5	6.5	6.3	6.5	6.8
of which COVID-19 fund				0.3					
State and local government	4.4	5.4	5.0	4.4	4.6	4.8	4.8	4.8	4.8
of which COVID-19 fund				0.1					
Extrabudgetary funds, ECA and implicit fuel subsidies	0.7	1.3	0.8	0.4	0.6	0.6	0.5	0.5	0.5
Overall balance	-5.4	-4.3	-4.8	-5.9	-4.7	-4.8	-4.5	-4.7	-5.0
Non-oil primary balance	-6.7	-7.2	-6.8	-5.9	-5.6	-5.4	-5.0	-4.8	-4.7
Financing	5.4	4.3	4.8	5.9	4.7	4.8	4.5	4.7	5.0
External	1.9	1.4	0.5	1.8	0.4	0.5	0.4	0.3	0.2
Borrowing	1.9	1.6	0.6	1.9	0.7	0.7	0.7	0.6	0.6
o.w.RFI				0.8	…	…	…	…	…
Amortization	0.0	-0.2	-0.1	-0.1	-0.2	-0.2	-0.3	-0.3	-0.3
Domestic	1.3	2.6	4.6	4.2	4.3	4.3	4.2	4.4	4.8
Bank financing	-0.4	1.1	3.5	1.1	3.0	3.0	3.1	3.3	3.6
Nonbank financing	1.7	1.2	0.6	1.9	1.0	1.0	1.1	1.1	1.2
Other financing	0.0	0.3	0.5	1.2	0.3	0.3	0.0	0.0	0.0
Asset Disposal		0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Statistical discrepancy	2.2	0.3	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Federal Government									
Total revenue	2.3	2.8	3.1	2.2	2.6	2.5	2.5	2.4	2.4
Oil revenue	1.0	1.6	1.5	0.8	1.1	0.9	0.9	0.8	0.8
Non-oil revenue	1.3	1.2	1.5	1.4	1.4	1.4	1.5	1.5	1.5
Total expenditure	6.4	7.0	7.6	7.5	6.7	6.6	6.4	6.7	7.0
Recurrent expenditure	5.4	5.7	6.2	6.5	5.3	5.3	5.1	5.3	5.6
Personnel	2.0	1.9	1.8	2.1	2.1	2.1	2.1	2.2	2.2
Overheads	0.4	0.4	0.8	0.8	0.8	0.8	0.8	0.8	0.8
of which COVID-19 fund				0.1					
Interest	1.4	1.7	1.6	2.1	1.6	1.7	1.8	2.0	2.3
Transfers	1.6	1.5	1.5	1.2	0.5	0.4	0.4	0.4	0.4
of which COVID-19 fund				0.1					
Arrears clearance	0.0	0.3	0.5	0.3	0.3	0.2	0.0	0.0	0.0
Capital expenditure	1.1	1.3	1.4	1.0	1.4	1.4	1.4	1.4	1.4
of which COVID-19 fund				0.1					
Overall balance	-4.1	-4.2	-4.6	-5.3	-4.0	-4.1	-3.9	-4.2	-4.6
Financing	4.1	4.2	4.6	5.3	4.0	4.1	3.9	4.2	4.6
External	1.9	1.7	0.5	1.8	0.4	0.5	0.4	0.3	0.2
Domestic	1.0	2.5	4.6	3.5	3.6	3.6	3.6	4.0	4.3
Bank financing	-0.7	0.9	3.5	1.3	2.3	2.3	2.5	2.8	3.1
Nonbank financing	1.7	1.2	0.6	1.9	1.0	1.0	1.1	1.1	1.2
Other financing	0.0	0.3	0.5	0.4	0.3	0.3	0.0	0.0	0.0
Statistical discrepancy	1.2	0.1	-0.6	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Nigerian authorities; and IMF staff estimates and projections.

Table 6. Nigeria: State and Local Governments, 2017–25
(Percent of GDP)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Projections					
Revenue	4.8	5.4	4.7	3.5	3.9	4.1	4.1	4.1	4.1
Oil revenue	1.3	2.0	1.6	0.9	1.1	1.1	1.1	1.0	0.9
Shared revenue	0.9	1.5	1.2	0.6	0.8	0.8	0.8	0.7	0.7
Derivation grant (13 percent)	0.3	0.5	0.4	0.2	0.3	0.3	0.3	0.3	0.2
Non-oil revenue	2.5	2.5	2.3	2.1	2.7	2.8	2.9	2.9	3.0
Corporate Income Tax	0.5	0.5	0.5	0.4	0.5	0.5	0.6	0.6	0.6
Customs	0.2	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2
VAT	0.7	0.7	0.7	0.8	1.1	1.1	1.1	1.1	1.1
Internal revenue	0.8	0.9	0.9	0.7	0.9	0.9	0.9	0.9	0.9
Net Transfers from FGN	1.0	0.9	0.8	0.6	0.2	0.2	0.2	0.2	0.2
of which COVID-19 fund				0.1					
Expenditure	4.4	5.4	5.0	4.4	4.6	4.8	4.8	4.8	4.8
Overall Balance	0.4	-0.1	-0.3	-0.9	-0.7	-0.7	-0.7	-0.7	-0.7
Financing	-0.4	0.1	0.3	0.9	0.7	0.7	0.7	0.7	0.7
External	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	0.5	0.2	0.3	0.9	0.7	0.7	0.7	0.7	0.7
Statistical discrepancy	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Nigerian authorities; and IMF staff estimates and projections.

Table 7. Nigeria: Central Bank of Nigeria (CBN) Analytical Balance Sheet, 2017–25

(Billions on Naira)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Dec.	Dec.	Dec.	Dec.					
				Projections					
Net foreign assets	10,826	12,127	7,797	8,816	5,905	4,770	4,150	4,310	4,915
Foreign assets	15,142	18,196	15,235	13,974	11,063	9,928	9,308	9,468	10,073
Foreign liabilities	-4,316	-6,069	-7,438	-5,158	-5,158	-5,158	-5,158	-5,158	-5,158
Net domestic assets	-4,342	-5,033	884	6,449	10,709	13,477	15,875	17,644	19,274
Net domestic credit	7,831	9,693	15,566	18,230	22,663	27,688	33,289	40,626	49,853
Net claims on consolidated government	519	1,450	5,892	9,163	13,596	18,621	24,222	31,559	40,786
Net claims on federal government [1]	-71	843	5,286	8,557	12,989	18,014	23,616	30,952	40,179
Claims	5,681	7,967	11,923	15,193	19,626	24,651	30,252	37,589	46,816
Deposits	-5,752	-7,123	-6,637	-6,637	-6,637	-6,637	-6,637	-6,637	-6,637
Net claims on state and local governments	590	607	607	607	607	607	607	607	607
Claims on deposit money banks	1,870	1,646	1,646	1,646	1,646	1,646	1,646	1,646	1,646
Other net claims	5,442	6,598	8,028	7,422	7,422	7,422	7,422	7,422	7,422
Other items net	-12,173	-14,640	-14,683	-11,782	-11,954	-14,211	-17,414	-22,983	-30,579
Reserve money	6,484	7,180	8,681	15,265	16,613	18,247	20,026	21,954	24,189
Currency in circulation	2,157	-1,947	-2,832	4,953	5,391	5,921	6,498	7,123	7,849
Banks reserves with the CBN	4,327	9,127	11,513	10,312	11,223	12,326	13,528	14,830	16,340
Memorandum items:									
Reserve money y/y growth rate	10.9	10.7	21	75.8	8.8	9.8	9.7	9.6	10.2
Money multiplier	4.4	4.6	4	2.5	2.7	2.9	3.1	3.3	3.5

Sources: Nigerian authorities; and IMF staff estimates and projection:

[1]The SLGs share of the ECA is included under the Net Claims on the FGN, as the FGN is the signatory of the ECA in the CBN. It is assumed that the domestic portion of sovereign wealth fund will have similar accounting treatment.

Table 8. Nigeria: Monetary Survey, 2017–25
(Billions of Naira)

	2017 Dec.	2018 Dec.	2019 Dec	2020	2021	2022	2023	2024	2025
				Dec.					
				Projections					
Net foreign assets	10,977	11,838	5,944	6,660	3,641	2,393	1,654	1,460	1,694
Central Bank of Nigeria (net)	10,826	12,127	7,797	8,816	5,905	4,770	4,150	4,310	4,915
Commercial and merchant banks (net)	152	-288	-1,853	-2,156	-2,264	-2,377	-2,496	-2,850	-3,222
Net domestic assets	17,454	20,917	28,907	31,574	41,205	50,565	60,384	70,768	81,910
Net domestic credit	25,603	26,784	36,715	43,356	52,893	61,878	71,584	83,313	96,055
Net claims on consolidated government	17,250	21,950	25,230	27,824	33,794	40,613	48,307	58,061	70,073
Net claims on FGN [1]	15,755	20,204	23,360	25,810	30,496	35,831	41,824	49,644	59,461
CBN	11,702	15,602	18,465	21,736	26,168	31,193	36,795	44,132	53,358
Commercial Banks	4,053	4,601	4,895	4,074	4,328	4,638	5,030	5,512	6,103
Claims on SLG	1,495	1,746	1,870	2,014	3,298	4,782	6,482	8,418	10,612
Claims on private sector [2]	14,767	13,227	16,250	18,746	22,314	24,481	26,492	28,467	29,197
o/w credit to the private sector	14,715	12,960	16,012	18,508	22,076	24,243	26,254	28,229	28,959
Other Claims	-6,414	-8,392	-4,765	-3,215	-3,215	-3,215	-3,215	-3,215	-3,215
Other items	-8,149	-5,868	-7,808	-11,781	-11,688	-11,314	-11,200	-12,545	-14,145
Broad money [3]	28,432	32,755	34,851	38,235	44,846	52,958	62,038	72,228	83,604
Currency outside banks	1,783	1,907	2,023	2,338	2,743	3,239	3,794	4,417	5,113
Demand deposits	7,697	8,495	8,624	11,480	13,465	15,900	18,627	21,686	25,102
Time and savings deposits	14,465	16,053	17,194	24,043	28,200	33,301	39,011	45,419	52,572
CBN Bills held by resident nonbank sector	4,529	6,284	5,973	0	0	0	0	0	0
Memorandum items:									
Broad money (y-o-y,%)	9.1	15.2	6.4	9.7	17.3	18.1	17.1	16.4	15.7
Credit to the private sector (y-o-y,%)	-1.8	-11.9	23.5	15.6	19.3	9.8	8.3	7.5	2.6
Velocity (non-oil GDP/broad money)	3.8	3.6	3.8	3.9	3.8	3.8	3.7	3.6	3.6
Gross international reserves (billions of US dollar)	39.3	42.5	38.1	29.5	21.8	18.8	17.2	17.6	19.2
Non-oil GDP (in billions of naira)									

Sources: Nigerian authorities; and IMF staff estimates and projections.

[1] The SLGs share of the ECA is included under the Net Claims on the FGN, as the FGN is the signatory of the ECA in the CBN. It is assumed that the domestic portion of sovereign wealth fund will have similar accounting treatment.

[2] Does not include AMCON bonds

[3] Broad money is based on an M3 definition.

Table 9. Nigeria: Financial Soundness Indicators 2013Q4–2020Q3
(Percent; unless otherwise specified)

	2013	2014	2015	2016	2017	2018	2019	2020Q1	2020Q2	2020Q3
Regulatory Capital to Risk-Weighted Assets	17.1	18.6	17.7	14.8	10.5	15.2	14.6	14.9	14.9	15.4
Regulatory Tier 1 Capital to Risk-Weighted Assets	17.1	15.5	18.1	16.3	8.4	13.5	12.8	13.0	13.0	13.2
Non-Performing Loans to Total Gross Loans	3.4	3.0	4.9	12.8	14.8	11.7	6.1	6.4	6.4	6.0
Return on Assets	2.3	2.5	2.5	1.3	2.4	2.0	2.5	2.2	2.5	2.2
Return on Equity	18.9	21.2	19.7	10.0	23.5	22.7	26.9	23.7	27.9	25.0
Interest Margin to Gross Income	63.9	51.2	62.2	67.6	61.2	67.3	61.0	61.9	56.8	48.5
Non-interest Expenses to Gross Income	68.1	56.9	63.1	62.8	58.2	60.9	64.7	63.1	55.3	63.8
Liquid Assets to Total Assets (Liquid Asset Ratio)	16.8	11.4	18.5	16.2	18.8	22.6	23.0	21.1	18.2	18.5
Liquid Assets to Short Term Liabilities	23.1	16.7	27.1	24.5	27.2	34.1	35.3	32.8	27.4	27.0

Source: Central Bank of Nigeria.

Table 10. Nigeria: Selected Economic and Financial Indicators under Adjustment Scenario, 2017–25

	2017	2018	2019	2020	2021	2022	2023	2024	2025
				Projections					
National income and prices	(Annual percentage change, unless otherwise specified)								
Real GDP (at 2010 market prices)	0.8	1.9	2.2	-3.2	1.5	2.5	3.6	4.3	4.3
Oil and Gas GDP	4.7	1.0	4.6	-10.5	3.0	6.5	6.0	4.6	2.2
Non-oil GDP	0.5	2.0	2.0	-2.5	1.4	2.2	3.4	4.2	4.5
Non-oil non-agriculture GDP	-0.6	2.0	1.8	-4.0	1.2	1.8	3.5	4.6	5.0
Production of crude oil (million barrels per day)	1.89	1.93	2.00	1.80	1.84	1.95	2.06	2.14	2.20
Nominal GDP at market prices (trillions of naira)	114.9	129.1	145.6	157.7	188.0	220.6	257.3	298.1	343.1
Nominal GDP per capita (US$)	1,969	2,033	2,230	…	…	…	…	…	…
GDP deflator	11.1	10.2	10.4	11.8	17.4	14.5	12.6	11.1	10.3
Consumer price index (annual average)	16.5	12.1	11.4	13.2	17.8	14.8	12.8	11.3	10.3
Consumer price index (end of period)	15.4	11.4	12.0	15.2	13.8	12.6	12.0	11.4	10.8
Investment and savings	(Percent of GDP)								
Gross national savings	18.2	20.8	22.4	20.9	21.2	22.6	23.0	23.6	23.7
Public	-0.5	0.7	0.4	-1.3	0.0	1.3	2.6	4.0	6.1
Private	18.8	20.1	22.0	22.2	21.2	21.3	20.4	19.6	17.7
Investment	14.7	19.0	25.4	24.6	23.6	23.7	23.6	23.5	23.5
Public	3.3	3.0	3.0	2.4	2.8	3.2	3.4	3.4	3.9
Private	11.5	16.0	22.4	21.3	20.3	20.0	19.8	19.6	19.2
Current account balance	2.8	1.0	-3.8	-3.6	-2.4	-1.2	-0.5	0.1	0.2
Consolidated government operations	(Percent of GDP)								
Total revenues and grants	6.6	8.5	7.9	5.9	7.4	8.8	10.0	11.4	14.2
Of which: oil and gas revenue	2.6	4.6	3.7	1.9	2.4	2.6	2.9	3.0	3.0
Total expenditure and net lending	12.0	12.8	12.6	11.8	11.9	12.6	12.6	12.9	14.3
Overall balance	-5.4	-4.3	-4.8	-5.9	-4.6	-3.8	-2.7	-1.5	-0.1
Non-oil primary balance	-6.7	-7.2	-6.8	-5.9	-5.6	-4.9	-3.9	-2.7	-1.1
Non-oil revenue	4.0	4.0	4.2	3.9	4.8	6.0	7.0	8.3	11.1
Public gross debt[1]	25.3	27.7	29.1	34.4	35.3	35.1	34.1	32.7	30.8
Of which: FGN debt	22.4	25.0	26.5	31.0	31.7	31.9	31.6	31.4	30.7
Of which: External debt	5.0	6.4	6.2	8.4	9.4	9.7	9.7	9.6	9.5
FGN interest payments (percent of FGN revenue)	58.4	60.7	52.6	92.7	58.8	55.9	51.9	52.1	48.3
Interest payments (percent of consolidated revenue)	20.5	19.9	20.5	35.2	22.1	19.5	17.5	16.9	14.8
Money and credit	(Change in percent of broad money at the beginning of the period, unless otherwise specified)								
Broad money (percent change; end of period)	-1.2	15.0	6.4	9.7	19.5	19.1	20.2	19.1	18.3
Net foreign assets	10.8	3.0	-18.0	2.1	-2.2	6.0	8.7	11.8	13.0
Net domestic assets	-12.0	12.0	24.5	7.6	21.7	13.1	11.4	7.4	5.2
o/w Claims on consolidated government	-1.0	5.1	16.2	7.5	14.9	11.2	7.6	4.6	0.3
Credit to the private sector (y-o-y,%)	-1.8	-11.9	23.5	19.0	16.4	11.7	13.3	13.4	15.3
Velocity of broad money (ratio; end of period)	3.8	3.5	3.8	3.9	3.8	3.7	3.6	3.5	3.4
External sector	(Annual percentage change, unless otherwise specified)								
Exports of goods and services	32.3	29.9	5.9	-32.4	17.3	10.3	10.6	10.0	8.9
Imports of goods and services	8.4	40.6	40.7	-24.1	3.9	1.9	5.5	6.8	8.7
Terms of trade	9.4	12.4	-5.1	-18.2	6.5	1.3	0.8	0.2	0.2
Price of Nigerian oil (US dollar per barrel)	54.4	71.1	64.0	42.8	48.0	49.6	50.9	52.0	53.0
External debt outstanding (US$ billions)[2]	81.5	96.0	109.9	104.6	106.1	112.5	118.7	125.2	132.6
Gross international reserves (US$ billions)	39.5	42.8	38.1	29.6	23.2	26.8	33.2	43.1	54.8
(equivalent months of imports of G&Ss)	6.6	5.1	6.0	4.5	3.4	3.8	4.4	5.2	5.5

Sources: Nigerian authorities; and IMF staff estimates and projections.

[1]Gross debt figures for the Federal Government and the public sector include overdrafts from the Central Bank of Nigeria (CBN) and AMCON bonds.

[2]Includes both public and private sector.

Box 1. Drivers of Inflation in Nigeria

This box tries to estimate drivers of inflation in Nigeria using a structural vector-autoregression model:

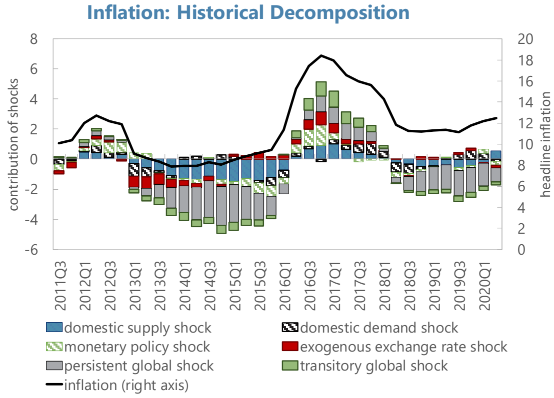
$$y_t = \nu + A_1 y_{t-1} + A_2 y_{t-2} + \mu_t,$$

where y consists of GDP growth, inflation, monetary condition (M2 growth), exchange rate, import prices and oil prices. A combination of short- and long-term restrictions are used to identify the structural shocks, $\mu_t = B w_t$, where w_t consists of independent shocks from domestic supply, domestic demand, monetary policy, exchange rate, as well as persistent and transitory global shocks.

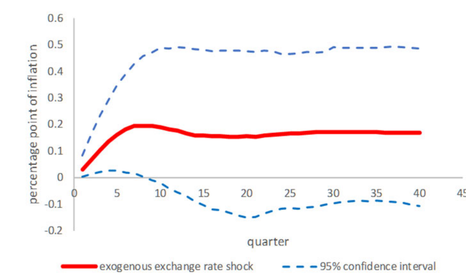
Long-term determinants

Empirical results show domestic supply shocks and global shocks have been the main contributors to inflation in the past decade. A negative supply shock, such as productivity decline of domestic firms, conflicts in the northern states, and floods, can cause inflation to rise. A global shock, such as decline in oil prices and weak global demand, can lead to weaker domestic demand through negative impact on the non-oil economy which depends on oil proceeds and remittances. A 10% depreciation in exchange rate is estimated to raise inflation by 2 percentage points based on the regression results. Taking into account the impact of depreciation on prices of imported fuel products, which were until recently subsidized, inflation could increase by 2.6 percentage points from a 10% depreciation. The findings are roughly consistent with other studies that find limited exchange rate pass-through to inflation (CBN, 2016) and the role of domestic supply and global shocks in driving inflation in sub-Saharan African countries (IMF, 2015).

Inflation: Historical Decomposition



Impact of Exchange Rate Shock on Inflation

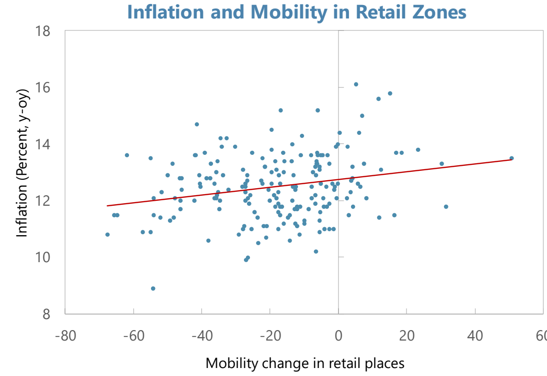


Note: The shock to exchange rate is 1% depreciation in the first year (four quarters).

Recent uptick

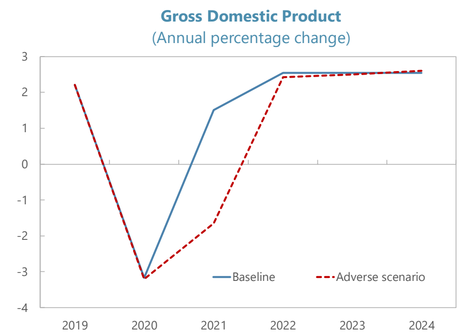
The COVID-19 pandemic has pushed Nigeria's inflation to new highs. Two important factors are at play. Domestic demand shocks from the lockdown have put downward pressure on prices, as evidenced by regional inflation in 2020 Q2—Nigerian states with higher declines in mobility experiencing lower inflation. However, this is outweighed by supply side factors, such as increase in production costs due to the pandemic and border closure/import restrictions, that pushed inflation higher.

Inflation and Mobility in Retail Zones

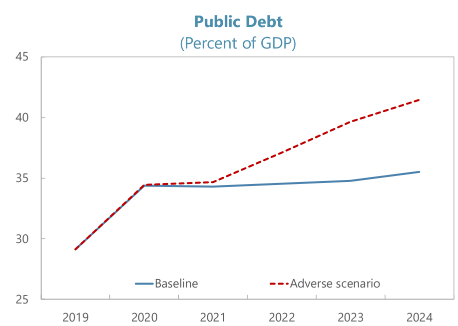


Box 2. Estimating the Impact of COVID-19 Resurgence in Nigeria [1/]

This box presents the estimated impact of a global and domestic resurgence of the COVID-19 pandemic on growth and public debt in Nigeria. The model used is a dynamic general equilibrium model, DIGNAR-19 (Melina and Zanna, 2020), combined with an epidemiological multigroup susceptible-infectious-removed (SIR) model (Cugat, 2020). The DIGNAR-19 model is calibrated to the Nigerian economy with the following features: financially constrained households; three sectors of production (oil, nontraded goods, and non-oil traded goods); and a government that has access to various fiscal instruments and can leverage on domestic, external commercial, and official debt. The multigroup SIR model, featuring age-varying susceptibility and parametrized to match the first wave of COVID-19 in Nigeria, is used to calibrate the health shock from a second wave.



The following simultaneous shocks are considered: (1) a health shock, which affects the labor force and government expenditures; (2) a commodity price shock affecting GDP, exports and government revenues; (3) external finance shocks causing a fall in remittances and a surge in borrowing costs; and (4) a shock to the non-oil economy due to its dependence on oil price. A resurgence of COVID-19 is captured as a new wave of cases domestically and globally, the latter captured by subdued oil prices and increased borrowing costs externally. It is assumed to occur in the 2021Q1 with the peak that is about half of that in the first wave. In response to this situation, the government (1) adopts a mild lockdown reducing contacts by one third of the reduction experienced during the first, more severe, lockdown of April 2020; and (2) increases health-related expenditures by 0.2 percentage points of GDP in 2021. In addition, under this adverse scenario, (1) oil prices would tumble in 2021, averaging at $30 per barrel; and (2) the sovereign bond spread on external commercial debt would rise to 3 percentage points, similar to the increase in 2020Q1.



These shocks would take a heavy toll on the Nigerian economy, with GDP contracting by 1.7 percent in 2021. While the 2021 fall in the labor supply is modest—under the assumption of a less severe COVID-19 spread and associated health measures—the decline in oil prices would propagate beyond the oil sector, given that oil exports are the major source of hard currency. The public-debt-to-GDP ratio would continue to increase in the medium term, not only due to the GDP denominator effect, but also because of the decline in oil fiscal revenues and, to a smaller extent, the increase in public health spending and borrowing costs. Absent fiscal consolidation measures, by 2024, the debt ratio would rise by 7 percentage points of GDP, reaching 41.4 percent of GDP—that is, 5.9 percentage points of GDP higher than in the baseline scenario.

[1]/This box was prepared by Gabriela Cugat (RES), Giovanni Melina (RES) and Felipe Zanna (ICD).

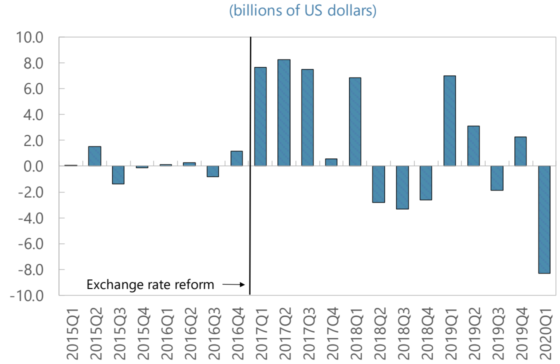
Box 3. Cross-Country Examples of Exchange Rate Reform

A number of countries have taken steps to unify the exchange rates and eliminate the parallel market premium in recent years. Examples include Angola, Egypt, Kazakhstan, Myanmar, Pakistan, and Uzbekistan. Key lessons include:

- When the official exchange rate is allowed to move to a market-clearing level, it does not go into freefall unless the parallel market rate was already in freefall.
- The parallel market rate is likely to be a reasonable indication of the market-clearing rate.
- Tightening of monetary policy at the time of the adjustment is important.
- Supportive fiscal policy is essential to stabilization.
- The inflation pass-through from an adjustment tends to be muted as it reflects the parallel rate already.
- If banks and their customers are caught by surprise, they may face losses, but in practice, they tend to expect some depreciation and position themselves accordingly.
- A rapid adjustment of the exchange rate is likely to be much less costly to the economy than a gradual approach.
- Central banks and governments sometimes do not wait long enough for the markets to stabilize and economic benefits to be seen.
- Communication of the change in exchange rate policy is difficult but crucial in helping to stabilize expectations.

Egypt: Net Portfolio Investment

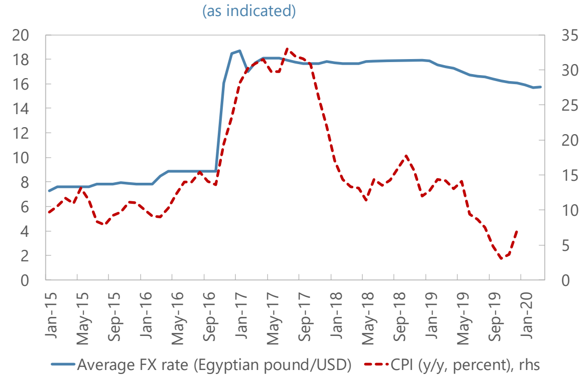
(billions of US dollars)



Sources: Haver

Egypt: Exchange Rate and Inflation

(as indicated)



Sources: Haver

Cases of Move to a Market-Clearing Official Exchange Rate

Country	Exchange rate adjustment		Inflation			Interest rate		
	Date	Size	Prior	Peak	Latest	Prior	Peak	Latest
Angola	Oct-19	30	16.3	16.4	23.41	14.5	30	15.5
Egypt	Oct 15–Apr 17	103	14.1	32.9	3.37	11.75	18.75	8.75
Kazakhstan	Jul 15-Jan 16	95.8	4	17.4	7	5.5	17	9
Myanmar	Mar 12-Apr 12	14500	-1.1	7.1	4.16	10	10	10
Pakistan	Mar-Jun 19	15.6	9.4	12.3	9.3	10.25	13.25	7
Uzbekistan	Aug-Sep 17	86	15.8	20.1	11.65	9	14	15

Simon Gray (2021) "Official and Parallel Exchange Rates – Recognizing Reality" IMF Working Paper" *Forthcoming*

Box 4. Assessing Nigeria's Monetary Policy Framework [1/]

This box takes stock of Nigerian's monetary policy framework to better understand key impediments to CBN's policy performance. Nigeria's inflation performance has lagged emerging market and regional peers, with the CBN falling short of anchoring inflation expectations.

Policy objectives

De jure. Section 2 of the 2007 CBN Act singles out (1) monetary and price stability; (2) safeguarding international value of the legal tender currency; and (3) promotion of a sound financial system as the principle objectives of the Bank giving primacy to both price and exchange rate stability.

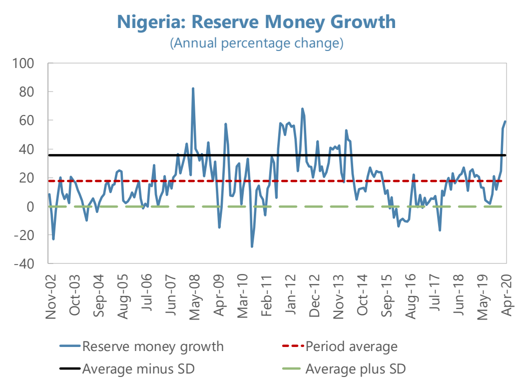
De facto. Staff's estimation shows that CBN's policy reaction function is procyclical, with the CBN's interest setting mainly driven by an impulse for exchange rate stabilization. The GMM estimates of the output coefficient (γ) of the following empirical Taylor rule is significantly negative implying pro-cyclicality.

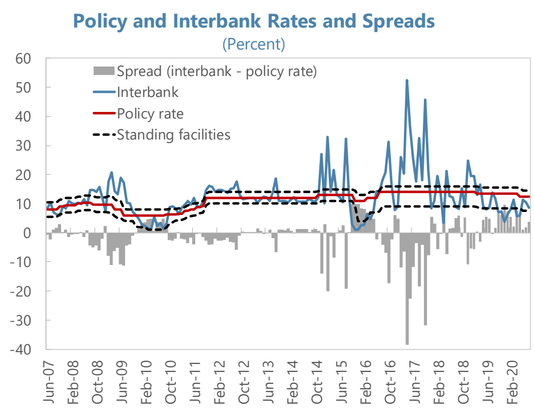
$$i_t = \rho i_{t-1} + (1-\rho)(i^* + \beta(E_t\bar{\pi}_{t+s} - \pi^*) + \gamma y_{t-1} + \delta REER_t + \mu OIL_t + \varphi Dummy_t) + \epsilon_t$$

(where $i, y, \bar{\pi}, REER, OIL$ denote nominal interest rate, output gap, inflation rate, real effective exchange rate, and crude oil prices; i^* and π^*natural interest rate and inflation target; E_{t-1} an expectation operator conditional on information available at time $t-1$, and ϵ a statistical disturbance).

Monetary policy regime

While the regime is de jure monetary targeting (MT), the volatility of both reserve money and interest rates would suggest a de facto regime that has yet to establish a credible nominal anchor.





CBN's toolbox does not suffer from a shortage of instruments. However, many of these instruments are calibrated inadequately or modified in a heterodox fashion. Nigeria's interest corridor does not bind with access restrictions hindering conventional functions of standing lending and standing deposit facilities. And the asymmetry of cash reserve requirement complicates banks' liquidity management and credit decisions. The CBN introduced minimum threshold for loan to deposit ratio in June 2019 in a bid to prop up credit growth. Evidence shows limited impact on credit given structural conditions holding back financial intermediation.

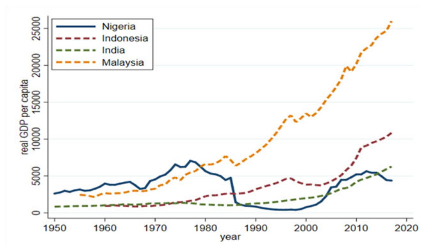
[1]/ This box is based on the forthcoming selected issues paper: *Nigeria—Strategy for a Monetary Policy Reset.*

Box 5. Diversification Experience of Malaysia, Indonesia, and India [1/]

Malaysia, Indonesia, and India each started with a development strategy similar to that of Nigeria centered on import substitution but changed course. This box provides insights that may be useful for Nigeria.

Malaysia adopted import substitution policies after its independence in 1957 to promote resource-based manufacturing and heavy industries. Such policies ran into difficulties due to insufficient job creation leading to high poverty rates and simmering social tensions. The culmination was the racial riot in 1969 that triggered the government to decisively shift its focus to labor-intensive manufacturing embarking on export-oriented industrialization which provided significant employment and living standard gains over time.

Real GDP per Capita: A Long View



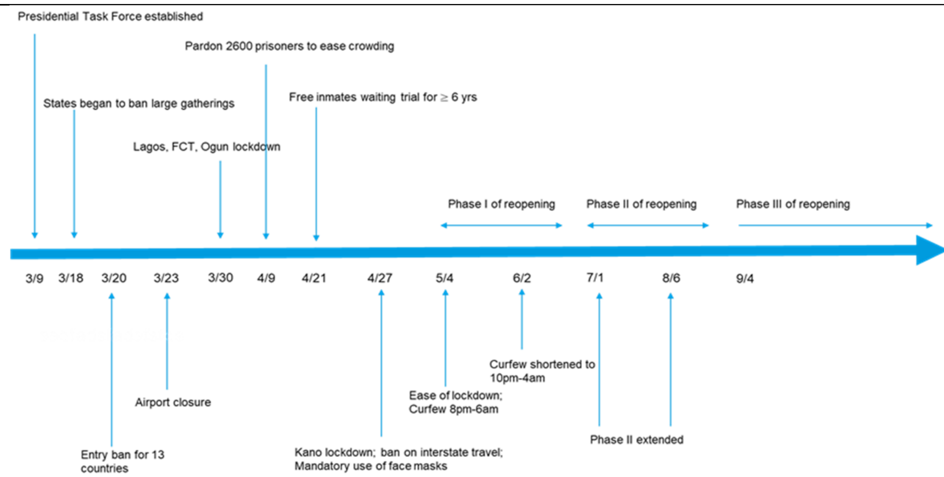
Source: Penn World Tables 9.1: and IMF staff calculations.

Indonesia in the 1970s and 1980s was an oil exporter with a similar level of oil production as that of Nigeria today. It had two competing forces within the government: Western-trained economists who embraced competition and open markets and nationalists who believed in protectionist policies. The oil boom between 1974 and 1982 tipped the balance of power toward the nationalists. The idea to rely less on foreign investment and protect infant industries gained momentum and guided protectionist policies. However, the secular decline in oil prices between 1982 and 1986, coupled with the worldwide recession drastically reduced Indonesia's oil revenues and exports and shifted a power balance. A set of reforms in exchange rate, monetary and financial sectors, fiscal and trade policies started to take hold paving the way for Indonesia's manufacturing sector to take off.

India, after its independence in 1947, had a key objective to achieve self-sufficiency in all sectors. It introduced an industrial and import licensing system, known as the *license-permit raj*, to reduce dependence on foreign exchange. The license-permit raj continued for decades until it could no longer be sustained. At the end of 1990, a balance-of-payments crisis occurred after years of growing fiscal and current account imbalances. The crisis led to sweeping liberalization measures in the 1990s, including the near abolition of industrial licensing and elimination of import licensing, relaxation of FDI rules and reduction of trade barriers. The external environment, including the collapse of the Soviet Union and the revolutionary reforms in China, also helped to build consensus among policy makers on the need for liberalization. While some restrictions on the manufacturing sector were still in place, the liberalization of the service sector generated enough momentum for rapid growth in India in the ensuing decades.

[1]/ This box is based on the forthcoming Selected Issues Paper: *Diversification of the Nigerian Economy.*

Annex I. Authorities' Response to COVID-19 Pandemic

Policy	Measures
Containment	
Monetary Policy	• Financial institutions were directed to engage International development partners and negotiate concessions to ease the pains of the borrowers; • The CBN provided credit support for the health industry to meet the potential increase in demand for health services and products; • The CBN initiated the Healthcare Sector Research and Development Intervention Scheme (HSRDIS) • The CBN coordinated CA-COVID - Private sector intervention scheme - which had mobilized over N32 billion to support the economy, lives and livelihoods; • Provided N1 trillion in loans to boost local manufacturing and production across critical sectors; • Took steps to unify the exchange rate; • Invoked partial risk guarantees for SMEs; • Granted additional moratorium of one year on CBN intervention facilities; • Reduced interest rate on intervention facilities from 9.0 per cent to 5.0 per cent; • Created N50 billion Target Credit Facility for affected MSMEs; • Granted regulatory forbearance to banks to restructure terms of facilities in affected sectors; and • Directed oil and oil service companies to sell foreign exchange to the CBN rather than the NNPC to improve foreign exchange supply to the economy.
Immediate Fiscal Measures	Unlock available funds in Special Accounts to create a ₦500bn intervention fund; **Specific measures to support the Private Sector:** • Activate the provisions of the Finance Act 2020 in support of MSMEs; • Structure and launch a Tax Resolution and Settlement Unit; • Extend deadlines and suspend penalties for filing tax returns; • Incentivize employers to retain and recruit staff during economic downturn; • Provide targeted tariff reduction and trade finance facilities to support strategic imports and serve as a boost to economic activity; and • Support strategic industries affected by the pandemic, such as the aviation, hospitality and road transport sectors. **Measures to support the Health Sector:** • Convert World Bank REDISSE program to support COVID-19 interventions in the states; • Provide funding to pharmaceutical sector to support the procurement of raw materials and equipment required to boost local drug production;

	• Provide ₦86bn intervention fund for health infrastructure; • Accelerated procurement of medical supplies and equipment; and • Develop incentive package for frontline healthcare workers **Accelerate Infrastructure Completion:** • Expand the scope of the Road Infrastructure Tax Credit Scheme (RITCS) • Accelerate the construction of 794.4km of approved roads and bridges under RITCS
Policy	**Measures**
Fiscal Measures to Safeguard Oil Revenues	Deregulate the price of refined petroleum products and establish a sustainable framework for maintaining the national strategic stock; • NNPC to ensure 100 per cent remittance of royalty and taxes paid by companies in kind to the Federation Account and periodic reconciliation with DPR and FIRS; • NNPC to continue to rationalize deductions from oil sector revenue in order to maximize payments to the Federation Account; • Maintain the practice of NNPC paying commercial value for all its crude oil lifting going forward; and • Reduce the average production costs of crude oil by at least 20 per cent in the first instance.
Fiscal Measures to Mobilize and Preserve Non-Oil Revenues	Implement the VAT reforms in the Finance Act 2020, maintaining the increase in VAT rate from 5 per cent to 7.5 per cent; • Develop business continuity plans for tax and customs administration to provide services to citizens, taxpayers, and importer s in case of widespread contagion (or mobility restrictions); • Rationalize ineffective tax incentives and exemptions; • Increase remittances and recovery of unremitted revenues from GOEs; • Sign-off of guidelines of Significant Economic Presence (to capture revenues from cross-border business transactions); • Unlock value from FG assets that are lying idle or under-utilized; and • Incentivize the use of up to N2 trillion of pension funds for roads and housing development.
Fiscal Measures to Reduce Non-Essential Spending	Adopt a Financing Plan for the Power Sector Recovery Program; • Eliminate non-critical and administrative capital expenditure; • Expand the biometric-based Integrated Personnel & Payroll Information System (IPPIS) to cover all MDAs; • Rationalize government agencies.
Measures to Mobilize External Support and Funding	Engage with multilateral and donor agencies to access additional funding for crisis response, i.e. IMF - \$3.4bn; World Bank - \$2.5bn; AfDB - \$0.5bn, African Export-Import Bank - \$0.5bn, Islamic Development Bank - \$113m; • Seek moratorium from official partners on bilateral and multilateral debts; and • Support arrangements to secure commercial debt relief.
Measures to Collaborate with and support The States	Negotiate suspension of payments in respect of ISPO; • Provide moratorium on deductions in respect of bailout loans; • Develop guidelines to protect inter-state commerce; • Encourage States to achieve SIFTAS and other World Bank program actions in order to access external support; • States should consider issuance of promissory notes to pay their construction debts; and • Collaborate with State Governments on Affordable Mass Housing, Agriculture and Off-grid Power Projects and other projects in the ESP.

Source: Central Bank of Nigeria Economic Report, First Half of 2020; IMF staff compilation.

Annex II. Status of Key Recommendations of Past Article IV Consultation

Recommendation	Status
Fiscal - *Revenue based fiscal consolidation to create space for higher capital and priority spending while improving spending efficiency and strengthening governance.*	- The authorities adopted the 2020 Finance Bill that includes higher oil price royalties and a VAT rate increasing from 5 to 7.5 percent. Fuel subsidies were removed by the revised 2020 budget; and the removal of electricity subsidy is being phased in. Significantly larger revenue mobilization is needed for which plans are yet to be firmed up.
Monetary and Exchange Rate - *Monetary policy should remain tight in view of above-target inflation. Heterodox policies should be replaced by more traditional one.* - *Moving towards a unified market-determined exchange rate and removing FX restrictions.*	- In response to COVID-19 crisis, monetary policy stance has been eased. This is appropriate given fiscal policy space at risk. However, heterodox measures—including through discretionary CRR or credit boosting initiatives—have increased. - Exchange rates in different windows converged within a modest margin. However, limited exchange rate adjustment and reduced FX supply by the CBN has resulted in de facto rationing, large parallel market premia and rising import restrictions. Existing exchange restrictions and MCPs are described in the accompanying Informational Annex.
Financial - *Enhancing banking resilience through strengthened capital buffers, risk-based supervision, no more regulatory forbearance and time-bound recapitalization plans for weak banks.*	- Adequate capital buffers and the CBN's timely engagement of forbearance is helping the banking sector weather the COVID-19 crisis—with NPL ratio remaining stable at 6 percent. - Progress with regulatory reforms and asset recovery has been mixed due including to the pandemic. Implementation of the Basel III reform package and macroprudential instruments has not progressed much.
Structural - *Accelerate structural reforms, particularly in the power sector, governance, the business environment, and financial inclusion.*	- Notable progress has been made in the power and fuel sectors, and financial inclusion. The Companies and Allied Matters Act (CAMA) has been passed to introduce beneficial ownership disclosure requirements. - Strengthening anti-money laundering/anticorruption institutions and implementing the CAMA by properly verifying and recording beneficial ownership information are important.

Annex III. Risk Assessment Matrix

Nigeria: Risk Assessment Matrix[1]				
Sources of Risk	**Likelihood**	**Time Horizon**	**Impact on Nigeria**	**Policy Responses**
External Risks				
Unexpected shift in the Covid-19 pandemic. ▪ **Downside.** The disease proves harder to eradicate (e.g., due to difficulties in finding/distributing a vaccine), requiring more containment efforts and impacting economic activity directly and through persistent behavioral changes (prompting costly reallocations of resources). ▪ **Upside.** Alternatively, recovery from the pandemic is faster than expected due to the discovery of an effective and widely available vaccine and/or a faster-than-expected behavioral adjustment to the virus that boosts confidence and economic activity.	High Low	**Short to Medium Term**	High High	• Allow greater ***exchange rate flexibility*** to preserve ***external buffers, structural reforms*** to enhance economic diversification and efficiency, and efficiency-based ***fiscal consolidation*** to ensure adequate resources to fight the pandemic. • Closely monitor developments and prepare for a domestic second wave of coronavirus infections. • To the extent oil prices recover faster, the impact would be positive for Nigeria, and good **resource management** practices including efforts on PIMA are recommended. • Strengthen the effectiveness of the anti-corruption and anti-money laundering frameworks.
Widespread social discontent and political instability. Social tensions erupt as the pandemic and inadequate policy response cause economic hardship (including unemployment, higher incidence of poverty, and shortages and higher prices of essentials) and exacerbate preexisting socioeconomic inequities partly due to governance vulnerabilities and corruption. Economic activity is disrupted. Growing political polarization and instability (e.g., contested elections) weaken policymaking and confidence.	High	**Short to Medium Term**	Medium	
Intensified geopolitical tensions and security risks (e.g., in response to pandemic) cause socio-economic and political disruption, disorderly migration, higher commodity prices (if supply is disrupted), and lower confidence.	High	**Short Term**	Low	
Oversupply and volatility in the oil market. Supply increases following OPEC+ disagreements and lower demand keep energy prices close to historical lows, but uncertainty about possible production cuts and the pace of demand recovery lead to bouts of volatility.	Medium	**Short to Medium Term**	High	• Allow greater ***exchange rate flexibility*** to support adjustment to external shocks. • ***Structural reforms*** to improve economic efficiency and enhance diversification. • ***Non-oil revenue mobilization*** to shield against declines in oil revenue and ***contain recurrent expenditure*** to conserve scarce resources for public investment.
Cyber-attacks on critical global financial systems, infrastructure and institutions trigger systemic financial instability or widespread disruptions in socio-economic activities.	Medium	**Short to Medium Term**	Low	• Strengthen the ***supervisory and regulatory framework***, especially as it pertains to oversight of holding companies; improve corporate governance; and address weaknesses in the bank resolution framework.

Accelerating de-globalization. Geopolitical competition and fraying consensus about the benefits of globalization lead to further fragmentation. Reshoring and less trade reduce potential growth.	**High**	**Short to Medium Term**	**Medium**	• ***Rebuild fiscal and external buffers*** including via non-oil revenue mobilization and greater exchange rate flexibility, to counter trade and/or financing shortfalls. • Continue improving the ***business environment*** to boost productivity and competitiveness and deepen regional trade integration. This, in a reform package with sound fiscal and monetary policies, would help ***diversify exports***, both in terms of export products (away from oil) and trading partners. • Address the ***infrastructure gap***. Significant public and private investments are needed to improve power generation, improve logistics and expand capacity.
Higher frequency and severity of natural disasters cause severe economic damage to smaller economies susceptible to disruptions (medium probability). A sequence of severe events hits key infrastructure and large economies, which disrupts trade, reduces global GDP, and prompts a recalculation of risk and growth prospects (low probability).	**Medium/ Low**	**Short to Medium Term**	**High**	• Rebuild fiscal and external buffers to counter effects demand shortfalls and adverse effects on vulnerable groups. • Continue improving the business environment to boost productivity and competitiveness, and to foster diversify to dampen negative effects. • Address the infrastructure gap. Significant public and private investments are needed to improve power generation, improve logistics and expand capacity.
Nigeria-specific Risks				
Speed of reform implementation Further delays could trigger a loss of confidence, lower growth and capital outflows. **Disruption of oil production in the Niger Delta** and deterioration of security conditions and/or insurgency-related humanitarian crisis in the North East.	**High** **High**	**Short Term** **Medium Term**	**High** **High**	***Integrated policy package*** (including communication strategy) to address near-term vulnerabilities to sudden stop and support transition to a more diversified economy. This includes strengthen monetary and exchange rate frameworks, structural reforms, and an improved business environment. • Strengthen security and investment environment in the ***oil and gas*** sector.
Protests against the Special Anti-Robbery Squad (SARS), sparked by a video showing the extra-judicial killing of a Nigerian, have spread across and outside the country despite government clampdown.	**High**	**Short Term**	**High**	Closely monitor the situation, resolve through mediation and dialogue, and deliver on promises (acceptance of 5-point demand).
Commencement of Dangote refinery operation has the potential to meet in full domestic demand of refined petroleum products and improve current account balance.	**High**	**Medium Term**	**High**	Closely monitor the development of the situation, including Nigeria's oil production and imports of refined petroleum products.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex IV. Public Debt Sustainability Analysis

Nigeria's public debt is assessed to be sustainable, albeit subject to high risks. Liquidity-based indicators— driven by low revenue mobilization—remain concerning, with the interest bill representing a high share of government revenue. This makes Nigeria's debt servicing capacity vulnerable to shocks. Stress scenarios confirm the vulnerability of gross financing needs to a low growth/wide primary deficit scenario, as well as contingent liability shocks. The interest-to-revenue ratio is particularly vulnerable to a real interest rate shock. A comprehensive policy package, including fiscal consolidation based on non-oil revenue mobilization over the medium term once the COVID-19 crises passes is essential to reduce the interest payments-to-revenue ratio to more sustainable levels.

Baseline Projections

1. **Nigeria's level of public debt has continued to increase**. Public debt – which includes general government debt, CBN overdrafts, CBN financing of the power sector, Asset Management Company debt (AMCON), and non-interest-bearing promissory notes issued to clear payment arrears (about 2.6 trillion naira from 2018 through 2022) – has increased to about 29 percent of GDP in 2019 from 9 percent in 2009 driven by large fiscal deficits arising from weak non-oil revenue mobilization and falling oil revenues. The impact of the COVID-19 crisis on economic activity and the sharp decline in oil prices are expected to increase public debt further to 34 percent of GDP in 2020. The debt level is expected thereafter to gradually increase but stay below 37 percent of GDP over the medium term, helped by favorable growth-interest rate dynamics. Gross financing needs are expected to increase to 9 percent of GDP in 2020 from 4.8 percent of GDP in 2019, and average about 11 percent of GDP in the medium term.

2. **Nigeria's public debt is considered sustainable under the baseline**. The level of public debt compares favorably with the EMDE average general government gross debt stock of around 50 percent of GDP, and significantly lower than the MAC-DSA's benchmark of 70 percent. On account of the expected recovery of oil revenue and some improvements in non-oil revenue collection, the primary deficit is projected to gradually improve but still surpass the debt-stabilizing level by the end of projection period. While medium and long-term debt account for more than 80 percent of public debt, the relatively high GFN-to-GDP ratio together with a declining effective interest rate suggests that the remaining maturity is likely short for a large share of the stock of debt.. Foreign currency denominated debt, mostly held by non-residents, constitute 21 percent of public debt, just above the lower early warning threshold. Concessional debt accounts for about half of external public debt, but only 12 percent of all public debt.

3. **Weak revenue mobilization poses significant risks to debt-servicing capacity**. Although interest payment is only 1.7 percent of GDP in 2019 and is projected to average below 2 percent of GDP over the medium term, about 60 percent of federal government revenues were absorbed by interest payments in 2019 reflecting poor domestic revenue mobilization capacity. The FG interest-to-revenue ratio is expected to exceed 90 percent in 2020 and rise steadily from about 60 percent in

2021 to surpass 90 percent again by 2025. High interest-to-revenue ratio puts fiscal space at risk and financing of current and capital spending needs highly dependent on debt. Similarly, the otherwise moderate public gross financing needs, which stays below the MAC-DSA's benchmark of 15 percent, would be significantly higher than general government revenues at about 7 percent.

4. Contingent liabilities and uncertainties arising from oil prices, as well as interest rate movements, present additional fiscal risks. Preliminary estimates suggest that explicit contingent liabilities of the federal government are around 3 percent of GDP. In addition, non-guaranteed liabilities of government owned entities and certain PPP and energy-related contingent liabilities, for which no data were available, are likely to pose significant risks. The revenue outlook remains subject to large uncertainties over the evolving trajectory of oil prices. With oil revenue projected to rebound and contribute to 1/3 of total revenue by 2021 under the baseline, a slower than expected recovery of oil prices would put further strain on the government's capacity to service debt. Real interest rates under the baseline projection are significantly lower than the historical average. Debt dynamics would worsen if real rates turn out to be higher than expected.

5. With regard to the forecast track record, past projections of the primary balance and growth show some optimistic bias pre-2017 reflecting oil price volatility. Forecast accuracy has improved since 2017 but remains dependent on oil price volatility.

Stress Tests

6. Debt level is vulnerable to the combined macro-fiscal shock. Individual shocks to real GDP growth, primary balance, real interest rate, real exchange rate, as well as a contingent liability shock would push up public debt no higher than 41 percent of GDP over the medium term. A standardized combined macro-fiscal shock that captures a combination of these shocks would increase the debt level to 49 percent of GDP by 2025, still below the 70 percent MAC-DSA benchmark, but close to the benchmark identified in the literature (40-58 percent of GDP) as safe and growth-supporting for countries like Nigeria, which is a lower-middle income country with poor/weak revenue mobilization capacity[1].

7. Gross financing needs would worsen under stress scenarios, signaling risks to debt sustainability. Gross financing needs would reach 14 percent of GDP under shocks to the real interest rate and almost 16 percent of GDP under the combined macro-fiscal shock.

8. The FG interest payments-to-revenue ratio is vulnerable to shocks. Higher interest rates will increase Nigeria's vulnerabilities by placing a principal risk on debt service capacity. In particular, an interest rate shock would increase the FG interest-to-revenue ratio to about 200 percent by 2025. A standardized combined macro-fiscal shock that captures a combination of shocks, such as to real GDP growth, inflation, expenditures, interest rate and exchange rate, would increase the ratio to

[1] A. Pienkowski, *Debt Limits and the Structure of Public Debt*, IMF Working Paper, WP/17/117. *Modernizing the Framework for Fiscal Policy and Public Debt Sustainability Analysis*, International Monetary Fund Staff paper, August 2011 *Debt Sustainability Analysis Framework for Low-Income Countries*, The IMF and the World Bank, July 2018,

237 percent. Other shocks to real GDP growth, primary balance and the exchange rate would increase the ratio to between 112 and 124 percent by 2025. The GG interest payments-to-revenue ratio, however, would be kept below 42 percent under shocks, except for the interest rate shock and combined macro-fiscal shock, under which the ratio would go up to 68 and 81 percent respectively.

9. The fan charts indicate that there is significant uncertainty around the baseline. The width of the symmetric fan chart, estimated at about 25 percent of GDP by the end of the projection period, illustrates the degree of uncertainty for equal probability upside and downside shocks. In an asymmetric fan chart, an extreme downside shock that constrains growth to zero results in a more upward-sloping debt path, reflecting a balance of risks skewed to the downside.

Heat Map

10. The heat map signals some vulnerabilities associated with gross financing needs and debt profile. Overall, there are three yellow cells (indicating medium risk) and one red cell (indicating high risk) out of a total of fifteen cells in the heat map. Foreign currency debt, external debt, and external financing requirements are above their respective lower early warning thresholds. Market perception presents a major vulnerability as sovereign spreads are currently above the upper early warning thresholds. While sovereign bond yields and spreads have narrowed since reaching a peak in March, 2020, they remain above their pre-COVID-19 levels, and the same is true of the 1 and 5-years credit default swaps. The gap between the 1 and 5-years credit default swaps has continued to widen.

Figure 1. Nigeria Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

(in percent of GDP unless otherwise indicated)

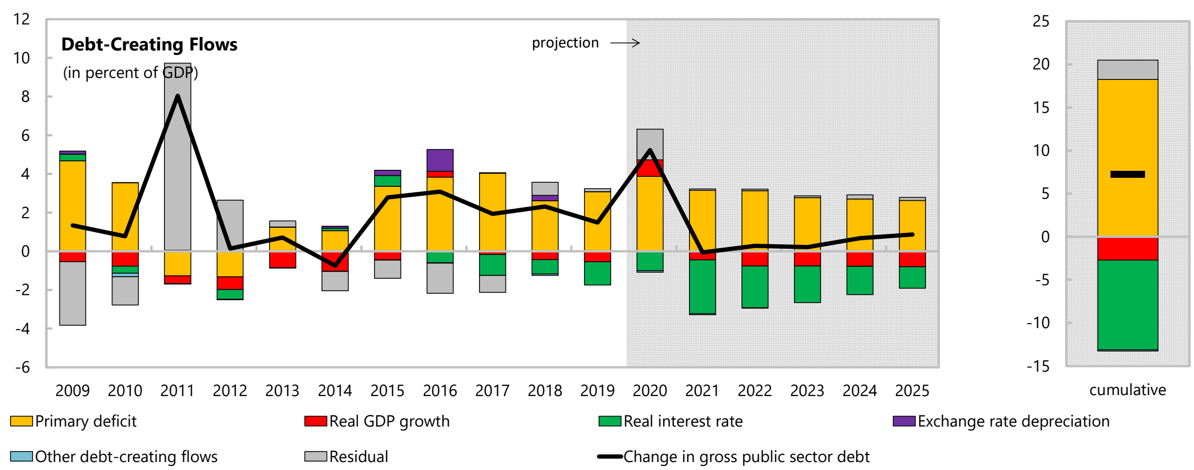
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2009-2017 [2/]	2018	2019	2020	2021	2022	2023	2024	2025
Nominal gross public debt	17.5	27.7	29.1	34.4	34.3	34.6	34.8	35.5	36.4
Public gross financing needs	3.1	4.5	4.8	9.0	11.4	11.6	10.7	11.0	11.3
Real GDP growth (in percent)	4.7	1.9	2.2	-3.2	1.5	2.5	2.5	2.5	2.6
Inflation (GDP deflator, in percent)	7.8	10.2	10.4	11.8	14.6	12.7	11.8	11.0	10.5
Nominal GDP growth (in percent)	12.8	12.3	12.8	8.2	16.3	15.6	14.6	13.8	13.4
Effective interest rate (in percent) [4/]	7.6	7.5	6.8	7.7	5.4	5.7	5.8	6.5	7.3
Adjusted effective interest rate (in percent) [5/]	7.6	8.3	7.6	8.5	6.6	7.5	8.2	9.7	11.5

As of November 18, 2020		
Sovereign Spreads		
EMBIG (bp) 3/		614
5Y CDS (bp)		486
Ratings	Foreign	Local
Moody's	B2	B2
S&Ps	B-	B-
Fitch	B	B

Contribution to Changes in Public Debt [6/]

	Actual			Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [11/]
Change in gross public sector debt	2.0	2.3	1.5	5.2	-0.1	0.3	0.2	0.7	0.9	7.2	
Identified debt-creating flows	1.6	1.6	1.3	3.6	-0.1	0.2	0.1	0.5	0.7	5.0	
Primary deficit	2.1	2.6	3.1	3.9	3.1	3.1	2.8	2.7	2.6	18.2	-1.9
Primary (noninterest) revenue and grants	10.6	8.5	7.9	5.9	6.9	7.0	7.1	7.1	7.1	41.1	
Primary (noninterest) expenditure	12.8	11.1	10.9	9.7	10.1	10.1	9.8	9.8	9.7	59.3	
Automatic debt dynamics [7/]	-0.5	-0.9	-1.8	-0.2	-3.2	-2.9	-2.7	-2.2	-1.9	-13.1	
Interest rate/growth differential [8/]	-0.7	-1.2	-1.8	-0.2	-3.2	-2.9	-2.7	-2.2	-1.9	-13.1	
Of which: real interest rate	-0.2	-0.7	-1.2	-1.0	-2.8	-2.2	-1.9	-1.5	-1.1	-10.4	
Of which: real GDP growth	-0.5	-0.4	-0.5	0.9	-0.4	-0.8	-0.8	-0.8	-0.8	-2.7	
Exchange rate depreciation [9/]	0.2	0.3	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	-0.1	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	-0.2	
Net privatization proceeds (negative)	0.0	-0.1	0.0	-0.1	-0.1	0.0	0.0	0.0	0.0	-0.2	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [10/]	0.4	0.7	0.2	1.6	0.1	0.1	0.1	0.2	0.2	2.2	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Defined as interest payments divided by debt stock (excluding guarantees and debt that do not carry interest payments) at the end of previous year.

6/ Gross debt includes general government debt, CBN overdrafts, CBN financing of the power sector and AMCON debt

7/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

8/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as -g.

9/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

10/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

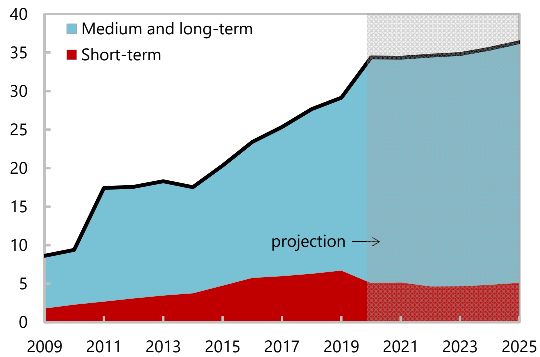
11/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 2. Nigeria Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

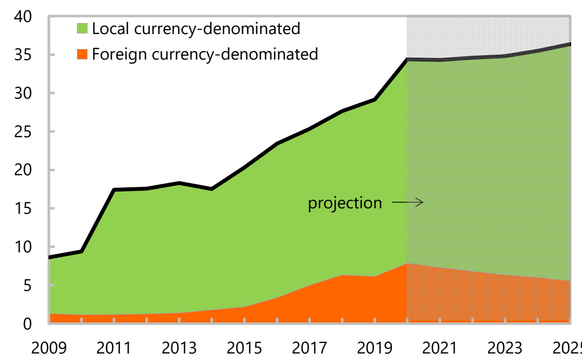
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

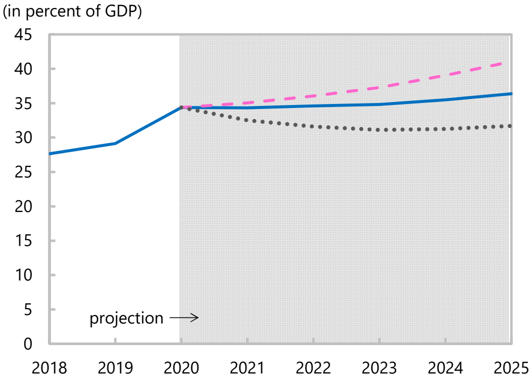


Alternative Scenarios

Baseline — Historical — Constant Primary Balance

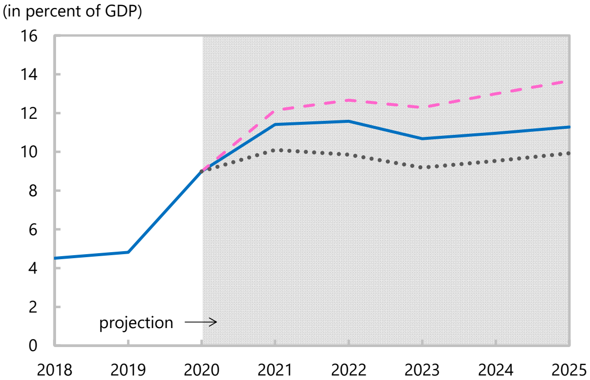
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

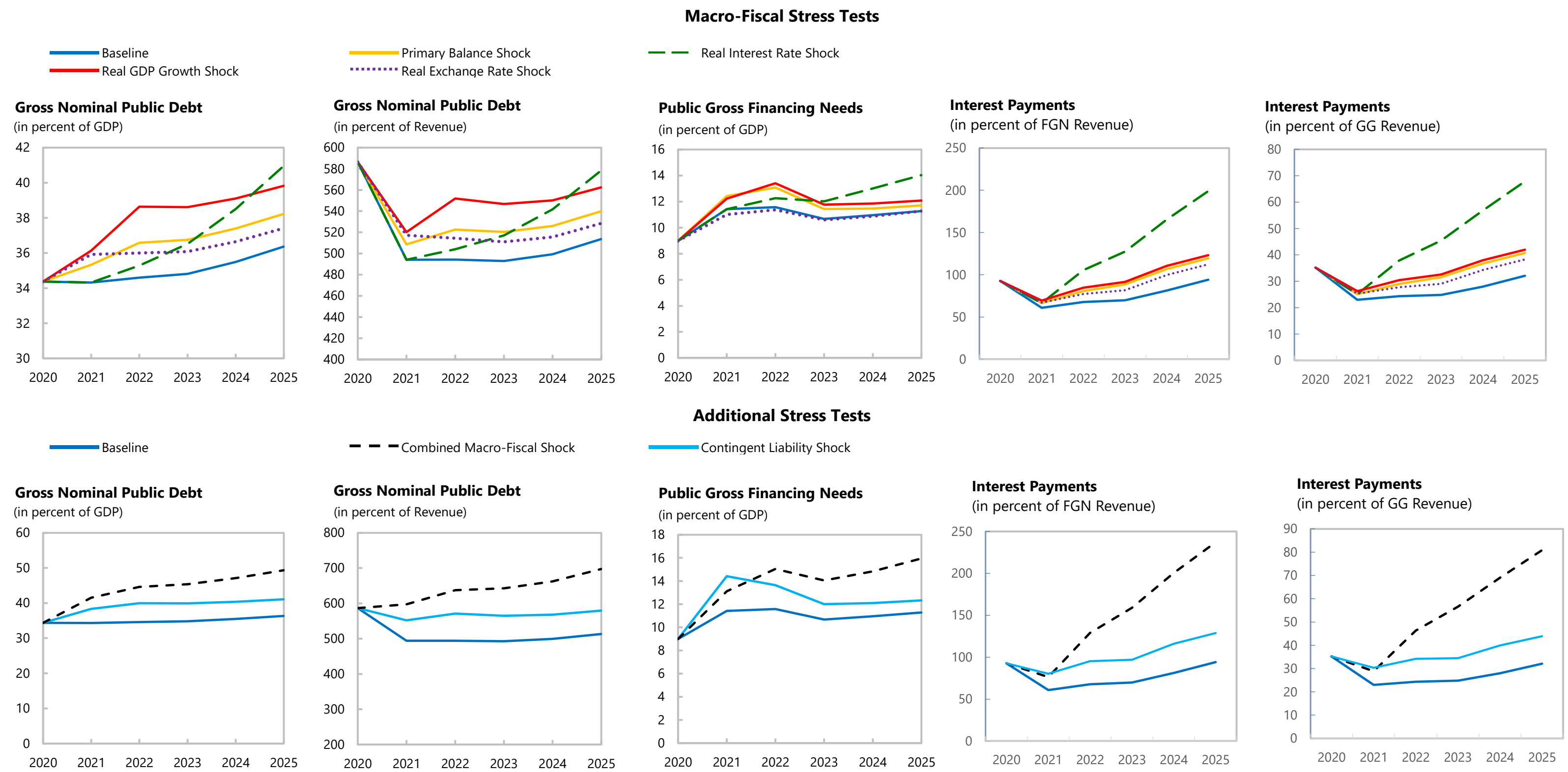
(in percent)

Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-3.2	1.5	2.5	2.5	2.5	2.6
Inflation	11.8	14.6	12.7	11.8	11.0	10.5
Primary Balance	-3.9	-3.1	-3.1	-2.8	-2.7	-2.6
Effective interest rate	7.7	5.4	5.7	5.8	6.5	7.3
Constant Primary Balance Scenario						
Real GDP growth	-3.2	1.5	2.5	2.5	2.5	2.6
Inflation	11.8	14.6	12.7	11.8	11.0	10.5
Primary Balance	-3.9	-3.9	-3.9	-3.9	-3.9	-3.9
Effective interest rate	7.7	5.6	6.1	6.3	7.4	8.0

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-3.2	3.8	3.8	3.8	3.8	3.8
Inflation	11.8	14.6	12.7	11.8	11.0	10.5
Primary Balance	-3.9	-2.0	-2.0	-2.0	-2.0	-2.0
Effective interest rate	7.7	5.6	6.6	6.8	8.2	9.0

Source: IMF staff.

Figure 3. Nigeria Public DSA - Stress Tests



Underlying Assumptions
(in percent)

	2020	2021	2022	2023	2024	2025
Primary Balance Shock						
Real GDP growth	-3.2	1.5	2.5	2.5	2.5	2.6
Inflation	11.8	14.6	12.7	11.8	11.0	10.5
Primary balance	-3.9	-4.2	-4.1	-2.8	-2.7	-2.6
Effective interest rate	7.7	5.6	6.2	6.4	7.4	8.0
Real Interest Rate Shock						
Real GDP growth	-3.2	1.5	2.5	2.5	2.5	2.6
Inflation	11.8	14.6	12.7	11.8	11.0	10.5
Primary balance	-3.9	-3.1	-3.1	-2.8	-2.7	-2.6
Effective interest rate	7.7	5.6	8.3	9.6	11.6	12.9
Combined Shock						
Real GDP growth	-3.2	-2.0	-1.0	2.5	2.5	2.6
Inflation	11.8	13.7	11.8	11.8	11.0	10.5
Primary balance	-3.9	-4.2	-4.1	-2.8	-2.7	-2.6
Effective interest rate	7.7	6.2	8.1	9.5	11.3	12.6

	2020	2021	2022	2023	2024	2025
Real GDP Growth Shock						
Real GDP growth	-3.2	-2.0	-1.0	2.5	2.5	2.6
Inflation	11.8	13.7	11.8	11.8	11.0	10.5
Primary balance	-3.9	-3.6	-4.0	-2.8	-2.7	-2.6
Effective interest rate	7.7	5.6	6.1	6.3	7.3	7.9
Real Exchange Rate Shock						
Real GDP growth	-3.2	1.5	2.5	2.5	2.5	2.6
Inflation	11.8	25.0	12.7	11.8	11.0	10.5
Primary balance	-3.9	-3.1	-3.1	-2.8	-2.7	-2.6
Effective interest rate	7.7	6.2	5.8	6.0	7.1	7.6
Contingent Liability Shock						
Real GDP growth	-3.2	-2.0	-1.0	2.5	2.5	2.6
Inflation	11.8	13.7	11.8	11.8	11.0	10.5
Primary balance	-3.9	-5.5	-3.1	-2.8	-2.7	-2.6
Effective interest rate	7.7	6.5	6.5	6.4	7.5	8.0

Source: IMF staff.

Figure 4. Nigeria Public DSA Risk Assessment

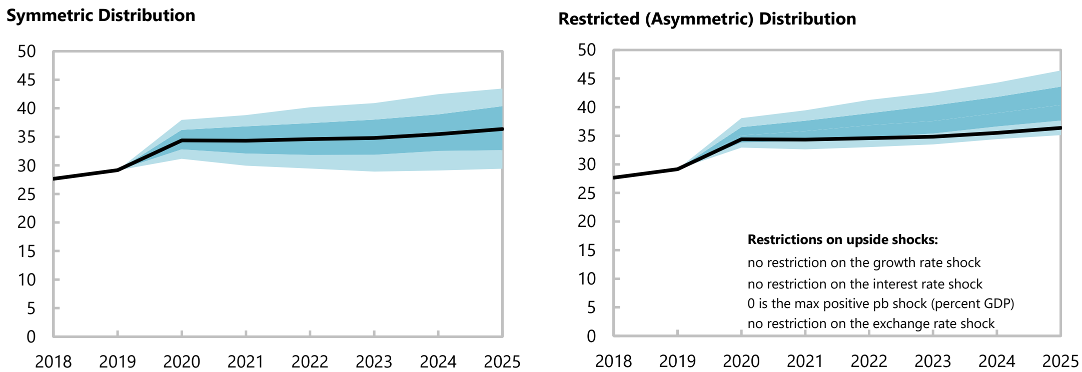
Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)

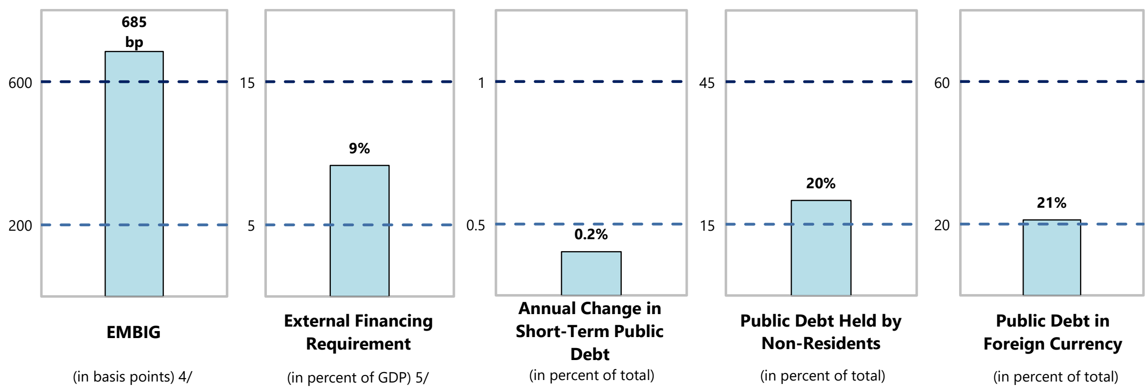
Baseline   Percentiles: 10th-25th   25th-75th   75th-90th



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2019)

Nigeria   Lower early warning   Upper early warning



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

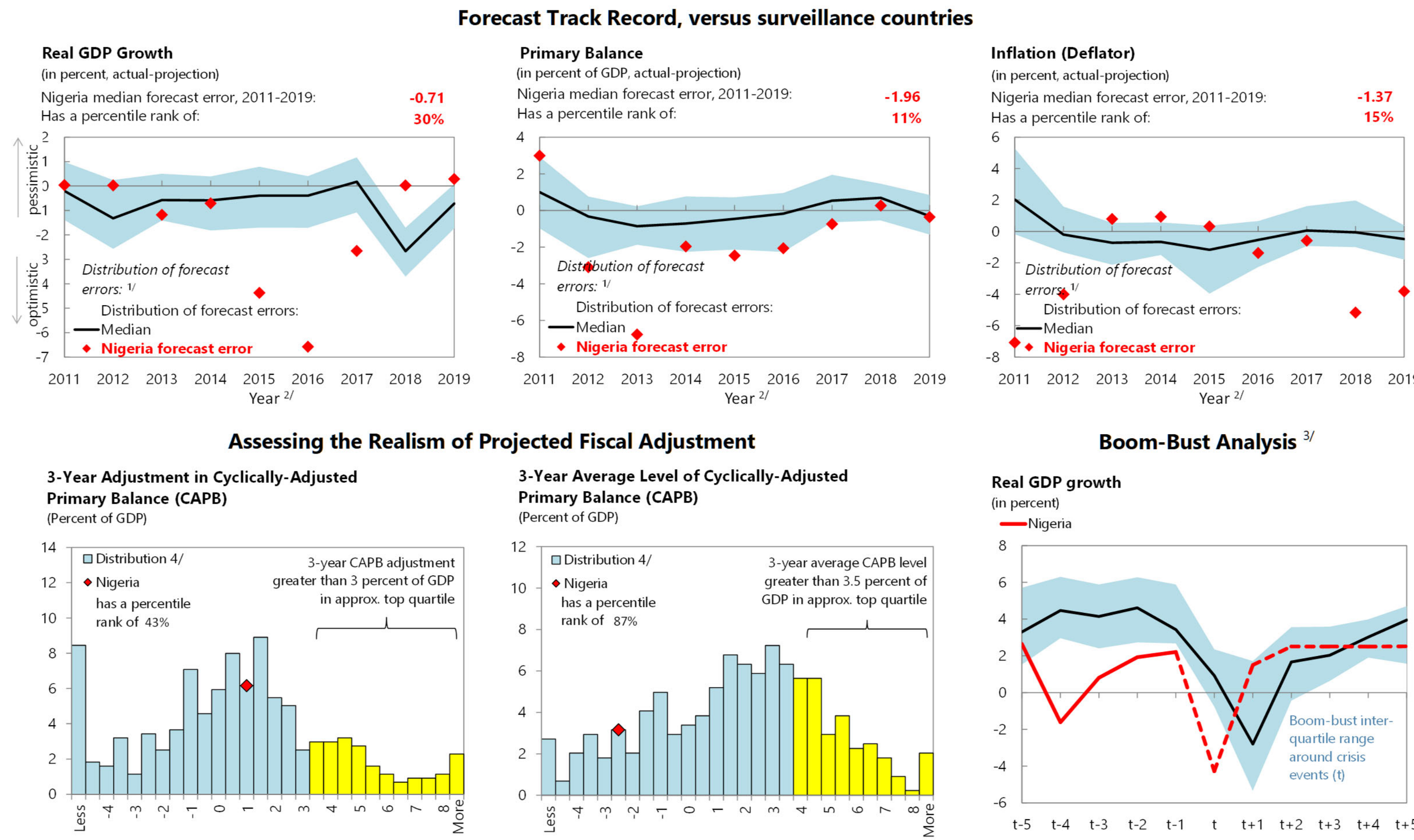
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 07-Jul-20 through 05-Oct-20.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 5. Nigeria Public DSA - Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Nigeria has had a positive output gap for 3 consecutive years, 2017-2019. For Nigeria, t corresponds to 2020; for the distribution, t corresponds to the first year of the crisis.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Annex V. External Stability Assessment

The external position of Nigeria in 2020 is preliminarily assessed, based on projections, to have been substantially weaker than consistent with fundamentals and desirable policy settings, although there are significant uncertainties linked to large balance of payment Errors and Omissions. The real effective exchange rate (REER) has depreciated in the course of 2020 but remains overvalued by about 18½ percent. Reserves at end-2019 corresponded to 64 percent of the Assessment of Reserve Adequacy (ARA) metric, including the oil buffer. The global COVID-19 crisis has made the external vulnerabilities more acute as the current account deficit is not expected to narrow considerably despite import compression due to a sharp drop in oil prices, and past reliance on capital inflows are putting large pressure on reserves which are propped up through tight rationing and administrative measures.

A. Current Account and Exchange Rate Regressions

1. The analysis is based on the revised EBA-Lite methodology with a focus on the current account and the Real Effective Exchange Rate (REER) regression analyses.[1] The main vehicle for the assessment is the EBA-Lite regression analyses of the current account given the following: (i) the current account deficit and its financing are at the core of Nigeria's difficult and vulnerable external position which has been worsened by the global pandemic, and (ii) Nigeria's complex exchange rate policy and multiple exchange rates complicates a meaningful REER analysis. This leads to an estimated current account gap of 4.5 percent of GDP corresponding to a REER gap of about 18½ percent remaining after some depreciation in 2020 (Table 1). On balance, the bottom-line assessment is that the external position of Nigeria in 2019 was substantially weaker than consistent with fundamentals and desirable policy setting in line with the current account regression, reflecting the recent deterioration and related pressures on external financing and reserves.

- **Current Account Approach**. The revised EBA-lite methodology models the current account balance as a function of the fundamentals of the economy, including the role of policy and financial variables.[2] The model finds that the current account in 2020 was substantially weaker than the norm by 4.5 percent of GDP, implying it was weaker than consistent with fundamentals and desirable policy settings, with macroeconomic policy gaps contributing 0.9 percentage points of GDP to the current account gap. It should be noted that the estimate is uncertain due to data gaps resulting from large and varying errors and omissions in the BOP, which are also reflected in a large negative residual estimated current account gap. Taking into account

[1] The review involved: (1) expanding the fundamentals and policy determinants in the EBA-Lite current account and REER regression models; (2) identifying complementary approaches to regression-based methods for the external assessment of large exporters of exhaustible commodities; and (3) a revised approach for the deterministic assessment of external sustainability. See IMF Working Paper 13/272 and the 2016 Methodological Note on EBA-Lite for information about EBA-Lite 1.0.

[2] The key revisions to the EBA-Lite current account regression model focus on clarifying the role of remittances and aid in the external balance; incorporating shocks (natural disasters and armed militarized conflicts) to better capture the determinants of the external balance in EBA-Lite countries; and, expanding the policy determinants by introducing social insurance policies and revising the financial policy variables.

exchange rate adjustments to date, the estimated overvaluation in the exchange rate is around 18½ percent.

- **Equilibrium REER Approach**.[3] This price-based approach directly models a REER norm within a panel framework as a function of cyclical and structural variables. The large inflation differential with trading partners is reflected in the appreciating real effective exchange rate and the model suggests the real exchange rate is currently undervalued by 1.3 percent and broadly consistent with fundamentals and desirable policies.

Table 1. Nigeria: EBA-Lite current account and REER Regression Results

	Current Account Regression[1]	Equilibrium REER Regression[1]
CA cyclically adjusted	-3.8	...
CA norm	-0.3	...
Current account gap	-4.5	...
Policy gap	-0.9	-4.9
Residual	-3.1	0.1
Natural Disasters and Conflicts	0.7	-1.8
		...
Real exchange rate gap[2]	18.7	-1.3

Source: IMF staff estimates.

[1] Based on the revised EBA-Lite methodology.

[2] Positive numbers indicate overvaluation. Staff estimated elasticity of CA to REER gap is 0.20, compared to an EBA model estimate of 0.10, reflecting increased sensitivity in recent years and the gap reflects the expected depreciation in 2020 through December.

B. External Sustainability Module

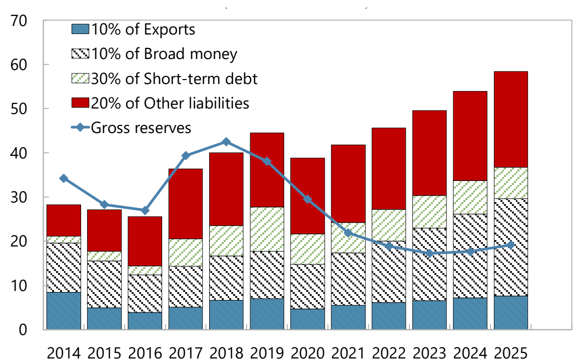
2. The External Sustainability (ES) approach suggests moderate current account and REER gaps. It calculates the REER adjustment required to satisfy the inter-temporal budget constraint as a measure of the external adjustment required to restore external sustainability. Specifically, the approach produces the adjustment to the exchange-rate and to the current account, through the CA-REER elasticity needed to prevent the Net International Investment Position (NIIP) from deteriorating, in the absence of other policy measures to correct the external imbalance. Results suggest a REER gap of about 8 percent for 2020 and a corresponding current account gap of -1.6 percent. That is, gaps are relatively moderate, reflecting Nigeria's moderately negative NIIP of 15½ percent of GDP at end-2019.

[3] In parallel with the revised current account model, analogous changes will be made to the revised EBA-Lite REER regression model. The REER model will use the indicative policy norms for the credit-to-GDP ratio, credit growth, and public health policy.

C. Reserve Adequacy

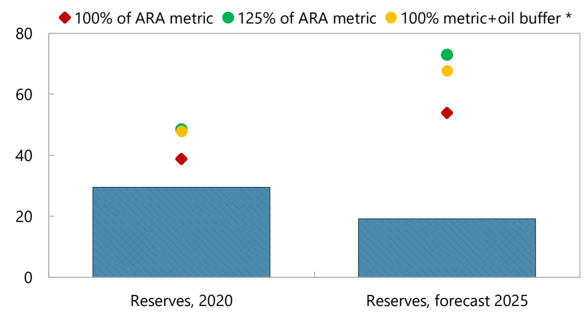
3. Gross international reserves have been declining and are below comfortable levels. After falling from mid-year peak levels, gross reserves declined to $38.1 billion at end-2019, which translates into 64 percent of the Assessment of Reserve Adequacy (ARA) metric including the oil buffer, leaving it $21½ billion short. Excluding staff estimated FX swaps and forwards of about US$8 billion, reserves of $30 billion represent 51 percent of the ARA metric including the oil buffer.[4] In 2020, the global COVID-19 crisis has put pressure on oil exports due to a sharp drop in oil prices, while capital inflows have turned into outflows. However, reserves have been propped up through tight rationing and administrative measures and boosted by an RFI purchase of about $3.5 billion, leaving the reserves at $35 billion at end-November. However, in the absence of major policy adjustments, including a unified and more flexible exchange, this is unsustainable and under baseline projections, reserves are expected to be just below $20 billion by 2025, equivalent to 26 percent of the metric including the oil-buffer, but before adjusting for FX swaps.

Contributions to Reserve Adequacy Metric
(Billion U.S. dollars)



Source: IMF staff calculations.

Reserve Adequacy Measures
(Billion U.S. dollars)



* Note: Oil price gap multiplied by oil exports, following 2016 ARA paper.
Sources: Central Bank of Nigeria; and IMF staff estimates.

D. Capital Flows

4. Portfolio outflows started already in the second half of 2019, and amid the COVID-19 shock there were strong outflows in 2020Q1, while foreign direct investments (FDIs) have been persistently low. Investor uncertainty in the context of increasing global trade tensions and low growth have discouraged portfolio inflows. Other factors for lower investment flows include lower domestic yields, distortive policies, low oil prices and, concerns about a deteriorating current account. FDIs increased in 2019 but were still low with an annual average net of about ½ percent of GDP in the past five years. In the first half of 2020, portfolio outflows were $8.5 billion, but would likely have been substantially larger in the absence of administrative measures. Complicating the

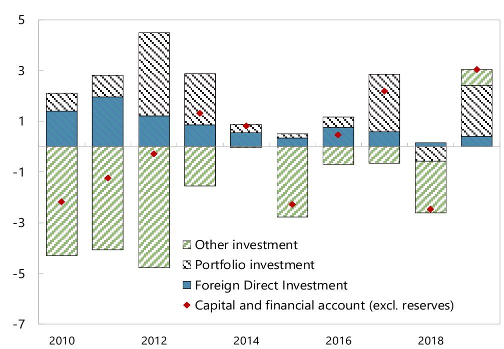
[4] See the 2016 ARA Board paper.

picture are large and varying errors and omissions, which in the first half of 2020 were $12.7 billion or 2.9 percent of projected full year GDP of unexplained inflows.

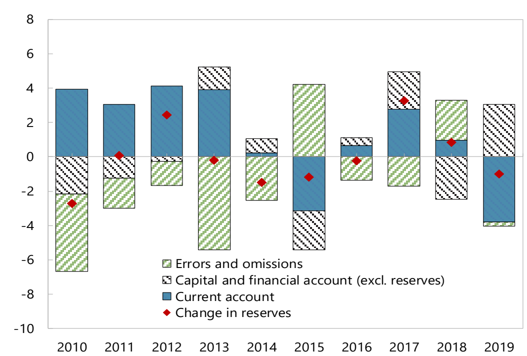
E. Overall Assessment

5. The external position of Nigeria in 2020 is preliminary assessed based on projections to have been substantially weaker than consistent with fundamentals and desirable policy settings. Reserves at end-2019 corresponded to 64 percent of the Assessment of Reserve Adequacy (ARA) metric including the oil buffer. The analysis based on the revised EBA-Lite methodology with a focus on the current account leads to an estimated current account gap of 4.5 percent of GDP, which corresponds to a substantially weaker external position. The assessment is subject to significant uncertainties, including significant one-off transactions, and large and varying errors and omissions in the Balance of Payments.

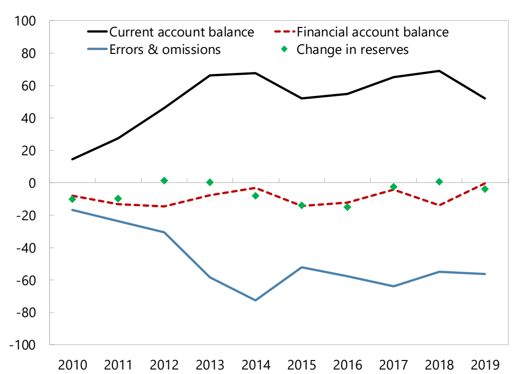
Financial Account (Net)
(Percent of GDP)



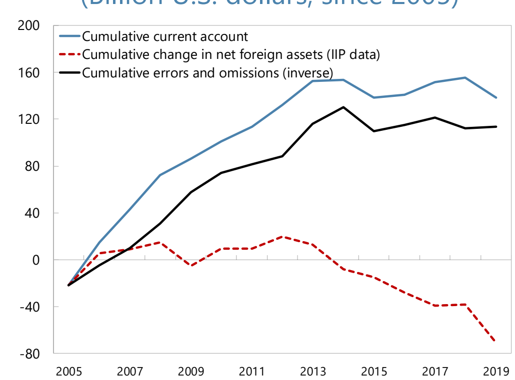
Balance of Payments
(Percent of GDP)



Current Account and Errors and Omissions
(Billion U.S. dollars; *cumulative* since 2010)



Measures of Net Foreign Asset Accumulation
(Billion U.S. dollars; since 2005)



Sources: Haver and IMF saff calculations.

Annex VI. External Debt Sustainability Analysis

1. **External debt has increased in recent years but remains relatively low and appears sustainable although external financing needs are significant.** The level of (public and private) external debt is projected at about 24.0 percent of GDP at end-2020 (Table 1).[1] Higher debt and lower exports in US$ terms have increased the external debt-to-exports ratio to about 223½ percent, up from just 106½ percent in 2015.

2. **Under the baseline,[2] external debt would decline as a share of GDP.** With oil prices expected to be well below the 2019 average and continued weak growth, private sector external borrowing is projected to be on a downward trend. The public sector is expected to continue to draw on financing from bilateral and commercial external sources. To some extent, the interest rate risk may be contained by the relatively high share of concessional loans in public external debt compared to peers.

3. **Stress tests are used to illustrate the sensitivity of debt levels to various potential shocks (see Figure 1)**. Higher interest rates or a slowdown in economic growth would not, by themselves, lead to outcomes substantially different from the baseline. On the other hand, a shock to the non-interest current account, which given the structure of Nigeria's trade can be interpreted as a substantial decline in oil exports, would place the external debt-to-GDP ratio on a substantially higher path. This result is driven by the high historical volatility of Nigeria's current account balance, largely owing to fluctuations in oil exports and prices. However, as has been experienced in the recent oil shock, it is likely that the impact would be buffered largely by import compression and lower income debits. A combined (interest rate, growth, current account) shock has a similar impact on the debt path, driven by the current account dynamics. A one-time real depreciation of 30 percent in the first projection year would cause an upward level shift in debt, but not place it on an upward path.

---

[1] The analysis is subject to gaps in the data on Nigeria's International Investment Position and remaining maturity of external obligations. Staff estimates are used for portfolio investment liabilities based on the estimated stock of non-resident holdings of government securities issued on the domestic market, capital market.

[2] For more details, see IMF (2008) "Staff Guidance Note on Debt Sustainability Analysis for Market Access Countries", IMF Board Paper SM/08/221, (Washington, D.C.: International Monetary Fund).

Table 1. Nigeria: External Debt Sustainability Framework, 2015–25

(In percent of GDP, unless otherwise indicated)

	Actual								Projections						
	2014	2015	2016	2017	2018	2019	10-Year Historical Average	10-Year Standard Deviation	2020	2021	2022	2023	2024	2025	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt 1/**	6.6	**10.6**	**14.1**	**25.2**	**24.9**	**25.1**			**24.0**	**22.3**	**20.2**	**18.4**	**16.8**	**15.5**	**-2.3**
2 Change in external debt	2.5	4.0	3.5	11.1	-0.3	0.2			-1.0	-1.7	-2.1	-1.8	-1.5	-1.3	
3 Identified external debt-creating flows (4+8+9)	-0.8	4.2	0.8	-3.3	-3.0	1.0			4.6	1.5	0.7	0.4	0.0	-0.1	
4 Current account deficit, excluding interest payments	-0.4	2.9	-0.9	-3.1	-1.3	3.5			3.2	2.2	1.7	1.2	0.9	0.7	
5 Deficit in balance of goods and services	0.3	4.7	2.1	0.0	1.4	6.9			6.7	5.0	4.4	3.8	3.5	3.4	
6 Exports	14.9	10.0	9.3	13.5	16.6	15.6			10.8	11.5	10.9	10.3	9.8	9.2	
7 Imports	15.1	14.6	11.4	13.6	18.0	22.5			17.4	16.5	15.3	14.2	13.3	12.6	
8 Net non-debt creating capital inflows (negative)	-0.2	0.0	-0.8	-1.4	-0.5	0.0			0.2	-0.4	-0.4	-0.4	-0.4	-0.4	
9 Automatic debt dynamics 2/	-0.2	1.3	2.6	1.2	-1.2	-2.5			1.3	-0.3	-0.5	-0.4	-0.4	-0.4	
10 Contribution from nominal interest rate	0.1	0.2	0.3	0.3	0.3	0.3			0.5	0.0	0.0	0.0	0.0	0.0	
11 Contribution from real GDP growth	-0.2	-0.2	0.2	-0.1	-0.5	-0.5			0.8	-0.3	-0.5	-0.4	-0.4	-0.4	
12 Contribution from price and exchange rate changes 3/	-0.2	1.2	2.1	1.0	-1.1	-2.3			...	...	...	...	...	...	
External debt-to-exports ratio (in percent)	44.1	106.4	151.6	186.5	150.3	160.8			223.3	194.2	185.4	178.0	171.8	168.5	
Gross external financing need (in billions of US dollars) 4/	1.2	20.7	4.4	-3.7	16.6	39.9			49.5	33.7	32.1	31.9	31.1	31.4	
in percent of GDP	0.2	4.2	1.1	-1.0	4.2	8.9			11.3	7.0	5.8	5.0	4.3	3.8	
Scenario with key variables at their historical averages 5/									**24.1**	**20.7**	**18.4**	**16.4**	**15.0**	**13.7**	**-1.5**
Key Macroeconomic Assumptions Underlying Baseline															
Real GDP growth (in percent)	6.3	2.7	-1.6	0.8	1.9	2.2	3.8	3.5	-3.2	1.5	2.5	2.5	2.5	2.6	
GDP deflator in US dollars (change in percent)	3.8	-15.6	-16.5	-7.9	4.0	10.1	0.9	10.4	1.1	8.3	12.7	11.8	11.0	10.5	
Nominal external interest rate (in percent)	3.8	3.2	2.2	2.1	1.3	1.5	2.2	0.9	1.9	0.0	0.0	0.0	0.0	0.0	
Growth of exports (US dollar terms, in percent)	-13.3	-42.0	-21.6	32.3	29.9	5.9	5.0	26.1	-32.4	17.3	9.6	8.5	8.0	6.6	
Growth of imports (US dollar terms, in percent)	16.5	-16.4	-34.7	8.4	40.6	40.7	10.3	26.4	-24.0	4.2	6.9	6.2	7.1	6.9	
Current account balance, excluding interest payments	0.4	-2.9	0.9	3.1	1.3	-3.5	1.5	2.9	-3.2	-2.2	-1.7	-1.2	-0.9	-0.7	
Net non-debt creating capital inflows	0.2	0.0	0.8	1.4	0.5	0.0	1.1	1.0	-0.2	0.4	0.4	0.4	0.4	0.4	

Sources: National authorities; International Monetary Fund, country desk data; and IMF staff estimates.

1/ Includes public and private sector liabilities; on a residence basis, i.e., includes non-resident investment in liabilities issued domestically.

2/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

3/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Annex VII. Capacity Development Strategy FY 2021

Summary

CD Strategy

1. **IMF's surveillance on Nigeria calls for a comprehensive policy package.** The country's exceptionally low revenue performance, unorthodox monetary policy in the face of persistently high inflation, foreign exchange restrictions, vulnerable banking system, and governance weaknesses have stifled its growth outlook while increasing vulnerability. An economy saddled with all these pre-existing conditions has been hit hard by an unprecedented global shock, which intensified the need for a fundamental policy reset. In this context, IMF's capacity development (CD) work on Nigeria should align closely with the policy adjustment advocated by staff (revenue-based fiscal consolidation, monetary policy reset focusing on price stability, and addressing banking sector vulnerability). TA provision should also consider the authorities' track record and receptiveness to staff's advice.

2. **In all, the proposed CD strategy continues to focus on revenue mobilization, public financial management, banking supervision, and macroeconomic statistics—the same priorities as in the 2019 Article IV consultation.** While monetary and exchange rate policy is a key priority, the authorities have only indicated interest in training on modeling and have no interest in operational technical assistance on foreign exchange and monetary policy operations, where past IMF advice has received little traction.

3. **Current mix between HQ/RTAC missions (about 1:2) is adequate to leverage on continuous regional engagement while also benefiting from strategic support from the HQ.** Training activities should be gradually expanded—both as standalone ones and a part of TA missions.

Key Overall CD Priorities Going Forward

Priorities	Objectives
Tax policy and revenue administration	**Traction:** TA advice on tax policy has been partially incorporated in the 2020 Finance Bill and draft Petroleum Investment Bill submitted to the parliament. The Strategic Revenue and Growth Initiative and future finance bills are expected to benefit from the most recent TA, including on petroleum. A tax administration compliance plan—in line with IMF recommendations is being put in place by the new tax agency chairman. **Going forward:** Revenue mobilization through comprehensive oil and non-oil tax policy reforms, including the rationalization of tax expenditures. Improved non-oil

	revenue mobilization by strengthening the tax and customs administrations. A two-step approach will be taken on more continuous CD support: through virtual missions and HQ-based support (step 1) and subsequently through a resident advisor (step 2).
Public financial management	**Traction:** A Treasury Single Account has been put in place, good progress on the Medium-term debt strategy and cash management, and on budget planning. Little intake so far of staff's TA advice on proper monitoring and classification of Government-Owned Enterprises, which is expected to be revisited in 2020. Good progress is expected on the just completed contingent liabilities mission recommendations in view of the very strong ownership. **Going forward**: TA to focus on more integrated cash, asset, liability (including public debt) management, macro-fiscal forecasting, and fiscal risks management.
Financial Supervision and Regulation	**Traction**: Good intake of policy advice on bank supervision, including towards Pillar implementation, and development of early warning system and risk-based supervision. **Going forward:** Capacity development in banking supervision and strengthening supervisory and regulatory tools, including for onsite and offsite functions.
Strengthen macroeconomic and financial statistics compilation	**Traction:** Good progress on real, CPI, and BOP statistics. Little intake on GFS statistics from the budget office, but expectations are that it would be followed up on in 2020. **Going forward:** Improving compilation of macroeconomic statistics –particularly those for national accounts and price measurement.

Main Risks And Mitigation

4. **Good progress has been made in implementing TA recommendations, albeit at a much slower pace for revenue mobilization and a few statistics areas.** Absorptive capacity and data quality will likely remain as main risk factors, thus continuing to require mitigating arrangements—such as a resident advisor program—for closer hands-on support. Resource allocation for new TAs should also continue to be merit-tested, including by the implementation record.

Authorities' Views

5. The authorities agree with the above-mentioned priorities and renewed their commitment and ownership. The authorities also appreciated the ongoing rebalancing of resources toward hands-on support, including peripatetic expert visits and long-term resident advisor placements. They particularly welcomed staff's following up on their request for an embedded advisor on revenue mobilization and agreed with staff's proposal on a two-step approach. They would like to have more peer learning opportunities, e.g., through attachment programs.