Proshare **Confidential**

Article IV vs. ERGP; The Third Way

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Executive Summary

Our Proshare confidential report for the month of May 2017 takes an insightful study into two different medium term economic projections on the Nigerian economy. These projections include the Economic Recovery and Growth Plan (ERGP) and the International Monetary Fund (IMF) Article IV on the Nigerian economy. The inflow of recent ex-post figures of the leading indicators for the first quarter of 2017, suggest a need to take a critical look at each projection.

Certainly, it provides an ample opportunity to find out:

- The convergence in policy prescription between the ERGP and the IMF Article IV
- How far apart both policies are in terms of proffering solution to the economic malefic.
- The kind of trade off made by each school of thought.

In the course of the study a risk matrix was constructed to point out the current underlining upside and downside risks to the economy. The risk matrix also highlighted how each individual tailwind or headwind has fared, compared to the previous horizon.

This report also detailed how potent certain risks like the limited finances of States and Local governments, porous monetary signalling and possible migration flow have on the macro end.

A heat map approach provided a hybrid approach to explain how other indicators such as credit cycle and the structure of bank balance sheet has weakened due to earlier nose dive in exogenous inflow. The study pointed out that exogenous inflow still remains limited and other autonomous inflow remains tepid. We are thus of the opinion that limited exogenous inflow will serve as a constraint for some time.

Therefore, there is a need to tap into less volatile inflow such as non-residential deposit and investment to bridge the finance gap. More importantly, the study stated that surfeit supply and technological gap can be addressed by engaging wholly capital such as licence agreements.

Evidently, the recovery remains fragile, with five quarters of consecutive contraction. The study further reignited the debate on whether to repel or lean on the cycle in response to bolster the recovery, while admitting that real variables have experienced substantial dilution due to double digit inflation.

Furthermore, the study stated that an inflation targeting is limited in response to dilution in real

variable, as structural factors and supply side shocks from within and abroad, make inflation depend both on monetary and non-monetary factors. Moreover, high cost of capital could amplify the growth of non-performing loan, eventually leading to a collapse in monetary. Thus, measures that will enhance labour productivity and reduce the growth inertia experienced by qualitative variables should be encouraged. We thus advocate a more mutual enforcing position, one that reduces output gaps and unemployment is as important as price stability. variable.

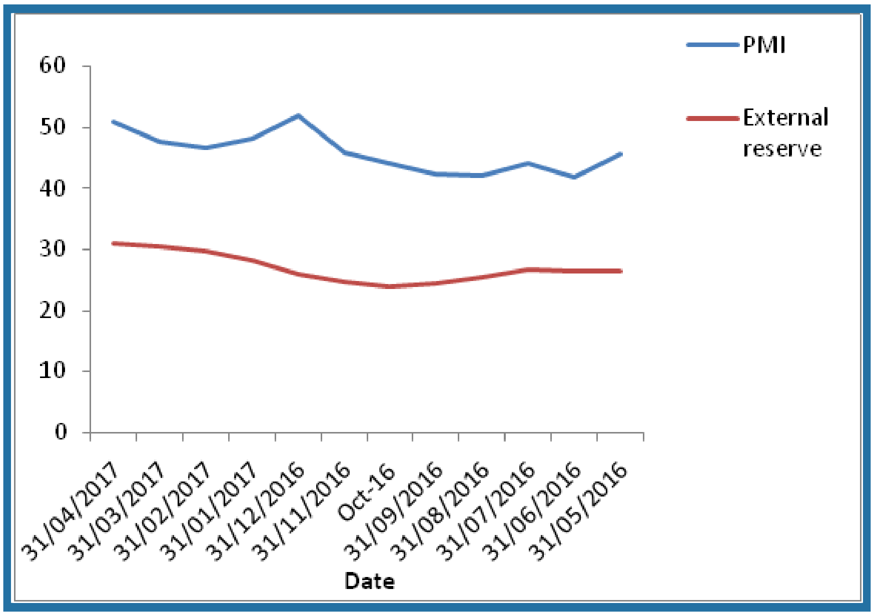
Introduction

The appreciation in the Naira, softening in headline inflation and rising Purchasing Managers' Index (PMI) (fig1), have provided a blurred green shoot in the economy.

Evidently, the momentum is a by-product of an uptick in oil price and rising oil production (fig 2).

Certainly, the positive momentum so far has not carved out a strong upward trunk. The levers that will support an upward trunk are deeply needed, as the economy still trends within negative output.

Fig 1: Graphical illustration of the Balance of Payment Deficit to GDP from 2010 to Q3 2016



Source: CBN, Proshare Research

The earlier slump in output has eased off a bit, regardless the recovery remains fragile. Downside risk to the recovery such as fragmented exchange rate, weakness in state and local government finances and depressed household consumption still linger

Even though the macro picture seems less plagued by headwinds compared to the previous horizon, regardless tail winds remain feeble. Once again a holistic approach which involves the aggregation of structural and cyclical reforms is inevitable. The nominal currency has become more prone to cyclical swings.

The presence of multiple foreign exchanges is affecting the dynamic adjustment path. The excruciating experience still felt by economic agents and the need for a dramatic shift anchored on more fiscal multipliers has become inevitable.

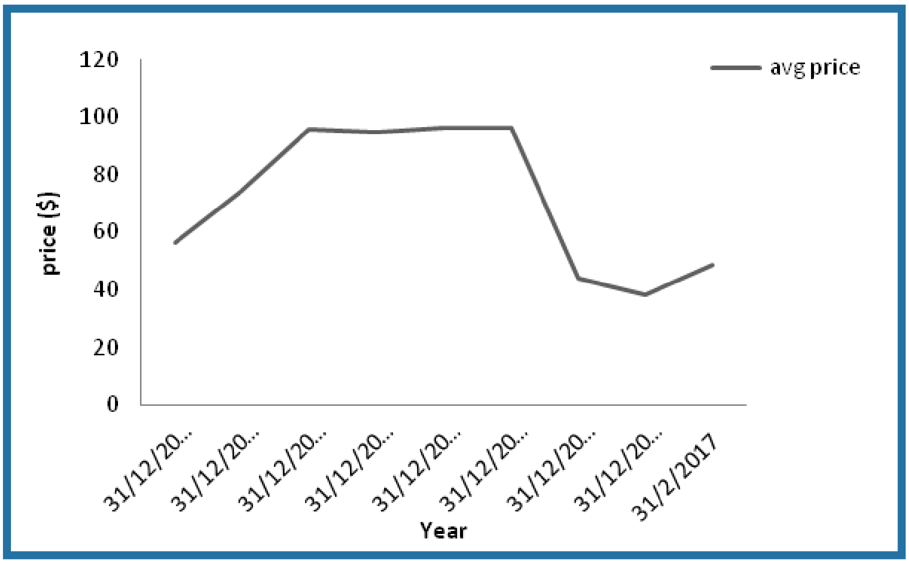
Statement of Problem

While carrying out the study, we identified the following as contours to the fragile recovery.

- Even though oil price has experienced an accretion on the back of a supply cut programme by both oil producing and exporting countries (OPEC) and Russia.
  Regardless, oil price remain dogged down by a combination of increased oil shale production and a subtle global demand for oil (fig 3).

- The hawkish stance of the Federal Reserve has off set the flow of funds. At the same time, the rising policy uncertainty is feeding risk premium.

Fig 2: Graphical illustration of the Balance of Payment Deficit to GDP from 2010 to Q3 2016



Source: United States Energy Department, ProshareResearch

Fig 3: Table Illustration of Daily Demand for Oil for each day 2016 and 2017 (million barrels per day)

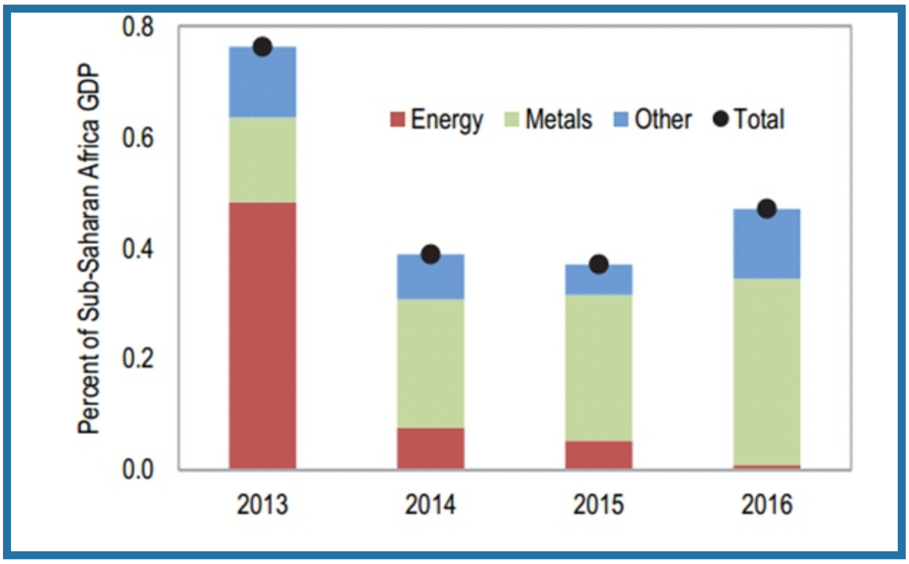
DAILY DEMAND FOR OIL FOR EACH DAY
2016 & 2017 (millions barrels per day)

Geographical Location	2016	2017
Africa	4.2	4.3
America	31.3	31.3
Asia / Pacific	32.9	33.7
Europe	14.6	14.6
Former Soviet Block	8.3	8.4
Global Demand	96.3	97.5
Growth in demand	-----	1.20%

Sources: Statista, Proshare Research

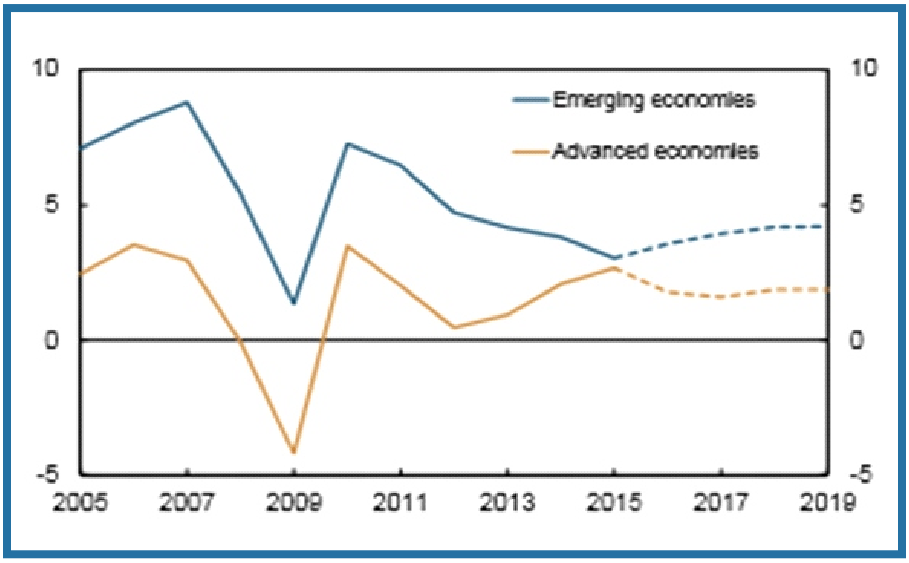
- The rebalancing in the Chinese economy has changed the country's investment pattern. This has led to a reduction of Chinese foreign investment in sub-Saharan Africa, thus affecting inflows in certain African countries. Moreover, its demand for Energy in sub Saharan has fallen (fig 4).

Fig 4: Chinese Inflows in Africa from 2013 to 2016



Source: IMF, Proshare research

Fig 5: Projected GDP of Advanced and Emerging Economies



Source: Thomas Reuters, Norges Bank, Proshare research

- Rising syndicated loans in foreign currency coupled with an alignment in the nominal currency has led to increased exposure of non-financial firms to the external condition.

- Active demand is still depressed due to the dwindling purchasing parity of households. This has led to a nose dive in real sales by firms.This has deeply affected the financial position of consumer goods.

- Fluctuation in real sales has slowed down the growth of inventories, eventually posing a upside risk to formation of gross fixed capital .

- The gap between the de-facto and de-jure exchange rate have slimmed down due to the increase in exogenous inflows and the recent emergence of the Import and export window.

  Regardless, the presence of multiple rates creates foreign exchange asymmetric, eventually hindering market competitiveness.

- The divergence in opinion between the International Monetary Fund and the handlers of the economy has whittled down market optimism.

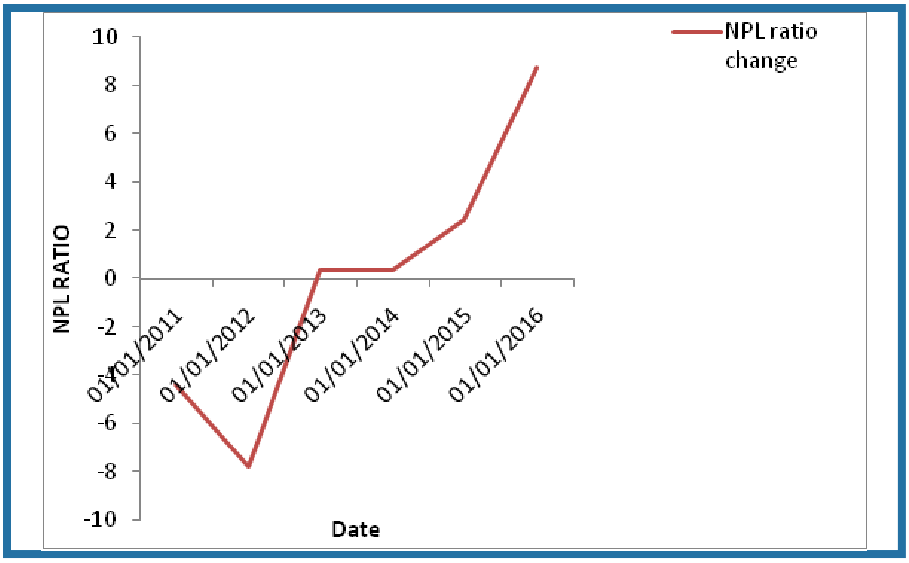
- Policy makers have been using their external reserve as a smoothening agent to cushion the bloodshed experienced by nominal currency. This has either depleted or slowed down the accretion in reserves.

- Countercyclical measures used to repel the cycle have widened fiscal deficit. The combination of rising domestic debt and high interest rate, have triggered a crowding out effect.

- The prolonged policy uncertainty, porous monetary signalling and relatively lack of fiscal clarity are affecting investment decisions negatively.

Naturally, bank balance sheets are exposed directly or indirectly to oil price. Earlier slump have increased the growth in non-performing loans. (fig6).

Fig 6: A Graphical Illustration of NPL Ratio as at 2016



Source: CBN Financial Stability Report 2016, Proshare Research

Objective and Purpose of Study

- The study will show how Nigeria's macro landscape has changed given the limited rise in exogenous inflow.

- The study will provide both a backdrop to developments in both sub Saharan Africa and Nigeria

- The research will compare solutions proffered by the International Monetary Fund and that of the Economic Recovery Growth Plan with the aim of showing where both documents reached a policy convergence, while identifying the divergence in policy.

- The study will press the need for a policy adjustment, one which revolve around a back ended adjustment. A gradually approach which accommodates growth and support fiscal multipliers.

- The objective is to bring to the front burner the importance of ensuring the effective exchange rate is anchored by a real effective exchange rate.
- Importantly, the study will point out that monetary policy is limited in inflation outcome.
- The study will make a case for an escape velocity and why policy makers must repel the cycle.
- The study will build a case for a rebalancing, which favours both an investment model and stronger growth rate of gross fixed capital formation.
- In addition, the study will highlight the need for stronger financial regulation, in order to avoid wide spread contagion of bad money.
- The study will advocate for a countercyclical approach to refill eroded micro prudential ratios.
- The study will proffer solutions on how to tap into other sources of finances.
- Lastly, the study will point out the need for monetary policy to shift from making trade off but searching for a multi enforcing balance which reduces output gaps and price stability.

Methodology and Data INTEROGATION

A wide range of data collected from reputable institution will be used in both building a case and reaching a conclusion. A bucket risk will be created to point out how both the downside and upside risk have fared.

A hybrid heat map will be created to widen the scope of the research.

Study Background

Prevailing Risk Matrix: What Has Really Changed?

How much has headwinds risk changed between 2016 horizon to present day will largely depend on the ability to identify the existing headwinds and how far they have changed. This will give an insight of the true "state of nature of the economy".

We thus employ a risk bucket matrix to sieve between country specific risks and cyclical risk. It eventually helps to reduce the identification lag.

Fig 7: A Table Illustration Of Risk with Its Possibility Degree of Occurrence and Impacts In 2016 And 2017

RISK WITH ITS POSSIBILITY DEGREE OF OCCURRENCE AND IMPACTS IN 2016 AND 2017

RISK	2016	2017
Tighter financial condition; • Dollar shortage • Asset decompression	A high likelihood of occurring, with an high impact on macro fundamentals	Already in play which still has an high impact on macro fundamentals
Slowdown in global growth; • Weaker growth levels in china • Weaker growth level in emerging economies	A high likelihood of occurring, with an high impact on macro fundamentals	Already in play which still has an high impact on macro fundamentals
Country Specific risk • State and local govt finances • Boko Haram	High likelihood of occurring with a high impact on the economy.	It has a low likelihood of occurring and has an high impact on the economy
Persistent deterioration in energy prices	High likely of occurring with an high impact	Low likelihood of occurring however still has a high impact.

Sources: IMF, Proshare Research

Macro dynamics have changed compared to the previous horizon, reinforcing our position early in the study. Obviously, the matrix bolsters earlier position. That the positive momentum is a by-product of a combined increase in oil price and improved production, certain specific risk has emerged due to policy response to the cycle (fig 8).

Fig 8: A Table Illustration of Unique Risk Associated To the 20117 Horizon Only

UNIQUE RISK ASSOCIATED TO THE 2017 HORIZON ONLY

RISK	2017
Political and policy uncertainty • Protectionism or anti trade • Refuge and immigration inflow	High likelihood of occurring and do have substantial impact on macro in 2017
Prolonged policy uncertainty • Foreign exchange policy • Porous-monetary signalling • Budget passage	High likelihood of occurring and has substantial impact of occurring

Sources: IMF, Proshare Research

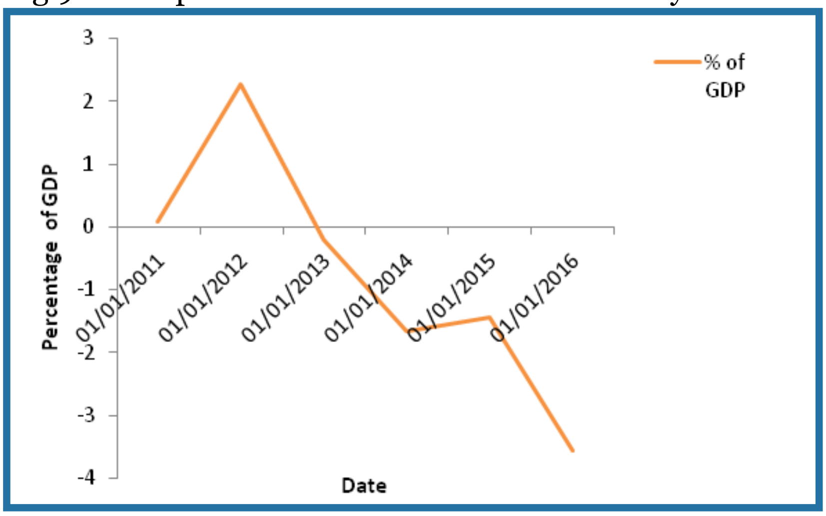
Outlook

Even though oil prices have taken a northward rise, regardless a subdued outlook remain due to limitation in exogenous inflow. Moreover, tight financial conditions blistered by divergent monetary policy abroad.

Certainly, foreign exchange through the economy and autonomous inflow will remain tepid for some time. The growing presence of country specific risk such as fragile finances of States and Local Governments (SLGs), rising non-performing loans and pediments of restiveness will continue to be an upside risk to growth.

The growing number of exchange windows will affect balance of payment, eventually straining the dynamic adjustment path.

Fig 9: Graphical Illustration on Balance of Payment to GDP till Present Day



Source: CBN, ERGP Proshare

- The need to shift the absorber from capital account and external reserve to the exchange rate has become imminent. Inflation has softened a bit but double digit inflation scenario will persist for some time. Expectedly, volatility in the open buy back rates and overnight rate will remain as monetary authorities consistently sterilize in money market.

- Resurgence in inflation due to a rise in energy prices or an uptick in power tariffs is less likely compared to the previous horizon. Therefore, headline inflation seems more likely to shed off transitory cost push factors.

- Food inflation has been reluctant to take a slide, the possibility of a drought in sub Saharan Africa will add to the supply risk. An increase in minimum wage would make inflation more vulnerable to inertia.

Widening in fiscal deficit will go on as fiscal policy employs a counter cyclical measure in the face of limited revenue cushion. The fall out effect is a rise in debt to gross domestic product and slimming down in soft land position.

The trio of a high neutral rate, ongoing deficit spending and pro-cyclical monetary policy will keep the crowding effect in place. The fallout from rising capital expenditure coupled with relatively no explicit or implicit money rules, will jolt currency in circulation upwards.

Economic Recovery and Growth Plan (ERGP)

The economic recovery and growth plan is the developmental plan calibrated by policy makers to lift the economy out of the recession. The objective of the ERGP is to addresses the structural imbalances that have hindered output maximization over the years. Holistically, these are the objectives of Economic Recovery Plan (ERGP).

- Macro- economic stability
- Economic diversification
- Investing in our people
- Building a competitive economy
- Improved quality of governance
- Service delivery

Economic Recovery and Growth Plan: Fiscal Policy

The ERGP intends to employ fiscal multipliers to spur economic growth, thus making fiscal policy largely counter cyclical in nature. Policy response revolves around the use of expenditure switching policies such as export promotion to address the external imbalances.

The plan intends to tweak domestic and foreign debt ratio from 84:16 to 60:40. At the same time extend the maturity profile of public debt and deploy more of long term debt to finance the budget. The policy is more receptive of a back ended adjustment approach to decompress its debt, while it intends to raise revenue by the following measure:

- Increasing the capacity of oil production to 2.2 million barrels per day.
- Increase VAT from 6% to 15% of gross domestic product (GDP).
- Increase vat on luxury item from 5% to % 15% from 2018.
- Mobilize 350 billion naira annually from company income tax and value added tax annually .
- Ensure 30 to 35% of the budget is meant for capital expenditure.
- At the other end, monetary policy is committed to a low inflation, low interest rate, flexible rate and growth.

ERGP vs. IMF

Recently the International Monetary Fund made available it position on the Nigerian economy and how best to address the trough. The fund's policy statement was published in its annual article IV publication on Nigeria, which was made public on March 29, 2017.

More recently the Fund published its outlook for sub Saharan Africa for 2017; which includes its outlook on Nigeria. Figure 10 details how much of a convergence in ideas the fund has with the ERPG.

Fig 10: Cycle Vs. Policy Response

CYCLE VS. POLICY RESPONSE

RISK	2016	2017
Inflation	The ERGP is committed to lowering inflation. It intends to stoke off inflation from 18.55% in 2016 to 9.9% in 2020. The document details policy makers' commitment to lowering inflation but it did not provide needed guidance on how it will re-jig its monetary anchor.	The fund is of opinion, that inflation is largely homogenous across the region. The fund projected that inflation will be 15.1% by 2020. The fund advocated the need to sharpen the monetary anchor. Thereby it supported a more hawkish monetary policy

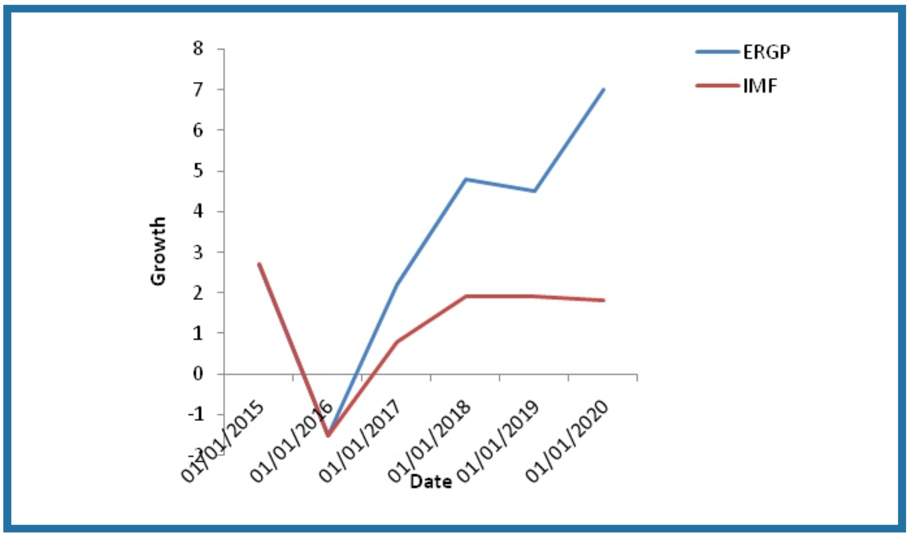
Sources: IMF, Proshare Research

CYCLE VS. POLICY RESPONSE

RISK	2016	2017
Money supply consideration	The ERGP is committed to an expansionary monetary supply. In order to support its counter-cyclical spending. It projected a rise in board money from N22.8 trillion in 2016 to N45.8 trillion in 2020. Reflective of a 114% increase in money supply. The ERGP was mute on the intermediary efficiency ratio.	It strongly holds the opinion that hair cuts to the Nominal Effective Exchange Rate (NEER) is inevitable as recent uptick in exogenous inflows still remain limited. Such hair shave will drive the quantity of money supply upwards. Therefore the funds projected an accretion in money supply from N23.64trillion to N46.9 trillion in 2020. This is reflective of a 98% increase in broad money
Exchange rate structure	The ERGP document is committed to a flexible exchange rate, while it will maintain the official rate at 305/$. Certainly the external reserve will still be absorbing external shocks for some time. It kept mute on the trajectory of the real effective exchange from 2017 to 2020	The fund is of the opinion that the nominal currency should be allowed to absorb the external pressure fully. Thereby devaluation in theReal Effective Exchange Rate (REER) will reverse the slack in balance of paymentand relief pressure off the external reserve. It project a 15.4% increase in CBN foreign asset, as it expect pressure on reserve to under-cut growth in CBN foreign asset.
Debt	The ERGP is of the opinion that debt should be decompressed through a back ended approach. Therefore a gradualist approach to debt decompression will be taken. In attempt to accommodate both fiscal multipliers and counter cyclical spending. The policy makers will extend theprofile of short term debt. The plan intends to reduce debt to reduce debt GDP from -2.26% to -1.12%	Empirically, high interest rate, volatile capital account and sluggish growth do raise debt levels. Earlier negative shocks to the trio have raised the debt levels. Regardless the fund maintains that its debt to GDP below the threshold. The fund recommended increase in the mobilization in foreign revenue and consistent access to credit market.
Growth	The ERGP projects a growth of 2.7% in 2017 which should climax at 7% in 2020 (fig 11)	The fund is of the opinion, that possible emergence of real shocks and the ability to address such shocks will largely determine the growth trajectory. The fund projects a low growth scenario (fig 11)
Where do they stand?	ERGP advocates that, fiscal policy should be countercyclical with an expenditure switch approach to solve external imbalances. On the other aisle, monetary policy has a broad commitment to the trio of curbing inflation, keeping low rates, providing growth and employing a flexible exchange rate	While the fund do support counter cyclical fiscal policy. Monetary policy is more pro-cyclical. Holistically the fund is conscious of inflation and concerned about distortion to external trade.
Our position	The ERPG has programmes and projects which bolsters its position as a developmental plan. The broad mandate of monetary policy in the ERPG makes it clumsy. This creates a disconnection between money supply and projected inflation. Eventually making exchange rate policy largely blurred.	The IMF IV harped on the need to have a competitive REER. This is necessary in order to beef up reserves and reverse the strain in balance of payment. Our concern is a prolonged period of pro-cyclical monetary policy becomes too rigid, such that it fails to recognise the break down in nominal spending and monetary aggregates (Alfred Minsk)

Sources: IMF, Proshare Research

Fig 11: Projected Growth by both ERPG and IMF from 2017-2020



Source: ERGP, IMF, Proshare

To Lean or Repel The Cycle: Counter or Pro Cycle

Fig 12: Proshare Heat Map Part 1

PROSHARE HEAT MAP PART 1

NIGERIA	2010	2011	2012	2013	2014	2015	2016
Credit Cycle (%)							
Credit to private sector/ Nominal GDP	0.18	0.22	0.21	0.2	0.19	0.2	0.23
Aggregate credit / GDP	0.198	0.19	0.19	0.186	17.89	22.61	24.81
Absolute change in credit/change in GDP	0.109	0.793	0.132	0.128	0.12	1.09	0.74
Real GDP growth	11.9	4.9	4.3	5.4	6.3	2.7	-1.5

Sources: CBN, ERPG, Proshare Research

Where do we stand? To lean or repel the cycle

“'What underdeveloped nations need is a scientific and technological society. It employs new techniques weather in the farm, in the factory or in transport. Modern technique is not getting a tool and using it.

Modern technique follows modern thinking. You can't get hold on to modern tool and have an ancient mind. It won't work''

Jawaharlal Nehru (former prime minister of India)

A policy is considered to lean on the cycle, when it mimics the cycle. The policy is expected to be expansionary in a period of boom and also contractive in periods of downswings. The policy objective is to be in tandem with the cycle. Thus, it is referred to be either “in alignment or searching for alignment" with the course of the cycle. The policy is regarded to be pro-cyclical.

A policy is considered to be repelling, when it moves in divergent direction with the cycle. Thereby it is contractive in period of a boom and expansionary in period of downswings. In reality the policy retains a surplus budget and builds up a strong reserve armoury in period of boom.

It crystallizes into limited debt position, healthy effective exchange rate and strong reserves, eventually widening its manoeuvring space in up-cycles. Therefore, in periods of downswings when growth levers are rusty, earlier buffers are deployed as interventionist measures. The aim is to build strong buffers in period of boom. With an end game, to use buffers to stabilize the economy in period of downswings.

Presently, fiscal policy has responded to the down turn in a counter cyclical manner, in order to provide levers for growth.

Thereby receding from it earlier acyclic objective (zero sum game), in reality ditching earlier budget balancing for a more expansionary one.

Moreover, the existing infrastructural gap reinforces the need for more capital expenditure. Thereby the expenditure switch being propped by the ERGP will stir up capital formation and correct structural imbalances. Such rebalancing have become inevitable, in order to return the economy to near its full potential growth level (fig 12).

Although the monetary anchor is below the neural rate, monetary policy has continued to mimic the cycle (pro-cycle). The apex bank has chosen inflation and currency stability ahead of growth. It is important to note, the policy has reduced the gulf between the de-jure official rate and de-facto exchange rate. Regardless, the presence of multiple exchange rates is offensive high rates due to market fragmentation.

Effective optimization of preferred habitation or high yield can't take place when foreign asymmetric are present. Thereby, a multiple exchange rate is repugnant to a high interest rate as the earlier repudiate the later. Evidently, the high yield has not lifted capital importation as earlier touted.

Inflation so far has been driven majorly by cost push factors, thereby money have neither been a major factor nor one of the factors driving inflation (B.Hole 2001): Interestingly, money seen to be limping after fewer goods in this peculiar scenario. The policy of inflation targeting, where the monetary anchor rate is set at a compactable rate with inflation do have its limitation and how?

The policy revolves around the assumption that inflation is demand driven. Thus, monetary policy is expected to respond using contractive tools to high inflation, regardless of the factors that fuel inflation.

In reality such policy neglects the other factors that fuel inflation such as supply shocks, sales taxes and inflation inertia. Several empirical studies have shown that inflation do not derive its flame from demand all the time.

In scenario where push factors drive inflation, inflation targeting will only be responding to symptoms. At the end it fails to address the structural factors that are responsible for inflation, in most circumstance it end up magnifying operating cost e.g. Brazil (Siscu 2002).

The outcome of such policy response produces limited output, stagnation in income and rising public debt. Therefore, monetary policy will be barking at the wrong tree, if stoking inflation is its primary mandate (Babalola Temitope 2016).

Monetary policy must see output stabilization as a mandate, after all inflation is not within its ambit of control. Policy alignment can best be achieved when monetary policy begins to support economic agents by reducing the blistering credit gap (fig 12).

Fig 13: Proshare Heat Map Part 2

PROSHARE HEAT MAP PART 2

NIGERIA	2010	2011	2012	2013	2014	2015	2016
Balance sheet buffers							
NPL to total loans ratio	15.7	11.3	3.5	3.2	2.9	5.3	11
NPL ratio change		-4.4	-7.8	0.3	0.3	2.4	8.7
Balance sheet structural risk (%)							
Loan to deposit	0.606	0.448	0.423	0.363	0.636	0.696	

Sources: CBN, Proshare Research

proshare ECONOMY

Recent findings showed that nonperforming loans and balance sheet structural risk has risen to levels similar to 2008 financial risk.

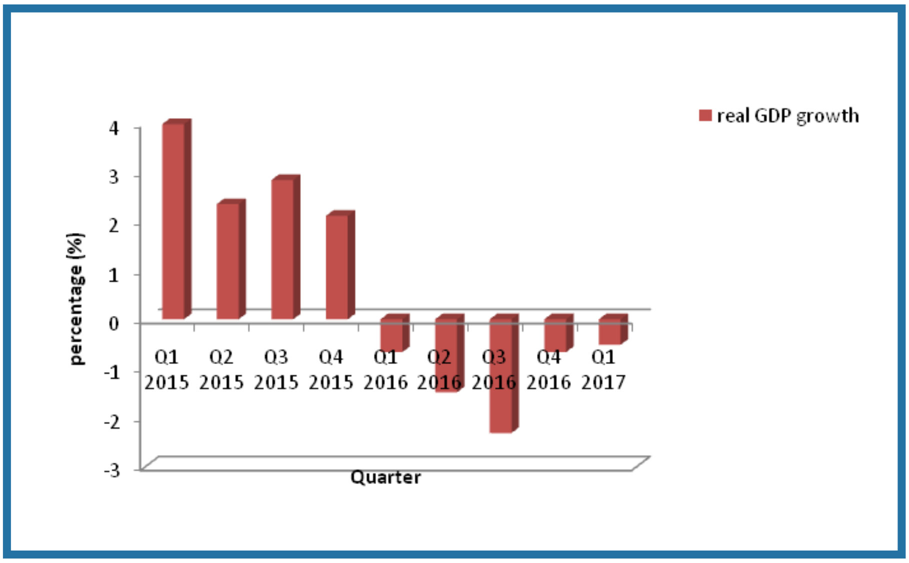
Prolonged presence of high interest rate could amplify the risk and trigger deeper down swings e.g. Greece. Certainly, high cost of borrowing at this time of the cycle could turn out to be a Trojan.

Certainly, monetary policy does not have enough room to absorb wide spread toxic asset. Therefore blunting the monetary anchor will reduce the quantum of bad money.

Making a Case for an Escape Velocity

The economy shrunk by 0.52% in the first quarter of 2017, making it the fifth consecutive quarter of contraction. In the first quarter of 2017, output contracted by 015% compare to the previous quarter. Though, output remains within negative territory, it also suggests an underline current of positive momentum.

Fig 14: The Real GDP Growth Rate



Source: CBN, Proshare Research

Contraction in output poses as an upside risk to ERGP growth projection of 2.7%. Therefore, the economy will need to hit an average of 3.77% growth for the remaining of the year. More than ever before the economy is in need of an escape velocity, in order to reduce the sterile effect of laggard growth on employment and other qualitative indicator.

The need to go beyond a rebound and return the economy to sustainable growth path have become pertinent. A recalibration in policy in order to accommodate an escape velocity has become inevitable and why? There is a desperate need to spur formation of gross fixed capital more aggressively not only from public but from private sources. In order to return Nigeria to a sustainable growth path, increase labour productivity and achieve an escape velocity.

For a country like Nigeria with a large population fused with rapid population growth; the dynamic of a dwindling per capital ratio, has made it more difficult to save for the required quantity of investment. The only solution is a rapid rate in capital formation to bridge the gap e.g. India.

Nigeria needs to intensify the manner at which capital goods are formed such as machine tools, plants and machinery and transport facility. Thereby, the laggard position held by private capital formation must be reversed.

More importantly policies that enable faster growth of private capital formation need to be formulated. Therefore, the following policies are needed.

- Provision of tax's incentives to companies considered as start up for 2 to 3 years in order to reinvigorate investment. Such incentive should also be made available for firms which are interested in the import substitution policy of the present government.

- A robust policy on backward integration need to be adopted.

- Reduction in government monopoly on infrastructure. Government should finance new infrastructure through concessions e.g. Mexico, India and Chile. Presently, concessionary policy on infrastructural development is widely been embraced by developing economies.

- The harmonization of developmental policies with regards the activities of developmental banks. Funds in the custody of such institutions should be consistently made available at single digit credit to firms in specific sectors or goods, where we do have competitive advantage.

- The presence of multiple exchange rates has consistently affected the growth of capital importation. Therefore unification of rates will enhance growth in capital importation.

- The weakness in purchasing power of households has made real sales more fluctuant. At the same time it has affected capital budgeting decisions negatively. Therefore, a reduction in rates will help to stir up investment decisions.

- Evidently there is a break down in the channels of credit; certainly there is a need to repair the channels of credit. In addition high cost of borrowing hinders both an escape velocity and growth in capital formation. Thereby real asset have a slim chance at growth in a clime of high borrowing cost. Thereby it is an upside risk to 2.7% growth.

- Diversification in foreign finances is critical to drive capital formation. For instance India has mobilized capital through non-residence deposit and investment in the past. Examples of Non-resident schemes by India.

1. It raised $2.8 billion by Indian developmental bond in 1991
2. Raised $4.23 billion by resurgent Indian bonds in 1998
3. Raised $6 billion through Indian millennium bonds

Thus, it is pertinent Nigeria tap into non-residential deposit and investment in order to drive capital formation.

- In addition, Nigeria need to access other forms of capital which are believed to be wholly-or-majorly owned FDI and exports. They have become relevant in financing real assets; they include international joint ventures, licensing agreements or contracts which provide host licences with access to technologies (knowhow), trademarks, management contract under which foreign companies manage projects and international subcontracting. Policy makers need to configure the ERGP to absorb this new form of capital, so as to reduce the technology gap and the present dearth in skill.

- It is important to highlight that policy clarity and reduced country specific risk will provide the well needed spring board.

Key Findings

External

- Divergent monetary policy and political uncertainty from abroad is driving risk northwards in developed economies.

- Inflation in sub-Saharan Africa is homogenous and the presence of drought, will be an upside risk to inflation.

- Crude oil prices are faced by oversupply and tepid growth in demand. Therefore oil prices will remain fragile due to the new dynamic.

- China's rebalancing is affecting the balance of payment of African countries. The spill over effect of reduced appetite for African resources by china has led to tighter finances in some African countries.

- The clock is ticking faster on quantitative easing in Europe and Japan, as cheap money has failed to provide the needed lift. The possibility of lifting the plug on cheap money in Europe and Japan is creating uncertainty in developing economies.

Domestic

- Oil prices and production have risen but they do still have a limited impact on the finances of the federal government compared to 2013.

- Although oil prices have risen, the fragile uptick in price and large quantum of debt still leave states and local government constrained.

- The purchasing manufacturing index and External reserve have maintained an upward direction, justifying a gathering in positive momentum.

Fluctuant real sales has affected capital decision negatively, which is undercutting capital formation.

- The gap between the de-jure and de-facto exchange has slimmed down due to a combination of the apex bank involvement and technical devaluation in the Naira.

- The presence of multiple rates is largely repugnant to a high interest, the later repudiate the other. It eventually becomes a barrier to the policy of preferred habitation.

- Policy uncertainty, such as porous monetary signalling and blur fiscal policy has embolden country risk.

- The magnified leverage coupled with growing operating cost has led to rising non-performing loans.

Moreover balance sheet structural effects have risen at the same time.

ERGP Findings

- Counter cyclical fiscal spending.

- A more aggressive mobilization of revenue .

- Stoke off inflation from 17% to 9.06 in 2020.

- Charge higher VAT rate on luxury goods.

- The document failed to cost the ERPG compared to other developmental programmes like the National Transformation Programme (NTP).

- It attempt to shrink debt to GDP from 2.12% to 1.2% by 2020.

- Monetary policy broad commitment, makes it largely porous .

- Project a 2.2% growth at the end of 2016, with an average growth projection of 4.62% over the next 4 years.

IMF Findings

- Support a counter cyclical fiscal policy.

- Highlighted the need for more banking supervision , given the rise in nonperforming loans and stronger balance sheet imbalances.

- Highlight the possibility of growing food inflation.

- Emphasizes on a more pro-cyclical monetary policy.

- Pointed an overvalued real effective exchange rate

- Projected 0.8% growth at the end of 2017, with an average of growth projection of 1.6% over the next 4 years.

- Ignored the effect of prolonged magnified leverage risk on the economy.

Measures Needed

Fiscal

Firstly, we need to cost the ERGP, it is important so as to enhance financing. The ability to cost the ERGP will also determine the structure of finance and how best it can be applied not only in terms of capital but also technology transfer.

Secondly, developmental plan are divided into phases, one example is the real plan of Brazil. Policy prescriptions are divided into phases, it provides policy clarity. The presence of policy clarity and fiscal guidance incentivize the businesses community to lock into the policy and make capital budgeting decision.

Evidently after five consecutive quarter of contraction, the current positive momentum is fragile. Premising the recovery on oil price at this point will not provide the needed take off. A more concerted effort which demands a roll out plan, with more strategic decisions on how capital will be spent is needed.

The rollout plan will itemize the investments that will be undertaken over the next 18 months. At the same time the structural policy reform that is expected to take place over the next 18 months. Besides it ushers in the reform and provides the needed take off for an escape velocity to occur.

There is need to configure projected targets for each ministry in the ERGP, it bolster the holistic performance delivery of the budget. The in ability to project for institutions, which are conduit of resources could make performance delivery harder to achieve.

There should be benchmark indicators to consistently measure the quality of performance of the ERPG and weigh it against the international average. It improves the transparency of the process and allow for re-adjustment when needed.

Thus such indicators show how social economic mobility fared, market concentration and provide a wider measurement of growth beyond quantitative indicators.

- Rank in open budget index.
- Herfindaht Hirschman index.
- Percentage of local content in capital and operational projects.
- Targeted contribution of private sector to GDP.

Rather, it bolsters the position of the ERGP as a developmental plan.

There is a need to address the technological gap, therefore government should emphasize on wholly–or-majorly owned FDI, such as international joint ventures.

Monetary policy
Exchange Rate

- While it is commendable that monetary policy has been a bit flexible on its exchange rate policy by technically allowing the Naira bite the bullet at the IEX window. Such move has reduced the gap between the de-jure and de-facto window. The increase in exogenous inflow is limited, rather than allowing the external reserve to absorb the pressure the currency should be allowed to absorb the external shock. Thereby unifying the window with limited involvement.

- Monetary policy need to achieve a competitive real effective exchange rate, which will ensure its non-oil exports take advantage of price competition. In 2014, non-oil exports generated $10 billion this was made possible due to a competitive real effective exchange rate.

Fig 15: Tabular Illustration of the Income Generated By Non-Oil Exports

INCOME GENERATED BY NON-OIL EXPORTS

Year	Non oil exports in bill $	Real effective exchange rate
2010	2.19	93.9
2011	2.16	89.82
2012	3.66	79.58
2013	6.5	74.2
2014	10.53	69.51
2015	3	70.83

Sources: CBN, Proshare Research

The presence of pegs in 2015 indirectly locked up the economy eventually affecting non-oil exports adversely.

Interest rate

After the Russian Rubble crisis, Chile and Mexico hiked interest rates in the face of economic slowdown. At the same time Brazil hiked interest rates in the face of a recession. More recently Egypt and many other developing countries hiked rates in the midst of a recession crisis. The hiking of interest rate in most circumstance is not necessarily an adherence to strict monetary target in the face of frequent demand shocks as the reality in most of this circumstances show that demand is subtle.

It is a by-product of lack of explicit or implicit money rules (Guillermo 2002). Thereby the policy of maintaining high interest rate by central banks in a bad state of nature like a recession is not totally anti-inflation, rather it is more concerned with restoring the portfolio investor confidence and stem capital outflow.

Thereby it is imperative that the apex bank should adopt a middle ground approach, where there is a balance between commitment to price stability and limiting cyclical swing in effective demand. This allows the apex bank to shift from making trade-off between price stability and growth. To one which view growth and price stability as multi enforcing. The following are pertinent at this point.

- There is a break down in the interest rate channel, which makes the prime rate and maximum rate numb to changes in MPR. Therefore the need to repair interest rate channels is important.

- The bank should avoid the temptation of using CRR; rather penal interest rate should be applied on the specific bank.

- The present volatility in both overnight rate and open buy back rate is a fall out of trying to stabilize the exchange rate market through a combination porous monetary signaling and open market operation. Thereby proper monetary signaling and limited sterilization is needed to smoothening of the flow of funds.

- Configuration of money rules explicitly or implicitly, so as to reduce the volatility experienced by short term rates.

- Blunting the nominal anchor is needed to achieve multi enforcing monetary policy.

- The bank should improve the quality of its supervision on the activities of the banks.

- Lastly, banks are already experiencing an erosion in their capital adequacy ratio, should beef up capital.

Conclusion

Recent leading indicators still reflect a fragile recovery that is in need of strong growth levers. The study is of the opinion that headwinds such as deterioration in oil prices has reduced a bit but country specific risk remain largely unchanged.

We are also of the opinion that exogenous inflows remain limited, even though an uptick in oil price has emerged. Factors such as oversupply and relatively tepid growth in oil consumption will dug oil prices down for some time. It shared the opinion that inflation is homogenous and it largely driven by push factors.

The study is of the opinion that measures which reduce output gaps and unemployment should be encouraged. More importantly, confidential is of the view that policy which repels the cycle should be encouraged at this point. After five (5) consecutive quarters of contraction, monetary policy should shift from making trade-offs to a multi enforcing one.

It pointed out that sustaining high lending cost could end up been a Trojan. In addition the study advocated for policy incentives that spur capital formation and why? There is a need for rapid growth in real asset and reduction in infrastructural gap, such economic feat is inevitable with a strong capital formation.

We further made a case for less volatile form of finance such as non-residence deposit and investment to bridge the deficit gap. At the same time it highlighted the need to use more of wholly-jig capital, such as sub-contracting, franchising as means of reducing technological gap and skill dearth.

The study was emphatically clear that policy makers must move beyond the circular reasoning of taming inflation and running after tepid recovery or paltry growth levels. Instead policy makers must be clear and precise on leading growth on a sustainable path.

Related News / Further Reading

1.Total Value of Capital Imported into Nigeria in Q1 2017 Estimated at $908.27m - NBS

2.GDP Contracts by -0.52% in Q1'17 from -1.73% in Q4'16; 5th Consecutive Quarter of Contraction

3.Nigerian Economy Gathers More Momentum; PMI Increased Marginally to 51.1% in April 2017 - FSDH

4.Regional Economic Outlook - Sub-Sahara Africa Restarting the Growth Engine

5.Nigerian Economy Gathers More Momentum

6.Lifting The Veil off The Financial Sector

7.Nigerians May Escape from Anxiety with a Stronger Naira - LBS EBS – May 2017

8.Nigeria Strategy Report Q2 2017 Outlook - Domestic Economic and Policy Environment

9.Nigeria Strategy Report Q2 2017 Outlook - Review of Global Economy and Markets

10.Towards An Economic Model for Nigeria; Going Beyond Symptomatic Responses - The Panama Model

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12.The EGRP Articulates Up To 60 Interventions and Initiatives That Must be Executed and Completed

13.The Hard Facts To Rescue The Nigerian Economy\

14.Nigeria ranks 161 in Global 2017 Index of Economic Freedom: Trade and Prosperity at Risk

15.Lagos State has the highest domestic and foreign debt profile in 2016 - NBS

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21.Weak Nigerian Economy Will Endanger Fiscal Consolidation - Fitch

22.Nigeria's Economic Recovery Prospects Reviewed at The Cordros 2017 Roundtable

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24.Nigeria Strategy Report H1 2017 (11) - Balance of Trade Deficit: Moderation In Sight?

25.NESG 2017 Macro Economic Outlook: Focus On 'How We Get Out of Recession'

26.Nigeria As An Import Dependent Economy - Outlook for Commodities and Impact on Ordinary People

27.Time for a Policy Reset – IMF Presentation at the LBS Session May 2016

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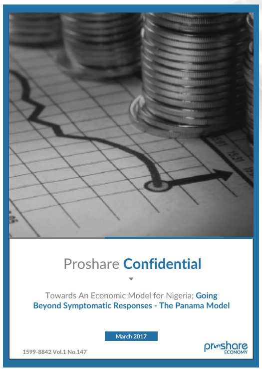

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