ECONOMIC REPORT FOR THE FIRST HALF OF 1999

The tempo of economic activities in Nigeria during the first half of 1999 was influenced by several factors, among which was the successful completion of the transition programme from military to civil rule, which commenced in the last quarter of 1998. The main objective of this report is to analyze the economic developments during the first half of the year. In particular, it reviews and appraises macroeconomic policy pursuit, noting the impact on domestic economic conditions. It also evaluates the influence of international developments on the economy, as well as Central Bank of Nigeria's (CBN) policy initiatives and responses during the period. The report is in six parts. Part I is an overview of the report, while Parts II and III are the review and appraisal of major economic developments during the period. Part IV gauges the influence of policy pursuits on domestic economic conditions. Part V evaluates some CBN's policy responses, while the final part presents the outlook for the rest of the year.

I. GENERAL OVERVIEW

2. A review of economic policy for the period indicates that its overall objective was to attain a minimum of 3.0 per cent growth in non-oil GDP and sustain a single digit inflation rate, which was subsequently revised to not more than 12.0 per cent. This was to be achieved through the pursuit of appropriate fiscal, monetary, trade and exchange rate, and real sector policies. In particular, the fiscal policy planned to curtail fiscal deficits to about ₦100,000.0 million for the half-year, through cutback in capital outlays and curtailing the wage bill. Monetary policy targeted the attainment of 4.1 and 10.0 per cent expansion in narrow and broad money respectively, through more active Open Market Operations (OMO) transactions, raising the cash reserve requirement and liquidity ratios, and the

transfer of retail banking functions of CBN to deposit money banks. External sector policies eliminated the dual exchange rate system, liberalized the foreign exchange market, abolished pre-shipment inspection of imports and replaced it with destination inspection. Among the sector-specific policies were completion of the turn-around maintenance of the refineries, incentives for promoting agricultural and industrial production, and support for infrastructure and social services.

3. An appraisal of policy outcomes based on available information shows that the fiscal operations of the Federal Government resulted in an overall deficit of about ₦245,701.0 million, surpassing the proportionate budgetary estimate by 143.2 per cent. This resulted mainly from substantial increase in expenditure in support of the transition programme, in spite of the modest improvement in revenue performance compared to showed set targets. Provisional data also show that the consolidated fiscal operations of the State Governments resulted in a deficit while that of the Local Governments was a modest surplus. The financial sector was characterized by rapid monetary expansion - as narrow and broad money rose by 37.5 and 30.6 per cent, respectively, exceeding the set targets of 4.1 and 10.1 per cent; relatively stable but wide divergence between lending and savings interest rates, and an active OMO transactions buoyed by improved yield rates. The external sector was under severe pressure, as the balance of payments resulted in an overall deficit of ₦304,414.8 million (US $3,397.7 million) as against ₦75,168.0 million (US $972.5 million) in the corresponding period of 1998. The financing was mainly from accumulation of

arrears of external debt obligations and draw-down on the stock of external reserves. Exchange rate at the Autonomous Foreign Exchange Market (AFEM) was relatively stable up to May, when it depreciated. On the average, the rate depreciated by 7.0 per cent, compared to its level in the corresponding period of 1998.

4. The performance of the real sector was below expectation during the period. The sub-sectoral analysis show that agricultural production expanded by 3.1 per cent compared with 2.0 per cent in the corresponding period of 1998. Industrial production fell by 4.8 per cent below the level in the first half of 1998, owing mainly to the fall in mining production, as manufacturing output and electricity consumption rose marginally. Available data from the Federal Office of Statistics (FOS) put inflation rate at 12.2 per cent as at May, 1999, and it is projected at 12.6 per cent in June, 1999. This could be explained by the expansionary fiscal and monetary policy outcomes during the period, as well as the rise in production costs occasioned by the poor state of infrastructure and energy supply problems.

5. World output grew at a lower rate than the previous year in spite of the resilience of industrialised countries, the apparent resolution of the East Asian financial crisis of 1998, strengthened demand and firmed-up of key commodity prices, especially crude oil. This led to further expansion in world trade.

5. An appraisal of the CBN's operations during the first half indicated that it faced enormous challenges, posed in part, by the excess liquidity in the banking

system, precipitated by the huge government borrowing through ways and means advances, and the transfer of public sector accounts to the deposit money banks and partly to the deployment of these funds by financial intermediaries to speculative transactions in AFEM, with consequent adverse implication for exchange rate management. It relied mainly on OMO as the main instrument of monetary management, that became less effective and had to be supported by complementary measures which included: the issuance of Special Treasury Bills in April and May, which mopped up ₦161.1 billion from the system; collateralization of AFEM demand in June, with mandatory purchase of treasury bills worth 200.0 per cent of the bid, in addition to 100.0 per cent cash cover; raising of the cash reserve requirement from 8.0 to 10.0 per cent and later to 12.0 per cent, among others. The bank intervened 26 times in the AFEM, at an average exchange rate of ₦90.0 per US $1.00 and met in full the total demand of US $2,887.3 million. It also engaged in increased surveillance of the banking system.

7. An analysis of the economic outlook for the rest of 1999 indicated that aggregate output performance may be sluggish owing to the prevalence of structural bottlenecks, while inflationary pressure may persist, arising mainly from fiscal, monetary and exchange rates policy out-turns. In order to moderate these effects, the report stressed the need for further fiscal and monetary restraints, expenditure restructuring and provision of the right incentives for private sector initiatives in agriculture, industry and other key sectors of the economy.

II. MACROECONOMIC AND SECTORAL POLICY REVIEW

8. The main thrust of economic policy in 1999 was to ensure stable prices and exchange rate, as well as encourage private sector-led growth. The programme priorities for the year were the achievement of a minimum of 3.0 per cent overall growth in the non-oil GDP and an end-period inflation rate of not more than one digit. This was subsequently revised to 12.0 per cent under the Staff Monitored Programme (SMP). The attainment of these targets were predicated on effective implementation of the following fiscal, monetary and credit, foreign trade, exchange rate and real sector policies that were proposed in the 1999 Budget as well as under the SMP.

Fiscal Policy Measures

9. Fiscal policy for 1999 was designed to address some of the negative developments in the preceding year, especially the adverse consequence on government fiscal operations which resulted from international oil price decline and the disruption in crude oil production. To this end, emphasis was placed on strengthening the non-oil revenue base of the Federal Government. The main policy measures were focused on improved taxation and reduction in recurrent and capital expenditure. Specifically, excise duty on tobacco, cigarettes and spirit were reinstated at 40.0 per cent, while the 25.0 per cent import duty rebate was abolished. In addition, the services of the Professional Import Duty Administrators (PIDA) were discontinued with effect from June 30, 1999. In the area of direct taxation, tax authorities were strengthened for more effectiveness in the collection of personal and corporate income taxes. Specific measures

included the broadening of the coverage and enhancing the collection of Value Added Tax (VAT), reducing the number of exemptions and establishing eight zonal VAT tribunals. Moreover, state and local government's shares of VAT revenue were increased to 50.0 and 35.0 per cent from 45.0 and 30.0 per cent, respectively, while the Federal Government's share was reduced from 25.0 to 15.0 per cent. Finally, the Federal Government reduced its outlay on capital expenditure, while at the same time containing the growth in Federal Government wage bill.

9. Total federally-collected revenue was projected at ₦667.0 billion, compared with ₦424.0 billion in 1998. Of this amount, ₦453.0 billion was estimated to come from crude oil sales, based on a reference price of US$9 per barrel and an exchange rate of ₦86.0 to US$1, as against US$17 per barrel and an exchange rate of ₦22 to US$1 in 1998. The expected revenue from non-oil sources was estimated at ₦214.0 billion, compared to ₦167.0 billion in 1998. A breakdown of the estimated non-oil revenue shows that ₦30.0 billion was expected from companies' income tax, ₦72.0 billion from Customs and Excise Duties, ₦12.0 billion from Federal government independent revenue, while ₦50.0 billion each was expected from Value Added Tax (VAT) and Petroleum Products Adjustment Revenue. The Federal Government's share of total federally-collected revenue, was estimated at ₦296.0 billion, 35.8 per cent higher than that of 1998.

10. Total Federal Government planned expenditure was projected at ₦498.0 billion, about 20.0 per cent higher than the level in 1998. Total recurrent expenditure

was estimated at ₦329.0 billion, while capital expenditure was expected to be ₦ 169.0 billion, compared to ₦116.5 billion and ₦143.2 billion, respectively for 1998. Expenditure on debt service was projected at ₦168.0 billion (₦39 billion and ₦129 billion for internal and external debt, respectively), compared with ₦ 66.0 billion in 1998. The overall budget deficit was estimated at ₦202.0 billion. This was to be financed by draw-down on reserves/transfers from other accounts of ₦168.0 billion, leaving an effective budget deficit of ₦34.1 billion. In addition to the budget estimates, other policy initiatives for fiscal 1999 were as follows: planned promulgation of a decree to give legal backing to the privatization programme, enhancement of the funding of small and medium scale industries, lifting of embargo on external borrowing in favour of concessional and project-tied loans, and intensification of efforts at facilitating the exploration and exploitation of solid minerals.

Monetary and Credit Policies

11. Monetary and credit policies adopted in 1999 were designed to maintain macroeconomic stability and lay the foundation for a sustained economic recovery. In order to achieve the objectives of the programme, monetary policy was expected to be non-accommodating, so as to ensure efficiency in resource allocation, and to support private sector activities.

12. Specifically, the primary objectives of monetary policy were to maintain an

inflation rate initially targetted at a single digit but revised to not more than 12.0 per cent and achieve a minimum GDP growth rate of 3.0 per cent, in addition to promoting employment growth and enhancing the overall efficiency of the economy. Consistent with these goals, and bearing in mind the negative developments in 1998, broad money (M2) and narrow money (M1) were targeted to grow at not more than 10.0 and 4.1 per cent, respectively, while government's borrowing would not exceed 40.1 per cent.

14. Open Market Operations (OMO) was to be the primary instrument of monetary management, complemented by reserve requirements, discount window operations, including repurchase agreements (REPOs), cash and liquidity ratio requirements. As in the past, OMO was to be conducted weekly, while cash reserve requirement (CRR) for commercial banks was increased from 8.0 per cent to 10.0 and 12.0 per cent of their deposit liabilities in April and June, respectively. The base on which the ratio was to be calculated included banks' total deposit liabilities (demand, savings and time deposits), certificates of deposit (CDs), promissory notes held by the non-bank public and other deposit items.

15. The exemption granted to merchant banks from observing cash reserve requirement continued. Though an initial liquidity ratio requirement of 30.0 per cent for both commercial and merchant banks for fiscal 1999 was proposed, it was raised to 40 per cent in June in the wake of the transfer of public sector accounts from CBN to trading banks. Banks were required to hold 40.0 per cent

of their liabilities in eligible liquid assets. In addition, the base for calculating liquidity ratio was to comprise the total deposit liabilities, CDs and promissory notes held by the non-bank public as well as inter-bank transactions. However, with effect from June 1999, inter-bank and Discount Houses placements were classified as loans and, therefore, not countable as part of a bank's eligible assets for the purpose of meeting the new liquidity ratio requirement. Discount Houses were required to continue to invest at least 60.0 per cent of their total deposit liabilities in treasury bills, while banks were allowed unhindered leverage in the structure of their liquid assets.

16. One of the major policy initiatives in the monetary sector was the transfer of retail banking functions of the CBN to commercial and merchant banks with effect from 31st March, 1999. In the wake of the surge in base money that accompanied the transfer of public sector accounts from the CBN, Special Treasury Bills were issued to banks in April and May 1999. These were 90-day securities that were not rediscountable for the initial period. The National Savings Certificate (NSC), a medium-to-long term security of between 3 – 5 years' maturity with relatively attractive yields, was introduced in the first half of 1999. Both banks and the non-bank public were free to invest in the instrument. Finally, to promote soundness of the financial system, the cut-off date for meeting the minimum paid-up capital requirement of ₦500.0 million for banks was not extended beyond 31st March 1999.

External Sector Policy Measures

17. The main thrust of external sector policy was to maintain a viable balance of

payment, and mitigate some of the negative developments of the preceding year. In order to achieve these objectives, the dual exchange rate system was eliminated with effect from 1st January 1999, and the prevailing AFEM rate was adopted for all foreign exchange transactions. In addition, all oil exploration, producing and service companies, were required to sell their foreign exchange receipts to the CBN at the prevailing autonomous rates. Banks were to continue approving all applications in respect of transactions not valid for foreign exchange, while transactions involving the use of bills for collection and open accounts were allowed. However, the transactions executed on private sector initiatives were to carry no government guarantee or obligations. The remittances were to be made through the AFEM subject to the prevailing conditions for payment and were to be channeled through the authorized dealers. Government also resolved to abolish pre-shipment inspection schemes for imports with effect from 1st April, 1999 and replace it with destination inspection.

18. In order to manage the steep decline in the external reserve position, authorized dealers were required to provide treasury bill cover for their foreign exchange demand in the AFEM with effect from 23rd June, 1999. Under the arrangement, banks bidding for foreign exchange were to provide the initial cash backing, while the amount demanded was to be collateralized with 200.0 per cent worth of treasury bills. The treasury bills were to be held for an initial period of one month and were not discountable.

Real Sector Policy Measures

19. The 1999 Federal Government budget projected real GDP growth of 3.0 per cent and a single digit rate of inflation. Fiscal, monetary and sector-specific policies were designed to stimulate output growth in the real sector. The policy measures that were intended to boost agricultural production included capital allocation of ₦5.8 billion or 4.3 per cent of total capital allocation for seed multiplication, research activities and counter part funding of projects, as well as for rehabilitation and completion of dams and other irrigation projects. Other sectoral policy measures for promoting agriculture included retention of import duty on fruit juice at 55.0 per cent, tomato puree at 45.0 per cent, while the import of agricultural spraying guns remained duty free; reduction in import duty on live/chilled chicken and eggs from 150.0 to 55.0 per cent and cooking oil from 55.0 to 35.0 per cent. In furtherance of the effort aimed at promoting non-oil exports, beans, yam and rice were removed from the export prohibition list so as to encourage investment, boost farm gate prices and enhance the income of farmers.

20. Recovery in the industrial sector was to be achieved through generous funds allocation to some industry-related programmes such as substantial increase in wages to stimulate demand, rural electrification, procurement of beneficiation (upgrading) plants and other facilities for the National Iron Ore Mining Project, airborne geophysical survey of solid mineral deposits, strengthening the Nigerian Mining Corporation, continued rehabilitation of the Nigerian Railway Corporation and reduction of the number of security and inspection agencies at the ports to six in order to reduce the cost of imports and enhance faster clearance of goods.

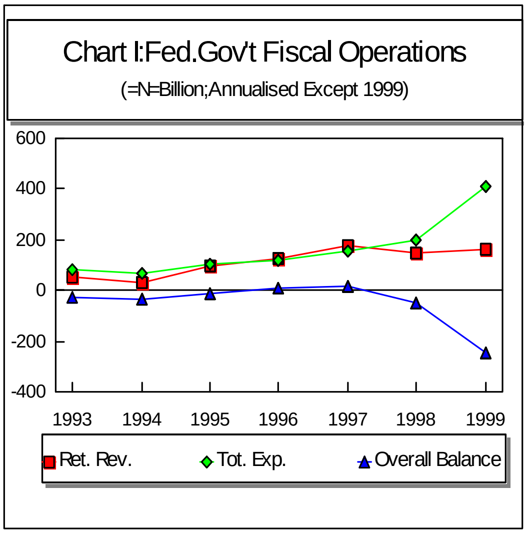
The measures that were intended to boost mining operations included allocation of US $2.0 billion to fund the NNPC joint venture cash calls, provision of adequate funds for the turn-around maintenance (TAM) of the Warri refinery and additional incentives to the gas sub-sector. The budgetary allocations to the ministries and departments in the social sector were increased to mitigate social problems.

III. MACROECONOMIC DEVELOPMENTS

Fiscal Operations and Developments

(a) Federal Government Finances

21. The Federal Government fiscal operations during the first half of 1999 resulted in an overall deficit of _245,701.0 million, which was 143.2 per cent higher than the proportionate budget estimate. The deficit was financed largely through Ways and Means Advances. Although, there was improvement in revenue performance compared with budget estimates, substantial increases in expenditure outlay led to deterioration in government finances.



22. Provisional data showed that total federally collected revenue amounted to

_354,019.4 million, surpassing the budget estimate for the period by 6.1 per cent and indicating an increase of 43.2 per cent over the level in the corresponding period of 1998. The growth in revenue reflected largely the contribution of the oil sector, which grew by 52.4 per cent over the level in the corresponding period of last year and exceeded the budget estimate by 11.9 per cent following sustained increase in crude oil prices during the period. In addition, non-oil revenue recorded an increase of 24.2 per cent, compared with the corresponding half of 1998, although it fell short of budget projections by 6.1 per cent.

23. At ₦161,789.9 million, the retained revenue of the Federal Government for the period was 17.4 per cent higher than the proportionate budget estimate and 6.8 per cent over the amount in the corresponding period of 1998. The retained revenue was mainly made up of statutory allocation, excess crude oil earnings, independent revenue and its share in value added tax.

24. The aggregate expenditure of the Federal Government, at ₦407,491.0 million, recorded a substantial increase of 103.9 per cent over the level in the first half of 1998 and exceeded the budget projections by about 63.0 per cent. A breakdown of the aggregate expenditure showed that non-debt recurrent outlay, at ₦ 98,400.0 million, exceeded its proportionate budget estimate by 22.2 per cent, while capital expenditure amounting to ₦216,180.0 million also overshot its budget estimate by 155.8 per cent. Debt service payments (internal and external) amounted to ₦92,911.0 billion or 22.8 per cent of total expenditure.

(b) State Governments' Finances

25. Provisional data on the consolidated fiscal operations of the State Governments indicated an overall deficit amounting to ₦12,241.5 million. However, a current account surplus which amounted to ₦15,302.7 million was recorded, indicating a decrease of 54.6 per cent, from its level in the corresponding period of 1998.

26. Aggregate revenue of the State Governments amounted to ₦62,729.9 million, representing a decrease of 11.6 per cent below the level in the corresponding period. This was accounted for by the general decline of 9.1 and 52.3 per cent in the statutory allocation and internally generated revenue of the State Governments, respectively. Total receipts from VAT amounted to ₦15,496.7 million, indicating an increase of 99.6 per cent over the corresponding half of 1998. The share of VAT in total revenue was 24.7 per cent compared with 11.0 per cent in 1998. The substantial increase was due in part to the upward revision of State Governments' proportional share from 45.0 to 50.0 per cent in 1999 and partly to increase in VAT proceeds during the review period.

27. The total expenditure of the State Governments rose by 8.3 per cent to ₦ 74,971.4 million, compared with ₦69,226.0 million in the corresponding half of 1998. Their recurrent expenditure increased by 27.3 per cent to ₦47,427.2 million and accounted for 63.3 per cent of the total outlay, while capital expenditure decreased by 13.8 per cent to ₦27,544.2 million and accounted for the balance of 36.7 per cent.

(c) Local Governments' Finances

28. The fiscal operations of the local governments during the first half of 1999 resulted in an overall surplus of ₦4,712.0 million, 64.4 per cent lower than the surplus in the corresponding period of 1998.

29. The statutory allocation to the local governments declined by 4.8 per cent to ₦ 26,905.4 million. However, allocation from VAT increased by 54.0 per cent to ₦ 7,942.0 million during the period under review. This was as a result of the higher ratio of VAT allocation from 25.0 to 30.0 per cent in favour of the local governments in the 1999 budget. Internally generated revenue also increased by 4.6 per cent to ₦2,681.3 million.

30. Recurrent expenditure showed an increase of ₦1,751.5 million or 12.0 per cent when compared with the corresponding period of 1998, while capital expenditure increased by a higher margin of 124.0 per cent to ₦15,174.9 million. The rise in capital expenditure resulted from the efforts of most local governments to complete on-going projects before the end of the political transition period.