Nigeria Economic Alert

The Global Trinity Threats: Impact on Nigeria

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In 2018, three global economic threats emerged from socio-economic and political conflicts. These are Brexit, US-China trade war and the Iran sanctions. Recent developments in these events are highlighted below:

Brexit

- British MPs rejected the Brexit deal, resulting in a deadline extension to October 2019
- Theresa May resigns after failing to pull the Brexit deal through Parliament in March
- The search for a new Prime Minister is on course with the Brexit deal at the forefront of the political circuit.

US-China trade war

- By 2018 year-end, US had imposed tariffs totalling $250bn on Chinese imports while China retaliated to the sum of $110bn of US imports
- At the G20 summit in June, US President, Donald Trump stated his decision to hold back on an additional $300bn proposed tariff.

Iran nuclear sanctions

- In 2018, US President, Donald Trump withdrew US from the Iran nuclear deal and placed economic sanctions on Iran, as well as selected Iranian trading partners
- The Iran government remains resolute on its nuclear programme
- The UK recently seized an Iranian oil tanker to checkmate Iran's continued nuclear threat
- UK foreign secretary, Jeremy Hunt, said the Iran deal can still be salvaged

The interaction of these three events have resulted in slow global economic growth, a tit-for-tat conflict on trade relationships, and heightened geo-political tensions in the Middle East. It is important to review the impact on an economy in recovery such as Nigeria, by examining the consequent impact on the following variables:

- **Inflation**
- **Economic growth**
- **Trade balance**
- **Interest rate**

Inflation

At 11.22% as at June 2019, inflation remains marginally stable though relatively high at double-digits. Inflation in Nigeria is mostly impacted by the level of agricultural production, exchange rate movements, money supply and aggregate demand. See diagram (with arrows) and the table below for the possible effect of the three global scenarios:

Brexit & Trade war ↓ Exports ↓ FX earnings ↓ Exchange rate ↓ Inflation

Iran sanctions ↑ Oil prices ↑ FX earnings ↑ Exchange rate ↓ Inflation

Brexit uncertainty
Increased pressure on Nigeria's inflation rate, if the Brexit crisis persists in the long-term. Britain imported 4.29% of Nigeria's export, valued at N215 billion and ranking in the 8th position (NBS 2018).
US-China trade war
Increased inflationary pressure, if the trade war persists.
Iran sanctions
Lower inflation, if the US-imposed Iran sanctions continue. Persisting Iran sanctions will lend support to oil price, oil revenue and FX inflows. This will counteract the effect from Brexit.

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If Brexit remains unresolved and the British economy experiences slowdown, the value and volume of Nigeria's exports to the country may decline. Foreign exchange earnings to the non-oil sector will also likely reduce, further impacting the naira exchange rate (especially naira to pound), and this could impact the inflation rate.

On the other hand, persisting Iran sanctions will lend support to oil price, oil revenue and FX inflows. This will counteract the effect from Brexit.

- If Brexit uncertainty persists longer than Iran sanctions, inflation could accelerate.
- If Iran sanctions persists longer than Brexit uncertainty, inflation could decelerate.

Economic growth

The economy has been growing at progressively low rates: from 0.72% in 2017Q3 to 2.38% in 2018Q4 and 2.01% in 2019Q1. The IMF predicted in April 2019 that the Nigerian economy will grow by 2.1% in 2019 compared to the earlier 2.3% predicted in October 2018. The downward revision of economic growth expectation is on the back of Brexit uncertainty and prolonged trade war spate.

Brexit & Trade war	↓ Exports	↓ GDP	↓ Economic growth
Iran sanctions	↑ Oil prices	↑ FX earnings	↑ Exchange growth

Brexit uncertainty

Possible economic slowdown, if Brexit continues… Export from Nigeria to Britain is threatened, if the British economy goes through a slowdown and this would reduce the level of real GDP.

US-China trade war

Possible economic slowdown if trade war continues…A prolonged US-China trade war could result in diversion of 'tariffed' products to Nigeria, increasing imports, worsening trade balance position and real GDP.

Iran sanctions

Higher economic growth if the sanctions continues…due to the increase in oil prices caused by the geo-political tensions in the Middle East, because of the Iran sanctions.

Economic growth in Nigeria is susceptible to the supply-demand dynamics of the global oil sector. On November 5, 2018, the US fully re-imposed the sanctions on Iran that had been waived under the Joint Comprehensive Plan of Action (JCPOA). From US$59.46 per barrel in November 2018, Brent crude price hiked to US$64.06 in June 2019. Escalation of the Iran sanctions has resulted in steady uptrend in oil prices.

Trade Balance

The exchange rate has been relatively stable at N360/$-N362/$ in the parallel market and N306/$-N307/$ in the official market in H1'19. Between oil revenues and remittance inflows from overseas, Nigeria recorded trade surplus, so the country can maintain stable exchange rates and accumulate reserves. Nigeria's balance of trade increased by 47.1% from N4.03 trillion in 2017 to N5.93 trillion in 2018.

Brexit & Trade war	↓ Exports	↑ Imports	↓ Trade deficit
Iran sanctions	↑ Oil prices	↑ Export earnings relative to import	↑ Trade surplus

Brexit uncertainty

Growing trade deficit if Brexit is unresolved

US-China trade war

Growing trade deficit if the trade war is unresolved

Iran sanctions

Probable trade surplus. Naira is not expected to depreciate if Iran sanctions continues.

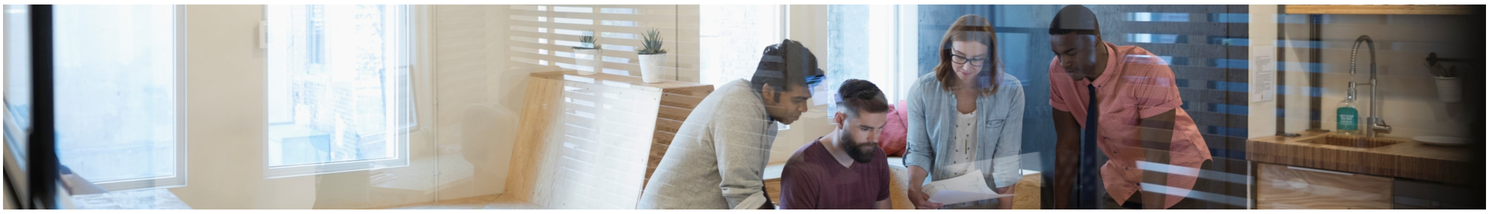
Imposing sanctions on Iran has resulted in rise in crude oil prices, which, in turn has stabilized the exchange rate in Nigeria. The value of the naira against other major currencies, especially the US dollar, is not likely to depreciate, if the US-led sanctions on Iran continues. On the other hand, Brexit and the US-China trade war will increase imports to Nigeria as British, Chinese and American manufacturing companies could divert some of their manufacturing output via exports to Nigeria. The supply-side effect is expected to induce trade deficit in Nigeria.

- Nigeria will record trade surplus if Iran sanction persists longer, Brexit is resolved, and trade war comes to an end.
- Nigeria will record trade deficit if Iran sanction ceases, Brexit remains unresolved and trade war persists.

Interest rate: The MPR

The Monetary Policy Rate (MPR) is determined by the Central Bank of Nigeria (CBN) in response to domestic and global developments. In March 2019, the CBN reduced the MPR from 14% to 13.5% in reaction to escalating Brexit uncertainties and the US-China trade war.

Brexit & Trade war	↓ Exports	↓ FX earnings	↓ inflation	↓ MPR
Iran sanctions	↑ Oil prices	↑ FX earnings	↑ Inflation	↑ MPR is maintained or reduced further



Brexit uncertainty

Interest rate could increase if the Brexit uncertainty continues.

US-China trade war

Interest rate could increase if the trade war persists.

Iran sanctions

Interest rate may be maintained, if the sanctions continue.

Whenever the level of inflation rises, CBN raises the MPR, and vice-versa. This is likely to occur because the impact of Brexit and the trade war on inflation is positive. We believe that the level of imports to Nigeria is expected to rise, if Britain, China and America channel some of their exports to reverse the slowdown in their respective economies and improve manufacturing output. This could cause import-induced inflation in Nigeria.

The stronger effect will likely come from Brexit and the US-China trade war. Both effects will constrain exports from Nigeria to Britain, the United States and China, and therefore reduce FX earnings. In addition, the outflow of FX from Nigeria as payments for imports to these three economies could trigger depreciation pressures on the exchange rate. Consolidating these effects, inflation will rise, and interest rates may likely be raised to mitigate the inflationary effects on the economy:

If the CBN effectively executes its 5-year monetary policy thrust to boost economic activities and output, especially with respect to inducing credit to the real sector, agriculture activities and SMEs. This will help to boost domestic production, which will result in enhancing the import substitution policies of the FG.

Conclusion

The trio of Brexit uncertainty, US-China trade war and Iran sanctions hold important consequences for the Nigerian economy. Iran sanctions offers an upside for the Nigerian economy. Brexit and the US-China trade war creates a downside for the Nigerian economy. Nigeria is exposed to global economic shocks due to significant debt accumulation, import-dependent economy and low diversification of exports. To assuage the effects of the global vulnerabilities in the Nigerian economy:

- Debt accumulation should be reduced.
- The export base should be diversified.
- Import-substitution should be encouraged and financed.

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