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POLICY **BRIEF**

NO. **009**

JUNE 2018

KEY POINTS

- Development in the crude oil market has pushed oil price to $76.79pb from $55.45pb in January 2017 representing a 38.49% increase.
- The 2018 budget which was recently passed by the National Assembly experienced a raise in crude oil benchmark from $45pb to $51pb, contributing to a 6% increase in proposed expenditure from N8.6trn to N9.1trn.
- Fiscal spending needs to be enforced and maintained by curtailing spending in order to maintain stability when oil prices fall.

Recent Oil Price Increase: Sustainability Implications for Nigeria

Development in the crude oil market has pushed oil price to $76.79pb from $55.45pb in January 2017 representing a 38.49% increase. This rise in oil price is the highest since the precipitous fall to $27.88pb in January, 2016. However, this recent increase has both positive and negative implication for Nigeria and has informed different responses. Against this backdrop, it is critical that the increase is examined for its implications and sustainability effects on the Nigeria economy. For instance, the 2018 budget which was recently passed by the National Assembly experienced a raise in crude oil benchmark from $45pb to $51pb, contributing to a 6% increase in proposed expenditure from N8.6trn to N9.1trn.

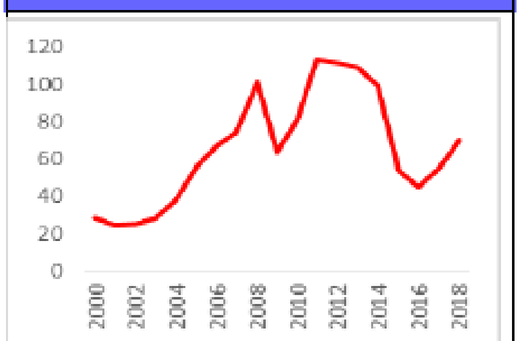
Globally, many factors affect the price of oil, but in the end, it comes down to supply and demand. These factors include, but not limited to, OPEC production decisions, spare production capacity, non-OPEC supply growth, political tensions, amidst other. For instance, the US president's decision to unilaterally exit the nuclear deal with Iran raised speculation of Iranian exports falling. Supply cuts by major oil-producing countries, led by Saudi Arabia and Russia, have equally made marks on the rising oil prices. In the same vein, the ongoing escalation of tensions between Saudi Arabia and Iran, continuing conflicts in Iraq, Libya, Syria and Yemen have significantly taken their toll on the region and oil prices. Further-more, with the IMF forecasting 3.9% growth in global economy this year, healthy economic activity has been an important factor in rising oil prices so far.

Rising crude oil prices is known to affect different areas and aspects of the economy. It increases export earnings and thus the current account balance. There is no doubt that recent occurrences and responses in the Nigerian economy are tethered to increasing oil prices. Instances include stability of the naira at around N360 naira to a dollar, steady disinflation which is attributable to stability of the foreign currency market, improvement in the level of liquidity in the foreign exchange market as well as external reserves that have risen to a 4 year high.

However, there are growing concerns about the sustainability of the surging crude oil prices. Observers have warned that crude oil may become so expensive such as to dent demand for oil. A report from Inter-national Energy Agency (EIA) paints pretty gloomy picture for OPEC members, who are hoping to phase out their supply cuts after this year. With non-OPEC supply rising quickly, particularly in the U.S., OPEC may struggle to figure out a way to increase output without pushing down prices. Similarly, the IMF has warned Nigeria and other dependent countries of a possible crash of the prices of crude oil in the near future and further advised intensification of economic diversification efforts in such countries.

Trend of oil prices has been typified by upturns and downturns over the years as shown in Figure I. Over the study period, oil price attained its highest peak in 2011 while the lowest oil prices were recorded in 2001 and 2002. Oil price rose steadily to an initial peak of $101.43pb in 2008 after which it fell sharply to $63.35pb in 2009 and then grew to its highest peak at $113.65. It falls sharply to $27.88pb in 2016 where it began to rise steadily till date.

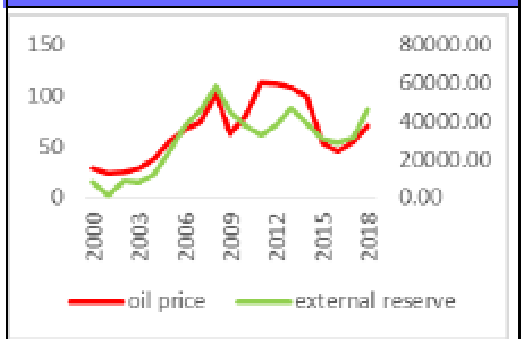
Figure I: Oil Prices from 2000 to 2018



Source: OPEC, AnaStat, 2018
ADSR Research

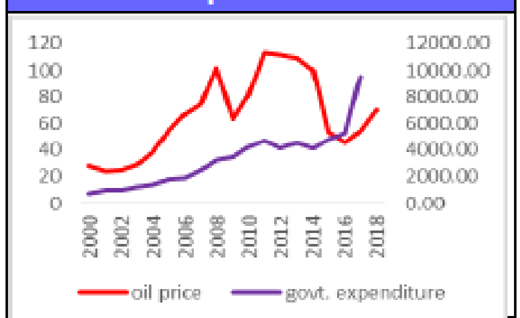
The relationship between oil price and external reserves is also presented in Figure II, it reveals that oil prices and external reserves exhibit similar trends. Moreover, Figure III shows that government spending increased steadily over the period of study, irrespective of the sharp peaks and downturns in the trend of oil prices. This is attributed to the fact that government spending is a combination of revenues, complimented by foreign and domestic borrowings. However, respective fall in oil prices are accompanied by some levels of downturns in government spending. A sharp expansion in spending is seen from 2016 as oil prices picks up.

Figure II: Oil Price and External Reserves



Source: OPEC, CBN, AnaStat
ADSR Research

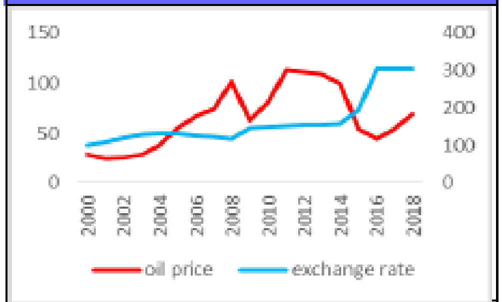
Figure III: Oil Price and Government Expenditure



Source: OPEC, CBN, AnaStat
ADSR Research

The association between oil price and exchange rate is shown in Figure IV. Increase in oil price informs corresponding decline in exchange rates (naira appreciation). However, between 2009 and 2015, stability is recorded in the trend of exchange rate regardless of the sharp expansion and downturn in oil prices. Non-appreciation of the naira in this period fueled reserves accretion as well as increased imports. Exchange rate plunged sharply between 2014 and 2016 during a period lengthy decline in oil prices. It then stabilizes from 2016 where the oil prices began to expand.

Figure IV: Oil Price and Exchange Rate



Source: **OPEC, CBN, AnaStat ADSR Research**

From the foregoing, First, it is clear that oil money spending remains an aspect that needs to be looked into in Nigeria. When oil prices are high, the descriptive above shows that Nigeria's external reserves rise, ex-change rate stabilizes and government expenditure continues on a rising trend. It is therefore important we save as much as possible so that spending can be increased when oil prices fall. In other words, fiscal discipline needs to be enforced and maintained by curtailing spending. Second, the near-absolute dependence of Nigeria on the oil sector remains a crucial challenge to be addressed. Having an economy that is not tied to the price of one product which is bound to have wild price swings is an obvious solution. Hence, it is expedient that Nigeria will learn from the past and avoid been carried away by the recent oil price increase as such had been attained before with little to show for it.

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