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The Impact of Macro-Economics Indices on the Development of Project Finance in Nigeria

Abstract. About \$67 billion is needed to meet up with the infrastructure needs of Nigeria which the government cannot provide. Project finance initiatives become a ready alternative to address this infrastructure challenge. The macro-economic condition in which firms operates has a lot of influence on the sustainability of business operations, especially for the fact that project finance initiatives are usually on a long-term basis between 25 to 30 years. The present initiatives of the government to put exchange rate and interest rate on a fixed rate of N197 to \$1 and 13% respectively is commendable, so also the plan of the government to increase spending with the application of \$3.5 billion concessionary loan from the World Bank and ADB. These initiatives coupled with the government taking up its responsibility to provide a conducive business environment will go a long way to have a positive influence on the development of project finance in Nigeria.

Keywords: economy; macro-economic indices; project-finance; infrastructure; Nigeria

Introduction

The Nigeria economy is in dire need of infrastructural development. A former minister of finance Dr Ngozi Okonjo-Iwela in 2013 estimated that Nigeria needs about \$67 billion to meet the need of infrastructure development in the area of road upgrades, repair of bridges, investment in the power sector, health sector and educational sector. This submission by the minister is similar to the position of African Infrastructure Country Diagnostic (AICD) in 2011. AICD had said that about \$14.2 billion per annum for the next decade is needed to meet up with the infrastructure gap in the country. Since the government is burdened with so many needs, project finance initiatives create a ready alternative to fund infrastructure needs of the country.

Project finance provides a platform for funding of public oriented projects in such a way that the financier of the project, has to wait for the proceed that will be generated from the operation of the project to recuperate their capital and return on investment for over a period of about 30 years. Yescombe (2014) defines project finance as a means for seeking debt financing on a long range term for big projects through a process that can be called "Financial Engineering". The lending of the

money is made to be dependent only on the cash flow that the project in question will generate. Thus before the contract is signed, the project construction is evaluated, risks that could arise from operations and revenue is also evaluated including their allocation among other parties involved in the project in a contractual and other arrangement.

The external environment in which a project is situated mainly the macroeconomic factors, has a lot of impact on the development of project finance in a country. Only the government can control the external environment through policies formulation and the operation of the central bank. Macroeconomic factors that can influence firms performance in a particular country includes: Inflation, interest rate, exchange rate, money supply, taxes, exports and imports, FDI, average salary, Population, firms number in a country, unemployment etc. The Nigerian government and the Central Bank as the financial institution regulatory body regulate the movement of some of these variables through fiscal and monetary policies.

Literature Review

Economist differs as per what type of economic policies can better generate economic growth. Some recommended macroeconomic policies for long term growth, some others believes that monetary policy has a better impact at a faster rate on economic activity, thus the recommendation on monetary measures rather than fiscal measure. Many scholars in different parts of the world have similar conclusions on the effect of macro-economic factors on business performance.

In a research conducted by Rokas (2012)¹ the researcher shows correlation between macro factors and corporate profitability. Factors such as average wages, monetary base, number of enterprises, and inflation were found not to be statistically significant and thus have no much impact on corporate profitability. However, interbank interest rate charges and unemployment rate have a lot of influence on company's profitability. Unemployment has the biggest impact on profitability, which shows that the profitability of firms reduces as unemployment increases.

Jukna (2004)² research to determine the impact of macroeconomic factors on the number of bankruptcies with consideration on GDP, FDI, inflation, imports, unemployment, general population, number and changes in business. The study shows that unemployment, FDI changes in business and the general population number have the greatest impact on bankruptcies. GDP, inflation rates and imports have the least impact on bankruptcies. Other factors that could also affect bankruptcy according to the author's analysis are: Foreign policy, government regulation, political stability, business culture and Scientific/technological achievement.

Antwi & Zhao (2013)³ study of the impact of macro-economic factors on economic growth in Ghana for the period 1980 to 2013 by the use of cointegration error correction models using yearly data for long run economic growth largely explained by physical capital, Foreign Direct Investment, foreign aid, inflation and government expenditure. The research also shows that economic growth is

¹ Rokas Bekeris (2012). The Impact of Macroeconomic Indicators Upon SME Profitability. Internal Business School at Vinius University, Lithuania. Vol. 91(3).

² Juka, N. & Ivaronaviciene M. (2004). Imoniu Bankrotai Lietuvoje: Priklausonbes nuo makroe konominiu veiksmiu tymras.

³ Antwi S. Mills E.F. & Zhao (2013). Impact of Macroeconomic Factors on economic Growth in Ghana: A Cointegration Anaysis. International Journal of Academic Research in Accounting Finance and Management Sciences, 3(1): 35-45.

not affected by short-terms changes in labour force. Ullah & Rauf (2013)⁴ study of the influence of macroeconomic variables on economic growth in some Asian countries shows that economic growth is positively affected by Foreign Direct Investment and savings, while exports have negative impacts on economic growth. Labour force and tax rate have no impacts on economic growth.

Asekome & Agbonkheshe (2014)⁵ empirical study on macroeconomic indicators/variables on risk assets creation in Nigeria from 1981 to 2011 using the econometric technique of ordinary Least square (OLS) shows that monetary policy has always been to have inflation rate as a single digit. It has however been difficult to achieve this, and the effect of an increase in inflation rate is readily seen in the Nigerian economy, like the increase of inflation from 10.3% in December 2011 to 12.6% a month after in January 2012 after the government made a partial removal of fuel subsidy. The authors recommended for a policy formulation to reduce lending rate, as high lending rate has the capacity to discourage credit to the productive sectors of the economy. They also route for macroeconomic formulation that can promote low inflation, low interest rate, favourable and stable exchange rate and the enhancement of industries capacity utilization, these the authors think has the capacity to enhance credit expansion, increase returns on profitability of commercial banks.

Ismaila & Imoughele (2015)⁶ used Real Gross Domestic Product (RGDP) measurement to examine the macroeconomics determinant of Nigeria economic growth. CBN time series data spanning a period of 26 years (1986 to 2012) was used. The result shows six co-integrating equations which established the existence of long run relationship. The Ordinary Least square statistics technique used to assess the degree of influence the variables have with each other shows gross fixed capital formulation, Foreign Direct Investment and total government expenditures are the main determinant of Nigeria economic output under a stable inflation rate.

The recommendation of the authors include: Development of the business environment especially as it relates to infrastructure development which is able to lower the cost of doing business in Nigeria. Retaining tight monetary and fiscal policies is also recommended as it's able to fight inflation in the Nigerian economy, as inflation has a negative effect on investment in the Nigeria economic. Policies that can tame incessant strikes by the labor force is also recommended. Other recommendations are: export promotion strategy, import substitution strategy and austerity measures.

Macro-Economic Indices and the Nigeria Economy

Before the global oil price crisis, the exchange rates in Nigeria has been stable even in the open market uptill the end of 2014, though there was always a difference of about N3 between the official exchange rates, what is obtainable in the Bureau de Change or informal markets of foreign exchange otherwise called parallel market. The sharp drop in oil price has caused a drastic drop in the value of the naira compared to foreign currencies like the US dollars and British pounds.

⁴ Ullah Fand & Rauf, A. (2013). Impacts of macroeconomic variable on Economic Growth: A Panel Data Analysis of Selected Asian Countries. *GE International Journal of Engineering Research*.

⁵ Asekone, M.O. & Agbonkheshe, A.O. (2014). Macroeconomic Indicators and Commercial Banks Risk Creation in Nigeria. *European Scientific Journal*. Vol. 10 (103).

⁶ Ismaila Mohammed & Imoughele, L.E. (2015). Macroeconomic Determinant of Economic Growth in Nigeria. A co-integration Approach. *International Journal of Academic research in Economics and Management Sciences* Vol. 4, no 1.

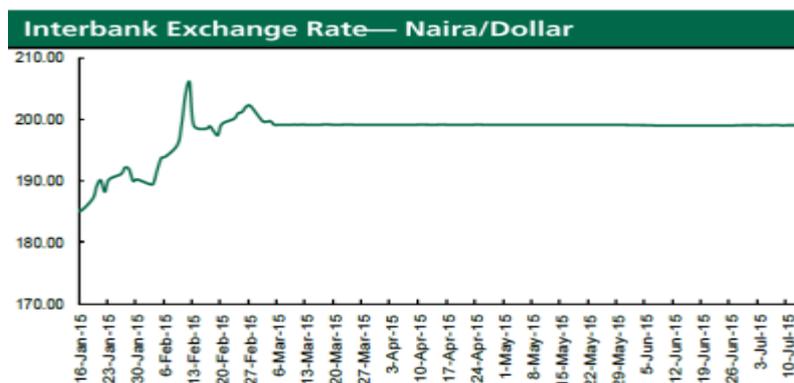


Figure 1. Nigeria Inter Bank exchange rate (source: www.euromoney.com)

Table 1

Nigeria official exchange rate (source: Central Bank of Nigeria)

Rate Date	Currency	Rate Year	Rate Mon	Buying Ra	Central Ra	Selling Rate
1/29/2016	US DOLLAR	2016	January	196	196.5	197
1/29/2016	POUNDS STERLING	2016	January	279.8684	280.5824	281.2963
1/29/2016	EURO	2016	January	213.836	214.3815	214.927
1/29/2016	SWISS FRANC	2016	January	191.9311	192.4207	192.9103
1/29/2016	YEN	2016	January	1.6192	1.6233	1.6274
1/29/2016	CFA	2016	January	0.3066	0.3166	0.3266
1/29/2016	WAUA	2016	January	270.2647	270.9541	271.6436
1/29/2016	YUAN/RENMINBI	2016	January	29.7999	29.8764	29.9529
1/29/2016	RIYAL	2016	January	52.2263	52.3595	52.4927
1/29/2016	DANISH KRONA	2016	January	28.6458	28.7188	28.7919
1/29/2016	SDR	2016	January	270.578	271.2683	271.9585

Figure 1 shows that the exchange rate was pegged at an official price of N197 per American dollar following a period of fluctuation since the beginning of the sliding down of oil prices in February 2015. The government maintained this policy to defend the naira but this rate unfortunately is not realistic not even as it relates to inter bank rates. Table 1 also shows that the official exchange rate as fixed by the Nigerian Central bank is still at N197 per American dollar in 2016, but to the dollar in the parallel market as of fourth week of January it goes for N270 up from an average of N250 to a dollar.

The sharp increase is attributed to the reduction of sales of dollars to Bureaux de Change (BDCs) by the Central Bank of Nigeria⁷. The reason for this action by the CBN is said to be a bid to provide incentives to financial institutions to engage in round-tripping according to financial expert⁸. The president of BDC Alh. Aminu Wadabe said the number of BDC was increased from 1,170 to 2,270 in January by the government but the amount of dollars sold to each BDC was reduced by 60% from \$30,000 to \$10,000.

Nigeria current president, President Muhammadu Buhari responded to calls of some people for him to officially devalue the naira in the wake of current economic reality. He said that such exercise will only favour countries with export driven economy, but devaluing the Nigerian currency

⁷ Vanguard Sunday 31st January 2015.

⁸ www.bellanaija.com.

will lead to high inflation in the country and hardship for the poor and middle class in Nigeria import dependent country. He actually sees official devaluation of the naira as a way of killing the naira. On the reduction of sales of dollars to BDC, he sees them as a drain to the nation's economy as the patrons of some of the BDC, uses their influence to buy dollars at official rate and then sell at BDC at a very high rate. He said he would rather direct the position of the country's foreign exchange to getting spare parts and expansion of infrastructure⁹.

If the approach of the government of Nigeria to the current economic recession were limited to just the implementation of policies which put interest rate and exchange rates at fixed rates one could say it's the Monetarist approach of modern economic theory that was adopted but of recent the Bloomberg reported the plan of the federal government to get a concessionary loan of \$3.5 billion, \$2.5 bn from the World bank and the remaining \$2 bn from Africa Development bank. This loan, according to the finance minister is expected to be invested in capital projects for the stimulation of the economy. It can therefore be said that the government is adopting the combination monetarism and Keynesian principles to address the present economic policies.

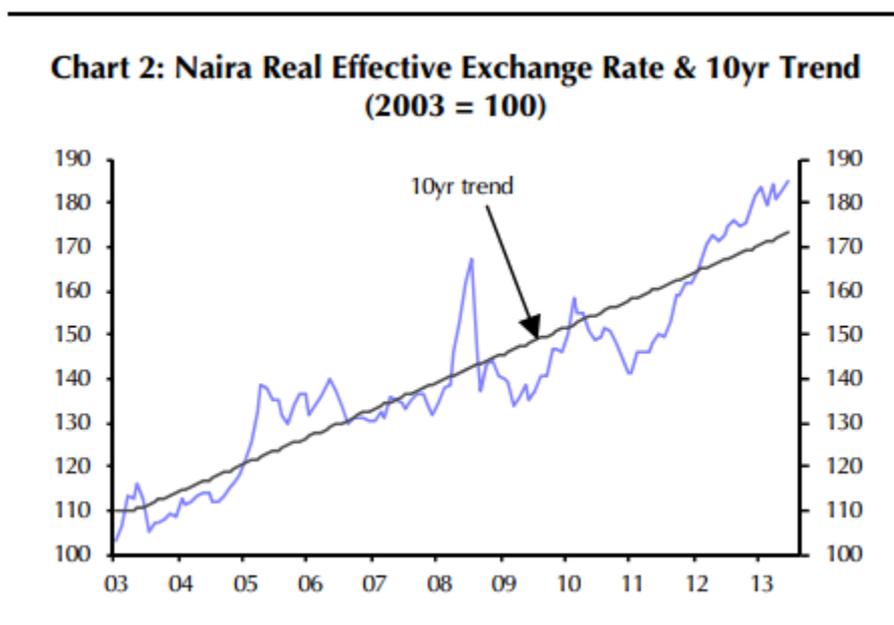


Figure 2. Nigeria historical exchange rate

Figure 2 shows that historically, exchange rate has always been fluctuating in Nigeria with moments of sharp rise and sometimes moments of sharp drop. The figure shows exchange rate between 2003 and 2013. The present experience of fixed exchange rate can thus be seen as a deliberate government policy to stabilize the economy.

⁹ The Punch 22 January 2016.

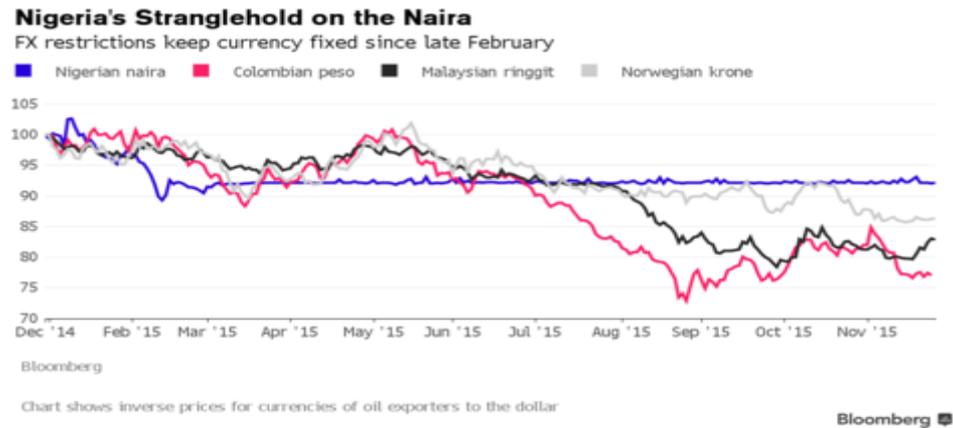


Figure 3. Nigeria fixed exchange rate compare with other countries floating rate

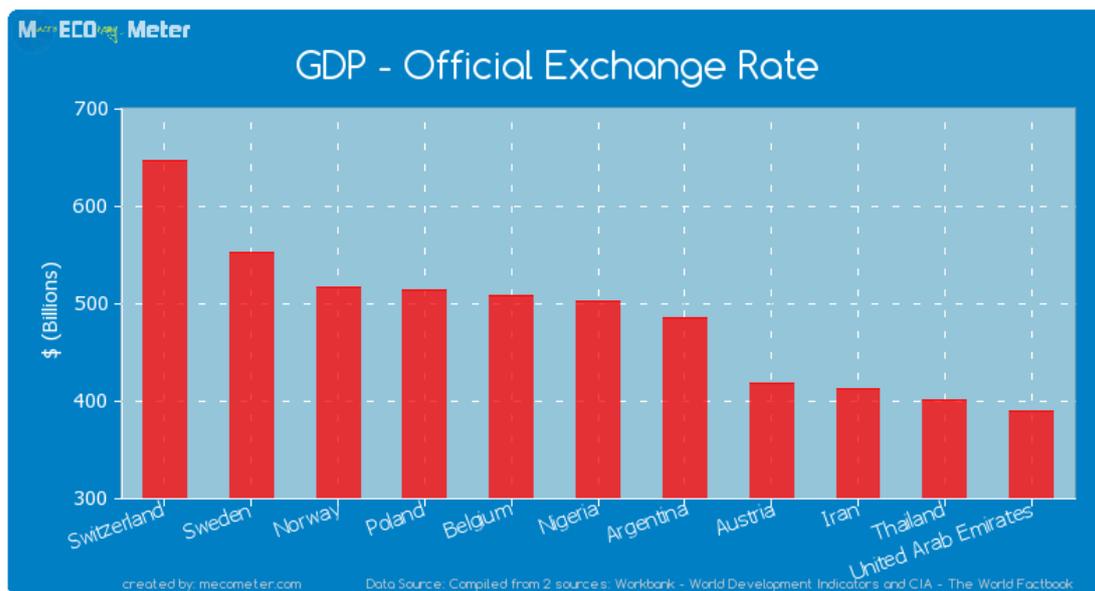


Figure 4. GDP and Official exchange rate

Figure 4 shows that while some developing countries, have chosen to maintain a floating exchange rate, Nigeria maintained a fixed exchange rate. Figure 10 compares Nigeria with some other countries in terms of the relationship between GDP and official exchange rate.



Figure 5. Dynamics of Interest rates in Nigeria

Figure 5 shows the dynamic of interest rates in Nigeria. The rate was a floating rate between 2007 and 2011, but in 2012 the government decided to make it a fixed rate at about 17%, the present economic crisis in Nigeria has forced the rate to be lowered to 13% with a forecast of 11%. The policy of fixed interest rate is also a deliberate policy formulation from the government to move the economy in a positive direction.

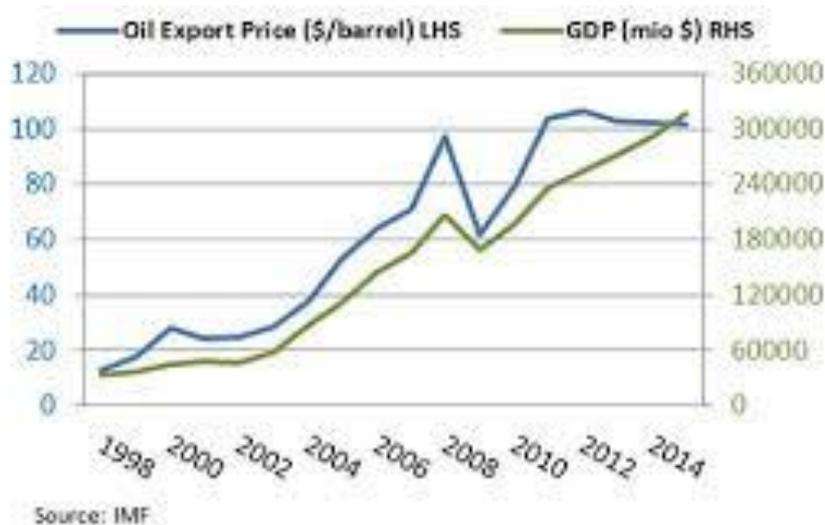


Figure 6. Oil export price compare with GDP

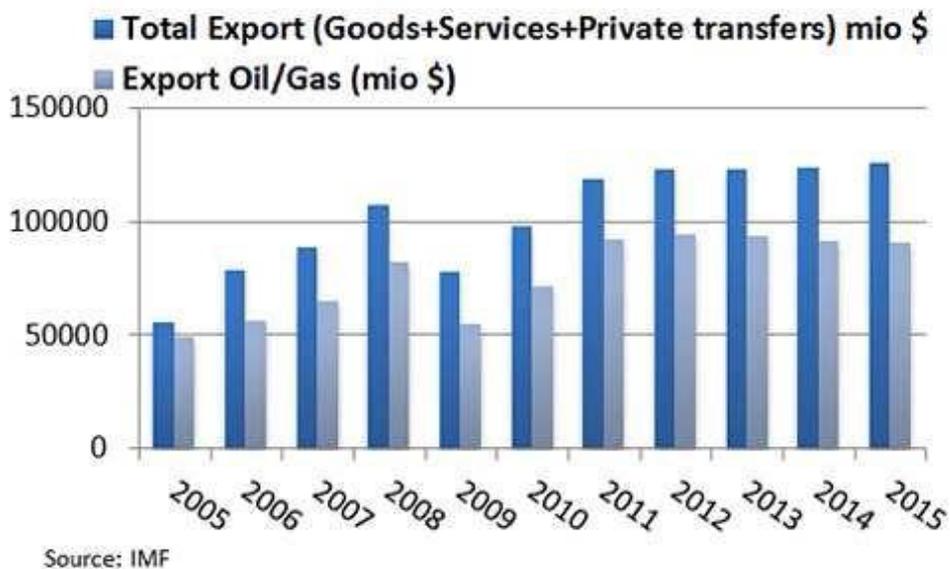


Figure 7. Indication of oil export volume compared to total export

	Sum of Cash Flows (in US\$ millions)	FX depreciation (in percent)	FX impact (in US\$ millions)	% of 2013 GDP (in percent)
Angola	1503	30%	451	0.36%
Cote d'Ivoire	12398	30%	3719	11.60%
Gabon	2552	30%	766	3.97%
Ghana	3325	30%	998	2.09%
Kenya	3178	30%	953	1.73%
Mozambique	1530	30%	459	3.00%
Namibia	792	30%	238	1.94%
Nigeria	2322	30%	697	0.13%
Rwanda	670	30%	201	2.64%
Senegal	2064	30%	619	4.18%
Seychelles	302	30%	91	6.55%
Tanzania	864	30%	259	0.78%
Zambia	3034	30%	910	3.39%
Ethiopia	1663	30%	499	1.05%
Total	36196	30%	10,859	1.13%

Figure 8. Comparison of Nigeria with other African countries on exportation

Webfeeds.brokings.edu

Figure 6 shows that the country's GDP flows in the same direction as oil price. A drop in oil price has a corresponding negative effect in GDP value. Figure 7 shows that oil export constitute about 80% of total volume of export in Nigeria. Figure 8 compares Nigeria with some African countries.

Promotion of Macro-economic indices to favour project finance in Nigeria

Inflation rate has an impact on household performance. Low inflation makes household to have more disposable income leading to increase in demand which will in turn stimulate firms to increase supply. A favorable interest rate can encourage savings which can provide capital base for investors. Low domestic savings rate may cause low-growth levels as Harrod Domar model suggested that savings is an important factor for economic growth.

The cost of producing goods and firms revenue generally can be influenced by the exchange rate especially in the construction industry. Some construction projects takes two years or more before final completion, contracts are signed with sub-contractors at the beginning of the project execution; a tangible upwards movement of the exchange will automatically increase cost at which materials will be supplied, especially in the Nigerian business environment where most building materials except cement and sand are imported. This could affect projected cash flow from a real estate development and some other businesses. The current stable exchange rate through the fixed exchange rate policy can therefore be commended, but effort must be made to strengthen the naira so that the fixed exchange rate can be realistic and to also produce the desired effect.

The stability of the financial institution in Nigeria is crucial to the development of project finance in Nigeria, since project finance is majorly dependent of debt as source of capital. Efforts must be made by the government to keep the banks in a good state even as the government try to bring down lending rate and interest rate, monetary policies decisions that has the tendency to favour investment should be encouraged.

The high population of Nigeria (about 174 million) is a major source of attraction to the Nigerian economy. Many investors turns to Nigeria because they see the population as good market target. While the high population also gives opportunities for project finance projects in terms of the needs for infrastructure development and high expectation for patronage, effort should also be made such that the population is skillful to provide huge manpower that is needed in the construction industry, and for human capital development. In this light effort must be made to reduce unemployment.

The plan of the federal government to get a concessory loan of \$3.5 billion from the World Bank and the African Development Bank to improve on government spending is a plan in the right direction. The current minister of finance specifically said the loan will be spent on capital expenditure for the provision of infrastructures. The loan can be a source of motivation for the government to embark on a number of project finance initiatives as it can readily provide about 20% equity contribution expected in Public Private Partnership (PPP) initiatives. States and local governments should also be encourage to adopt the PPP initiatives for the provision of public infrastructure, the Lagos State government have taken a lead in this direction, other states in the federation should be encouraged to follow.

Conclusions

The Nigeria government recognizes the inadequacy of infrastructure development in Nigeria, its importance to economic development and also the inability of the government to bridge the gap, hence the support for private sector initiatives in the form of project finance, which could transfer the financial burden of the provision or maintenance of public infrastructure and other development of public interest to the private sector.

There is no compromise among economist as to which of fiscal policy or monetary policy is best suited for economic growth. The examination of a particular economy should suggest the best approach. In the case of Nigeria, both fiscal policy and monetary policy are applied. Exchange rate and interest rate are currently on a fixed rate N197 to \$1 and 13% respectively, as against the usual

practice of the use of floating rate. The government has also concluded plans to increase government spending by getting \$3.5 billion concessionary loan from the World Bank and Africa Development Bank. This will definitely facilitate the development of project finance in Nigeria.

The huge population of Nigeria should be converted to a source of strength like the case of China which the West now relied on for labour because they are skillful. Effort should be made to enhance skills acquisition among youths in Nigeria, this will lead to reduction in unemployment. Nigeria can now be said to be stable politically after witnessing peaceful transfer of power from a civilian leader to a civilian leader in 2007 and from a ruling party to an opposition party in 2014. The government should therefore consolidate on this political gain by pushing for steady flow of Foreign Direct Investment (FDI).

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Влияние макроэкономических показателей на развитие проектного финансирования в Нигерии

Аннотация. В настоящее время приблизительно \$67 миллиардов необходимо для того, чтобы улучшить инфраструктуру Нигерии, развитие которой в должной степени не может обеспечить правительство. Инициативы проектного финансирования представляют собой готовую альтернативу развития финансовой и иной инфраструктуры. Макроэкономические условия, в которых работают компании, оказывают большое влияние на устойчивость деловых операций, особенно это влияние ощутимо для проектного финансирования на долгосрочной основе продолжительностью от 25 до 30 лет. Существующие инициативы правительства, касающиеся фиксации валютного курса и курса обмена валюты на уровне 197 единиц национальной валюты за 1 доллар США и процентной ставки на уровне 13% годовых особенно похвальны, так также план правительства увеличить расходы с применением льготной ссуды в размере \$3.5 миллиардов от Всемирного банка и Агентства по развитию бизнеса. Эти инициативы, реализуемые вместе с правительством, увеличивают его гарантии и обязанности обеспечить благоприятную деловую среду, будут иметь далеко идущие последствия для проектного финансирования в Нигерии.

Ключевые слова: экономика; макроэкономические индикаторы; индексы; проектное финансирование; инфраструктура; развитие Нигерии

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