

22 January 2018

Nigeria Strategy Report – H1 2018 Excerpts

Domestic Economy and Markets

GDP: Juggling optimism on a tightrope

We expect a juggling act between recovery and headwinds in the near term. However, we hold the view that economic direction will be more tilted towards a recovery. Tying our views on both oil and non-oil component of growth, we forecast a real GDP growth of 1.9% YoY as our base case in 2018

Contents

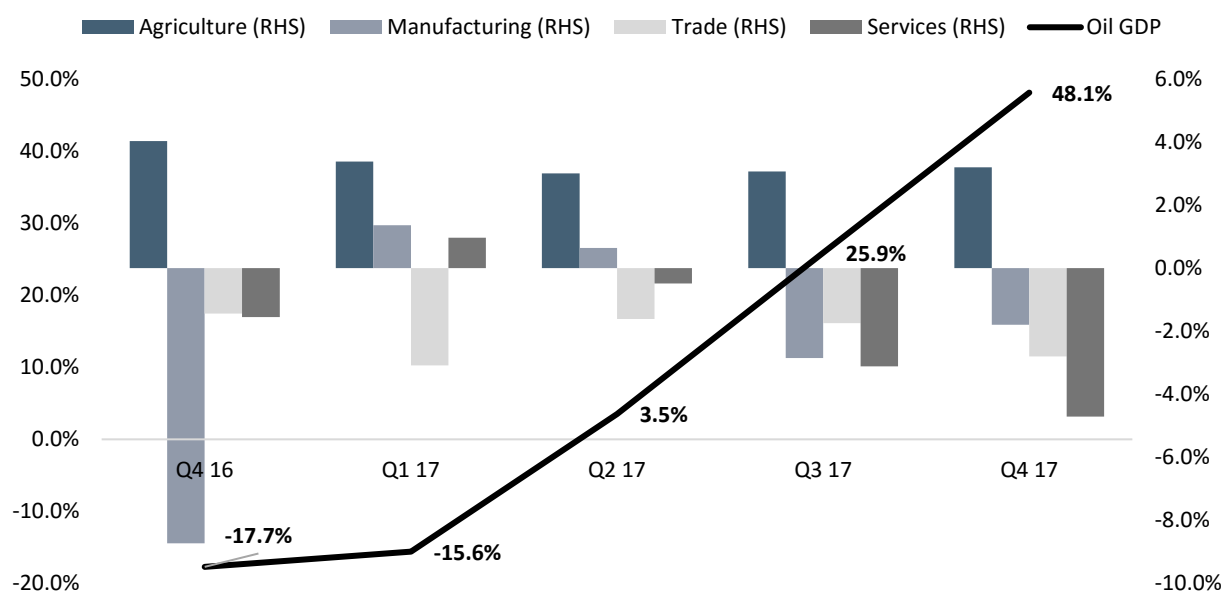
- Domestic economy back from the brink
- Upturn in crude production boosts Oil GDP
- Agriculture sector proves its resilience
- Oil and Agric Output to support 2018 GDP growth story

Domestic economy back from the brink

After four consecutive quarters of contraction, Nigeria's economy recovered in the second quarter (0.72% YoY) and sustained momentum in the third quarter (1.4% YoY) with combined GDP growth of 0.4% YoY as at 9M 17. Much of the growth reflected higher oil production (26.1% YoY to 2.03mbpd in Q3 17) while the performance of the agricultural sector remained robust. Consequently, oil and agriculture GDP expanded by 25.9% and 3.1% YoY respectively over 9M 2017. Despite the growth in agriculture, non-oil GDP swung into a contraction in the third quarter (Q3 17: -0.8% YoY; 9M 17: +0.1% YoY) underpinned by deceleration in services, manufacturing and trade sectors¹ which printed at -3.1%, -2.9% and -1.7% YoY respectively in the review period. Over the fourth quarter, we project production at 2.05mbpd (+16.5% YoY), which translates to a 48% YoY growth in Oil GDP. For non-oil, despite the resilience in Agriculture which we expect to grow 3.2% YoY, sustained deceleration in Services (-4.7% YoY), Manufacturing (-1.8% YoY) and Trade (-2.8% YoY) translates to a 2.3% contraction in non-oil GDP. Consequently, we forecast Q4 17 real GDP to print at 1.1% YoY which translates to 2017 real GDP growth estimate of 0.6% YoY.

¹ The three sectors accounts for 63.9% of non-oil growth

Figure 1: YoY Growth in Oil, Agric, Manufacturing, Trade, Services GDP



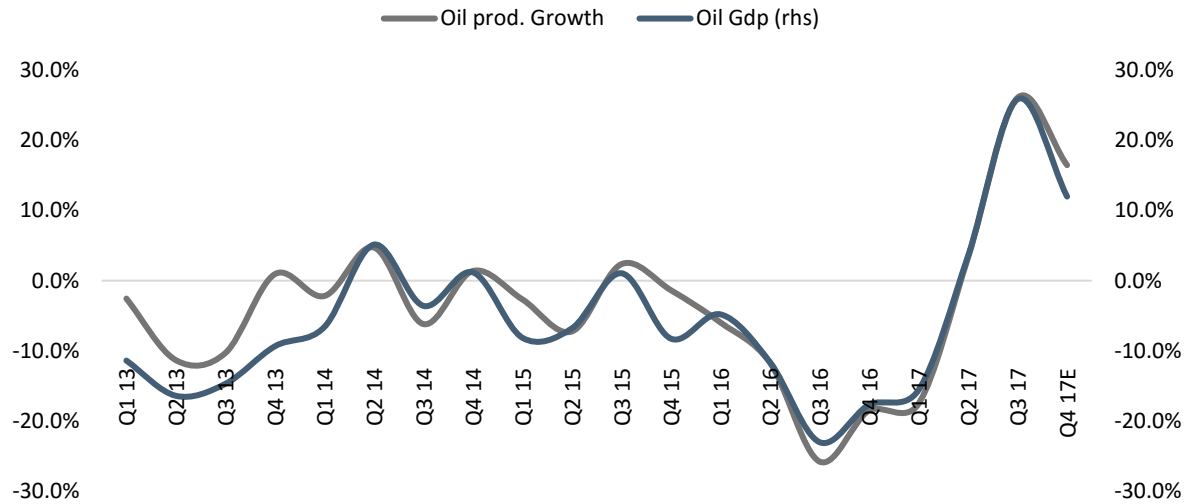
Source: NBS, ARM Research

Upturn in crude production boosts Oil GDP

Over 2016, militant attacks and insurgency in the Niger Delta region drove heightened production outages (+115% YoY to 573kbpd) with average crude oil production printing at 1.8mbpd – the lowest in over a decade. Consequently, oil GDP recorded steep deceleration over 2016 to drive an overall contraction in the economy. However, in 2017, improved reconciliation efforts between the FG and stakeholders in the Niger Delta region as well as higher amnesty payments accelerated the recovery in crude oil production. Pertinently, oil production which expanded by 26.1% YoY to 2.03mbpd² in the 3rd quarter received major boost from the lifting of force majeure on the Brass terminal (February 17) and Forcados terminal (May 17). Accordingly, extending the trend in the second quarter of the year where oil GDP expanded for the first time in seven quarters, oil output grew by 25.9% in Q3 17.

² having come off a low base of 1.6mbpd in Q3 16

Figure 2: YoY Growth in Oil GDP and Crude Production



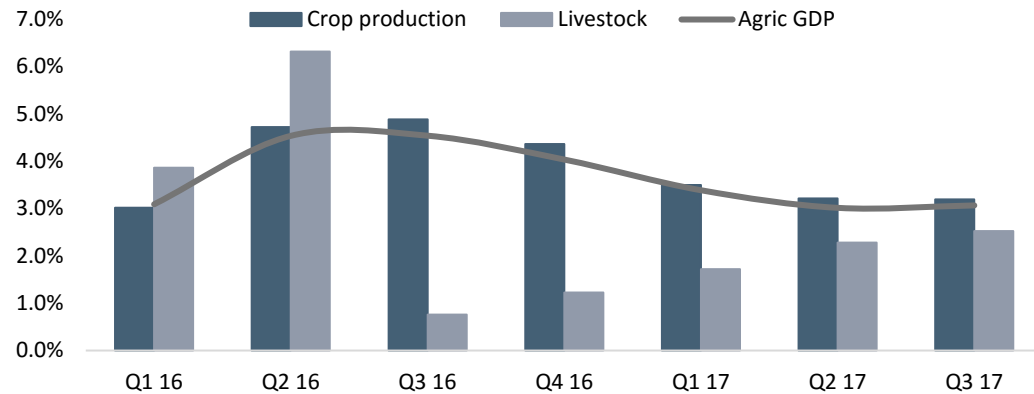
Source: NNPC, NBS, ARM Research

Agriculture sector proves its resilience

As earlier stated, the only positive on the non-oil leg was the Agriculture sector which proved resilient despite economic recession. In the third quarter, the sector grew by 3.1% YoY reflecting growth in its largest component - crop production³ (3.21% YoY) even as livestock grew by 2.5% YoY. The growth was buoyed by increased access to inputs during the growing season, cultivated land as well as favourable rainfall distribution in the southern region. Over the last quarter of the year, we still expect a sturdy growth of 3.2% with support largely from the main harvest season which started in September with FEWSNET noting average to above average harvest in the quarter. Notably, benefits from favourable rainfall and increased cultivated land during the growing season would also filter into the fourth quarter.

³ Accounts for 94% of the sector growth

Figure 3: YoY Agric GDP growth vs Crop production and Livestock



Source: NBS, ARM Research

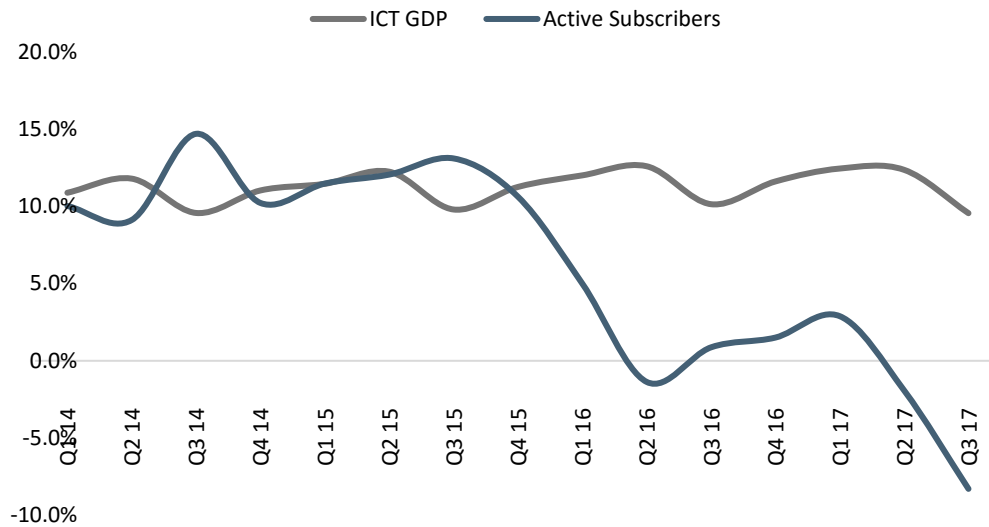
Services thrusts Non-Oil GDP into negative territory

Starting off with the largest component of non-oil GDP, Services slipped back to negative territory in the prior 2 quarters (Q2 17: -0.5% Q3 17: -3.1% YoY) after recording its first growth in Q1 17 (1.0% YoY). Our attribution analysis further reveals that the non-oil GDP would have remained positive⁴ if we assume no growth in services GDP whilst leaving the other components unchanged. The contraction in Services was largely driven by a deceleration in ICT as well as the real estate sector which jointly accounts for 50% of the output in the services sector. The ICT sector contracted for the second consecutive quarter due to slower activities in the telecoms industry. Pertinently in Q3 17, the NCC reported a decline of 8.3% YoY in subscriber base (Q2 17: -1.92% YoY). For context, MTN, the largest player in the industry reported a 5% decline in its voice calls which accounts for over 70% of total output. Furthermore, across board, telecom subscribers have continued to switch from customary cellular services⁵ to data bundles. On the other hand, the persisting downtrend in luxury building activities and urban office rentals against a backdrop of shrinking corporate profitability continued to weigh on real estate to a decline of 4.1% YoY in the third quarter of 2017. To add, the financial services bucked the positive trend in Q3 17 printing at -6%YoY which we attribute to the high base in 2016 stemming from the impact of NGN devaluation on its loan books.

⁴Non-oil GDP would have printed at 0.3%

⁵ The major driver of output in the telecoms industry

Figure 4: YoY Growth in ICT GDP and Active subscribers



Source: NCC, ARM Research

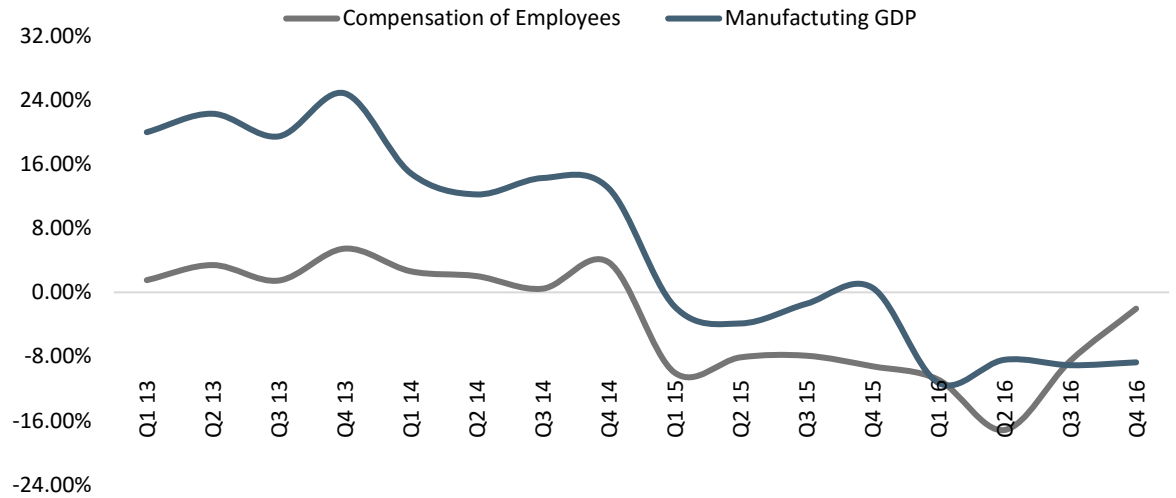
Elsewhere, after reporting two consecutive quarters of growth on the back of improved FX liquidity and economic recovery, the manufacturing sector turned the corner in Q3 17, declining 2.9% YoY. Though the major drivers of growth for the sector slowed (Q3 17; FBT⁶ 0.6% YoY and TAF⁷ 0.2% YoY), much of the weakness is attributed to a 45% YoY decline in oil refining as well as the cement sector (-4.6% YoY). The downtime in refinery operations, reflects ongoing maintenance on two refineries, as reported by NNPC. Elsewhere lower output on cement continues to reflect weak sales, a pass-through from subdued purchasing power and higher cement prices. Furthermore, notwithstanding the support from stable FX environment which boosted non-oil imports by 10.6% YoY in Q3 17, lower consumer demand underpinned by the sustained contraction in wage growth⁸ (Q4 16: -2.03% YoY) as well as higher unemployment rate (Q3 17: 18.8% Q2 17: 16.2%) further exacerbated weaker demand in the FBT and textiles segment. For the rest of the year (Q4 17), we do not expect the drastic decline in oil refining to subsist even as gains from strengthening of the currency as well as festivities is expected to drive a slight pick-up in consumer demand. Thus, we project a smaller decline in growth which is estimated at -1.8% YoY.

⁶ Food, Beverage, and Tobacco

⁷ Textiles apparel and footwear

⁸Employees' compensation has been declining since Q4 2014

Figure 5: YoY growth in employee compensation and manufacturing GDP



Source: NBS, ARM Research

Oil and Agric Output to support 2018 GDP growth story

Notwithstanding the recovery in crude oil production and resilience in Agriculture which lifted the domestic economy, we believe the structural headwinds in the Services and Manufacturing segment—a good proxy for economic productivity—serves as a caution to the optimistic outlook for the economy.

Starting off with Oil GDP where higher crude production remains the mainstay, we do not see room for any disruptions as government continues to make efforts to ensure peace and security in the Niger delta region⁹. Though the OPEC decision to cap the country’s crude production level limits any room for expansion beyond current levels, we expect crude oil production to peak at 2.2mbpd and forecast an average crude oil production of 2.04mbpd in 2018 which is 6.7% higher relative to 2017 average of 1.91mbpd. Consequently, we forecast oil GDP growth of 8.4% YoY.

On the non-oil side, we start off with the Agriculture sector. The agriculture sector is in the middle of a mid-cycle renaissance, both structurally and politically. FX-induced concerns on importation combined with the clamour for economic diversification and self-sufficiency in food production have laid the foundation for a self-sustaining recovery that could last for

⁹ ₦65 million was provided for the 2018 presidential amnesty program

a while. Consequently, we expect the sector's performance to remain robust stemming from increased government support and incentives¹⁰. Elsewhere, FEWSNET noted that rainfall levels in 2018 would be average to normal and the pest infestations are expected to have minimal impact on aggregate staple production. On this premise, we forecast a 3% YoY growth in the Agriculture sector over 2018.

Away from the agriculture sector, we also see room for a soft growth of 0.9% and 0.8% YoY in the manufacturing and trade sector accordingly underpinned by currency stability as well as the prospects for a wage increase in the coming year which points towards an improved consumer demand and spending. On oil refining and cement, increased FG commitment to revamp the local refineries as well as lower cement prices, higher gas supply and spending by both state and federal government remain the crux for growth in the two subsectors.

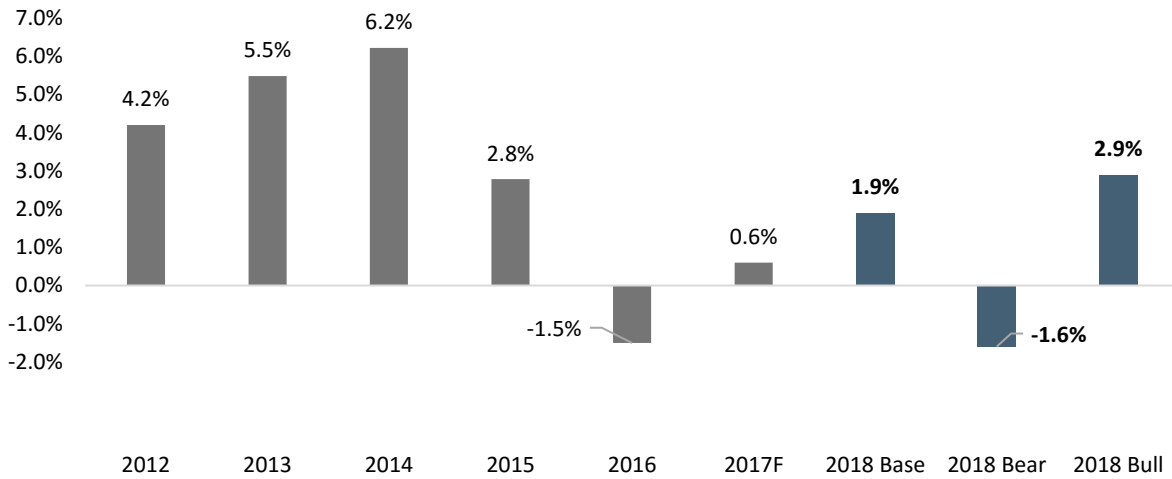
Given the low base in Services over 2017 and accelerated pace of internet penetration, we look for a mild growth of 0.6% YoY over 2018. This is premised on the expectation that the government would bring in more initiatives in achieving its 30% broadband penetration in the coming year which is aimed at accelerating speed internet¹¹. The tele density for internet users as at Q3 17 is currently at 66%¹², which means there are more opportunities for growth and increased likelihood of the government prioritizing growth driven policies in that segment of the telecoms business. Also, we expect a slower contraction in the real estate sector premised on our expectations for a mild pickup in demand for properties designed for middle income earners, while demand at the luxury end is expected to remain depressed. Tying our views on both the oil and non-oil component of growth, we forecast a real GDP growth of 1.9% in 2018 which is the base case.

¹⁰ The initiatives amongst others include CBN Agric lending via NIRSAL and others, presidential fertilizer initiative, import restrictions as well as the restoration of the Badagry agreement between Nigeria and Republic of Benin aimed at reducing smuggling plus other cross border crimes.

¹¹ Broadband penetration is currently at 21%

¹² Q3 Industry tele density is at 99.6%

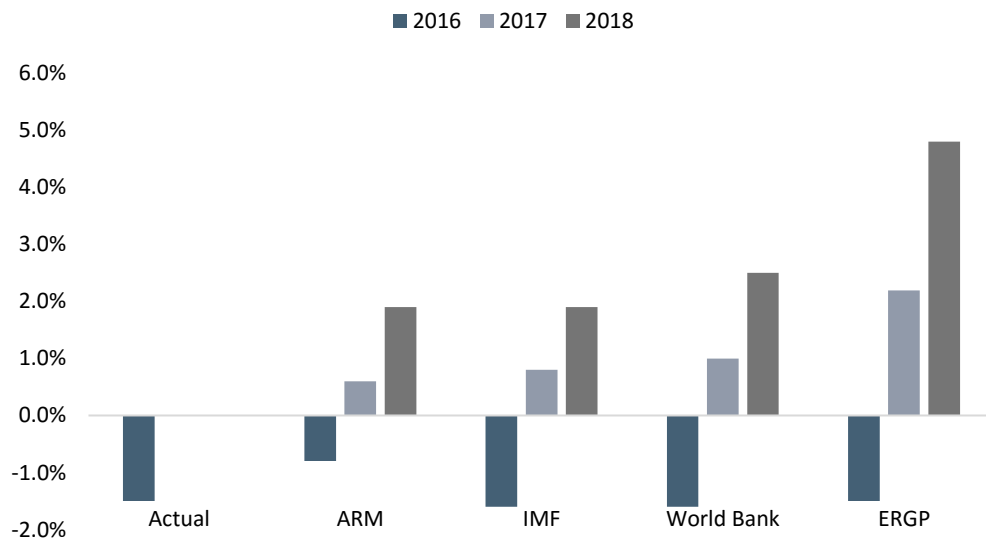
Figure 6: Annual Real GDP Growth



Source: NBS, ARM Research

In playing out other scenarios, we assume a real GDP growth of 2.9% as the bull case based on the expectation that oil production touches the 2.2mbpd and government fuels its spending with constructive sector-specific initiatives in Agric, services and Manufacturing sector. In terms of the downside, we presuppose the resumption of rebellious activities from the Niger delta militants in lieu of the 2019 elections and sustained deceleration in output from the services sector feeding into the negative forecast of -1.6%.

Figure 7: YoY overall GDP Actual & Forecast



Source: NBS, IMF WEO, World Bank report, Budget Office

Copyright © 2018 Asset & Resource Management Company Limited (“ARM”).

All rights reserved. Unauthorised use, reproduction, distribution, or disclosure of this document is strictly prohibited.

This material has been issued by Asset & Resource Management Company Limited (“ARM”), a Company regulated by the Nigerian Securities and Exchange Commission. The analyst(s) primarily responsible for preparing this research report, in whole or in part, certifies that with respect to each security or issuer covered; all of the views expressed accurately reflect his/her personal views about the subject securities and issuers and no part of his/her compensation was, is, or will be, directly or indirectly, related to the inclusion of specific recommendations or views in the report.

This research report is based on information from sources that ARM, and its analysts believe to be reliable. Neither ARM nor any of its research analysts, nor any member of the ARM Group, gives any representation or warranty, express or implied, or undertaking of any kind or assumes responsibility or liability of any kind with respect to the accuracy or completeness of the information set out in this report or any third party’s use (or the results of such use) of such information. This report is provided solely for informational purposes and is not to be construed as providing advice, recommendations, or endorsements of any kind whatsoever. The investments and strategies discussed here may not be suitable for all investors; counsel of investment advisor should be obtained with regard to such investments and or strategies. This research report is not a replacement for advice from an accountant, lawyer, personal finance advisor or other category of investment advisor. The investments discussed in this report may oscillate in price or value. Opinions and information provided are made as of the date of the report issue and are subject to change without notice. This research report is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Reference herein to any specific security or financial instrument does not necessarily constitute or imply its endorsement or recommendation by ARM, its directors, officers, employees, or designated agents. Members of ARM may act as broker, advisor, or lender, or make a market in any investments or issuers referenced in this report. Further information on any of the securities discussed herein may be obtained upon request to ARM. By accepting this document, you agree to be bound by the foregoing limitations.