



VACC-INTERVENTION

**A MEDICAL AND POLICY
ANTIDOTE**

NSR H2:21 REPORT

August 5, 2021



Nigeria Strategy Report

H2 2021

Global Economy and Markets

"Growing Divergence Across Countries"

Executive Summary

March the 11th 2021 marked 1-year since the world began adopting sweeping measures to check and counter the horrendous effects of the coronavirus pandemic. Not many shocks can force policy makers to rip apart the rule book and effectively short-circuit the economic-cycle without hesitation, but not many shocks have had such an instant ripple-effect on the global economy as the Novel coronavirus. Over the past 18-months, we have seen major economies reopen, dust off the debris and embark on the most **wholesome** economic rebuilding witnessed since the 2008/2009 global financial crisis. A few others, however, alongside some emerging market economies are still feeling the far-reaching effects of the pandemic. This report x-rays the recovery efforts by some of these advanced and emerging market economies and offers some insight into the themes expected to play out over the rest of the year.

According to the IMF, Global growth is now projected at 6% in 2021 (previous projection: 5.5%), with growth in advanced economies set to print at 5.6% (previous estimate: 5.1%) and expansion in EMDE's¹ expected higher at 6.3% (previous estimate: 6.7%). The upward revision reflects additional fiscal support in a few advanced economies, anticipated vaccine-powered recovery in H2 2021 and continued adaptation of economic activity to reduced mobility. Downside risks surrounding this outlook pertain to the future trajectory of the pandemic, effectiveness of policy support measures to bridge the gap in global vaccine supply and developments in financial and labor market conditions.

In this report, we look at the major themes that dominated the global, economic, and financial landscape in H1 2021, as well as our outlook for the rest of the year.

¹ Emerging Markets and Developing Economies

US leads the way for advanced countries

A host of advanced economies re-imposed restrictive measures at the start of the year to mitigate against a fast spreading third wave of COVID-19 infections. These measures weighed on economic activities and the effects of the lockdowns were glaring in their GDP numbers. While some economies like the Eurozone and the UK have been able to kickstart economic proceedings again, others such as Japan have experienced a more protracted recovery process. Then there is the U.S, which buoyed by massive government spending and an (eventually) impressive vaccination rollout, remained resilient and recorded a 6.3%QoQ growth in the first quarter, putting any lingering fears of a covid- induced relapse to bed.

Following the 2.4%YoY dip recorded in Q4 20 which saw GDP contract by 3.5% in FY 2020, the negative growth trend was halted in the first quarter of this year as the U.S economy expanded by 0.4%YoY. Anchoring this was the strong rebound we saw in PCE² (1.8% YoY vs -2.7%YoY in Q4 20) as Americans spent more on Goods (+13.2%YoY) while staying mostly indoors, as well as further advancement in Gross Private domestic investment (5.3%YoY vs 3.7%YoY in Q4 20). Government consumption expenditure and gross investment also picked up during the quarter (+0.6%YoY). In QoQ terms, the narrative was similar as the economy grew at a quicker pace of 6.3%QoQ (Q4 20: 4.3%QoQ). PCE and Government consumption expenditure and gross investment rose by 11.4%QoQ and 5.7%QoQ respectively while Gross private domestic investment declined by 3.4%QoQ as business investment in structures fell for a sixth straight quarter. Trade remained a drag on overall performance as some of the domestic demand was satiated with imports (+9.5%QoQ) and the struggles of major trading partners in Europe and Asia saw exports tumble by 2.1%QoQ. Household's disposable income before accounting for inflation surged by a mammoth \$2.36 billion during the quarter, helping to spur the rise in PCE, the economy's biggest driver. A huge chunk of the funds received from the one-time \$1,400 direct payments embedded in the "American Rescue Plan"³ was set aside however, and this saw household savings jump by 83.1% to \$4.12 trillion in the quarter (Q4 20: \$2.25 trillion). Economists estimate that households are currently sitting on at least \$2 trillion in excess savings accumulated over the course of the pandemic. Thus, against the backdrop of massive fiscal stimulus and record saving levels, it was no surprise to see Americans increase their spending by 0.5% in April 2021 (March 2021: +4.7%) despite a 13.1% fall in consumer income (March 2021: +20.9%). While a dip in the latter was expected and reflected a halt in the one-time individual stimulus checks, the former was a clear indication of a rapidly rebounding economy and a

² Personal Consumption Expenditure

³ \$1.9 trillion economic stimulus bill signed into law by President Joe Biden on March 11, 2021

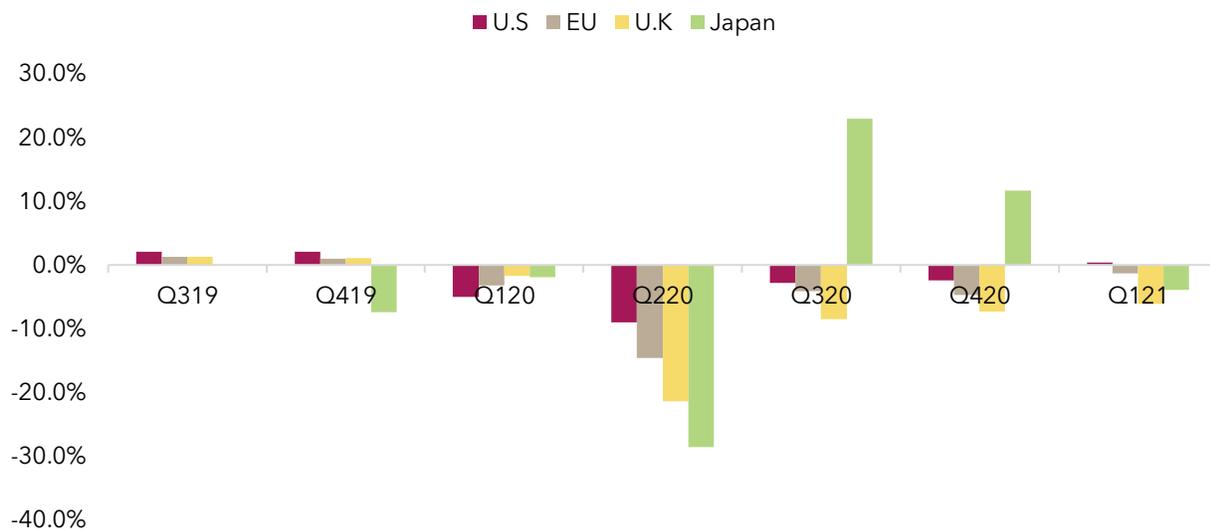
probable sign of things to come. Many argue that the latest round of fiscal stimulus checks have on one hand left households brimming with cash and on the other left a reopening economy susceptible to an onslaught of lockdown-delayed consumer spending, a perfect recipe for an inflationary boom. Such argument was only strengthened by inflation peaking at 5.4% in June (Average inflation printed at 1.90% in Q1 2021 vs 1.27% in Q4 20) the highest on record since 2008. Furthermore, inflation jitters have been a key theme of investors sentiment in H1 2021, with the Fed reserve's preferred measure of inflation affirming rising price pressures. The Personal Consumption Expenditure (PCE) index advanced to 4% in June while the core price index, which strips out volatile food and fuel prices, rose to 3.5% in the year through June, both at their highest levels since the global financial crisis of '08. The flames of recovery have also been evident in terms of employment, with the labor market on much firmer footing than it was a year ago. Unemployment rate averaged 6.17% in Q1 2021 (Q4 20: 6.8%), much lower than the 13.03% average posted in Q2 20, at the peak of the pandemic as the economy added a seasonally adjusted 1.4 million jobs during the first quarter of the year. Another useful gauge of momentum gain in the labor market is the initial jobless claims which measures the number of Americans filing for first time unemployment benefits. That metric has consistently declined over the past few months, with a fresh pandemic-low figure of 360,000 recorded in the week ended June 26th, 2021.

Recovery in the Eurozone was once again disrupted by a surge in infections, forcing governments across the bloc to reimpose lockdown measures in their countries. This saw the bloc's GDP shrink by 1.3% YoY in the first quarter of this year, the softest pace on record since the start of the pandemic. The Bloc's biggest economies; Germany (-3.1%YoY vs -3.3%YoY in Q420), Spain (-4.3%YoY vs -8.9%YoY in Q420) and Italy (-0.8%YoY vs -6.5%YoY in Q420) all recorded slower rates of contraction, while France went one step forward to record growth during the quarter (1.2%YoY vs -4.6% YoY). On a QoQ basis however, the French economy entered a double dip recession as GDP contracted by 0.1%QoQ in Q12021 (Q420: -1.5%QoQ; Q320: +18.5%QoQ), dragged mainly by the external trade sector. In France, export of goods and services fell 0.2%QoQ (Q420: +4.9%YoY) reflecting tighter restrictions in the economies of key trading partners while imports grew by 1.1%QoQ (Q420: +2.2%QoQ). Elsewhere, public consumption contracted for the second consecutive quarter, falling 0.1%QoQ (Q420: -0.7%QoQ). Across the zone, most governments have sustained or renewed their lofty job-support measures to counteract the effects of the lockdown measures. With Over 6 million jobs across the zone's leading economies backed by the furlough scheme, unemployment in the region remained largely under check during the quarter (average unemployment: 8.20% in Q1 2021 vs 8.33% in Q420).

Britain recorded a fifth consecutive period of contraction as GDP shrank by 6.1%YoY in the first quarter of the year. Lockdown measures were re-imposed to curb a rise in infections, and this saw growth in the dominant services sector slow by 6.2%YoY (Q420: -6.8%YoY), with distribution, hotels and restaurants (-13.9%YoY vs -11.7%YoY in Q420), government and other services (-7.1%YoY vs -7.1%YoY in Q420) and business services and finance (-3.1%YoY vs -4.5%YoY in Q420) all experiencing downticks. On the expenditure leg, household consumption expenditure fell at a quicker pace (-11.0%YoY vs -9.2%YoY in Q420) and gross fixed capital formation declined by 3.2%YoY during the quarter, of which business investment dipped by 16.9%YoY (Q420: -7.4%YoY). Similar to its European counterparts, the UK’s jobless rate has once again been kept down by the government’s furlough programme. Unemployment averaged 4.90% in the first quarter of this year (Q420: 5%) as the scheme, which has cost more than £60billion so far, supported in paying wages on approximately 11.5 million jobs in the first half of this year.

Following the imposition of lockdown measures in various regions, The Japanese economy shrank for the first time in three quarters as GDP contracted by an annualized 3.9% in Q1 2021 (Q4 20: +11.7%YoY). Anchoring this slowdown was a sharp decline in both demand and consumption levels, specifically household consumption (-6.0%YoY vs 9.1%YoY in Q420), private consumption (-5.8% YoY vs 9.0%YoY in Q420) and government consumption (-4.5%YoY vs 7.3% YoY in Q420). The suppressed spending level ensured that the country remained in a deflationary phase all through the quarter as inflation averaged -0.40% (Q4 20: -0.83%) while Retail sales moderated further, averaging 2.03% as against the 2.27% recorded in Q4 20. On a positive note, the jobless rate remained on a downward trajectory all through the quarter, averaging 2.80% (Q4 20: 3.03%) and printing as low as 2.60% in March 2021.

Figure 1: GDP growth in developed economies



Source: Bloomberg, ARM Research

Rubbles remain in most emerging markets

Unlike most of its emerging counterparts, China consolidated its recovery from the pandemic as the economy advanced 0.6%QoQ and 18.3%YoY (Q420: 6.5%YoY) during the first quarter of the year, the latter signaling its strongest pace of expansion in over two decades. On one hand, the record expansion was affected by incomparable factors such as low base effects of last year and an increase in working days due to staff staying put during the Spring festival. On the other hand, however, the quarter-on-quarter growth demonstrated a steady recovery of the national economy. On an industry basis, the primary industry expanded by 8.1% YoY as overall agricultural production was steady and pig production recovered significantly during the quarter. The secondary industry advanced by 24.4%YoY with industrial production rebounding steadily (+24.5%YoY) and that of manufacturing demonstrating strong growth momentum (+27.3%YoY); while the tertiary industry grew by 15.6%YoY supported by strong rebound in service sector activities, particularly transportation and real estate services which surged 32.1%YoY and 21.4%YoY respectively. Being an export driven economy, foreign trade witnessed noticeable momentum of growth and contributed positively to overall performance with exports (+38.7%YoY) outpacing imports (+19.3%YoY) to translate into a trade surplus of 759.3 billion yuan. On the price front, following two consecutive months of deflation earlier in the year, average inflation printed at -0.03% in Q1 as domestic consumption was disrupted by a resurgence in COVID cases. To remedy this, the Chinese government, as part of its “dual circulation”⁴ economic strategy, launched a series of promotional activities which included a new consumer goods expo in Southern Hainan Province, as well as in other major cities such as Beijing, Chongqing and Suzhou. This saw market sales improve markedly as total retail sales of consumer goods soared 33.9%YoY during the quarter, peaking at a healthy 34.2%YoY in March.

India happened to be the emerging nation most affected by third wave of COVID-19 infections, with the country recording a record number of daily new cases and deaths over the first half of the year. At some point in May, India recorded more cases over a 7-day span than any other country in the world, leading experts to believe that the real death toll, which was estimated at 399,000 at the time of writing, may be higher than the Indian health authorities state. During the first wave, India did a commendable job in containing the spread but as time went on, complacency and “corona fatigue” set in, particularly before events like the “Kumbh Mela”⁵ and election campaigning where social distancing

⁴ A strategy to reorient the economy by prioritizing domestic consumption while remaining open to foreign trade

⁵ A major pilgrimage and festival in Hinduism

was near impossible. Impressively, the economy posted its second straight quarter of growth since exiting a pandemic-included recession last year, expanding by 1.6%YoY in Q1 2021 (Q4 20: 0.5%YoY). On the expenditure side, private (2.7%YoY vs -2.8%YoY in Q4 20) and public (28.3%YoY vs -1%YoY in Q4 20) spending both rebounded strongly, and gross fixed capital formation rose at a quicker pace (10.9%YoY vs 2.6%YoY in Q4 20). On the production side, output for construction (+14.5%YoY), utilities (+9.1%YoY) and manufacturing (+6.9%YoY) all remained resilient while net-trade weighed on the overall performance as imports (12.3%YoY vs -5%YoY in Q4 20) rose quicker than exports (8.8%YoY vs -3.5%YoY in Q4 20). To help soften the effects of the renewed lockdown restrictions, the Reserve Bank of India announced an additional round of stimulus funding, opening a \$6.8 billion liquidity window with tenors of up to three years at the repo rate available until March 2022. The goal is to allow banks lend money to hospitals, manufacturers and distributors of COVID-19 vaccines as well as assisting micro, small and medium-sized businesses.

In Emerging Market Europe, Turkey's economy recorded its strongest quarterly growth in 3 years, advancing 7%YoY in Q1 2021. (Q4 20: 5.9%YoY). Growth was driven by industrial production and other key sectors that have recovered from their COVID-induced setbacks. The manufacturing (12.2%YoY vs 10.5%YoY in Q4 20) and services (5.9%YoY vs 4.6%YoY in Q4 20) sectors expanded further while construction activities rebounded sharply (2.8%YoY vs -12.5%YoY in Q4 20). Impressive GDP numbers aside, it wasn't all smooth sailing for the Turkish economy as President Erdogan abruptly ousted a third central bank governor in the space of two years. The dismissal of Naci Agbal, which further eroded the bank's credibility and sent the Lira to near all-time lows, came just days after a sharp interest rate hike⁶ was enacted to support the Currency and head off spiraling inflation that had risen to a two-year high at the time⁷. While the President's disdain for tight monetary policy has been well documented, his latest move perplexed markets that had praised Agbal's aggressive rate hikes, which have seen about \$20 billion of foreign funds flow into Turkish assets and led the Lira up by more than 15% against the dollar since his appointment last November.

In Russia, lockdown measures have been less far-reaching compared to many other countries and this ensured that the economy, which shrank by 0.7% YoY in Q1 2021 (Q4 20: -1.8%YoY), recorded its softest pace of contraction since the inception of the pandemic. While breakdown components were unavailable as at the time of this report, positive contributions from net-trade, sizable fiscal support and a relatively sparse service sector all contributed to the improved economic picture and helped cushion the double blow of a dip in domestic demand and a drag

⁶ Up 200bps to 19% in March 2021

⁷ Inflation stood at 16.19%YoY in March and accelerated to 17.53%YoY in June

from the OPEC-led oil production cuts. Recent indicators all point towards further recovery in economic activities with manufacturing and services PMI numbers both on an upward trajectory; unemployment rate consistently moving in the opposite direction (down to 4.9% in May 2021 from 5.9% in December 2020); and retail sales rebounding strongly – they surged 34.7%YoY in the month of May. Further underpinning the bounce back in economic activities has been rising price levels, which has seen inflation climb to a near five-year high rate of 6.02% in May and forced The Central Bank of Russia into three rate hikes so far this year, totaling a cumulative 125bps.

In Latin America, the Brazilian economy advanced by 1%YoY in Q1 2021(Q4 20: -1.1%YoY), bucking a contractionary trend that began at the tail end of 2019 and was exacerbated by the coronavirus pandemic. Growth was driven by an expansion in the industrial sector (3%YoY vs 1.2%YoY in Q4 20), specifically in manufacturing (5.6%YoY vs 5%YoY in Q4 20) while strong fixed investment (+17%YoY) during the quarter also contributed to the bounce-back. Agricultural activity rebounded sharply (5.2%YoY vs -0.4%YoY in Q4 20) and the service sector declined at a softer pace (-0.8%YoY vs -2.2%YoY in Q4 20), both aided by President Jair Bolsonaro's, initial reluctance to enact fresh lockdown measures to stem the spread of infections. Meanwhile, with international trade also recovering in H1 2021, Brazil's external trade sector helped in easing the Covid-induced strains on government revenue. Exports outpaced imports in the January to May period (+31%YoY vs +21%YoY) and this saw the country's trade surplus for the first five months of the year total \$27.5 billion, sharply up from the \$15.8 billion surplus posted a year ago. Recovery has also helped in accelerating inflation⁸, prompting the Central Bank of Brazil into aggressive rate hikes as it aims to return to neutral rates sooner than expected. The bank's COPOM⁹ delivered its third consecutive rate hike of 75bps last month, a move that raised the benchmark Selic rate to 4.25%.

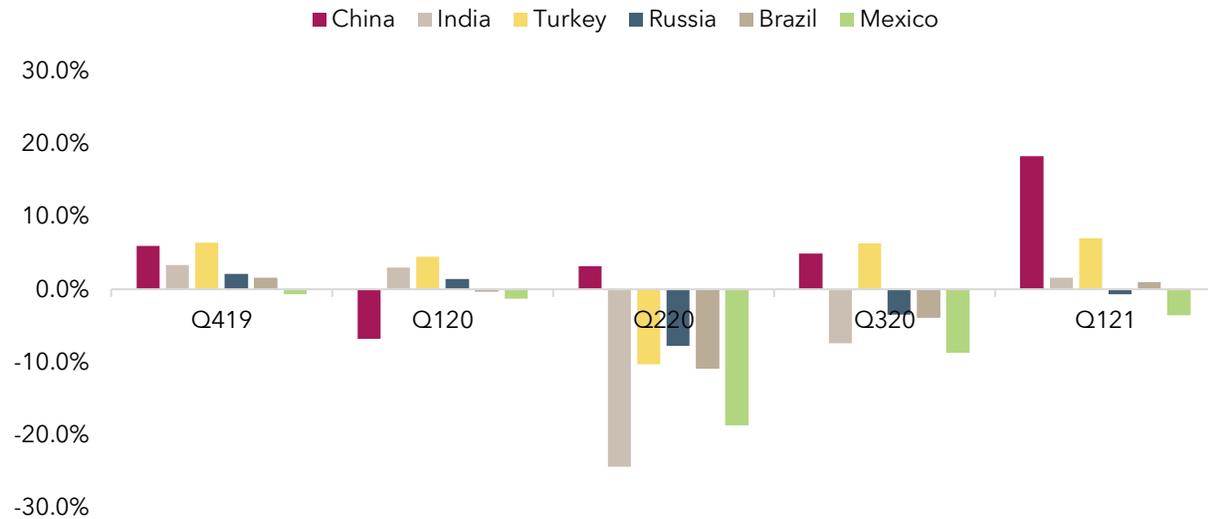
Mexico's GDP contracted by 3.6%YoY in the first quarter of 2021 (Q4 20: -4.5%YoY) owing largely to an imposition of lockdown measures across the globe. Consumer and tourism related sectors like transportation and storage (-12.7%YoY) and other recreational services (-44.9%YoY) continued to suffer while the Texas Freeze in February disrupted manufacturing activities in northern and central Mexico. Since then, however, the easing of lockdown measures and a pickup in export activities helped steer the nation's recovery train. The economy grew by 24.8%YoY in May 2021 (April 2021: +21.6YoY), reflecting expansion in both manufacturing (+36.4YoY) and services (+19.8%YoY) sectors while unemployment rate eased to 4% in May 2021 as the economy added 11.6 million people

⁸ Printed at a 45-month high of 8.35%YoY in June

⁹ Monetary Policy Committee

to the labor force during the month. In an attempt to marry rising inflation expectations with a rapidly rebounding economy, the Bank of Mexico (Banxico) delivered its first-rate hike in two-and-a half years, raising its policy rate by 25bps to 4.25%.

Figure 2: Emerging and developing economies GDP growth



Source: Bloomberg, ARM Research

New wave weighs on recovery in advanced economies

As previously stated, the level of success attained by advanced nations in containing the resurgent pandemic has varied greatly. While some seem to have put the virus in the “rear-view”, others look to be heading into some turbulent months ahead. Dithering and complacency have contributed immensely to the surge in cases seen so far this year and to this effect, most governments and central banks have deemed it necessary to maintain the sweeping stimulus measures enacted to counteract the Covid-induced disruptions and provide additional relief to those most affected by the pandemic.

Despite being the first advanced economy to approve and rollout Coronavirus vaccines, the UK was not exempted from the third wave of infections that ravaged majority of Europe. Prime minister Boris Johnson announced a third national lockdown in early January following a rapid rise in infections, hospital admissions and case rates across the country. The drastic jump was attributed to the new variant of COVID-19 which was estimated to be between 50 - 70% more transmissible and left hospitals in the UK under more pressure than they had been at any point throughout the pandemic. To boost its chances of a swift reopening, the government added the AstraZeneca/Oxford jab to its arsenal, allowing them to expand the rollout to more priority groups. This in turn saw over 39.7 million people receive at least one dose while over 26.4 million

people had received the complete dosage at the time of writing. Unsurprisingly, the number of daily new and active cases have both been in constant decline since peaking in January. The significance of the aforementioned facts and figures cannot be overemphasized as Prime Minister Johnson had repeatedly stated that the relaxation of measures will be cautious and driven by "data, not dates". In view of this, it was no surprise to see him announce plans for the lifting of restrictions as early as February with the plan staggered into four(4) phases and Key performance indicators put in place to measure the level of implementation before each stage is attained. To provide the economy with a short-term boost, Chancellor Rishi Sunak in the government's 2021 budget, extended a host of Covid-19 support measures such as the furlough scheme, reduced VAT for the hospitality sector and more generous unemployment benefits, which were all set to expire in April. In detail, the Chancellor; (I) ramped up virus-related rescue support to households, businesses and public services by a further £44.3 billion, taking its total cost to £344 billion; (II) encouraged businesses to bring forward future investment spending plans into this year and next, most notably through a temporary tax break costing more than £12 billion per year. As the economy normalizes, Sunak is expected to take steps to repair the Covid-induced damages to the nation's public finances. This would include raising headline corporation tax rate, freezing personal tax allowances and thresholds and taking around £4 billion per year off departmental spending plans, raising a total of £31.8 billion by 2025-2026.

The World Health Organization criticized Europe's "unacceptably slow" vaccine rollout and predicted that EU countries would have to impose lockdowns and other measures to compensate for the delays. Rather than a prediction, this turned out to be a spoiler as the continent was faced with a third wave of infections earlier in the year, prompting the zone's largest economies to impose lockdown or restrictive measures to control the spread. Italy, still in a state of emergency, has most parts of the country emerging from a two-month lockdown; France announced a third lockdown in March with non-essential businesses shut; Germany has enacted changes to its Infection Protection Act, granting the federal government greater control over regulations; Spain is out of lockdown but still emphasizes the use of masks in most public places. To shed light on the zone's early struggles, the EU has been involved in a running battle with AstraZeneca as the company repeatedly cut its supply to the zone amid concerns over the efficacy and safety of their vaccine. The Anglo-Swedish drug maker warned in January that it would fall short of its first-quarter commitments due to production issues, with plans to deliver only 130 out of the 300 million doses agreed by the end of June.

This pushed the European Commission to launch legal action against the company for not respecting its contract and failing to devise a “reliable” plan to ensure timely future deliveries. In reaffirming its support for the 27-member region, the ECB left its key interest rates unchanged and the governing council expects them to remain at their present levels or lower until inflation outlook robustly converges to its new 2% target. Furthermore, the bank conducted net asset purchases under the PEPP¹⁰ program at a significantly higher pace from April till June, with the program expected to last until at least March 2022 and will maintain net purchases under the APP¹¹ program at €20 billion monthly.

Once heralded as the nation with the most impressive handling of the virus, Japan now faces an uphill battle in the fight against the pandemic. Recently, Japan recorded its 700,000-positive case over the course of the pandemic, with a daily average of 4,000 - 5,000 positive cases posted during the so called “fourth wave” currently bedeviling the country. In light of this, the central government declared a third state of emergency in April, with new restrictions imposed in Tokyo, Osaka, Hyogo and Kyoto prefectures, all at the request of local leaders. A month later, 6 more regions including Hiroshima and Okayama were added to the list and the measures imposed were extended till June 20th. Adding to the country’s plight was a delayed vaccination rollout, which saw the first vaccine approval coming in mid-February while inoculation of the general public, particularly those regarded as ‘high risk’, only starting a month later. This meant Japan gained the unwanted tag of being the last advanced nation to begin vaccinating its citizens. In response to the latest state of emergency, the Bank of Japan kept short-term interest rate at a record low level and extended its pandemic relief programs, which include corporate bond purchases and special lending programs, by another six months beyond September 2021. Furthermore, policy makers revealed plans to launch a new scheme to provide funds to financial institutions that either invest in or extend loans in relation to climate change issues. On the fiscal end, Japan’s huge public debt, which happens to be the largest among advanced nations, has led the present administration to shrug off numerous calls to compile a supplementary budget in support of the Covid-ridden nation. According to Government officials, a 5 trillion-yen (\$46 billion) pool of funds has been set aside under this fiscal year’s budget to meet pandemic-related costs. The government is also banking on strong recovery in its trading partners, namely China and the US, which should translate into stronger demand for Japanese exports. The government did however pledge to boost aid to firms with large-scale facilities such as department stores and malls, with the facilities set to receive \$1,829 per building, each shop \$18 daily and movie theaters getting \$183 per screen day.

¹⁰ Pandemic Emergency Purchase Program

¹¹ Asset Purchase Program

More of the same in the coming months

In our previous report, ([NSR H1 2021 Excerpts - Global - The Road to Recovery](#)), we predicted that the approval and subsequent rollout of coronavirus vaccines would help spur a return to relative normalcy and this has so far been the case in most advanced nations of the world. Also fueling the recovery witnessed in H1 2021 was the sustained effort by fiscal and monetary authorities in ensuring the adequate flow of liquidity to financial markets. The IMF opines that saving lives and livelihoods is the most effective trigger to global recovery, stating that a faster end to the pandemic could inject the equivalent of \$9 trillion into the global economy by 2025.

That said, advanced economies, likely to spend the most in this effort, would see the highest return on public investment in modern history - attaining about 40% of the cumulative \$9 trillion gains in global GDP and roughly \$1 trillion in additional tax revenues. Looking ahead, the major downside risks stem from Japan's struggles to contain the latest surge in infections, but with vaccination now belatedly in full swing and major sporting events just around the corner, there appears to be light at the end of the tunnel for the Japanese economy. Furthermore, with additional spending planned expected to hit the US economy coupled with a steadier inoculation drive expected across Europe in the coming months, it is easy to see why the IMF upwardly revised their growth projections for advanced economies to 5.6% in FY 2021 (previous estimate: 5.1%).

In its latest report, the IMF projected a 7.0% growth outlook for the U.S in 2021, and those at the helm of affairs have acted swiftly to place the world's largest economy at the forefront of the global recovery. So, while policy makers can cite their moral and social obligation to act in the face of a global pandemic, the swiftness of their actions was in no small part born out of regrets over their handling of the last major global shock. In retrospect, their responses to the global financial crisis of '08 were seen as inadequate and rather lopsided. Lessons have been learnt and now with a "bottom-up" approach adopted, a strafe of Washington-backed spending not only pulled the economy out of its slump in quicker- than- expected time, but also placed it on the brink of a boom. On the vaccination front, the U.S missed its target of vaccinating 70% of adult Americans by July 4th, but with states flush with supply, roughly half of the U.S. population has now received at least one jab. Drug makers delivered on their promise to deliver enough shots to fully vaccinate more than 300 million people by the end of June, enough to cover the entire population for which vaccines are currently approved. Elsewhere, with over \$6 trillion in stimulus funds already expended since the start of the pandemic, Biden's latest plans show his administration has no intentions of taking its foot off the pedal. The "spend big and act

now” mantra touted during his campaign remains the order of the day and was evident in the president’s inaugural budget proposal to Congress. The \$6 trillion budget, roughly 50% higher than pre-COVID-19 federal expenditure, would ramp up spending on education and combating climate change while roughly \$1.2 trillion has been set aside separately for spending on infrastructure, although both proposals are subject to congressional approval. In the face of extensively debated risks that rising inflation poses, the Fed has stuck to its promise of keeping interest rates near zero, at least until substantial recovery is achieved in the labor market. For the most part, we’ve seen policymakers shrug off these signals, labeling the factors responsible for the upward price pressures as “transitory”. According to them, inflation is expected to rise beyond the reserve bank’s 2% target by year end, before easing. However, some Fed officials have voiced their concerns about inflation pressures building to unwelcome levels and suggested that if the economy continues to heat up strongly and is thrust into boiling point, it might be appropriate to begin discussing plans for tapering its bond purchase program in future meetings. The first of such discussions took place in the bank’s June meeting, where policy makers also penciled in two earlier-than-expected rate hikes for 2023.

With GDP growth rate in the Euro Area forecast at 4.6% in 2021 by the IMF, we expect further recovery in the zone in H2 2021, spurred chiefly by a steadier vaccination program and access to additional fiscal stimulus. Supporting our expectation is the Zone’s most recent agreement with Pfizer & BioNTech, which reserves an additional 1.8 billion doses on behalf of all EU Member States, between the end of 2021 up till 2023. The Advance Purchase Agreement will allow for the purchase of 900 million doses of the current vaccine and of one adapted to variants, with the option to purchase an additional 900 million doses at a future date. In fiscal terms, after months of parliamentary debates and judicial procedures, all 27 EU countries have ratified the legal instrument that underpins the bloc’s €750-billion recovery fund, paving the way for funds to reach national governments by July 2021. The European Commission is now in the process of scrutinizing the national recovery and resilience plans submitted by member states as these plans outline how each country intends to spend the funds, they will receive from the €672.5 billion Recovery and Resilience Facility (RRF). A note of worry for the zone comes in form of the continued dependence on furlough schemes as most European nations look set to scale back their unprecedented support in the coming months. Since March, workers on France’s furlough scheme have received a smaller proportion of their total salary and more of it has been paid by their employers. In Spain, their scheme was recently extended to run up till September 30th, 2021 and is expected to benefit just around 460,000 individuals while Italy’s scheme is also set to expire in the spring. The expiration of these programs will expose the zone’s labor market to the vicious effects of the pandemic, triggering an impending upsurge in unemployment levels.

As the UK economy reopens further and their vaccination program strengthens, the IMF predicts that the British economy will expand by 7.0% in 2021. Since its exit from the EU was announced, the British government stepped up its efforts to pivot away from Europe, build global influence and form new trading links with faster growing economies. The first of which came in form of a trade agreement signed with Japan late last year and happened to be the UK's first big post-Brexit deal. Though the accord was originally negotiated last summer, the provisions only took effect from January 1st, 2021 and is expected to boost trade between the two countries by about £15 billion. Beyond the positive impacts the deal could have on the overall economy, it also served as a stepping-stone on the UK's path to joining a bigger trading bloc, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Unlike the EU, this trading bloc does not aim to create a single market or customs union and removes 95% of tariffs between its members which include Canada, Japan and Malaysia to name a few. In June 2021, member nations agreed to allow Britain to start the process of joining the pact, a move which is expected to bring cumulative GDP of zones covered by the pact almost on par with that of the EU when completed. The major downside risk to the UK's short-midterm outlook remains the underlying tensions that exist between them and the EU. Tensions between both parties continue to simmer as both sides try to break the deadlock over Brexit checks in Northern Ireland. EU officials have accused Britain of not delivering on the pledges it made last year with regards to its dealings on Northern Ireland and the recently concluded G7 meeting offered no signs of these tensions abating.

The IMF predicts that the Japanese economy will grow by 2.8% this year, although just as seen by the government in recent months, that projection was a downward revision from the previous estimate as the country struggles to contain the virus. The emergency measures enacted came in lieu of a full lockdown and took effect just as Tokyo prepares to host the Summer Olympics. Ultimately, the consequences of this will be felt from a tourism standpoint as international spectators will be barred from attending the games and bringing in some much-needed boost to already suppressed domestic spending. On a positive note for Japan, most of its major trading partners, (i.e the US, UK and China), are doing a much better job at containing the spread of infections in their respective countries. With progress in global vaccination expected to spur international trade activities further in H2 2021, that should bode well for Japan's prospects. Furthermore, The Free Trade Agreement (FTA) signed with the British government should help in ensuring business continuity and strengthening the bilateral relationship between the two nations. The deal largely duplicates the Japan-EU FTA, including gradual elimination of British tariffs on Japanese cars by 2026 and immediate removal of its duties on most Japanese agricultural goods.

Vaccine-driven recovery on the cards, but growth expected to vary

While the path of recovery seems relatively straightforward for many advanced nations, the same cannot be said for the poorer emerging economies still grappling with a resurgence in infections and a largely underwhelming vaccination rollout. At the time of writing, enough doses had been administered to fully vaccinate roughly 14% of the global population. This translated to more than 2.1 billion doses being administered across 176 countries, with the latest rate roughly at 38 million doses a day – but the distribution of these shots has so far been lopsided. Countries and regions with the highest incomes are getting vaccinated more than 30 times faster than those with the lowest. To bridge this gap, the IMF has appealed to richer nations to step up and assist institutions such as the World Health Organization (WHO), the World Bank and GAVI¹² in the fight against the pandemic. On its own part, the Bretton-wood institution recently unveiled its \$50 billion “proposal to end the COVID-19 Pandemic” plan, which proposes the inoculation of at least 40% of the world’s population by the end of the year, with the figure rising to at least 60% by H1 2022. Elsewhere, through the COVAX¹³ vaccine-sharing plan, the US has pledged to donate 500 million Pfizer vaccines to about 100 countries over the next two years, Japan pledged 30 million doses of domestically produced vaccines and EU leaders agreed to donate at least 100 million doses. Furthermore, EU member states, as part of their latest agreement with Pfizer, have the possibility of reselling or donating additional doses to countries in dire need outside the Union. As far as monetary contributions go, countries and private donors have pledged nearly \$2.4 billion in vaccine funding which should allow COVAX secure 1.8 billion fully subsidized doses for delivery to lower-income countries over the next 18 months. The IMF, at the recently concluded G-7 summit, said it expects the group to provide “a very clear indication” of support for proposals to reallocate \$100 billion of reserve funds to aid more vulnerable countries in their recovery from the pandemic. Taking all of these into consideration, The Breton-woods institution projects a 6.3% expansion in EMDE’s in 2021, with recovery across the region expected to be vaccine-driven but divergent.

Growth in emerging and developing Asia is expected to print at 7.5% this year, with the world’s second largest economy, China, set to expand at 8.1%. The Chinese government itself set a modest economic growth target of just over 6% as it plans a careful course out of the covid-induced disruptions while also maintaining a tight lid on risk and debt appetite. Premier Li outlined plans to create over 11 million new urban jobs this year and boost annual R&D spending by more than 7% every year until 2025 while on the COVID front, China has now administered over one billion doses of COVID-19 vaccines in spite of the sluggish vaccination

¹² Global Alliance for Vaccines and Immunization

¹³ COVID-19 Vaccines Global Access

rollout across Asia. In less positive news for China, tensions between them and the US has continued to simmer, with the latter now garnering additional support from other members of the G-7. Finger pointing with regards to the origin of the novel coronavirus has been a constant theme so far this year and while China has consistently refuted claims that the virus originated in a lab in Wuhan, one of Biden's aides believes that the country risks international isolation if it fails to allow a "real" investigation into the origins of the pandemic.

Following the latest wave of COVID infections, the IMF now projects a 9.5% growth rate for the Indian economy (Previous estimate: 12.5%). The surge forced the Serum Institute of India (SII), the producers of the AstraZeneca vaccine, to halt its exports to several countries in order to meet rising domestic demand and this embargo is expected to remain in place until at least October. To limit the impact the resurgent pandemic could have on the economy in the second half of the year, the government has proposed a string of fiscal stimulus measures. Firstly, the government plans to extend a \$35 billion guarantee on bank loans to small businesses and the health and tourism sector. The limit on the guarantee on loans to businesses will be expanded from 3 trillion to 4.5 trillion rupees while visa fees for 500,000 foreign tourists would be waived to help attract tourists. Secondly, there are plans to spend an additional \$12.6 billion on providing free food grain to poor people up until November this year and \$5.78 billion on expanding health and digital network services in the current fiscal year. With the pandemic far from controlled, a particular cause for concern in India remains the spread of new variants of the COVID-19 virus. At least 20 cases have been linked to the new Delta variant and scientists fear that the presence of the variant, which was first detected in India, and a slow vaccination drive could trigger another episode of spiraling infections.

The IMF predicts a 4.9% expansion in Emerging and Developing Europe, with growth in the Russian economy, expected at 4.4% in 2021, underpinned by advancements in its vaccination program and further recovery in global oil prices and demand. OPEC+ forecasts a 6 million bpd jump in oil demand in 2021- equivalent to 6% of global consumption- as the world recovers from the pandemic and oil producers have agreed to stick to the existing pace of gradually easing supply curbs, currently at 5.8 million bpd, through July and August. Meanwhile, in what has been labeled a political move by some, President Putin announced plans to boost spending on infrastructure, education and healthcare while also proposing to extend an infrastructure loans program until 2026 alongside a \$1.4 billion pandemic recovery program. On the flip side, Sanctions from other world powerhouses provide the greatest downside risks to Russia's growth outlook. In retaliation to its political interference and other malign actions, the Biden administration

blacklisted Russian companies and barred US financial institutions from participating in the primary market for Russian sovereign bonds. The EU has also taken some stringent measures against Russia in recent times over its military dealings and alleged human right excesses. Positively for Russia however, the nation remains an important player in the global Oil market and given the pertinent role the Russian energy sector in plays Europe, most analysts opine that additional sanctions from the bloc are unlikely to have a crippling impact on the economy. Akin to most of its emerging market counterparts, Inflation, which is currently at a multi-year high, remains a glaring risk and analysts view devaluation of the ruble as a likely outcome of the aforementioned sanctions.

Finally, in Turkey, the IMF foresees a 6% expansion in economic activities this year. An acceleration in the country's vaccination program should spur recovery in the services and tourism sectors that have been most affected by the pandemic. In addition, improvements in the current account balance is expected to continue heading into H2 2021 due mainly to developments in foreign trade. The Eurozone remains Turkey's top trade partner, accounting for almost half of the country's exports, thus recovery in the zone should drive up bilateral transactions between the two.

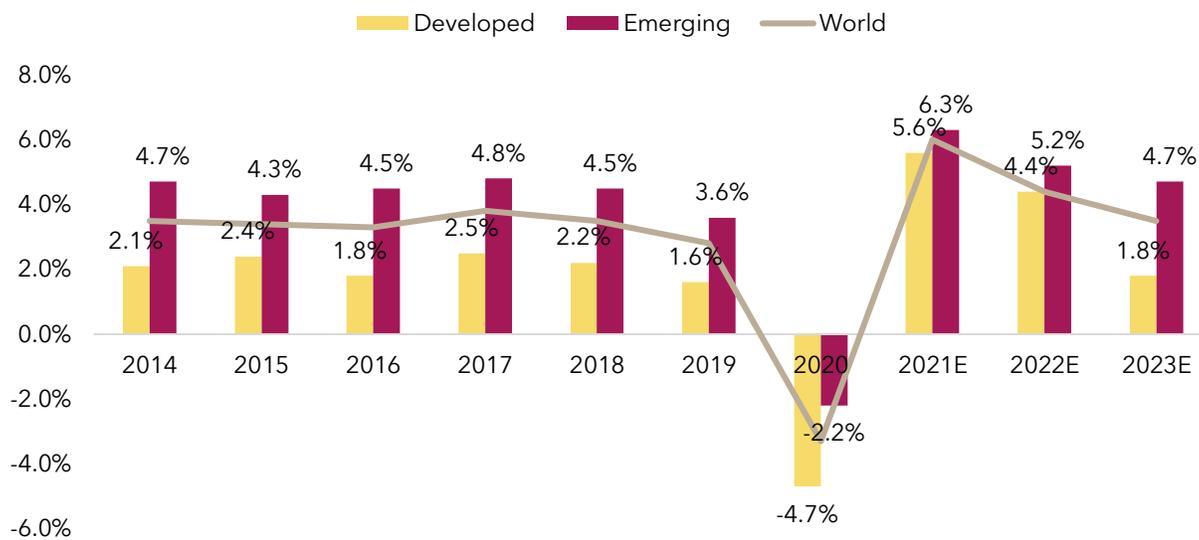
With increased vaccination efforts set to underpin recovery in H2 2021, Latin America looks poised to benefit from the US's exports of COVID-19 vaccines. The region, projected to grow by 5.8% in 2021 by the IMF, is set to receive millions of U.S-made COVID shots as the Biden administration considers prioritizing countries within its own hemisphere for the 80 million domestically made jabs. Brazil, which officially became the global epicenter of the pandemic in the first quarter of this year, is expected to grow by 5.3% in 2021 according to the IMF's latest projections. The country's vaccine rollout has so far been plagued by delays and shortages in supply and the upsurge in infections led to the cancellation of the world-famous Carnival festival and the eventual re-imposition of lockdown measures despite strong political resistance. To prevent further struggles, the government approved another \$8 billion stimulus package and announced plans to (I) channel an additional \$1.05 billion of federal spending towards the production, supply and distribution of COVID-19 vaccines; (II) Expand the "Bolsa Familia" welfare scheme to include a greater portion of the populace. The revamped program is expected to come into play either in December or early next year and could see welfare payments to the poor average between \$50-56 per month.

For Mexico, the IMF, as well as the Mexican government have both made upward revisions to the nation's outlook in recent months, premised chiefly on recovery prospects North of its Border in the U.S. Mexico has benefited greatly from stimulus spending in wealthier nations, particularly the U.S which is Mexico's top trade partner and absorbs about 80% of the nation's goods export.

That said, the Bretton-wood institution has penciled down a 6.3% growth for Mexico (previous estimate: 5.0%) while the finance ministry reckons the economy could grow by as much as 6.5% (previously 5.5%), buoyed by a gradual but steady vaccination program and stronger external demand in H2 2021.

In summary, we foresee sustained recovery in the global economy heading into the second half of the year, supported by a more inclusive global vaccination campaign, further reopening of economic sectors, additional fiscal and monetary support and increased trade among nations. While downside risks remain, particularly pertaining to the spread of new COVID-19 variants, expectations are that World financial and health institutions, alongside governments across the world, will remain proactive in the fight against the pandemic.

Figure 3: Trend in global growth and projection (%)



Source: IMF, ARM Research

Global Economy and Markets

Crude Oil: Optimistic Outlook Amidst Concerns

Executive Summary

2020 was riddled with shocks to the global crude oil market, impacting it at unprecedented degrees, on the back of oil price wars and the COVID-19 pandemic. Thus, Western Texas Intermediate benchmark (WTI) traded at a negative price for the first time in oil market history (-\$37pb in April 2020). Historic supply cuts from the Organization of Petroleum Exporting Countries (OPEC) and agreements introduced in form of the Declaration of Cooperation (DoC) to limit production by oil producing nations supported prices. Yet, Brent crude price averaged just \$43.79pb in the second half of 2020. The real watershed moment for oil prices, we believe, begun in November 2020, following two crucial events; the conclusion of the US presidential elections, and the announcement of a COVID-19 vaccine with 95% efficacy as indicated by data from phase III trials by Pharma giants, Pfizer and BioNTech. Between November and December 2020, Brent crude rose by 38.28% setting up the momentum for 2021. OPEC+ had significantly improved member cooperation pertaining to the supply limitations, and Saudi Arabia, UAE, Kuwait, amongst others were at the driving seat of influencing trader sentiment. With these, foundations for an upward trajectory in the oil market was laid, and the new year was set for a journey to a rebalanced market. In H1:2020, Brent crude rose by 45.04%, outperforming estimates and reaching a year high of \$76.18pb - the highest since October 2018.

Looking into the rest of 2021, our projections are in line with EIA's forecast of an average net deficit of 0.98MMbpd - indicating a shift from an average net surplus of 1.92MMbpd in 2020. This is following an expected net deficit of 0.12MMbpd in Q3 and Q4, reflecting the increased number of barrels poised to return to the market as OPEC output restrictions ease. The oil market has had a relatively bullish run this year with OPEC+ remaining monitoring the market and being proactive, as well as strong developments with the COVID-19 vaccination process. Brent crude reaching a high of \$76.18pb highlights the positivity that has permeated the trader sentiment; however, few downside risks however continue to cloud the outlook for oil prices. Overall, we project average oil prices could print within a range of \$61.11pb - \$71.37pb for FY2021, with our base case printing at \$67.43pb (EIA: \$68.78pb); based on our assumptions.

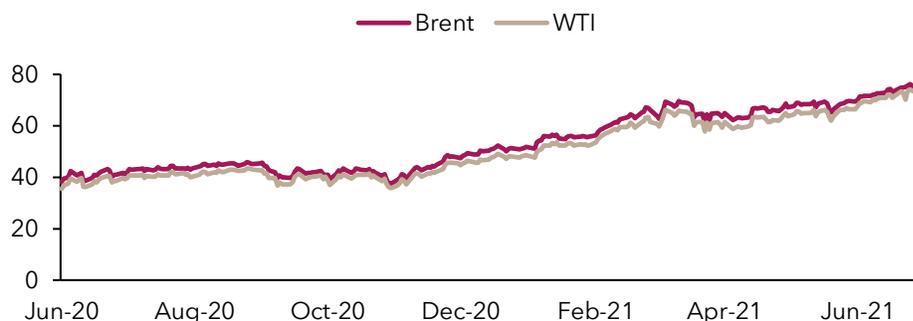
In this report, we review major drivers in Global oil markets in H1 2021 and convey our outlook for the rest of the year.

New Year, New Highs

2020 was riddled with shocks to the global crude oil market, impacting it at unprecedented degrees, on the back of oil price wars and the COVID-19 pandemic. Thus, Western Texas Intermediate benchmark (WTI) traded at a negative price for the first time in oil market history (-\$37pb in April 2020). Historic supply cuts from the Organization of Petroleum Exporting Countries (OPEC) and agreements introduced in form of the Declaration of Cooperation (DoC) to limit production by oil producing nations supported prices. Yet, Brent crude price averaged just \$43.79pb in the second half of 2020. The real watershed moment for oil prices, we believe, begun in November 2020, following two crucial events; the conclusion of the US presidential elections, and the announcement of a COVID-19 vaccine with 95% efficacy as indicated by data from phase III trials by Pharma giants, Pfizer and BioNTech. Between November and December 2020, Brent crude rose by 38.28% setting up the momentum for 2021. OPEC+ had significantly improved member cooperation pertaining to the supply limitations, and Saudi Arabia, UAE, Kuwait, amongst others were at the driving seat of influencing trader sentiment. With these, foundations for an upward trajectory in the oil market was laid, and the new year was set for a journey to a rebalanced market. In H1:2020, Brent crude rose by 45.04%, outperforming estimates and reaching a year high of \$76.18pb - the highest since October 2018.

Aiding the rebalancing in the oil market was the improvement in the global economy, following a pandemic induced slow down. With developments in vaccine administration and dispensation globally, lockdown measures began to ease and oil-intensive sectors such as transportation and travel experienced a gradual rebound in their activities, improving petroleum demand. In addition, global oil inventory levels which were principal in suppressing crude oil prices last year rose by 1.2 billion barrels between January and May 2020 but declined by 0.8 billion barrels between June 2020 and June 2021, according to the Energy Information Administration (EIA). Moreover, while global liquid fuels inventories advanced by 6.3MMbpd in H1:2020, it declined at an average rate of 2.1MMbpd in the second half of 2020 and the first half of 2021.

Figure 1: Brent and WTI prices (\$/bbl.)



Source: Bloomberg, ARM Research

Tightened Taps Loosen

In the first six (6) months of 2021, global supply averaged 93.87MMbpd, a 2.14% increase from H2:2020 average levels (91.90MMbpd). This was following an increase in both OECD¹⁴ and Non-OECD supply, according to data from the EIA.

Although there was increase in average supply across the globe, numbers out of the former Soviet Union, inclusive of Russia, were outstanding as average supply from the region in H1:2021 rose to 13.51MMbpd (vs. 12.93MMbpd in H2:2020). Leading oil producer, Russia, hiked crude oil supply especially in April 2021 where its OPEC agreement quota rose by c. 0.13MMbpd. OPEC+ reached a deal on the 1st of April to gradually boost production between May and July, adding a total of over 2MMbpd to global supplies allowing Russia to add 130,000bpd each month in this period, ultimately bringing the country's production to 10.4MMbpd in June. Russia has also proven ability to restore idle production on very short notice, with capacity to boost supply by c. 0.7MMbpd within six (6) months to a year.

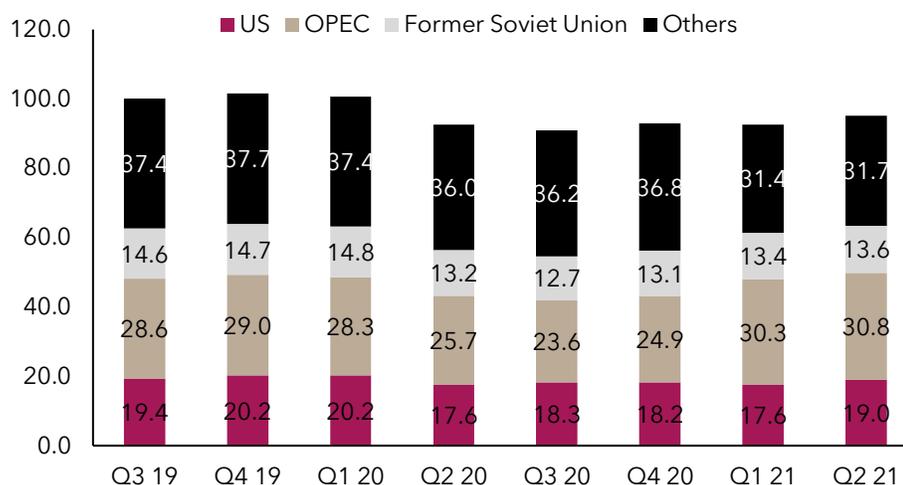
OPEC's average supply also rose by 4.25% between H2:2020 (29.33MMbpd) and H1:2021 (30.58MMbpd) as quotas rose across board, even with Saudi Arabia committing to voluntary cuts of 1MMbpd between February and April. However, the Kingdom added back 0.35MMbpd in May and plans to raise its supply by another 0.4MMbpd in July.

Canadian average crude oil production also rose by 4.19% between 5.24MMbpd in H2:2020 and 5.46MMbpd in H1:2021. With the third largest reserves in the world, Canada's top oil province Alberta averaged 3.62MMbpd in March, making it the highest March production on record. This reflects that the delays to critical transportation infrastructure and production logistics in Canada caused by the effects of COVID-19 pandemic have begun to wane.

However, while most regions recorded increases in average supply, the US printed a marginal decline over the period, falling by 0.15% from 18.31MMbpd in H2:2020 to 18.28MMbpd in H1:2021. After a deep freeze in February that shutdown the oil industry in Texas, shale operators are more inclined to increasing cash flow return to investors this year than raising supplies. This is as we suggested in our last Strategy report.

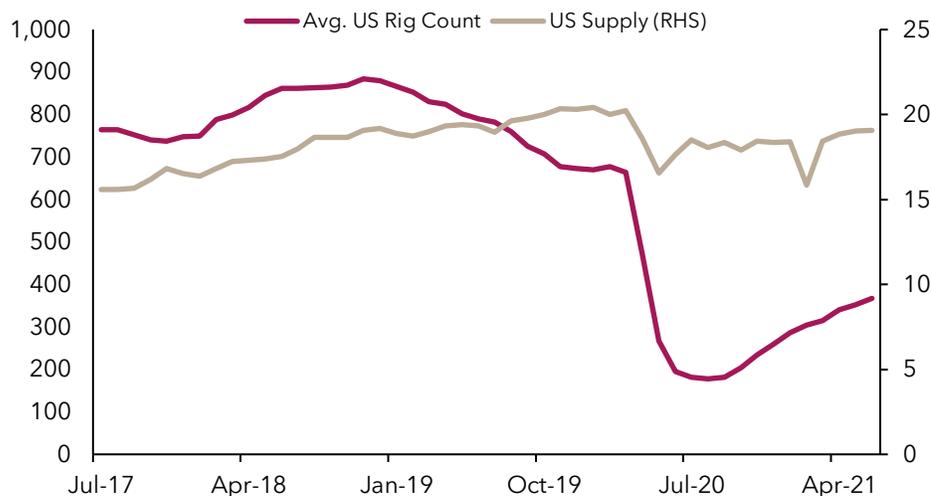
¹⁴ Organization for Economic Co-operation and Development. An intergovernmental economic organization with 38 member countries, including Germany, France, and Switzerland

Figure 2: Global supply (MMbpd)



Source: EIA, ARM Research

Figure 3: US Average rig count vs. US Supply (MMbpd) (RHS)



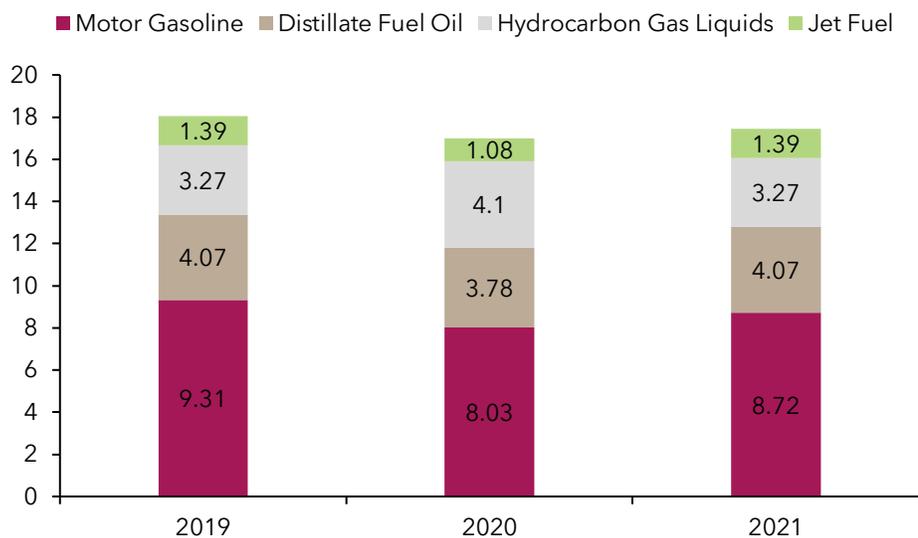
Source: Baker Hughes, ARM Research

Increased Activity Spurs Demand

On the demand front, the pick-up in economic activity following the easing of various COVID-19 lockdown measures were adequately reflected in consumption numbers as average

consumption in H1:2021 came in at 95.62Mbpd; 1.25MMbpd more than H2:2020's average. The ongoing market recovery allowed nations like the US Virgin Islands and Philippines bring US territories' oil demand to an average of 0.19MMbpd in H1:2021 from an average of 0.16MMbpd in H2:2020 - a 16.80% rise. The EIA's Other OECD nations classification also realized a 5.98% increase in consumption H2:2020 to 6.05MMbpd in H1:2021. Improved vaccine administration also helped underpin robust economic activity in countries like Mexico and Australia. Refining runs also increased following an ease in social distancing measures around the world, with the International Energy Agency (IEA) estimating global refining throughput to have increased MoM by 1.6MMbpd in June 2021 - the largest MoM increase since July 2020 at the peak of lockdowns around the world. Average consumption in the US rising to 19.10MMbpd in H2:2020 from 18.53MMbpd in H1:2020 is also testament to the aftereffects of the stimulus packages and vaccination efforts for the US government. Stockpiles in Oklahoma and Cushing depleted by over 5 million barrels in June, as the demand rebound outpaces production.

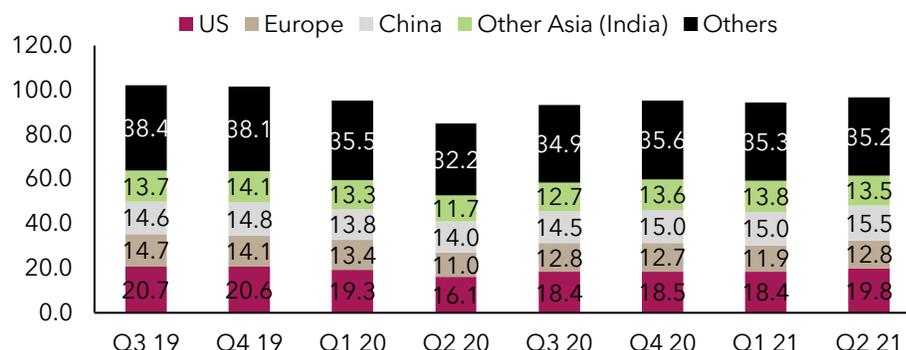
Figure 4: US fuels consumption (MMbpd)



Source: EIA, ARM Research

Whilst the rising consumption levels have incited some US producers to boost drilling activity, with US rig count growing for 11 consecutive months by June 2021, the drilling rate is not sufficient. Consumption from India also improved despite its battles with the lingering COVID-19 pandemic in the region. Asia's third largest economy's increased industrial activity and auto fuel demand spurred refineries which were undergoing maintenance in 2020 to return to the gasoline market. India's average demand in H1:2020 came in at 13.65MMbpd - 0.54MMbpd more than in H2:2020.

Figure 5: Global demand (MMbpd)



Source: EIA, ARM Research

Stagnation with the Nuclear Deal

Following the election of Joe Biden as the US President, expectations were that a more diplomatic hand under the Democrat’s administration could see Iran and the US close out on the Joint Comprehensive Plan of Action (JCPOA), also known as the Iran nuclear deal. This would ultimately facilitate an easing of sanctions on Iranian exports, potentially paving the way for millions of barrels of Iranian crude oil to return to the market. Iran has been exempted from OPEC’s plans, considering its US sanctions, and another layer of factor which could complicate matters for the cartel is that Saudi Arabia are rivals to Iran. The influx of Iranian supply into markets if the US penalties are removed could negatively impact prices if OPEC continues its path of easing supply restrictions and the Iranian Ministry of Petroleum has expressed its readiness to raise crude production to 6MMbpd expeditiously should the sanctions be lifted (Iran currently produces c.2.5MMbpd). There have been six rounds of talks between the US and Iran for negotiations pertaining to the JCPOA, but Tehran has ramped up its nuclear activity past the deal’s limits, in what appears to be a protest against the sanctions. We expect this protest, alongside the sanctions imposed on the President elect Ebrahim Raisi to further delay an agreement between all parties involved.

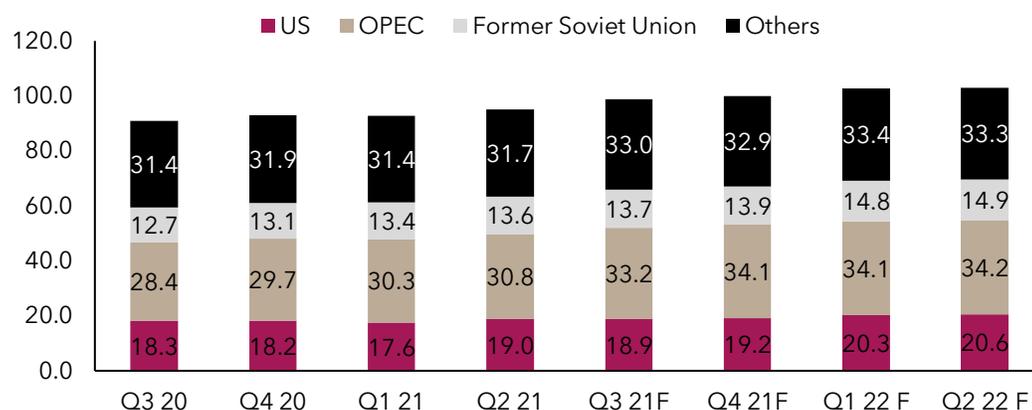
The oil market has however not been phased by the prospects of the deal materializing or otherwise. Brent crude oil has returned +45.04% in H1:2021 and traders appear to be more focused on the promising demand levels, especially within the summer months. Whether Iran will accept a production quota if brought back into the market or seek to maximize its market share to compensate for lost time is yet to be seen, but the projected contribution from Iran on its own should not be enough to push oil markets back into surplus this year.

Switch to a Deficit Despite Increased Supply

The EIA estimates average supply for Q3:2021 will come in at 98.83MMbpd - the fastest QoQ growth rate expected this year, as August should see Russia and OPEC members raise productions quota's by significant amounts. There has already been a tiff within the cartel as the United Arab Emirates (UAE) rejected the plans to increase oil production by around 0.4MMbpd in monthly installments starting from August until the remaining supply restrictions were relaxed. This led to OPEC abandoning talks for the short term, and whilst that sprinkled some uncertainty amongst traders, the supply increase is imminent.

Global supply is also expected to come in at 99.39MMbpd in H2:2021 - 5.88% more than in the first half of the year. Breaking it down, OPEC supply is expected to rise the fastest and come in at 33.63MMbpd in H2:2021 - 9.97% more than in H1:2021, as the cartel should remain on its path of easing production cuts and seek to meet up with the rising demand. Non-OECD nations are also expected to record growth in average production levels in H2:2021, particularly in the former Soviet Union (+0.16MMbpd).

Figure 6: Supply forecast (MMbpd)



Source: EIA, ARM Research

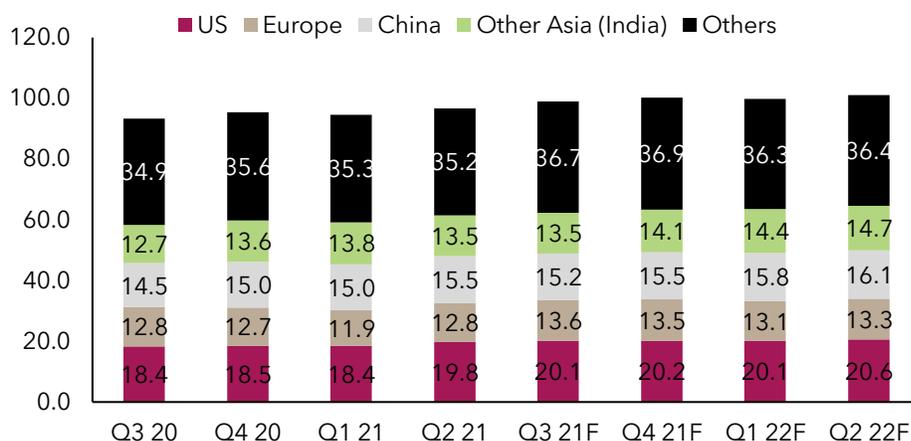
Demand Prospects Not Quite at 2019 Levels, but Better Than 2020

On the demand side, as countries around the world return to normal business activities, we expect to see a rise in refinery activity, travel, transport, and industrial activity, driven by a demand for oil and its resultant products. Consequently, Q3:2021 and Q4:2021 average demand is expected to come in at 99.04MMbpd and 100.15MMbpd respectively. In addition to the summer driving season in the US which increases demand for gasoline, global demand for heating fuels rise owing to the winter seasons in the fourth quarter.

Considering this, demand is expected to grow by 4.16% (3.98MMbpd) through H2:2021 to 99.60MMbpd, from 97.90MMbpd in H1:2021 of. Despite this projected increase, we still anticipate a 2.03% (2.02MMbpd) shortfall in comparison to pre-COVID levels (101.62MMbpd, H2:2019), but 5.25% (5.23MMbpd) higher than 94.37MMbpd in H2:2020.

Delving further into the numbers showed the European region to have the biggest boost in average demand in H2:2021 (+1.18MMbpd), followed by the US (+1.06MMbpd). China and India are also expected to increase average demand in the second half of the year by 0.11MMbpd and 0.14MMbpd respectively. Japan alone is expected to witness a drop in average demand by 90,000bpd in H2:2021 reflecting the country’s risk to consumer inflation and import costs.

Figure 7: Demand forecast (MMbpd)



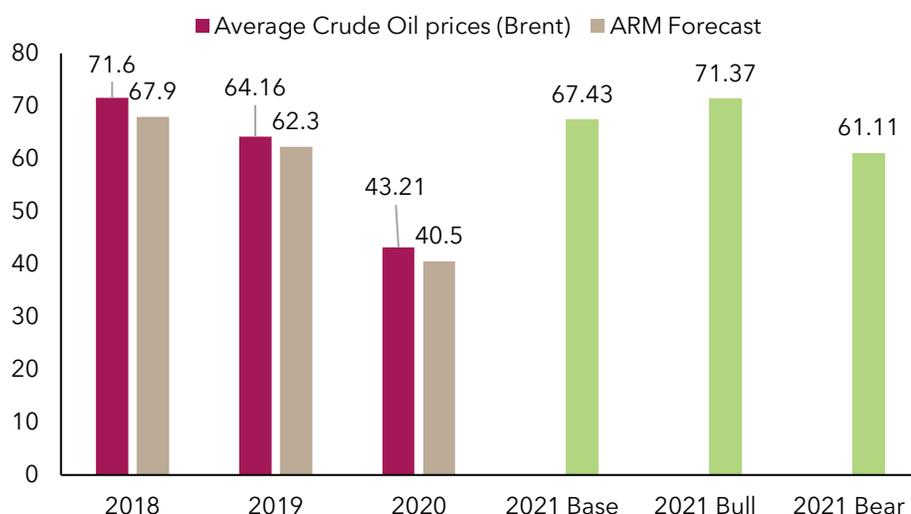
Source: EIA, ARM Research

Optimistic Outlook Amidst Concerns

Looking into the rest of 2021, our projections are in line with EIA’s forecast of an average net deficit of 0.98MMbpd - indicating a shift from an average net surplus of 1.92MMbpd in 2020. This is following an expected net deficit of 0.12MMbpd in Q3 and Q4, reflecting the increased number of barrels poised to return to the market as OPEC output restrictions ease. The oil market has had a relatively bullish run this year with OPEC+ remaining monitoring the market and being proactive, as well as strong developments with the COVID-19 vaccination process. Brent crude reaching a high of \$76.18pb highlights the positivity that has permeated the trader sentiment. A few downside risks however continue to cloud the outlook for oil prices. Concerns over the spread of the new COVID-19 variant, Delta, has worsened fears of a setback to oil demand.

In addition, the potential return of Iranian exports to the market could place downward pressure on prices. In recent periods, we have seen how lockdown measures and rising costs caused slower factory growth in China, and this could influence trader’s perspective on the market. On the flipside, however, should demand reach H2:2019 levels, the expected deficit could widen and fears pertaining to Iran could be at least delayed, considering the relationship the President-elect, Ebrahim Raisi has with the US. OPEC’s commitment to supporting the market also shines a light as economies across the globe drive in the full throttle, post the COVID-19 era. The compliance levels have been encouraging - unlike in the past and allows the cartel more influence within the market. Overall, we project average oil prices could print within a range of \$61.11pb - \$71.37pb for FY2021, with our base case printing at \$67.43pb (EIA: \$68.78pb); based on our assumptions.

Figure 8: Oil price forecast in \$/bbl. (Base, Bull and Bear)



Source: Bloomberg, ARM Research

Global Economy and Markets

EM Portfolio flows: Is there Respite in Sight?

Executive Summary

Contrary to our expectation of increased Foreign Portfolio Inflows (FPI) into the domestic economy, hinged on the rollout of COVID-19 vaccines, a higher yield environment, higher crude oil prices and thus less pressure on the currency, amongst other factors, foreign portfolio inflows have further thinned out so far in 2021. Nonetheless, domestic investors have increased their participation in the market, reflected by a 6.74% increase in the value of transactions carried out YtD. According to data from the Nigeria Exchange Group (NGX), the value of foreign transactions carried out in the equities market dipped by 49.13% YtD, while domestic transactions grew by 37.56%, championed by institutional investors. As at May 2021, total FPI inflows to the equities market YtD had dipped to NGN91.32bn, compared to NGN104.68bn in 2020.

Going into the second half of the year, the current trend of net portfolio outflows is expected to remain, hinged on similar factors which have kept foreign investors away. Considering the current state of the macroeconomic environment, insecurity and political instability across the country and the possibility of regulatory pronouncements forcing investors to remain in the system beyond desirable periods, the outlook for foreign inflows is not encouraging. However, With the economy on a rebound from the recession, vaccinations spreading across the country and the globe, a general pick up in business activity and strong positive expectations for crude oil, investor sentiment in the market could stir up, making the market seemingly more attractive to investors.

In this report, we look at the major themes that dominated portfolio flows to EM over H1 2021 as well as our outlook for flows to EM over the rest of the year.

Is there Respite in Sight?

Contrary to our expectation of increased Foreign Portfolio Inflows (FPI) into the domestic economy, hinged on the rollout of COVID-19 vaccines, a higher yield environment, higher crude oil prices and thus less pressure on the currency, amongst other factors, foreign portfolio inflows have further thinned out so far in 2021. Nonetheless, domestic investors have increased their participation in the market, reflected by a 6.74% increase in the value of transactions carried out YtD. According to data from the Nigeria Exchange Group (NGX), the value of foreign transactions carried out in the equities market dipped by 49.13% YtD, while domestic transactions grew by 37.56%, championed by institutional investors. As at May 2021, total FPI inflows to the equities market YtD had dipped to NGN91.32bn, compared to NGN104.68bn in 2020.

Further analysis of the data however revealed a significant ease in outflows; NGN107.22bn in 2021 from NGN235.61bn in 2020. Net FPI outflows thus eased as well to NGN15.90bn from NGN130.93bn. While we commend the reduction in net outflows, we also acknowledge the slowdown in inflows from NGN104.68bn in 2020 to NGN91.32bn in 2021.

The decision of foreign investors to refrain from the domestic market has not come as a shock, considering the deteriorating state of other macroeconomic variables, worsened by increased adverse regulatory pronouncements and heightened insecurity in the country. Weighing these risks in comparison to alternative investment options available to foreign investors, it is no surprise foreign portfolio inflows have continued to thin out. Recall in 2020, the Central Bank of Nigeria issued a directive which restricted the repatriation of funds by foreign investors, essentially trapping them in the domestic market. A singular directive which has pushed new investors away from the market, despite the high and attractive rates in the OMO market.

Going into the second half of the year, the current trend of net portfolio outflows is expected to remain, hinged on similar factors which have kept foreign investors away. Considering the current state of the macroeconomic environment, insecurity and political instability across the country and the possibility of regulatory pronouncements forcing investors to remain in the system beyond desirable periods, the outlook for foreign inflows is not encouraging. Furthermore, the performance of the equities market which has been largely unimpressive, -5.87 YtD% as June 30th, 2021, has not done much to attract or retain investors. This is further compounded by the dearth of new listings in the market, alongside a generally bleak outlook on possible drivers of a turnaround in market performance.

However, just as the equities market turned around in the second half of 2020, we do not rule out the possibility of a turnaround in 2021 as well. With the economy on a rebound from the recession, vaccinations spreading across the country and the globe, a general pick up in business

activity and strong positive expectations for crude oil, investor sentiment in the market could stir up, making the market seemingly more attractive to investors.

Domestic Economy and Policy Environment

Gross Domestic Product H1 2021 - Second recession in 5 years

Executive Summary

Nigeria recorded its second recession (-1.92%) in 5 years in 2020 representing the worst performance in more than two decades following two consecutive quarters of negative growth in Q2 and Q3 2020. The economy suffered downturn resulting from the double-whammy of effect of the pandemic on oil prices and oil supply reduction to support prices. The oil sector contracted 8.89% as oil production declined to 1.8mbpd from 2mbpd in 2019 in compliance with OPEC+ supply cut. The non-oil sector also reported a 1.25% contraction in 2020 (2019: 2.06%) owing to dampened economic activities on account of the various lockdown measures introduced in major commercial cities to curb the spread of COVID-19. Services sector, the largest non-oil GDP component, declined 2.22% in 2020 as Transportation & Storage contracted 22.26%, still on the back of lockdowns and restrictions. Agriculture (+2.2%) with a contribution of 24.45% to GDP grew in 2020 on the back of growth in Crop production (+2.2%) and Livestock (+1.9%) and was the only component of non-oil GDP that reported positive performance.

In Q121, GDP grew by a faint 0.51% as the non-oil sector rebounded by 0.79% due to a surprising 3.4% growth in the Manufacturing sector and improvement in 8 other sectors. Agriculture posted a 2.28% despite the dampened production recorded on the back of insecurity in the food-producing region. Services sector was the only component of non-oil GDP that remained in contraction in Q121, down 0.39%. The oil sector, however, remained in contraction as oil production remained below the exceptional Q120 levels of 2.07 mbpd at 1.72 mbpd.

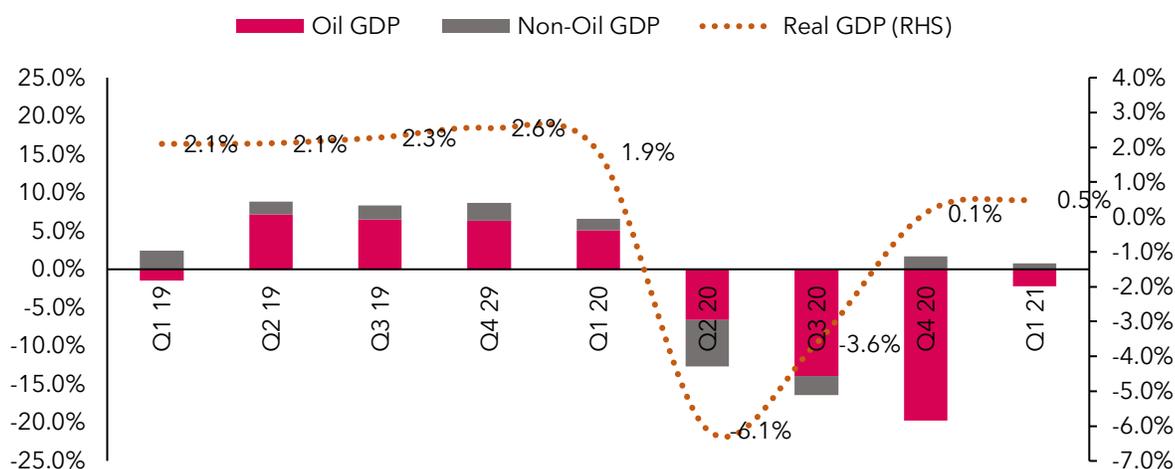
For FY2021, the IMF expects Nigeria to return to pre-recession growth levels and inch higher by 2.5% as the economy recovers from the pandemic woes and this is in line with our projections of 2.4%. The growth is hinged on base effects, recovery in oil exports and prices as well as improvement in domestic demand.

In this report, we focus on development in the domestic environment, highlighting our views on the drivers for growth over H2 2021.

GDP Performance in FY2020... Second Recession in 5 Years

FY2020 GDP growth printed negative at -1.92%, following two consecutive quarters of decline and representing the second economic recession in 5 years, the worst performance in more than 2 decades. It was, however, unsurprising considering the effect of the pandemic on economic performance globally as the global economy contracted by 4.4% in 2020. As gloomy as it seems, the 1.92% contraction came in better than projected (IMF had projected -3.2% in its January outlook) especially considering the double-whammy effect of the pandemic on oil prices and oil supply reduction to support prices. This performance reflects the two successive negative growth recorded in Q2-Q320 at the peak of the pandemic notwithstanding the marginal recovery (+0.11%) in Q420.

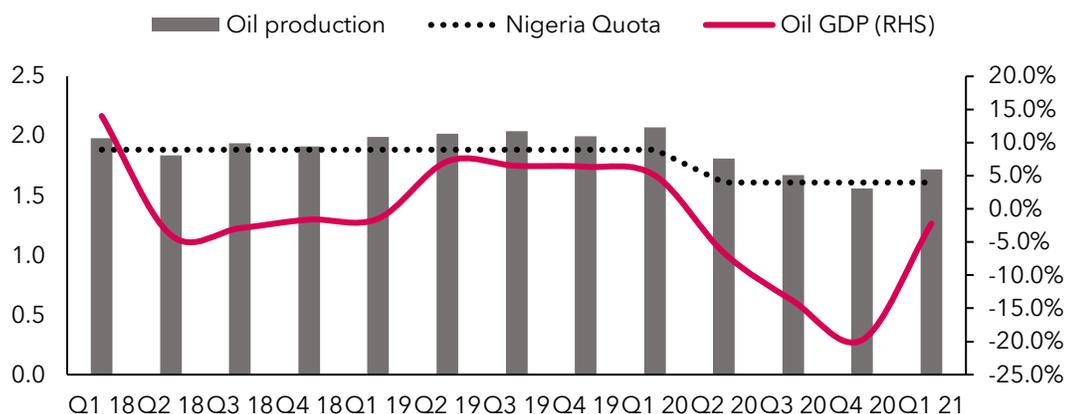
Figure 1: Growth in Real GDP vs contribution from Oil and Non-oil sectors



Source: NBS, ARM Research

In the oil sector, growth came in at -8.89% on the back of the OPEC+ agreement to reduce production volumes which saw average oil production decline to an average 1.8 million barrel per day (bpd) compared to an average of 2million bpd in 2019. Nigeria had initially classified Agbami field as condensates and stepped up volumes, however, OPEC rejected the classification and Nigeria had to effect deeper production cut towards the close of the year in compliance. Hence, the oil sector reported negative growth from Q2 through Q420.

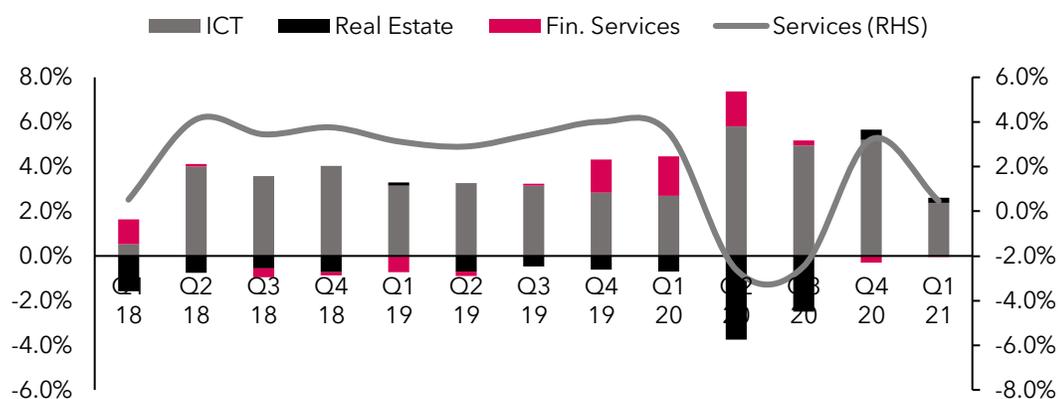
Figure 2: Trend in oil production vs Nigeria's Quota and oil GDP



NBS, ARM Research

The non-oil sector also reported a 1.25% contraction in 2020 (2019: 2.06%) owing to dampened economic activities on account of the various lockdown measures introduced in major commercial cities to curb the spread of COVID-19. Performance across sectors in the non-oil economy was mixed. Services sector, the largest non-oil GDP component, declined 2.22% in 2020 as Transportation & Storage contracted 22.26%, still on the back of lockdowns and restrictions. On the bright side, the resilient Information and Communication (ICT) sustained its double-digit growth track record with a 12.90% growth (2019: 11.08%). The superior performance was mainly driven by telecoms services, on the back of increased service demand during the lockdown period. Financial institutions and Insurance sector also recorded an impressive 9.37% growth, boosted by a 13.34% growth in financial institutions and this may be due to the increased loan drive from the apex bank.

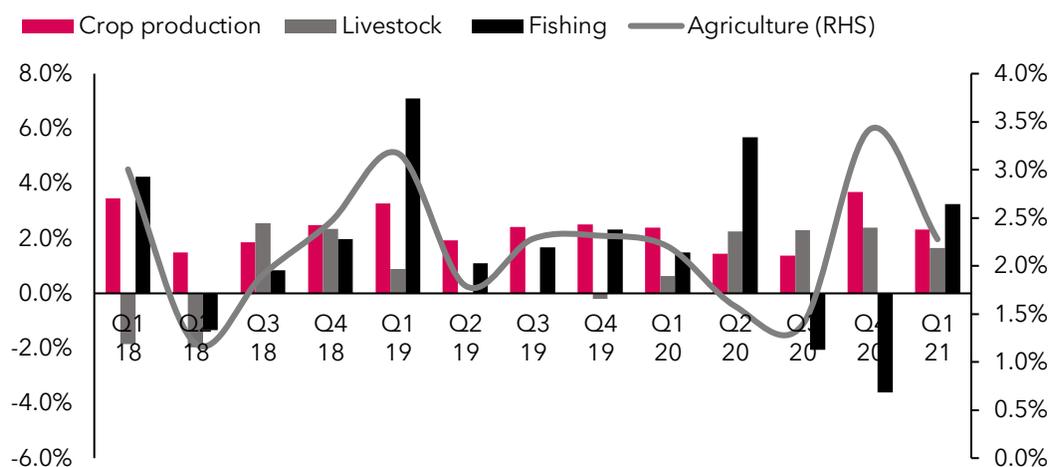
Figure 3: Attribution analysis of services GDP sector and key sub-components



Source: NBS, ARM Research

Agriculture (+2.2%) with a contribution of 24.45% to GDP grew in 2020 on the back of growth in Crop production (+2.2%) and Livestock (+1.9%) and was the only component of non-oil GDP that reported positive performance. On the flip side, real estate and trade posted lackluster performance of -9.22% and -8.49% respectively from contractions of -2.36% and -0.38% in 2019. The Manufacturing sector was not spared as it contracted by 2.75% in 2020 dragged by negative performance in the main sub-sectors including Oil refining (-62.22%), Electrical and Electronics (-16.48%) and Textile, Apparel and Footwear (-7.59%).

Figure 4: YoY Agric GDP growth vs Crop production, Livestock & Fishing



Source: NBS, ARM Research

Q12021 GDP... Fragile Post-recessionary Growth

In the first quarter of 2021, economic growth came in at a faint 0.51% representing the second-consecutive quarter of positive performance, post-recession, but contrary to expectations given economic realities at that time. Again, the oil sector remained in recession, contracting by -2.21% (Q120: 5.06%) as oil production remained below the exceptional Q120 levels of 2.07 mbpd at 1.72 mbpd.

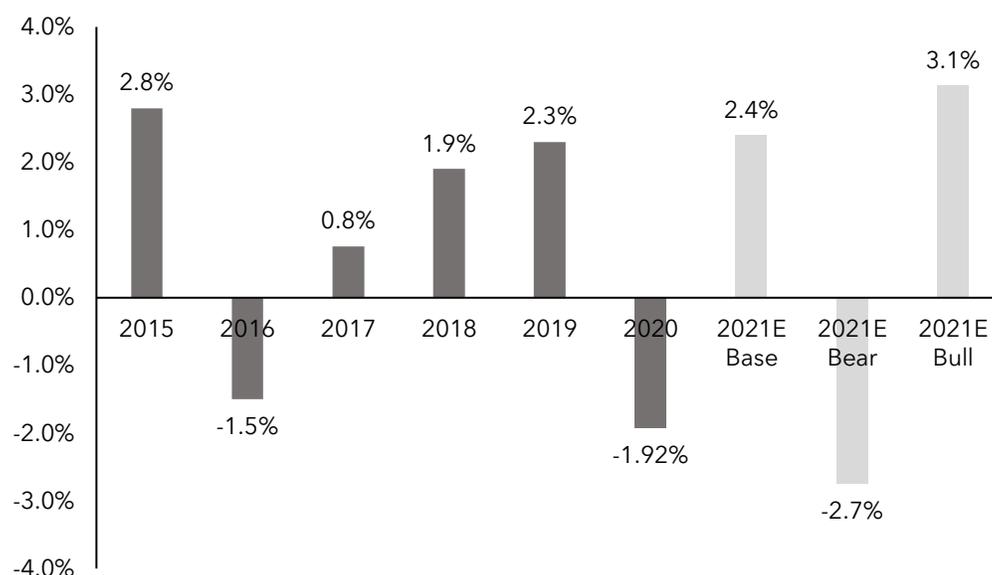
In the non-oil sector, growth remained sub-par at 0.79% (Q120: 1.54%). Due to the reopening of the economy and improvement in oil prices, 8 of the main sectors reported positive performance. Agriculture posted a 2.28% despite the dampened production recorded on the back of insecurity in the food-producing region. The Manufacturing sector also reported a 3.4% growth, the highest since 2015 and this was driven by significant improvement in Cement volumes (+11.20%) upon renewed construction activities post-lockdown.

Services sector was the only component of non-oil GDP that remained in contraction in Q121, down 0.39%. The contraction came on the back of abysmal performance in Transportation & Storage (-21.89%). In a similar vein, Finance and Insurance posted a 0.46% decline due to weak

growth in Financial institutions (+0.15%) as the effects of the loan-to-deposit ratio regulation wanes and a contraction in insurance services (-4.58%). On the other hand, the ICT sector grew slower by 6.31%, bucking its double-digit trend and this was dragged by a slow 7.69% growth in telecoms services. We believe this was due to the restriction on registration and retrieval of new SIM cards by the Nigeria Communications Commission which placed a lid on growth.

For FY2021, IMF expects Nigeria to return to pre-recession growth levels and inch higher by 2.5% as the economy recovers from the pandemic woes and this is in line with our projections of 2.4%. The growth is hinged on base effects, recovery in oil exports and prices as well as improvement in domestic demand.

Figure 5: Annual real GDP growth and forecast



Source: NBS, ARM Research

Specifically, we expect the oil sector to exit its 4-quarter long recession and grow at 4.5% in 2021 (2020: 8.89%) as the excess oil production in 2020 has been fully compensated for and OPEC+ agreed in July to ease production cuts in 2021. We expect crude oil production to average 1.85mbpd in 2021 and this fuels our outlook.

In the non-oil sector, we expect a recovery from the contraction recorded in 2020, however, the sector group would grapple with about 2.3% growth. Agriculture is expected to maintain resilience as pickup in crop production activities should drive growth and the loan moratorium from the CBN supports the sector. The insecurity and flooding menace in the food-producing regions pose major risks. The services sector should exit contraction

as ICT services sees improved demand on the lifting of SIM card purchase and retrieval ban. However, the high base effect of 2020 should keep growth in check. Growth in financial services is expected to be marginal given the waning effects of the increased loan drive by the CBN and reduced activities in the insurance sector as the recapitalization exercise stalls. Considering the improvement, we witnessed in the manufacturing sector in Q121 and the low base effect of 2020, we expect a strong rebound this year as activities pickup gradually.

Overall, we expect growth to be driven by improvement in both the oil and non-oil sectors as the economy recovers from the pandemic. However, the major risks remain to the downside, including the effect of the third wave of the pandemic and its associated restrictions and the existing structural weakness in the economy.

Domestic Economy and Markets

Nigerian Inflation - Subdued by Base Effect

Executive Summary

In our H1 2021 NSR, we analyzed possible shocks to the CPI in the first half of 2021 - highlighting our expectation on the market-determined PMS prices, currency devaluation and reopening of the land border. Our projections for CPI were premised on several factors, the first being the reopening of the land borders, seasonal effects on food prices, the hike in electricity tariffs and an upward movement in PMS prices, following a deregulation of the downstream sector. On the downside, we considered a higher than anticipated hike in PMS prices and further devaluation in currency to aggravate inflationary pressures over 2021. This informed our projection of an uptick in inflation rate over 2021 to 18.5% YoY and 1.49% MoM, which is our bear case scenario.

Looking into the second half of the year, some of the major concerns for inflation have still not been abated and remain threats to Nigeria's inflation. We still anticipate a deregulation of the downstream sector, the extent to which when determined by the government could have far reaching impacts on prices. On the currency front, while there has already been a devaluation to N410-412/\$1, we expect the pressure on the currency to remain strong, swaying parallel market rates from side to side and ultimately trickling down into higher prices. We acknowledge the possibility of a Eurobond issuance later in the year and thus expect some respite for the reserve base and the currency. Ultimately, the base effect from last year is expected to keep inflation subdued through 2021, barring any significant shocks to the economy. Thus, we maintain a base case scenario of 15.55% by year end.

In this report, we focus on the major themes that steered consumer prices over H1 2021 and delineate our outlook for inflation over the rest of the year.

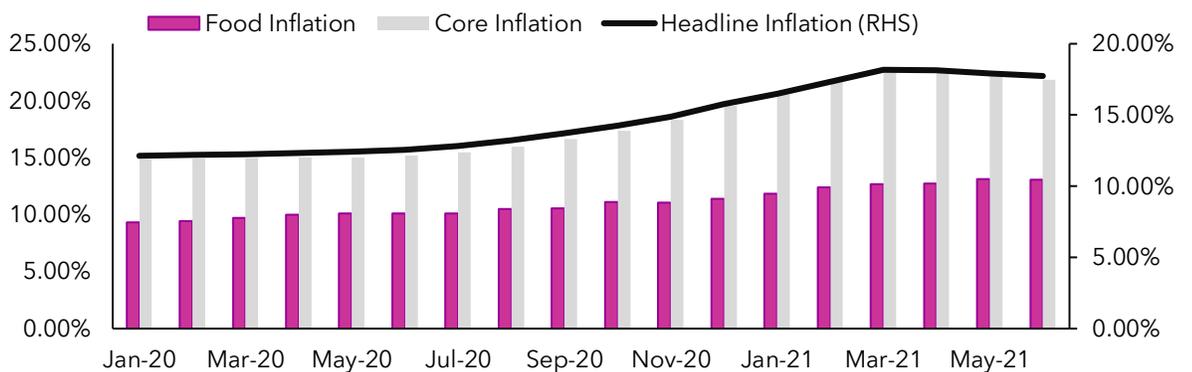
Inflation - Subdued by Base Effect

Nigeria’s headline inflation rate kicked off the year at 16.47%, the highest it has been since April 2017, and trailed an upward path, reaching a high point of 18.17% by March before slowly easing to 17.75% by June 2021. In our H1:2021 strategy report, we highlighted certain factors as possible shocks to inflation - the deregulation of the downstream sector, currency fluctuations and the reopening of the land border. Of the three (3) factors highlighted above, the fluctuations in the currency and reopening of the land border have come to fruition with varying levels of effects on inflation, while the possible deregulation of the downstream sector remains a threat to the current moderating inflation rate. While the opening of the land borders has had minimal effects on subduing food inflation, the FX fluctuations and constraints have remained a chief driver of both core and food inflation.

Delving further into the numbers, supply side factors remained chief drivers of inflation, ranging from insecurity in food producing states to exchange rate induced price movements and the ever present logistical and storage issues, facing food producers in the country. Consequently, food inflation spiked from 20.57% in January to 21.83% to a high point of 22.95% in March after which some respite was enjoyed and food inflation moderated to 21.83% in June.

On the core inflation front, the rebound in economic activities, easing of lockdown measures, a pick-up in global travel activities and the passthrough effects of the depreciating currency remained firmly in the cockpit, driving core inflation from 11.85% in January to 13.09% by June. This uptick is expected to persist as the FX illiquidity issues challenging the economy do not seem to be abating anytime soon. With the recent addition of Sugar and Wheat to the list of import items for which FX will no longer be provided, coupled with the already existing demand for FX, we expect the demand pressures in the market to remain present in the market, keeping core inflation on the high side.

Figure 1: Inflationary Trend (2020 till Date)

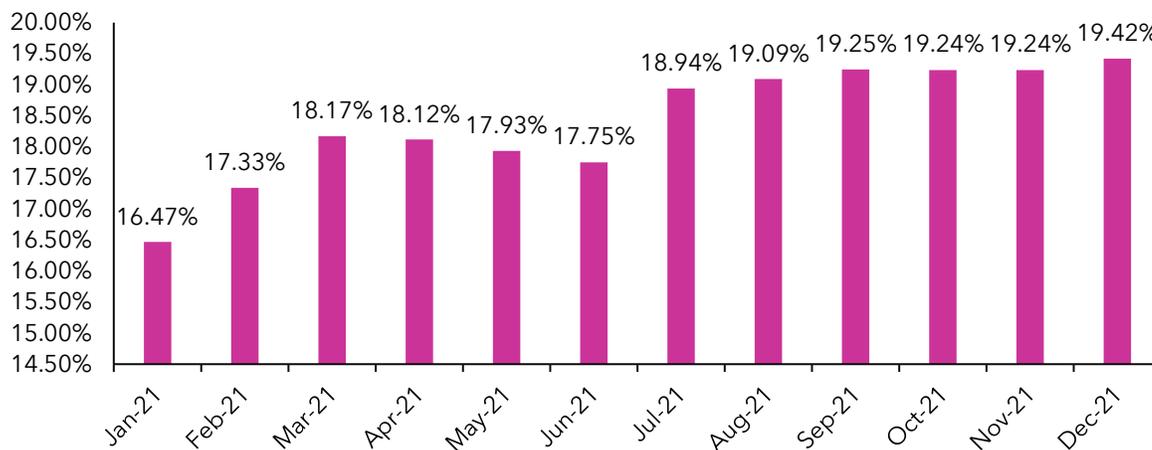


Source: NBS, ARM Research

However, we acknowledge the base effect from 2020 and thus expect inflation to moderate further in the coming months. Nonetheless, upside risks to inflation still exist. The likelihood of a deregulation of the downstream sector and the possible uptick in electricity tariffs pose significant threats to inflation and could easily induce a spike in Nigeria’s inflationary trend.

Our bear case scenario was initially hinged on two factors; a higher than anticipated hike in PMS pricing from current levels of NGN162.50 to NGN300 or more and a further devaluation of the currency. While PMS price hike could still be in the offing, there has already been a devaluation of the currency to NGN410/\$1 and its effect can be seen in the uptick in core inflation. Thus, we maintain a bear case scenario of an uptick in inflation over 18.50% over 2021.

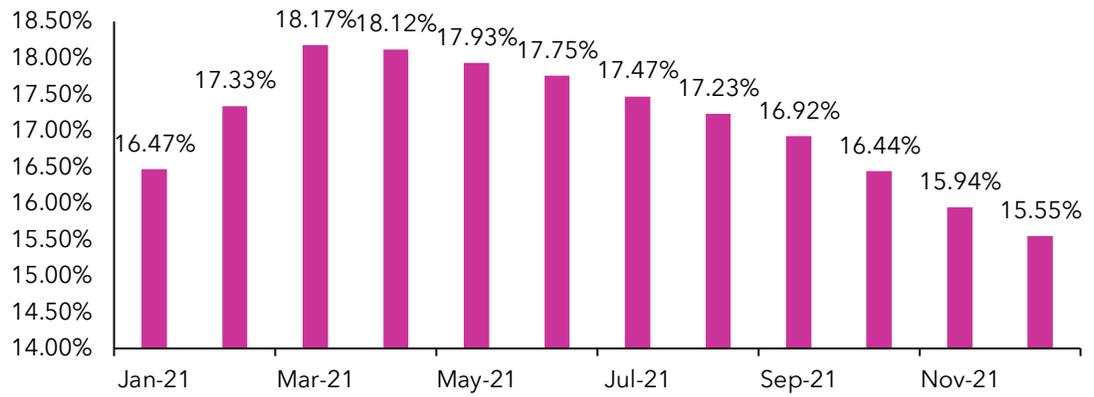
Figure 2: Monthly Inflation Forecast (Bear Case)



Source: NBS, ARM Research

Looking at a base case scenario, we expect a moderation in inflation in through the second half of the year, primarily premised on the base effect. Other factors which could stall a marked uptick in inflation include a delay in the deregulation of the downstream sector and thus a lower than expected hike in PMS prices, the possibility of a Eurobond issuance easing pressure on the currency and ultimately food prices. Thus, we project a year end inflation rate of 15.55% in a base case.

Figure 3: Monthly Inflation Forecast (Base Case)



Source: NBS, ARM Research

Domestic Economy and Policy Environment

Nigerian Fiscal: FG's Finances to improve in H2:2021

Executive Summary

In our H1:2021 NSR report, we estimated fiscal deficit over 2021 to print at NGN5.74trillion (vs budgeted NGN4.89trillion, excluding Government Owned Enterprises) - from our revenue expectation of NGN4.56trillion and expenditure of NGN10.30trillion, which translates into a funding gap of NGN847billion. However, In the first five months of the year, actual fiscal deficit was NGN3.01trillion due to higher government spending which exceeded FG's receipt over the same period. Precisely, FG's revenue in 5M:2021 was NGN1.84trillion, 67% of the pro rata target of NGN2.77trillion with the major drag stemming from crude oil and other revenue sources which recorded a performance rate of 50% and 43% respectively. However, FG's total expenditure was N4.86trillion (excluding GOEs and project tied debt) over the same period - slightly exceeding 100% of the prorata target of NGN4.80trillion following higher than budgeted spend on debt servicing. In terms of domestic borrowing, the FG net issued N1.85trillion in H1:2021 - 61% of the actual deficit between January and May 2021, implying that the remaining deficit may have been sourced from alternative sources.

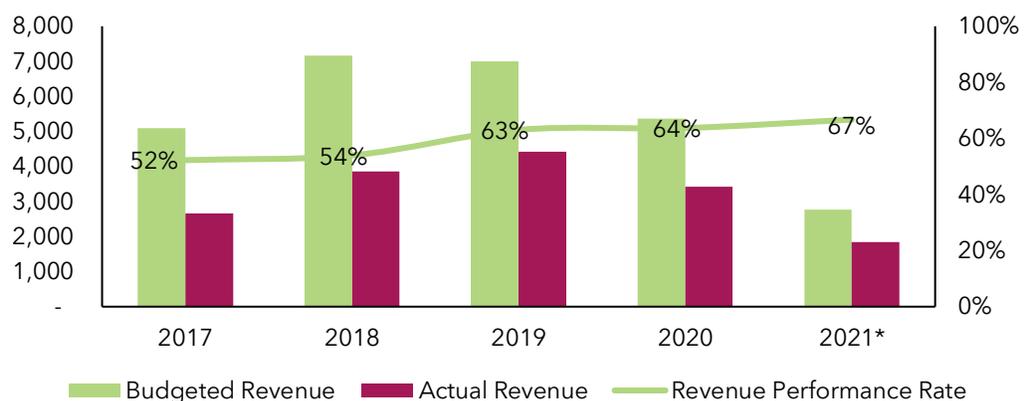
For the remaining part of the year, we expect strengthening crude oil prices, possible increase in production supply and further improvement in non-oil tax receipts to bolster FG retained revenue. With a budget implementation rate of 65%, we now expect fiscal deficit to print at NGN5.99trillion in FY:2021, higher than our initial guidance of NGN5.74trillion at the start of the year. This is premised on significantly lower actual crude oil revenue vs budgeted in 5M:2021, which may drag FY:2021 numbers despite the improvement expected in the remaining part of the year. In terms of financing, we retain our view on the possibility of a Eurobond issuance in 2021. Furthermore, net domestic debt issuance would likely shoot above the initial domestic debt guidance of NGN2.34trillion. We highlight the recent approval of the NGN982bn supplementary budget by the senate and note that it may be largely financed with debt. However, we do not see additional domestic net debt issuance printing as high in H2:2021 than it did in H1: 2021. This coupled with the fact that FG still accesses backdoor lending from the CBN, and the likelihood of a Eurobond should keep accretion in yields limited for the remaining part of the year.

In this report, we focus on developments in the fiscal space over H1 2021 and delineate our view for the rest of the year.

Oil and Other revenue drag FG receipts

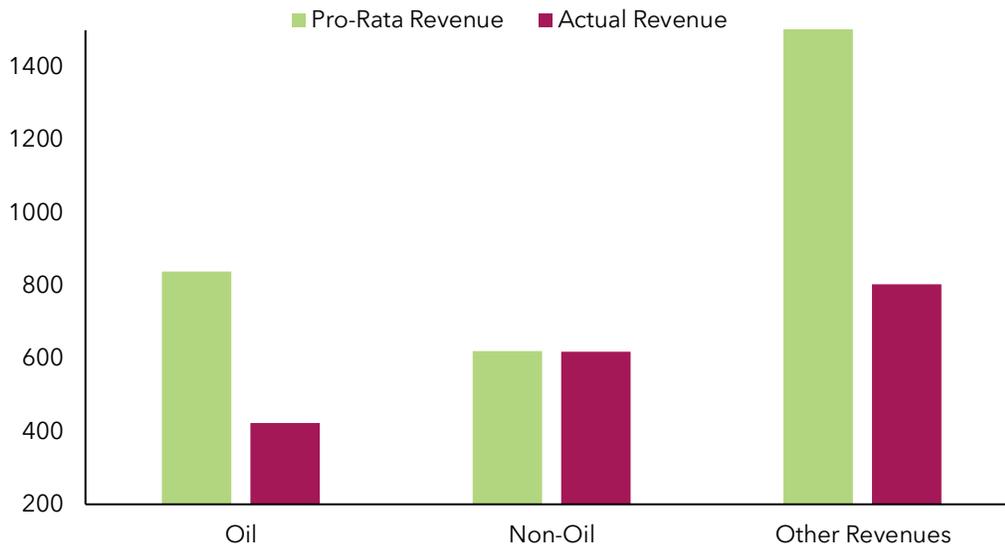
Over the first five months of 2021, the Federal Government fiscal deficit printed at NGN3.01trillion due to higher government spending which exceeded receipt over the same period. Beginning with receipts, FG collected NGN1.84trillion between January and May 2021 - 67% of the prorated budget - despite strong recovery in crude oil prices which averaged \$65.23/bbl in H1:2021, a significant premium compared to the \$40/bbl estimate in the 2021 budget. We suspect the drag in oil revenue may have stemmed from lower oil production which averaged 1.72mbpd in Q1: 2021 according to data from the National Bureau of Statistics. While OPEC’s monthly report for the month of June 2021 suggests improvement in Nigeria’s crude oil supply - comparing April and May 2021 average of 1.42mbpd to Q1:2021 average of 1.41mbpd- we note that this is still below the 1.86mbpd provisioned for in the budget, assuming condensates were the same during both periods. Elsewhere, non-oil receipts of N618.76bn was supported by higher tax collection following improvement in economic activities. To buttress further, CIT of NGN290.90bn in the first five months of the year was 2% in excess of the prorated amount. Similarly, VAT collection printed at NGN123.85bn, 25% above the prorated amount while revenues from customs and federation account levies were 89% and 62% respectively of its budgeted estimate for January till May 2021. Furthermore, receipts from Other revenue sources underperformed over the period with a performance rate of 43% of its prorated amount, driven mostly by significantly low revenue generation from Signature bonus, FGN Special Levies and Stamp duty, which more than offset the excess of 110% performance rate of FGN independent revenue. We also note zero revenue thus far on Domestic Recoveries and Grants and Donor Funding. Having said the above, we highlight that FG’s actual receipt in 5M:2021 was 33% short of budgeted revenue (NGN2.76trillion) largely due to shortfall in oil and other revenue sources.

Figure 1: Revenue Performance Rate



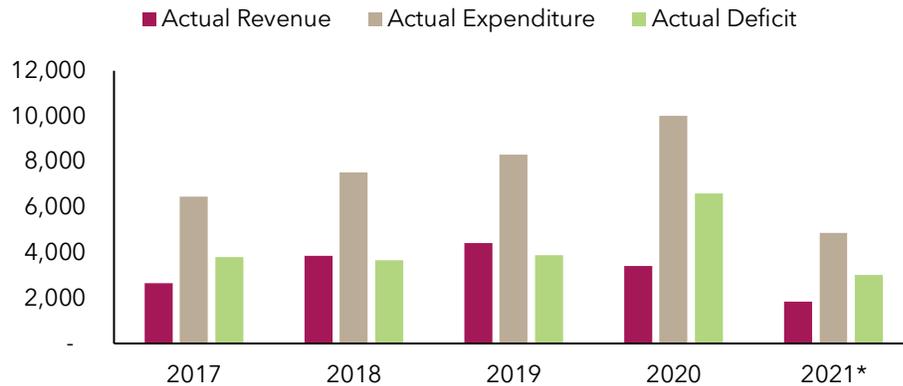
Source: ARM Research, Budget Office (Note: 2021* refers to data from Jan till May 2021)

Figure 2: Revenue Performance in 5M:2021 (NGN' bn)



Source: ARM Research, Budget Office

On expenditure, outflow over the period printed at NGN4.86trillion (93% of the prorated budget) with recurrent expenditure (NGN1.86trillion) accounting for 38% of the total spend while the balance was disbursed for debt servicing (37%), capex (20%) and Statutory transfer (4%). Relative to prorated 5M:2021 budget, actual non-debt recurrent expenditure suggests that FG achieved 97% implementation rate. The 3% deviation stemmed from lower spend on pension and gratuities and zero government spend on special intervention programme which moderated the impact of higher government spend than budgeted on personnel expenses, overheads and other service wide votes. For debt servicing, total government expenditure was NGN1.80trillion in 5M:2021, 30% more than budgeted majorly due to interest on Ways and Means of NGN480.52bn- an indication that FG continued to source CBN financing during the year. We also observed the cost of servicing foreign debt printing 4% higher than budgeted over the period, which likely reflects the impact of Naira devaluation. Furthermore, implementation rate for capex was 57% in 5M:2021, printing at a total of NGN978.13bn.

Figure 2: Revenue Performance in 5M:2021 (NGN' bn)

Sources: ARM Research, Budget Office (Note: 2021* refers to data from Jan till May 2021)

Despite fiscal deficit of NGN3.01trillion in 5M: 2021, FG net issued NGN1.85trillion in H1:2021. This therefore suggests that FG sourced funding from alternative sources to meet the balance of NGN1.17trillion. We are not aware of proceeds from the approved \$1.5bn and 995mn euros coming into the country's treasury following senate's approval in April 2021. However, we believe a part of these deficit may have been financed by the CBN as the CBN's net claim on the FG rose by NGN810.82bn over Q1:2021. The NGN480.52bn interest on ways and means included as part of debt service payment in 5M:2021 also alludes to this.

FG Finances to improve in H2:2021

Going into the rest of the year, we expect fiscal deficit to print at NGN5.99trillion (vs our initial estimate of NGN5.74trillion). This translates into a funding gap of NGN1.1 trillion when compared with the budgeted fiscal deficit of NGN4.89trillion, excluding GOEs. We now expect government revenue to come in at NGN4.31trillion in FY:2021, which is lower than our initial estimate of NGN4.56trillion. The downward review was primarily driven by the gross underperformance we saw in crude oil revenue in 5M:2021, where it recorded a performance rate of 50% relative to its prorated amount. Notwithstanding, we review upwards our estimate for average crude oil prices to \$69.63/bbl for FY:2021 premised on the strong recovery we have seen thus far in the year and our expectation for further improvement in H2:2021. We note that this is significantly higher than the budgeted oil price benchmark of \$40/bbl. Also, we see scope for possible increase in global crude oil supply in H2:2021, which should be supportive of an improvement in crude oil revenue in H2:2021. Thus, we estimate average crude oil production of 1.9mbpd for FY:2021 (budget:1.86mbpd) which coupled with an exchange rate of NGN380/\$ translates to oil receipts of NGN1.75trillion, 13% lower than budgeted estimates.

Furthermore, we raised our expected performance rate on non-oil revenue projections to 92% (vs 89% at the start of the year) on the back of the positive surprises on the CIT and VAT revenue leg thus far in the year. Performance rate for both CIT and VAT revenue have exceeded 100% on a 5M:2021. Also, custom's revenue has registered a performance rate of 89% in the first five months of the year. While retaining our expectations for a 100% performance rate on non-debt recurrent service spend, transfers and debt service as well as a 60% performance rate on capex spend, we arrive at a fiscal deficit of NGN5.99trillion for FY: 2021.

Going into the rest of the year, we still retain our view on the possibility of a Eurobond issuance in 2021. To begin with, the likelihood for a gradual reversal from an accommodative monetary stance in 2022 globally suggests that the pricing environment for a Eurobond issuance is more favorable now than next year. Furthermore, the consistent current account deficit and negative capital account balance also lends reasons as to why there should be a Eurobond issuance this year. For context, FX reserves have continued to decline despite efforts to defend the Naira from a free fall. Year to date, the reserve base has shed \$2.05bn despite solid recovery in crude oil prices. Foreign investors have remained bias towards Naira denominated assets with a net foreign outflow recorded thus far, according to data from Nigeria Exchange Group and FMDQ. With the trend set to continue and economic recovery putting pressure on FX demand, there is a need to cushion the pressure either with a further devaluation of the Naira or tapping the Eurobond market to proffer support for the Naira in the FX space. Furthermore, we see a possibility for net domestic debt issuance to shoot above the 2021 domestic debt guidance of NGN2.34trillion. We highlight the recent approval of the NGN982bn supplementary budget by the senate and note that it may be largely financed with debt.

However, we do not see additional domestic net debt issuance printing as high as in H2:2021 than it did in H1:2021. Going by the 2021 supplementary budget proposal, the budget has a deficit of NGN760.84bn of which NGN715.21bn would be financed through debt and the remaining balance funded with grant and restructured loans. If we assume the entire NGN715.21 will be sourced from the domestic debt market, we estimate total borrowing to peak at NGN1.19trillion in H2: 2021, which is lower compared to H1:2021. This coupled with the fact that FG still accesses backdoor lending from the CBN, and the likelihood of a Eurobond should keep accretion in yields limited for the remaining part of the year. Also, while the tight liquidity in the market should have provided support for upward accretion in yields, we believe government now has the legroom to manage its expectations given that it has done the majority of its borrowing plan in the first half of the year.

Domestic Economy and Markets

Balance of Payment: Current Account Deficit to Narrow on FX scarcity and Export Recovery

Executive Summary

In our H1 2021 strategy report, we had mentioned that current account deficit should widen further compared to 2020 levels, premised on a recovery in service import and higher deficit on the income leg of the current account, which we posited would neuter the expected recovery in export. Contrary to our expectations, external trade deficit narrowed by 66% QoQ to \$1.75bn, in Q1 2021 largely due to slimmer than expected deficit number on the service and income leg. Elsewhere, while current transfer surplus surprised positively in Q1 2021 with an 8% uptick compared to the previous quarter, our forecast on trade deficit was largely in line (with a deviation of 0.3% relative to actual Q1 2021 numbers). On the financial account ledger, we suspect flows into Nigeria has continued to thin out. As at Q4 2020, capital importation printed at \$1.07bn, the lowest since Q1 2017 according to the Q4 2020 Nigerian Capital Importation report released by the National Bureau of Statistics. Similarly, data from FMDQ and the Nigerian Exchange Group indicated a net outflow of funds as at the end of H12021 which suggests continued foreign investor bias for Naira denominated investment vehicles.

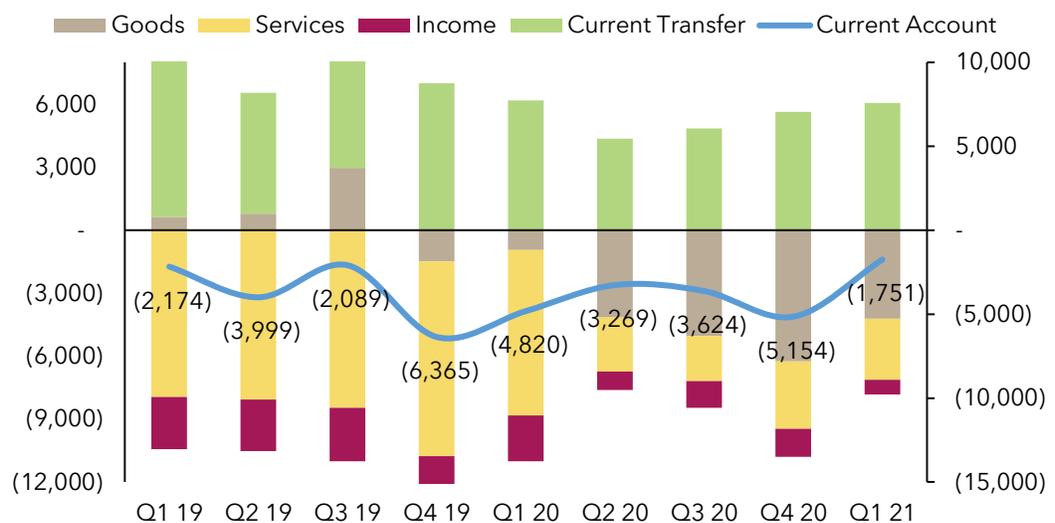
Going into the rest of the year, we believe the cocktail of higher crude oil prices and production alongside the sustained recovery in the non-oil sector of the economy will continue to support export earnings. Similarly, import may continue to increase from Q1 2021 levels, reflecting the recovery in economic activities. However, the expected level of increase could be moderated by FX illiquidity and further depreciation of the Naira, raising the cost of imports. On the rest of the ledger, we expect recovery in activity levels to generate wider deficits in travel, transportation and other businesses with difficulty in accessing FX, putting a cap on the level of increase. On financial account, we expect the macroeconomic uncertainties, FX challenges and policy uncertainties to sustain foreign investor aversion towards naira denominated assets and by extension, subdue capital flow into Nigeria. Against that backdrop, we expect deteriorating capital flow amidst continued but moderated trade deficit to put the nation's BoP on the edge.

In this report, we focus on developments in the Domestic environment, highlighting our views on Nigeria's current and financial accounts position.

Remittance Inflow and Dollar Scarcity narrows deficit in Q1 2021

In Q12021, Nigeria’s current account deficit position narrowed by 66% QoQ to \$1.75bn (Q4 2020: \$5.15bn). This was supported by the expansion in current transfer surplus as well as moderation in trade, services and income deficit over the period mostly due to FX scarcity. The shrinkage in trade deficit, despite lower QoQ export, was majorly supported by a faster decline in import. Furthermore, whilst the significant moderation in investment deficit was majorly responsible for the contraction in income deficit, it was the case of narrowed deficit in transportation - freight and others, that supported the marginal reduction in service deficit. Nonetheless, all of these masked the remittance driven improvement in current transfer, which was brought about by the continued normalization in the global economy.

Figure 1: Movement in components of CA balance (\$'million)

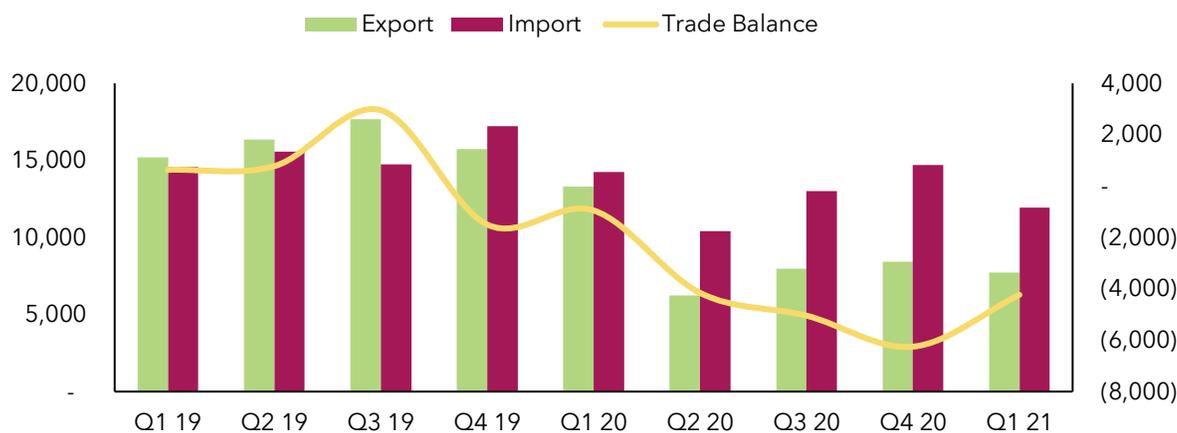


Source: ARM Research, CBN

In our H1:2021 strategy report, we highlighted our expectation of a wider current account deficit on the back of an expected recovery in service import and higher deficit in the income leg of the current account which we posited would neuter the expected recovery in export. Contrary to our expectations, external trade deficit narrowed by 66% QoQ to \$1.75bn largely due to slimmer than expected deficit on the service and import leg with trade deficit also falling by 32% QoQ to \$4.23bn. While our forecast for trade deficit in Q1:2021 was largely on track (ARM Estimate: \$4.22bn), the trade mix was quite different from what we had anticipated as total export fell by 9% QoQ to \$7.71bn while total import fell at a faster pace of 19% QoQ to \$11.94bn. Despite higher average crude oil production (+10% QoQ to 1.76mbpd) and prices (Avg Brent: +29% QoQ to \$62.26/bbl), oil export numbers fell by 16% to \$6.48bn (Q4 2020: \$7.75bn). Recall that Nigeria trades its crude oil in the futures market, which implies that the Q1

2021 oil numbers could have been reflective of the oil sector operational performance in Q4 2020. During this period, we saw average crude oil production decline by 7% to 1.5mbpd which more than offset the 4% marginal increase in average crude oil prices to \$45.26/bbl. On the other leg, non-oil export grew by 79% QoQ to \$1.22bn mostly supported by Other non-oil export (+81% QoQ to \$1.21bn) as electricity export revenue was relatively unchanged QoQ. Elsewhere, after expanding in the prior quarter due to higher oil and non-oil import, overall import in Q1 2021 shrank (-19% QoQ to \$11.94bn) driven by significant moderation in non-oil import (-23% QoQ to \$9.84bn) while oil import increased by 14.2% to \$2.09bn over the same period. For us, given that oil import is usually undertaken by the NNPC, we suspect it may have been more responsive to domestic needs bearing in mind the ongoing recovery in economic activities despite the tight liquidity in the FX market. We opine that non-oil import may have better reflected the nation’s FX challenges, which is better explained by the widened differential between the official and parallel market rates.

Figure 2: Trade Balance (\$'million)



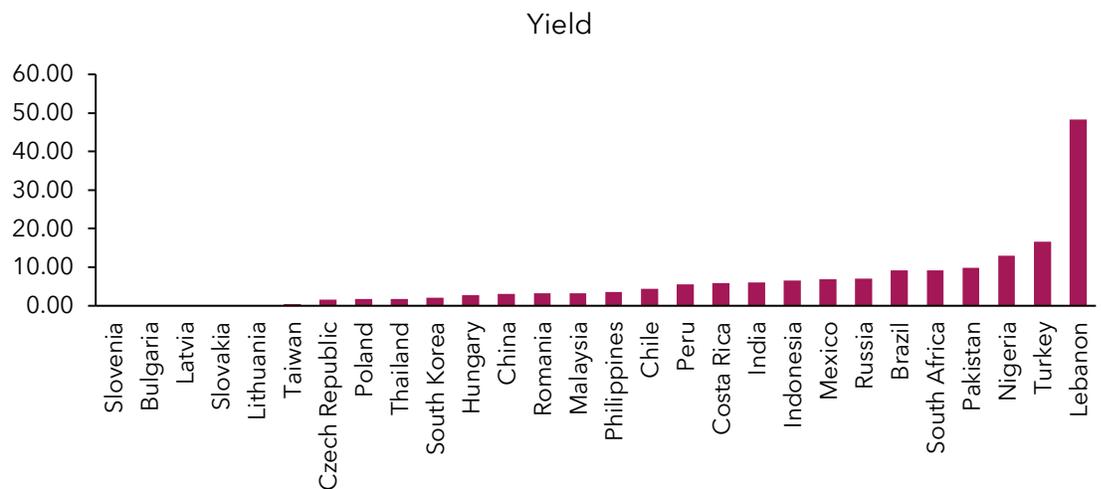
Source: ARM Research, CBN

On other fronts, service deficit narrowed by 10% QoQ to \$2.90bn largely supported by transportation (-63% QoQ) which outweighed the 6% QoQ and 31% QoQ increase in the deficit on travel and other business services respectively. Precisely, the increase in travel deficit was driven by personal travel with education related expenditure contributing the largest chunk. Elsewhere, income deficit narrowed by 93% QoQ to \$683m mostly driven by contraction in investment income deficit (-50% QoQ to \$730m). Overall, the impact of slimmer deficit balances on the trade, services and income leg coupled with higher current transfer led to a narrowing of the current account deficit to \$1.7bn in Q1 2021.

Portfolio Inflows continue to thin out

On the financial account ledger, capital flows into Nigeria printed at its lowest levels since Q1:2017 when it came in at \$1.06bn in Q4:2020. A further look at the numbers revealed that foreign portfolio investments, which historically contributes the most to overall capital inflows, continued to thin out as investors have remained averse towards investing in Naira denominated assets. This is no surprise given the policies and regulations surrounding foreign portfolio investment in Nigeria, alongside the weak state of other macroeconomic variables. As at the end of H1:2021, data from FMDQ showed a net foreign outflow of \$0.29bn despite Nigeria having the third highest yield in the emerging market category according to data from Bloomberg. Similarly, data from the Nigeria Stock Exchange showed that net foreign outflow from the equities market persisted in the first five months of the year, printing at NGN15.9bn as at the end of May, albeit at a slower pace than witnessed in H2 2020. (NGN97.93bn).

Figure 3: Emerging Market Yields



Source: ARM Research, CBN

Export Recovery and FX to dictate the tune in 2021

Going into the rest of the year, we expect the current account deficit to narrow compared to H1:2021 levels. To begin with, we expect oil export to improve in the second half of the year, on the back of strengthening global crude oil prices following improved outlook for worldwide demand for crude oil as increasing COVID-19 vaccination rate continues to support the normalization of the global economy. Also, the decision of OPEC to increase production supply going into the year would also afford more room for oil export revenue in the second half of the year. This alongside the sustained recovery in non-oil export should lead to higher export revenue numbers in H2:2021 than in H1 2021. Compared to our initial estimate of \$8.7bn, we

have now revised our estimate for total non-oil export to \$6.1bn reflecting the impact of FX scarcity and its consequential effect on the non-oil sector and by extension, non-oil export. Also, the devaluation of the Naira is another pressure point to focus on as touching export revenue numbers.

On the import leg, we believe the factors that incited a drag in Q1:2021 have persisted and will continue to impact on import numbers in the rest of the year. However, we expect a more significant impact to be felt on the non-import side as the continuous demand and relative scarcity of FX could inhibit expected volumes and values of transactions, placing downward pressure on import numbers - a situation which could be compounded further by the devaluation of the Naira. Thus, we have revised our forecast for total import to \$52.2bn (vs our initial estimate of \$65.0bn). Overall, we expect trade deficit to print at \$14.9bn as import numbers are expected to mask the value of total export.

On the rest of the ledger, beginning with the service leg, we expect deficit numbers to increase from Q1 2021 levels. Majority of these increases may be driven by higher demand for travel, especially education and health related expenditure, as well as other business services which reflects increased private demand for expatriate services as the economy recovers. However, subdued foreign inflows owing to macroeconomic related challenges could continue to weigh on the income leg of the current account position. And on the current transfer leg, recovery in global economy should continue to support higher remittance inflow through to the end of the year.

Domestic Economy and Markets

Monetary Policy: Poised to Keep to Global Trend for 2021

Executive Summary

Since the Monetary Policy Committee (MPC) cut the benchmark interest rate by 200bps to 11.50% in September 2020, the committee has maintained status on the Monetary Policy rate (MPR), in recognition of the bubble the Nigerian economy is in. The need to support the economy has been an influencing factor in maintaining a dovish stance, as a pro-growth approach to encourage domestic lending and boost economic activity is adopted - especially following the hit from the COVID-19 pandemic last year. The MPC in its three (3) meetings in H1:2021, expressed its overwhelming commitment to supporting the govt in ensuring full restoration of the productive capacity of the economy.

From a historical point of view, Nigeria has mirrored global market trends pertaining to monetary policy. Following the COVID-19 pandemic, central banks in advanced and emerging economies have taken policy actions to ease monetary policy across the globe, provide sufficient liquidity to core funding markets, and sustain the supply of credit. To lessen pressure in local bond markets and currency, many emerging market central banks used FX interventions. And despite rising inflation in the US and Europe, the US Fed, and European Central Bank (ECB) officials reaffirmed the view that inflationary pressures would prove to be temporary. We believe the CBN will follow this trend of allowing flow of credit, especially now that the need to strengthen growth to avert a relapse into a recessionary period is evident.

We anticipate total maturity of NGN3.49 trillion in H2:2021 from Bonds, T-bills and OMO (23.30% lower compared to NGN4.55 trillion over H1:2020). We believe OMO stop rates have limited upside, as it already surpasses rates in other regions should the aim be to attract foreign investors. The CBN has been concerned with managing liquidity management cost, and raising rates further seems counter-productive. On the flipside, an anticipated inflow from future oil receipts and Eurobond issuance should nullify any pressure on the apex bank to raise rates.

In this report, we focus on developments in the Monetary space over H1 2021 and delineate our outlook for monetary policy direction over the rest of the year.

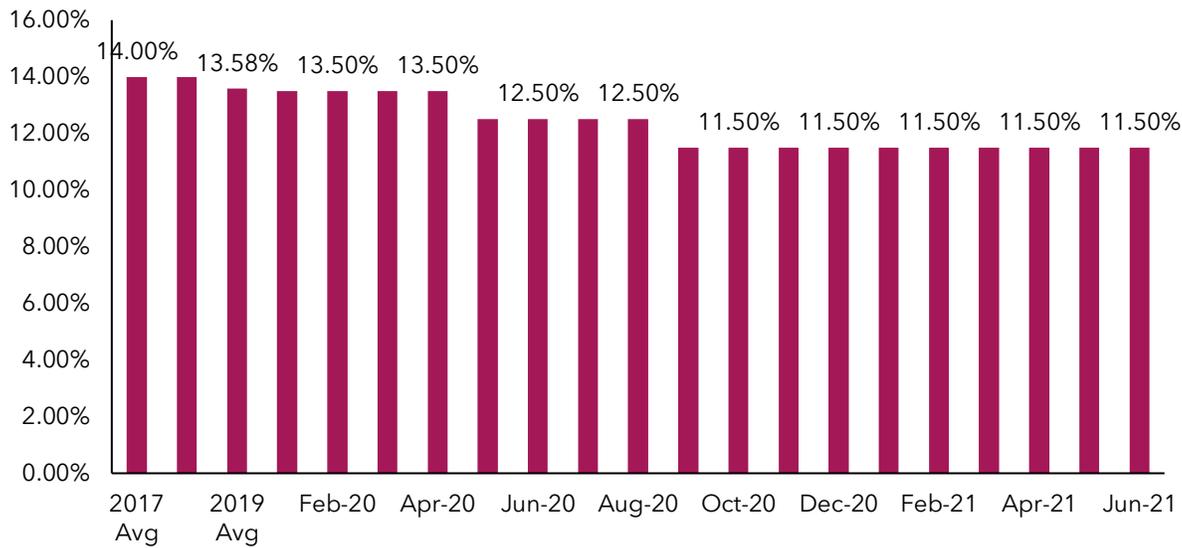
Pro-Growth Stance Sustained

Since the Monetary Policy Committee (MPC) cut the benchmark interest rate by 200bps to 11.50% in September 2020, the committee has maintained status on the Monetary Policy rate (MPR), in recognition of the bubble the Nigerian economy is in. The need to support the economy has been an influencing factor in maintaining a dovish stance, as a pro-growth approach to encourage domestic lending and boost economic activity is adopted – especially following the hit from the COVID-19 pandemic last year. The MPC in its three (3) meetings in H1:2021, expressed its overwhelming commitment to supporting the govt in ensuring full restoration of the productive capacity of the economy.

Nigeria's GDP growth in Q1:2020 came in at 0.51% YoY – a second consecutive expansion in real GDP (0.11% YoY in Q4:2020) following the exit from recession. The National Bureau of Statistics (NBS) reported a 2.28% growth in the Agricultural sector in real terms in Q1:2021 (3.42% in Q4:2020). We believe this growth, although shaky was driven by the boost in credit supply to the sector, as well as targeted intervention programs in the form of stimulus payments; such as the NGN107.60bn credit provided to 548,109 farmers between Q4:2020 and Q1:2021 to support agricultural value chain development. Consequently, money supply (M3) advanced by 3.18% during the first five (5) months of 2021 to close at NGN40.01 trillion in May, while Net domestic credit rose by 4.09% during the first five (5) months of 2021 to close at NGN44.71 trillion in May. Whilst the figures reflect the gradual recovery in domestic economic activity, the CBN recognizes that structural issues like insecurity, infrastructural deficit, and FX instability as possible threats to further expansion.

The committee considered easing the benchmark rate to further ease access to credit, or tighten the MPR to moderate price development, or hold rates constant to allow previous policy measures to continue to permeate the economy while observing domestic and global development. While an expansionary stance could transmit to reduced pricing of the loan portfolio of Deposit Money Banks (DMB), and result in cheaper credit to the real sector, the expected transmission may be constrained by security challenges and infrastructural deficit. The CBN also acknowledged that while a contractionary stance could help the monetary component of price development, supply side constraints such as security crises can only be address by policies outside the horizon of the apex bank.

Chart 1: MPR Trend



Source: CBN, ARM Research

Cannot Have Our Cake and Eat It

From an exchange rate perspective, lower oil inflows as well as significant repatriation of foreign flows quaked the FX reserves and in turn, the CBN’s bearing. The apex bank had compromised free capital mobility by limiting importation and restricting repatriation of funds to lessen FX outflow, and ease pressure on the reserves. In April 2021, the CBN added sugar and wheat to the list of imports banned from accessing FX from official channels. This protectionism approach still allowed monetary autonomy whereby the CBN could control interest rates but, although it wouldn’t directly impact having a fixed exchange rate the depleting external reserves made it unviable.

The CBN has now adjusted the exchange rates, as the official rate was devalued from NGN379/\$1 and the NAFEX rate of NGN410/\$1 was adopted as its benchmark. At the parallel market, the limited sales of FX to Bureau De Changes (BDC) since sales restarted again in August 2020, continued to pressure rates in the market as demand remained elevated. With this move to devalue the currency amidst depleting reserves (Gross external reserves in H1:2021 depleted by 5.80% to \$33.32 billion), we suspect the apex bank is looking to ease its restrictions on capital mobility after oil receipts improve, and a visit to the International debt market. In this case, monetary autonomy would still be achieved, and interventions would increase.

Moving to Attract FPIs

While the apex bank kept OMO rates subdued in January 2021, with stop rates for 96 day, 180 day and 362 day tenors at 1.51%, 4.34% and 5.74% respectively, it subsequently raised stop rates in February, March, April, May and June to 7.00%, 8.50% and 10.10% respectively. We believe the decision to elevate rates at the OMO market stemmed from a change in course from managing liquidity costs to attracting and retaining foreign interest to the Nigerian market. While oversubscriptions were witnessed across board when rates were elevated in February, we note a marginal decline in Bid to Offer ratios in May 2021, as demand fell below offers on the 3-month and 6-months tenors. We believe investor preference for longer-term instruments is partly linked to an anticipated drop in yields later in the year¹⁵ and an active decision to enjoy the high rates in the market, considering historical lack of clarity from the CBN on the direction of rates. By H1:2021, average OMO rates had risen to 7.70% - 154bps higher compared to H2:2020 average of 6.16% across tenors. Though stop rates are still not at 2019 levels yet, a balance must be sought between managing liquidity costs and attracting/retaining foreign interest to the Nigerian market. Thus, the uptick in rates was impending, as the need for foreign inflow and ease pressure on the declining reserves was apparent.

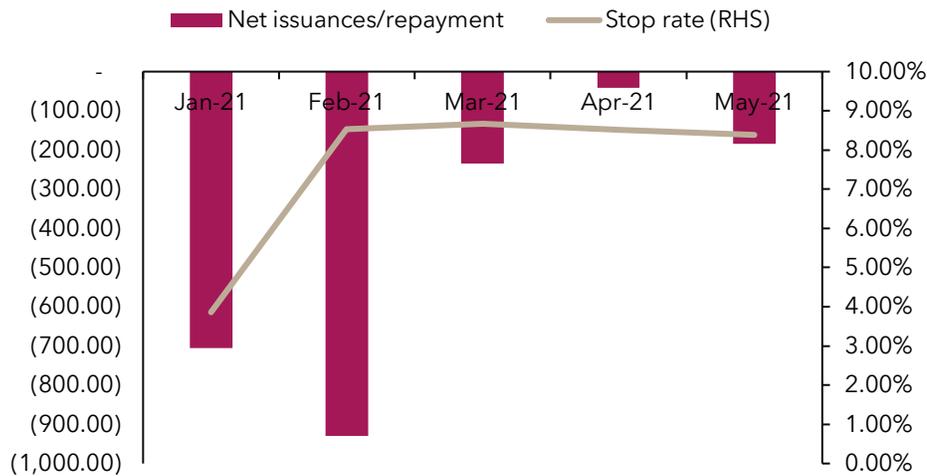
Table 1: OMO Stop rates vs. Bid to Cover and Bid to Offer ratios

Auction Date	Tenor	Stop Rate (%)	Bid to Cover	Bid to Offer
Jun-21	89 Day	7	1.0	0.6
Jun-21	159Day	8.5	2.1	1.8
Jun-21	348 Day	10.1	5.1	5.1
Jun-21	89 Day	7	1.0	0.8
May-21	180 Day	8.5	2.0	1.8
May-21	348 Day	10.1	4.9	4.9
May-21	96 DAY	7	1.0	0.3
May-21	96 DAY	7	1.0	0.3
May-21	180 DAY	8.5	1.0	0.8
May-21	348 DAY	10.1	1.6	1.6
May-21	89 Day	7	1.0	0.4
May-21	180 Day	8.5	1.0	0.5
May-21	355 Day	10.1	1.6	1.6
May-21	89 Day	7	1.0	0.9
May-21	180 Day	8.5	1.0	0.8
May-21	348 Day	10.1	1.6	1.4

Source: CBN, ARM Research

¹⁵ With the likely increase in liquidity following debt issuances at the international market, prices of money market instruments could rise, while yields fall

Chart 2: OMO net issuance/repayment vs OMO rate in H1:2021

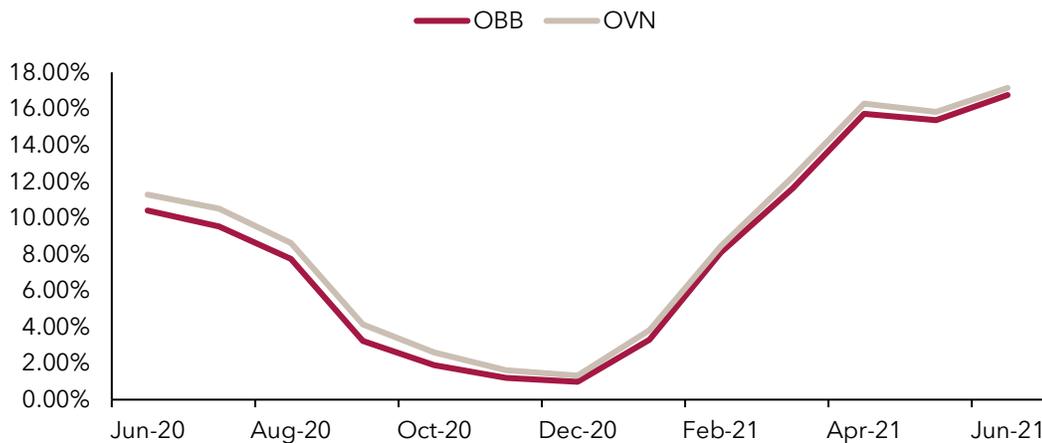


Source: CBN, ARM Research

The amounts offered at the auctions significantly fell through H1:2021. In the first quarter, total amount offered at OMO auctions came in at NGN858 billion, but by the second quarter, amount on offer had dipped significantly to NGN220 billion.

The drop in the CBN's liquidity mop up activities is further evidenced by the drop-in rates at the money market as average OVN16 rate went from 1.32% in December 2020, to 17.14% in June 2021. Average OBB17 rate also rose to a 16.75% in June 2021, from 0.98% in December 2020.

Chart 3: Trend in interbank rates



Source: CBN, ARM Research

¹⁶ Overnight rate

¹⁷ Open Buy Back rate

Net domestic Assets Rise, while Net Foreign Assets Slim

Examining monetary aggregates, broad money supply (M3) expanded by only 2.99% over the first five (5) months of the year. This uptick came on the back of increases in net domestic asset (+3.37% from January to May 2021) and Net foreign assets (+0.24%). Money Supply (M2) rose by 2.32% over the same period following a 3.57% rise in Quasi Money, and 1.97% increase in Narrow Money (M1) with improved demand deposits. Credit to the Private Sector rose by 6.52% from January to May 2021 as the accommodative stance with interest rates was sustained to drive economic revival. Growth in Net domestic asset is largely reflective of the increase in credit to the private sector (NGN1.97 trillion increase), growth in aggregate credit supported by the ongoing broad-based monetary and fiscal stimulus. On the other hand, expansion in net foreign assets by NGN17.54 billion in the first five (5) months of 2021 can be linked to the devaluation in May, which consequentially boosted the naira value of foreign assets.

Poised to Keep to Global Monetary Policy Trend for 2021

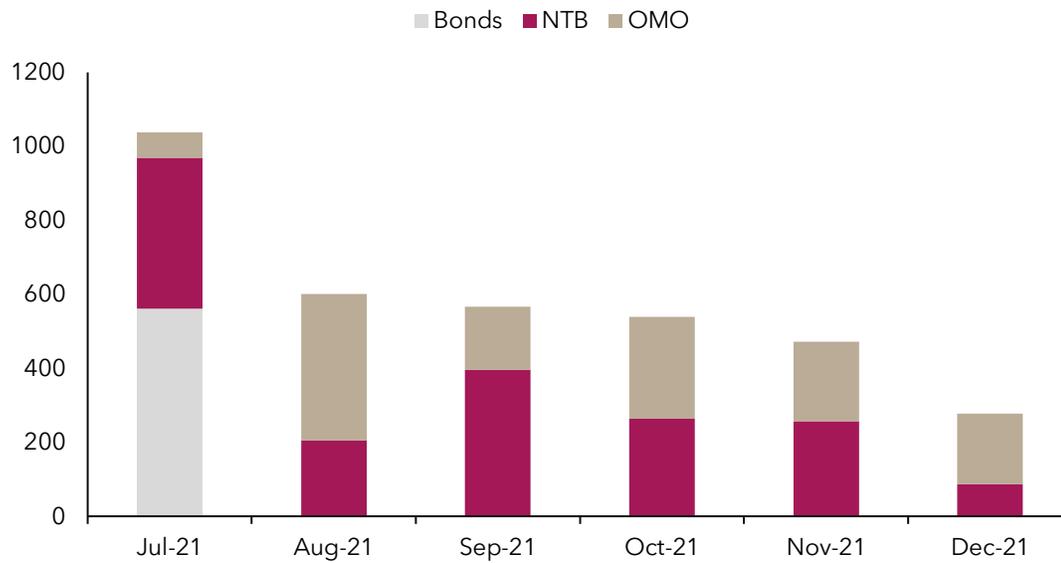
From a historical point of view, Nigeria has mirrored global market trends pertaining to monetary policy. Following the COVID-19 pandemic, central banks in advanced and emerging economies have taken policy actions to ease monetary policy across the globe, provide sufficient liquidity to core funding markets, and sustain the supply of credit. To lessen pressure in local bond markets and currency, many emerging market central banks used FX interventions. And despite rising inflation in the US and Europe, the US Fed, and European Central Bank (ECB) officials reaffirmed the view that inflationary pressures would prove to be temporary. We believe the CBN will follow this trend of allowing flow of credit, especially now that the need to strengthen growth to avert a relapse into a recessionary period is evident.

Asides foreign investor attraction, an argument for the MPR to be tightened is the high inflation. Nigeria's headline inflation averaged 17.63% YoY in H1:2021, but the CBN and MPC have reiterated that while a contractionary stance could aid the monetary aspects, structural issues such as insecurity and absence of infrastructure are the fundamental causes of the rising inflation, and can only be address by policies outside the apex bank's horizon. Headline inflation during H1:2021 peaked in March 2021 at 18.17% YoY, and subsequently tapered to 17.75% YoY by June 2021. We believe this slowdown in inflation will only fortify the determination of the MPC to keep MPR dovish.

We anticipate total maturity of NGN3.49 trillion in H2:2021 from Bonds, T-bills and OMO (23.30% lower compared to NGN4.55 trillion over H1:2020). We believe OMO stop rates have limited upside, as it already surpasses rates in other regions should the aim be to attract foreign

investors. The CBN has been concerned with managing liquidity management cost, and raising rates further seems counter-productive. On the flipside, an anticipated inflow from future oil receipts and Eurobond issuance should nullify any pressure on the apex bank to raise rates.

Chart 4: Maturity Profile H2:2021 (N'billion)



Source: FMDQ, ARM Research

Domestic Economy and Policy Environment

Fixed Income: Solid Bounce back for yields

Executive Summary

In a complete reversal of the trend witnessed in the second half of 2020, fixed income yields have sustained an upward trend so far this year, so much so that the average fixed income yield soared by an accumulated 591bps to 8.99% in H1:2021 (H2:2020: +205bps to 3.08%). Overall, a modest maturity profile (totaling ₦8.04 trillion in FY 21 vs ₦17.31 trillion in 2020), relatively subdued liquidity levels and a clamor for higher yielding instruments in the primary market in the face of rising rates at OMO auctions all underpinned the bounce back in secondary market yields.

Looking ahead to the second half of the year our expectation for the direction of yields is premised on the interplay between the demand and supply of fixed income instruments over the next 6 months. The main driver for demand is system liquidity which is strongly affected by the maturity profile. Despite a huge bond maturity of ₦561 billion expected in July 2021, H2's maturity profile of ₦3.49 trillion lies below the ₦4.55 trillion recorded in H1 by 23%. While we do not see much scope for rates to drop significantly this year, we do not rule out the possibility of a downturn as has been witnessed in previous years. Nonetheless, we encourage investors to play on the mid to long end of the curve to enable them take advantage of the various yield movements through the second half of the year.

In this report, we look at the major themes that dominated the fixed income space over H1 2021 and delineate our outlook for the rest of the year.

Recovery in secondary market yields gathers pace

In a complete reversal of the trend witnessed in the second half of 2020, fixed income yields have sustained an upward trend so far this year, so much so that the average fixed income yield soared by an accumulated 591bps to 8.99% in H1:2021 (H2:2020: +205bps to 3.08%). Overall, a modest maturity profile (totaling ₦8.04 trillion in FY 21 vs ₦17.31 trillion in 2020), relatively subdued liquidity levels and a clamor for higher yielding instruments in the primary market in the face of rising rates at OMO auctions all underpinned the bounce back in secondary market yields.

In the bonds market, the uptick in yields which began towards the end of 2020 carried on firmly into 2021, resulting in a 5.71% increase in the average bond yield to 11.41%. Over the first three months of the year, the average bond yield jumped 356bps, as fears of heightened inflation coupled with tight system liquidity stirred bearish sentiments. For context, tenor rates for the three re-opening instruments rose by 252bps, 276bps and 305bps respectively and this in turn spurred renewed interest at the subsequent primary market auctions. This heightened interest in primary market instruments was particularly evident in March's auction where demand hit a new year high with aggregate bid-to-cover ratio of 2.2x and enticed the DMO into raising allotment to take advantage of the robust subscription levels. In April, the average yield in the secondary market accelerated by 211bps, MoM, reaching a 17-month high of 11.40%, with the surge anchored by upticks at the belly-to-tail-end of the curve, specifically in the Apr-2023 (+418bps), Mar-2024 (+343bps) and Apr-2037 (+246bps) instruments. Further supporting the higher yields in April was the release of the Q2 2021 bond issuance calendar which came with a few noteworthy surprises. First off, the amount on offer range was raised by ₦10 billion per month, indicating a willingness to raise more funds domestically. Secondly, the DMO signaled its preference to reopen the 2049 and 2050 instruments for May and June's auctions, before possibly reverting to its status-quo which involves offering of the 25-year paper going forward. Rounding up the half, there was some bullish momentum in June as yields declined by 62bpsMoM, a probable result of investors taking up buying positions in response to expanding yields seen across the curve. Placing focus on individual bonds, sell-offs were mostly observed in short and mid-dated instruments, specifically the Apr-2023 (+795bps), Mar-2024 (+694bps) and Mar-2025 (+654bps) papers.

At the short end of the curve, the bounce back was even stronger for Nigerian Treasury Bills (NTB) yields which experienced a turbulent end to 2020. Average yield surged 6.11% to settle at 6.58% in line with uptick in OMO auction rates, from 0.46% in December 2020, with the 1-year (+929bps) and 270-Day (+754bps) bills anchoring the resurgence. Akin to what played out in the bond space, expansion in the primary market saw investors turn their attention to the Primary Market Auctions (PMA) in search of higher returns. While yields firmed by 59bps and 44bps in

January and February respectively, March brought about the largest monthly increase (+264bps MoM) as only ₦135.97 billion worth of treasury bills matured, and investors contended with tight funding levels for most parts of the month. Notably at the second monthly auction, investor demand shifted to the long-dated offer, which recorded a subscription rate of 2.8x (first auction: 1.9x) while the stop rate in the long-term offer rose by 100bps to 7.00% (first auction: +50bps). Sentiment unsurprisingly remained bearish in May and June, with yields rising by an accumulated 182bps over the last two months of the half. At the OMO auction in H1'21, average marginal rate increased 171bps to 7.7% from 6.0% in H2'20 despite lower offer amounts of ₦1.08 trillion (Vs H2'20: ₦1.58 trillion) as CBN raised rates to retain FPI inflows.

Rise in yields to slow in H2

Looking ahead to the second half of the year our expectation for the direction of yields is premised on the interplay between the demand and supply of fixed income instruments over the next 6 months. Supply will be solely determined by the level of domestic borrowing undertaken by the Federal Government (FG) to fund their budget deficit. As at the end of June total net borrowing by the FG printed at ₦1.81 trillion which amounts to 77% of the ₦2.34 trillion the FG set aside for domestic borrowing in their budget. Based on these budget numbers the FG should be issuing just about ₦530 billion worth of new instruments in the second half of the year. However, we estimate that the actual budget deficit in 2021 will now print at ₦5.51 trillion which, when compared to the FG's deficit estimate of ₦4.89 trillion, presents a funding gap of ₦620 billion. As expressed in our fiscal report, we believe that this gap will be bridged by a combination of a Eurobond issuance (which will also help address the relative scarcity of FX) and an increase in domestic borrowing, beyond what the FG specified in the budget. Furthermore, despite earlier proclamations made by the FG, we believe that backdoor funding from the CBN will still be accessed to bridge the funding gap.

The main driver for demand is system liquidity which is strongly affected by the maturity profile. Despite a huge bond maturity of ₦561 billion expected in July 2021, H2's maturity profile of ₦3.49 trillion lies below the ₦4.55 trillion recorded in H1 by 23%. This lower maturity profile implies less flow of funds into the system to beef up overall liquidity when compared to H1'21. This is not to say that system liquidity will be lower this H2 but that the increase will be at a seemingly slower pace. With both government borrowing and the rate of increase in system liquidity expected to slow over the second half of this year we can expect yields to remain around current levels with the possibility of a marginal uptick, but nowhere near the increase recorded in H1:2021. A further uptick in yields could be

driven by an increase in domestic borrowing thus increasing supply while also shifting from the FG's policy of closely sticking to its borrowing target. Higher borrowing from the FG also means investors at auctions can bid higher rates at auctions which would then translate to higher yields in the secondary market.

While we do not see much scope for rates to drop significantly this year, we do not rule out the possibility of a downturn as has been witnessed in previous years. Nonetheless, we encourage investors to play on the mid to long end of the curve to enable them take advantage of the various yield movements through the second half of the year.

Domestic Economy and Policy Environment

NSEASI: Market Performance to remain Subdued

Executive Summary

In the first half of the year, the weak state of macros and the high yield environment in the fixed income market induced a reallocation of assets to the fixed income market, thus, dragging the performance of the equities market through H1. Although the year kicked off on a positive note with a monthly return of +5.32% in January, losses were recorded in four (4) of the other five (5) months in the first half, settling the All-Share Index at 37,907pts and a YtD return of -5.87%. Beyond the reallocation of assets stemming from a tepid yield environment, we also acknowledge the effects of profit taking activities on some large cap stocks like DANGCEM, following the completion of the first phase of its share buyback programme in December 2020.

The factors which dragged market performance in the first half of the year are still very much present and we believe they will continue to shape market outcomes for the rest of the year. With rates in the fixed income market on the high side and expected to remain elevated through the year, the incentive to shift to the equities market and carry on more risk is lacking. Furthermore, the concerns which foreign investors have had about the state of the macroenvironment and regulatory uncertainty do not seem to be abating in the near term.

However, we note that in the event of a Eurobond issuance, short term interest in the equity space could be sparked, as the apex bank will be afforded sufficient legroom to defend the currency, easing some of the FX liquidity concerns. We also do not rule out the possibility of prices falling further to points which are considered quite attractive to investors, inciting a possible rally in the market. On the corporate actions' spectrum, we expect to see minimal positive activity driven by impressive financial scorecards or declaration of dividends. Thus, we project a negative close to the year as investors continue to weigh their investment options vis-à-vis the direction of rates in the fixed income market, the state of the macroenvironment and the regulatory (un)certainly in the economy.

In this report, we look at the major themes that dominated the equity market space in H1 2021 and delineate our outlook for the rest of the year.

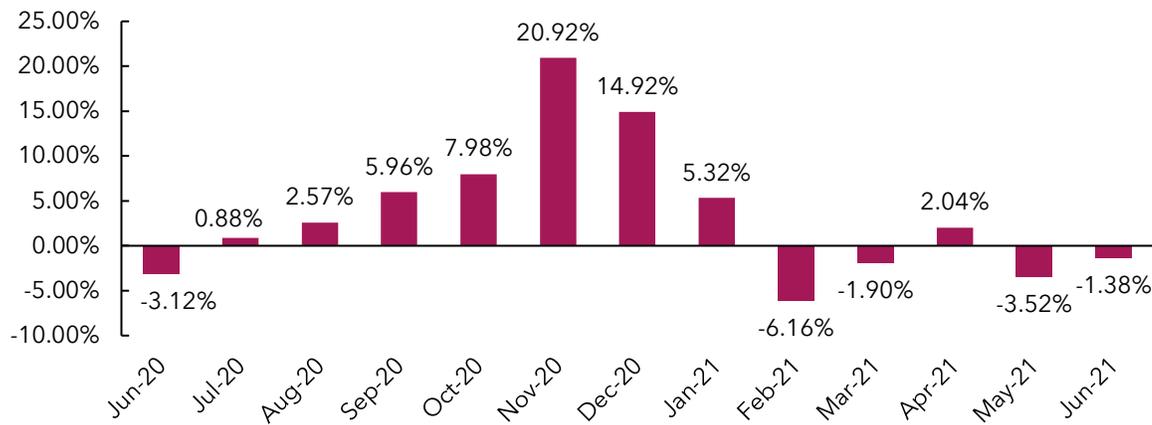
Unanticipated early recovery in yields drag performance

The performance of the Nigerian equities market so far in 2021 has reflected the economic uncertainties surrounding the economy, with a return of -5.87% in the first half of the year. Not much is expected to change going forward as performance will likely be dictated by direction in yields, developments in the FX market as well as attractive entry opportunities in fundamentally sound names and possibly so, the anticipated DANGCEM share buy-back programme. Earlier in the year, we highlighted how the potential for more profit taking in equities market could lead to a negative performance at the end of H1:2021. This was a slight deviation from the flattish performance we had guided in our January 2021 NSR report with our reason for a review premised on the unanticipated and early recovery in yields in the fixed income space.

In the first half of the year, the weak state of macros and the high yield environment in the fixed income market induced a reallocation of assets to the fixed income market, thus, dragging the performance of the equities market through H1. Although the year kicked off on a positive note with a monthly return of +5.32% in January, losses were recorded in four (4) of the other five (5) months in the first half, settling the All-Share Index at 37,907pts and a YtD return of -5.87%. Beyond the reallocation of assets stemming from a tepid yield environment, we also acknowledge the effects of profit taking activities on some large cap stocks like DANGCEM, following the completion of the first phase of its share buyback programme in December 2020.

Despite some positives in the market like the impressive full-year and First quarter earnings releases, the expected demutualization of the exchange and the of approval Holding Company licenses to three banks (Sterling Bank, Access bank and Guaranty Trust Holding Company [formerly GT Bank]), market remained unfazed and profit taking activities persisted. However, the market witnessed some respite in April, but this was short-lived as bearish sentiment returned to the market and dragged performance even further. Foreign investors who have historically bene known to champion market activity continued to pull away from the market, leaving domestic participation at the helm of affairs. This came as no surprise considering the currency volatility, monetary policy uncertainty and regulatory instability which essentially left foreign investors holding the short end of the stick.

Figure 1: Monthly Returns



Source: ARM Research, Nigeria Exchange Group (NGX)

Performance drag despite strong oil price recovery

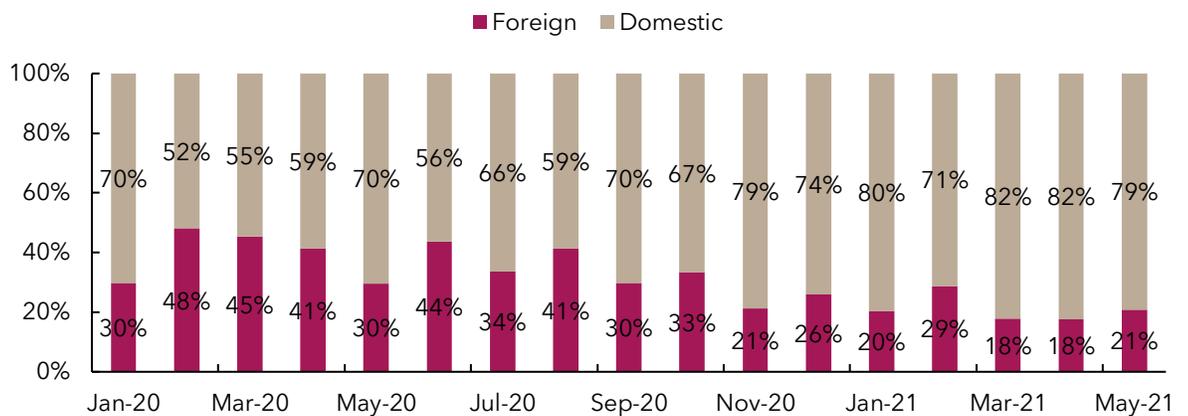
Despite the strong recovery we have seen in the crude oil prices in the first half of the year (+45.0% as at the end of June 2021), the Nigerian equities market posted a negative YtD return of -5.87% in the same period. Foreign participation in the market has been known to have strong positive impacts on performance over the years. However, with the current state of the macroeconomic environment, the political instability and the regulatory uncertainty which have all posed challenges for investors and businesses alike, foreign participation in the market has significantly dwindled, from an average of 51% in 2019 to 35% in 2020 and further down to 21% between the period of January and May 2021. So far in 5M:2021, the equities market has witnessed a net foreign outflow of NGN15.90bn, a trend that started in 2018 and worsened in 2020 due to the outbreak of the COVID-19 pandemic.

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Although the strong recovery in crude oil prices is positive for the economy, factors ranging from technical and operational issues as well as leakages in pipeline and sabotages continue to weigh on oil production numbers and by extension, oil revenue. This largely explains the 16% QoQ decline in crude oil export revenue in Q1:2021, according to data from CBN, and the lower than projected average oil production numbers in Q1:2021. This coupled with the relatively subdued remittance inflow (\$4.27bn in Q1:2021 vs \$5.63bn in Q2:2021) amidst increasing FX demand owing to domestic economic recovery has thinned out FX liquidity in the market. Consequently, foreign investors negative bias continued to center around FX illiquidity and uncertainties around monetary policies that could be embarked upon to salvage the economy.

Recall in 2020, the CBN halted the sale of FX to BDC operators from March up till the third quarter of the year leading to the inability of foreign investors to repatriate funds. A move which raised serious concern and has done well to leave foreign investors skeptic about investing in Naira assets given the possibility for a repetition of such policy or worse. Furthermore, with FX illiquidity remaining a major challenge, questions about a further devaluation on the Naira are being asked and this has contributed to foreign investors decision to remain on the sidelines.

Figure 2: Domestic and Foreign Participation on a Monthly basis



Source: ARM Research, Nigeria Exchange Group (NGX)

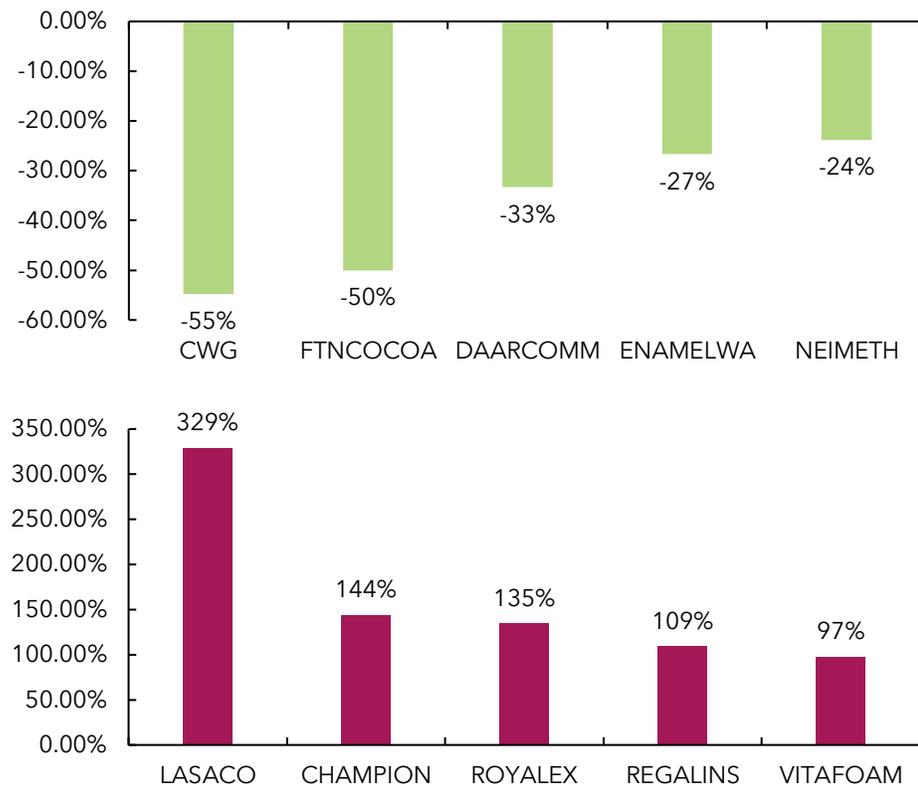
Performance Led by Oil & Gas Sector

Sectoral performance has been mixed in H1:2021, with Oil & Gas (+38.41) leading the gainers list while Industrial (-8.02%) topped the losers' chart. Other sectors like Insurance (+7.57%) and Consumer Goods (+4.80%) have also witnessed gains over the period while Banking (-6.76%) recorded loss. On a company specific basis, AIRTELAFRI (-21.6%), UBA (-15.6%), DANGCEM (-9.8%), BUACEMENT (-7.6) and GTCO (-7.6%) were the most contributors to the market losses

posted in H1:2021. For AIRTELAFRI, we recall the significant gain posted on the stock in 2020 supported by improved data usage and more importantly foreign investors buy interest as a way to repatriate funds owing to its dual listing status. Furthermore, BUACEMENT has continued to remain relatively expensive compared to peers with a P/E ratio of 34.10x vs the industry's average of 19.63x, thus, evidencing the reason for the selloffs we have seen on the stock. For DANGCEM, the first tranche of buyback programme executed late December 2020 led the stock to gain 72.5% YoY in FY'2020, thus, giving investors an opportunity to take profit on the counter.

GTCO has also been a major contributor to the losses posted in the market despite its corporate restructuring into a Holding Company. In the first half of the year, the company announced its plan to diversify from a standalone commercial bank to a group structure that allows it to invest in other areas like pension, asset management and fintech. On the flipside, SEPLAT (+71.5%), STANBIC (+6.6%), NESTLE (+2.3%) and among other names have registered gains over the period. For SEPLAT, the strong recovery in crude oil prices have been quite supportive of improved sentiments towards the stock. Given that it lost significantly in 2020 (-38.8% YoY) owing to the material decline in crude oil prices because of the pandemic, it has also been used as a mean to repatriate funds from the Nigerian market as the FX market remains illiquid and AIRTELAF believed to be relatively expensive. From a return perspective, the top gainers in H1:2021 has been LASACO (+328.6), CHAMPION (+144.19%), ROYALEX (+134.6%), REGALINS (+109.1%) and VITAFOAM (+97.44%) while CWG (-54.7%), FTNCOCOA (-50.0%) and DAARCOMM (-33.3%) led the losers' chart. Over the period, investors continued to bargain hunt on names that are believed to be fundamentally sound and perceived to be trading below their fair value position. This may have informed the buy interest we have seen in some of the names that returned positive at the end of H1:2021.

Figure 3: Top gainers and losers in H1: 2021



Source: ARM Research, Nigeria Exchange Group (NGX)

Is there Respite in Sight?

The factors which dragged market performance in the first half of the year are still very much present and we believe they will continue to shape market outcomes for the rest of the year. With rates in the fixed income market on the high side and expected to remain elevated through the year, the incentive to shift to the equities market and carry on more risk is lacking. Furthermore, the concerns which foreign investors have had about the state of the macroenvironment and regulatory uncertainty do not seem to be abating in the near term. Despite a net foreign inflow in Q2:2021 vs an outflow in Q1:2021, we are not convinced of a significant rebound in foreign interest in the Nigerian bourse in the second half of the year. We believe that foreign participation in the market will remain subdued till there is a significant bargain hunting opportunity in the market.

However, we note that in the event of a Eurobond issuance, short term interest in the equity space could be sparked, as the apex bank will be afforded sufficient legroom to defend the currency, easing some of the FX liquidity concerns. We also do not rule out the possibility of

prices falling further to points which are considered quite attractive to investors, inciting a possible rally in the market. On the corporate actions' spectrum, we expect to see minimal positive activity driven by impressive financial scorecards or declaration of dividends. Thus, we project a negative close to the year as investors continue to weigh their investment options vis-à-vis the direction of rates in the fixed income market, the state of the macroenvironment and the regulatory (un)certainty in the economy.

ARM Securities Contact

Research	234 (1) 2701653	research@armsecurities.com.ng
Institutional Sales & Trading	234 (1) 448 8833	trading@armsecurities.com.ng
Customer Service	234 (1) 4488282	customerservice@armsecurities.com.ng

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