

Nigeria Strategy Report

H1 2016



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NIGERIA STRATEGY REPORT H1 2016

ARM Research

SUMMARY

The world's output growth decelerated to five-year lows in 2015 as a handful of countries shouldered the burden of positive growth impetus. Previous short-term outperformers (Europe and Japan) and even some longer term ones (China and Brazil) witnessed significant reversal of fortunes by the latter part of the year with the US being the most significant growth story after reversing Q1 15 doldrums. The sequential disappointment in aggregate output on multiple fronts is perhaps best encapsulated by the multiple downward reviews of 2015 growth expectations (IMF 3x; World Bank 2x). Interestingly, despite the multiplicity of the standard easing response across climes, there was hardly any push impetus that materialized in any worthwhile portfolio flow, except perhaps to India. While this again reaffirms the importance of the role of the US in stimulating global capital flows, it is perhaps more pertinently an indication of the soreness with which those measures were needed in the respective home markets as upheaval grew. Unsurprisingly, net portfolio flows were negative to EMs who were grappling with their own growth issues and hardly had any pull power on capital flows.

A key symptom of the aggregate dourness was found in the commodity market where prices remained broadly under pressure. However, some soft commodities found support from El Nino which reduced their available supply and, by buoying prices, provided spotty relief. Nonetheless, the underlying demand-supply dynamic remains broadly unfavourable though certain grains appear to be nearing an inflection point. In contrast, oil continued to pelt downhill without restraint to reach the lowest level in over a decade towards the end of 2015.

Going forward, the shift in the battleground of the price wars away from conventional vs shale producers to being between conventional producers does not in any way mitigate the scope and timeframe of the potential additional pressure. If anything the decision to allow US producers export, which has already seen WTI reverse its traditional discount to Brent to now trade at a premium, suggests prices will remain depressed for longer despite signs that shale output is starting to drop. We believe the attempt to find stability as these contrasting influences interact portend significant

volatility for domestic markets in 2016. In that light, the commencement of the tightening cycle late in December 2015 adds another layer of macro risk as it raises the opportunity costs of investing and also, by reinforcing the dollar strength, potentially accentuates commodity downside. Perhaps the even bigger issue is that we feel both events (oil lows and rate hikes) occurred too late in 2015 for domestic markets to fully react and we expect to see some of that delayed response in 2016. Though the government appears to be ticking the right policy and operational boxes after the delays in cabinet formation engendered significant investor anxiety—an anxiety we had earlier questioned—it remains clear that there will be no quick fixes. Combining this with slow growth and still pressured corporate earnings portends further headwinds for equities though specific government actions, if delivered upon, could open the blinds for some bright lights to shine through. Similarly, whilst the FI market has a somewhat more broadly positive outlook to our thinking, much of it is contingent upon continuation of recently emerging influences that would barely qualify as fundamental but despite that, are not any less potent.

INTRODUCTION

The balancing act required by the shifting landscape of global events remained very much in demand in H2 15. The baton of growth momentum switched hands, again, as Eurozone's stimulus-swelled growth sapped while Japan narrowly avoided a recession. In contrast, the US which had shown signs of deceleration earlier in the year rebounded sufficiently to eventually give the US Fed the confidence to implement long-debated rate hike. However, the ensuing divergence in monetary policy, as other regions remained in stimulus mode on slow growth or even firmly in recession, was just one of the contrasts that manifested in the environment. Before this, and perhaps reflecting the same underlying dynamics, currencies had already diverged with the US dollar strengthening against most other global currencies. Interestingly, even the typically highly correlated commodity market responded to the differing dynamics in various home regions with the influence of El Nino on certain weather patterns adding even more variability to performance of individual commodities. Depending on main product, certain EM/FM economies benefited but for oil producers the economic ravages only deepened.

That clearly meant the threats Nigeria faced were even more pronounced and the questions around economic direction and policy more pertinent. In that regard, clear positives emerged with the formation of government swiftly followed by policy pronouncements that not only communicated the needed will was available but also showcased a more lucid grasp of the economic challenges than is usually on display. Specifically, efforts to tackle the petroleum sector rot, economy-jumpstarting focus of planned expansion in government spending and the raising of electricity tariffs to competitive levels resonate well within the context of needed reforms. However, the failure to allow a more flexible exchange rate regime and the shunning of outright subsidy removal are drawbacks that question the appropriateness of the overall policy response to the global challenges.

In our last report, we framed the key assessment parameter for the new government as the question of whether the time taken in government formation

will be justified by the actual initiatives being "bold and insightful enough to change the tide of current challenges and help cope with the inevitable next wave (likely including further downside from oil)?" The first part appears to have been satisfactorily dealt with but it is the coping with the deepening challenges that still weigh on our minds. Our thoughts on the policy framework frame it more poignantly: Whilst fiscal prudence, plugging of leakages and fighting corruption are all laudable and show the needed political will, the real question is whether the economic ravages are so deep cutting as to render all those ultimately ineffectual?

REVIEW OF GLOBAL ECONOMY AND MARKETS

UNEVEN GLOBAL GROWTH DRIVING DIVERGENT POLICY AGENDA

DM economic recovery slows in tandem with global demand

Over the course of the year, the IMF revised its 2015 global growth thrice, eventually settling at 3.1% YoY—lowest since the 2009 financial crisis. The subdued pace of growth reflects deceleration of economic activities in EM countries which weighed on import demand as well as slow recovery in DM countries.

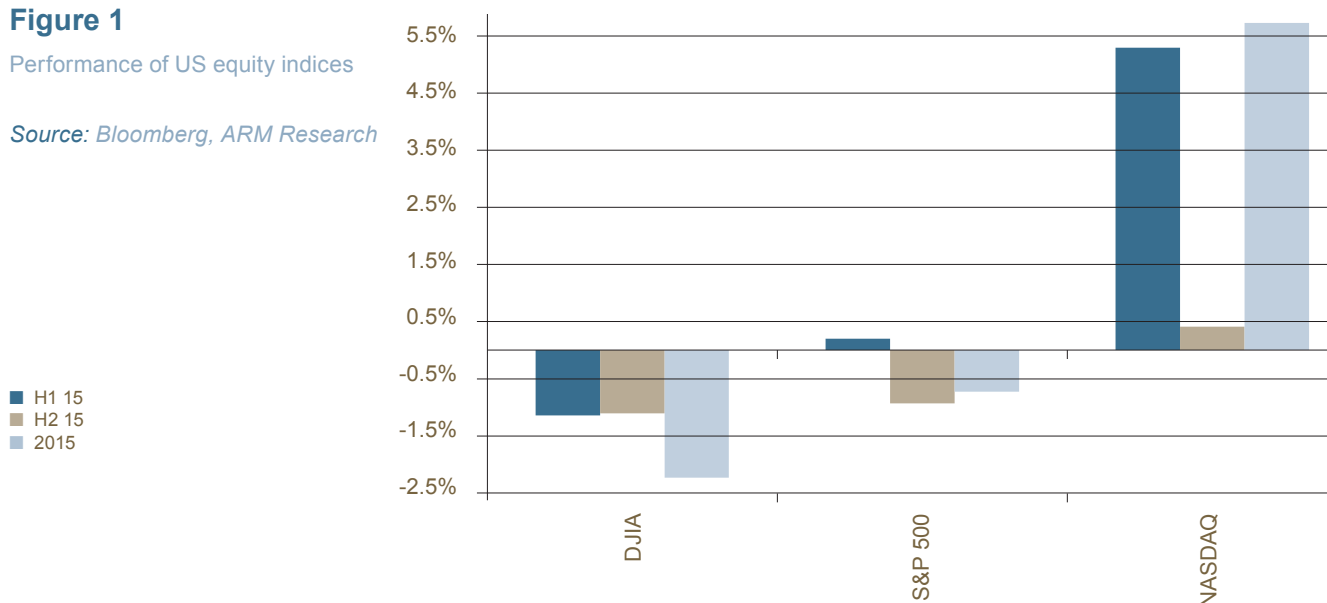
Focusing on DM countries, US economic growth slowed in Q3 15 with an annualized quarterly growth of 2.1% YoY (Q2 15: +3.9% YoY) partly reflecting lower

private inventory, non-residential fixed investment and exports—impacted by softening external demand. Notwithstanding the deceleration in output, the US economy is perceived to be resilient as consumer spending continues to rise (+1.4% YoY in November 2015) on sturdy labour market data with unemployment rate of 5% being the lowest since April 2008. Whilst this positive picture induced the US Federal Reserve to hike interest rates in December 2015 (+25bps to 0.5%), for the first time since 2006, it was not enough to offset concerns of declining global growth especially from China, ultimately weighing on US equities. Nonetheless, the relative strength of the US economy underpinned the outperformance of the US dollar (+9.3%) against a basket of other major currencies in 2015.

Figure 1

Performance of US equity indices

Source: Bloomberg, ARM Research



Across the Atlantic, economic recovery in the Euro-zone lost momentum in Q3 15 as weaker-than-expected growth from Germany (+0.3% QoQ) and Italy (+0.2% QoQ), fresh contractions in Greece (-0.9% QoQ), Finland (-0.6% QoQ) and Estonia (-0.5% QoQ) as well as stagnation in Netherlands and Portugal more than offset improved economic activities in France (+0.3% QoQ). While lower exports underpinned the

weakness in Germany and Italy, contraction in Greece is unsurprising following the bailout drama which saw banks shuttered and capital controls imposed in the country's financial system. The tepid economic growth as well as persistently low inflation (0.2% YoY in December 2015) necessitated the ECB's inclusion of regional and local Euro Area debt in its €60 billion per month bond buying program which, also, the

bank extended to at least March 2017. In addition, the central bank announced the reinvestment of principal payments on securities purchased as well as reducing its deposit rate further by a further 10bps to -0.3%. The negative sentiment which arose from the ECB measures, as it fell short of investors' expectations, combined with concerns from the Paris attacks, which weighed on travel shares, to drag European bourses lower in H2 15.

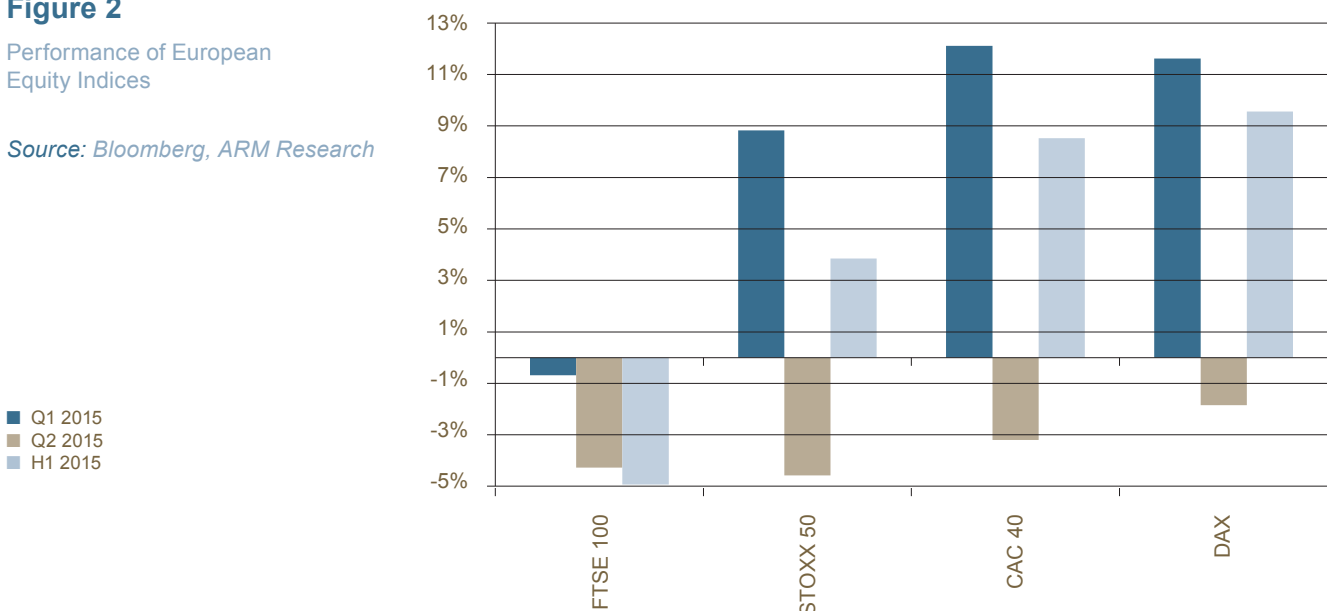
Though the United Kingdom continues to outperform many of its European peers, its economy floundered in Q3 15 (QoQ: +0.4%) as renewed recession in its

manufacturing sector (-0.4% QoQ) and slump in construction sector (-1.9% QoQ) muted impact of improved services sector (+0.6% QoQ). With CPI figures still hovering around zero (Nov 15: 0.1% YoY) the Bank of England voted to leave both interest rate of 0.5% and 375-billion-pound asset-purchase program unchanged. Nonetheless, in tandem with slumping commodity prices (GSCI: -22.01%), towards which the British equity market is heavily weighted, the FTSE 100 posted a negative performance.

Figure 2

Performance of European Equity Indices

Source: Bloomberg, ARM Research



Japan's economy avoided a technical recession as stronger domestic demand and improved business investment (+0.6% YoY) underpinned an upward review of its annualised Q3 15 GDP to 1% YoY (previous estimate: -0.8% YoY). Despite an upbeat growth number and a decline in jobless rate to 3.1% in October—lowest in two decades—depressed oil prices induced three consecutive months of negative core inflation. The deflationary trend, which last occurred in 2013, when BoJ announced its asset purchase program, had underpinned expectations for expansion of the QE program. Whilst the BoJ left the asset purchase program unchanged, it extended the duration of the Government bonds bought from 10 to 12 years as well as set up

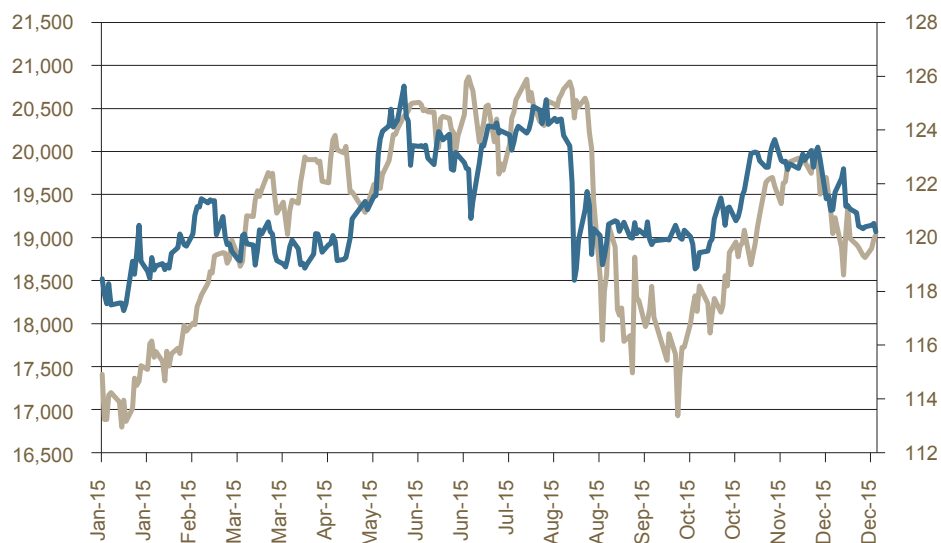
a 300-billion-Yen fund to buy exchange-traded funds (ETFs) that specifically target firms actively spending on capital expenditure and wages. The latter decision was taken to prod more companies into raising wages and increasing new investment. To further stimulate private consumption, the Japanese Prime Minister ordered his cabinet to compile an extra budget for the fiscal year ending March 2016 which, among other things, would include cash payouts to low-income groups. These expansionary policies were enough to sustain the Nikkei's positive momentum (+9.1% YTD), whilst managing to keep Japanese Yen largely flat (-0.4%), notwithstanding the roiling of Asian markets in H2 15 by successive devaluation of the Chinese Yuan.

Figure 3

Performance of Japanese Equities and Exchange Rate

Source: Bloomberg, ARM Research

■ NIKKEI
■ YEN (RHS)



Discordant growth picture across EM

Notwithstanding a wide range of stimulus measures including cutting interest rates (-25bps) and reserve requirements (-50bps), as well as 3% devaluation of the Yuan adopted by the Chinese authorities in the third quarter to boost demand, Q3 15 GDP growth of 6.9% YoY is the country's slowest growth since the global financial crisis of 2009. In a bid to stabilize economic growth, the PBoC consequently reduced interest rate further (1 year lending rate: -25bps to 4.35%, 1 year deposit rate: -25bps to 1.5%, SLF: -175bps to 2.75%, 7-day bank loan rate: -225bps to 3.25%), lowered reserve requirements of banks (-50bps to 17.5%). In addition, the central bank lessened the Reserve Requirement Ratio (-50bps) of banks which lend to agricultural firms and small companies while scrapping the cap on deposit rates for China's commercial lenders and rural cooperatives. Furthermore, amid strengthening dollar—in anticipation of US Fed rate hike—the PBoC loosened its grip on the Yuan by allowing it to weaken for 10 consecutive days (longest weakening streak on record) to 6.48 Yuan to \$1 on 17th of December 2015 (2015: -4.6%). Notwithstanding the aforementioned policies, sustained contraction in China's manufacturing sector with the PMI hitting a three-year low of 49.6 in November 15 as well as negative sentiment from the currency depreciation led the Shanghai index (YTD: +9.4%, H1 15: +32.2%) to erode most of the gains recorded in H1 15.

Economic activities continue to deteriorate in Brazil as its 4.5 % YoY (-1.7% QoQ) GDP contraction in Q3 15 is the steepest decline since the beginning of the current data series in 1996. Pressure points included investment which fell for its ninth consecutive quarter (-4% QoQ) while output from services (-1% QoQ) and industrial sectors (-1.3% QoQ) contracted sequentially for the fourth⁽¹⁾ and sixth⁽¹⁾ straight quarters. Further shattering consumer and business confidence is the surging inflation figures which rose to a 12 year high of 10% YoY in November (target inflation: 4.5%) notwithstanding a 50bps hike in the Selic rate to 14.25% (highest since October 2006). The spike in inflation as well as deteriorating jobs data, with unemployment rate of 7.9% in October 15 being the highest in six years, weighed on Household consumption (-5.6% YoY). The floundering economy, deteriorating fiscal⁽²⁾ conditions together with ongoing political crisis, threatening to unseat President Dilma Rousseff, all combined to effect ratings downgrade by major ratings agencies⁽³⁾ to junk in H2 15, and underpinned the weakness of the Brazilian Real (-49%) as well as its equities (-13.3%).

Similar to Brazil, economic weakness in Russia persisted into the third quarter as Q3 15 GDP contracted 4.1% YoY in line with similar contractions since the beginning of this year (Q2 15: -4.6% YoY, Q1 15: -2.2% YoY). Western imposed sanctions and

(1) Longest slump on record

(2) Budget deficit soared to 9.5% of GDP in October 2015 (October 2014: 5% of GDP)

(3) Both Fitch and S&P cut Brazil's credit rating to Junk, while Moody's placed the country's investment grade status under review.

sustained plunge in oil prices (50% of government's revenue) weighed on output and induced a 25.9% QoQ decline in seasonally adjusted current account surplus to \$13.7 billion in Q3 15. The weakened trade balance underpinned weakness in the Ruble (2015:-19.4%). Largely reflecting pass-through from currency depreciation, elevated inflation figures (November 2015: 15%) continue to constrain consumer spending (October real disposable income: -5.6% YoY, November 2015 real wages: -10.1% YoY). Notwithstanding the blurred economic picture, the Russia Micex ASI rallied to a 2015 high of 1,868 following agreements between Russia and US to join forces in the fight against ISIS November—which is perceived to herald easing of western imposed sanctions on Russia—consequently nudging the index returns over 2015 to 26.1% (H2 15: +6.5%). In contrast to the rest of EM countries, India's economy grew 7.4% YoY, outpacing China as the

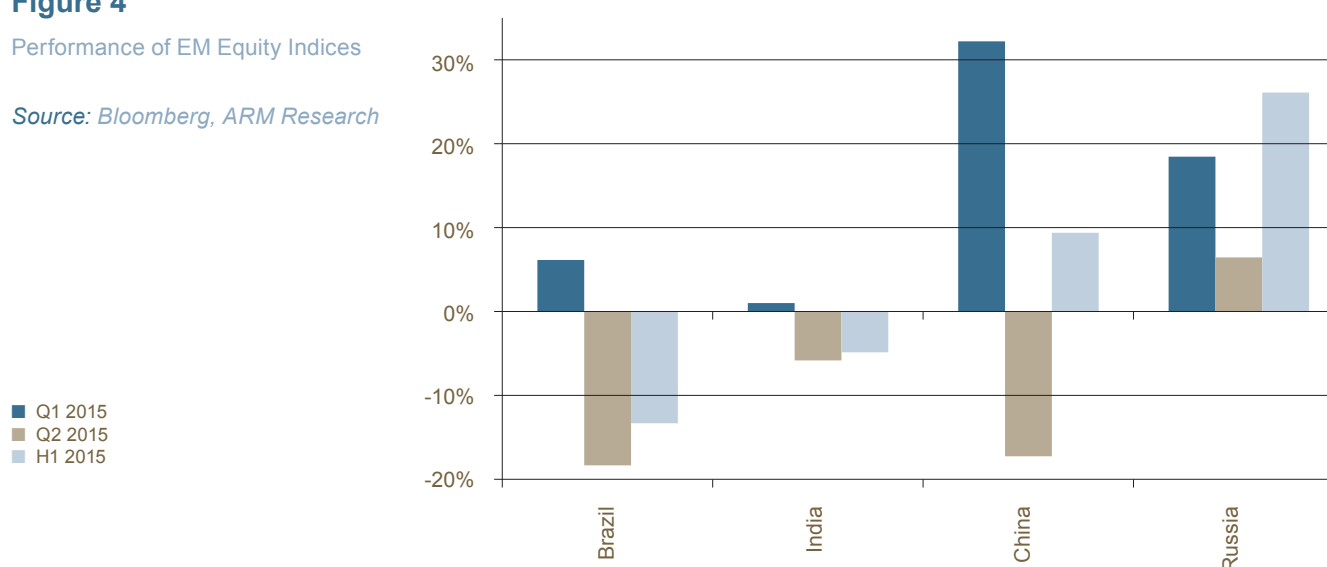
fastest growing economy in the world. The sanguine economic picture benefitted from sustained monetary easing of the Reserve Bank of India which undertook its fourth interest rate cut in 2015 to 6.75% in September 2015—lowest since April 2011. As a result, India's manufacturing (+9.3% YoY) sector and investment (6.8% YoY) both improved, overshadowing a 13 month high inflation of 5.41% YoY in November 2015. Nonetheless, concerns about US interest rate hike underpinned renewed portfolio outflows (November: -10.8 billion Rupees, December⁽⁴⁾: -7.5 billion Rupees)—after a brief respite in October (22.4 billion Rupees)—dragged the Indian currency to the lowest on record at 67.1037 rupees to \$1 on the 14th of December 2015 (2015: -4.9%). The capital flight over H2 15 (FPI outflow from equities: -23.3 billion rupees) also weighed on the Sensex index (2015 performance: -4.9%)

(4) December 1st- 21st 2015

Figure 4

Performance of EM Equity Indices

Source: Bloomberg, ARM Research



EM economic recovery and bearish energy prices to drive global growth higher

Global economic growth is projected to pickup in 2016 with IMF estimating a 50bps YoY expansion to 3.6% largely underpinned by lower oil prices (2016 IMF forecast: -18% YoY to \$42/bbl). Across the DM countries, US economic growth (+20bps to 2.8% YoY) is expected to be driven by improved domestic

consumption on projections of lower energy prices as well as stronger jobs data with US Fed forecasting unemployment rate to fall to 4.7% in 2016.

The bearish outlook for oil prices is also expected to support ongoing monetary easing by both the ECB and BoJ to drive economic growth in the Euro Area (+10bps to 1.6% YoY) and Japan (+40bps to 1% YoY) respectively. On a contrary note, the IMF forecasts

a 30bps deceleration in UK's growth to 2.2% YoY amid challenging outlook for exports and declining business confidence.

As for the EM countries, India is expected to strengthen further (+20bps to 7.5% YoY), benefitting from recent policy reforms, including liberalization of FDI in 15 sectors, which should boost investment as well as from lower commodity prices. Furthermore, expected hike (23%) in government salaries should further boost domestic consumption. The foregoing, together with slower pace of contraction in Russia (+320bps to -0.6% YoY) and Brazil (+200bps to -1% YoY), is expected to neuter growth deceleration in China (-50bps to 6.3% YoY). As a result, the IMF forecast a 50bps expansion in EMs GDP to 4.5% YoY in 2016.

The uneven pace of economic recovery posits sustained divergence in global monetary policies as the BoE, ECB and BoJ prolong easing monetary policies while the US Fed is looking to further raise interest rate (2016: +100bps). The impact of the foregoing is in twofold. Firstly, the divergent monetary policy is expected to drive a broad based strengthening of the US currency, compounding the already bearish outlook for commodity prices and consequently exacerbating fiscal vulnerabilities of commodity exporting countries. Secondly, it would lead to tightening of global financing conditions as monetary authorities of EM countries will be forced to offer higher yields to attract the more expensive US funds. In sum, capital flows will increasingly discriminate based on country prospects and vulnerabilities with the resultant readjustment of capital flow causing volatility across financial markets. Further risks exist to financial market performance as investors react to outcome of Britain's referendum on EU membership. With the EU referendum likely to hold in 2016, an exit could trigger various economic negotiations leaving foreign companies to question the wisdom of investing in the U.K. The resultant effect will be weaker trade and investment, a situation which would have repercussion on the pound and gilts.

Overall, global growth is expected to improve from its multi-year lows, while divergent monetary policies will drive most currencies weaker and impact on capital flows.

ESCALATING CHALLENGES DRIVE AFRICA'S GROWTH LOWER

Similar to trends across EM countries, Africa's macroeconomic picture worsened on the back of sustained decline in commodity prices as well as inherent domestic challenges. Focusing on growth, Africa's economic output floundered with IMF revising its 2015 GDP growth projection for SSA from 4.5% in April 2015 to 3.8% in October 2015—lowest annual growth in sixteen years—while mean North Africa growth estimate of 2.08% is 1.8pps lower than its April 2015 forecast. The even tamer growth picture for the North African region stemmed from economic weakness in Algeria, Tunisia and Egypt. For Algeria, lower oil prices are the main culprit whilst the other two are feeling the dampening impact of terrorist attacks in their tourism industries. Notably, Tunisia's GDP growth of -0.1% in Q3 15 is the country's first negative GDP growth in 15 quarters. Security concerns also underpin the Egyptian tourism ministry's expectations for a 15% YoY contraction in 2015 tourism (5.9% of GDP) revenues. Alongside insecurity effects, sustained downtrend (nine consecutive months by October 2015) in revenues from Suez Canal (-5.2% YoY to \$4.38 billion) despite multi-billion dollar expansion project, as well as slowing growth among trade partners showcase the pressure on the Egyptian economy. In Central Africa, ongoing sectarian violence in Central African Republic (CAR) continues to ravage the country, with the United Nations calling for urgent humanitarian aid for more than a million malnourished children. The Western part of Africa also had its fair share of insurgent activities, as Al-Qaeda linked Al-Mourabitoun, based in Northern Mali, extended its attacks to the South when its November 2015 siege on an hotel left 27 people dead. In the same vein, Boko Haram continues to wreck havoc in Cameroon, Chad, Niger and Nigeria with the insurgency impact in the latter compounded by the economy's reel from lower oil prices. In addition to weaker commodity prices, Ghana's economy continues to be impacted by electricity challenges and fiscal consolidation. Economic performance in the Southern region was similarly pressured as the region's biggest economy, South Africa, posted its lowest growth rate since the 2009 recession in Q3 15 as electricity shortages and falling metal prices (GSCI metals: -25% YTD) impacted its manufacturing sector (Q3 15: +1.4%

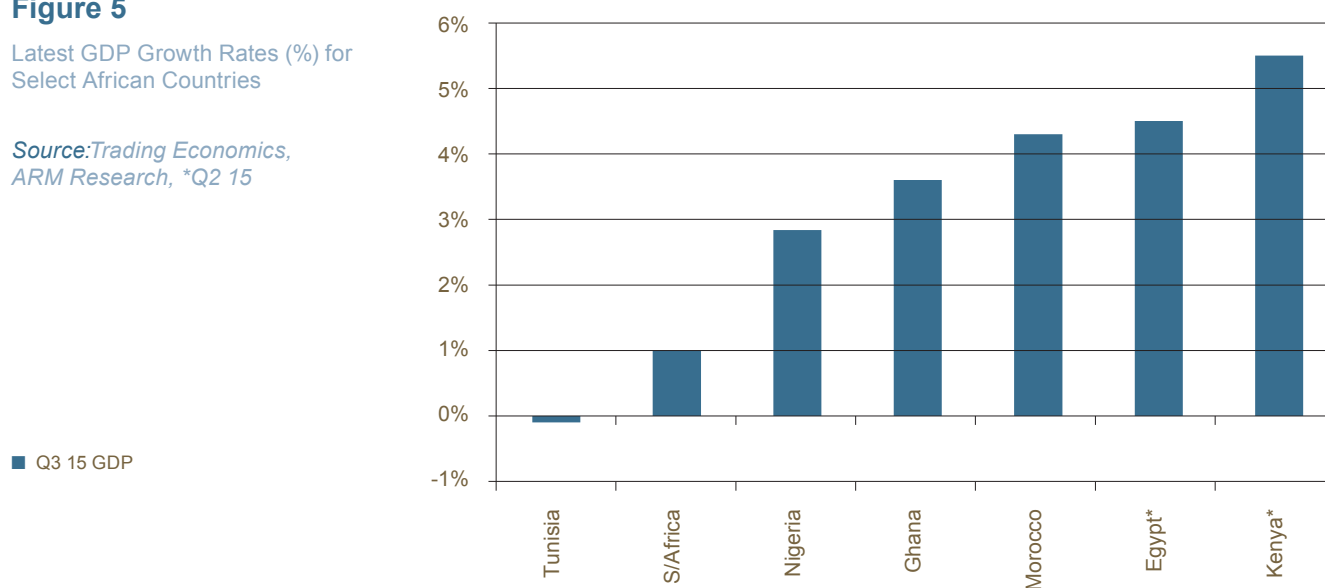
YoY), while the country's worst drought since 1982 underpinned the recession in its agricultural sector (-16.2% YoY). The story was similar for other countries in the southern region, but particularly Zambia, whose largely hydro sourced electricity

was severely impacted by drought, exacerbating weakness emanating from plunging copper prices (2015: -24.9%) even as bearish trend in oil prices (2015: -45.3% YTD) continue to drag Angola's economic growth lower.

Figure 5

Latest GDP Growth Rates (%) for
Select African Countries

Source: Trading Economics,
ARM Research, *Q2 15



Commodity price rout undermines African currencies

Given the heavy dependence of African countries on commodity exports (SSA: two-thirds of total exports), sustained downtrend in commodity prices (GSCI: -22.01%) worsened the current account position, consequently underpinning IMF's revised 2015 current account deficit for SSA (+1.1pps

to 5.7% of GDP) and North Africa (Average: +2.6pps to 16.9%) in October 2015. As a result of the foregoing, governments' needs to finance the resultant fiscal deficit drove borrowings higher, with Eurobond issuance rising 8.8% YoY to \$9.25 billion in 2015. However, given the macroeconomic challenges, these loans were issued at higher yields, limiting the current account support.

Table 1

Africa sovereign euro-bond issuance

COUNTRIES	AMOUNT (\$'MILLION)	2014			AMOUNT (\$'MILLION)	2015		
		COUPON	YIELDS	TENOR		COUPON	YIELDS	TENOR
Angola	1,500	9.50%	9.94%	10 years	-			
Cameroon	750	9.50%	10.23%	10 years	-			
Cote d'Ivoire	1,000	6.38%	7.62%	13 years	750	5.38%	7.30%	10 years
Egypt	1,500	5.88%	8.16%	10 years	-			
Ethiopia	-				1,000	6.63%	8.18%	10 years
Gabon	500	6.95%	9.67%	10 years	-			10 years
Ghana	1,000	10.75%	10.52%	15 years	1,000	8.13%	11.30%	12 years
Kenya	-				2,000	6.88%	9.11%	10 years
Kenya	-				750	5.88%	7.82%	5 years
Namibia	750	5.25%	5.89%	10 years	-			10 years
Senegal	-				500	6.25%	7.90%	10 years
South Africa	-				1,000	5.38%	5.88%	30 years
Tunisia	1,000	5.75%	7.62%	10 years	500	2.45%	2.10%	7 years
Zambia	1,250	8.97%	12.00%	12 years	1,000	8.50%	12.04%	10 years
Total	9,250				8,500			

Source: Bloomberg, ARM Research

The balance of payment concerns were evident in the 2015 performance of the South African Rand (-33.7%), Angolan Kwanza (-31.5%), Algerian Dinar (-21.7%), Ghana Cedi (-18.3%) and Kenya Shillings (-12.9%). In addition, the Egyptian Pound was devalued for the third time in October, driving cumulative year-to-date depreciation to 9.5% following the biggest monthly decline in the country's foreign reserves since January 2012 in September 2015 (\$16.3 billion) while the CFA Franc (-14.1%) continued to track movement of its Euro peg (-11.4%). Zambian Kwacha remained the worst performing currency in Africa, depreciating 72.3% YTD.

Higher food prices induce inflationary pressures across Africa

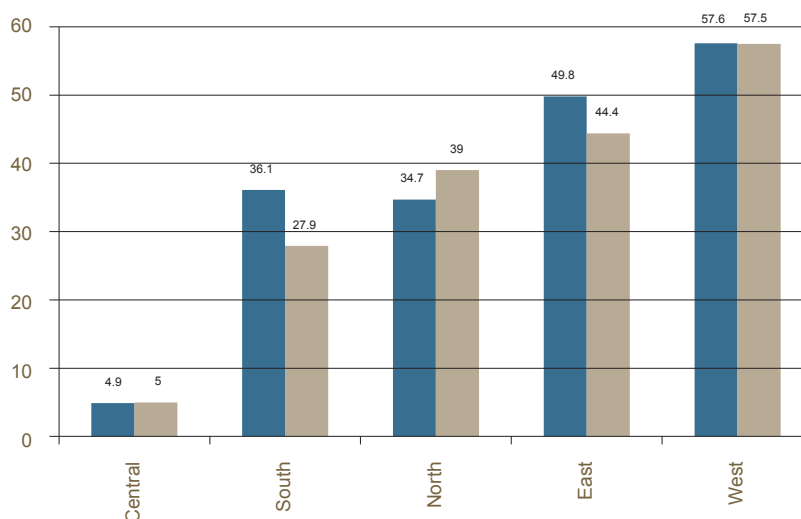
In addition to inflationary pressures from weakening currencies, food prices trended higher across Africa, particularly in Southern Africa, which experienced its worst drought in four decades, and Eastern Africa, where torrential rainfall led to flood, consequently hampering agricultural harvests. As a result, headline inflation peaked in Zambia (highest since 2005), Angola (highest since August 2011), Uganda (39 month high) and Kenya (13-month high).

Figure 6

Africa's Cereal Production
(Million Tonnes)

Source: FAO, ARM Research

■ 2014
■ 2015F



Nonetheless, in the same period Zimbabwe mired further into deflation largely underpinned by its currency crises, which further stifled domestic production and consumer demand, as well as influx

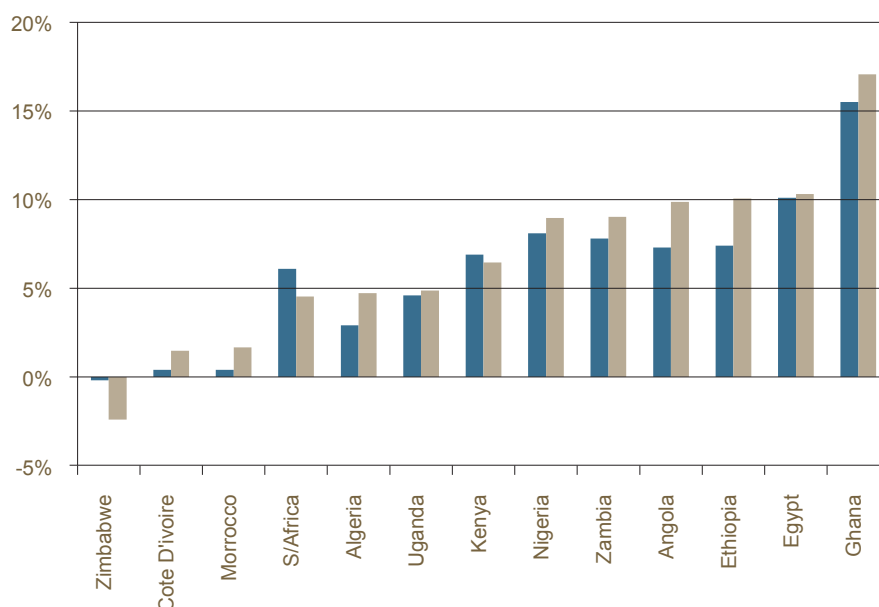
of cheaper goods from South Africa, while inflation in Sudan, which had skyrocketed following South Sudan's secession and cut in subsidies in 2013, eased to 2011 levels over the year.

Figure 7

Mean Inflation across
Major African Countries

Source: Trading economics ARM
Research,*Year-to-November

■ 2014
■ MEAN 2015*



In response to depreciating currencies and rising inflation, African central banks intensified monetary policy tightening over H2 15 with both South African Reserve Bank and Bank of Malawi raising key interest rate 50bps and 200bps to 6.25% and 27% respectively, while Bank of Ghana raised its benchmark monetary

policy rate for the fourth time in 2015 by 200bps to 26%. Similarly, Bank of Zambia raised benchmark lending rate 3pps higher to 15.5% for the first time in a year in November 2015, while the Bank of Burundi hiked its interest rate to 15.98% (+3.59pps). In contrast, and with their eyes firmly on boosting

economic growth, the Central Bank of Nigeria (MPR: -2pps to 11%, CRR: -11pps to 20%), Bank of Mauritius (benchmark repo rate: -25bps to 4.4%) and Central Bank of Tunisia (interest rate: -50bps to 4.25%) all underwent accommodative policies in H2 15.

Deteriorating fundamentals drive weaker equities performance

Reflecting the progressively weaker macroeconomic fundamentals, equity markets across the continent declined, with the S&P All African Index falling 20.9% in H2 15, dragging 2015 loss to 21.2%. The index' loss was underpinned by weakness across Egypt (-24.4%), Namibia (-20.9%), Nigeria (-19.8%), Mauritius (-12.7%), Ghana (-12.1%), Kenya

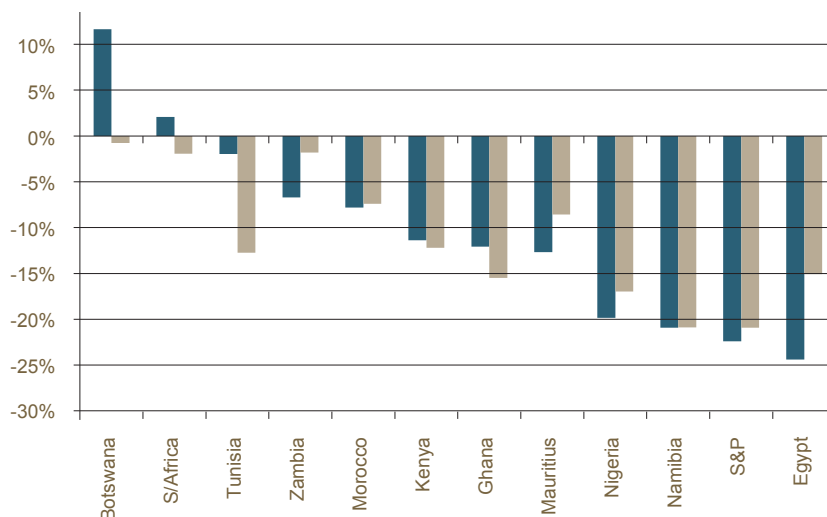
(-11.4%), Morocco (-7.8%), Zambia (-6.7%), Tunisia (-2.0%) which, combined, more than offset gains from Botswana (+11.6%) and South Africa (+2.1%). Negative performance in Nigeria reflects concerns about fiscal vulnerabilities induced by plunging oil prices and tempered corporate earnings while increased concerns about performance of Egypt's tourism sector—following terrorist attacks in November 2015 and downing of the Russian jet—weighed on the country's bourse. Elsewhere, closure of Imperial Bank Ltd on malpractice and fraud charges and placement of Dubai Bank Kenya Ltd under receivership for breaching daily cash-reserve-ratio requirements roiled the equity market in Kenya while depreciating Cedi remains a concern for investors in Ghana.

Figure 8

Performance of Major African Equity Markets

Source: Bloomberg, ARM Research

■ 2015
■ H2 15



External headwinds weigh on Africa's macro-outlook

Going forward, Africa's growth is expected to pickup in 2016, with the IMF forecasting a 4.3% GDP growth for SSA while projecting a mean growth rate of 3.9% for North African countries. The upbeat macroeconomic picture stems from recovery of economic activities in Ebola torn countries in West Africa (Liberia, Sierra Leone and Guinea) as well as faster pace of growth in the low income countries on the back of large scale infrastructure investment and improved consumer spending. Similarly, economic growth is expected to improve in Nigeria (+30bps to 4.3%) as a result

of higher government spending, reduced policy uncertainty and accommodative monetary policies. In Ghana, rising oil production, diminishing fiscal imbalances and easing of electric power crisis is expected to lift growth (+120bps to 5.7%). Elsewhere, South Africa's growth is expected to decline (-10bps YoY to 1.3%) as unfavourable weather conditions (i.e. drought) continues to hamper electricity supply and affect agricultural produce. Notwithstanding the improved growth picture, fiscal vulnerabilities persist as expected decline in commodity prices should exacerbate current account pressures to resource exporters across the continent. Further compounding the current account outlook is the commencement of

interest rate normalization in the US, which underpins prospect for a stronger dollar. Given sizable foreign denominated debt of most African countries, debt-service costs across the region is set to rise. The weak fiscal and current account position together with expected decline in portfolio flows given US monetary tightening posit sustained depreciation of the continent's currencies. In sum, the balance of payment concerns, rising terrorists' attacks, as well as political risks associated with the electoral process, especially in crises-torn countries, could remain significant enough to weigh on investors' sentiments towards the Africa's financial markets.

FPI FLOWS EXIT EM DANCE FLOOR

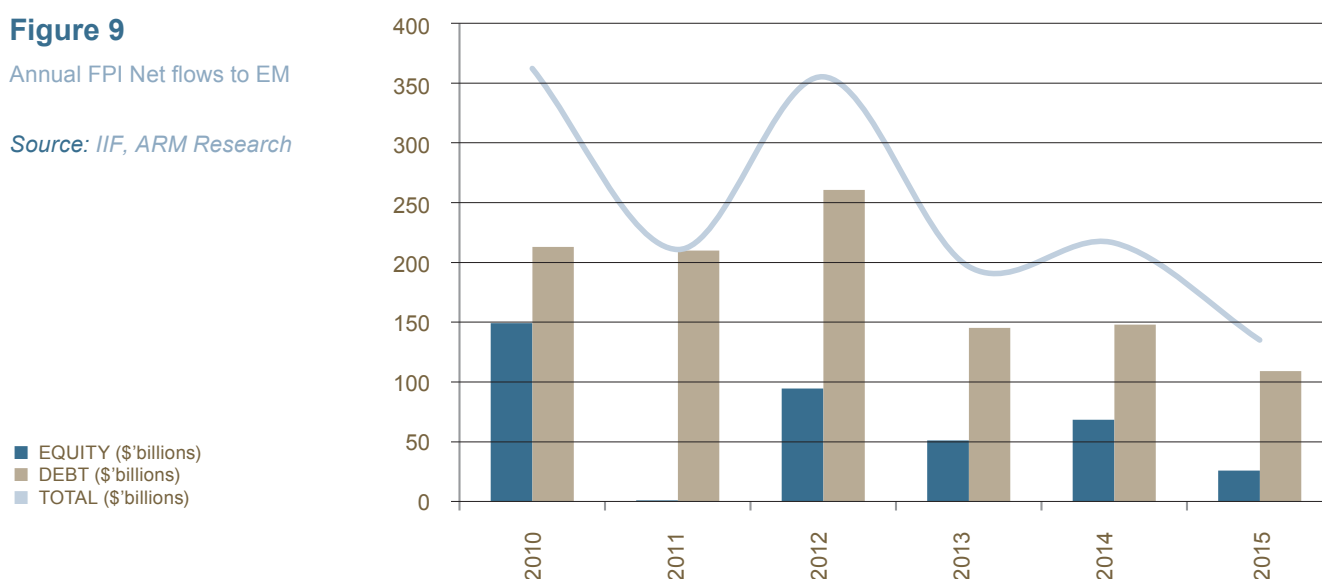
Softening push-pull factors drive lower FPI net flows

In its latest report, the IIF estimates that net portfolio flows to EM over 2015 should fall 37% YoY to \$135 billion - the lowest level since the trough during the 2009 financial crisis. This view was hinged on the net impact of a cocktail of influences in H2 2015 which included: heightened fears over the latest episode of the Grexit saga (which ended in July), mounting uncertainty over onset of US interest rate hike, an extended downturn in commodity prices and further deterioration in EM growth picture. The exodus reflects a reversal in the combination of push-pull factors (QE, EM growth and rate differential to DM and robust commodity prices) which had driven heightened flows into EM in the three years prior to 2015.

Figure 9

Annual FPI Net flows to EM

Source: IIF, ARM Research



On the push side of FPI flows, as discussed under our global review, monetary policies remained broadly accommodative across major global central banks for much of H2 15 with the US Federal Reserve being the exception by hiking interest rates 25bps to 0.5% in December. On the pull side, heightened concern over deterioration in Chinese GDP growth came to a head in August after the PBoC devalued the Yuan by 3% in a surprise move which stoked concerns about a fresh currency war. FPI flows also grappled

with recessionary growth in Brazil and Russia while beyond the BRICs, capital outflows from other EM countries reflect investors' concerns about impact of sustained downdraft in commodity prices on economic growth and on fiscal and trade balance sheets. On balance of factors, the derivative effect of turmoil across commodity markets and sliding economic growth fortunes on EM exchange rate and asset prices in an atmosphere of tightening US monetary policy induced tamer FPI flows over H2

2015. In what follows we dimension how the broad theme translated in FPI flow patterns across key EM geographies.

With similar impact across different EM geographies In Asia, poor growth and uncertainties in China led to sharp selloffs of domestic stocks and bonds in H2 15 with the IIF estimating that net capital flows swung negative to \$555 billion over 2015 (2014: +\$10 billion). Tailing a steady stream of softening macroeconomic data and the sharp plunge in equity markets over June, the perceived move towards Yuan weakness seemed to be what primarily spurred FPI outflows over H2 2015. Aside from negative sentiment arising from China's macroeconomic growth picture, uncertainty around interest rate hike in the US underpinned negative portfolio flows to both India (H1 15: \$12.5 billion, July-October: -\$2.1 billion) and Indonesia (H1 15: \$14.7 billion, Q3 15: -\$1.5 billion). While Malaysia had witnessed capital outflows over H1 15 (RM 19.7 billion) due to depressed commodity prices, the pace of exit accelerated over H2 15 (Q3 15: RM 24.4 billion) as alleged fraudulent activities by the Prime Minister, Datuk Najib Razak, induced a political crises in the country, further exacerbating the negative sentiment of investors.

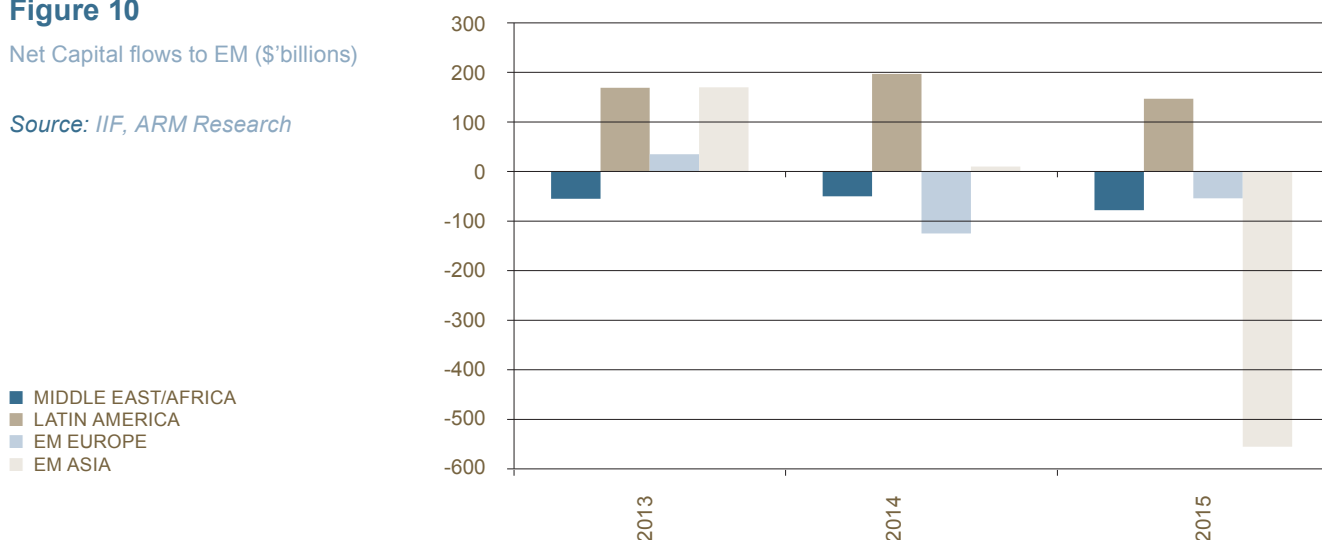
Over in Latin America, softer commodity prices, global risk aversion, and domestic policy failures have heightened pressure on local currencies, weakened real GDP growth and discouraged foreign capital inflows in H2 15 with the IIF estimating that FPI inflows have declined 13% YoY to \$274 billion. In Brazil,

slowing FPI flows stem from a deteriorating economic environment, with real GDP contracting for three quarters, and political infighting, which has made it difficult for the Rousseff-led government to garner enough legislative support for the implementation of pertinent fiscal measures. The worsening domestic conditions triggered the loss of its investment grade credit rating from Standard and Poor's in Q3 15 and resulted in tamer FPI flows with the Brazilian currency sliding 49.9% over H2 2015—the most among major currencies—to reach its weakest level in over two decades. In response to the currency slide, the Brazilian Central Bank, Banco Central do Brasil, stepped up intervention in the spot as well as the FX derivatives market and hiked rates by 50bps to 14.25% over H2 2015. In Mexico, speculation over US rate hike drove 25% YoY contraction in foreign investment flows to \$41.4 billion over the first three quarters of 2015. In turn, the cutback in FPI flows drove 16% depreciation in the Mexican Peso over 2015, necessitating sizable interventions by the Mexican Central Bank (Banxico). In Argentina, capital inflows remained minimal, in part reflecting inability to tap international debt markets as the standoff with the hold-out creditors remained unresolved and capital controls on outward foreign currency transfers in place, since 2011. Nonetheless, opposition victory in the October 2015 polls, subsequent removal of capital controls in December 2015 (which drove a 30% devaluation in the Argentine Peso) and pledge to negotiate with creditors, in contrast with outgoing government's belligerence, could mark an inflection point for FPI flow activity.

Figure 10

Net Capital flows to EM (\$'billions)

Source: IIF, ARM Research



In a similar light, the IIF estimates that the oil price rout has resulted in \$165 billion reduction in net foreign assets across MENA exporting countries to \$2.5 trillion in 2015. The development reflects outward FPI flows and impact of redemptions by Arab SWFs from the region in response to the oil price plunge with the Saudi Arabian Monetary Agency (SAMA) redeeming \$70 billion while other Middle-East based Sovereign Wealth Funds withdrew \$19 billion in Q3 15 from overseas funds to stem capital account pressures. Similar sentiments swung Egypt from net inflows of \$316 million in 2014 to net outflows of \$1.4 billion over Q3 15 using data from the Central Bank of Egypt.

Similar to the weak trends across other regions, net FPI flows to EM Europe remained negative with the IIF estimating mean quarterly FPI inflows declined by more than half from 2014 levels to \$9 billion in 2015 whilst outflows remained elevated largely driven by Russia, where concerns over impact of declining oil prices and economic sanctions continued to hurt economic growth. Further FPI slowdown reflects cutback in debt issuance across the region from \$19 billion in Q1 15 to \$5 billion in Q3 15 on tightening US rate outlook. On the flipside, backed by US guarantees, Ukraine returned to the Eurobond market with a \$1 billion issue.

Africa not spared as bearish commodity prices drives FPI exodus

As with other regions, lower commodity prices, weaker Chinese growth and expectations of Fed liftoff have had a negative consequence for capital flows to Sub-Saharan

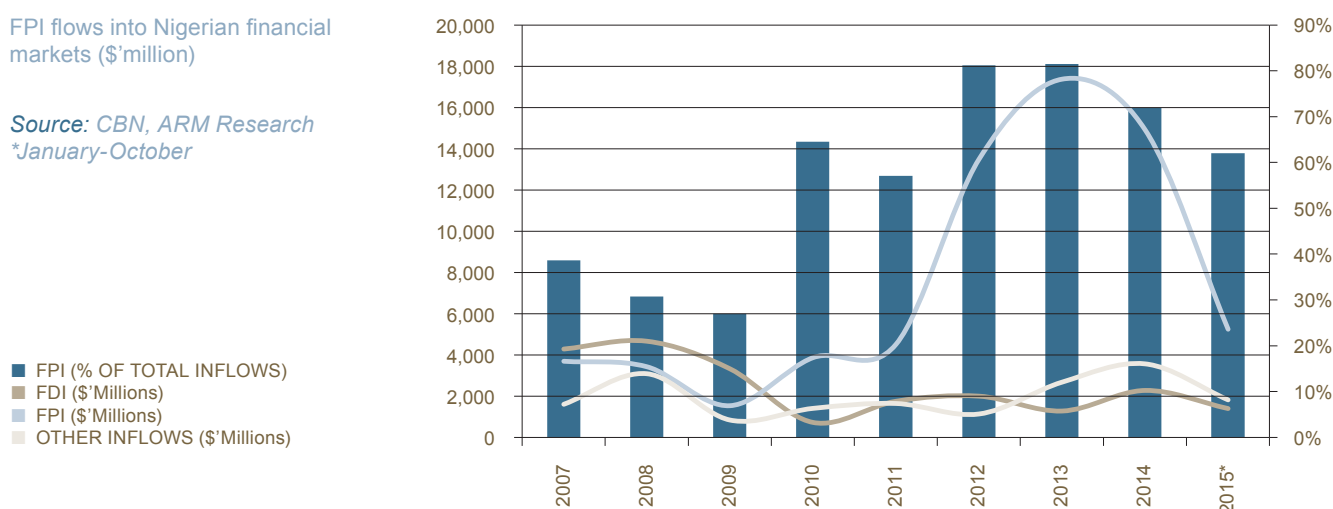
Africa in 2015 with attendant currency depreciation in a number of countries and policy tightening to stem inflation. Though sovereign debt issuance rose 8.8% YoY to \$9.25 billion, the cost of borrowing rose significantly as investors priced in prospect of rising US policy rates and softening economic fundamentals.

In South Africa, declining commodity prices and a weakening Rand drove a 25.4% YoY contraction in FPI flows to R47.1 billion in Q3 15. In particular, the continued declines in commodity prices drove a fresh wave of job cuts and, by extension, labour unrest across the mining industry. Though data is unavailable for Q4 15, outflows likely heightened following Moody's downgrade of South Africa's debt rating to Baa2 from Baa1 in December and unanticipated removal of finance minister Nhlanla Nene and subsequent replacement with a political novice, David Van Rooyen. Though President Zuma returned former finance minister Pravin Gordhan three days after the move, the sudden nature of the changes roiled South African equity and bond markets with the rand weakening to a record low (YTD: -31%) on heightened FPI outflows. In Nigeria, the collapse in oil prices, uncertainties bothering on the new government's policy direction as well as the Central Bank of Nigeria's reluctance to devalue the naira have had a major impact on capital flows. Further dampening FPI sentiment was JP Morgan's decision to phase out Nigeria from its Emerging Market Government Bond Index (GBI-EM) in early Q4 15 which was followed closely by Barclays' announcement that it would eject Nigeria from its emerging market local currency bond index in Q1 16. Consequently, mean monthly FPI flows into equities and

Figure 11

FPI flows into Nigerian financial markets (\$'million)

Source: CBN, ARM Research
*January-October



debt markets shrank 82% and 46% from H1 15 levels to \$268 million and \$32 million respectively, placing YTD flows 62% lower YoY at \$5.2 billion.

Tightening US rate outlook and still soft EM growth picture dampens FPI flow prospects

Going into 2016, while supply of QE stimulus remains unchanged with the ECB and BoJ maintaining their LSAP programs, onset of a tightening cycle in the US implies a less accommodative monetary policy outlook relative to recent past. Following the rate lift-off, focus now switches to second guessing the timing of subsequent rate hikes with the US Fed dot plot pointing to a cumulative 100bps increases over 2016. Nonetheless, Janet Yellen's conditioning of rate hikes on sustained improvement in the US economy implies a more gradual evenly spread rate hike over the four quarters of 2016.

The implication of the northward rate shift for US rates on FPI flows is at least two-fold. First, the rising rate trajectory raises the discount rate applied by dollar investors on all asset classes which should drive lower valuation for, and attractiveness of, EM investments. Second, the rising US key rate raises prospects of a stronger USD, which given an atmosphere of divergent monetary policy stokes probability of exchange rate volatility across EM currencies. Overlaying both implications with prevailing macro-economic conditions across EM countries who are characterized by weak-commodity-price-induced trade deficit, lower export revenues and limited fiscal leg-room, drives tame FPI flow outlook. In China in particular, extended deceleration in GDP growth which raises prospects for further Yuan weakness continues to underpin expectations for weaker capital flows. On the other hand, FPI flow to EM Europe is expected to improve largely on the back of diminishing outflow from Russia. Whilst Western imposed sanctions are likely to remain over 2016, concerns emanating on this front should diminish following more conciliatory gestures between Russia and Western countries following recent terrorist attacks in France.

Across Latin America, FPI outlook is largely mixed with recent removal of currency controls and other actions of the new Mauricio Macri-led government in Argentina bolstering outlook. The IIF forecasts \$15 billion-\$25 billion in inflows into the country's

financial markets. On the other hand, the outlook is negative for Brazil as political uncertainties, amplified by impeachment moves against President Dilma Rousseff, and corruption cases amongst high-profile national figures will make it even more difficult for the executive and legislative arms of government to reach a consensus on fiscal measures needed to restore the country's economic fortunes. On account of this therefore, we expect the country to continue to witness larger net capital outflows. However, Brazil's woes may turn out to be a blessing for Mexico as it has continuously benefited from FPI flows out of Brazil. The country's strong economy which has been forecasted to grow faster in 2016 on account of its strong fundamentals informs our expectations of higher net inflows in 2016.

Across Africa, prospect of further currency depreciation on softening current account positions should continue to underpin tame prospects for FPI flows. Similarly, limited visibility over Nigeria's policy response to the oil price shock on the fiscal side, dovish monetary policy twist and trading curbs on FX trading should continue to dampen prospects for FPI flows into financial markets. In particular, continued doubts over the USDNGN, with the volatile trend in BDC-interbank premium and low FX reserves coupled with progressive ramp-up in administrative measures pose hurdles for FPI.

On balance, continued economic weakness across EM, uplift in US interest rates which should drive global monetary policy divergence points to dampened FPI flows over 2016.

Latest wave of commodity out spares a few, barely

If the H1 15 performance of commodities was seen as a breather, then the second half of the year brought the next wave of wailing. Especially for oil whose support in the first half (bounce) proved shortlived. Whilst the broader soft commodity basket was similarly depressed, quite a few of our coverage names held onto the signs of recovery that materialized in H1 as demand-supply dynamics became increasingly favourable. Nonetheless, the support for some of these bright lights might prove tenuous due to their weather driven nature but the underlying improvements suggests that the current platform of stability could at least last through H1 16.

OIL SCRAPES EVEN LOWER DOWN THE BARREL

OPEC Maintains Oil Production

OPEC supplies rose 2.14% from H1 15 to 38.25mbpd⁽⁵⁾ in H2 15. Saudi Arabia continued its production war to retain market share, as they maintained production levels above 10mbpd, as has been the case since March 15. Meanwhile,

(5) IEA November 2015

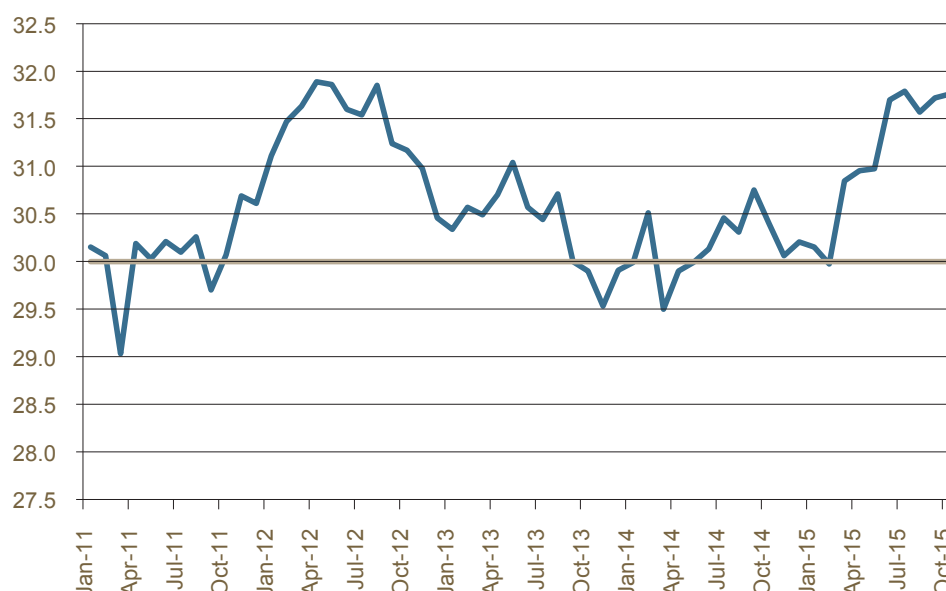
production in Libya which hit its highest level of 430kbpd since May in October 15 and in Nigeria which increased 40kbpd MoM to 1.9 mbpd also in October made up a part of the OPEC nations that boosted production levels despite the low pricing environment. In addition, the outcome of the December 4th meeting resulted in no changes to the corporation's stance on oil production, as key members such as Saudi Arabia refused to cut production unless other member countries agreed to the same.

Figure 12

Oil Production OPEC (mbpd)

Source: OPEC MOMR, IEA, ARM Research

■ OPEC OUTPUT
■ OPEC QUOTA



Non-OPEC output slows on capex cuts and pricing wars

In H2 15, total non-OPEC crude oil production increased by 0.60% from H1 15 to 58.50 mbpd, compared with its increase of 1.30 % in H1 15, from H2 14⁽⁶⁾. The higher output from the US, which had been a key contributor to the increase in crude supplies, began to slow, as companies went through more capex cuts and shutdown active rigs to keep their businesses afloat amidst the record levels of crude production from Saudi Arabia. Nonetheless, the decreased pace of production did not ripple into countries outside of North America as Russia, China and Brazil posted healthy increases to production

(6) IEA Nov 15

during the period. In Russia, production levels hit a record high in October at 10.78 mbpd, an increase of 135kbpd YoY as domestic producers shifted their focus to developments that could boost output in the short term.

On aggregate, global crude oil supply increased by 1.20% from H1 15 to 96.75 mbpd (2.16% YoY).

Global demand picks up, driven by Europe

Global demand increased 1.76% in H2 15 and 1.87% YoY to 95.35mbpd as global oil demand growth hit a four and a half year high of 2.2mbpd YoY in Q3 15. The peak was primarily driven by Europe and

the Middle East as both regions added an increase of 2.60% and 3.75% from H1 15 respectively. The economic recovery in Europe was reflected in its industrial production numbers (+1.2% YoY: Oct 15), improved retail sales (+2.4% YoY: Oct 15) and manufacturing PMI indicators (+0.96% MoM: Nov 15). In addition, the positive momentum seen in European car sales continued as data showed an

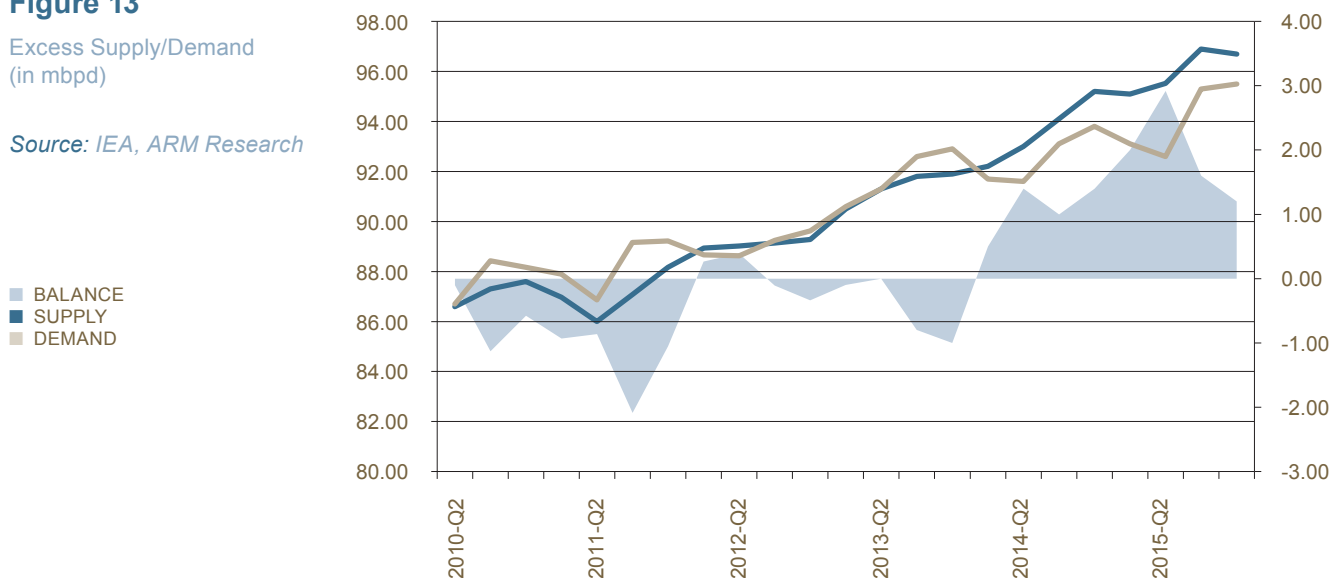
increase for the 26th consecutive month in October 2015 (+3% YoY). Meanwhile in the Middle East, the boost to the demand for crude was driven by Saudi Arabia (+15% YoY)⁽⁷⁾, driven by the transportation sector, industrial fuels and direct crude burning. The improvements in global demand for crude contributed to the decline in the excess supply glut, which fell 26.32% from H1 15 to 1.4 mbpd.

(7) OPEC Monthly Oil Market Report December 15

Figure 13

Excess Supply/Demand
(in mbpd)

Source: IEA, ARM Research



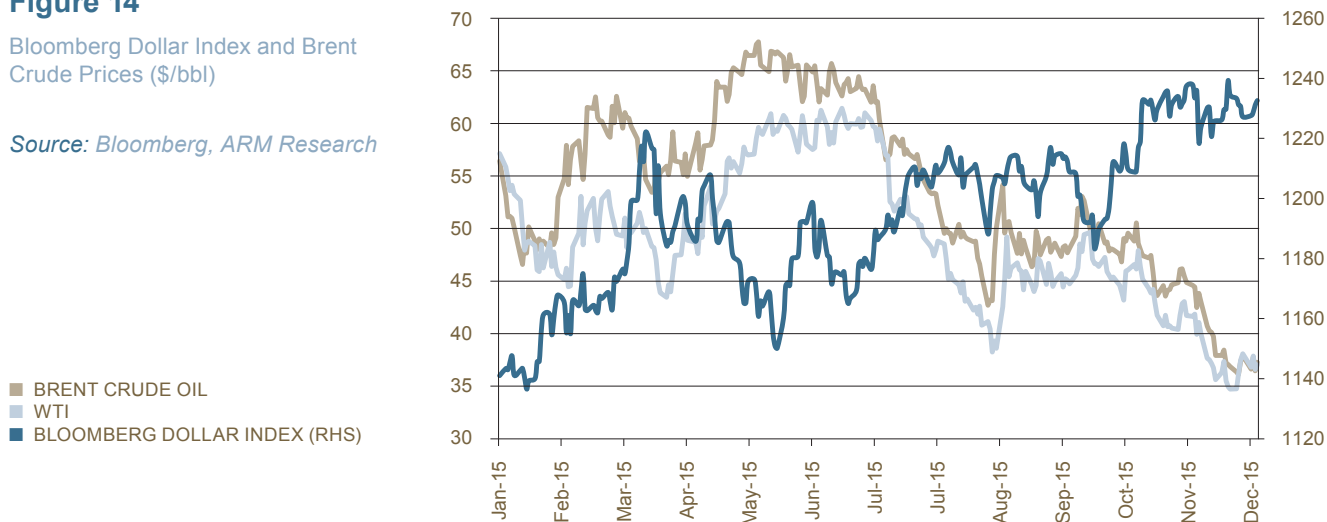
In spite of the improvements in global demand, the persistence of an excess supply situation (Q2 15: 2.30 mbpd, Q3 15: 1.50 mbpd, Q4 15: 1.40 mbpd) weighed negatively on oil prices, with both Brent and WTI falling below technical support levels of \$40.00 (est.). During this period, both Brent and WTI fell to 11 year lows of \$36.11/bbl and \$34.73/bbl respectively.

It appears the renewed strength of the dollar in H2 15 to reach new highs also contributed to the weakness in oil (and other commodities). However, with the decision by the US to lift its 40-year export ban, WTI recovered from its 11-year low to reverse the previous Brent premium with the grades respectively closing 2015 at \$37.28/bbl and \$37.04/bbl.

Figure 14

Bloomberg Dollar Index and Brent
Crude Prices (\$/bbl)

Source: Bloomberg, ARM Research



Saudi Arabia producing at record levels, as Iran waits on news of sanctions

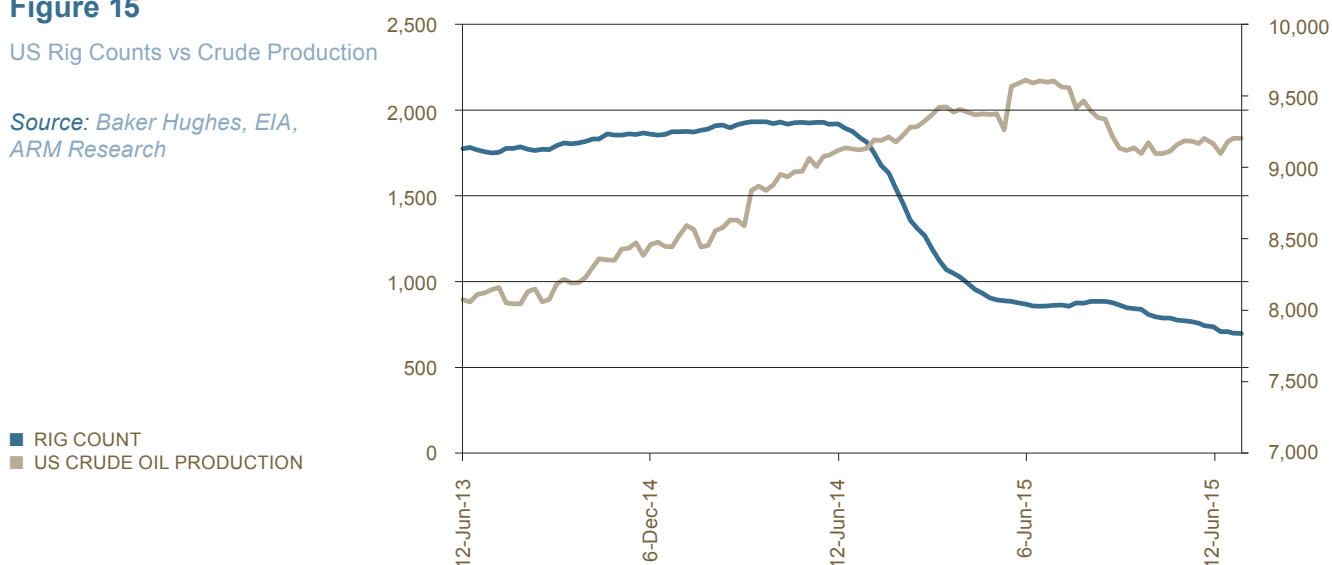
As the competition for market share continues, we expect Saudi Arabia to continue its production of crude at high levels in H1 16, in spite of the country's increasing budget deficit (\$98 billion in 2015). Partly in consequence of the low oil price environment

and its impact on CAPEX cuts, reduced oil hedges and decreased profits, the outlook is for US Shale production to decrease in 2016 as the lagged impact between falling rig counts and crude production begins to materialize. Most recently, US total rig counts fell to a 16-year low of 698 in the week ended December 11th as production hit a year to date low of 9.1mbpd in the week ended September 25th.

Figure 15

US Rig Counts vs Crude Production

Source: Baker Hughes, EIA, ARM Research



Whilst the falling shale output ostensibly suggests that Saudi Arabia's policy is achieving its goals, a commensurate cutback in Saudi output, whenever the dust settles, may not necessarily imply a rebound for crude prices. One clear factor is the impending impact of Iran's re-entry into the oil market should sanctions be released in H1 16. The Middle Eastern nation is expected to contribute 500kbpd to global crude supply following the removal of the sanctions and an estimated 3.4mbpd to 3.6mbpd six months after. In addition to Iran's potential re-entry into the market, Indonesia's re-inclusion into OPEC after 7 years may contribute 800kbpd to global crude supply. Secondly, Russia is expected to continue pumping at record levels in 2016 as it aims to fight off competition for market share in Europe from Saudi Arabia, Iran and Iraq. IEA analysts forecast an increase in Russian crude supply of 120kb/d in 2016 due to the shelter provided for Russian companies through Moscow's oil tax system. However, the actual rate of increase will

be dependent on the impact of international sanctions and the country's increasing fiscal burden.

Slower economic growth tugs on global demand

We expect the increase in global demand to fall from 1.75mbpd (+1.80%) in 2015 to 1.2mbpd in 2016⁽⁸⁾ as the factors that were associated with the increase in demand begin to fade. In Europe, the recovery from the post-recessionary bounce and potentially warmer winter climate are set to result in a smaller sized increase than the 0.20mbpd increase YoY seen in 2015. In contrast to the slowdown in the aforementioned countries, India will be looking to boost its demand for crude as it has done during the year when demand growth hit a decade high of +15.3% YoY in September 15 stemming from strong economic growth prospects. With a 21%

(8) IEA report

growth in passenger vehicle sales in October 15, Indian demand is expected to increase by 4.56% to 4.2mbpd in 2016.

'Pricing Wars' for Crude Exports could take on new dynamic in H1 16

Current trends reaffirm our expectations, which were set out in our previous report, for price and market share competition amongst the oil players to persist. As Saudi Arabia continues to pump crude at record levels to compete against US producers, who themselves seem to be receiving less boost from the factors that appeared set to help sustain shale production for longer than initially thought, a new front appears to be opening up amongst the conventional crude producers. The battle between Middle Eastern nations such as Saudi Arabia, Iraq and potentially Iran, is expected to intensify as the aforementioned nations compete against each other for the energy-hungry Asian market made up of India and China. This may result in further discounting of costs associated with crude sales through discounts on actual crude prices or on freight costs. In addition, we reference the decision by the US to raise its export ban which, given its increasing inventory levels, could yet make it a major player in the pricing war as it could export crude at lower freight costs to provide a source of revenue for struggling shale producers. Brent crude prices averaged \$48.10/bbl in H2 15, but based on the foregoing dynamics and historical

price movements, we envisage even more pressure could lead prices to trade within the range of \$30.00-\$35.00/bbl on average in H1 16, with a potential recovery towards \$40 later in the year.

SOFT COMMODITIES RESUME BEARISH TREND BUT HAS AN INFLECTION POINT BEEN FOUND?

After staging a brief resistance in the first half of the year, soft commodity prices returned to the bearish cycle that begun in 2010. Post the 5.4% rally in H1 2015 on expectation of stronger consumption, the SP GSCI declined massively from Q3 15 onwards, ending FY 15 with returns of -25.5%. Though supply gluts continue to narrow, they still linger across coarse grain markets like wheat, corn, and barley. Furthermore, other exogenous factors have weighed on prices. One such is the strength of the dollar, in which most commodities are priced and traded, and which, according to the Bloomberg Dollar Index, has appreciated 9% YTD against other currencies. Another factor is sluggish global economic growth (driven chiefly by weakness in China) which has placed considerable pressure on commodity market sentiment. Overall, the SP GSCI Agriculture sub-index posted -19.27% returns in FY 2015. However, among our coverage the picture is, with the exception of wheat, becoming more optimistic strong signs of recovery materializing as from September 2015 buoyed by the technical support from El Nino.

Figure 16

SP GSCI Agriculture Index

Source: Bloomberg, ARM Research



Lingering oversupply in wheat market worsens on strengthening dollar

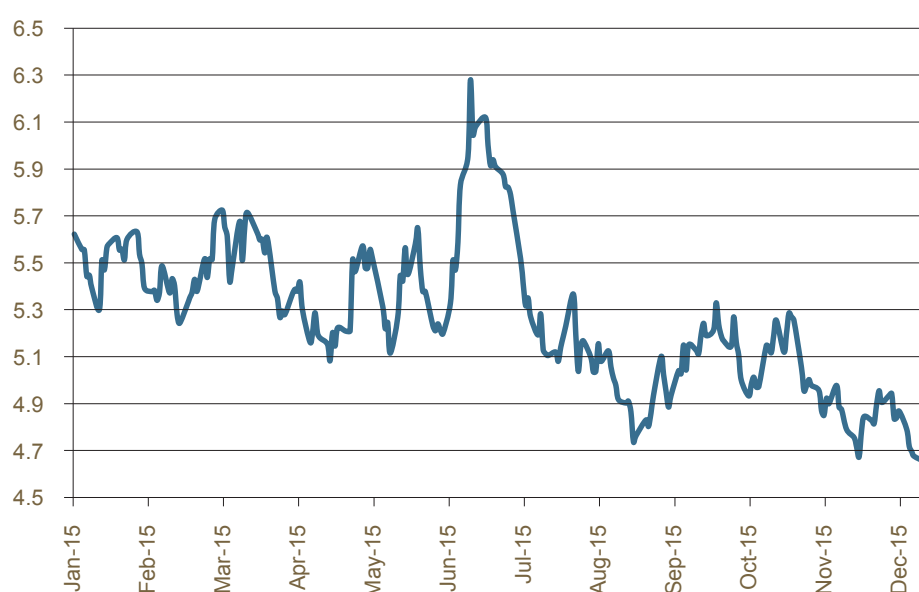
From data reported by the United States Department of Agriculture (USDA), global wheat harvest for the 2014/15 season grew by 10 million metric tons or 1.4% from the prior year to 725.3 million MT—500,000 MT more than the agency had projected earlier in the year.

The increase was driven mostly by strong output from the world's top four producers; specifically Russia (+13% YoY)—who overtook the US as the fourth largest global producer, the EU (+8% YoY), China (+4% YoY) and India (+3% YoY). These increases offset declines in other major markets like the US (-5% YoY) and Canada (-22% YoY) where long-term price depression continues to encourage the substitution of soybean (in US) and barley or canola (in Canada) for

Figure 17

CBOT Wheat Prices (USD/Bushel)

Source: Bloomberg, ARM Research



wheat as cash crop. The USDA attributes the jump in EU and Russian output to bumper harvests resulting from favourable weather in planting regions. In China and India however, the increases continue to reflect response to high levels of domestic price support.

In the same period, wheat consumption also grew, albeit at a slower pace than output. The numbers recorded by the USDA for the 2014/15 season fell 3.7 million MT short of the projections it made at the start of 2015 with consumption growing 8.4 million MT or 1.2% YoY. The net increase was tempered by sharper than expected declines in US, Brazil, and Canadian consumption primarily resulting from reduced demand for biofuels as a result of the downdraft in oil prices. Unsurprisingly, in FY 15, global inventories climbed for the second consecutive year (9.4% YoY to 212 million MT) and wheat prices declined 24.1%. Also adding

pressure to prices was the rapid appreciation of the dollar which rose 9% according to the Bloomberg Dollar Index (BDI) over the 2014/15 season.

In its latest projections, the USDA expects wheat production to grow 9.5 million MT (1.3% YoY) in the 2015/16 season; a slower rate than the prior year. The estimates come on the heels of increased acreage in Canada and an expected change in policy in Argentina which should see caps on wheat production removed under the new administration. Contributing to the projected slowdown is expectations of reduced US and Russian output. On the other hand, consumption is projected to accelerate as increases in Africa and Far East Asia offset reduced demand for biodiesel and feeding wheat in the EU. Consequently, inventories are projected to grow 100 bps slower than the previous year's at 8.4% growth

YoY to 299 million MT. Nonetheless, the global wheat market is expected to remain oversupplied and this underpins our expectation for wheat prices to remain bearish over FY16.

El Nino cautiously tips the scale towards bullish Barley fundamentals

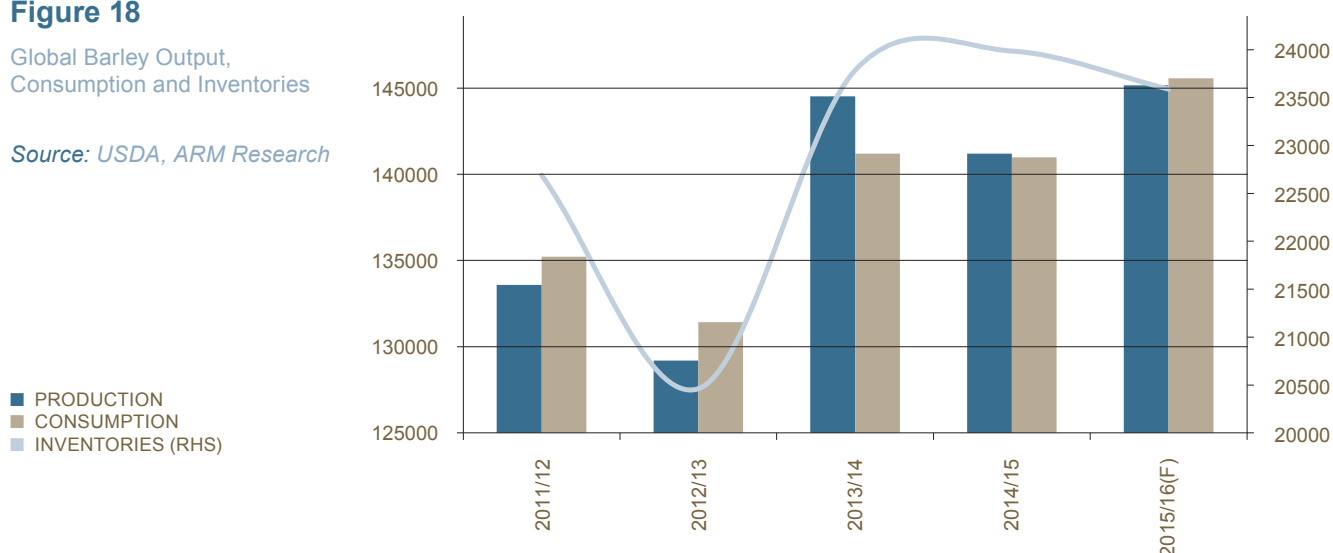
After posting 2014/15 season returns of -3.5% (-2%: H1 15), Barley prices have shown more resilience in the latter part of 2015 with prices down just 0.55% in FY 15 at \$134.67/MT. The negative trend over the 2014/15 season was driven primarily by prolonged high levels of market inventories. The USDA reported a -2.3% drop in global barley output from the prior

season to 141 million MT driven by sharp cuts in output from major producers: Canada (-30.5% YoY), Australia (-12.6% YoY), the US (-16.2% YoY), Turkey (-45.2% YoY), and Argentina (-38.9% YoY); caused by a combination of lower acreage in some regions and poor weather in others. These declines more than offset the contributions caused by favorable growing weather in other major producing regions: EU (+1.3% YoY), Russia (+30.1% YoY), and Ukraine (+25% YoY). Similarly, the USDA reports that consumption also fell but by a much smaller margin of 0.1% YoY, as large increases in China (+81% YoY) and Russia (+11% YoY) offset aforementioned declines. As a result, the season ended with a minuscule increase in inventories by 202,000 MT to 23.9 million MT.

Figure 18

Global Barley Output,
Consumption and Inventories

Source: USDA, ARM Research



For the 2015/16 season, both the International Grains Council (IGC) and the USDA forecasts increases in both output and consumption. The USDA projects a more bullish market for prices in 2015/16 with consumption growth (+3.2% YoY) expected to be greater than output's (+2.8% YoY), with ending inventories down 2% YoY. The growth is seen driven by recoveries in output in Canada, Argentina, and Turkey, which are expected to offset moderations in the EU, Russia and Ukraine. On the other hand, the IGC expects higher output than consumption, and for inventories to grow. On the whole, we are more inclined to agree with the USDA's projections, which accounts for the impact of El Nino activity reminiscent

of last year even as the IGC itself reports increasing substitution of barley for wheat feed in the Middle East and EU. Consequently, we expect moderate increases in Barley prices over the season with more risk to the upside depending on the length and intensity of El Nino.

Sugar recovers as El Nino casts doubt on global output

Sugar prices staged a comeback in the first half of the 2015/16 season. Specifically, prices increased 18.3% in Q4 15 to 15.24 cents/lb after a 21.6% inventory-driven decline in the first three quarters of

2015, bringing the YTD decline in price movement to -7.2%. The recovery in prices is in line with our earlier forecasts though, admittedly, it has come surprisingly early as demand-supply dynamics changed. For the 2014/15 season, the USDA reported 0.3% decline in global sugar supply as a result of dry weather in

Brazil, US, and China (which jointly account for 31% of global supply) while also reporting a 2.6% rise in global consumption – thus marking the first time in over 5 years where demand surpassed supply. Inventories dropped by 0.7% to close the season at 43.5 million MT.

Figure 19

ICE Sugar prices (cents/lb)

Source: ARM Research, Bloomberg



Going forward, the USDA forecasts global production to decline 1.7% to 172 million MT, mostly driven by declines in four of the top five producing regions (Brazil, India, EU, and China). Reports of overactive El Nino weather patterns from the National Oceanic and Atmospheric Agency (NOAA) has increasingly lent support to expectations of a drier than usual monsoon season in India, and droughts in China. In Brazil, the declines in output were driven by the conversion of more sugar crop to ethanol instead of traditional consumable sugar and the continuation of this trend adds to the bullish sentiment surrounding sugar. Overall, reports of the European Environmental Agency (EEA) citing a reduction in planted acreage of beet sugar reinforces expectations for lower output for the 2015/16 season.

On the demand side, the USDA projects a 1.2% increase in global consumption, driven chiefly by a 3% increase in India (the world's largest consumer), a 31% increase in Iranian consumption on the back

of oncoming sanction lifting, and minor increases in other regions which altogether offset the decrease in the only major regional consumer Brazil. Given the prevailing demand supply dynamic, the substance of our outlook for sugar prices in the second part of the 2015/16 season remains unchanged; we expect the uptrend to continue as inventories fall in 2016.

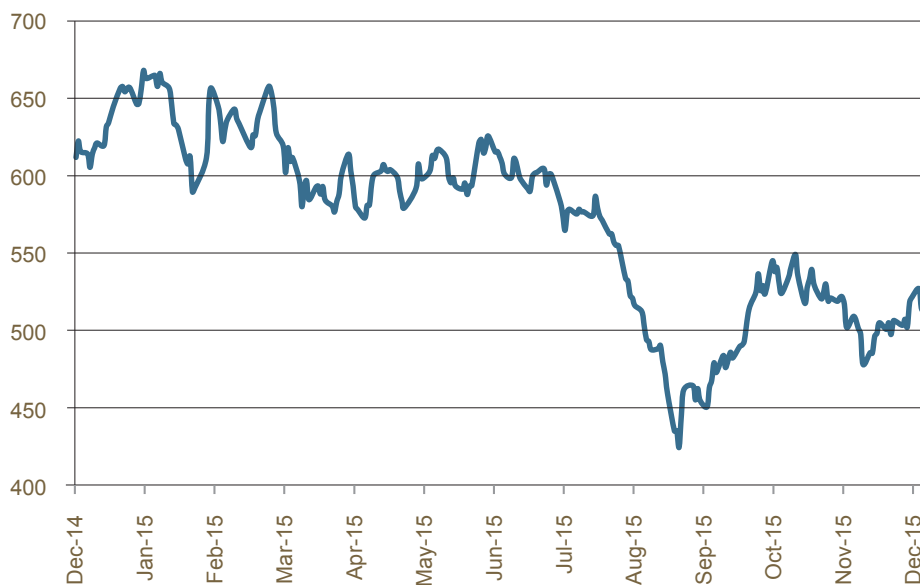
Fortunes changing for CPO as price support policies look to materialize

As reported by the Malaysian Derivatives Exchange (MDE), CPO prices declined 14.9% in FY 15. In H1 15, the downward trend in prices over the previous season reversed, driven by positive sentiment built on expectations of positive impact of oncoming regulations on demand, and stalling inventories. However, the bearish trend resumed as the 2015/16 season commenced with recoveries in Indonesian and Malaysian crop yields.

Figure 20

MDE CPO Prices (\$/MT)

Source: Bloomberg, ARM Research



For the 2014/15 season, supply grew 3.6% to 61.4 million MT while consumption rose only 1.1% to 58.5 million MT. In Indonesia, which accounts for over 50% of global CPO output, 2014/15 output surged 8.2% YoY to 33 million MT, driven by good weather and on streaming of output from plantations planted in 2011. This increase more than compensated for 1.4% and 10% declines in output from the next two largest producers Malaysia and Thailand. In Malaysia, flooding in key regions and El Nino related dryness over the course of the season led to declines in yields. El Nino was also the key factor cited for drier than average weather which frustrated yields in Thailand too.

Consumption grew for the fifth consecutive year by 1.1% or 623,000 MT; still, this was a slower growth pace than supply. The growth was driven chiefly by 7.1% YoY increase in India, where rising income levels and economic growth continues to broaden demand for CPO. The growth in India helped it supplant Indonesia as the world's largest CPO consumer, with the 15.5% YoY drop in the latter's consumption caused by major reform of the government's biofuels subsidy regime. The 2014/15 season ended with inventories up 9.5% from the previous year to 8.3 million MT.

Good growing conditions in South-East Asia for H1 15 have prompted expectations of greater output for the 2015/16 season. The USDA projects CPO

output to grow 1.9% YoY by the end of the season to 62.6 million MT; with Malaysian and Thai output expected to post comebacks. Increases from the early season are expected to compensate for the impact of El Nino activity on harvests in the latter part of the season – CPO is harvested all year long. On the demand side, global consumption for the season is expected to grow 7.1% YoY, driven by surges in Indonesia, Malaysia and the US as regulation favoring increased use of biofuels translates to higher demand. Consequently, the USDA expects global consumption to surpass output for the first time in a decade and projects ending inventories to fall 19% to 6.7 million MT. Hence, outlook for the 2015/16 season prices is cautiously optimistic; we expect stability in the early part of 2016, tested by a strengthening dollar, with some latent recovery possible at the end of the season.

Harmattan fears buoy Cocoa prices

Bucking the trend in commodity prices, Cocoa prices have trended upwards in 2015. Prices from the Intercontinental Exchange (ICE) indicate that Cocoa prices increased 13.1% in FY 15 to \$3211/MT. In the Cocoa market, demand and supply tend to be evenly matched given its small size relative to other commodity markets. Hence, prices are largely driven by monthly production and grinding reports.

Figure 21

Cocoa Prices

Source: Bloomberg, ARM Research



For most of the 2014/15 season, high demand hoisted prices progressively higher. Prices surged in the early part of the season as harsh harmattan towards the end of 2014 threatened harvests in the world's two largest producers (Ivory Coast and Ghana). As the season progressed however, this assessment of the markets turned out to be half true. Ghanaian yields experienced strong declines, due to harmattan, intermittent power failures and poor water supplies leading to a 22.4% YoY decline in output to 696,000 MT for the season. On the other hand, output in Ivory Coast stayed flat (+0.2% YoY) at 1.75 million MT as the impact of harmattan partly offset the strength of the early season. Overall, global output declined 4.9% to 4.2 million MT compared to a smaller decline of 4% in consumption, leading to a demand surplus of 22,000 MT for the season.

Our outlook for the 2015/16 season is moderately bullish for Cocoa prices given the re-emergence of last year's harmattan fears and the threat of El Nino to cocoa producing regions in South-East Asia. However, the ICCO reports declining orders from Cocoa processors in the wake of slow global economic growth which could temper the net upside price effect we expect.

Global macroeconomic headwinds reinforce cautiously bearish outlook in the mid term

Overall, our outlook for commodity prices in the near term remains broadly bearish but as legacy supply gluts continue to shrink, we could see some recoveries in the medium term. Closely looking at influences on the broader pattern, a large part of the decline in commodity prices has hinged on bearish sentiment regarding the global economy, underpinned chiefly by weakening emerging market economies especially China – where the Peoples' government attempts to transition from export to consumption-led growth. We expect this sentiment to continue into the first half of 2016 as the 32% YTD downdraft in oil prices appears to have reduced the momentum in demand for cleaner fuels, removing a potential boost to soft commodities that serve as biofuels. Furthermore, given the trajectory of the dollar and its strong negative correlation to commodity prices, the shift by the US Fed in favour of tightening suggests more headwinds for commodity markets. However, the move by some key stake holders like Indonesia and Malaysia to support their domestic prices could be an important development for commodities, potentially resulting in some price recovery for certain commodities as early as H2 16.

In terms of the domestic impact, we expect lower input costs for some FCMGs. For Nestlé and Cadbury however, expectations of strong cocoa and sugar prices foretell no such benefit. Nonetheless, given the diversification of Nestlé's product portfolio, we might see some cost savings in other segments

of the business. For palm oil producers, we are cautiously bullish on CPO prices in the midterm, with current forex restrictions likely to accentuate near-term benefits for domestic players.

It is worth noting that even as the fundamentals of some of the commodities in our coverage look increasingly bullish, we remain cautious. On the whole, the prospect for any

benefit or otherwise to corporate earnings is secondary to our expectations from the Nigerian economy in 2016 (especially currency) which we believe will exert greater influence on aggregate demand and input costs, which will impact these companies' revenues. On that note, our bearish outlook for the economy given the weak outlook for oil price is hardly good news for corporations.

KEY DEVELOPMENTS IN DOMESTIC ECONOMIC AND POLICY ENVIRONMENT

Whilst the political risk from the general elections somewhat subsided in H2 15, claiming that the environment improved significantly would be a hard-sell even for the most optimistic of investors. If anything, the macro-vulnerabilities deepened, problems that seemed near-eradicated somehow persisted, and the political risk seems to have been replaced by a less vocal but just as debilitating uncertainty around policy direction, reform progress and simply getting on with the business of governance. With limited clarity in the first few months post-handover, even as global conditions worsened and everything with Naira implications seemed destined for a downturn, the question inevitably become one of whether things were so bad that there was even any point waiting for government action as the gloomy realities threatened to obscure any hope of improvement. Whilst the jury is out on whether it was worth the wait, the glimpses of direction that eventually materialized appear to indicate a better grasp of the challenges from policy makers and, perhaps more importantly, carry a strong undertone of will to see it through. In that sense, the perception of policy guidance as important for all states of economic health remain quite valid and it is this that makes the additional reform progress in H2 15 still of some of relevance if delivered in these tough times.

NEW GOVERNMENT'S PROGRESS THREATENED BY HEADWINDS

Infightings within ruling party and election annulments increase...

The strong bond that held sway among members of the All Progressives Congress (APC) prior to their historic victory at the polls in H1 15 gave way to infighting shortly after the May 29 inauguration of the new government. The fiasco was compounded when the leadership of the bicameral legislature emerged through a rancorous process with both the President of the Senate and Speaker of the House of Representatives, both members of APC, teaming up with the opposition Peoples Democratic Party (PDP) to defeat their party's 'anointed' candidates. Similar intra-party acrimony was also witnessed at the state level. And the quick schisms seem to underline the absence of an overarching political (and economic direction) philosophy.

Aside the aforementioned, a recurrent development on the Nigerian political turf in H2 15 is the annulment of elections by the judiciary. Oil-rich Rivers led the pack as the state's governor and 3 senators, all of the PDP, were sacked by the appellate court which ordered the conduct of fresh elections though the annulment of the governorship election is currently being challenged at the Supreme Court. In the same vein, Benue South senatorial election which returned the immediate past Senate President David Mark to the senate was annulled. Mark's victory at the polls was challenged by Daniel Onjeh of the APC.

Table 2

Number of Annulled Elections in Nigeria Post-May 29, 2015

ELECTION	NUMBER
Governorship	3
Senate	12
Rep	16
Total*	31

Source: Media reports, ARM Research *As at December 2015

...as Buhari finally constitutes his cabinet amidst increase in corruption probes

After what seemed like an endless waiting period, President Muhammadu Buhari finally constituted his cabinet and trimmed federal ministries to 24 from previous 29. The President himself assumed direct responsibility over the Ministry of Petroleum and appointed the Group Managing Director of the state-owned Nigerian National Petroleum Corporation (NNPC) to deputize as minister of state for Petroleum. Babatunde Fashola, the immediate past governor of Lagos, was saddled with the bulk of the infrastructure development efforts of the current administration as he was handed Power, Works and Lands & Housing, a merger of three previously separate ministries. Other notable appointments include those into the ministries of Solid Minerals (Kayode Fayemi, former governor of Ekiti state), Transportation (Rotimi Amaechi, former governor of Rivers state), Finance (Kemi Adeosun, former commissioner of Finance in Ogun State), Industry, Trade & Investment (Okechukwu Enelamah co-founder and head of the country's first private equity firm), and Budget and National Planning (Udo Udoma, a former senator and head of the Securities and Exchange Commission).

Projecting an ethical dimension of governance and fulfilling a campaign promise, in a move introduced by the late Musa Yar'Adua, President Buhari and his deputy, Osinbajo, publicly declared their assets and in addition slashed their salaries by 50% (Yar'Adua 20%). Furthermore, in line with his anti-corruption promises, the president set up a seven-member Presidential Advisory Committee on Anti-corruption, headed by Itse Sagay, to formulate a strategy and co-ordinate the anti-corruption war of the administration. The president also appointed a new head for the Economic and Financial Crime Commission (EFCC).

All the foregoing appears to suggest the expected focus on tackling corruption remains intact and, hitherto, the president's actions seem to be in consonance with his statements. Back in July, the president pledged to recover "mind-boggling" amounts of stolen oil money and bring those responsible to book, alluding that 250,000 barrels of crude were being stolen every day by fraudulent individuals. He further explained in October that preliminary steps had been taken to sanitize the NNPC and improve its operations so that the inefficiency and corruption

could be reduced to a minimum level. Additionally, he indicated he had ordered a complete audit of other revenue generating agencies: Central Bank Nigeria, Federal Inland Revenue Service, Nigerian Customs Service and Nigerian Communications Commission, for better service delivery to the nation. While there has been a series of high-profile corruption-related arrests and probes (including of current officer⁽⁹⁾), actual recoveries remain a while off—a situation that may not change soon, with reports of a relatively paltry ₦8 billion returned to government coffers thus far. Perhaps the important thing is that while the recoveries may not materialize, the plugging of leakages might still help government make the most of currently diminished revenues.

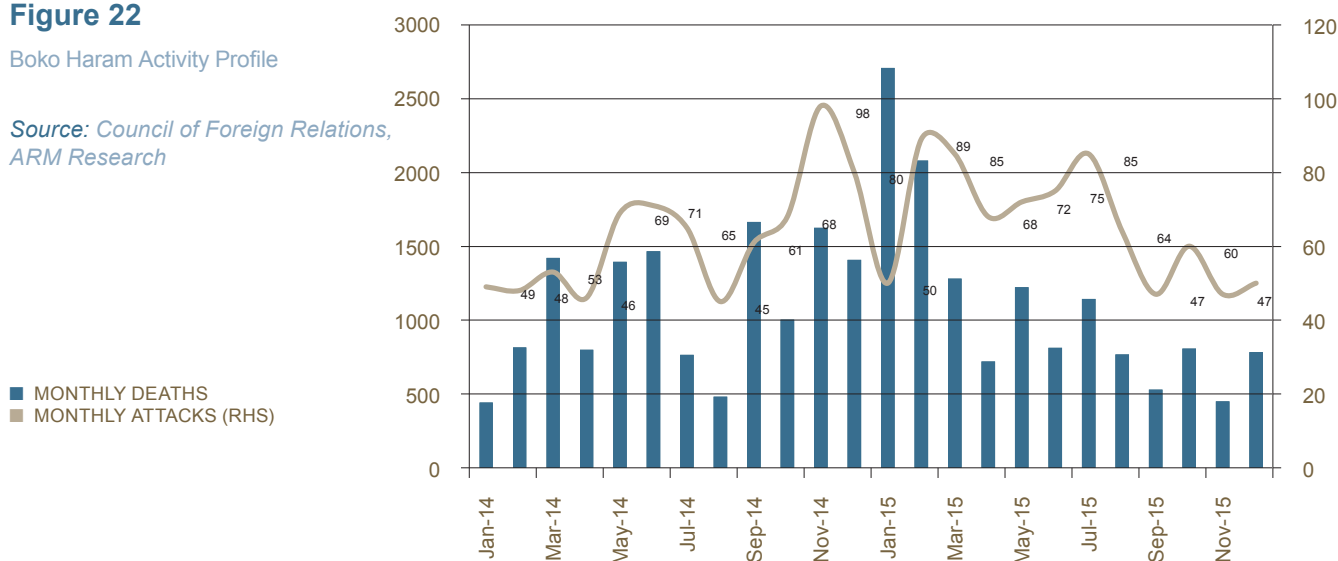
Political risks heighten as agitation for Biafra compounds security concerns

In spite of the recovery of strategic territories from Boko Haram by the Nigerian military, amidst other gains which include arrests of some key sponsors of the terrorist group, the war against terrorism appear destined to be longer than expected. Though the military has consistently maintained that it is on course to fulfilling the December 2015 timeline given by the president to end the group's activities, the spate of attacks on both the civilian and the military by the terrorists, while reduced, remains a concern. Buttressing the concern on the feasibility of the deadline, Nigeria's number one military officer, Abayomi Olonishakin, recently guided that the harmattan weather, "and some other logistics", has been an impediment to the war on terror.

(9) During the period, the Senate President, Dr. Bukola Saraki, was arraigned before the Code of Conduct Tribunal (CCT) for a 13-count charge of false declaration of assets even as the Senate commenced a probe of Ibrahim Lamorde, the former EFCC boss.

Figure 22

Boko Haram Activity Profile

Source: Council of Foreign Relations,
ARM Research

In addition to other security concerns such as kidnapping and armed robbery in different parts of the country, a new security threat appears to be rising in the south east with the agitation for secession by proponents of Biafra. This movement appears bent on resurrecting moves to create a Sovereign State of Biafra which was the crux of the country's civil war (1967-1970). The recent arrest of Nnamdi Kanu, Director of Radio Biafra, by the DSS provoked mass protests by pro-Biafra agitators in the south eastern states which led to shut down of commercial activities and clashes with government security forces. Intriguingly, similar protests were held in the commercial cities of Port-Harcourt and Lagos. Though many have denounced the ongoing agitation for secession as a rally of politically motivated miscreants, some of the acts allegedly perpetrated under this umbrella indicate that there is a risk that this development could snowball into a much bigger crisis if appropriate measures are not taken to curb it. Nonetheless, the veracity of a unified Biafran agenda is already being called to question by the absence of a clear-cut philosophy or a united front, evident in the emergence of diverse factions.

Is there still a way, even with newfound will?

Thus far, the political will to follow through on reforms for key aspects of the socio-economic fabric appears stronger than at any time in the recent past. For

instance, the arrest of past and present high-profile political actors, including those of the ruling party, appear to affirm the pledge to tackle corruption is being taken seriously. Similarly, the recent reforms also suggest that the president means business with respect to improving efficiency and transparency in the polity. In the same vein, whilst the insecurity challenge has not been fully addressed, with the December deadline for Boko Haram missed, unlike the wimpy response previously, it is not for lack of effort. The formation of strategic alliances with countries such as Niger and France, and much better equipment of the military with all necessary support indicate the fight against insecurity is being taken much more seriously. Perhaps most important is that, after about six months of uncertainty, the policy direction of the Buhari-led administration is now much clearer. His appointment of former public servants, who have well-established precedents, as heads of critical ministries, has helped to set the right tone with the team appearing to buy into the presidential agenda and coming across as well-driven to deliver the promised change.

Nonetheless, whilst the administration might enjoy strong marks for its efforts the real aim is to create a change and the real question is then whether, in light of current economic headwinds and other factors, those efforts will achieve the desired effect. To elaborate, despite all the efforts at probity and fighting corruption, stimulating the economy and ensuring fiscal prudence, the real question is whether things have gotten so bad that none of these laudable initiatives would ultimately

matter. For instance, whilst it is all well and good to choose to plug leakages could it be the case that the oil-induced decline in revenues is set to be so devastating that there is no leakage worthy of the name to protect against or even enough revenues to achieve any key goals? With oil forecast to stay below \$40/bbl through 2016, even if all leakages are successfully blocked, the impact of the falling oil price on the country's books will still be felt. Or if one shifts focus to the fact that only ~N8 billion loot has been recovered, concern inevitably grows as it would seem the corruption fight is not yet as strong as to cause panic and stimulate real reflux to the government coffers. In addition, the persistence of suicide bombings in the North East, growing clamour for the Sovereign State of Biafra and rising cases of armed robbery and kidnapping also imply that insecurity remains a major concern in Nigeria. To our thinking, addressing concerns such as these will be key to the eventual success of all the efforts to stimulate the economy and drive growth in 2016. Furthermore, in spite of their antecedents, it remains to be seen whether or not the president's men will effectively execute the lofty goals they have professed as several challenges persist and portend a credible threat to success. Hence, the question is whether the administration has even a fighting chance of meeting rising expectations?

Thus, while the budget is what is currently flying the flag of the administrations' key hopes and aspirations the implications of the issues raised lend gravity/ importance to how and when the answers materialize

in every facet of the economy—knowing that, given the grim scenario, optimism or pessimism regarding outcomes will be on a case by case basis. From where we stand, it seems clear that at the very least the specific policies and implementation drive in each specific area of the economy will go a long way towards overcoming the odds posed by the endemic issues that continue to make this a challenging domestic macro-environment going into 2016.

FISCAL IMBALANCE PERSISTS ON SOFT OIL PRICE

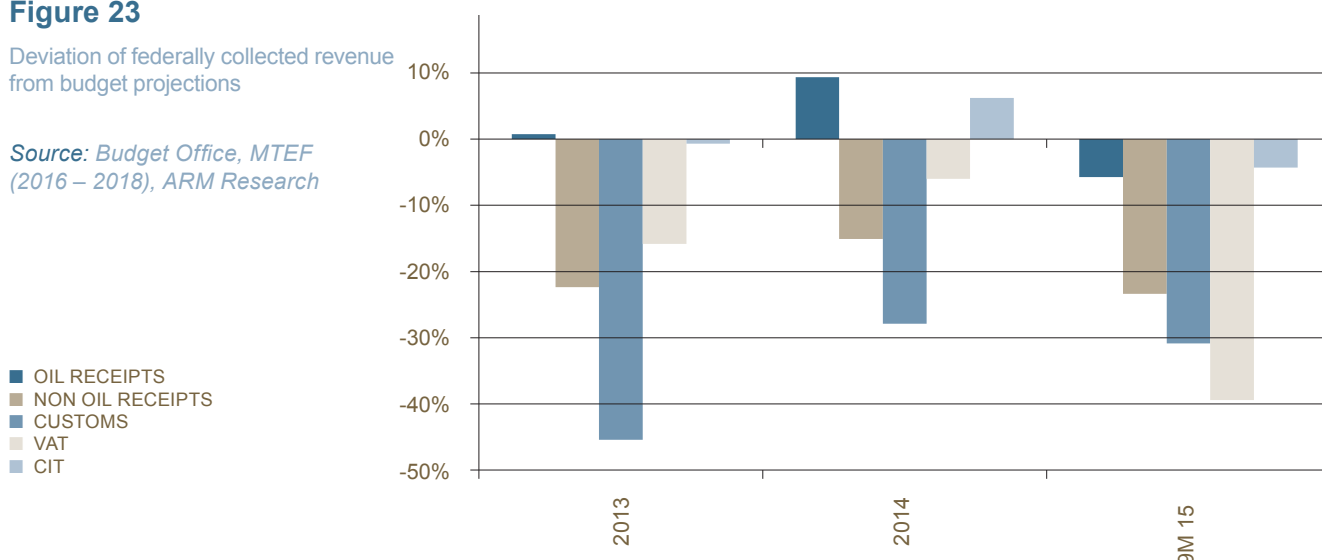
Low customs and VAT underpin revenue shortfall...

Federally collected revenue of N4.4 trillion in the first 9 months of 2015 is 13% below budget projections primarily due to lower than expected non oil receipts of N2.0 trillion (-23% short of projections). The shortfall in non-oil receipts was driven by lower-than-estimated receipts from customs (-31%) and VAT (-40%). Importantly, both shortfalls are more symptomatic of aggressive projections with 2015's targets set at least 50% higher than actual receipts in each of the last two years. That said, cumulative non-oil receipt is 10% higher than the corresponding period in 2014. On the other hand, despite further declines in oil prices and output running 10% shy of target, oil & gas receipts of N2.7 trillion (-36.4% lower YoY) is only 6% short of projections, flattered by the cut back on JV cash calls (15% shy of proposed).

Figure 23

Deviation of federally collected revenue from budget projections

Source: Budget Office, MTEF (2016 – 2018), ARM Research



...as NLNG taxes buoy FG's revenue

Although the lower revenue translated into lower FAAC across the tiers of government, FG's retained revenue (₦2.3 trillion as at 9M 15) is only 9% lower than estimate buoyed by ₦211 billion special NLNG tax distributed in July 2015. However, with nearly ~₦3.1 trillion in expenditure over the first nine months (91% budget implementation) fiscal deficit came in at ~₦1 trillion. Mirroring historic trends, budget implementation was skewed in favour of recurrent spend (₦2.7 trillion) which ran 6% ahead of projections primarily on higher debt service. This outcome fits the prognosis in our H2 15 Strategy Report where we noted that the refinancing of maturing paper at significantly higher interest rates (15%) would exert upward pressure on FG's debt service bill. Indeed, actual debt service of ₦908 billion as at 9M 2015 is 30% ahead of budget

estimates but the run rate is in line with our estimate of ₦1.1 to ₦1.3 trillion. Also mirroring recent trends is the paltry capex budget (₦722 billion) which was only ~36% implemented due to funding challenges. Interestingly, the FG relied on a CBN loan to fund more than 60% of the ₦1 trillion fiscal deficit with the balance largely sourced from the domestic credit market. Consequently, the FG (via the DMO) issued only about 60% of the budgeted ₦530 billion new borrowing for 2015. Although terms of the CBN's advance are not available, the FG's reliance on this route highlights its disposition on accumulating public debt at "high cost". Buttressing this cost aversion, the DMO sold only 77% of planned bond offer in Q3 15 due to elevated marginal rates of 15.5% on average, while selling 33% more than was planned in the last quarter, when rates were 400bps lower.

Table 3

2015 federally collected revenue: Budgeted (B) vs. Actual (A)

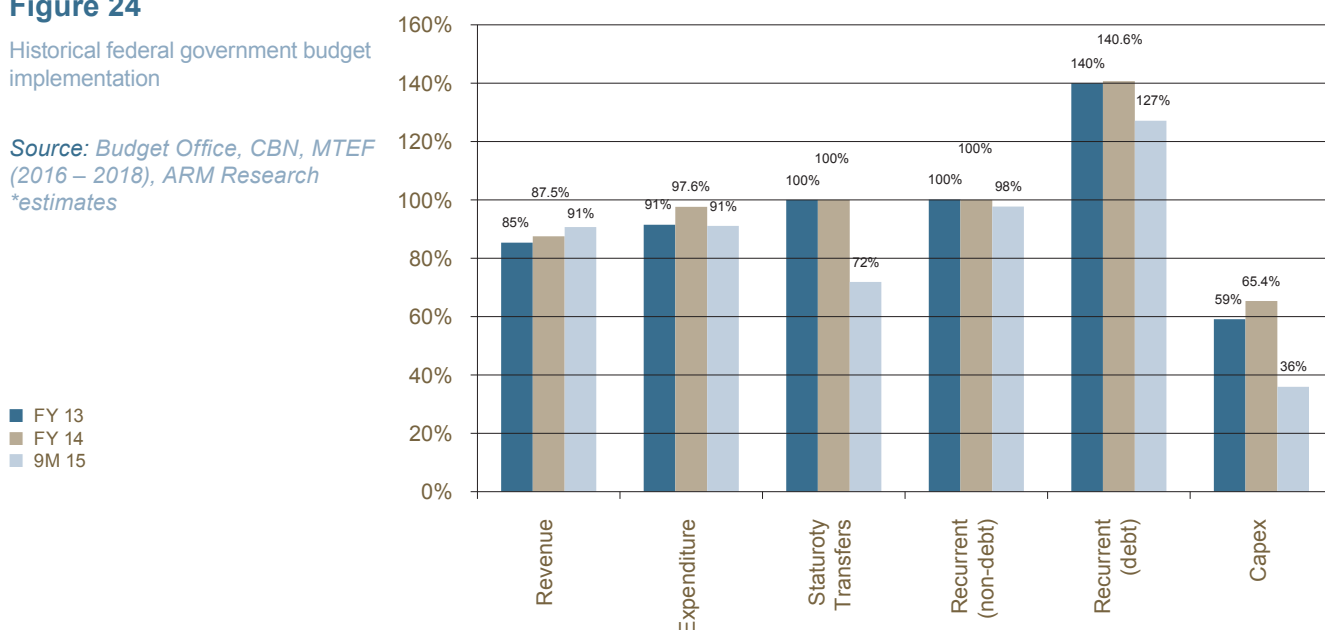
	9M 2015 B	9M 2015 A	Deviation	9M 2015 YoY
Oil production (mbpd)	2.2782	2.0449	-10.2%	0.1%
Oil price (\$/bbl)	53	47	-11.3%	-56%
Oil and gas receipts	4,073	3,393	-16.7%	-35.8%
Deductions				
JV cash calls	765	649	-15.1%	-32.0%
Others deductions	1,859	0		
Subsidy	109	0		
Net oil revenue	2,911	2,745	-5.7%	-36.4%
13% derivation	378	298	-21.2%	-24.9%
Oil receipts to federation account	2,533	2,446	-3.4%	-7.9%
Non-oil receipt	2,681	2,054	-23.4%	10.7%
VAT	963	583	-39.4%	-3.0%
Corporate taxes, CIT, Stamp duties	1,068	1,022	-4.3%	20.9%
Custom: Import, Excise & Fees	650	449	-30.9%	9.7%
Special levies	0	0		
Deductions	137	94	-31.6%	8.5%
Non-oil to federation account	1,638	1,414	-13.7%	18.6%
Total to federation account	4,171	3,861	-7.4%	0.3%
VAT pool account	924	559	-39.5%	-3.2%
Grand total	5,095	4,420	-13.3%	-0.1%

Source: Budget Office, MTEF (2016 – 2018), ARM Research

Figure 24

Historical federal government budget implementation

Source: Budget Office, CBN, MTEF (2016 – 2018), ARM Research
*estimates



FG's bailout package eases states' fiscal dilemma

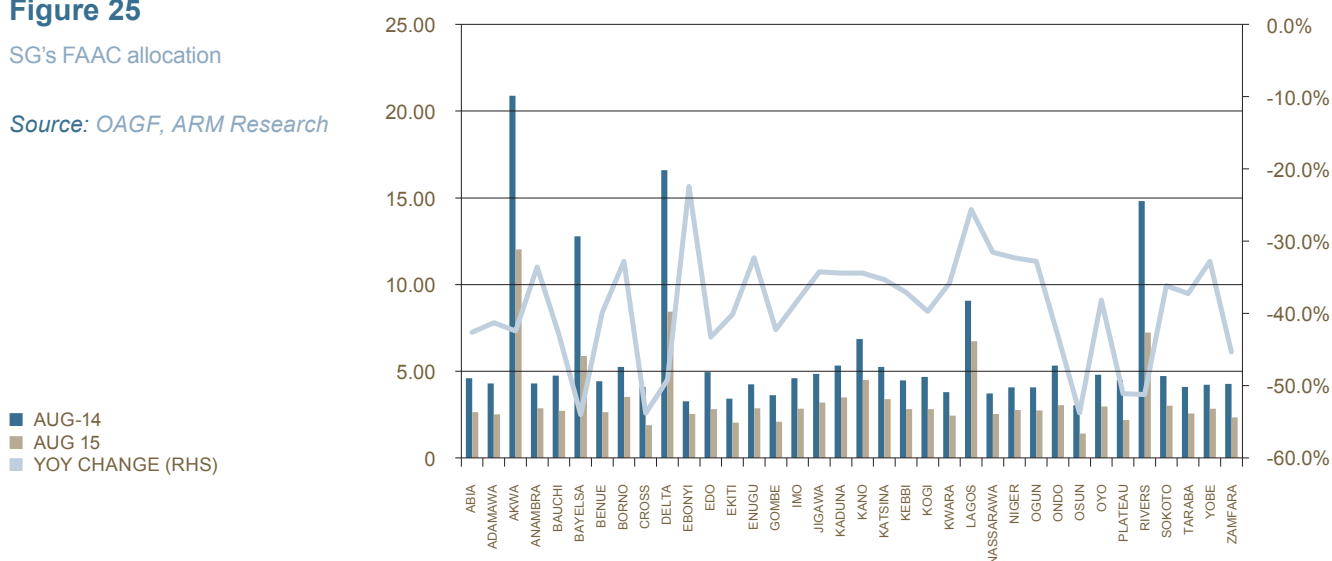
The tale at the state level was much worse as ISPO deductions for outstanding bonds and, more importantly, similar deductions by commercial banks for their own loans, amplified fiscal pressures. On an aggregate basis, SGs FAAC dipped as much as 40% with the ultimate

fiscal impact much worse for states with weak internally generated funds. This resulted in salary backlog which, in some cases stretched up to 8 months, and led the FG to intervene with a ₦1.1 trillion bailout package. In addition to the ~₦200 billion proceed of special NLNG taxes, commercial bank loans of ~₦600 billion were refinanced into 20 year FGN bond, even as the CBN opened a ₦300 billion credit line for the states.

Figure 25

SG's FAAC allocation

Source: OAGF, ARM Research



2016 fiscal thrust appears to hit the right notes

The President presented the 2016 budget to the National Assembly on 23rd December with fiscal policy thrust that will focus on attainment of macroeconomic & fiscal stability, social development and infrastructure development. On macroeconomic & fiscal stability, key areas of focus are reform of the oil & gas sector, economic diversification and zero-based budgeting to enhance efficient allocation of resources. Indeed, the focus on the oil & gas sector is not surprising, given the revenue generation significance of the sector which itself is highlighted by the President's appointment of himself as the substantive minister. Importantly, reform of the oil & gas sector already kicked off with the renegotiation of offshore processing contracts—due to unfavourable terms—and there are already proposed “alternative” funding structure for the JV agreements. Under the proposal, JV oil assets will raise funds directly from the capital market and pay taxes and royalties to the government just like the IOCs currently do. Perhaps the most important development is the exclusion of the “contentious” fiscal terms from the newly proposed Petroleum Industry Bill (PIB). This should make for easier passage of a bill that has languished at the National Assembly for almost a decade, in the coming months. Elsewhere, ₦500 billion is to be set aside for social developments which will include school feeding, conditional cash transfer and post-NYSC grant. Although details are still sketchy, the pilot phase is to commence after harmonization of databases by various government agencies. This suggests implementation could be pushed deep into 2016. Last, the FG looks to tackle critical infrastructure—energy, transport and housing—via increase in capex and plans to set up a \$25 billion (₦5 trillion) infrastructure fund. Amidst fiscal challenges, public-private partnership will be the primary funding model. On power, off-grid power supply, that will bypass the national grid for distribution, is to be encouraged even as policies that will engender reduction in cost of building materials are formulated for the housing sector.

Surge in non-oil receipts to ameliorate impact of lower oil prices in 2016

In this guise, the FG has proposed cumulative expenditure of ₦6.1 trillion for 2016, 22% higher than 2015 budget, primarily due to the tripling of

capital expenditure to ₦1.8 trillion and proposed social investments. On the revenue side, despite the downward revision in oil price benchmark to \$38/bbl (vs. \$52/bbl in 2015) and modest downward revision in output to 2.2mbpd (-3.4%), FG's retained revenue is projected to be 31% higher at ₦3.8 trillion in 2016 as higher non-oil receipts (+20% relative to 2015 projections) is expected to offset soft oil receipts (-50% relative to 2015 projections). The increase in non-oil receipts is expected to be buoyed by sharp jumps in VAT and corporate taxes as well as FGN independent revenue which is expected to triple, and consequently account for ~40% of FGN's expected FG's retained revenue in 2016. The jump in the latter is buoyed by expected improvement in collections from MDAs after the FG implemented the Treasury Single Account earlier in the period. Indeed, the vice president's comment that collections into the TSA had hit ₦1.4 trillion probably strengthens this optimism, at least going into 2016. In all, largely reflecting higher expenditure, 2016 fiscal deficit is projected at ₦2.2 trillion (~2.2% of GDP) matching 2015 numbers. According to the budget, the deficit will primarily be financed via borrowing (~80%), split almost equally between the domestic credit market and foreign, as well as proceeds from misappropriated funds (16%). On the latter, the FG expects ~₦350 billion in recoveries likely on the back of on-going forensic audit of key revenue generating and collection agencies.

Funding shortfall: the potential clog in the wheel of capex implementation

Given Nigeria's huge infrastructural deficit, the ramp-up in capital spend to ₦1.8 trillion is welcome with recurrent expenditure ratio down to (still relatively high) 70% from 87% in 2015. Reinforcing priority areas for the government, capital allocation to economic infrastructure projects is now ~35% of capex budget (vs. 6% in 2015), split between the ministry of works, power & housing (24%) and transportation (11%), even as additional ₦200 billion (11% of capex) is provided for capital projects related to FG's social investments. Although the quantum of resources allocated to critical infrastructure reaffirms the FG's resolve to tackle the current deficit, based on estimated⁽¹⁰⁾ required annual spend, there is still a substantial gap of nearly ₦17.5 trillion. To close this gap, we believe alternative funding models, like the PPP, have to be pursued

(10) According to the National Planning Commission, Nigeria requires ~₦19 trillion investment annually for 30 years to implement the National Integrated Infrastructure Master Plan (NIIMP)

with more rigour under better frameworks that aim to reduce political risks which, arguably, has hampered a number of PPP funded projects in recent times. Indeed, given limited funds, the short-term strategy of ministry of works, power & housing as articulated by

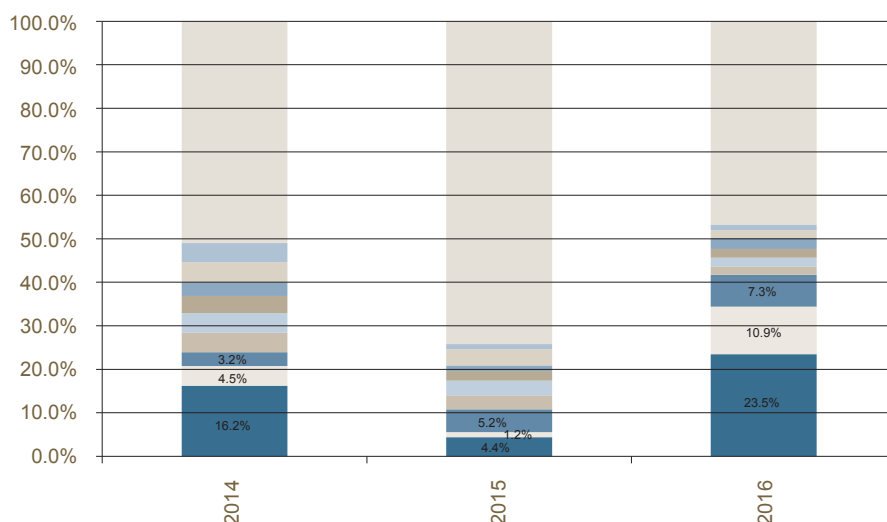
the minister is to prioritise inter-state roads that are near completion. This should facilitate connectivity but more importantly improve regional trade which appear set to attain increased prominence if restrictions on foreign currency subsist.

Figure 26

Sectoral allocation of 2016 capital budget

*Source: Budget Office, MTEF (2016 – 2018), ARM Research *includes interest of capitalised loans, capex in statutory allocation amongst others*

■ WORKS, POWER & HOUSING
■ TRANSPORT
■ DEFENCE
■ HEALTH
■ EDUCATION
■ WATER RESOURCES
■ AGRICULTURE
■ OFFICE OF NSA
■ NIGER-DELTA
■ OTHERS*



That said, the bigger concern for us is that revenue projections appear optimistic in light of current realities that could push fiscal deficit to record levels. Specifically, 2016 targets for VAT and corporate income taxes (CIT) which are 15% and 32% higher than 2015 are nearly double actual receipts in 2013 and 2014. On the former, VAT collection which has averaged ₦800 billion in 2013 and 2014 and set to hit this target going by 9M 15 run rate is projected to hit ₦1.5 trillion in 2016. Although improvement in collection rate could help improve VAT receipts, we think a more realistic timeline for this target, given the lax compliance over the last few years could, possibly, be up to 3 years. Consequently, we struggle to see how this target will be met, in the near-term, without a hike in VAT rate which in itself could generate negative reaction from the populace. Our argument on 2016 CIT target tows a similar line in terms of being far above usual run-rate and, indeed, is further strengthened by likelihood of lower tax receipts on weaker corporate earnings in 2016. Concomitantly, we remain cautious on 2016 customs receipts (~20% of non-oil receipts) which are projected to be 50% higher than FY 2014 and 9M 2015 run rate. We think subsisting ban on items by the FG as well as forex

constraints which in part has driven contraction in import bill (-17%) over the first 9 months, will continue to weigh. These factors suggest that, like 2015, revenue could easily trail estimates. In view of this, we adopt conservative estimates that assume only 70% of non-oil receipts' targets are met and arrive at a potential 2016 fiscal deficit of up to ₦2.8 trillion, 24% higher than budgeted. Notably, while the payment of the ₦780 billion MTN fine could improve the FG's fiscal position, current litigation being pursued by the firm makes timing of potential inflow highly uncertain. In the same vein, our analysis shows that the impact of further devaluation of up to 40% only shrinks the budgeted deficit by 14%. This prognosis suggests 2016 capex budget might be beleaguered by poor implementation like prior budgets; the fact that total revenue target, even if met, will only cover 80% of recurrent expenditure without touching capex highlights the scope of financing required. Thus, despite the FGs lofty plans, Nigeria appears set for an even bumpier road ahead. However, with expectation of Nigerians, arguably at the highest level in recent years, we think the FG might be forced to ramp up borrowing (via capital market, DFIs or CBN) as it fervently tries to deliver on campaign promises.

Table 4

2015 and 2016 budget projections

	2015	2016	2016*
Federally collected revenue			
Oil production (mbpd)	2.2782	2.2	2.2
Oil price (\$/bbl)	53	38	38
Oil and gas receipts	5,431.0	3,534.8	3,534.8
Deductions			
JV cash calls	1,019.6	1,094.3	1,094.3
Others deductions	384.5	739.9	739.9
Subsidy	145.5		
Net oil revenue	3,881.5	1,700.6	1,700.6
13% derivation	504.6	221.1	221.1
To Federation account	3,376.9	1,479.5	1,479.5
Non-oil			
VAT	1,283.7	1,475.0	1,032.5
Corporate taxes, CIT, Stamp duties	1,423.6	1,877.0	1,313.9
Custom: Import, Excise & Fees	866.8	862.4	603.7
Special levies	-	-	
Deductions	182.6	198.1	138.7
To Federation account	3,391.5	4,016.4	2,811.5
Federation account	6,768.4	5,495.8	4,290.9
VAT pool account	1,232.4	1,416.0	991.2
Federal Budget			
FAAC (FGN)	2,859.2	2,274.69	1,738.4
FG Independent revenue	489.23	1,505.88	1,505.88
Others	103.78	75.17	75.17
FGN retained	3,452.2	3,855.7	3,319.4
FGN expenditure	4,493.4	6,077.7	6,077.7
Fiscal deficit	(1,041.2)	(2,221.9)	(2,758.3)

Source: Budget Office, MTEF (2016 – 2018), *ARM Research estimate (based on adjustments to different components of non-oil revenue)

PETROLEUM SECTOR REFORMS LEAD REVAMPED DRIVE FOR NEW POLICY DIRECTION

Twenty fixes, one ailing institution

Consistent with expectations, the Senate's ministerial ratification accentuated ongoing reforms at the NNPC, with the new Minister of State for Petroleum—Dr. Ibe Kachickwu—communicating NNPC's adoption of “20 fixes” to reposition the ailing state-owned institution in the aftermath of his swearing in. According to NNPC, “20 fixes” is structured to resolve challenges such

as asset integrity issues, crude oil and product theft, sub-commercial contracts, low capacity utilisation of refineries, issues of subsidy management, and an overall inefficient business model. In laying the foundations for the proposition, FG had ratified the trimming of NNPC's top managerial hierarchy and operational directorates respectively from 122 to 83 members and 8 to 4 directorates, in an attempt to make the institution lean, efficient, business-focused, transparent, and accountable. According to the minister, the overriding objective is to ensure the institution remains a business concern in spite of global dip in crude oil prices. So far, NNPC has reportedly reduced cost and restructured its

corporate centre but there's more to be done. According to NNPC, the process of realizing the end outcome would require renegotiating existing contracts including Production Sharing Contracts (PSCs), strengthening of subsidy management, improving pipeline security, and enhancing transparency.

Table 5

NNPC's "20 Fixes" reform proposition

NNPC's 20 Fixes
Reduce and audit cost
Restructure corporate centre and staffing
Renegotiate existing contracts
Renegotiate PSCs
Streamline subsidy management
Boost pipeline security
Enhance transparency and accountability
Achieving zero tolerance for corruption
Rebrand NNPC and unbundle PPMC
Unbundling of the Nigerian Gas Company
Reduce contracting Cycle
Restructure refineries
Improve information technology to drive business
Embed staff and business performances management
Restructure JV funding and reduce Cash Call
Improve retail profitability
Deploy and attract focused investments
Re-kit NPDC
Expand crude marketing
Generate power profitability

Source: NNPC, ARM Research

fund joint venture cash calls between NNPC and oil multinationals. According to the minister, this move will relieve the FG from bearing the burden of funding capital intensive projects in the upstream sector. Importantly, this could also forestall scale down in oil production by oil multi-nationals who have often had to wait endlessly for the NNPC to meet its JV obligations. In this light, the proposed initiative ties neatly with FG's resolve to raise oil production to 2.4 mbpd in 2016 (vs. an average of 2.1 mbpd for 2015).

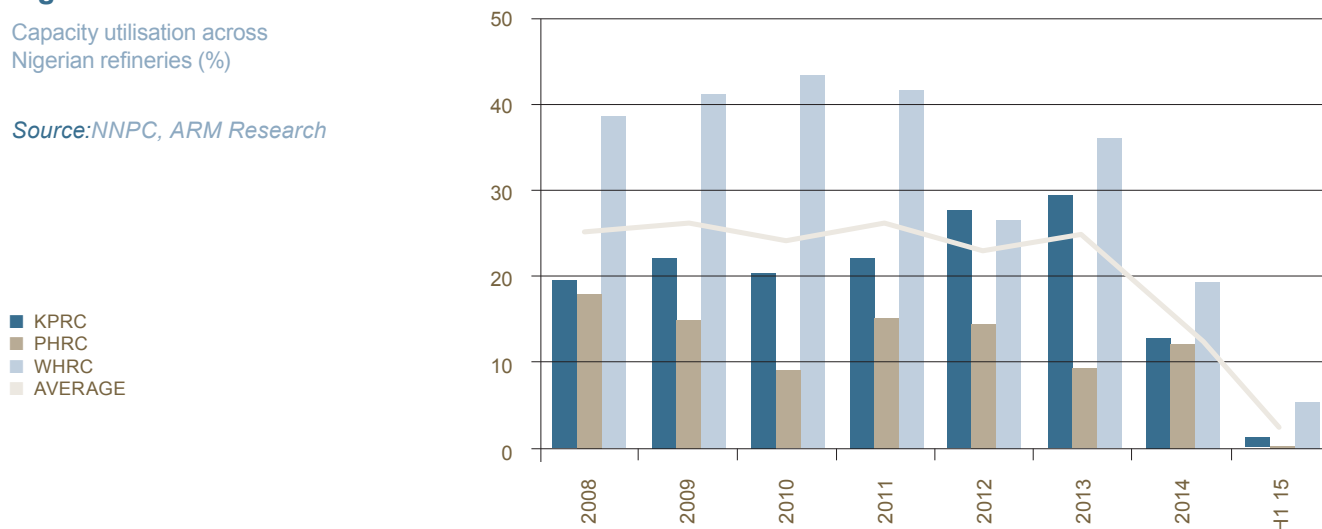
On the downstream sector, the minister communicated plans to privatize over 5000 kilometers of NNPC's pipelines across the country in a bid to enhance efficient management of the infrastructure and reduce vandalism to the barest minimum. In

Perhaps a more pertinent move of the FG—looking forward—is its resolve to end the perennial JV cash call challenge, given its impact on oil production and overall economic output in recent times. To address this, FG expressed willingness to raise funds from international investors and the private sector to

addition to this, technical support and technical joint venturing models were also proposed for refineries. Reportedly, with these models, refineries would be granted semi-autonomy to buy their own crude, refine it and subsequently make remittances to the Federation Account. In the interim, the corporation has outlined plans to replace Offshore Processing Agreements (OPA) with more efficient Direct Sales-Direct Purchases (DSDP). The switch to DSDP is intended to eliminate the activities of middle men, facilitate direct sale of crude oil by NNPC as well as permit express purchases of petroleum products from credible international refineries. The ultimate aim is to enhance PMS availability and reduce its cost. To be clear, the corporation noted that only bona fide owners of refineries who have

Figure 27Capacity utilisation across
Nigerian refineries (%)

Source: NNPC, ARM Research



scaled through due diligence and analysis by NNPC appointed consultants will be engaged in the DSDP transactions going forward.

Domestic environment to benefit from reform thrust...

As premise for this inquiry, we restate that moving to tackle JV cash call challenge represented one of the most pivotal economic game changers of the current reform policies, given that JV partnerships accounts for over 60% of total crude production in Nigeria. On other fronts, NNPC is being strategically positioned to lead the charge for improved symbiotic relationship with host oil communities—in a development that should mitigate vagaries associated with constant unrest in oil producing areas. However, the resultant impact on government revenue remains slightly blunted by OPEC's quota restriction as well as continued declines in oil prices. Whatever the case, the greater insight into oil reform intent is expected to attract over \$20 billion in foreign investments in 2016 which should facilitate funding for major oil projects.

On other fronts, while the switch to DSDP and ongoing restructurings in local refineries—with Kachikwu guiding to ~50% cumulative capacity utilisation as early as January 2016—looks set to re-write recent history of incessant PMS scarcity around the country. This should have the two-pronged effect of stemming harsher cost of living for the populace as well as keeping cost of running businesses contained in the

near term. Besides, the attendant greater availability of the product could also guard against major production downtime akin to that of May 2015 which contributed to lowest GDP growth, in more than five years, of 2.35% in Q2 15. Beyond these, the more benign regulatory environment that has seen downstream retail margins expand 50bps further provides backing for FG's expectations for some positive outcome in the coming period.

In closing, the more efficient regulatory handling could facilitate soft landing for Dangote Refinery as it looks to ease into operations in December 2017—one year ahead of the earlier scheduled December 2018 date. The revision of the business' commencement date is consequent upon the early completion of preliminary works at the refinery. Interestingly, the United States Trade and Development Agency (USTDA) had, in August 2015, already signed an agreement with Dangote Group for a grant of \$997,443 for the training of Dangote Oil Refining Company's personnel. The USTDA grant will fund a multi-year programme to train over 100 Dangote Company staff on refinery fundamentals. Through the training, the Dangote staff will be able to operate and maintain the Greenfield Refinery in Lekki, Lagos.

...though investors remain wary of PIB

In a deft move, FG approved the splitting of the long-dragging Petroleum Industry Bill, which is now styled "Petroleum Industry Governance and

Institutional Framework 2015” with a focus to creating commercially oriented profit driven entities. Amongst other things, the proposed bill is reportedly structured to reduce the powers of the minister and split the NNPC into two distinct entities: Nigeria Petroleum Assets Management Company and a National Oil Company (NOC). Whilst running as a private commercially viable company, the NOC is billed to retain its revenues, deduct costs, and pay dividends to government. In addition, the minister disclosed plans to remove the contentious taxation element of the bill to speed up its passage. According to Kachikwu, the country loses an average volume of investments of about \$15 billion annually due to the non-passage of the PIB. FG further affirmed that quick passage of the bill will reduce overall uncertainty in the sector. However, this process of redrafting the PIB would require large scale engagement with all stakeholders in the sector with the current minister of state already guiding to a one year time frame for execution. Thus, in spite of the underlying good intentions, we believe the elongated process involved will no doubt delay the implementation of a piece of legislation that seeks to establish a new legal framework and regulation mechanism for an industry that has been scarred by commercial-scale theft, sabotage and corruption.

Subsidy in the spotlight

Over the last 12 months, FG has spent over ₦1 trillion on subsidy claims for oil marketers—with the amount also reflecting subsidy backlog from prior year as well as adjustments for currency and interest rate changes. The expensing of this sum at a time of severe financial challenges, with state governments already clamoring for a downward review of the ₦18,000 minimum wage barely 3 months after receiving FG’s bailout funds, posed questions on the overall reasonability of the subsidy regime. In particular, the World Bank noted that current declines in oil prices to multi-year lows present the Nigerian government a clear opportunity to get rid of the contentious oil and gas regulation. To be clear, last updated information on PPPRA’s PMS pricing template also puts current subsidy payment at ₦6.18 per litre (vs. ~₦32 per litre in the first 10 months of the year), which based on current consumption of about 40 million litres, would imply annual subsidy budget of ₦90 billion for 2016—a relatively small figure. Thus, sensing the opportunity to transit into deregulation with minimal threat of backlash from the populace, FG may have concluded plans to gradually

deregulate PMS prices. As premise for this surmise, we note that the government recently communicated 2016 budget with a resolve to allow components of PPPRA pricing reflect current economic realities.

However, the minister of state for petroleum fell short of describing this FG’s agenda as a subsidy removal—tagging it price modulation instead. According to him, in view of the new pricing strategy, the Petroleum Products Pricing Regulatory Agency (PPPRA) has been directed to adjust its pricing model to reflect competitive and market driven components. In contrast to previous cases of adjustments (most notable in January 2012) though, the new arrangement is unlikely to lead to higher PMS prices with oil prices still significantly subdued (and other hitherto fixed components likely to be revised lower). In this arrangement, PMS prices would not be fixed but possibly banded by an upper interval of ₦97 per litre, according to the minister. Importantly, government’s current posture is now considerably closer to global realities where countries—including India, Ghana, Egypt, and Argentina—that faced twin deficits over the last couple of years commenced gradual phase out of subsidy on petroleum products. In any case, with regulation a bit more relaxed and expected further declines in oil prices pointing to sustenance of the current trend, private investors look set to find a more benign business environment come 2018.

Power reforms thus far: mammoth investments; puny impact...

Since February 2015, CBN has disbursed 30% of its ₦213 billion power intervention fund earmarked for turnaround maintenance of facilities, capacity recovery at power stations, purchase of meters, rehabilitation of transformers, procurement and construction of new distribution substations, among others. According to the apex bank, the disbursements of the funds has allowed Discos purchase 171,071 prepaid meters, and rehabilitate over 332 kilometers of 11KV lines as well as 130 kilometers of 0.45KV lines since the commencement of the programme. In addition to CBN’s efforts, a number of Discos have entered into partnerships with global ICT firms to increase meter production and distribution in 2016. More importantly, the new Minister of Power, Works and Housing—Babatunde Fashola—went ahead to sanction the long-dragging upward review of electricity tariff in the country despite patches of public agitations to the contrary. The review effectively scraps out

Table 6

Changes in variable cost of electricity per KWh

	R1/flats or residences with electricity lifeline of 50 kWh	R2 Abuja/ residential customers, who use single and three-phase meters in the houses and residences	R2 Eko/ residential customers, who use single and three-phase meters in the houses and residences	R2 Ikeja/ residential customers, who use single and three-phase meters in the houses and residences	R2 Benin/ residential customers, who use single and three-phase meters in the houses and residences	R2 Kaduna/ residential customers, who use single and three-phase meters in the houses and residences	C2/Commercial consumers in Ibadan who use their residences as factory for manufacturing goods and classified with maximum demand consumption capacity	C2/Commercial consumers in Ibadan who use their residences as factory for manufacturing goods and classified with maximum demand consumption capacity
Previous (Naira per KWh)	4	13.91	12.87	13.61	12.54	16.9	25.18	24.01
Current (Naira per KWh)	4	23.51	22.87	21.61	21.8	27.95	37.26	37.36
	0%	69%	78%	59%	74%	65%	48%	56%

Source: NERC, ARM Research

fixed charges (an approved amount of money that consumers pay whether or not electricity was consumed over the period) while instituting ~70%. At another level, following relatively more stable gas supply over H2 15, power generation has since moved from a low of ~3000MW in May to an average of 4600MW over the last six months of 2015. Without much ado, FG was quick to pin the improvement on its progressing clamp down on pipeline vandalism as well as infrastructure upgrade—partly a fall out of CBN's power fund allocation. FG has also hinted at the possibility of further northward review of gas prices to increase influx of private investment resources into gas infrastructure while reportedly intensifying plans to boost NNPC's investment in critical gas infrastructure over the coming 18 months. The latter investment is expected to enhance gas supply to associated power plants and generate an additional 2000MW of power in the process.

In addition to the developments at both the distribution and generation phases, Transmission Company of Nigeria (TCN)—owned by government but managed by Manitoba of Canada—noted that its capacity (5300MW) remains a nudge ahead of power supply (with peak at 4662) over most of 2015. According to its management, TCN was successfully wheeling out 4662MW of power supplied over the latter half of 2015. However, slower speed of progress on transmission projects may make it difficult to keep pace with developments in power generation, highlighting potential complications in the process of transporting purchased power from

GENCOs to sub stations of Discos in the coming periods. To proactively combat this, TCN recently shortlisted 30 local and foreign investors willing to invest in transmission infrastructure as it steps up plan to expand capacity to 8000MW by end of 2016. Highlighting the scale of the funding challenge—especially amidst stifled FG revenues, TCN noted that a minimum of about ₦15 billion annual private funding/investments over the next three years would be required to push transmission capacity to the 8000MW mark. Whilst TCN is yet to give full clarity on modalities for repayment to the potential 30 transmission investors, it however made it explicit that there would be no form of sovereign guarantee for the funding from the private participants. Repayment for their investment is billed to stem from wheeling charges which is part of TCN's internally generated revenue. Regardless, as has been the situation over the years, bureaucratic process involved in obtaining government approval would have to be scaled to determine government's readiness for this investor finance scheme. The potential bureaucracy would be particularly regrettable considering considering TCN's assertion that government's failure to meaningfully improve its funding to the transmission segment, caused a number of projects to stall in the pipelines. Nonetheless, a greater allocation of planned capital expenditure (i.e. 24% of total ₦1.8 trillion earmarked; 2015: ₦55billion 8% of proposed capital expenditure) to the ministry of Works, Power, and Housing appears to signpost better intent from government going forward.

In contrast to TCN's more optimistic standpoint, the new minister subsequently declared that transmission capacity is currently unable to support all generated power in the country, unveiling greater depth of concerns at the transmission end in the process. Additionally, the minister hinted that, of the entire 142 identifiable transmission project in pipeline, only 22 can be completed within the next 12 months, implying a possible protraction of the noted transmission

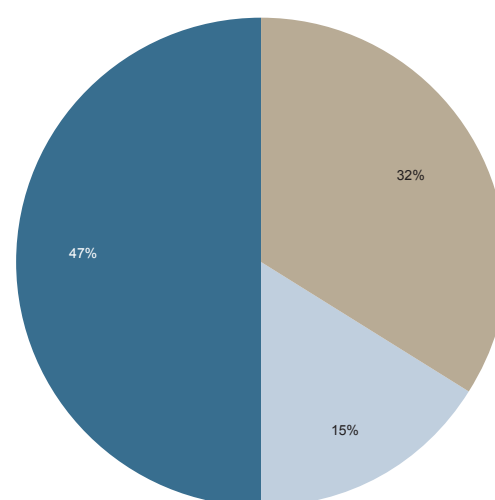
concerns when weighed against further additions to generation capacity already mentioned. Perhaps also buttressing the minister's view point is NERC's support for embedded power supply across the country as a near term solution. This process will enable GENCOs supply electricity directly to Discos without going through the transmission system networks. The urgency to address transmission issues is mainly re-enforced by an expected ramp up in power generation

Figure 28

142 TCN Projects and status

Source: Minister of Power, Works, and Housing; ARM Research

■ 50% LEVEL OF COMPLETION
■ CAN BE COMPLETED WITHIN A YEAR
■ OTHER PROJECTS



in the next 15 months that could mount more pressure on the current transmission facilities.

Going forward, we expect the recent increase in electricity tariff to cascade to improved margins for Discos who have previously struggled with cost of electricity due to second order effect of higher gas prices. In addition, with Discos largely sorted, both GENCOs and TCN look set to enjoy a more improved cash flow position in 2016 in view of an expected improvement in payment turnaround time for power generated and transported. Away from these positives though, the disbursement of CBN's power fund appears to have assumed a much slower pace over the last 9 months. Specifically, whilst in the first month of implementation a total of ₦58 billion was disbursed to selected GENCOs and Discos, the subsequent 9 months only saw an additional ₦7 billion allocated to power companies nationwide. This translates to an average monthly allocation of ₦778 million over the period and signals an obvious

temperance in power fund allocation. We believe this reflects stringent key performance indicators (KPIs) attached to the fund by the CBN as well as delays in scheduled implementation of commercially viable tariffs. Additionally, with only 15% of TCN's ongoing projects due for completion in the next one year and with embedded power supply option yet to be attained significant progress, transmission challenges are likely to persist in 2016.

PENCOM INITIATIVES CONTINUE BUT STALLING IMPLEMENTATION SLOWS PROGRESS

Attention shifts to curbing AVC exploitation and reducing housing deficit

The National Pension Commission finally released a draft guideline governing the Additional Voluntary Contribution (AVC) wherein the objective of the AVC was expressly stated as enhancing retirement benefits. Under the Pension Reform Act 2014, which currently

guides pension contributors' voluntary payments, only the income earned on such contribution was taxable and only if such income was withdrawn within 5 years of the contribution; the contribution itself was tax-exempt regardless of time of withdrawal. Scheme participants exploit this loophole in the AVC, by making additional contributions for extremely short periods with PENCOM suggesting that some accounts were being run in a semblance of savings accounts. In sum, the AVC was seen by some contributors as an avenue to lower tax liability, by making tax exempt contributions and withdrawing same tax free, rather than increasing retirement benefits. In a bid to restore the real objective of pension contributions, PENCOM stipulated in the draft guideline that only 20% of the voluntary contribution balances would be accessible for withdrawal and that will only be once every four years. After the last withdrawal, a further withdrawal of 20% of subsequent additional contributions is allowed but the remaining 80% would only become available at retirement. Whilst adoption of this guideline should reduce scheme participants' utilisation of the AVC, it should remain appealing to contributors whose true aim is to augment their retirement assets.

Furthermore, in a bid to stem the lingering infrastructural deficit, the National Pension Commission released a guideline that will govern use of RSA balance to secure residential mortgages. According to the guideline, pension contributors in active employment who have consistently contributed for at least 10 years and with a low leverage position (Maximum Debt/Equity: 33.33%) will be able to access up to 25% of pension fund as equity contribution in respect of their first home ownership mortgage. Furthermore, PENCOM stipulated that the mortgage loan must range between ₦1.5 million and ₦50 million with a tenor of between 5 to 20 years. In addition, proceeds from the loan must be used to purchase either a single-family home or an apartment in a multi-unit building, which must be owner-occupied. Given the aforementioned restrictions, at least half of pension

contributors would likely be excluded from accessing their RSA funds for home mortgage as PENCOM's target audience appear to be middle income earners. Whilst an immediate impact may not be felt, we see this as a critical legislation that could unlock massive capital that would flow into the real estate sector and help bridge the housing deficit.

FI market captures most of pension asset growth

Pension fund assets continued its steady growth with AUM rising 11.7% year through October 2015 to ₦5.1trillion, largely reflecting expansion in Fixed Income (FI) instruments (+14.7%) which muted declines in Variable Income (VI) securities (-1.7%). In particular, FGN securities (bond and treasury bills) rose 18.4% to ₦3.4 trillion over the period as pension fund managers likely increased purchases to take advantage of attractive yield over the period (average yield: Year through October: 15.1%; 2014: 12.66%) with the asset class' share of total assets climbing 3.78pps to 67%. Elsewhere, percentage holdings of Sub-National (-60bps to 3.1%) and Corporate (+40bps to 3%) securities were relatively unchanged with the directional changes largely in tandem with available new issuance in each category. Sub-national issues in particular appeared subdued as a consequence of fiscal challenges. . Though the value of domestic equity assets contracted 5.4% year to October, its slower decline relative to the NSE-ASI's performance over the same period (-15.8%) suggests increased purchase of stocks. Meanwhile there was sizable movement in the holdings of alternative investment, though overall share remains tiny, as value of private equity assets rose 56.3% over the aforementioned period to ₦17.3 billion while infrastructure fund witnessed an inflow of ₦1.3 billion over 2015 vs. nil at the end of 2014. Whilst percentage holdings of foreign securities (1.4%) remain insignificant, value of foreign assets rose

Table 7

Sub-National Issued Bonds over 2015, trend in pension assets

Name	Date of Issuance	Date of Maturity	Amount (₦' billion)	Coupon
Benue	February 2015	February 2022	4.95	16.50%
Cross River	May 2015	May 2022	8	17%

Source:FMDQ

Table 8

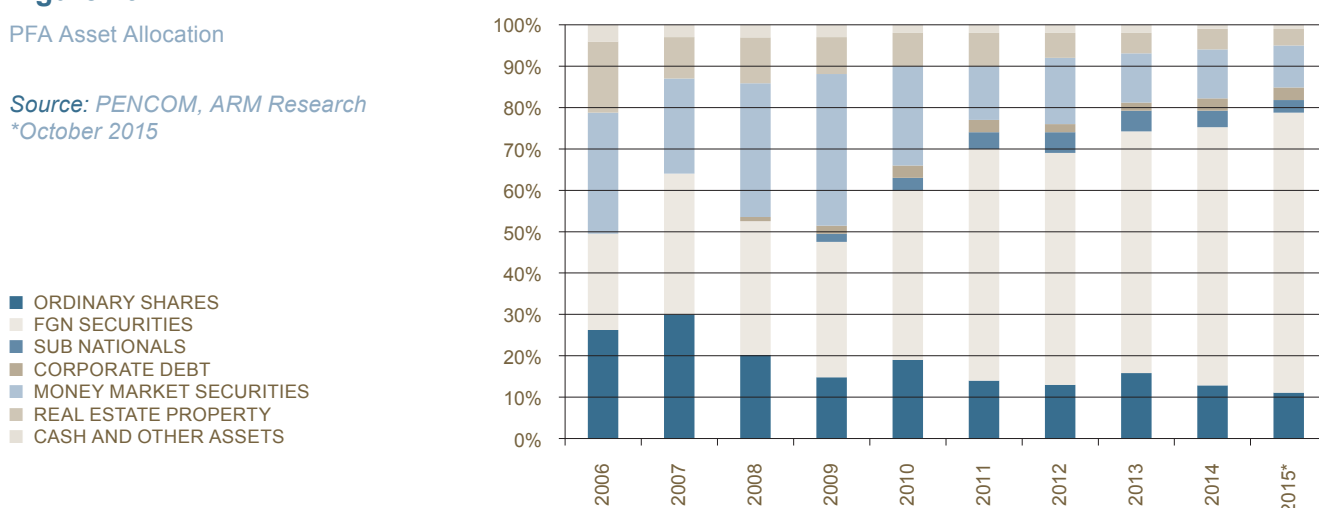
Corporate debt issuance in 2015

Name Bonds	Date of issuance	Date of maturity	Amount (₦'billion)	Coupon
Fidelity Bank Plc	May-15	May-22	30	16.48
NMRC	Jul-15	Jul-30	8	14.9
Transcorp Hotels PLC	Oct-15	Oct-22	10	16
FCMB	Nov-15	Nov-20	23.2	15
Commercial Papers				
NB	Oct-15	Dec-15	17.71	12.5
Wema bank	Jul-15	Jan-16	8.15	16.51
Flour Mills	Aug-15	Nov-15	5	14.465
Guinness	Nov-15	May-16	10	13.25
Guinness	Nov-15	Jul-16	10	13.75
Skye bank	Oct-15	Jan-16	10	14
Skye bank	Oct-15	Apr-16	10	14.52
Skye bank	Oct-15	Jul-16	10	15.12
NB	Dec-15	Mar-16	5	7.5
NB	Dec-15	Jun-16	5	8.5
NB	Dec-15	Sep-16	5	9.5
Stanbic Bank	Dec-15	Jun-16	10	7.75
Stanbic Bank	Dec-15	Sep-16	15	8.75

Source: FMDQ, ARM Research

Figure 29

PFA Asset Allocation

Source: PENCOM, ARM Research
*October 2015

17.9% (foreign money market securities: more than five-fold to ₦652 million, foreign equities: +17.1% to ₦69.7 billion) largely in tandem with the scale of the

USD/NGN devaluation in February (18%). In sum, PFAs continue to maintain limited exposure to VI securities (16.2% of total pension assets)

highlighting the risk-averse nature of pension managers despite a long term liability structure⁽¹¹⁾ that should give scope for greater risk asset creation.

New efforts to catch cold from key initiatives still on ice?

Perhaps, in a bid to address this long-standing dislocation, PENCOM issued revised guidelines for two complementary initiatives earlier in the year: the multi-fund structure and transfer window. For the multifund structure, whilst our previously analysis clearly indicated the potential for the multifund structure to raise allocation to equities/VI instruments, even if PFAs only met the minimum floor allocation in risk asset category of each of the four sub-funds. However, the lack of implementation, perhaps due to absence of a PENCOM board which should give final approval meant the expected impact (boost to VI) did not materialize. Similarly, the expected opening of the transfer window which was expected to catalyse operational efficiency and a scramble by operators

(11) 78% of pension contributors are below the age of 50

to differentiate their investment strategies, in a bid to retain clients, also failed to kick off. For this second initiative, the apparent reason for inactivity was the need to clean up multiple registrations present on the existing database. Based on the nature of the issues that impaired implementation of these prior initiatives, in particular the absence of a sitting board, and the necessary interplay with other regulators to push the investment-related changes through, we do not expect significant action on this front going into H1 16. In contrast, we are of the view that the operational nature of new AVC, especially since its basically an amendment to an existing process, could see the regulator follow-through. Nonetheless, we do not expect significant dampening implications from the initiative for pension assets given the previous AVC structure simply served more as a pass-through for seekers of tax shelter. For the mortgage initiatives, we believe more clarity needs to be provided for pension contributors as to exactly how the process will work, before the impact can be seen on any of the industries involved (banking, pensions, real estate).

ECONOMIC REVIEW AND OUTLOOK

GDP GROWTH STUCK IN THE SLOW LANE

Delayed policy direction amidst weak oil prices weighs on Nigeria's output growth

In 2015, real GDP growth slowed to 3.96% YoY in the first quarter and further to 2.35% YoY in Q2 2015 compared to respective growth of 6.21% YoY and 6.54% in the corresponding quarters of 2014. This was largely due to tempered activities in the manufacturing sector as the effect of the February 2015 devaluation of the Naira kicked in, with expensive imports resulting in inflated operating costs. Aside the higher costs, the Central Bank of Nigeria's (CBN) decision to bar many importers from accessing foreign exchange at the official rate also limited the quantity of raw materials they could procure, exacerbating declining output for manufacturers. The trend of depressed economic activities continued into the second half of the year, as uncertainty over economic direction reigned despite hints as to the new government's plans.

Aside devaluation, other sources of pressure contributed to the economic doldrums. Despite the relative stability early in H2 2015, oil prices remained

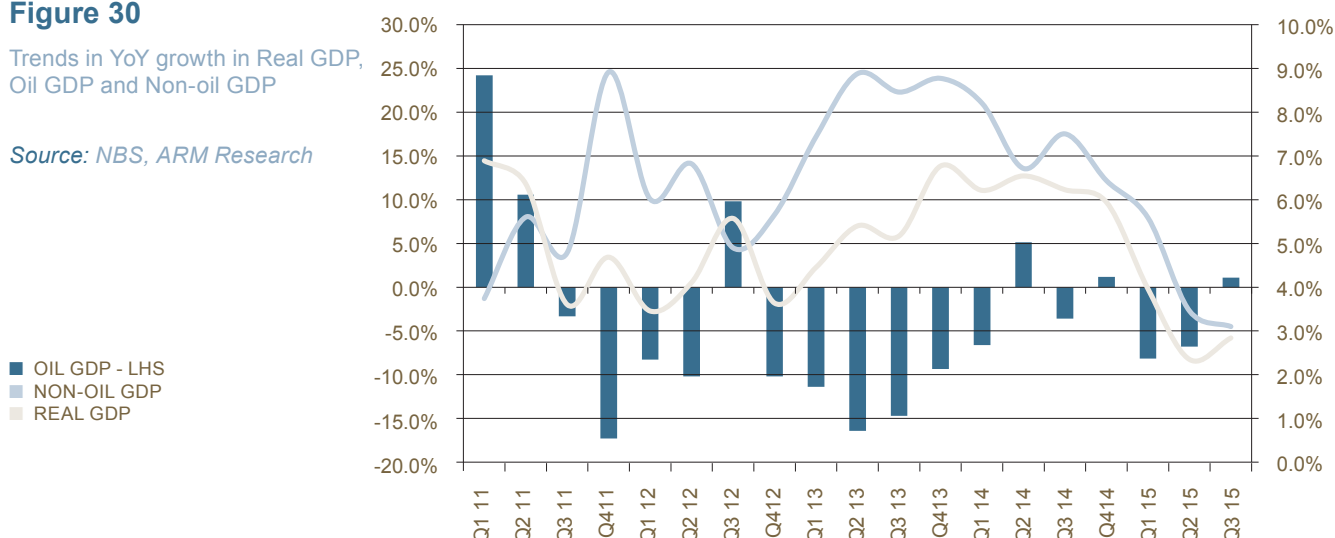
43% lower YoY, with Brent crude averaging \$63.75/bbl for the month of June 2015. Further into H2 2015, prices kept tanking to hit a 7-year low of \$36.88/bbl in December with the sharp decline mounting severe pressure on currencies and economies of major oil exporters, with Nigeria not being an exception.

Thus, whilst real GDP picked up marginally in Q3 2015 at 2.84% YoY, a closer look at the Q3 15 output numbers however, showed the improvement had at best a tentative basis. Non-oil GDP growth decelerated further slumping to a new low of 3.1% YoY, (Q1: 5.6% YoY, Q2: 3.5% YoY). Similarly, for the three quarters available, real GDP growth for the manufacturing sector declined consecutively (-0.70%, -3.82% and -1.75% YoY), compared with growths of 15.41%, 14.01% and 16.00% YoY in the corresponding quarters of 2014. Hence, a positive 1.1% YoY rise in oil GDP, which represents a 790bps swing from Q2 level, was the primary source of QoQ improvement in Q3 15 headline numbers.

Figure 30

Trends in YoY growth in Real GDP, Oil GDP and Non-oil GDP

Source: NBS, ARM Research



Oil GDP swings positive even as industry reform gathers steam

Despite extended weakness in crude prices, which weighed on NNPC's ability to meet funding obligations to JV partners and induced industry wide mothballing of oil exploration activities, mean oil production rebounded over Q3 15 to 2.17mbpd, from the multi-

year low of 2.05mbpd in Q2 15. Nonetheless, the NBS data for September 2015 production is an estimate, as NNPC is yet to release oil production data beyond August, which suggests the bureau made fairly strong oil assumptions⁽¹²⁾, possibly hinged on the on-streaming of Shell's 50kbpd Bonga Phase III which occurred during the month.

(12) July (2.18mbpd) August (2.04mbpd)

Figure 31

Crude oil prices and production

Source: CBN, ARM Research

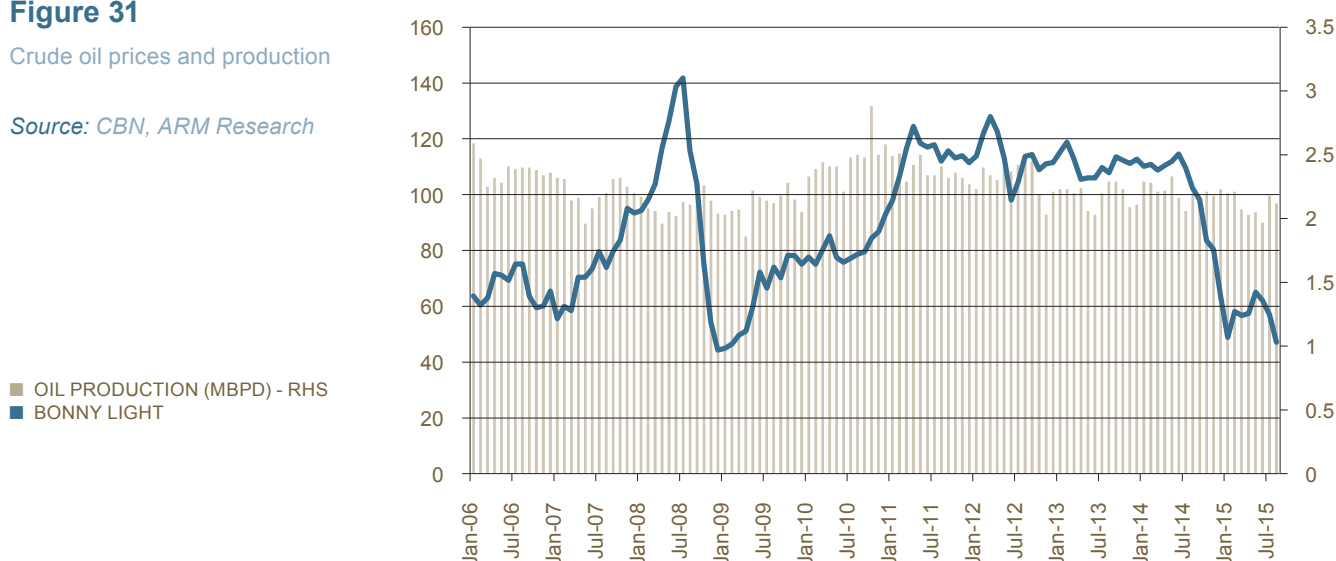


Table 9

NPDC JV Assets for conversion to IJV

Asset	JV Partner	Key Share-holders	Production (kbpd)
OML 30	Shoreline Natural Resources	Shoreline & Heritage Oil	50
OML 26	First Hydrocarbon Nigeria	Afren	11
OML 34	ND Western	NDPR, Petrolin, First E&P and WalterSmith	2
OML 40	Elcrest E&P Nigeria	Eland Oil & Starcrest	2.5
OML 42	Neconde Energy	Nestoil & Kulczyk	22
OMLs 71&72*	West African Exploration and Production company	Dangote and First E&P	N/A

Source: Petroleumindustrybill.com, ARM Research *OML 71&72 are currently not producing

Beyond the fundamentals front, two developments over 2015 with impact on oil sector GDP are worth noting. First, to tackle the persistent problem of funding for JV cash calls, the Buhari administration granted approval to the NNPC to convert JV assets into corporate entities called Incorporated JVs (IJVs) which can raise money to execute projects, control own budgets and share profits to shareholders under an operating model similar to the NLNG. Under this new system, IJVs have the flexibility to raise money to meet cash calls without recourse to parliamentary approval, as in the old regime, which eliminates the impact of delayed cash payments on production. At inception, the model will be trialed for six JV assets between indigenous companies and NPDC, thereafter it would be extended to other assets.

In a related development, the draft copy of a new petroleum industry bill (PIB) proposes splitting the NNPC into two (vs. 12 entities under old PIB) successor companies – the Nigeria Petroleum Assets Management Company (NPAM) and a National Oil Company (NOC) with the latter to be a fully integrated oil and gas company run on a commercial basis while the former would manage O&G assets run under newly created IJV and PSC agreements where upfront funding is not required from the FGN. The NOC would be provided start-up capital of \$5 billion or at least the five-year average of the amount of money NNPC requires for joint venture operations and partly privatized with at least 30% of shares divested in six years.

Importantly, the new PIB avoided mention of the adjustment to fiscal terms on oil production under the old PIB which generated opposition from the IOCs, perhaps reflective of the adverse impact of depressed oil price outlook on exploration activity. Whilst the draft does not provide clear visibility over long term outlook for regulation in the oil industry, we see increased prospects for this simplified version to gain legislative approval with minimal controversy than the last bill.

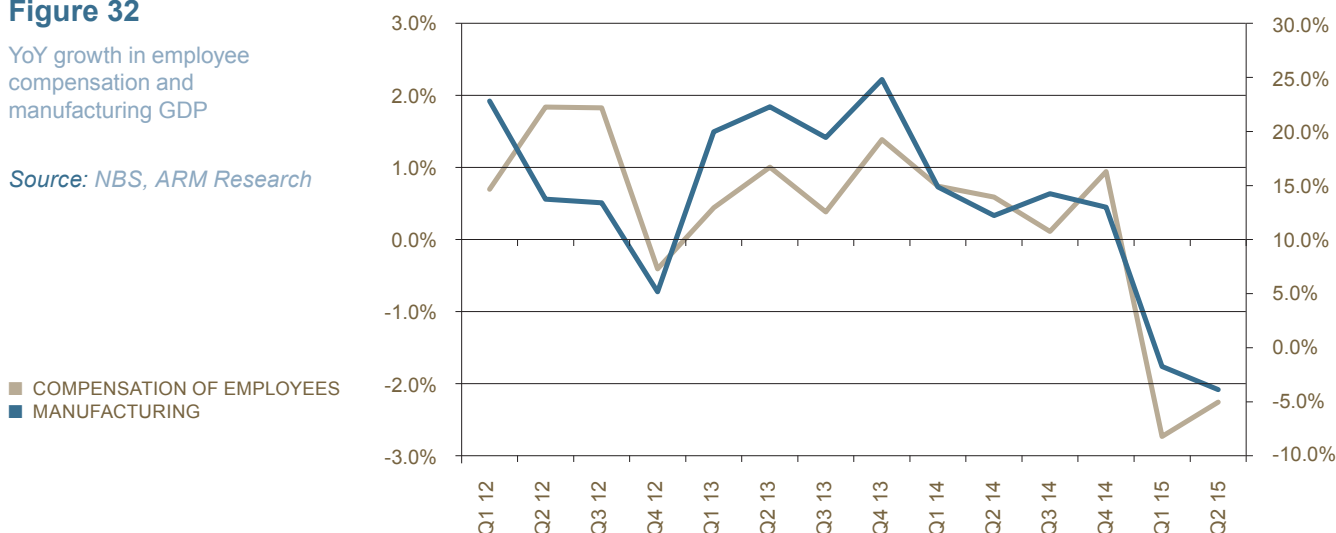
Negative wage growth drives manufacturing GDP into recession

In contrast to the oil GDP picture, the slowdown in non-oil GDP continued with manufacturing GDP contracting for the third consecutive quarter (Q3 15 -1.4% YoY), on account of further weakness in Food, Beverage and Tobacco (FBT) (Q1 15: -0.8% YoY, Q2 15: -5.9% YoY, Q3 15: -8.9% YoY) and Oil Refining among others. The feeble trend in FBT mirrors top-line softness across listed FMCG companies in the Q3 15 results season. However, the weak Q3 reading contrasts with our expectations for modest improvement as energy constraints which impacted Q2 15 eased. Furthermore, considering there has been increased fiscal and monetary stimulus to enable state governments meet their recurrent expenditure needs, the sustained recession in manufacturing speaks to an environment of underlying demand weakness as a consequence of restrained consumer incomes. From Figure 33 below, co-movement is evident between real wage growth and expansion in manufacturing GDP with negative growth in the former over 2015 coinciding with a slide into recession in the latter.

Figure 32

YoY growth in employee compensation and manufacturing GDP

Source: NBS, ARM Research



ICT and Real Estate underpin Services GDP slowdown

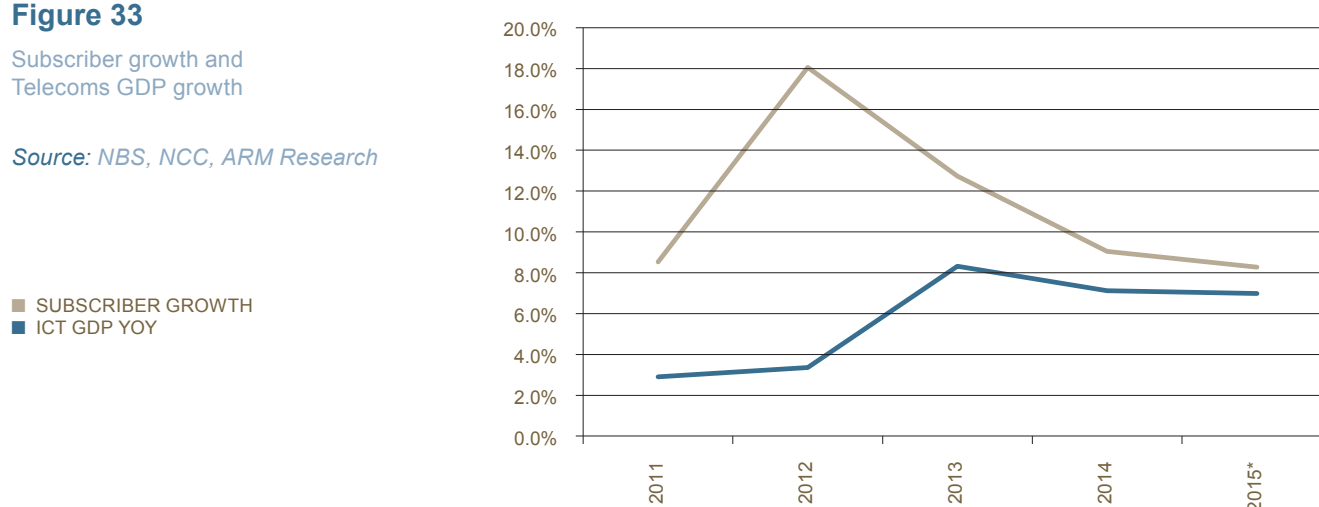
Similarly, Services GDP growth slid 70bps to 3.8% YoY dragged lower by weakness across its two largest subcomponents: communication (-100bps YoY to 5.3% YoY) and real estate (-90bps to 2.1% YoY). On the latter, slowdown reflects impact of political cycle as financing for real estate development shrank in the run-up to the elections. Post the elections, fund flows to the sector remain tepid as the changed political landscape

induced caution following the commencement of anti-graft investigations by the new administration. Elsewhere, extended deceleration across ICT reflects impact of declining telecommunications subscriber growth which firms hints about a sector approaching maturity. Further slowdown should emerge in Q4 15 reading following recent regulatory activism on the telecommunications sector, which resulted in ₦1 trillion fine on sector heavyweight MTN Nigeria, and forced disconnection of 5.1 million lines (3.4% of total active lines using latest NCC data as at September 2015).

Figure 33

Subscriber growth and
Telecoms GDP growth

Source: NBS, NCC, ARM Research



Constrained capital spending budget drives muted construction activity

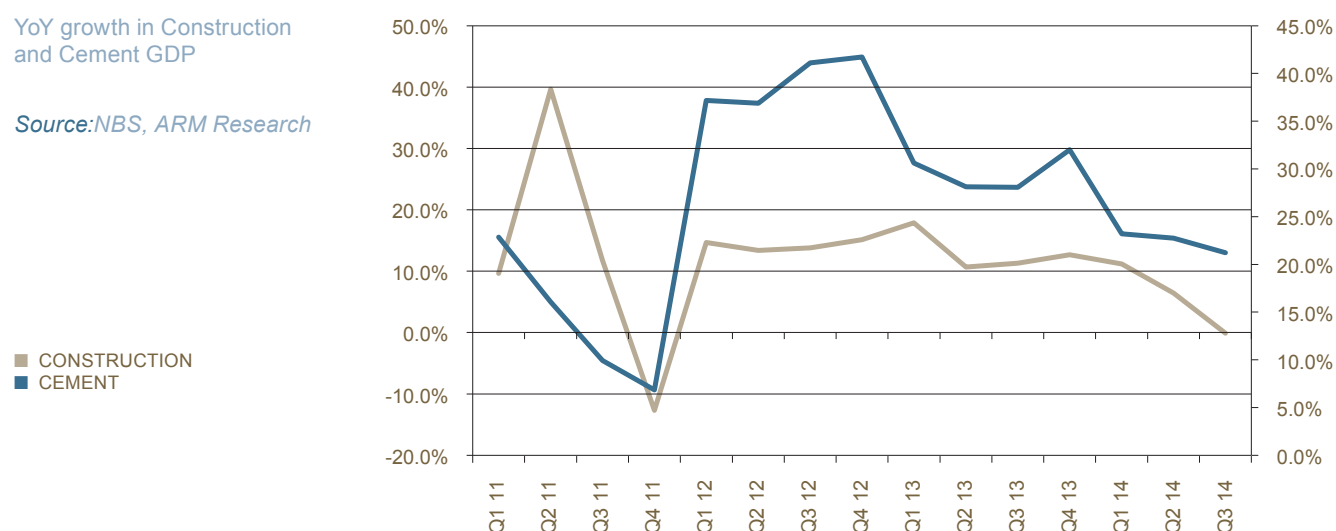
Largely reflecting the cutback in capital spending in the FGN 2015 budget (Proposed: -35% YoY to ₦722 billion, 9M 15 Actual: ₦194 billion) and similar

moderation at state level in response to the tamer fiscal oil receipts, Building and Construction GDP contracted for the first time in three years (-0.11% YoY) over Q3 15 (Q1 15: +11.2% YoY, Q2 15: +6.4% YoY). The reduced construction activity weighed on cement GDP growth, which eased for the eight consecutive quarter, sliding

Figure 34

YoY growth in Construction
and Cement GDP

Source: NBS, ARM Research



150bps from Q2 15 to 21.2% YoY. Here, developments track top-line performance for listed cement producers in Nigeria, with sector heavyweight Dangote Cement announcing price cuts over the period to try to stimulate weak cement demand in Q3 15.

Lower fiscal spending and weather shocks weigh on agricultural output

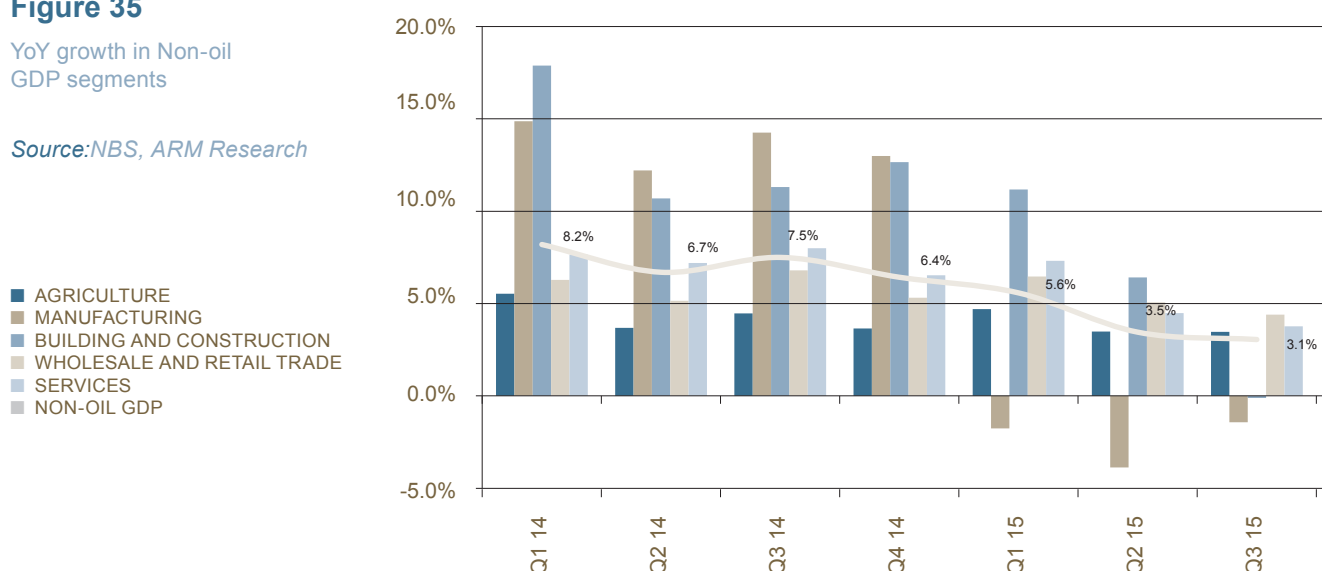
Rounding up our review of the sectors, Agriculture GDP growth, in line with trends in other non-oil segments, slowed, albeit marginally, to 3.46% YoY.

That outcome lends credence to a FEWSNET field assessment survey conducted in September, which reported declines in sorghum (-6% YoY), maize (-3% YoY) and millet (-3% YoY) as late rainfall across many areas of the country delayed crop growth. In addition, the agency noted that reduced fiscal spending power drove a moderation in input supply from the FGN Growth Enhancement Scheme which weighed on farming activity across major food producing areas in the north.

Figure 35

YoY growth in Non-oil GDP segments

Source: NBS, ARM Research



Growth deceleration essentially a story of weaker exports and declining real wages

Recasting GDP data using the expenditure and income approach provided by the NBS for the first two quarters of 2015 sheds greater clarity on the issues the Nigerian economy grappled with over 2015. Disaggregating GDP growth via an attribution analysis using the expenditure approach, current growth slowdown largely stems from negative net exports growth (Q4 14: -41.6% YoY, Q1 15: -39.4% YoY, Q2 15: -33.2% YoY) which emits impact of the oil price plunge on export growth despite import demand contraction. In addition to export contraction, slowdown in fiscal expenditure, in Q2

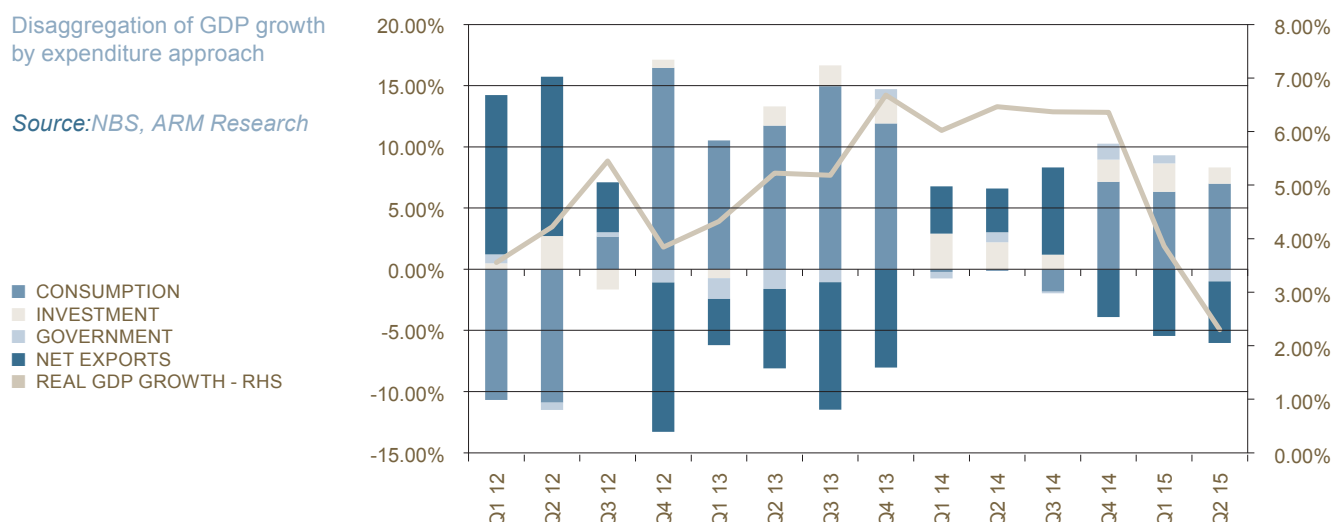
15, itself a derivative of the oil price weakness supported slide in GDP growth over Q2 15. The developments across net exports and government spending overrode the impact of mean, low-base driven, double-digit growth in consumption expenditure, which accounts for 64% of GDP on average, during the first half of 2015.

Replicating an attribution analysis on GDP figures under the income approach isolates contraction in employee compensation (27% of GDP) over the first half of 2015 and slow growth in corporate profits (66% of GDP) as the drivers of GDP growth deceleration.

Figure 36

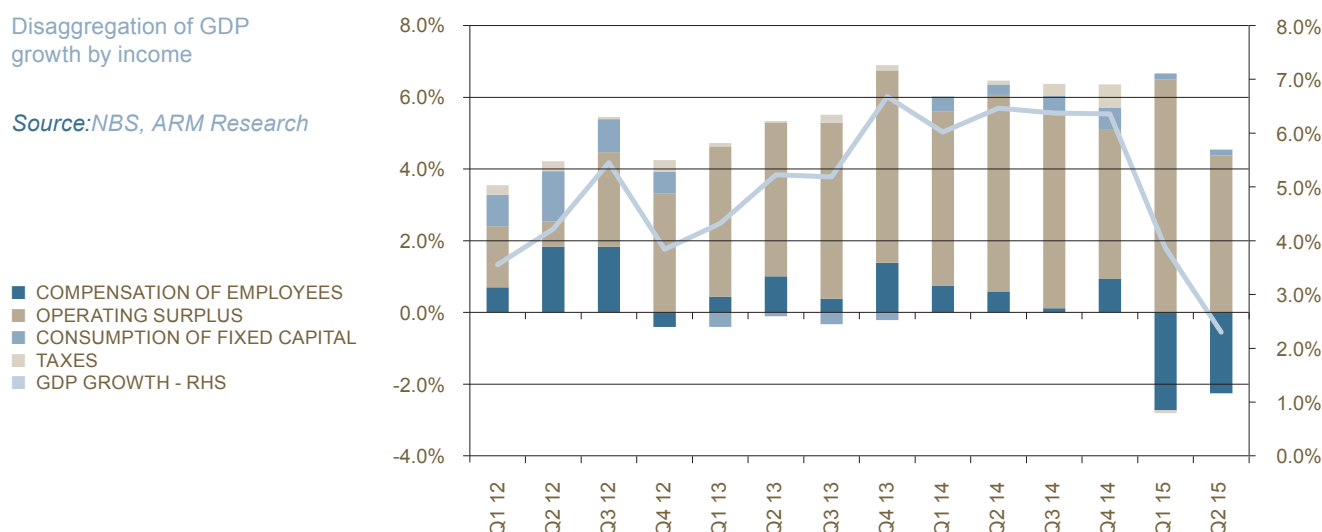
Disaggregation of GDP growth by expenditure approach

Source: NBS, ARM Research

**Figure 37**

Disaggregation of GDP growth by income

Source: NBS, ARM Research



Economic policy holds ephemeral promise for GDP uplift

Incorporating insights gleaned from our analysis of GDP using alternative approaches, we frame our growth outlook for 2016, by considering interplay of monetary and fiscal policies and how developments on these fronts can shape the economic direction.

Starting off with the fiscal side, the recently announced 2016 budget showcases an attempt to stimulate aggregate expenditure via a stimulatory budget with the FGN seeking to raise total spending 22% from

2015 to ₦6 trillion. Given that ~38% of the increment in 2016 budget stems from expansion in capital expenditure on critical economic overheads, we see some immediate scope for improvements in fortunes for construction and cement GDP which cumulatively account for ~4% of GDP (using mean contribution since start of rebased series in 2010). On the planned ₦500 billion welfare spending we envisage some upside to consumption expenditure as most of the social spending for the poorest Nigerians should filter into staple foods. This is not only positive for consumer goods companies, especially the food producers, but also for the agriculture sector which should benefit

significantly from the increase in demand required to meet the one meal per day program for primary school pupils.

On the monetary policy front, fiscal reluctance over devaluation has resulted in a focus on FX demand management measures which, in stifling import demand, pares impact of the export contraction on net exports—and GDP growth. While the tilt to incentivize import-substitution manufacturing should ultimately help extend this trend of limited impact of export weakness on output, infrastructure bottlenecks and, perhaps more importantly, reliance on foreign inputs tempers scope, in the near-term, for any gains to manufacturing GDP and outrightly dampens expectations for Trade output, from the policy move. In a nutshell, we see the current monetary policy focus (easing & demand management) as being beneficial to output via boost to corporate earnings, from lower interest costs, and also via supporting net exports.

Scanning through the sectors, for Oil GDP, akin to FY 15, lower oil prices should continue to drive moderation in E&P capital spending as access to financing becomes more difficult under current price environment. On production, whilst 2016 budget projects unchanged JV cash calls from 2015 levels, the depressed oil price outlook implies that the problem of elevated NNPC receivables to JV partners should persist over 2016 leading to pressures on production. Whilst the establishment of the IJV structure provides reprieve on this front, the fact that it is still being test-run, on smaller oil fields with combined capacity of 87.5kbpd, limits scope for feed-through of gains from the new structure on 2016 production. Nonetheless, as in Q3 2015, when on-streaming of new oil fields provided a boost to production, EIA reports of two projects by Chevron (the 70kbpd Dibi field and 30kbpd Sonam natural gas field), coming online over 2016, suggest some upside to production. Though continuing difficulty selling Nigerian crude cargoes to traditional markets on increasing global oversupply should pose further headwinds, on balance, we see oil production staying flat to positive over 2016.

For non-oil GDP, as earlier discussed increased capex and introduction of welfare program in 2016 budget should provide upside to construction and agriculture GDP. Elsewhere, increased regulatory scrutiny which has resulted in telecom operators disconnecting lines over Q4 15 due to incomplete

registration should pose hurdles to subscriber growth over 2016 and by extension drive further deceleration in telecommunications GDP. In addition, the continued anti-graft investigations should continue to deter private capital flows to real estate which should create further drag on that sector's prospects.

In sum, though 2016 seems set to be a tough year given the headwinds hinted above, we expect headline GDP growth to slightly improve on 2015 numbers. However, output reading will likely pale in comparison to the immediate five-year average of 5.3% YoY given recent trends across both oil and non-oil sectors. In distilling our thoughts to a number, we project the increased government spending numbers which accounts for ~7% of nominal GDP, assuming no leakages, and calibrate impact of forecast decline in crude prices over 2016 on net export growth. Furthermore, we assume depressed real wages and shrinking FDI prospects should drive sub-trend growth in consumption and investment expenditure over 2016. Given this backdrop, we estimate the aggregate expenditure could be boosted by 3.5% (+/- 50bps) from 2015 levels, with our forecasts particularly sensitive to successful transmission of government stimulus to the economy.

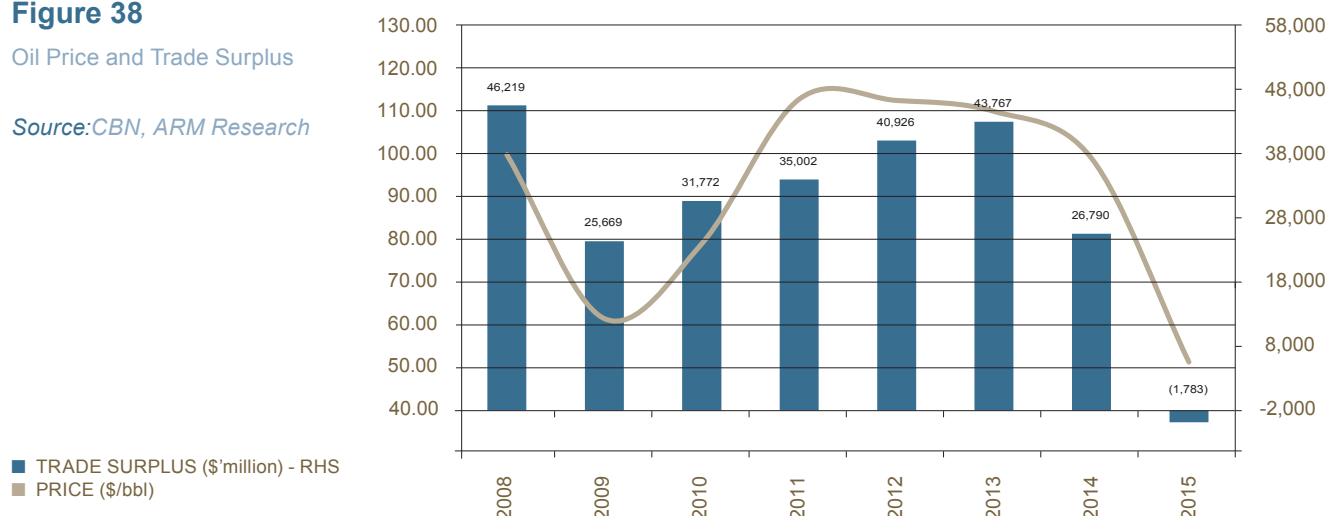
RENEWED OIL PRICE DESCENT SWINGS TRADE BALANCE DEEPER INTO DEFICIT

In line with patterns over H1 15, developments in the trade balance continue to reflect the impact of oil price contraction on exports. Over Q3 15, extended dip in the average oil price (-51% YoY) induced further shrinkage in oil exports (-50% YoY to \$10.1 billion) which, assisted by contraction in non-oil exports (-33% YoY to \$549 million), drove overall exports 49% lower YoY to \$10.7 billion. On the flipside, the declining oil price underpinned a 20% YoY contraction in oil imports to \$2.4 billion which helped offset the impact of a 2.1% YoY expansion in non-oil imports to \$10.2 billion leading overall imports lower (-2.9% YoY to \$12.5 billion). Thus, in a reverse from the surplus recorded in Q2 15 (\$873 million), Nigeria recorded a \$1.9 billion trade deficit over Q3 15 bringing cumulative trade deficit over the first 9 months of 2015 to \$1.8 billion.

Figure 38

Oil Price and Trade Surplus

Source: CBN, ARM Research



Price plunge masks gains from broad-based volume growth on oil exports

Over 2015, the strength of the price plunge on exports is magnified by examining developments in oil export volumes over the period. Across all markets, with the exception of South America (-2% YoY) and Oceania (-100% YoY), Nigeria recorded higher exports: North America (+10% YoY), Europe (+6% YoY), Asia (+13% YoY) and Africa (+50% YoY) resulting in overall crude export volumes rising 10% YoY to 569 million barrels over the first three quarters. Nonetheless, the steep price drop overrode the volume gains and drove a 46% YoY contraction in oil exports over 9M 2015.

Moderation in export volumes to South America reflect impact of deepening economic recession in Brazil and continuing squabbles at the state owned oil company PetroBras whose management has been embroiled in the much discussed corruption scandal. Complicating the situation is an ongoing tussle with unions at PetroBras over planned asset sales which resulted in several strikes over the period. Extending recent trends, Oceania continued to record nil crude imports, where as we noted in our H2 2015 NSR reflects complete import dependence for gasoline following closures of all but four refineries.

In contrasts to those outcomes, Bonny-Light exports to North America rose 10% YoY to 17.6million barrels over the first three quarters of 2015, having declined 46% per annum on average since 2010 due to rising US shale production. Unsurprisingly, the recovery in exports to that destination in part reflects declining US oil production, a fall-out of the sliding price and rig counts. Similarly a further rise in Europe-destined

exports entrenched its position as Nigeria's biggest export region. The increased off-take was bolstered by a triumvirate of declining shipping costs to the Mediterranean (where sizable European refining capacity exists), shrinking European imports of Russian crude and gradual economic recovery.

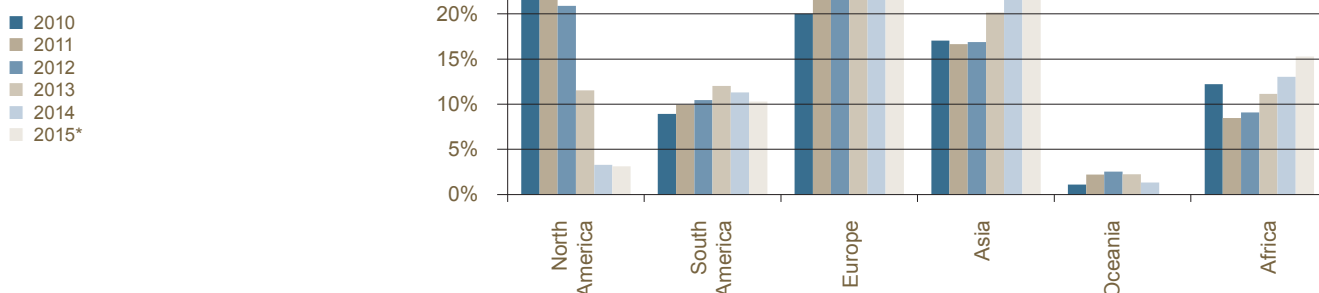
On the other hand, higher Indian purchases of Nigerian crude largely explain the increased exports to Asia. Gains on this front in part reflect 25% YoY cutback in India's oil imports from Iran to 220kbpd, despite increasing prospects of sanctions being lifted. However, the gains to Nigeria also embodied Indian refineries' increased imports of light-sweet crude, which is high yielding in gasoline, following removal of diesel subsidies which drove higher preference for gasoline cars in India. Elsewhere gains in crude shipments to the rest of Africa could be attributed to South Africa where continuing electricity challenges in the face of low oil prices, spurred higher demand for energy from the latter.

Feed-through from tamer oil prices on PMS and restrictive measures drive imports lower

Whilst the developments in exports are largely a linear function of the downward movement in oil prices, the emerging patterns on the import side show signs of a pushback in import demand from Nigeria's economic managers with assistance from the tamer oil price. Disaggregating NBS data over the first three quarters isolates weakness across petroleum imports (-26% YoY), transport equipment & parts (-32% YoY), industrial supplies (-6% YoY) and Consumer durables (-17% YoY)

Figure 39

Breakdown of Nigeria's oil exports by region

Source: NNPC, ARM Research
*9M 15

as underpins for import contraction. The weakness across these items offset increases in Food & Beverage (+2% YoY) and Capital Goods (+3% YoY) in driving a 10% YoY moderation in total imports over 9M 2015.

On petroleum imports, cutback was largely price driven as the plunging crude oil price underpinned a drop in refined gasoline prices⁽¹³⁾ amid broadly flat YoY import quotas. Elsewhere, moderation in transport equipment & parts reflects weakness across all sub-segments: vehicle imports (-52% YoY), industrial and non-industrial equipments (-23% YoY) and parts &

(13) Using PPPRA data, cost and freight charges of refined PMS shrank 28% YoY

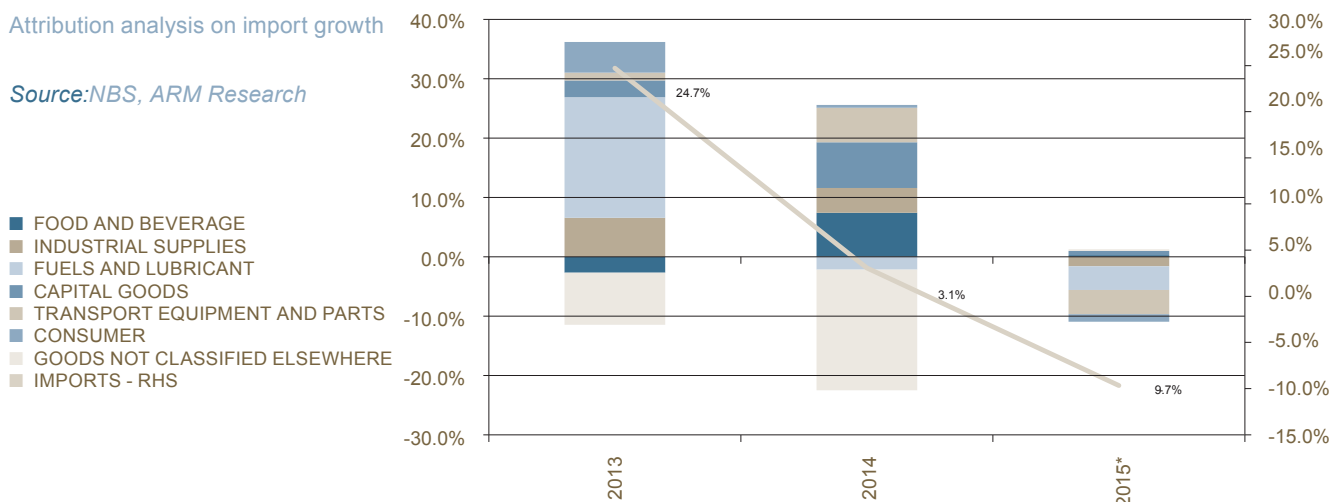
accessories (-20% YoY). In that light, the cutback in car imports appear to reflect continued implementation of raised tariffs on new automobiles with Toyota noting a 67% YoY decline in new car imports to 15,031. Across other segments, cumulative impact of naira weakness and CBN proscription of FX access to certain items drove declines across consumer durable goods. Evidence of the import curtailment posture of the FX policy was also visible in industrial supplies⁽¹⁴⁾, which accounts for 26% on average of imports, where breakdowns provided show the key driver was a 6% YoY decline in its processed import supplies.

(14) Industrial Supplies accounts for 26% of total imports

Figure 40

Attribution analysis on import growth

Source: NBS, ARM Research



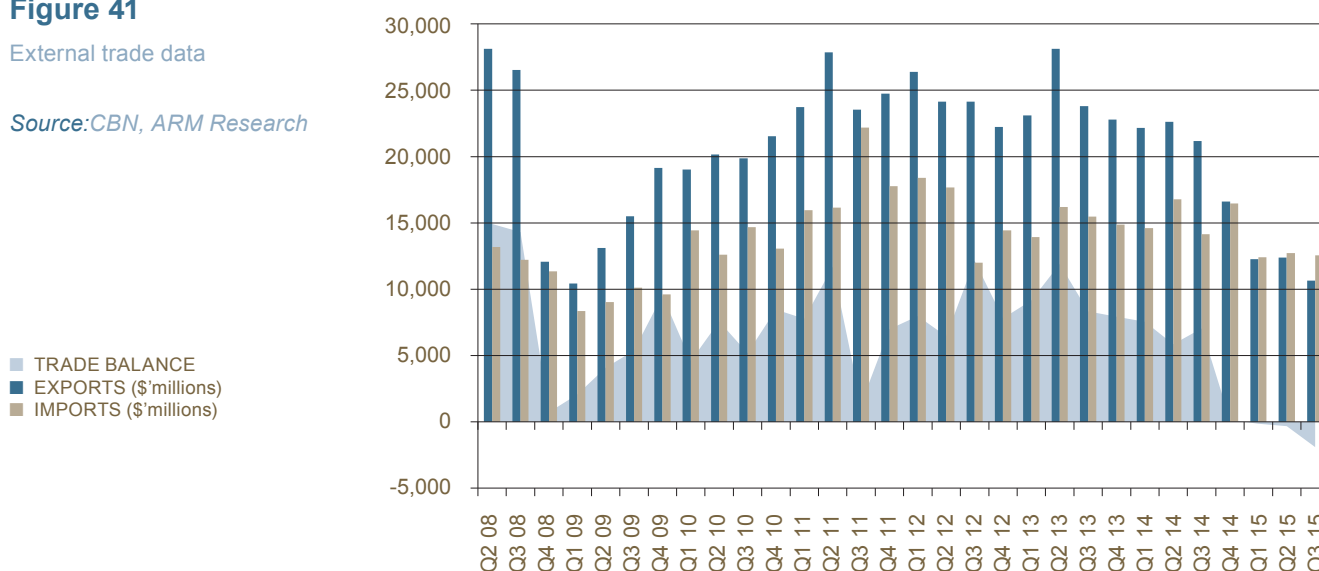
Overall, the story of the trade account, where Nigeria is on track to record a negative annual balance for the first time since 1998, largely reflects the impact

of the bearish oil price trajectory which offset gains from the first moderation in imports in three years.

Figure 41

External trade data

Source: CBN, ARM Research



Intensifying competition on export markets and price weakness to keep trade deficit

Going into 2016, our bearish outlook for oil prices and developments across major exporters point to a deadbeat outlook for exports. At the centre of the dour volume picture is the increased prospects for removal of Iranian sanctions and the phasing out of restrictions on US oil exports. Whilst the direction of US exports would be determined by the Brent-WTI spread, geographical shipping costs point to Europe as the likely destination for American crude. In addition, returning Iranian oil should compete for market share in Europe which previously accounted for 25% of Iranian oil. Furthermore, ahead of the sanctions termination, Iran is considering offering 90-day credit and free shipping, in addition to discounts on crude prices, to Indian refiners. This poses serious downside risk to Bonny-light purchases from a key export destination for Nigeria. Elsewhere, sustained economic weakness in Brazil, political gridlock over impeachment proceedings and continuing union debacle at Petrobras continue to crimp outlook for overall export growth.

On the import side, the sliding oil price acts as an automatic stabilizer, with the counter impact on oil imports. Furthermore, CBN FX restrictions should continue to drive import moderation over 2016 which should weigh across import components. Farther out, the ongoing trade deficit underscores the need for export diversification. Any potential move in that regard recently received a boost following CBN's conditional cut in CRR with the proviso that banks channel such funds to employment generating activities including the agriculture, infrastructure, solid minerals and the real sectors. On the fiscal side, the increased allocation to capital expenditure to 30% of total budget should help in reducing the infrastructure deficit and ultimately drive investment in sectors other than the oil sector, ultimately making Nigeria less dependent on oil exports which are the main driver of exports (95%). Nonetheless, the impact of these policies will be long term, which the President hinted at in his budget presentation. Given the neglect of other sectors overtime, the odds of a quick fix appear unlikely. In conclusion, our outlook for trade balance in 2016 remains negative.

USDNGN: CALM IN-BETWEEN STORMS?

Naira performance at odds with weakening fundamental picture

Over H2 15, the interbank USDNGN continued to trade within the narrow trading range (~₦199-199/\$) established post the commencement of the order-based 2-way quote (OB2WQ) system in February 2015. Coming after a topsy-turvy 2014, when a 44% drop in oil prices culminated in a 14% weakening in the USDNGN over the year, the 'stable' trend in the naira since the 8% de-facto devaluation in February 2015 contrasts with continued deterioration in the fundamental picture.

Specifically, Brent crude prices have declined a further 38% from February end with profound implications on Nigeria's balance of payments. Amid largely unchanged production levels, feed-through from the sustained oil price drop resulted in a 44% YoY decline in exports over 9M 15 to \$36billion. The export cutback overrode impact of a 10% YoY contraction in imports to \$37.8 billion and underpinned the emergence of a deficit in the goods sub-component (9M 15: \$1.7 billion – 0.5% of GDP) – an infrequent event in Nigeria's economic history⁽¹⁵⁾ and putting it/the nation on track to report the first negative CA balance since 2002. (9M 15: \$11.5 billion – 3.3% of GDP).

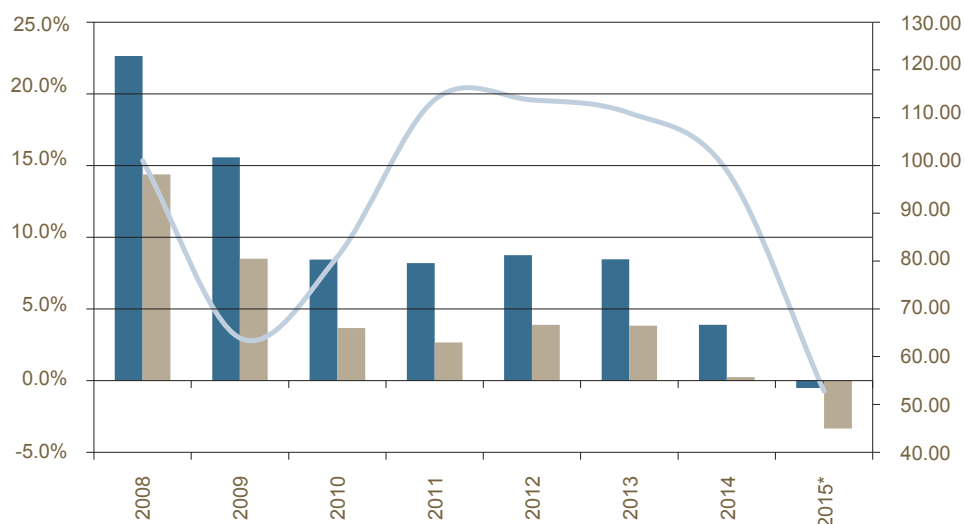
(15) Using available data from 1981, Nigeria has reported a deficit in the goods account on four occasions – 1981, 1982, 1983 and 1998 all underpinned by steep drops in oil exports.

Figure 42

Trends in Nigeria's current account and oil price

Source: CBN, ARM Research
*9M 15

■ GOODS BALANCE (% OF GDP)
■ CA BALANCE (% OF GDP)
■ OIL PRICE (\$/bbl)



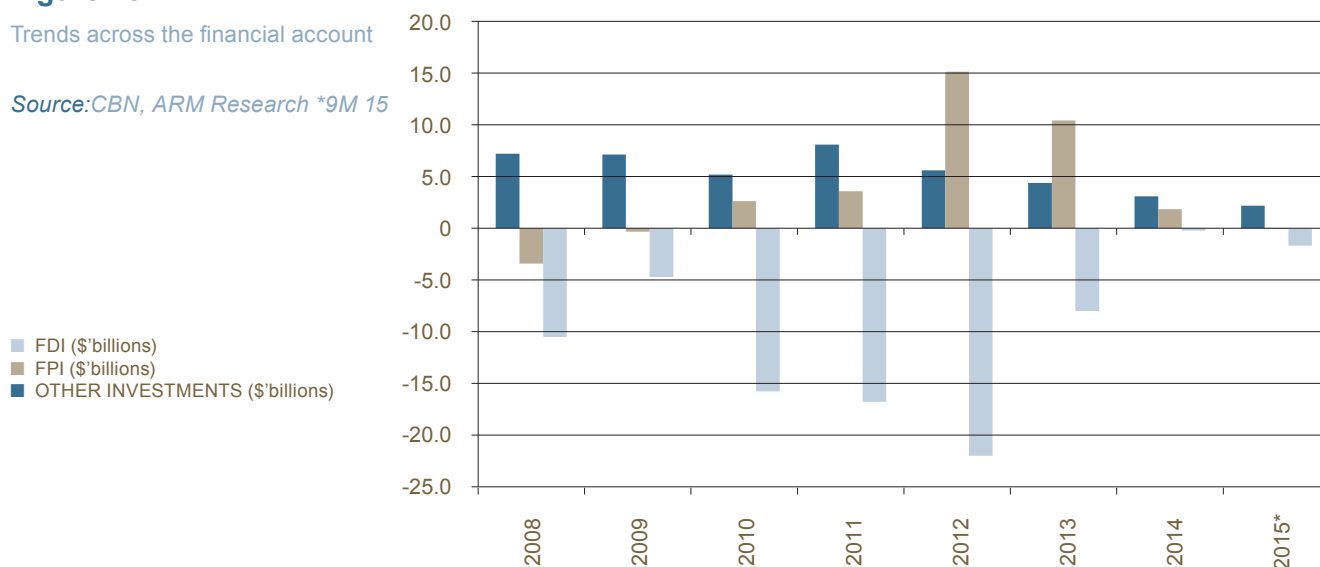
Exacerbating the weakening fundamental picture are developments in the financial account where mean monthly FPI flows shrank 55% to \$301 million from H1 15 mean (2014 avg: \$1.2 billion) while mean monthly FDI flows were 26% lower at \$140 million. On the former, compressed reading in part reflects FPI anxiety over impact of less accommodative US monetary policy on EM countries and impact of oil price shocks on economies of oil exporting countries. On the latter, FDI pull-back (in historically larger) reflects subsisting uncertainty over policy environment and surrounding

the PIB, in particular. Thus, on the heels of an 82% YoY plunge in net FPI inflows over 2014 to \$1.84 billion, 9M 15 reading of a \$74 million net outflow places Nigeria on track for the first negative FPI flow since 2009 whilst FDI net flows are at multi-year lows (-12% YoY to \$2.2billion)

Figure 43

Trends across the financial account

Source: CBN, ARM Research *9M 15



Naira's strength is also at variance with a broad weakening trend across currencies of oil exporting countries over H2 2015. Relative to a basket of 15 currencies for oil exporting countries, USDNGN's performance places Nigeria in the top quartile of the group, in company of the likes of Saudi Arabia, Qatar and Kuwait whose currencies remained largely unchanged over the period. However, ranking these

countries by reserves' firepower, using a reserves-to-import cover ratio, Nigeria is closer towards the middle of the group. Furthermore, using CA balances to GDP, the 3.3% current account deficit over 2015 situates Nigeria near the lower rungs of the basket. In sum, USDNGN performance over H2 15 is dislocated from deterioration in Nigeria's own fundamentals, sustained down leg in oil prices and relative movements in oil exporting peers.

Figure 44

Trends across currencies of select oil exporters

Source: Bloomberg, ARM Research

*Label values are for H2 15 performance

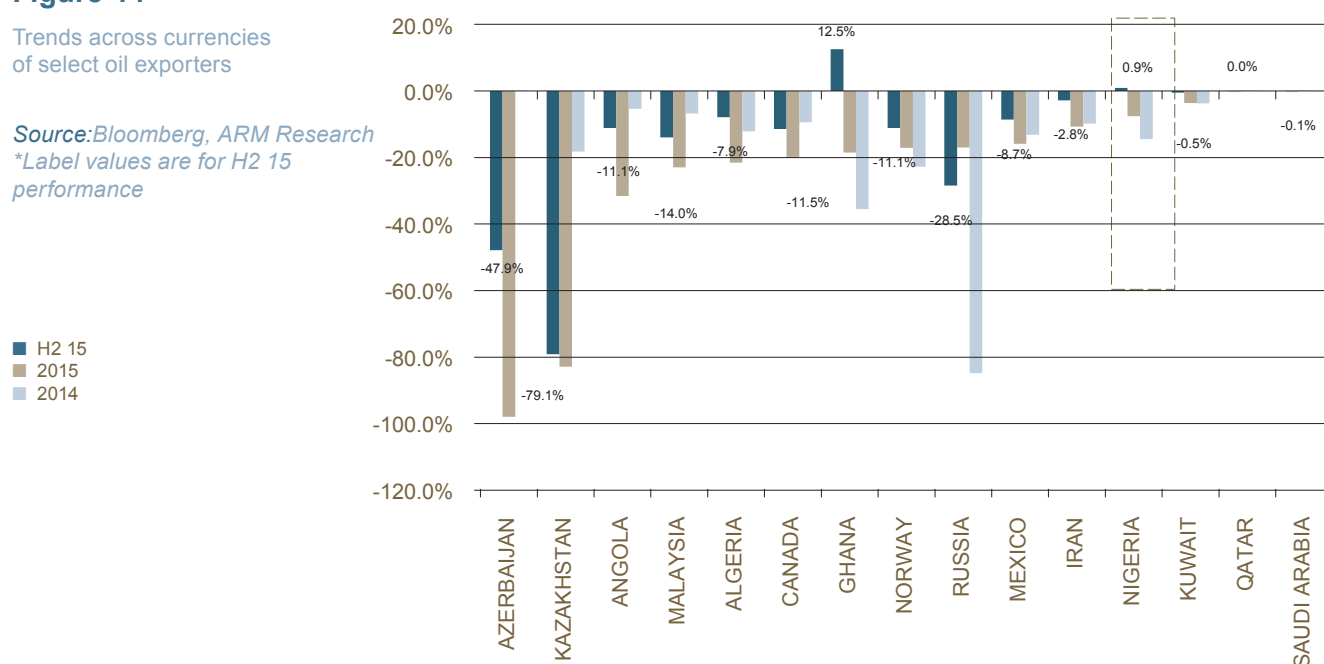
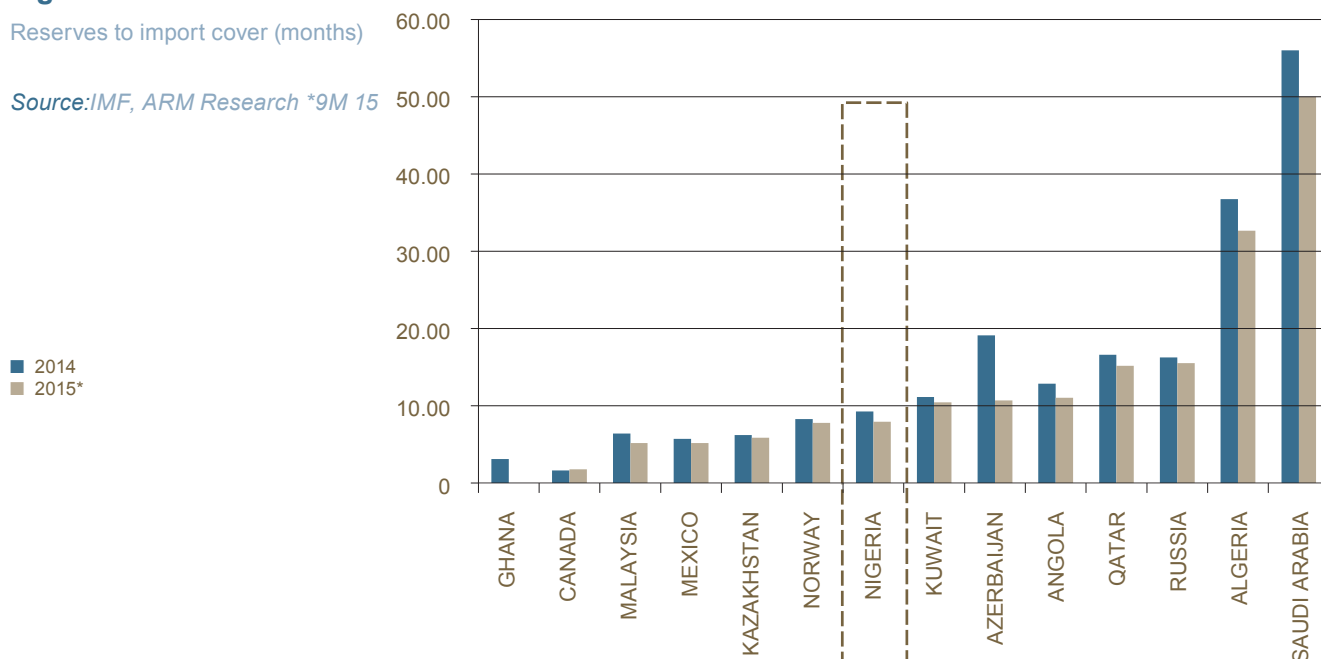


Figure 45

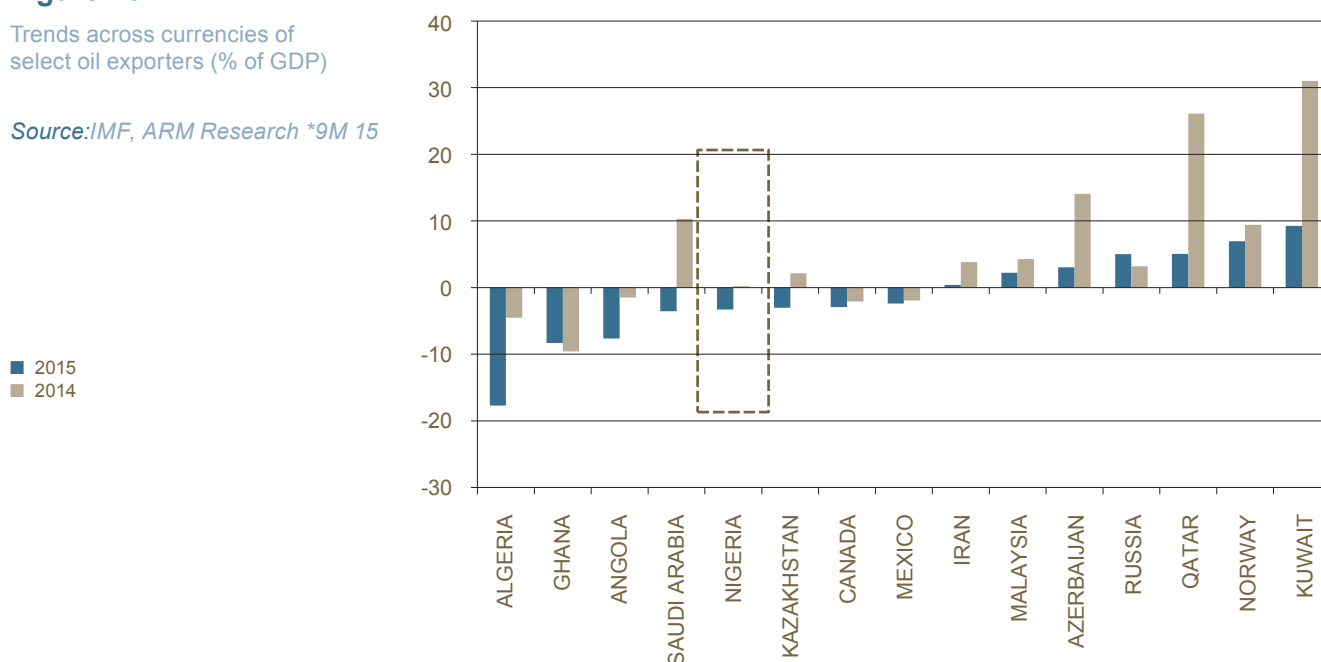
Reserves to import cover (months)

Source: IMF, ARM Research *9M 15

**Figure 46**

Trends across currencies of select oil exporters (% of GDP)

Source: IMF, ARM Research *9M 15



But widening parallel and offshore market premiums casts doubts over NGN 'strength'

Retracing the roots of the stability, the February commencement of OB2WQ imposed FX trading curbs, switched market architecture from a quote driven market to an order based one and mandatorily pegged daily interbank pricing to CBN's daily clearing rate. Having effectively anchored market price to

itself, the apex bank then set about trying to regulate 'quantity' of dollar demand through imposition of several administrative measures. These measures were wide-ranging, starting with April 2015's reduction in overseas cash withdrawal limits on naira cards⁽¹⁶⁾ to June 2015's proscription of a list of 41 items from accessing the official foreign exchange market. The impact of the demand curtailment measures was felt at the parallel market where premium over the

(16) Slashed 67% to \$50k per annum implying daily limit now \$300

official rate widened 9pps from H1 15 average to 20% in July (2014: 4%).

Following the spike, the apex bank, officially citing the fight against money laundering, stopped granting export approvals to banks for changing dollar cash into telex format abroad. In response to the move, banks stopped accepting dollar deposits and commenced BTA/PTA sales to get rid of dollar cash in their vaults resulting in the USDNGN appreciating in the parallel market over August (+16% MoM to ₦207/\$) with parallel market premium to interbank declining 10pps over the month. Though the move helped calm scarcity at that segment of the market, implementation

of a CBN circular mandating linking of BVN numbers to FX transactions to track annual dollar limits⁽¹⁷⁾ stoked a jump in parallel market premiums to 18% in November. Events came to a head in December 2015 following CBN's suspension of 56% of registered BDC operators in December which underpinned a depreciation of the USDNGN at the segment to record lows of ₦280/\$ with mean premium over the month climbing to 31%.

Akin to onshore markets, sentiment over tightening dollar liquidity in domestic markets drove expansion in the implied NGN yields on non-deliverable forward

(17) BVN registration deadline was on October 31, 2015.

Figure 47

Trends in Interbank USDNGN and BDC premium

Source: CBN, Bloomberg, AbokiFX, ARM Research

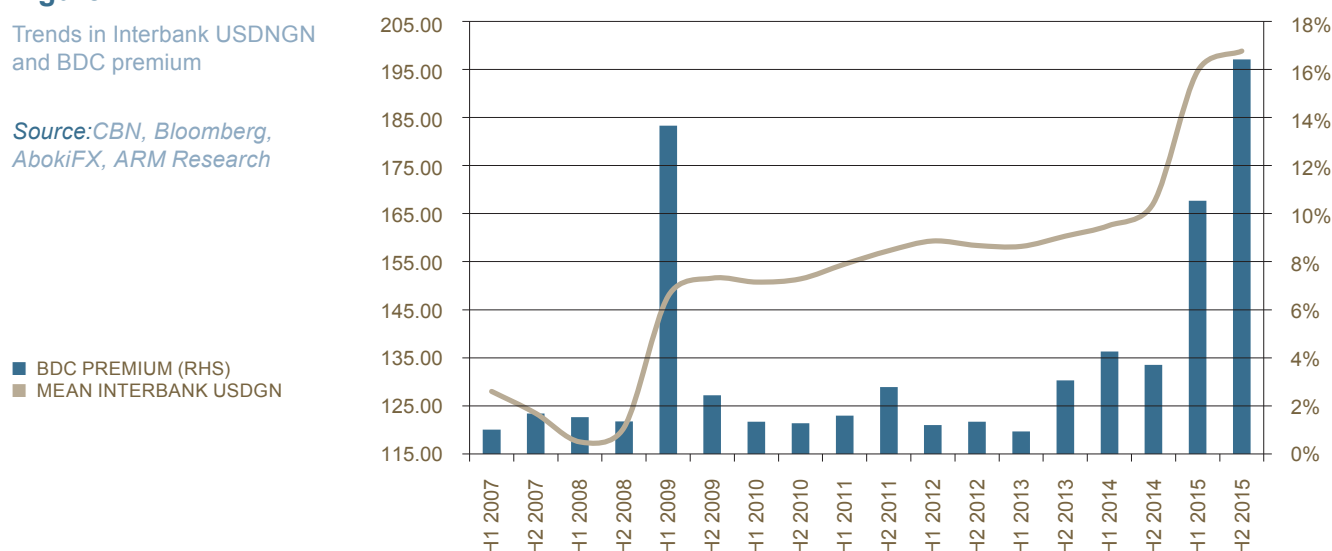
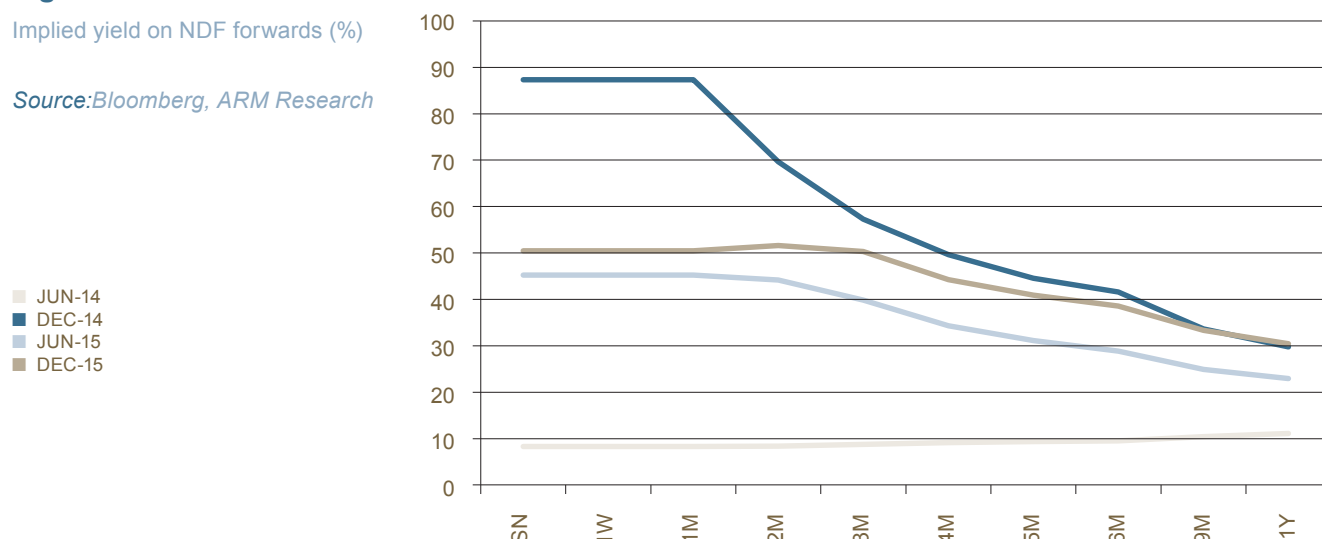


Figure 48

Implied yield on NDF forwards (%)

Source: Bloomberg, ARM Research



(NDF) contracts widened in December to 50% for short dated contracts (+7pps higher than the June average). The elevated yields on the short end of the NDF curve imply that foreign investors are less optimistic over current naira stability.

Does CBN need be so fearful of true reform of market architecture?

Despite the broadly weak trends in the fundamental picture, a look at CBN cash flow data on FX flows through the economy highlights shortcomings of the CBN reforms of FX market architecture. In particular, at \$57.3 billion thus far in 2015, autonomous flows into the economy are nearly double inflows through the CBN reserves (\$29.2billion) extending a trend since 2008—with the source now accounting for 69% of total FX flows into Nigeria over the last three years (2008: 55%). Nonetheless, on the outward side, these autonomous flows do not show up either implying they remain onshore or they exit unnoticed via the parallel market. For evidence, autonomous inflows into the economy over 2015, only \$2.4 billion has left officially with the remnant still sizable to handle CBN outflows thus far estimated at \$33 billion without resorting to reserves. In consequence, Nigeria has consistently reported positive dollar net-flows averaging 18% of GDP since 2008 which singularly should serve as a veritable source of dousing CA induced pressures on the currency.

To our long held views, this irrational behavior reflects the moral hazard problem associated with CBN's positioning of itself as the centre-piece of USDNGN determination, in place of a properly functioning market system. A derivative effect of the ensuing price distortion is that the allocative efficiency of the FX market is impaired on occasions when the arbitrarily determined price is perceived by autonomous flows to be misaligned with fundamentals, creating a hesitation on their part to bridge widening dollar scarcity at the going rate. Indeed, rather than encourage these autonomous flows to aid liquidity, the misalignment creates arbitrage opportunities that some of these same flows become keen to exploit.

Under a functioning free market system, these sizable autonomous flows could easily offset demand side pressures as prices would determine

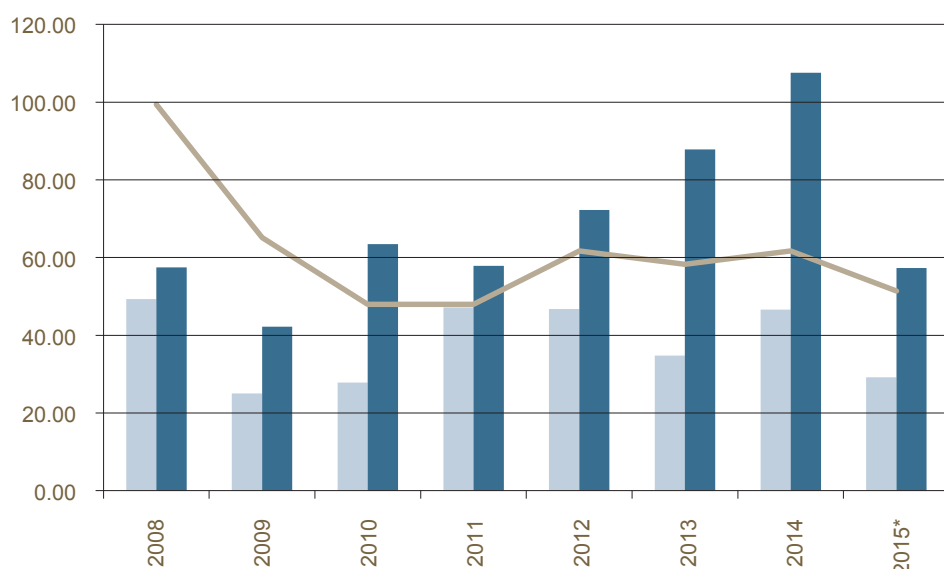
allocation leaving the apex bank on the sidelines, with no commitments to a set price, free to intervene as a market participant in the event of supply shortfalls. In contrast, whilst on the implementation of the OB2WQ the CBN guided to no set commitment to any fixed rate, the apex bank went ahead to anchor the interbank USDNGN to its largely unchanged clearing rate which retained the moral hazard problem of the old two-tier system. Whilst the CBN reluctance on naira floatation likely stems from political disapproval to wider NGN volatility, deteriorating oil price outlook, growing integration with global financial markets and sizable domestic demand for foreign goods and services ultimately render its ability to maintain the peg unsustainable. More importantly, as developments across the parallel market over H2 15 showed, the administrative measures only raise the returns available to speculative demand. In particular, the widening spread showed that BVN implementation diverts demand away from the official market to the less visible parallel segment. Thus, despite the longer term benefits (principally forex flow tracking and less speculation), the short term impact is that the BVN system's aid in demand management is limited to the formal market and does not help curb the fundamental supply–demand mismatch of the current system.

To improve the FX markets, we reiterate our long held view that the CBN would need to relax its stranglehold and allow the demand and supply interplay set prices. Granted that the initial phase might result in a sizable NGN depreciation, this would be in tune with the underlying fundamental picture which warrant a weakening. Nonetheless, such volatility should be short-lived as the strong net-flows from autonomous sources, no longer distorted by multiple prices, gradually assert their influence on FX markets. Importantly, this allows the CBN to use reserves intelligently as a market participant with sizable influence.

Figure 49Trends in autonomous
and CBN inflows

Source: CBN, ARM Research

■ CASH INFLOWS THROUGH
CBN (\$'billion)
■ CASH INFLOWS THROUGH
AUTONOMOUS SOURCES (\$'billion)
■ NET FLOWS THROUGH
ECONOMY (% OF GDP)



Resilience in foreign reserves: Evidence of leakages being blocked?

Despite the tamer oil prices, mean monthly oil inflows into CBN reserves at \$1.9 billion in H2 15⁽¹⁸⁾ were 16% higher than H1 15 levels, reflecting the impact of a \$2.1 billion dividend payment by NLNG in July 2015. Assisted by 67% increase in average monthly non-oil inflows to \$1.7 billion from H1 15 levels and a 16% drop in average monthly outflows from reserves to \$2.9 billion relative to H1 15, foreign reserves are on track to close H2 2015 2% above levels at the June 2015.

(18) July-October 2015

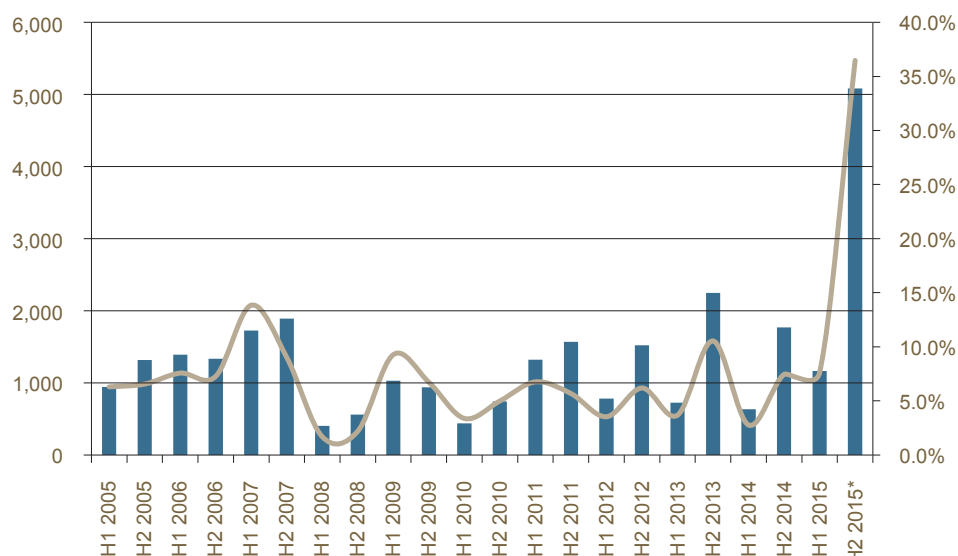
The resilience in foreign reserves in the second half of 2015 (H1 15: -16%) despite the tamer oil price bears further questioning given the source of the gains in non-oil. Parsing through breakdowns provided by the CBN isolates 'other official receipts' as the key driver with the H2 15 reading of \$5.1 billion accounting for 75% of the jump in non-oil inflows into CBN reserves. Indeed the cumulative H2 15 'other official receipts' number, which covers only four months, is the highest on record using available data from 2005. Whilst CBN provides no further definition, we draw interpretation on the line item using breakdowns provided on the corresponding items under reserve outflows (other official payments) where the apex bank lists: FGN estacode payments, foreign embassies etc.

Figure 50

Trends in Other Official Receipts

Source: CBN, ARM Research

■ OTHER OFFICIAL
RECEIPTS (\$'billion)
■ OTHER OFFICIAL RECEIPTS
(% OF OIL INFLOWS)



Whilst inflows from this line item has been constant over the years, the spike starting in July, which coincided with commencement of payment of NLNG dividends to the FGN, lends support to CBN Governor's claim at the July MPC about measures by the Buhari administration aimed at blocking leakages resulting in positive accretion to foreign reserves. We draw attention to the fact that previously NLNG dividends were received on behalf of the FGN by the NNPC, before the new government's insistence that the practice be discontinued. Thus, we believe a similar dynamic is at work with the 'other official

receipts item' which largely accounts for the scale of the gains over the four month period.

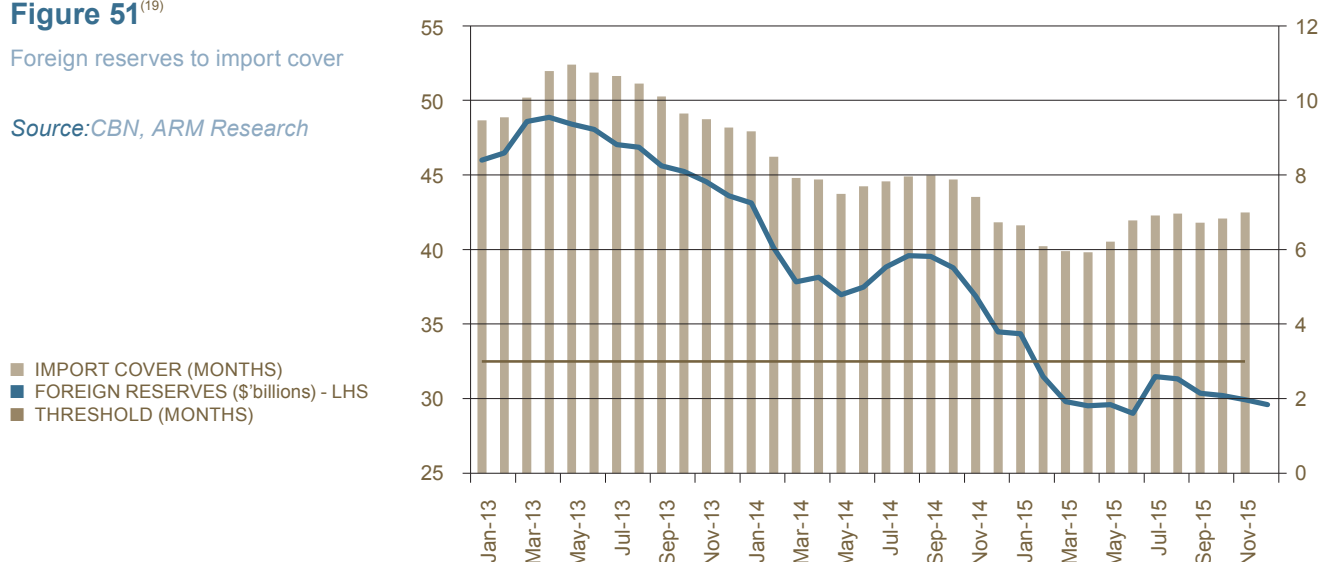
Similar support to the reserves also emerged from CBN FX swap activities, which have considerably risen since June 2014 with the net swap position as at October 2015 standing at \$5.6 billion. Relative to import cover, current foreign reserves are able to sustain ~7-months' worth of imports using the 12-month rolling average of imports up to October 2015.

(19) IMF recommends that reserves should cover three months of imports at the minimum

Figure 51⁽¹⁹⁾

Foreign reserves to import cover

Source: CBN, ARM Research



Deficit laden services account underpins extended BOP pressures on USDNGN

Regardless of the benefit of blocking leakages, our framing of naira outlook for 2016 still puts more stock on the fundamental picture as the impact of the oil price downturn on reserves offsets aforementioned gains on non-oil inflows. Looking through the current account, whilst dollar scarcity and CBN demand management measures should continue to drive tamer imports, our bearish prognosis for oil prices in 2016, which implies a tepid export outlook should drive an extension of the weak trends in the goods account.

Additional pressures to the current account should emanate from the historically⁽²⁰⁾ deficit services sub-accounts which has recorded an average annual

deficit of \$20billion (5% of GDP) since 2008. Though, CBN administrative measures, drove a moderation in Services sub-segment over 2015, the sector should remain in deficit over 2015 owing to lack of competitive domestic alternatives to foreign services like transportation, travel, foreign insurance, education, etc. Absent a miraculous turnaround in crude oil prices, net imports of goods and services underpin scope for a current account deficit in 2016.

On the financial account, limited clarity over financing of the 2016 FGN budget, investor backlash to the fines on Telecommunications heavyweight MTN and lack of appreciable progress on two bills introduced to reform the oil sector, should dampen FDI prospects over 2016. On FPI, the combination of still depressed oil price outlook, global monetary policy divergence on the external front and commencement of an easing cycle

(20) Nigeria has recorded a deficit on the services account using CBN series starting 1981

on the domestic front drives scope for contraction in flows over 2016. In sum, both segments of Nigeria's BoP point to fundamental weakness over 2016.

Set against this backdrop, and observing recent devaluation episodes of USDNGN devaluation, we note that CA pressures and widening parallel market premiums typically coincide with eventual CBN capitulation. From Figure 52 below, naira devaluation in H1 2009, occurred following oil price induced contraction in CA surplus (-400bps to 4.5%) from H1 2008. At the time, average parallel market

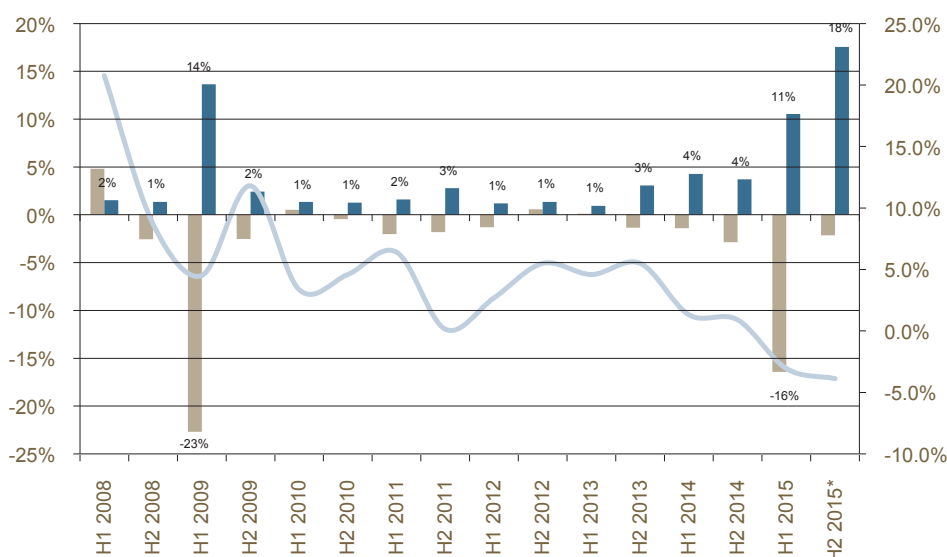
premium to the interbank USDNGN widened 12.3pps to 13.7% from H2 2008 levels before the USDNGN was devalued by 22% over H1 2009. The pattern repeated itself in H2 2014 and H1 2015 with CBN's intransigence preventing a more recent repeat in H2 2015 but perhaps that is just a delayed outcome and not yet an exception. Calibrating current parallel market premiums to past episode of devaluation and factoring in prospects for extended CA deficit trends into H1 2016, we see fundamental driven concerns underpinning scope for 20-25% USDNGN devaluation from current level.

Figure 52

Current Account balance,
naira performance and
parallel market premium

Source: CBN, ARM Research * %
change in average USDNGN over
period

■ USDNGN*
■ PARALLEL MARKET PREMIUM
OVER INTERBANK
■ CA BALANCE (% OF GDP) - RHS



But presidential body language points towards wider divergence in FX rates

Nevertheless, despite the fundamentals pointing towards a need to devalue in 2016, as in 2015, the monetary authorities should continue to remain reluctant towards releasing current naira peg without affirmative signals from the fiscal side on the matter. On this wise, recent comments by President Buhari at the December 2015 media chat ruled out a near term NGN devaluation with the president electing to provide FX for target end-users. The statement corroborates media reports of CBN's decision to ration FX with preference for matured LCs, refined petroleum products and raw material and equipment imports and an agnostic position to the rising parallel market premiums. Given this backdrop, the apex bank could deploy further administrative measures

aimed at demand curtailments to stave off naira devaluation with the fall-out driving 'devaluation' in the parallel market FX rate leaving the official rate unchanged at ₦199/\$.

NO RESPITE FOR PRESSURED PRICES AS FAMILIAR FEARS RE-EMERGE

Movements in core components drive focal pressures on headline

Over the first 11 months of 2015, headline inflation rates maintained an upward trend as supply-side pressures saw increases in general price level exceed 9% upper band of CBN's inflation target as early as mid year. Precisely, from 8.2% in January, headline inflation accelerated to 9.4% in November 2015—

implying 89bps YoY rise in mean headline reading to 9.0% over the period.⁽²¹⁾ Nonetheless, this inflation level lags our revised FY 2015 inflation forecast of 9.4% as pace of MoM readings in H2 stayed relatively contained. Disaggregating the components, average core and food inflation respectively expanded 125bps and 31bps YoY to 8.2% and 9.8%. NBS attributes core pressures to sharp price increases in Housing Water, Electricity, Gas and Other Fuels (HWEGF);

(21) On MoM basis, headline inflation rose sharpest in March and May.

Transport; Clothing and Footwear; and Furnishings and Household Equipment Maintenance divisions of the sub-index. Together, these segments have accounted for ~60% of core inflationary pressures in 2015. On the other hand, food inflationary pressures were driven by 48bps YoY acceleration in mean farm produce prices to 9.9% over the first 11 months of 2015. Importantly, movements in food readings were firmly in line with our expectations for the lean season as carryover stocks from previous harvest

Figure 53

Headline, Core and Food Inflation

Source: NBS; ARM Research

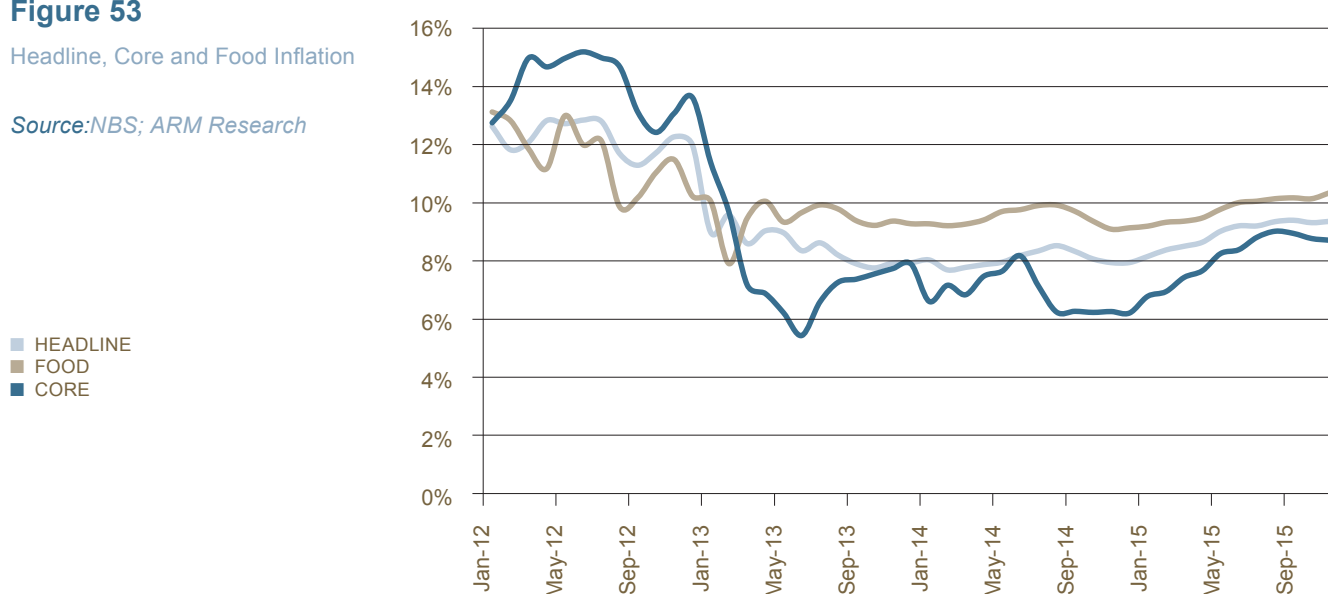
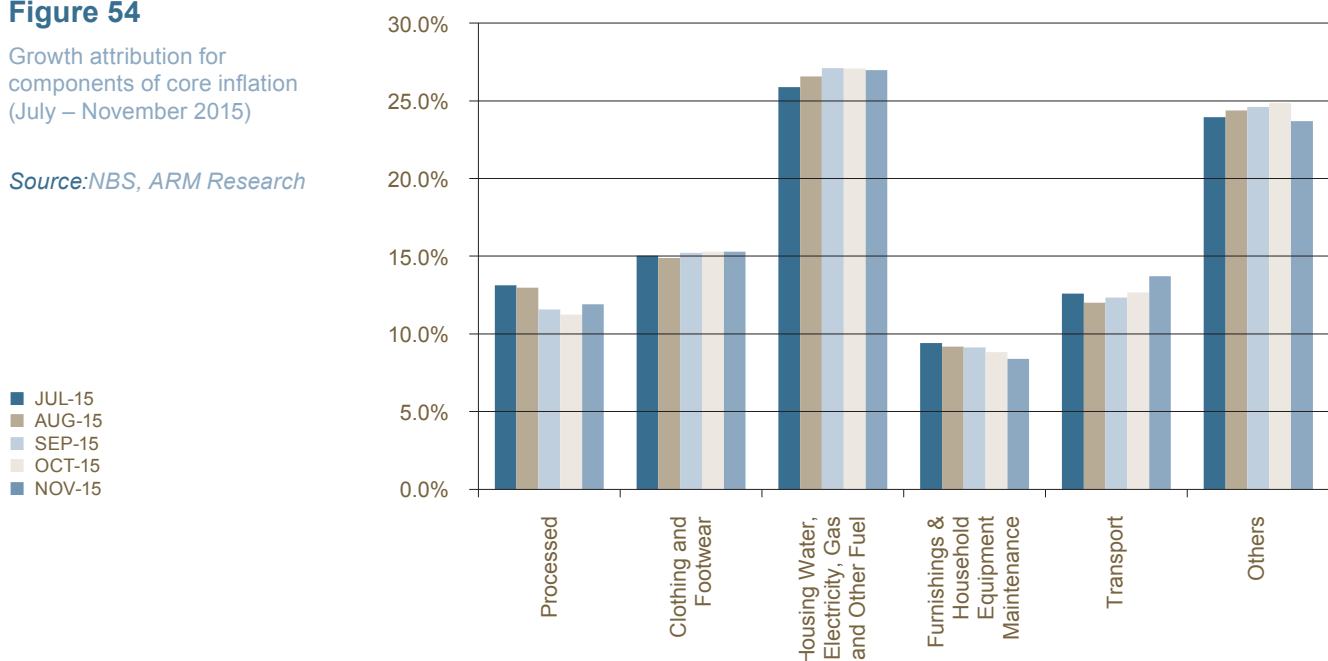


Figure 54

Growth attribution for components of core inflation (July – November 2015)

Source: NBS; ARM Research



depleted and underpinned the resurgent farm produce pressures (see NSR H2 2015). However, despite the commencement of main season harvest in October, food inflation tapered only a mild 3bps from September to 10.1%, vs. 34bps MoM moderation in October 2014. Whilst we believe that low base limited the moderating impact of the current harvest on food prices, it also seems transport costs played a role. Nonetheless, core portion of the basket was the primary source of pressure on headline inflation with lingering fuel shortages across the country particularly in May/June and November/December contributing to the overall uptick.

Fluid PMS supply dictates H2 15 CPI trajectory

Coming into the second half of the year, improved PMS supply drove a moderation in PMS prices from June peak (See Figure 56) and slowed down inflation momentum over Q3 15. Calm on this front worked with improved food supplies on commencement of main harvest in

September to drive even more benign outcome in October. Though FEWSNET noted that heavy flooding and military engagements resulted in below average harvest in the north, benign outputs from southern states have made up for the shortfall. Largely premised on this offset, FEWSNET projected temperance in food prices in November and December as well as in Q1 2016. Though these expectations would ordinarily be positive for inflation, fresh PMS shocks emerged in November following scarcity issues which drove gasoline prices higher (+24% MoM to ₦116/litre) and underpinned 60bps quickening of transportation CPI to a 34 month high of 9.8% in November. Subsequent feed-through to food prices drove 20bps acceleration in food inflation to a three year high of 10.4% in November. The PMS supply issues also tilts risk to food inflation firmly to the upside for the remainder of 2015, in our view. Thus, with fuel shortage still endemic over December and given the sheer weight of food in overall CPI basket, we expect PMS to remain an accelerant for headline inflation (Dec 2015F: +10bps) despite ongoing harvesting.

Table 10a

Typical year seasonal calendar (North)

Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
					Land preparation			Planting			
Harvest							Off season harvest			Lean season	
Lean season											

Source: FEWSNET, ARM Research

Table 10b

Typical year seasonal calendar (South)

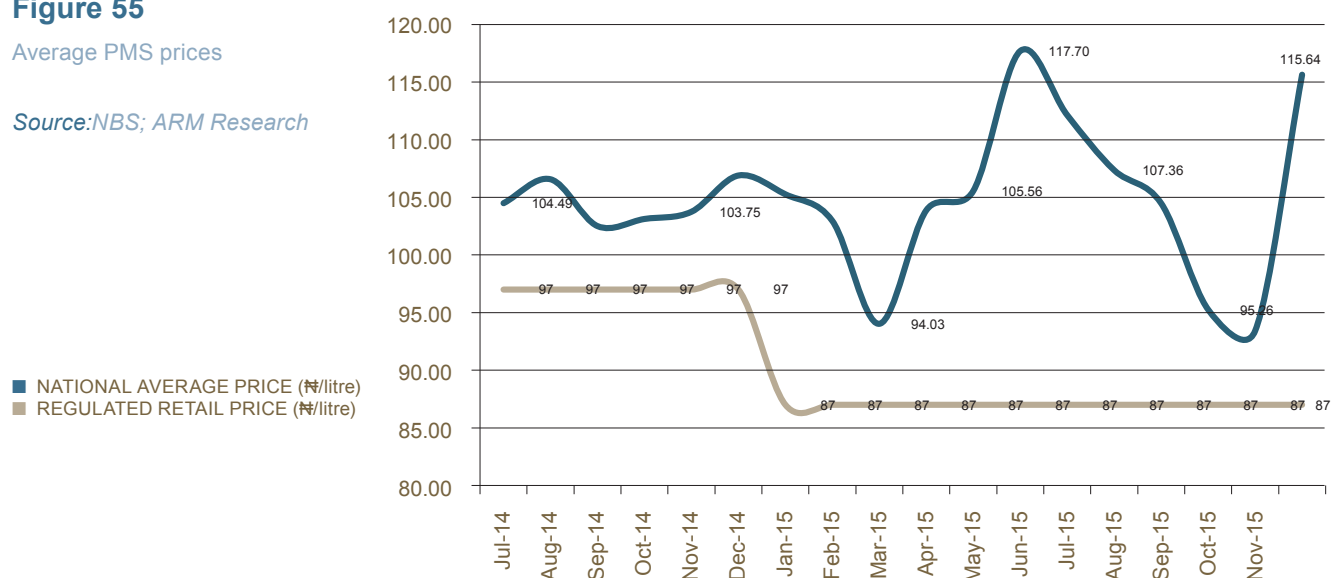
Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
					Land preparation		Planting				
Main Harvest									Green Harvest (maize, yams)		
									Lean season		

Source: FEWSNET, ARM Research

Figure 55

Average PMS prices

Source: NBS; ARM Research



Tripod of concerns to tow inflation northward

Indeed, PMS issues could remain a stoking influence on inflation for longer. To buttress, despite Senate's December 2015 ratification of ~₦407 billion for payment of backlog of oil subsidy claims and the proactive inclusion of a further ₦110 billion to cover claims through year-end, fuel scarcity in major cities has subsisted. This is in spite of a follow-up presidential order seeking to ensure immediate disbursement of the approved claims. According to reports, dollar-scarcity is impinging on marketers' ability to import refined crude into the country. Worse still, local refineries have shown little aptitude for picking up the slack with average capacity utilization across state-owned refineries nose-diving to 2% as at last NNPC report (vs. ~15% in 2014). Thus, the legislative approval of subsidy payment in itself is unlikely to significantly curb PMS price and inflation pressures going into 2016.

Beyond this, recent hike in electricity tariff and naira depreciation at the parallel market look set to adversely impact inflation trajectory in the coming year. On the electricity front, despite resistance from Citizens Access to Electricity Initiatives (CATEIN) and National Association of Chambers of Commerce and Industry, Mines and Agriculture (NACCIMA), the power minister went ahead to raise electricity tariff by ~70% and 52% for residential and commercials

respectively, with the FG hoping this will attract credible investors to support government's plan to expand distribution and transmission capacities. Despite the positive connotations (margin, cash flow) for Discos and GENCOs, the tariff increment is likely to slightly aggravate price increases from virtually every segment of the CPI basket but particularly on key core components such as HWEGF. Importantly, we recount that the implementation of Multi Year Tariff Order 2 (MYTO 2) electricity tariff increase had corresponded with 521bps MoM jump in HWEGF reading to 20.48% in June 2012—albeit also reflective of fuel scarcity in some major cities and overall increase in energy prices (+447bps to 21.16%) in the period.

Furthermore, there are indications the FG may bow to devaluation pressures. In stark contrast to a firm opposition to devaluation in prior months, the president, in his budget discuss with law makers, declared that the apex bank is currently fine-tuning the management of foreign exchange so as to introduce some flexibility and encourage additional inflows into the country. Whilst the actual timing of potential currency adjustments may be difficult to call, the inflationary effect of devaluation, though varied, is well documented in our prior reports⁽²²⁾. In any case, given government's determination to keep PMS prices subdued in the near term, official

(22) Mean headline reading in the five months after respective 28% and 3.3% naira devaluations in November 2008 and November 2011 jumped 643bps and 11bps YoY. More recently, November 2014 and February 2015 devaluations (8% and 17% respectively) only cumulatively led to 46bps rise in headline reading as at April 2015.

currency adjustment is likely to take hold, at the earliest, in the latter part of H1 16 with knock-on effect on inflation spilling into the other half of 2016. Whilst more recent inflationary impact has been subdued due to a regime change, underpinned by better storage facilities and greater value chain integration, that restricted impact of devaluation outcomes on the inflation

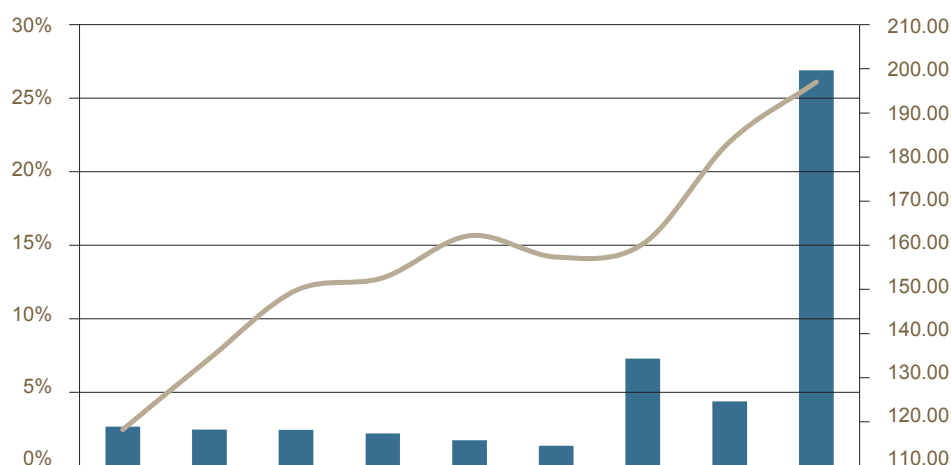
basket relative to prior episodes, we believe currency impact could still be significant. Indeed, going by the magnitude of the current BDC/Interbank spread—and the potential currency adjustment that may come with it—we feel that this could be one of the more impacting devaluations and thus estimate a cumulative 20bps impact on headline inflation as early as end of H1 16.

Figure 56

Historical BDC/Interbank
FX Spread

Source: FMQQ; ARM Research

■ BDC-INTERBANK PREMIUM
■ INTERBANK USDGN - RHS



Of the three key factors impinging on outlook, the PMS fire seems the more likely to be quickly doused but with the mooted options potentially creating more volatility in inflation readings. The clamour for deregulation of downstream oil and gas appears to have gained more grounds in recent times owing to narrowing subsidy per litre payment and expectations, in some quarters, of minimal backlash from the populace in the event of complete removal. Amidst these agitations, FG has recently communicated a preference for the more scientific price modulation rather than an outright subsidy removal in 2016. To be clear, PMS prices are

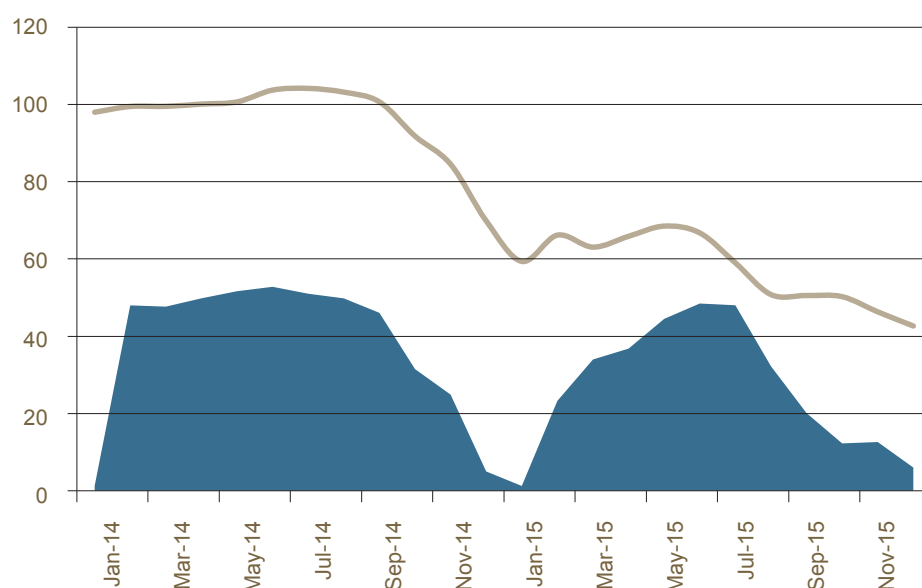
going to be structured to reflect global changes in crude oil prices with a proviso that will keep them within an upper band of ₦97 per litre. According to the minister of state for petroleum, with subsidy payment completely eroded by sharp declines in oil prices, the new pricing policy is unlikely to be a major concern going forward. Importantly, whilst FG's position on the 'non-effect' of the proposed pricing methodology on the populace comes across as plausible within the presently subdued oil price environment, it leaves Nigerians and businesses exposed to greater price instability.

Figure 57

Narrowing subsidy per litre, oil prices

Source: PPPRA, ARM Research

■ SUBSIDY PER LITRE (₦)
■ OIL PRICES (\$)



In summary, largely owing to already highlighted pressures at the BDC market, naira weakness is likely to remain a pivotal inflation risk in the coming year whether or not CBN's dogged currency support eventually gives way. However, although previous partial subsidy removal had coincided with near term headline pressures (+230bps to 12.6% in January 2012), the current congruence of non-subsidized PMS price of ₦87 per litre with the current official rate makes an outright deregulation of downstream oil and gas less of a problem in the current period. In that sense FG's clarification that an outright deregulation is not on the table holds little extra currency inducing concerns about potential push for inflation from this direction. Specifically, the apparent preference for PMS price 'mark-to-market' suggests direction is likely downward alongside oil prices. However, that approach leaves room for greater volatility in transport cost and headline reading. Hence, our forecast for mean inflation of 10.1% YoY +/-0.5% over H1 16 (vs. 8.7% YoY in H1 15), with FY 16 average at 9.9%, largely reflects anticipated pressures from higher electricity tariff and parallel market currency depreciation.

MONETARY POLICY: REWRITING THE PAST

Extended contraction in net foreign assets crimps money supply in H2

After the brisk pace of growth in the first half of 2015 (+11.8%), broad money supply (M2) contracted 3.2% to ₦18 trillion in H2 through October 2015. Unlike H1 15 where the upswing in net domestic credit (+33%) and other net assets (+29%) offset the contraction (-19%) in net foreign assets (NFA), each of these three major components sank over H2 15. The continued deterioration in net foreign assets (H2 15: -22%) primarily reflects the contraction in the CBN's net foreign position (-19%) as it tried to stabilise the naira in the face of dwindling oil receipts and also underpinned the negative growth of M2 in the second half. Indeed, without certain currency restrictions imposed by the CBN the decline would possibly have been worse. However, the consequence of the currency measures heightened the already elevated, oil-induced credit risk and weighed on domestic credit. In H2 15 net domestic credit (NDC) contracted 0.3% to ₦21.4 trillion as credit to private sector (CPS) slowed to 1% (H1 15: +4%) due to a cut back in bank loans to the core private sector (-3.7% to ₦11.7 trillion) and contraction in net credit to government (-10%). Notably, the contraction in the latter reflects the implementation of the Treasury Single Account (TSA) in September, with the sharpest MoM contraction in October (-19%), the month after implementation of the TSA.

Figure 58

Growth in M2 and drivers

Source: CBN *up to October 2015;

** annualised

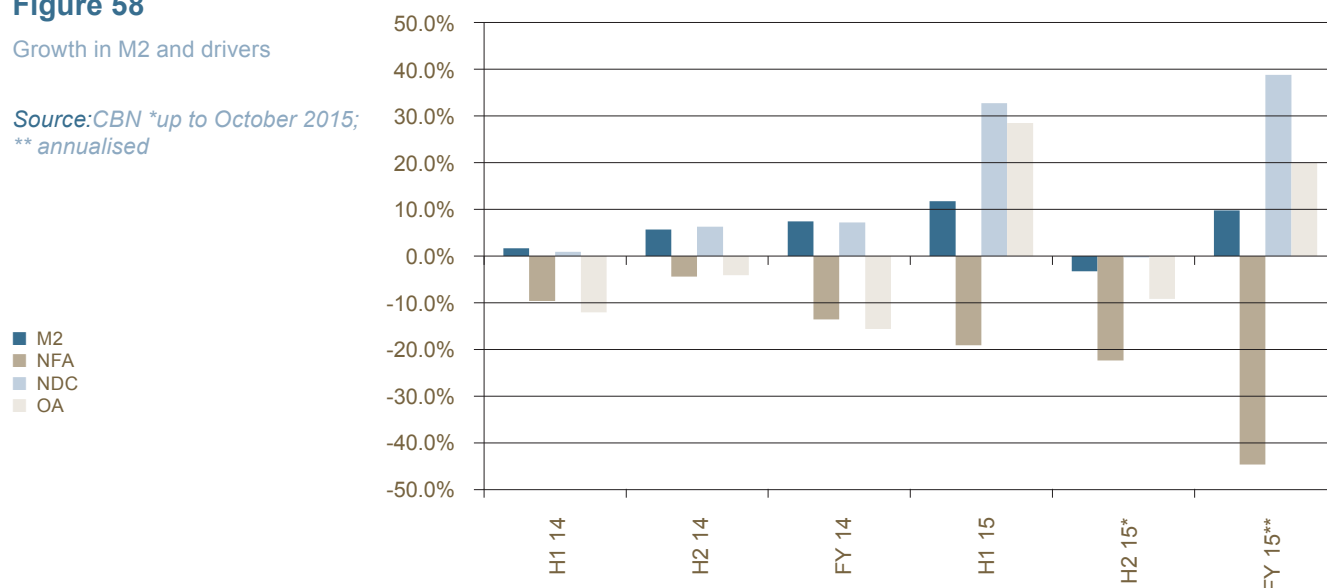
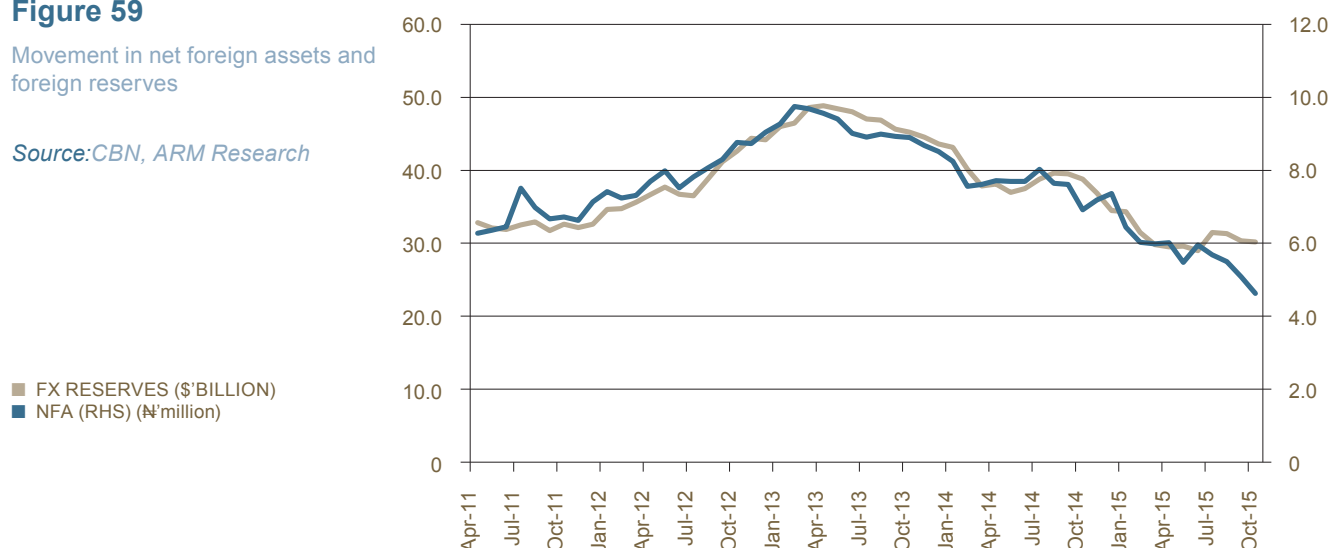


Figure 59

Movement in net foreign assets and foreign reserves

Source: CBN, ARM Research



The outcome of the interaction of these aggregates was more visible on quasi money (QM)—time, savings and foreign currency deposits—which contracted 6% over H2 15. Unsurprisingly, the key pressure point for quasi-money was foreign deposits which fell 13% in H2 15 (accounting for nearly a third of the decline) as banks rejected forex deposits and cutback on forex exposure in response to CBN forex controls. Growth in narrow money (M1) slowed to 2.3% in H2 15 (vs. 4.4% H1 15) on back of slowdown in demand deposits (+2.4%; H1 15: +9.4%) while base money (M0) shrank 7% (H1 15: -0.3%), transmitted by a decline in bank reserves (-9.1%), despite sizeable monetary easing over the period. Overall, annualised M2 growth of 9.8% is about half of the apex bank's FY target of 15.4%, but tracks ahead of 2014 (+7.4%). Perhaps, more worrying, is the sharp slowdown in CPS underpinned by the pullback in credit to the core private sector.

As macro-concerns force policy to unwind the past

To tackle the sluggish pace of monetary aggregate growth, but also stimulate output, after GDP softened to lowest in more than 5 years, the apex bank switched monetary policy in H2 15 to a dovish tone from the hawkishness of the last 5 years. However, we think a good grasp of recent events is unlikely without a quick review of the just-ended tightening cycle,

and motivation for same. After the sharp rebound in oil prices that started in 2010 and with a very expansionary fiscal budget being operated, system liquidity tripled YoY to monthly average of ~₦400 billion in 2011. However, despite relatively low MPR (6%) and CRR (2%) at the time, there was minimal impact on credit to the “core” private sector (2010: -13% and 2011: -4%) and intermediation spreads in credit markets widened in excess of 20 pts. Added to this, the excess liquidity threatened price stability, as banks “speculated” in forex market which eventually resulted in devaluation late in 2011 and partly aided the jump in inflation to 12% in 2012.

To combat the effects, the CBN effected tight monetary policy to limit available liquidity and raise the cost of funds for currency speculators on the one hand, but more importantly, to attract foreign portfolio investors (FPIs) as the 1 year minimum investment horizon for FPIs was jettisoned. By 2014, CRR had risen to 31%⁽²³⁾ from 1% in December 2010 while MPR had more than doubled to 13%. The higher yields that came about as a result of this tighter environment was aided by the subsequent inclusion of some FGN bonds in JP Morgan Bond Index in 2012 in driving the jump in FPI into fixed income market to ~\$3.5 billion by 2014, from under \$1 billion in 2011. Concomitantly, money market rates climbed into double digits with the SDF—at at 10%

(23) Average public and private: a dual system was in operation by then.

for nearly 4 years—as the effective floor. Although the naira enjoyed some stability, the opportunity costs of these outcomes were quite evident. The high FI yields saw banks increase their share of outstanding treasury bills to over 80% by 2015 (2012: <40%). Concomitantly, already elevated sub-prime borrowing costs increased further to highs of 28% on average in 2015 (Dec 2009: 23%) weighing on growth of credit to private sector; 8.6% CAGR in the last five years, relative to CBN's average annual target (30%). Interestingly, prime interest costs contracted 200bps on average over the period. In essence, going by the foregoing combination of events, the high

yield opportunities created by the tightening regime, that saw ~N5trillion mopped up between Jan 2010 and August 2015 excluding impact of CRR hikes, resulted in even more severe disintermediation, with only government and the most credit worthy private sector being serviced. Indeed, considering that a germane but less publicised motive of the tightening was to dis-incentivise government borrowing which was perceived to be crowding out the private sector and disrupting the financial markets, the fact that banks raised exposure to government was counter-productive at best.

Figure 60

Deposits and lending rates (%)

Source: CBN, ARM Research

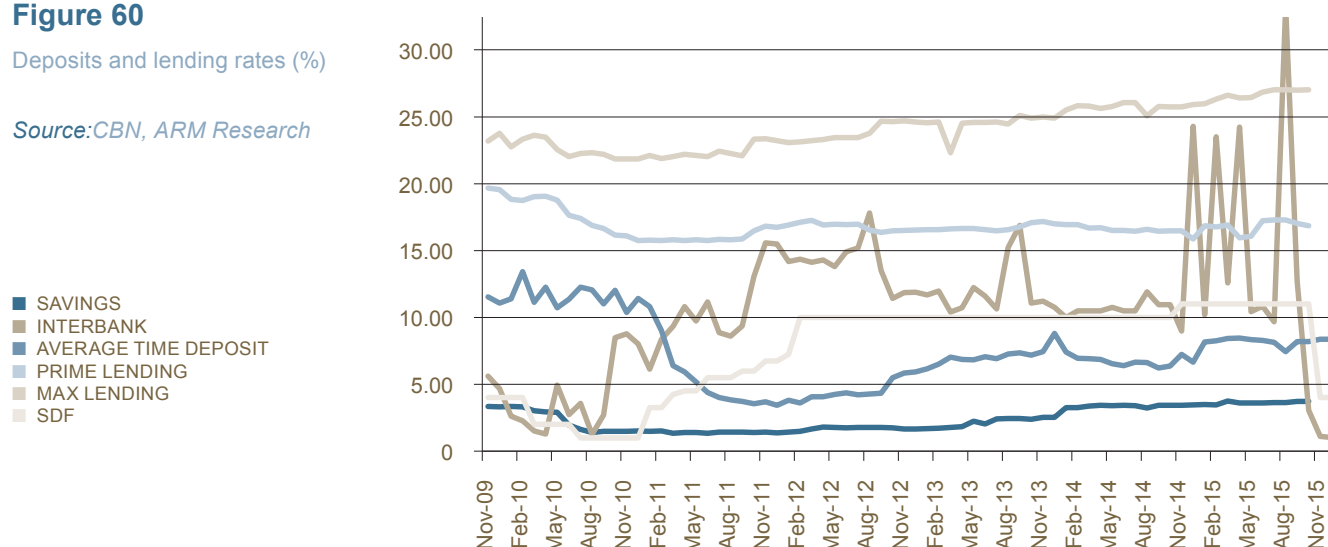
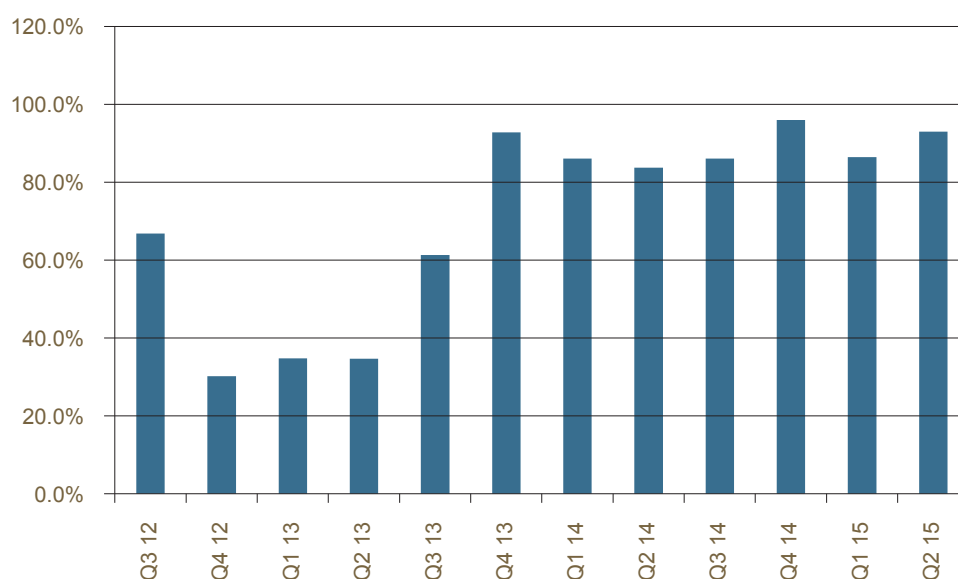


Figure 61

Banks holding of outstanding treasury bills

Source: DMO, CBN



CBN shuns FPIs to stimulate growth as money market rate hit multi-year lows

However, against the backdrop of unintended effects (private sector crowd-out), and mixed success with the main aims (FPI attraction, currency stability, government borrowing) of the tightening, recent events appear to be forcing a rethink of monetary policy tools and methods. Whilst the era of tightening was indeed possible because of robust macro conditions (GDP growth averaged 6% and external and fiscal balances were relatively comfortable), the deterioration in external balances, triggered by the precipitous drop in oil price since Q4 2014, and spectacularly weak growth in 2015, are giving cause for pause. Interestingly, the apex bank initially tried to give more of the same medicine by stepping-up its monetary tightening to stem the impact of the unwinding FPI positions on price stability via rapid depreciation of the exchange rate. MPR was hiked 100bps in late 2014 with ~₦1.2 trillion net OMO sales in H1 15 (vs. ₦800 billion repayment in H2 14) even as additional forex controls were imposed by the CBN to slow the rate of forex reserves attrition. However, with GDP growth plummeting to, then, multi-year lows in Q1 15 (+3.96%), and little success on the forex side, even after the double devaluation over Q4 14 (-8%) and Q1 15 (-19%), the monetary authorities were faced with the broadly two choices. One, tighten further in hopes of limiting FPI outflows, but risk further economic weakness or, two, ease and risk accelerating FPIs outflows while hoping to stimulate credit creation and ultimately output growth. The apex bank went with the latter, and the rest, as

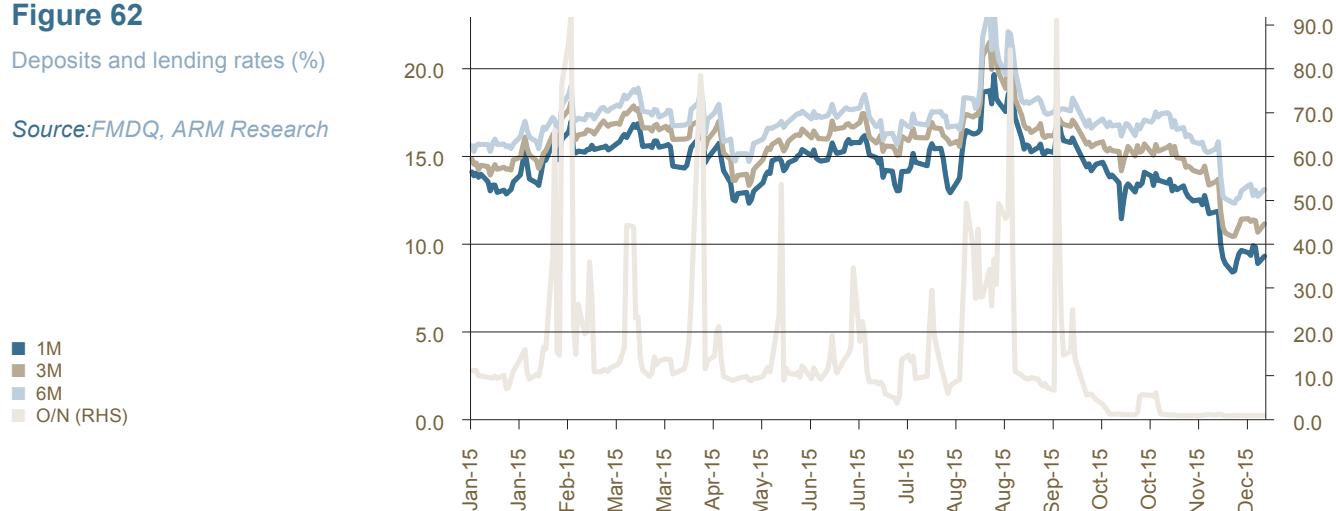
they say, is history. Since then, the apex has allowed ₦2.2 trillion into the system (via OMO maturities: ₦1.5 trillion and 600bps cut in CRR at the September MPC). Furthermore, by the November MPC, the CBN cut CRR by an additional 500bps but more importantly, delivered the first key rate cut in 7 years (-200bps to 11%). Unsurprisingly, system liquidity climbed to record 'extended' levels in Q4 15 pushing money market rates to multi-year lows as overnight and call rates dropped (and remained) below 1% with sharp compression in interbank placements. One month tenor placement tightened over 500bps⁽²⁴⁾ into single digit territory (9.5%) for the first time in four years with the 3 and 6 months at 420bps lower on average to 11% and 13% respectively. Whilst, in abandoning the tightening, the apex bank may have felt it had achieved its forex aims, the expulsion of FGN bonds from the JP Morgan index in September clearly meant there was little reason to further pursue that line anyway. Indeed, the apex bank appeared to have grown a whole new set of priorities by this time with weak growth being the most major. In that sense, in contrast to the era where tightening aimed to raise FG's borrowing costs to discourage borrowing, any perceived support to the fiscal side from the ongoing monetary inducement of lower interest rates ultimately serves apex bank's growth-stimulating objectives, especially now that FG budget seems to have more productive outcomes. For intermediation spreads, despite the initial widening that will likely accompany the automatic revision in MPR-pegged saving rates, we think the real benefit might be clearer with time and as data becomes available.

(24) CRR rebates is conditioned on banks meeting increased lending threshold to the target sectors: Real, infrastructure, agriculture, and solid minerals

Figure 62

Deposits and lending rates (%)

Source: FMDQ, ARM Research



Monetary easing to persist, but deterioration in credit quality could slow feed through to credit growth

Going forward, our bearish outlook for oil prices suggest that current internal and external imbalances will remain fragile, exerting negative pressure on already worrying output growth and foreign exchange market. This dire prognosis—particularly for output growth—favours an extension of the current monetary policy thrust especially as focus has shifted away from forex and attracting FPIs to more fundamental domestic considerations. Furthermore, developments on the fiscal side also support an extension of easing. The FG plans to raise nearly ₦1 trillion from the domestic market in 2016 (vs. ₦500 billion in 2015) but at an implied interest rate of 14.2% (+40bps YoY), based on projected debt service, could be saddled with heavy borrowing costs. However, considering the budget priorities dovetail neatly with the CBN's own aspirations for the economy, there seems to be a strong case for keeping the borrowing costs tame. Having maintained the easing stance through 2015, despite step-up in OMO at the tail end of 2015, system liquidity remained elevated at ₦800 billion. Current OMO maturity profile over 2016 (₦2.2 trillion) and still high CRR (20%) leaves enough headroom for the CBN to sustain its accommodative policy. In addition to these tools, given the signaling effect of MPR adjustments, we think the odds for further cuts to single digit territory, possible over the H1 15, are relatively high. This could

mirror the rapid cuts in MPR (from 10.25% to 6%) over about 6 meetings, following the 2008 financial crises.

Indeed, our prognosis suggests money market rates will remain depressed in the near-term, but the outlook for credit creation is unlikely to become positive so quickly. On the latter, we expect interest costs for high credit quality borrower to track the decline in money market rates, as they renegotiate loan terms or refinance existing facilities. However, subprime interest costs are likely to be downward sticky given the challenges implied by the deterioration in the macro landscape. Indeed, this reality appears to partly inform the CBN's latest approach to CRR credit, but the risks are self-evident. We note that at the same MPC meeting, where the MPC tied CRR rebates to certain criteria, banks were encouraged to employ more stringent criteria in evaluating their portfolio and business decisions.

Thus, we are unconvinced that the CRR cash-carrots being dangled by CBN for lending will have the desired impact on banks' lending appetite in the near-term, given heightened credit risk. However, given other encroachments on banks' revenues, their recent touting of efforts to build credit-writing capabilities and, indeed, questions surrounding the long-term viability of lenders that do not start to build a client base now, we think this is an area that banks have little choice but to address, even if it takes a while longer to feed through.

CAPITAL MARKET REVIEW AND OUTLOOK

MONETARY STROKES
NORMALISE YIELD CURVE

The contraction of the treasury yield curve over Q2 15, as investors ramped up purchases on diminished political risks, proved shortlived. Further downleg in oil prices as OPEC held status quo at its June meeting and Iran sealed an historic nuclear deal in July, reminded investors of subsisting macroeconomic risks. Beyond the negative implications of the depressed oil price environment on internal and external balances as well as the apex bank's response to same, investors also had to grapple with the lull on the fiscal scene, with no cabinet formed till the final quarter of 2015. Added to these, the market was also faced with external factors, from the exclusion of FGN bonds from the JP Morgan Emerging Market Bond Index to the US rate lift-off which eventually happened in December. However, after being largely dominated by political considerations in H1 15, it was the switch in monetary policy to a dovish tone that ultimately underpinned yields trajectory over H2 15.

Excess liquidity forces yields to multi-year lows

Unsurprisingly, coming into Q3 15, the CBN responded to headwinds by extending its 5-year monetary tightening regime, with step-up in net OMO issuance

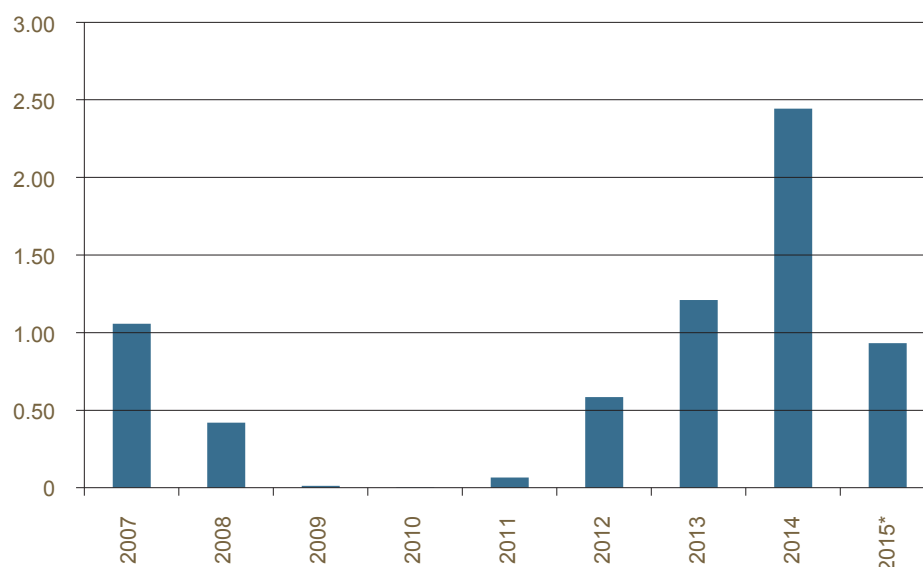
in July (₦400 billion) even as it introduced additional forex demand management measures which further drained liquidity. With market expectation stoked for further tightening at the July MPC, the committee then disappointed by leaving key variables unchanged resulting in a 30bps pullback in bond yields. However, August brought additional admin measures by the CBN—the 48 hour forex prefunding requirements halved system liquidity to ₦70 billion within days—even as the 'vacuum' on the fiscal side, with cabinet not yet formed more than 2 months after inauguration, became a cause for concern. Responding to these events, as well as the then-looming 15th September⁽²⁵⁾ deadline for the implementation of TSA, the yield curve shifted 130bps higher to 15.71% by the end of August, despite net OMO repayment that month, as investors' unwound long positions across the yield curve. The selloff was more severe at the short end which jumped (+200bps to 15.64%) nearly twice the change at the long end of the curve. Curiously, the impact of the exclusion of FGN bonds from JP Morgan Index, announced on the 8th September, on bond yields was short-lived as yields closed only 15bps higher at 16.09% on average the next day, after touching intra-day summit of 17.5%. This somewhat muted yield response reflects the net short position of FPIs, with flows into the bond market ~70% lower YoY in the first 10 months of 2015,

(25) Initial deadline was 1st September 2015

Figure 63

Trends in FPI flows into bond market

Source: FMDQ, ARM Research *Year to October, annualised



and increased purchases by domestic players who deployed additional liquidity—due to cut back in OMO sales and CRR cut—to take advantage of the elevated yields. Consequently, the yield curve reversed earlier upswings to end Q3 15 100bps lower at 13.28%.

The downturn in the yield curve persisted over Q4 15 as commencement of monetary easing by the apex bank forced deposit money banks, already grappling with deteriorating credit quality in the corporate space, increased purchases across the curve. Specifically, liquidity levels doubled to ₦600 billion as additional net inflow of ₦1.2 trillion hit the banking system. Awash

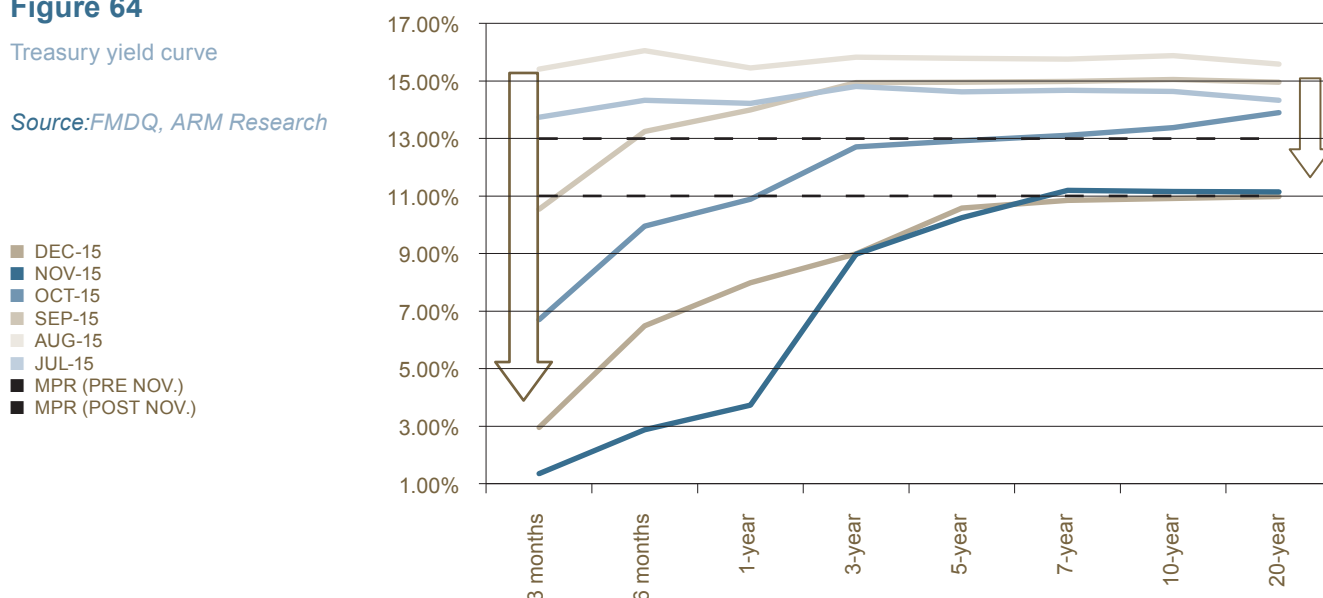
with excess cash, at a time of slow paper issuance by the monetary authorities⁽²⁶⁾, investors' ramp-up of purchases subsumed the DMO's Q4 15 issuance (₦240 billion: +50% QoQ, driven by ₦60 billion non-competitive allotment) and resulted in the yield curve tightening another 640bps on average over Q4 15 to multi-year lows of 6.8% (H2 15: -750bps). Unsurprisingly, given the liquidity-driven stimulus, the short end of the curve fell significantly sharper (-9.5pps) to ~4% (vs. 5.5pps contraction at the long end). Consequently, the treasury yield curve now has a positive slope, having essentially been flat in the last few years.

(26) There was only one OMO issuance in September and none in October and November.

Figure 64

Treasury yield curve

Source: FMDQ, ARM Research



Credit spreads widen as Eurobond yields respond to further downleg in oil prices

In usual fashion, Nigerian Eurobond yields continued to react to the gyrations in the oil markets. As oil prices dipped to multi-year lows over H2 15, yields of each of the three outstanding issues climbed to record peaks, with the 7 and 10 year notes crossing the 8% (+270bps over H2 15) mark for the first time since issuance. Consequent upon the spike, and with benchmark US note relatively flat, credit spread on the 10 year Eurobond widened as much as 6.5pps (from 3.9pps at the end of H1 15). That said, we think the sell-off might be overdone as Nigeria's ability to meet these obligations remain intact. The quantum of

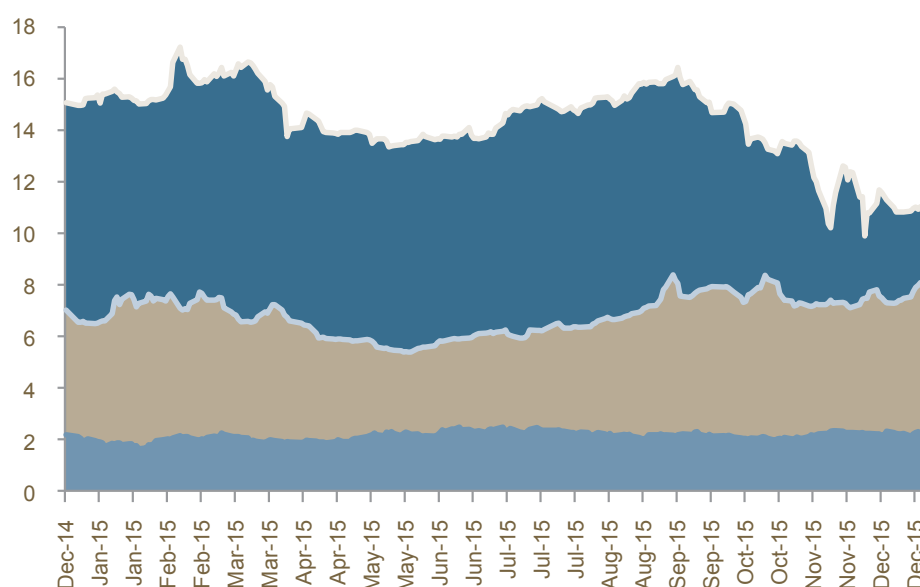
annual interest (\$0.2 billion) is only about 2% of forex receipts even at sub- \$40/bbl oil but more importantly, average duration on the outstanding bonds (\$1.5 billion) is fairly long (~4 years), giving enough time for improvement in forex receipts. Perhaps, the highlight of the period is that the contrasting movement for the local currency bonds and dollar denominated sovereign notes in H2 15 have seen borrowing costs' differential between domestic and foreign capital market narrow significantly, for the FG. Specifically, the differential between the FGN 2024 and Eurobond 2023 is now 2.5pps (vs. 6.5pps in H1 15) and an extension of this trend could be an important consideration in determining the source of borrowing for the 2016 budget.

Figure 65

Nigerian local & foreign currency bonds and US 10 year Treasury note

Source: Bloomberg, FMDQ, ARM Research

■ COST DIFFERENTIAL
■ CREDIT SPREAD
■ FGN 2024
■ EUROBOND 2023
■ US 10 YEAR



Bailout of SGs forces FG to halt supply of 20 year paper...

In the primary market, the DMO issued ₦399 billion worth of bonds in H2 2015, 11% lower than preceding half-year. Perhaps more importantly, this is 4% above the proposed issuance calendar for the period with the DMO taking advantage of the lower rate environment over the fourth quarter (avg. -400bps QoQ) to raise additional ~₦60 billion on a non-competitive basis. In all, H2 15 bond issuance brings cumulative 2015 bond sales to ₦850.72 billion, 19% lower than 2014.

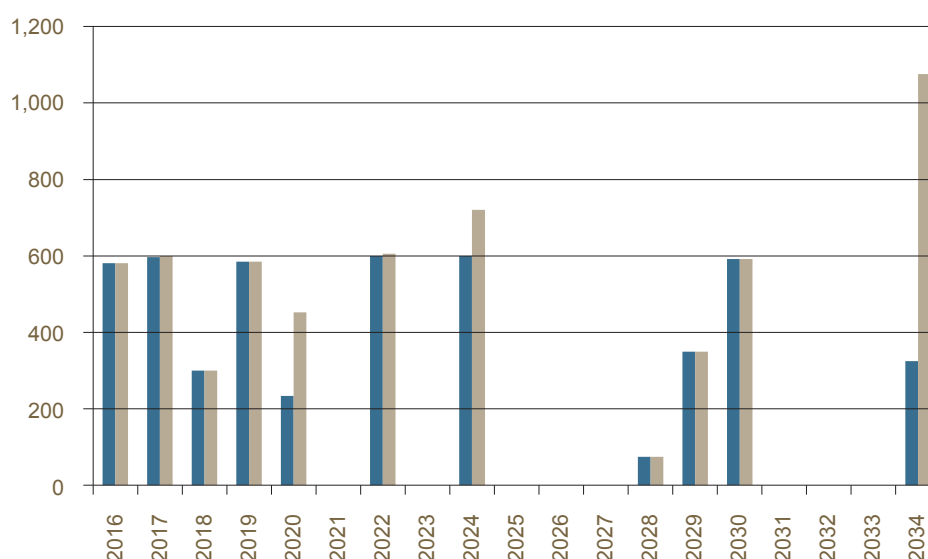
Pertinently, on a net basis, the DMO borrowed only about half (₦315 billion) of projections as the FG relied heavily on credit facility (over ₦600 billion) from the central bank to fund its budget shortfall. The reliance on CBN facility and rampup in borrowing when rates were significantly lower, re-affirms our earlier prognosis on the FG's resolve to cap the fast climbing domestic borrowing cost which is projected at 15.5% for 2016 (+40bps higher YoY). That said, the tenors of issues were somewhat dictated by the fiscal strait facing the state governments. Although the DMO extended its issuance of the 5 year paper into

Figure 66

Outstanding FGN Bond (₦'billion) and maturity gaps

Source: FMDQ, ARM Research

■ H1 15
■ H2 15



H2 15 (~50% of total bond sales), it switched to the 10 year paper in Q4 15 from the 20 year paper over the prior quarter. This switch was necessitated by the elevated maturity profile in 2034 which crossed ₦1.1 trillion after the FG refinanced nearly ₦600 billion worth of state government loans into 20 year FGN bonds in Q3 15.

...as investors position for increased paper supply

Curiously, the improvement in investors' appetite since conclusion of the elections in Q2 15 persisted into H2 15, with bid to cover at the bond auction fairly

stable at 2.5x each quarter. Whilst, standalone, this does not mean much, putting it side by side with increased interest at the T-bill auction where bid-cover doubled to 3.3x in Q4 15 shows investors continue to stay short. Given the quantum of liquidity over the final quarter, this posture—which partly explains the relatively steep nature of the yield curve—imply the market expects widening of yields or at least require a higher premium for taking tenor risk today, perhaps in view of fiscal headwinds.

Figure 67

Bid-cover ratio and system liquidity (₦billion)

Source: DMO, CBN, ARM Research

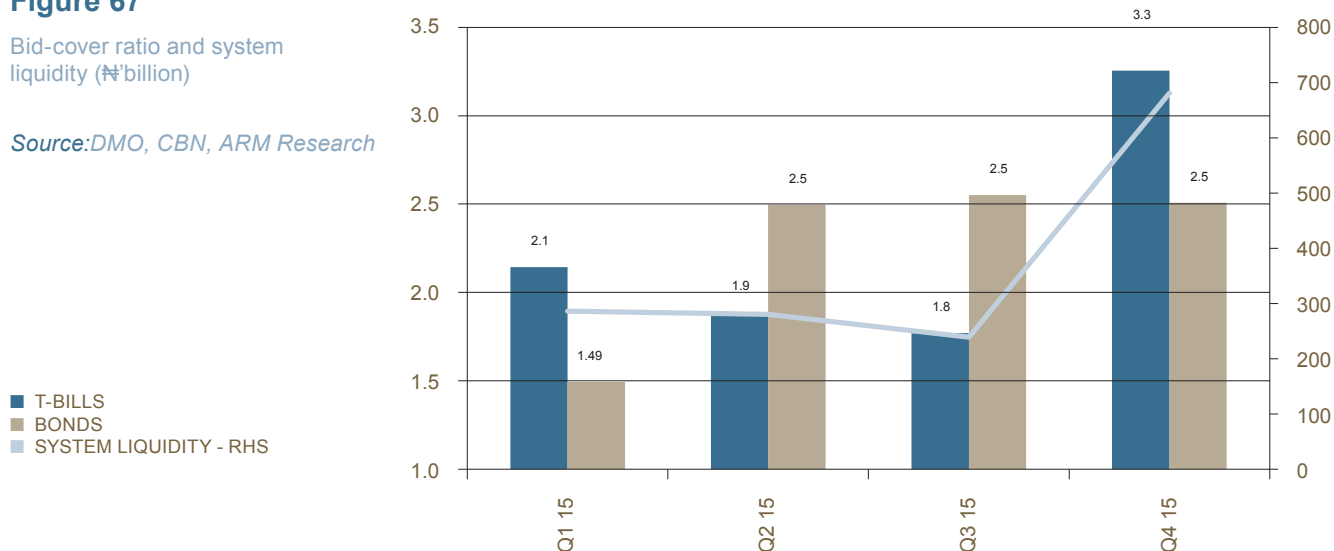
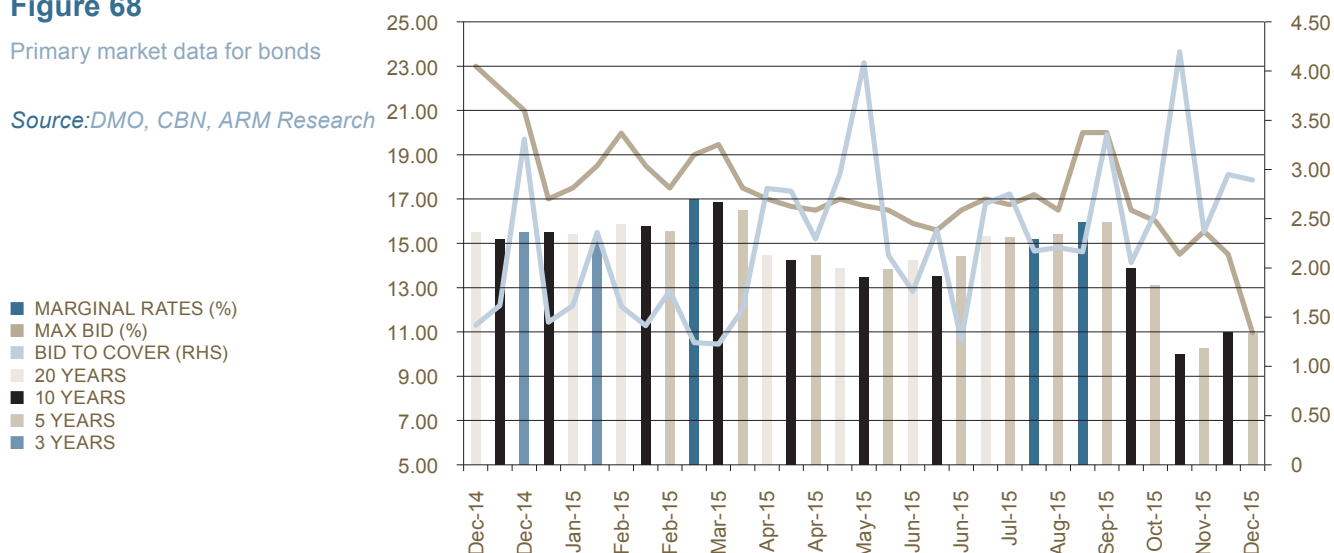


Figure 68

Primary market data for bonds

Source: DMO, CBN, ARM Research



...but monetary influence could undercut expected impact of paper supply on yields

Going forward, developments with fiscal balances will be central to yield trajectory, given the FG's plans to ramp up borrowings. In the same vein, having established the influence of monetary policy on yield direction (and shape) over H2 15, the CBN's posture in this regard, will continue to play a key role in determining level of the yield curve over 2016. On the fiscal balance, the FG's expansionary budget projects a ₦2.2 trillion deficit, with ₦1 trillion to be sourced from the domestic credit market (vs. ₦900 billion external). The quantum of domestic issuance is double estimates for 2015, but crucially, nearly three times actual bond sales over 2015, as the FG relied on the CBN and cutback on implementation of the capex budget. However, as we noted earlier, after the historic victory at the 2015 general elections, the current government is under pressure to deliver on campaign promises. This suggests that implementation of the 2016 budget, including the often neglected capex portion, will be significantly higher, raising scope for stronger paper supply over 2016. Added to this, our analysis that 2016 deficit could be wider than projected—due to aggressive projections—as well as narrowing local/foreign borrowing cost differentials could further boost domestic issuance. Specifically, using estimate for fiscal deficit, domestic borrowing could hit ₦1.3 trillion in 2016—assuming fixed financing ratio. Based on the foregoing, we expect the FG's bond sales to be significantly higher in 2016. On the other hand, like H2 15, the tale of demand is likely to be mixed. We expect foreign investment into the bond markets to remain weak on lower FGN rates, subsisting currency restrictions and prospects of further hikes in US interest rates even as monetary thrust likely underpins strong local participation. On the latter, hinged on the need to stimulate output growth, we expect the current monetary easing to persist and the net inflow in December (₦150 billion), despite the surprise resumption of OMO sales, appears to reaffirm this posture. Crucially, it appears the CBN has both the comfort and sufficient legroom to sustain this stance with average daily system liquidity of ₦700 billion since October 2015, CRR still elevated (20%) and ample OMO maturity (H1 16: ₦1.8 trillion). This suggests system liquidity will stay elevated, at least over the first half of 2016, exerting downward pressure on the treasury yield curve. Specifically, H1 2016 OMO maturities which translates into average

monthly inflow of ₦300 billion, is more than twice the expected gross monthly bond issuance (₦130 billion). Indeed, further cut in CRR could potentially increase liquidity, likely offsetting potential upward pressure from additional supply if our prognosis on wider deficit pans out. Overall, whilst we anticipate higher paper supply, we believe the impact will be blunted by easing and, should our expectation for additional cut in key rate pan out, could even drive the treasury yield curve lower.

SUSTAINED OIL PRICE WEAKNESS COMBINES WITH POLICY OPACITY TO STOKE MARKET DOWNTURN

Nigerian equities resumed the bearish run briefly punctuated by euphoria over peaceful conclusion of the 2015 general elections in Q2 15, by posting two quarters of losses in H2 15, which places NSEASI on track for its worst performance in six years (2015:-17.4%). Renewed market weakness over the period matches our call in our H2 15 NSR for a set of factors: further down-leg in oil prices, sustained FPI aversion to Nigerian equities in a fluid global financial market place and policy uncertainty (following the electoral victory of the opposition party at the March 2015 polls), to weigh heavily on investor psyche in inducing market sell-offs.

Recasting performance on a monthly basis illustrates the impact of these drivers more clearly, starting in July when turmoil across global markets over possibility of Grexit combined with the biggest MoM drop in crude oil prices (-18%) since December 2014 in triggering fresh FPI investor anxiety. This resulted in ₦58 billion outflows over the month and a 9.8% MoM contraction in NSEASI. While crude prices pared back declines with a 3.7% MoM gain in August, domestic equity markets closed lower as investors waited for clarity from Nigeria's economic managers in response to the scrawny fiscal revenue profile following the collapse in oil prices. Progress on the policy direction front in September, with the submission of ministerial nominees for legislative screening, helped markets reverse the negative tide in September (+5.2% MoM) despite an abundance of negative sentiment triggers with Brent Crude posting another negative MoM performance (-11%) and JP Morgan excluding Nigeria from its widely followed EM government bond indices. Nonetheless, the eventual

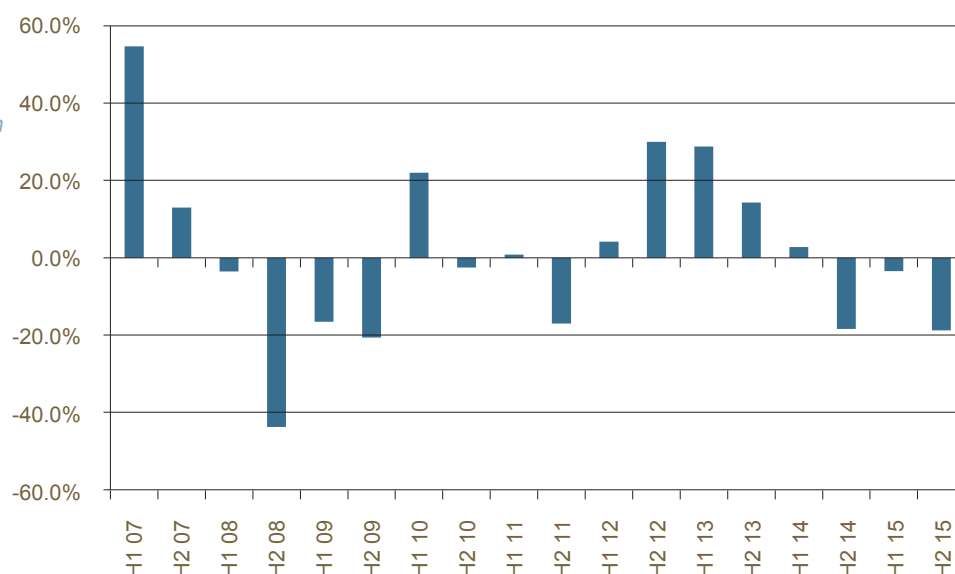
unveiling of the cabinet nominees did not prove to be inspiring for markets as despite Brent's 3% MoM rise in October, the NSEASI shed 6.5% over the month. Market performance resumed its lockstep dance with oil prices in November sliding 6% as Brent slid 10% over the month, a trend which has since continued

in December. In sum, a rich sprinkling of negative fundamental developments and scant clarity over economic outlook amid a souring global investor sentiment to EM/Border market assets underpinned negative NSEASI performance over H2 2015.

Figure 69

NSEASI Half-yearly returns

Source: Bloomberg, ARM Research



Weaker earnings trajectory underpins bearish sectoral performance across NSEASI

In terms of negative fundamental developments, perhaps the more glaring came with the release of Q2 and Q3 15 results respectively in July and October. Across the two sets of results, evidence of deteriorating macroeconomic environment was visible starting with cement where slowdown in construction GDP (Q2 15: 6.4% YoY, Q3 15: -0.11% YoY) could be seen in tame volumes reported by sector heavyweights DANGCEM (Q2 15: +1% YoY, Q3 15: -4% YoY) and LAFARGE (Q2 15: +3% YoY, Q3 15: -9% YoY). The slower revenue growth reflects weak construction activity as Federal and State governments grapple with tame crude oil receipts which melded into cutback in capital expenditure. In response to sliding volume growth, cement producers slashed prices in Q3 15 which exacerbated adverse investor sentiment with the cumulative impact of slowing volumes and weaker pricing driving 15.5%

contraction in sector capitalization over the second half of 2015. Similar to the cement stocks, FMCG companies also felt impact of the difficult operating environment as weak consumer purchasing power and factory downtime following bouts of power shortages in July hurt top-line. Faced with slack revenue growth, FMCGs were unable to fully transmit the higher cost environment occasioned by NGN devaluation to consumers, leading to margin pressures across the industry.

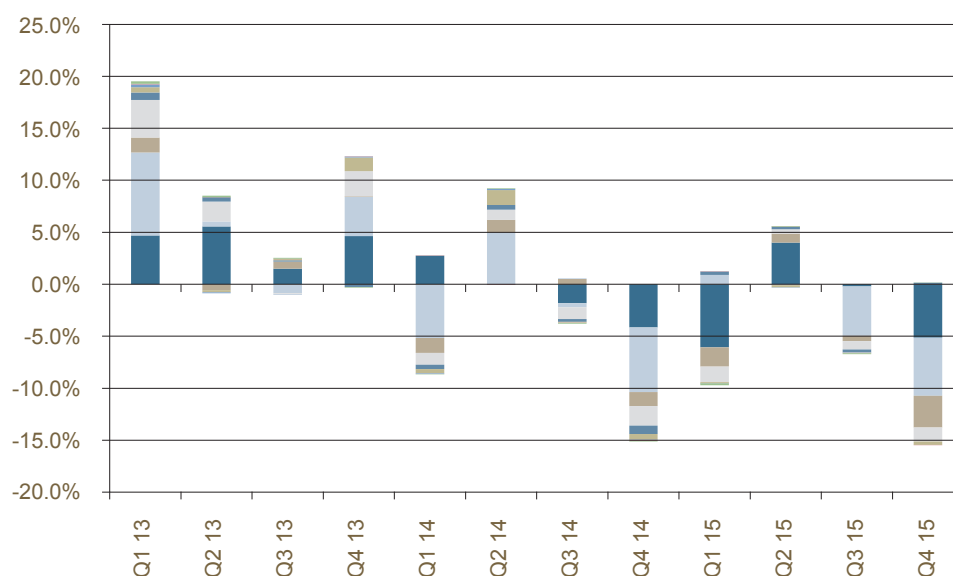
Elsewhere, banking stocks grappled with deteriorating asset quality in Q2 15, with our coverage universe reporting on average 80bps YoY uptick in cost of risk with impairments, on average, more-than-doubling from 9M 2014 levels. In addition to the rise in provisions, coverage banks also responded to the declining oil price by restructuring oil and gas books to reflect the reduced cash flows under the new price environment. On the asset side of banks' balance sheet side, the state debt-FG bond swap program drove a sector wide contraction of loan books (-1.1%

Figure 70

Disaggregation of NSEASI performance by sector

Source: NSE, ARM Research

■ CEMENT
 ■ BANKING
 ■ BREWERS
 ■ FOOD
 ■ PERSONAL CARE
 ■ OIL & GAS
 ■ INSURANCE
 ■ REAL ESTATE
 ■ CONSTRUCTION



YoY) over the first three quarters of 2015 (2014: +25% YoY) while on the liability portion, TSA implementation drove a 4.3% YoY cutback on deposits across the sector which translated into higher funding costs in Q3 15⁽²⁷⁾. As investors priced in the public sector concerns in addition to higher credit risks, banking sector market capitalization shrank 31.5% over H2 15.

Last, Oil and Gas sector buckled under the weight of declining oil prices for E&P companies and delayed subsidy payments for downstream players over H2 15.

(27) Across our coverage mean WACF 9M 2015: +70bps YoY

On the former, the oil price contraction triggered asset write-downs leading to record losses by upstream player OANDO, while the delayed payments drove petroleum marketers to curtail fuel imports resulting in lower revenues for 9M 2015.

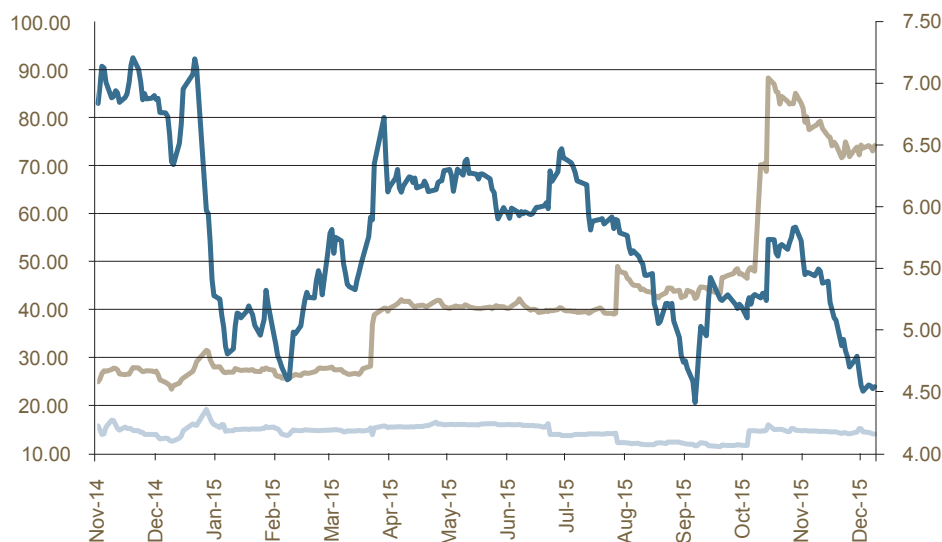
The fundamentals-driven compression in share prices over H2 15 triggered a decline in sectoral PE multiples across board: Banks (-25% to 4.5x), Oil and Gas (-21% to 60.2x), Materials (-11% to 13.9x) with the exception of consumers where steeper declines in earnings, relative to price, kept multiples elevated.

Figure 71

Valuation multiples across select sectors

Source: Bloomberg, ARM Research

■ CONSTRUCTION
 ■ CONSUMERS
 ■ BANKS-RHS



Tame fundamental picture and policy uncertainty starves NSEASI of home and foreign support

Overlaying these fundamental drivers with sentiment news, we trace out investing pattern across domestic and foreign fund managers over H2 15 with foreign transactions shrinking 43% YoY to ₦312 billion while domestic transactions declined 53% YoY to ₦241 billion⁽²⁸⁾. After switching to net long positions on Nigerian equities in June, FPI have stayed net short to the NSEASI over H2 15 to the tune of ₦39 billion (vs. H1 15: ₦18 billion). Post the removal of political risk from Nigerian equities which induced

(28) NSE Data is from July to October

two months of net inflows in H1 15⁽²⁹⁾, FPI sentiment towards Nigerian equities soured in July on delayed clarity over fiscal policy, specifically how the new government would deal with the impact of the oil price drop, and on naira trajectory. Amid floundering oil prices (-18% MoM), release of broadly weak Q2 15 earnings across NSEASI and heightened global risk as Grexit tensions peaked, July was perhaps the month in which the worst of sentiment triggers came together, with FPI outflows climbing to a five month peak of ₦58.8 billion. Tracking the exit of foreign investors, domestic funds also reduced exposure in that same month with NSE data showing a 52% MoM drop to a five month low of ₦24 billion.

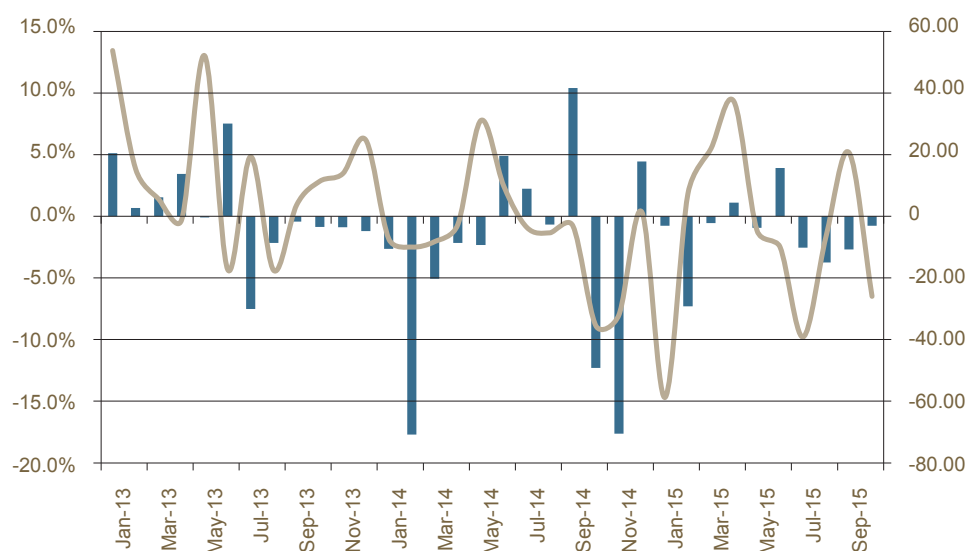
(29) April (₦4.4 billion) June (₦15.5 billion)

Figure 72

NSEASI MoM performance and net equity flows

Source: NSE, Bloomberg, ARM Research

■ NET FLOW
■ NSEASI (MOM %)



Though a rebound in oil prices over August should have buoyed sentiment, FPI remained net short Nigerian equities even as domestic investors stayed away.

Even in September when market turned positive (+5.2% MoM), FPI remained net short (₦10.8 billion) in response to renewed weakness in oil prices and JP Morgan's expulsion of Nigeria from its bond indices. In contrast, domestic investors who perhaps had been so damaged by July's potpourri and consequently stayed out in August despite a rebound in oil prices that month, appeared to be tempted back in September by the arrival of a ministerial list with the majority of the daily gains coming in the last week in the month. Data on PFA and Mutual Fund AUM also supports this view though

the lower domestic transactions value relative to August hints at a lack of conviction.

Indeed, the ultimate release of specific ministerial names did little to sustain market confidence which soon ebbed outright with release of weak Q3 15 earnings in October. Consequently, FPI remained net short (₦3.1 billion) with inflows sliding to the lowest (₦25.5 billion) since NSE began reporting monthly data while domestic investors also moderated exposures (-13% MoM to ₦52.6 billion).

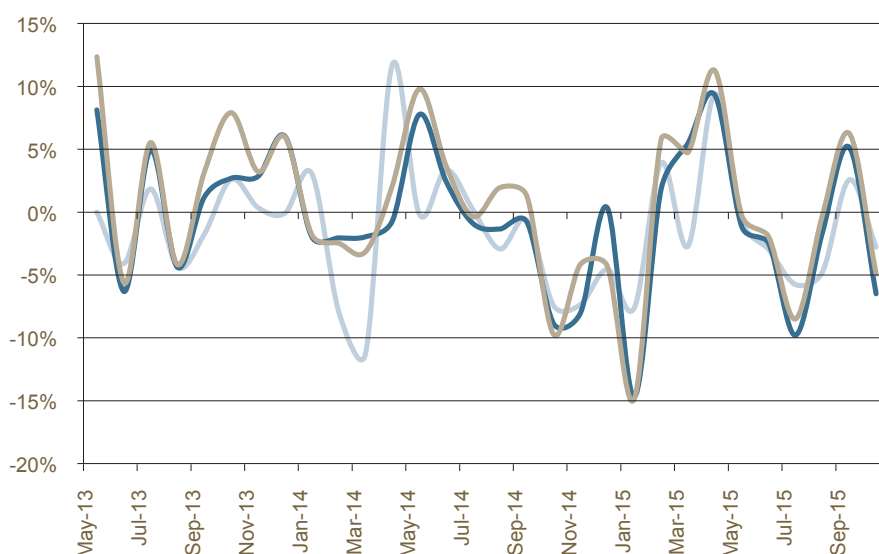
Over H2 15, the dour macroeconomic underpin combined with poor visibility on economic policy to drive net short FPI positions and reduced exposure to the domestic market by local investors.

Figure 73

MoM change in NSEASI and mutual fund/pension fund NAV

Source: NSE, PENCOM, SEC, ARM Research

MUTUAL FUNDS (MOM)
NSEASI (MOM)
PENSIONS (MOM)



Bearish market and shrinking liquidity keeps primary market dry

A fall-out of the reduced interest in Nigerian equities from domestic and offshore investors was the resulting slide in average daily volume (-13% YoY to 316 million shares) and value traded (-27% YoY to ₦3.14 billion) over H2 15. Beyond leaving the market susceptible

to further downtrend, the shrinking market depth and declining valuations made it difficult to raise equity or to list companies. For evidence, while H2 15 witnessed announcement of seasoned offerings, none of the proclamations came into effect as declining prices dampened optimism to follow-through⁽³⁰⁾.

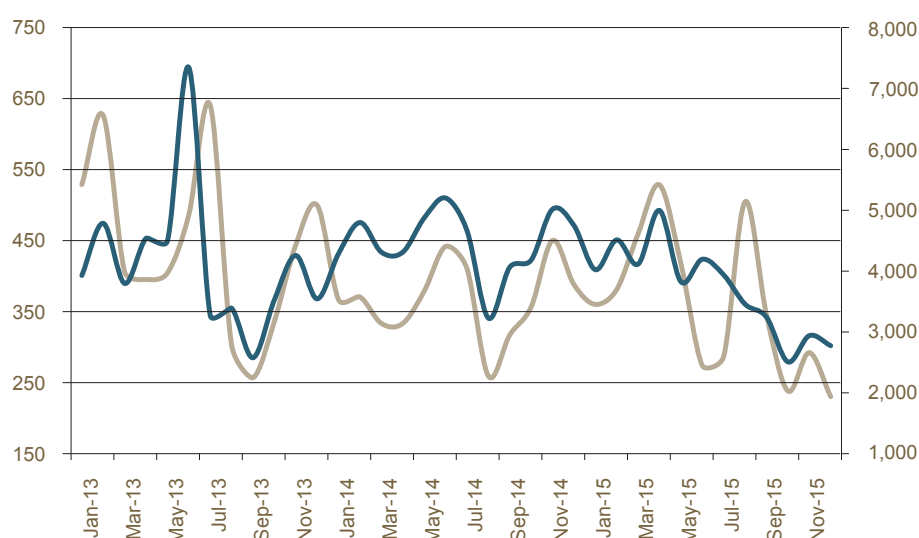
(30) Both FMNL (₦30 billion) and UACN (₦4.8 billion) announced rights issue plans but did not undertake the plan.

Figure 74

Mean monthly volume and value traded

Source: NSE, ARM Research

VOLUME (BILLION)
VALUE (₦million) - RHS



As regulatory bodies ramp up push to bring market standards in line with best practice

Perhaps as a reflection of the depressed market performance, the NSE did not go ahead with the downward adjustment in par value from ₦0.50 to ₦0.01 per share. Nonetheless, in another effort at aligning equity market architecture to global standards, the Exchange together with the Central Securities Clearing System (CSCS) announced plans to commence a post-trade allocation service to enable fair allocation of securities for pooled transactions to various client accounts by December 1, 2015. Previously this process was done at the discretion of the brokers which left the system open to unfair practices for pooled trades.

Among other developments aimed at improving market standards, the SEC, under its three point agenda (direct settlement of investors, smart trading and full dematerialization of the capital market) commenced enrolment for e-dividend payments in September 2015. Leveraging on the BVN initiative and seeking to curb the problem of rising unclaimed dividends, the scheme seeks to register investors on an online portal (e-dmms) managed by SEC to co-ordinate direct dividend payments on investment holdings. In addition, the SEC set January 2016 as the commencement date for the direct cash settlement, whereby sales proceeds on trades executed by brokers are directly wired into customers' accounts.

In line with the uptick in activity by SEC, the NSE released draft guidelines to amend listing company

rules which require financial audits before dividend announcements and raised sanctions for delayed results releases. The new rules are largely in response to the furore following the delayed release by OANDO of its 2014 results and infraction committed during the period by making payouts from reserves⁽³¹⁾.

In a related development, the NSE also introduced a new index called the premium board designed to track the performance of "large cap, liquid stocks of firms with excellent corporate governance and sustainable business models". To qualify for inclusion, firms are required to, by the date of application to the board, achieve:

1. Market capitalization that's equal to or in excess of ₦200 billion.
2. Minimum free float requirement of 20% of its issued share capital; or the value of its free float is equal to or above ₦40 billion
3. Minimum rating of 70% under The Exchange's Corporate Governance Rating System (CGRS).

Following the announcement, the NSE named ZENITH, FBNH and DANGCEM as the only three firms to be admitted upon commencement of the Premium Board in August 2015. Going by the first two criteria alone, several other firms (see table 11 below) also qualify, implying future inclusion over the near term.

(31) Oando released FY 14 results in November 2015

Table 11

NSE Premium board: current and potential members

NGSEINDEX Index	Market Cap (N'billions)	Free Float %	Free Float (N'billions)
DANGCEM NL Equity	2,595	8.89	23.07
NB NL Equity	944	48.23	45.50
NESTLE NL Equity	634	36.51	23.15
GUARANTY NL Equity	559	99.82	55.76
ZENITHBA NL Equity	440	90.47	39.82
WAPCO NL Equity	421	29.61	12.47
FO NL Equity	392	n/a	39.20
ETI NL Equity	397	38.78	15.41
FBNH NL Equity	171	98	16.79

Source: Bloomberg, ARM Research * current members are in bold

Can impact of stimulatory domestic policy offset effect of bearish FPI stance on NSEASI?

Similar to 2015, events across the global landscape and the impact of domestic policy responses to these developments form the basis for our equities outlook. On the global front, the lift-off in US interest rates in December 2015, in a manner similar to the decision to start of tapering, and guidance to 100bps increase over 2016 raises the opportunity costs for investing outside the US economy. In addition, amid rising monetary policy divergence, the upbeat growth picture for DM renders the economic case for FPI activity in EM/frontier markets less compelling. Exacerbating the case for Nigeria is the bearish base case for oil prices over 2016, which expands prospects for higher BoP and fiscal deficits.

The foregoing shifts investor focus to developments on the home front where the emerging theme from the fiscal side is an attempt to reignite aggregate demand via Keynesian-style stimulus measures. While the government has since announced a ₦6 trillion expenditure outlay with projected deficit of ₦2.2trillion, uncertainty remains over how the budget will be financed. The efficacy of the budget itself in stimulating aggregate demand holds import for various sectors of the market starting with FMCGs. The 'welfarish' twist to recurrent spending with the planned primary school feeding and unemployment package should provide upside to consumption demand. Whilst this should benefit FMCGs, per our budget review we expect the impact might not materialize soon even as our views on naira weakness suggests margin pressures as companies struggle to transmit FX induced pressures on import costs to customers. However, some form of relief appears on the horizon for highly geared companies as low rate environment translates to tamer interest expense pressures in 2016⁽³²⁾. Nonetheless, the delayed feed-through of the stimulus and FX pressures on margins should temper gains from interest expense leaving bottom-line broadly subdued over 2016 for FMCGs.

For cement stocks, the appointment of erstwhile Lagos state governor, who gained a reputation for sizable infrastructure uplift in Nigeria's financial capital, and announcement of a ₦2 trillion capital

expenditure budget should buoy optimism about construction activity at the Federal level which should translate into volume growth for players in the cement sector. Nonetheless, details of the 2016 capital budget focus on road construction, which tips the scales in favour of asphalt, implying that expansionary capital spending might not directly impact the cement sector. Whilst an expanding non-Nigerian footprint has raised prospects for top-line support, the lower share in total revenues and pressured macro climate across Africa dim scope for expanding offshore divisions to offset weakness on the Nigerian leg. The weak top-line picture melds into gross margin weakness stemming from FX induced pressures on dollar exposures on gas contracts and gypsum imports. Incidentally, ~70% of loans across the cement sector are inter-company or on concessionary terms, which narrows scope for any sizable savings from lower interest costs. Overall, sector outlook remains broadly muted over 2016.

For downstream oil and gas companies, the increased prospect of the end to the PSF scheme puts sector outlook at an inflection point over 2016. First, deregulation allows players within the sector with deeper access to capital and logistics infrastructure to push greater volumes without uncertainty over payment delays. Furthermore, recently announced moves to review the present PMS template with a view to switch fixed naira margins to a more flexible arrangement, with prospect for upward adjustment in trade margins, should buoy margin outlook. In addition, interest expense which has averaged 34% of PBT annually since start of delayed payment saga in 2012 (pre-2012: 12%) should moderate with the disappearance of subsidy at current oil price levels. This should remove the need for borrowing that is typically necessitated by delayed government reimbursement, with the emerging low rate environment providing additional down-leg in finance costs. In summary, the stronger revenue and margin outlook combine with savings on finance charges in driving broadly positive earnings outlook for petroleum marketers. On the other hand, for the upstream O&G sector, continued downdraft in oil prices, which are set to approach the breakeven range for Nigerian oil fields, broadly speaks to a dour earnings outlook. Furthermore, following expiration of the three-year tax concession for sector heavyweight SEPLAT, prospects for the supplementary two-year renewal appear weak given the depressed state of fiscal revenues.

(32) Average Interest expense to PBT (9M 15: 30%)

In contrast to the broadly positive vibes dovish monetary policy gives non-financials, for banks, the reverse is the case as benefits of tamer funding costs are likely to be more-than-offset by declining asset yields from downward loan pricing and depressed rates on government securities. Compounding this is the marked contraction in loan book over 2015, which implies that banks would have to raise loan volumes to raise interest income. Nonetheless, as the macro environment remains weak we see modest loan growth

largely driven by various on-lending initiatives whose impact on interest income is, however, tempered by the lower rates. Furthermore, financial performance should be negatively impacted with onset of zero COT and persisting asset quality issues which should heighten over 2016 as the combination of weaker oil prices and impact of CBN FX measures drive deterioration in risk assets to upstream Oil & Gas, general commerce and manufacturing. Thus, banks are more likely to struggle to grow earnings over 2016.

CAPITAL MARKET STRATEGY

JUGGLING MOVING PARTS WHILE WALKING FISCAL TIGHTROPE DEMANDS DEXTERITY

In many respects, events in the FI market in the latter half of 2015 played out nearly exactly in line with the strategy calls we made. From the call for domestic influences to predominate, to the specific expectation for the insurgency and political risk—the more recent yield influencers, at the time—to wane, reality matched expectation. Similarly, not only did the sequence we set out for duration-building opportunities, for brief Q3 spikes to be followed by significant and decisive declines in Q4, come to life but also our recommendation for investors to expect nowhere near Q1 yield levels fit eventual outcomes with the H2 peak 56bps lower than the year peak of 16.8% set in February. Given the extent to which eventuality matched expectation, it then seems somewhat nonplussing to have to so heavily reassess our overarching submission that “H2 15 levels on average could yet mark the final chapter of still elevated yields as newfound fiscal prudence and leakage plugging deliver a new normal of possibly 200-300bps lower rates than recent history”. However, after Nigerian domestic bonds became the second best performing asset globally in 2015 it is only prudent that the sustainability of such a run is reassessed and, in this regard, the key drivers bear the first round of the renewed scrutiny.

In assessing the quantum of risk in the domestic environment as at our last report, we split our consideration into global and domestic. Of the global factors, it was oil that we felt posed the greatest challenge to the domestic environment as we envisaged portfolio or capital flows were unlikely to have any decisive influence under prevailing conditions. In this regard, we were not disappointed, as portfolio flows stayed negative and FDI posted a non-impactful positive as detailed in our review of the FI section. However, oil contrived to post another dolorous performance, exacerbating the wreckage on government revenues. Ordinarily this should then have reinforced the surviving key factor of the domestic risk influences—fiscal tightness—

especially as the oil weakness came with a shift in market share competition away from Saudi Arabia vs. shale to competition even among conventional oil producers. To that end, the role of improved crude oil volumes pushed by Nigeria in supporting the fiscal side is quite important, though likely unsustainable. However, the real boon was the extension of the role of “alternative and unexpected funding sources” in easing the pressure on the government, starting with the NLNG dividend (₦400 billion) and CBN line (₦300 billion). In Q3, the FG then got a windfall of \$5.1bn in ‘other official receipts’ which further boosted reserves and government balances. However, perhaps the most important dynamic when it came to the FG’s financing was the commencement of monetary easing by the apex bank which helped midwife much of the impact seen on yields. It is balancing the addition of the easing to the equation that has continued unexpected fiscal support on one side and the even more dire fiscal straits on the other, that we consider essential to determining FI market outlook in 2016.

Already, despite Q4 15 declines, investors appear to be looking at the fluid oil dynamics and the necessity to implement government’s plans to the fullest extent possible and, as a consequence, projecting increased FG paper supply in 2016. Indeed, our projection of a ₦2.8trillion deficit (vs. budget’s ₦2.2trillion) only captures downward adjustment to non-oil receipts and if crude prices fall short of budget threshold the gap could be wider. Furthermore, there is the possibility that, in a bid to avoid undue currency risk and potentially higher Eurobond costs as dollar revenues shrink, plans for foreign borrowing could be shelved in favour of domestic, given limited cost differential and better control of naira denominated debt. The yield stoking implication of these is supported by FG’s own projection of higher borrowing costs in 2016. On the other hand, the divergence in government’s response relative to history, by not indiscriminately issuing paper, and the potential influence of plugging fiscal leakages i.e. other receipts, suggests supply may still not be as copious as the fiscal constraints dictate. While the limited evidence regarding the sustainability of the alternative funding sources (with NLNG dividend and other receipts possibly taking

a hit in current environment) raises the potential for some yield spikes to occur in H1 16, we expect such to be short-lived. To our thinking, a sustained yield uptick will in all likelihood require, on the fiscal side, an alignment of an urgent funding need, absence of any of the domestic supporting sources, a willingness to change the current mindset and zero external support—a low probability alliance to say the least. Overlaying this with ongoing easing indicates we expect yields, on average, to stay depressed and barely positive in real terms in 2016, but with that trend to be intermittently interrupted by one or more of the yield-stoking influences which we jointly consider too fundamental to not have their say at some point in the year, especially the fiscal deficit. Strategy-wise, this introduces a change to our duration-building strategy of the past year with inflation pressures narrowing the available room for declines. Specifically, we recommend allocating a not insignificant portfolio proportion to trading the bumps on the yield slope as they occur. Longer term, we see the inflationary pressures and potential for yields to turn negative in real terms as perhaps the only significant curtailing factor on the apex bank's easing measures. However, even if that curtailment does happen, we expect the ongoing reallocation of resources away from the money market by domestic institutional investors to help prevent a sustained rise in yields. In that light and considering we do not see state bonds benefiting from such a cap on yields and, accordingly, expect any state issuance that barely makes it to market to feel the full hurt of the fiscal pain, we think descending the credit ladder (including corporate) is how worthwhile opportunities for yield maximization can be found.

DEADBEAT EQUITIES LOOKING FOR TRIGGER TO LIFE?

Like a solitary spike on a flatlining ECG, but with ultimately the same outcome of forlorn, denied, hope, the MoM gain in September 2015 proved a dishonest harbinger of optimism for equities. The equity market posted another poor performance in H2 15, extending the weakness since H2 14. Over the year, the downbeat earnings performance we envisaged broadly materialized and combined with an uncertain policy environment to drive the declines. Whilst the domestic issues were more than enough flogging for a near-dead horse, it could be argued that the dour performance did not even capture the full scope of negative triggers in the period. Two key events appear

to have flown under the rather somewhat, at least in terms of visible impact on Nigerian equities. First, the eventual commencement of US rate hike cycle raises the opportunity cost for portfolio flows which appear to have a more dominant impact in the equity, compared with the FI, market. To that end, while it is likely that the trend of negative flows up to October will continue till the end of the year, the hike itself did not seem to have made much of an impact on share prices. Second, while the bearish expectation for oil prices was always going to be negative for equities, the plunge to the lowest levels in over a decade late in December again seemed a bit of a non-event for Naira assets. Granted, saturation effect might be a factor in both of the foregoing scenarios, with those events not really grabbing markets by surprise. However, the lack of any real response to either one and, given the timing of the events, indeed to the combination of both events, seems to be more like a delayed reaction.

In the interim, the domestic issues that drove much of the weakness remain intact with government spending pattern and finances a key influence in most facets. It is against this backdrop that the anticipation around the stimulus-focused 2016 budget can be understood. Whilst the numbers continue to showcase the dominant role of government spending in national discretionary spend, and in expenditure-measured output, our analysis suggests the expected budget-boost might be somewhat delayed and perhaps not as pervasive. In a similar vein, whilst the new administration appears to have found its policy voice, and not only seems quite keen to get down to business but also to have the right priorities, the corporate impact might ultimately proved double-edged. With the unviability of planned seasoned offerings and shrinking market activity both pointing to increasing apathy, it is clear the equity market faces a challenging year ahead.

One small positive is the signs of increasing interest in equities by pension funds though the official asset allocation numbers are not yet out. The development appears to be as a result of both the constricting yields in the FI space and the need to find alternatives to unattractive reinvestment rates especially for money market instruments. The value proposition of certain equity names themselves, despite the extant risks, just further sweetened the pot. Regardless of motivation, this increased interest from a class of investors that has typically been equity-shy could be significant.

Indeed, the reforms by PENCOM could then have more import going by our analysis that the multi-fund structure could force a minimum equity allocation of at least 10% compared to no floor under status quo.⁽³³⁾ Notwithstanding, we see this more as a stabilizing influence against the volatility that's likely to be induced by the eventual reaction to negative developments on the global front and, in particular, the likelihood for oil to be choppy as it tries to settle this year.

Whilst our sector dimensioning focused on the value driven fundamentals last time out, this time we overlay it with the likely developments on the policy front. Banks are still our value proposition for risk-reward, especially top-tier names, but policy does not seem likely to favour them. From a weak macro environment and reduced paper supply taking away their asset opportunities and monetary easing lowering the yield on what is left, to operational risk challenges and global oil rout forcing delinquencies, investors find sufficient reason to continue to discount the steady cashflows

(33) Currently, mean equity allocations across PFAs in 2015 are 12%, but implementation of multi-fund structure could potentially raise maximum PFA equity holdings to 61% of total AUM.

the financials find a way to generate. Petroleum marketers appear to be in the next phase of the 'now on, now off' attractiveness which essentially reflects the policy uncertainty in the environment. However, with subsidy removal now seriously back on the table, dynamics once again appear favourable aided by potential cashflow boost from interest savings given their relatively high debt burdens. Consumers may benefit from government spending but we consider devaluation, difficulty sourcing forex, reduced inputs, slow recovery in spending power and rich valuations as too potent a cocktail to overlook. Industrials appear to be the ones in the middle ground with moderate valuations and likely to benefit most from government budget implementation and policy thrust. With oil approaching breakeven for most Nigerian fields and a still-negative outlook for fiscal revenues this would probably be the best sector to put money on. However, with the potential for oil to find a bottom aiding pension inflows in creating a floor for equities sometime this year, we see opportunities for bottom-fishing across the depth of the market in 2016.

ABBREVIATIONS

ABS	Asset Backed Securities
AfDB	African Development Bank
AFS	Available for Sale
AGO	Automotive Gas Oil
AMCON	Asset Management Cooperation of Nigeria
ANC	African National Congress
ATC&C	Aggregate Technical, Commercial and Collection
AUM	Assets under Management
BDC	Bureau de Change
BFT	Beverage, Food and Tobacco
BJP	Bharatiya Janata Party
BPE	Bureau of Public Enterprises
CAGR	Compound Annual Growth Rate
CBN	Central Bank of Nigeria
CEMAC	Central African Economic and Monetary Community
CMEC	China Machinery Engineering Cooperation
CPI	Consumer Price Index
CPO	Crude Palm Oil
CPS	Credit to Private Sector
CRB	Commodity Research Bureau
CRR	Cash Reserve Ratio
DANGCEM	Dangote Cement
DG	Director General
DIL	Dangote Industries Limited
DM	Developed Markets
DMO	Debt Management Office
ECA	Excess Crude Account
ECB	European Central Bank
ECOWAS	Economic Community of West African States
EIA	Energy Information Administration
EM	Emerging Markets
EMGBI	Emerging Market Government Bond Index
EPSR	Electric Power Sector Reform
EPSR	Electric Power Sector Reform
ETF	Exchange Traded Fund
EU	European Union
FAAC	Federation Accounts Allocation Committee
FAO	Food and Agriculture Organisation
FCT	Federal Capital Territory
FDI	Foreign Direct Investment
FEWSNET	Famine Early Warning Systems Network
FG	Federal Government
FGF	Future Generation Fund
FGN	Federal Government of Nigeria
FI	Fixed Income
FM	Frontier Markets
FMARD	Federal Ministry of Agriculture and Rural Development
FOMC	Federal Open Market Committee
FPI	Foreign Portfolio Investment
FRC	Financial Reporting Council
FX	Foreign Exchange
GBP	Great British Pound
GDP	Gross Domestic Product
H1	First Half of the Year
H2	Second Half of the Year
HHK	House Hold Kerosene

HTM	Held to Maturity
ICT	Information Communication Technology
IEA	International Energy Agency
IFRS	International Financial Reporting Standards
IGC	International Grain Council
IIF	International Institute of Finance
IMF	International Monetary Fund
IOC	Independent Oil Cooperation
IPO	Initial Public Offer
IPS	Investment Policy Statement
ISO	International Sugar Organization
Kpbd	Thousands of Barrels Per Day
LSAP	Large Scale Asset Purchase program
LTRO	Long Term Refinancing Operating
M1	Narrow Money Supply
M2	Broad Money Supply
Mbpd	Millions of Barrels Per Day
MDA	Ministries, Departments and Agencies
MENA	Middle East and Africa
MMscf	Million Standard Cubic Feet
MoM	Month on Month
MT	Metric Ton
MW	Mega Watt
NBET	Nigerian Bulk Electricity Trading Company
NERC	The Nigeria Electricity Regulatory Commission
NIF	Nigeria Infrastructure Fund
NNPC	Nigerian National Petroleum Corporation
NSEASI	Nigerian Stock Exchange All Share Index
NSIA	Nigeria Sovereign Investment Act
OECD	Organization for Economic Co-operation and
OPEC	Organization of Petroleum Exporting Countries
PBoC	Peoples Bank of China
PENCOM	Pension Commission
PFA	Pension Fund Administrator
PHCN	Power Holding Company of Nigeria
PMI	Purchasing Managers Index
PMS	Premium Motor Spirit
PPT	Petroleum Profit Tax
PRG	Partial Risk Guarantee
SARB	South African Reserve Bank's
SF	Stabilization Fund
SG	State Government
SME	Small and Medium Enterprises
SPGSCI	S&P Goldman Sachs Commodity Index
SPM	Single Point Moorings
SSA	Sub-Saharan Africa
SWF	Sovereign Wealth Fund
TAM	Turn Around Maintenance
TCN	Transmission Company of Nigeria
TLTRO	Targeted Long Term Refinancing Operating
U.S	United States
UK	United Kingdom
US Fed	United States Federal Reserve
USDA	United States Department of Agriculture
WAEMU	West African Economic and Monetary Union
WTI	West Texas Intermediate

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