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Nigeria Strategy Report – H1 2018 Excerpts

Global Economy and Markets

Global Growth: Riding on the swing of improved fundamentals

We forecast a further expansion in global GDP with growth in emerging and frontier economies offsetting the slower growth in advanced economies.

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Entering 2017, investors worried that the downside risk from political elections across the Euro Area and anti-trade rhetoric in the face of a strong US dollar under a Trump presidency could dampen growth in the globe. However, the global economy was upbeat with economic momentum in developed nations (DMs) prompting a rumbling effect across the globe. Accordingly, the IMF estimated that global GDP expanded by 3.6% over 2017 relative to 3.2% in 2016. The driver for growth was a recipe of supportive fiscal policies in some key countries following years of slower growth, low inflation, and strong global trade – estimated to have grown 4.2% YoY over 2017 relative to 2.4% in 2016. For context, DMs are estimated to have grown by 2.2% YoY (compared to 1.7% in FY 16) while growth in emerging economies' (EMs) is estimated at 4.6% from 4.3% in FY 16. On the former, higher growth emanated from growing domestic demand and exports in US, Euro area and Japan which masked the fragile growth in UK. Growth in EMs was largely underpinned by higher commodity prices and strong consumer spending which supported growth in Russia, Brazil, China, and Turkey even as India recovered from the downturn. In the third quarter alone, based on consensus estimate, global GDP growth came it at 3.3%[1] reflecting the troika of recovery in global investment and manufacturing activity,

[1] 10bps higher than the 3.2% in Q2 17

expansion in world trade, and increased global consumption. Against the backdrop of the broad-based growth across the emerging, developing, and developed economies, global financial markets sustained their positive trend by gaining over 2017 (MSCI World Index: +22.4%).

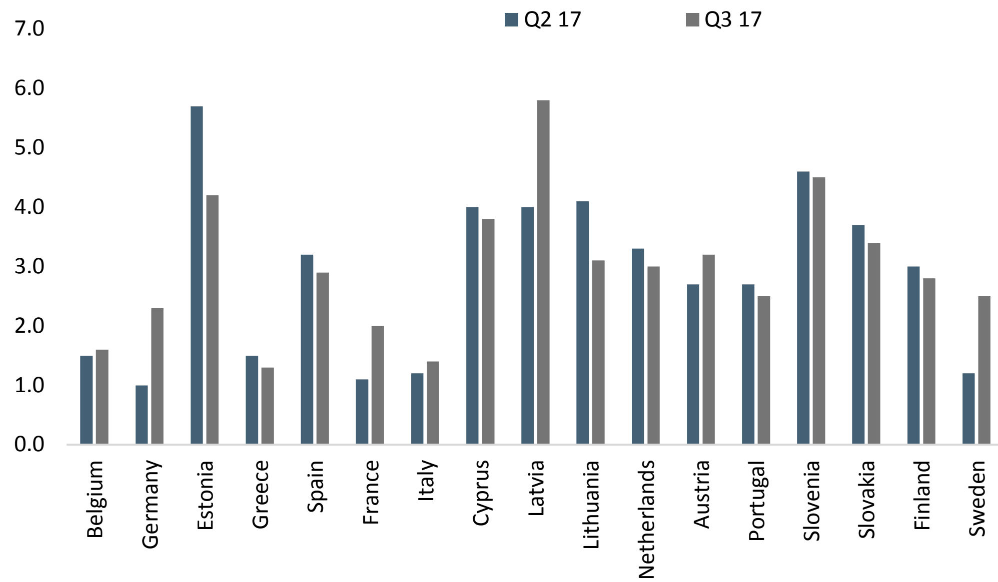
Robust export demand and private consumption propels growth in DMs

Preliminary estimates from the US bureau of labour statistics reveal the US economy grew by 3.3% YoY in the third quarter of 2017, its fastest pace since Q3 2014. Growth in US was mainly reflective of strong numbers on private domestic investment (+1.20% YoY) and private inventory investment (0.8% YoY), an off-shoot of strong demand from manufacturing and energy sectors. Despite slower growth in consumer spending[2], which makes two-thirds of the GDP, growth in net exports (+0.43%) and government spending (+0.07%) neutered its impact.

Across the Atlantic, growth in the Euro area remained robust, with Q3 17 GDP expanding by 2.3% YoY. The improved output in Q3 17 reflected the continued transmission impact of an accommodative monetary policy on household final consumption expenditure (+1.8% YoY), increased gross capital formation (+4.1% YoY) and healthy trade balance (+6.5% YoY) across the region. However compared to Q2 17, GDP was down 10bps to 0.6% in Q3 17 stemming from decelerations in twelve countries, including France (-10bps to 0.5% QoQ), Spain (-10bps to 0.80% QoQ) and Netherlands (-110bps to 0.4% QoQ), which neutered the growth in Germany (+20bps to 0.8% QoQ), Italy (+10bps to 0.4% QoQ), Portugal (+20bps to 0.5% QoQ) and Latvia (+10bps to 1.5% QoQ). The solid output momentum in Germany was fuelled by uptick in exports and investment, while a strong performance in the industrial and services sectors supported growth in Italy. Other economic indicators across the Euro area remained strong with employment rising by 0.4% QoQ in Q3 17 and unemployment falling to a low of 8.8% in October 2017 (compared to 8.9% in September 2017 and 9.8% same period in the prior year).

[2] personal consumption expenditure (Q3 17: +1.60%, Q2 17: +2.2%)

Figure 1: GDP growth across Euro Area countries



Source: Eurostat, ARM Research

Elsewhere, UK economy remained resilient over 2017 despite Brexit concerns, with output advancing 1.8% YoY (0.4% QoQ) in Q3 17[3], propelled by growth in industrial production (+2.7% YoY), agriculture (+1.6% YoY), construction (+2.8% YoY) and services (+1.5% YoY). Despite improvement in economic activities in the second half of the year evidenced by the improvement in Services and Manufacturing PMI[4], the Brexit-related constraints on investment amidst weakness in consumption[5] and slowdown in employment growth remained a concern.

In Asia, Japan economy expanded by 2.1% YoY in Q3 17 (Q3 17 annualized rate: 2.5% vs 1.7% YoY growth in Q2 17) buoyed by faster growth in private investment - 3.6% YoY and a lower net imports (Q3 17: ¥577 billion vs Q2 17: ¥3.2 trillion) neutering the effect of slower growth in private consumption[6] (YoY; Q3 17:0.9% vs Q2 17: 1.8%) and government spending (0.2% YoY). The slower expansion in private consumption just reflects the negative wage growth in the period. On the political front, president Abe Shinzo won the snap parliamentary election[7] which took place in October following the resurgence

[3] Highest QoQ growth in 2017
[4] Rose to 55.6 and 56.3 in October from 53.6 and 56.0 in September respectively
[5] given the lower purchasing power from the high inflation
[6] Private consumption is the largest driver of growth. It contributes 56% to the economy's growth
[7] The country was scheduled to have its parliamentary election in 2018

of the North Korea crises[8]. Following his win, his economic stance of fiscal stimulus[9], monetary easing and structural reforms (Abenomics) remains unchanged.

Strengthening global growth drives policy normalisation

On the monetary policy front, the Fed raised its monetary policy target range for the third time by 25bps to 1.25% – 1.50% at its last meeting in 2017, based on the strengthening labour market conditions[10] amidst strong real sector activity[11]. Also, in line with expectations of a further uptick in inflation rate[12] from increases in energy prices and the lagged pass-through from import prices to consumer prices, the BoE raised its key interest rate[13] (+25bps to 0.5%) while it maintained the pace of sterling non-financial investment-grade corporate and UK government bond purchases. Reflecting the hike in interest rate and the resilient economy which underpinned a stronger sterling (GBP appreciation over H2 17: 3.8%; FY 2017: 10.2%), Britain's trade deficit widened by £3.0 billion to £9.5 billion in Q3 17, as exports decreased by £0.3 billion (-0.2% QoQ), while imports increased by £2.6 billion (+1.6% QoQ). In the Euro area and Japan, the ECB and BoJ retained key policy rates in 2017. However, the ECB extended its bond purchase program until September 2018, with a cutback in its monthly asset purchase program to €30 billion starting January 2018 as growth in the region remained strong amidst expectations of sustained adjustment in the path of inflation

Table 1: Overview of macro indicators across DM

		US	Euro area	UK	Japan
Latest Monetary Policy Action		1.25% - 1.50%	Unchanged	+0.25% to 0.50%	Unchanged
Mean CPI:	**2016**	1.30%	0.20%	1.00%	-0.13%
	2017	2.10%	1.60%	2.55%	0.41%
GDP (Q3 17)		3.30%	2.30%	1.75%	2.50%
GDP (Q3 16)		2.80%	1.60%	1.97%	0.90%
Avg. Unemployment 2017		4.40%	8.80%	4.73%	2.85%

Source: Eurostat, BoE, BoJ, ECB, US bureau of labour statistics and ARM Research

[8] Pyonyang fired a missile over Japan for the first time in over a decade
[9] Half of the planned sales tax hike in October 2019 would be used for child care and education
[10] Unemployment rate (Nov 17: 4.1%), Employment Wages (Q3 17:0.7%, Q2 17: 0.5%)
[11] Manufacturing PMI (Nov 17: 55.0, Oct 17:53.9) and Services PMI (Nov 17: 54.5, Oct 17:55.3)
[12] Rose at the fastest pace in six years in November to 3.1%, above the BoE target of 2%
13 First hike since 2007

Consumption in EMs boosts the growth picture

Real GDP in China remained robust in the third quarter of 2017 (6.8% YoY), though lagging the 6.9% apiece recorded in Q1 and Q2 17. Growth was steady in key sectors of the economy as policy tweaks by the government continued to support growth. Irrespective, fixed investment spending continued to decelerate (-110bps to 7.5% YoY) underpinned by structural adjustment of the economy. Notably, policy makers' move towards tightening the monetary system[14] in the face of surging house prices and a build-up in leverage in non-financial corporates (NFC) impacted investment spending.

Following 11 quarters of contraction, Brazil economy changed course in the 2nd quarter and leaped further in the third quarter underpinned by improvements in domestic demand and gross fixed investment. Household spending increased 2.2% YoY in the third quarter as government's decision to permit workers to make early withdrawals from an employee severance package boosted spending even as the labour market improved. Also, fixed investment declined moderately (0.5% relative to 6.7% in Q2 17) on the back of lower interest rates[15] and improving business confidence. On the external leg, higher commodity prices and sturdy agricultural output drove an improvement in exports (7.6% YoY).

In a similar vein, India's economy turned the corner in Q3 after five consecutive quarters of economic deceleration. Precisely, real GDP expanded by 6.3% in the review period, with private consumption, the largest demand side component, expanding at about the same pace with the overall economy. Further supporting the growth picture, fixed investment spending accelerated by 7.1% YoY while government expenditure also recorded a modest expansion (4.1% YoY relative to 17.2% YoY in Q2 17). More so, trade deficit moderated by 20% as export growth of 4% amid robust domestic demand supported a contraction in imports (-2% QoQ in Q3 17). Moving over to inflation, higher food (4.41% YoY) and energy (7.92% YoY) prices swung inflation higher in H2 (3.15% in H2 vs 3.05% in H1 2017). That said, inflation remained within the Reserve Bank of India (RBI) inflation target of 4% (+/- 200bps band) over the medium term. Despite the improved growth and

14 PBOC increased the rates on reverse repos and medium-term lending facility by 5bps each, in a bid to reduce risky lending in the financial markets and better-quality economic growth.
15 successive reductions in the Brazilian policy rate, by 675bps since October 2016

inflation outlook, the RBI kept interest rate unchanged hinged on a longer-term approach in addressing growth and inflationary concerns.

Elsewhere in Russia, real GDP rose 1.8% YoY in the third quarter underpinned by rising real net export and consumer spending given recent stability in commodity prices and the ruble even as inflation receded. That said, growth was slower relative to the prior quarter (+2.5% YoY) reflecting waning short term factors[16] which boosted the recovery in Q2 as well as slowing industrial (Q3 17: 2.3%, Q2 17: 4.6%) and retail production (Q3 17: 3.5%, Q2 17: 4.7%). Turkey's economy also expanded by 11.1% YoY (Q2 17: +5.4% YoY), its fastest growth in six years. Strong fiscal stimulus drove the growth, coupled with pick up in household consumption (+11.7% YoY), fixed investment (+12.4% YoY) and exports (+17.2% YoY). Similarly, a strong rise in consumption (+4.8% YoY) together with rising exports and a recovery in investment (+3.3% YoY) propelled Poland's economy growth to 4.9%, its fastest pace in more than 5 years. The rise in consumption continued to reflect a declining unemployment levels[17] as well as a hike in minimum wage (+8% YoY) earlier in the year.

In a departure from trend in other climes, Mexico's GDP moderated -40bps YoY to 1.5% in Q3 17 following a series of natural disasters which derailed economic activities. This decline was further exacerbated by the depressed industrial sector, higher inflation (+26bps YoY to 6.63% in October) and lower direct investments due to rising uncertainties ahead of the 2018 elections.

[16] Anomalously cold weather, restocking of inventories and the strengthening of the ruble which boosted imports and consumption.
[17] Unemployment rate declined to a record low of 6.6% in October (September: 6.8%, August: 7.0%)

Table 2: Overview of macro indicators across EM

	China	India	Russia	Brazil	Poland	Turkey	Mexico
Latest Monetary Policy Action	Unchanged	Unchanged	-50bps to 7.75%	-50bps to 7%	Unchanged	Unchanged	+25bps to 7.25%
Mean Inflation: 2016	2.00%	4.97%	7.10%	8.77%	-0.66%	7.78%	2.82%
2017	1.57%	2.19%	3.80%	3.58%	2.07%	11.06%	5.97%
GDP (Q3 17)	6.80%	6.30%	1.80%	1.40%	4.90%	11.10%	1.50%
Avg Unemployment (2017)	3.96%	3.43%	5.23%	12.94%	7.42%	11.12%	3.46%
Currency (2017)	6.31%	5.93%	6.16%	-1.77%	16.79%	-7.80%	5.12%
Equity market (2017)	6.57%	31.87%	-5.51%	26.90%	23.60%	47.60%	8.13%

Source: Eurostat, Bloomberg and ARM Research

Recovering commodity prices to buoy global growth

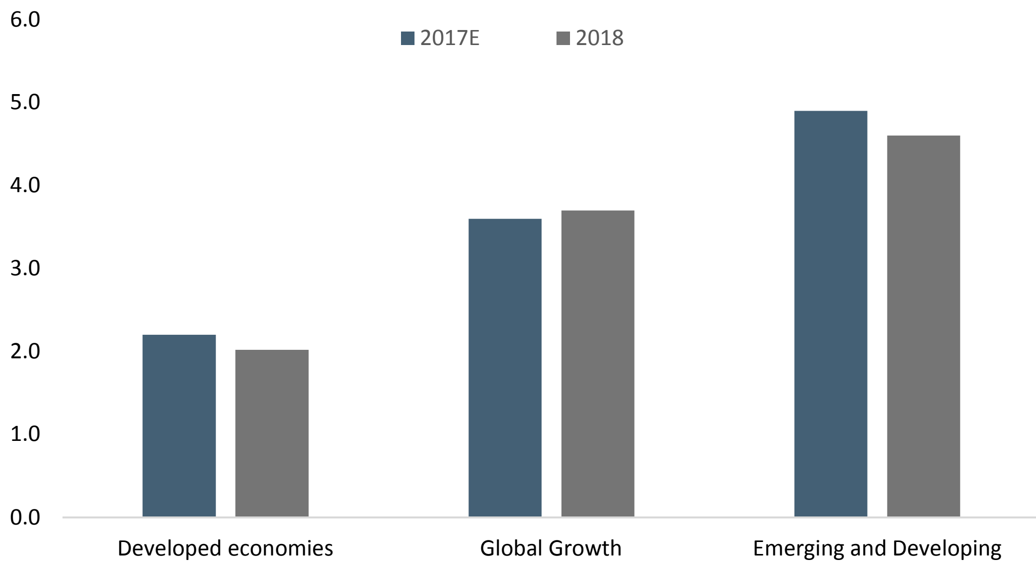
Going into 2018, the IMF estimates a 10bps expansion in global GDP to 3.7% YoY largely reflecting improved output in most regions excluding the middle east. Precisely, growth in emerging markets and developing economies is expected to offset slower expected growth in advanced economies. Growth in EMs is projected 30bps higher than 2017 reading at 4.9% YoY reflecting a rebound in commodity prices and improved confidence in the region. While the pass-through effect of gradual tightening of monetary stance in advanced economies is expected to be negative on emerging markets and developing economies, the projected rebound in global trade (4.0% YoY in 2018) is expected to more than offset the feed through of the monetary policy normalisation. In the advanced economies, growth is expected to slow in 2018 – projected to decline 20 bps YoY to 2.0% – as the high base of 2017 in the Euro area, Japan and UK are expected to the neuter the expansion in US.

In the US, the passage of the republican tax bill, job growth as well as other fiscal expansionary measures will be major drivers for growth next year. The tax bill, which represents a reduction in both corporate as well as individual taxes, is expected to make the US environment more attractive for private investment, support growth in individual wages and invariably translate to higher private consumption. On this backdrop, the IMF forecasts 2.3% growth in 2018 (2017:2.2%). Elsewhere, inflationary pressures should have marginal impact in 2018 as core CPI remains below its target rate giving no room for a more aggressive monetary policy in 2018. On the balance sheet normalization, we do not expect a significant impact on yields as gradual steps in the redemption would only take out a total of $870 million off its balance – translating to 0.25% of the total maturing securities in the coming year ($342 billion)[18].

The EU and the UK found some form of agreement over the challenging divorce bill, with the UK committing to support the EU budget up to 2020[19], allowing them to work out a smooth transition. However, the market focus in 2018 should revolve around political uncertainties in Germany and Italy, complexities of Brexit procedures, weakness in the EU banking sector as well as changing monetary policies. On the political front, a less stable fourth Angela Merkel's administration in Germany, possibly disruptive results in upcoming elections in Italy, political tension in Spain with Catalonia could further trigger uncertainties in the region. Also, the ongoing reform of the EU banking sector could further dampen growth in the region[20] – particularly as bank financing and loans remain a key lifeline for growth in the EU. On the positive, tailwinds from an improving labour market and accommodative financial conditions should continue to support growth, with the IMF growth forecasts of 1.9% in 2018 (2017: 2.1%). For UK, IMF forecasts growth to rise 20bps to 1.7% YoY in 2018 as consumption growth is expected to remain weak – in line with modest wage growth in 2018, despite the effects of rising import prices on inflation expected to diminish – and Brexit uncertainty continues to weigh on business investment despite support from net exports growth. In Japan, we expect a slower pace of economic expansion in the coming year on the backdrop of a moderate growth in private consumption and slower projected growth in foreign demand. On other front, inflation is expected to grow moderately in the coming year as the government embarks on fiscal measures to boost wages[21] and capital investment in the economy whilst maintaining its ongoing monetary stance.

[18] The total treasury, agency and mortgage securities is currently at $4.2 trillion
[19] EU members will therefore keep contributing the same share to the budget up to 2020
[20] Which would require banks to hold more collateral against non-performing loans after January 2018
[21] Japan approved s tax reform package effective in 2018 which allows a 20% tax credit of increased salary payments for firms that raise wages by at least 3%.

Figure 2: 2017 and 2018 Global growth projection



Source: IMF, ARM Research

EM set to sustain upbeat growth picture

Going forward, we expect concerns over rising housing prices and China's bulging debt in the NFC to weigh on fixed investment spending, thereby, keeping growth subdued in 2018. Elsewhere, we expect a sustained pick-up in India's economy underpinned by private consumption and fixed investment spending – IMF estimates a 6.7% growth in 2017 and forecast 7.4% over 2018.

Across the Atlantic starting with Brazil, we think the sequential cut in the policy rate since October 2016 will continue to support gross fixed investment even as higher commodity prices will rejig government consumption. Russia is estimated to grow by 1.8% and 1.6% in 2017 and 2018 respectively given dissipating shocks, higher commodity prices and rebound in real disposable income growth that has allowed the central bank to reduce its main policy rate to 7.75%.

To another place, growth in emerging and developing Europe is forecasted to grow by 4.5%[22] in 2017 (2016: 3.1%) and eventually moderate to 3.5% in 2018. Turkey's growth

[22] Revised upward from 3.0% in April

rate (2017: 5.1%, 2018: 3.5%) is expected to moderate as government fiscal stimulus[23] begins to fade in addition to the political risk attached to the 2019 elections. Overall, EM growth is expected to remain upbeat led by consumption and recovering global trade. Recoveries in both Russia, Brazil, and India will become more rooted, while growth in Mexico and India should remain robust.

Rising inflation raises prospect of pullback in stimulus

With the robust growth recorded over 2017 amidst rising inflation expectations across advanced economies, the prospect for a more less accommodative monetary policy has gained traction. In the United States, the gradual improvement in the labour market[24] and guidance towards an accommodative fiscal stance in 2018, justifies the policy normalization in our view. Unsurprisingly, the Fed retained its forecast for three additional rate increases in 2018 and 2019 unchanged. In the Euro Area, the planned halving of monthly purchases to 30 billion euros starting January until September 2018, suggests a gradual wound down of quantitative easing by the ECB. However, a faster rate of growth in the inflation rate, from rising energy prices in 2018, could change the ECBs position earlier than anticipated.

The BoE, in response to the rising inflationary pressure, raised its key rate for the first time in 10 years, despite growth slowdown over 2017. With economic outlook over 2018 largely uncertain amidst the rising price pressure from imported and energy related products, the prospect of a further rate hike is likely. Elsewhere in Japan, the BoJ continues to reiterate its resolve to maintain its accommodative policy until inflation attains its 2% target from current level of 0.2% as at October 2017. While a rate hike in the short term could induce the strengthening of the yen and undermine the external trade balance, the possibility of the BoJ raising its long-term cap on 10-year bonds – which is currently at around zero – is likely in a bid to support bank lending.

[23] Temporary VAT cut and a credit guarantee fund
[24] With unemployment rate at an historic low of 4.1% in November 2017

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