

Nigeria Strategy Report

H1 2019

Domestic Economy and Policy Environment

2019 GDP: Stable Growth, in dire need of fresh impetus

Executive Summary

For the first nine-month in 2018, the Nigerian economy grew by 1.76%, up from 0.3% reported in a similar period of 2017 – with support stemming largely from the services and agriculture sector. On the Q3 18 numbers, while the oil sector remained in contraction, though moderate, increased output from the services, agriculture and manufacturing sectors pushed economic growth to 1.8%. Over the fourth quarter of 2018, we expect a stronger growth in the economic activities stemming largely from rebound in in the oil sector (4.7% YoY) following higher oil production which we estimate to print at 2.01mbpd (Q4 17: 1.96mbpd). On the non-oil leg, our estimated growth in Agriculture (3%), Services (3.5%) and Manufacturing (1.4%) informs a non-oil sector growth of 2.5%. Consequently, we project a stronger growth in Q4 18 of 2.7% YoY. On balance, full-year 2018 growth estimate stands at 2% relative to 0.8% in full-year 2017.

Over 2019, we are projecting expansion in growth by 10bps to 2.1% YoY as our views on FX stability for most of the year and expected calmness in the polity post-election is expected to support growth in the economy. Basically, with oil production at 2.0mpd, nearing its peak of 2.3mbpd, economic growth will be largely hinged on the non-oil sector, wherein the need for investment friendly policies will be required to provide fresh impetus for sustained growth. Thus, while we expect the absence of herdsmen conflict, normalcy in the oil producing region, and relative stability in the FX market to support growth in the agriculture, oil and manufacturing sector over 2019, we highlight the risk to growth in our scenarios.

In this report, we focus on development in the domestic environment, highlighting our views on the drivers for economic growth over 2018 and our outlook for 2019.

2018: Non-oil masks underlying weakness in Oil Sector

Following the recovery in 2017 (+0.8%), Nigeria's economic gained momentum in 2018 on the back of strong growth in the non-oil sector – precisely agriculture and services – which offset slower growth in the oil sector, with our 2018 growth estimate printing at 2.0% (IMF & World bank: 1.9%). In terms of actual, economic expansion in the first nine-months of the year settled at 1.76% YoY relative to 0.3% YoY growth recorded in the corresponding period of 2017. Unlike in 2017, in which the rebound in oil sector supported growth, improved activities in the Services and Agriculture Sectors – both of which triggered expansion in the non-oil sector by 1.7% YoY (9M 17: 0.1% YoY), were the drivers of growth. On the other hand, growth in the oil sector slowed in the period at 2.6% YoY (9M 17: 3.7%), reflecting lower oil output in the late quarters of the period.

Parsing through the quarterly breakdown reveals varying movements and drivers across the period. First quarter 2018 growth was welcoming at 1.95% due to improved output in the oil sector (14.8% YoY) and resilient growth in Agriculture (3% YoY) even as Manufacturing (3.4%), and Services (0.5%) also supported improved picture in the non-oil domain to drive a 0.8% growth YoY. In the second quarter, the agriculture sector was impacted by herdsmen conflict in food producing areas (1.2% YoY) while a decline in oil production which led to a contraction in the oil sector (-4.0% YoY) drove a slower growth in the quarter of 1.5% YoY. Following the efforts put in place to curb the impact of conflict on crop production as well as the re-opening of the transforcados pipeline, economic activities picked up in the third quarter of 2018 – with growth expanding by 1.8% YoY.

Over the fourth quarter of 2018, we expect a stronger growth in economic activities. In the oil sector, production is expected to print at 2.01mbpd (Q4 17: 1.96mbpd) which translates to a 4.7% YoY growth in oil GDP. On the non-oil leg, our estimated growth in Agriculture (3% YoY), Services (3.5% YoY) and Manufacturing (1.4% YoY) informs a non-oil sector growth of 2.5% YoY. Consequently, we project a stronger growth in Q4 18 of 2.7% YoY. On balance, full-year 2018 growth estimate stands at 2% relative to 0.8% in full-year 2017.

Table 1: YoY Growth in Oil, Non-Oil, Real GDP

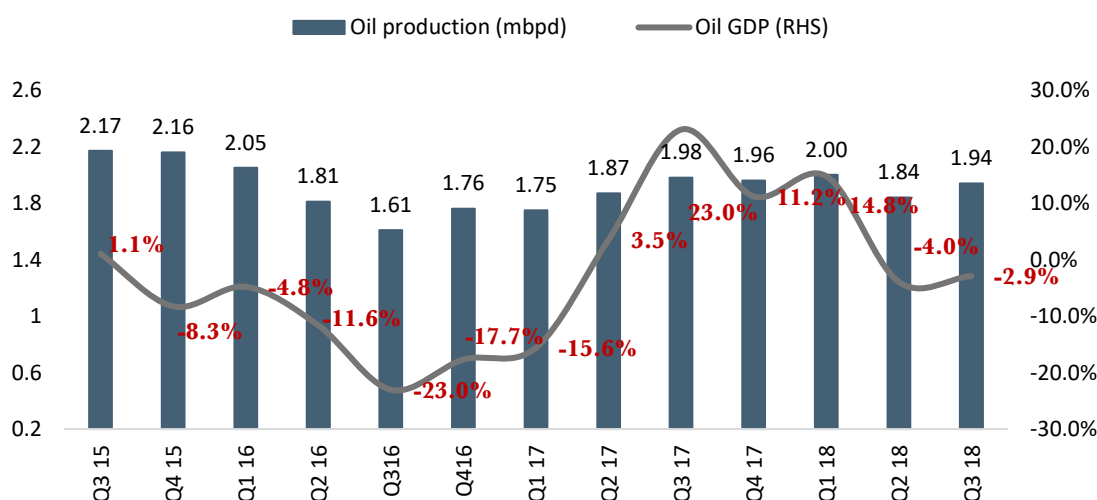
	Q1 17	Q2 17	Q3 17	Q4 17	Q1 18	Q2 18	Q3 18	Q4 18E	FY 16	FY 17	FY 18E
Agriculture	3.4%	3.0%	3.1%	4.2%	3.0%	1.2%	1.9%	3.0%	4.1%	3.4%	2.3%
Crop production	3.5%	3.2%	3.2%	4.6%	3.5%	1.5%	1.9%	3.1%	4.2%	3.6%	2.5%
Livestock	1.7%	2.3%	2.5%	0.2%	-1.9%	-2.0%	2.6%	2.2%	3.0%	1.7%	0.2%
Manufacturing	1.4%	0.6%	-2.9%	0.1%	3.4%	0.7%	1.9%	1.4%	-6.8%	-0.2%	1.9%
Food, Beverage & Tobacco	4.1%	2.7%	0.6%	2.2%	5.5%	1.2%	2.9%	1.0%	-6.3%	2.4%	2.6%
Textile, Apparel & Footwear	1.2%	0.2%	0.2%	1.6%	1.9%	2.7%	1.0%	0.5%	-1.1%	0.8%	1.5%
Cement	1.8%	-4.2%	-4.6%	-1.9%	5.3%	3.8%	8.1%	5.0%	-5.4%	-2.2%	5.6%
Services	1.0%	-0.5%	-3.1%	-0.8%	0.5%	4.1%	3.4%	3.5%	-1.1%	-0.8%	2.9%
ICT	2.7%	-1.2%	-4.5%	-1.5%	1.6%	11.8%	12.1%	8.4%	2.0%	-1.1%	8.5%
Real Estate	-3.1%	-3.5%	-4.1%	-5.9%	-9.4%	-3.9%	-2.7%	1.0%	-6.7%	-4.2%	-3.7%
Financial Services	0.7%	10.5%	-6.0%	0.2%	13.3%	1.3%	-4.8%	2.0%	-4.2%	1.3%	2.9%
Construction	0.1%	0.1%	-0.5%	4.1%	-1.5%	7.7%	0.5%	3.0%	-5.9%	1.0%	2.4%
Trade	-3.1%	-1.6%	-1.7%	2.1%	-2.6%	-2.1%	1.0%	1.0%	-0.2%	-1.1%	-0.7%
Oil GDP	-15.6%	3.5%	23.0%	11.2%	14.8%	-4.0%	-2.9%	4.7%	-14.3%	5.5%	3.2%
Non-Oil GDP	0.7%	0.4%	-0.8%	1.5%	0.8%	2.0%	2.3%	2.5%	-0.2%	0.5%	1.9%
Real GDP	-0.9%	0.7%	1.1%	2.1%	2.0%	1.5%	1.8%	2.7%	-1.5%	0.8%	2.0%

Source: NBS, ARM Research

Recession hits the oil sector

After a strong first quarter in the oil sector (+14.3% YoY), due to low base in Q1 17 of 1.75mbpd – a reflection of militant attacks and subsequent recovery in crude oil production to 2.0mbpd, the oil sector contracted in the second quarter by 3.95% YoY. The contraction was due to temporary closure of the transforcados terminal for repairs, due to a leakage discovered in May that occasioned a 1.6% YoY decline in crude oil production to 1.84mbpd. In the third quarter, crude oil production picked-up mildly to 1.94mbpd, which is lower than 1.98bpd recorded in Q3 17, thus propelling the sector into recession with the second consecutive quarter of contraction of 2.1%.

Figure 1: Trend in Crude Production (mbpd) and Oil GDP growth (%)



Source: NNPC, NBS, ARM Research

Non-oil sector comes to the rescue with a slight improvement

In the Non-oil space, the services sector was the front runner for growth, supported by robust output in the information & technology subsector (ICT). Coming from the high single digit growth reported between 2013 and 2015, activities in the ICT sector slowed in 2016 to 2% YoY as the sector approached its mature phase. Further amplifying the downtrend was the restructuring exercise carried out by the key sector player in 2017¹, which drove the sector into recession. However, in 2018, the sector recovered, hinged on increased promotional offers by key sector players as well as improvement in quality and capacity of data networks – with both voice subscribers growing by 8.1% YoY to 157 million subscribers, while data subscribers increased by 8.3% YoY to 99.5 million over 9M 18. Consequently, the sector grew by 15% in Q3 18, up from 11.5% in Q2 18 and 1.6% in Q1 18. Elsewhere, financial services sub-sector also supported the growth over the nine-month period, up 3.3% YoY, with support stemming from increased activities in the non-core banking operations. Overall given the contribution of these two subsectors², services sector expanded by 2.7% YoY over 9M 2018 (9M17: -0.9% YoY). Looking at the quarterly breakdown, the services sector grew by 3.4% YoY in Q3 18, 4.1% YoY in Q2 and 0.5% YoY in Q1 18.

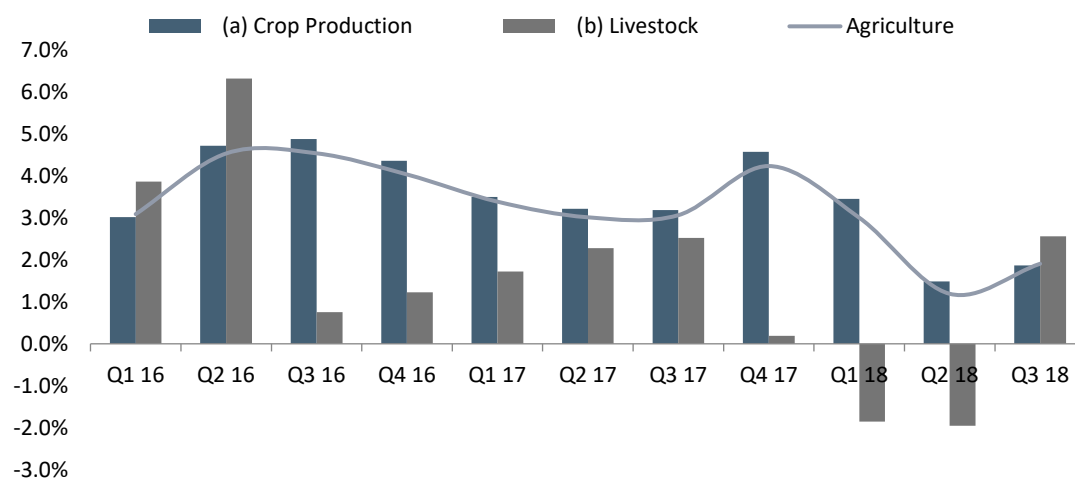
Agriculture Output pulled by herdsmen conflict

Activities in the agriculture sector slowed over the first nine-month in 2018. The slow-down mirrors the impact of the herdsmen conflict which intensified in 2nd quarter. According to FEWSNET, the conflict between farmers and herdsmen led to the destruction of many farmlands and invariably the farm yields which was evident in reported numbers for growth in crop production – 1.5% in Q2 18 (Q1 18: 3.5%). However, coming into the third quarter wherein relative calmness occurred in these areas, both crop production and livestock subsectors picked up by 1.9% YoY and 2.6% YoY respectively. Consequently, activities in the third quarter expanded by 1.9% YoY.

¹ In 2017, MTN disconnected its inactive lines, causing them to lose over one million subscribers.

² The ICT and financial service subsectors accounts for over 40% of total output in the services sector

Figure 2: Trend in Agric GDP and Sub Components



Source: NBS, ARM Research

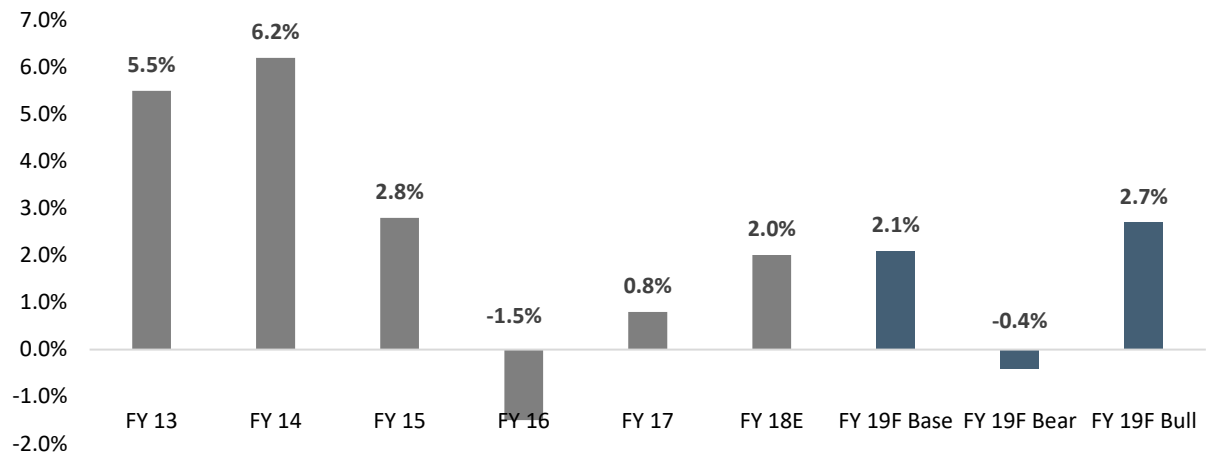
Manufacturing sector recovers, thanks to FX availability

Manufacturing sector was strong over 9M 18, printing at 2% relative to a contraction of 0.3% in the corresponding period of 2017. Drilling down, the food, cement and textile production supported the sector output. We perceive the FX availability as well as lower cement pricing as the harbinger of the improved production in these subsectors. Buttressing our view, food and cement companies across our coverage universe reported mid to high single digit growth in volumes over the review period. Looking at the quarterly breakdown, the manufacturing sector expanded by 1.9% YoY in Q3 18, up from 0.7% YoY in Q2 18.

2019 Outlook: Moderate Growth, Great Risks

Over 2019, we are projecting expansion in growth by 10bps to 2.1% YoY as our views on FX stability for most of the year and expected calmness in the polity post-election is expected to support growth in the economy. Basically, with oil production at 2.0mpd, nearing its peak of 2.3mbpd, economic growth will be largely hinged on the non-oil sector, wherein the need for investment friendly policies will be required to provide fresh impetus for sustained growth. Thus, while we expect the absence of herdsmen conflict, normalcy in the oil producing region, and relative stability in the FX market to support growth in the agriculture, oil and manufacturing sector over 2019, we highlight the risk to growth in our scenarios.

Figure 3: Annual Real GDP Growth

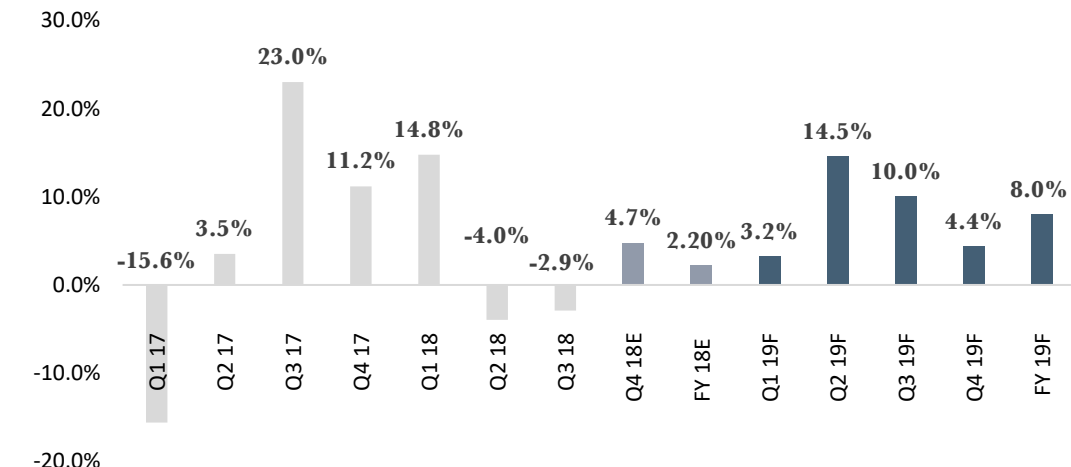


Source: NBS, ARM Research

Oil sector growth gradually peaks

Starting with the oil sector, while we see limited room for disruptions to crude oil production from the militants, we see limited scope for growth in the sector as production is nearing its peak even as the production cap recently placed by OPEC further caps growth. For clarity, OPEC and Non-OPEC members agreed to cut 1.2mbpd from global crude supply, with Nigeria expected to reduce its production by 40-50kbpd, using October production as the reference level. That said, as oil production begins at Egina oil field, production for FY 2019 is expected to print at 2.08mbpd (FY 18E: 1.95mbpd), suggesting sector output growth of 8.0% YoY. For clarity, the Egina oil field is a new offshore development by Total Upstream, in partnership with CNOOC, Sapetro and Petrobras. Towards the end of 2018, Total announced first production from the field with an estimated production capacity of 200,000bpd.

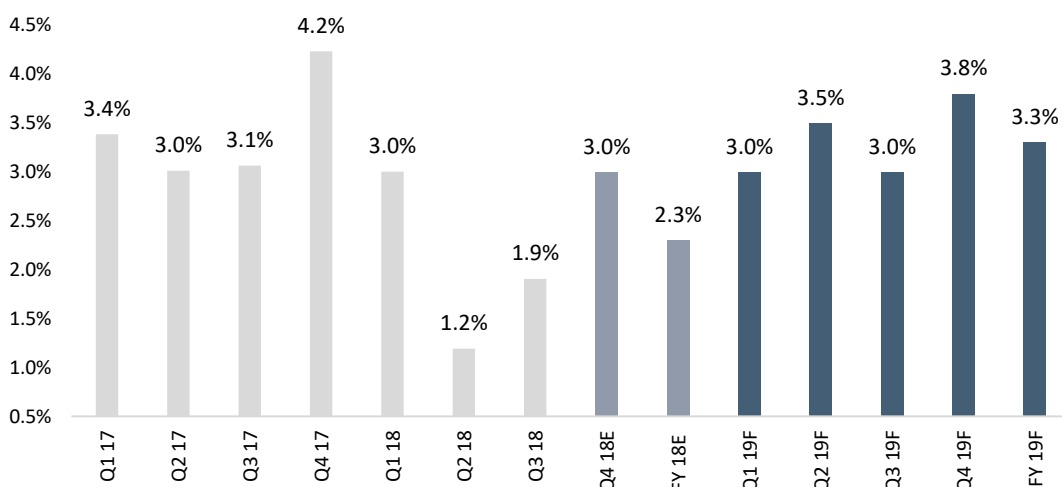
Figure 4: Oil Sector Growth (Historical and Forecast)



Source: NBS, ARM Research

Non-Oil sector on a cruising altitude

In the non-oil sector, we expect activities to expand by 1.6% YoY over 2019. Starting off with the Agric sub-sector, while favorable rainfall and support initiatives implored by the government would likely support output, the downside risk remains ongoing conflict between herdsmen and farmers. However, given the critical nature of the sector to the country's growth, we are positive on increased deployment of military personnel to the north with the aim of curbing the ongoing resource-based conflict. According to FEWSNET, pasture availability is expected to be slightly above average due to the abundant rainfall in most areas that support the livestock grazing, which guides towards improved livestock conditions and a moderation in the conflict. Furthermore, off season activities which began in December 2018 is expected to yield average to above harvest, with more population engaging in dry season cultivation of rice, maize and vegetables to recover the crop losses experienced during the widespread flooding observed across the country in summer/fall 2018. The foregoing combined with the low base observed in the prior year guides to a sector growth of 3.3% YoY over 2019.

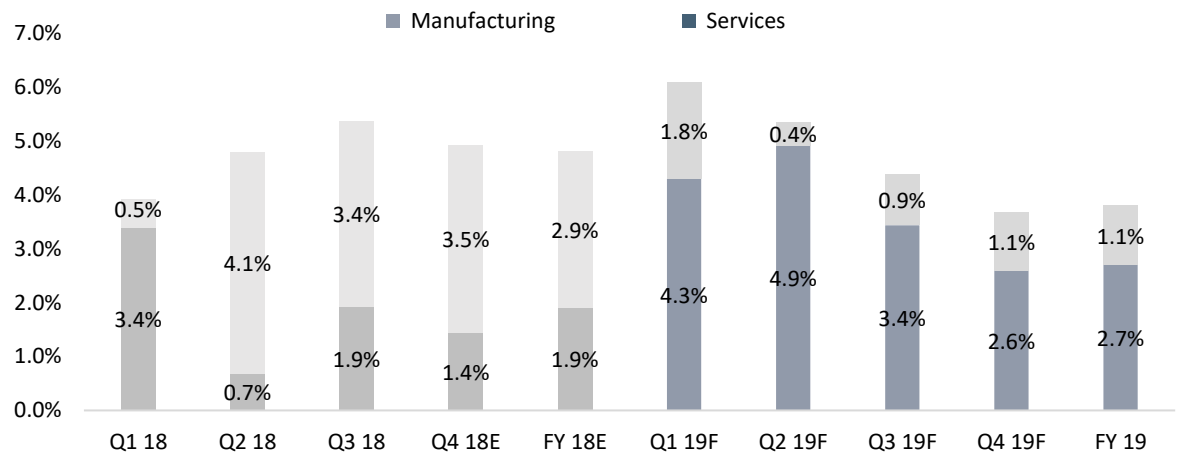
Figure 5: Quarterly growth in Agric GDP (Historical and Forecast)

Source: NBS, ARM Research

On services, we expect a sector growth of 1.1% (lower than 2018E: 2.9% YoY) – with ICT driving the moderation. In the ICT territory, we see less room for significant growth as the voice output seems to be nearing its peak at 162 million subscribers and a substantial growth in data output would require significant long-term capital investment. Consequently, we expect a sub-sector growth of 2.4% YoY (FY 18E: 8.4% YoY). Elsewhere, with our expectation of relative stability in the currency for most part of the year, as well as approval

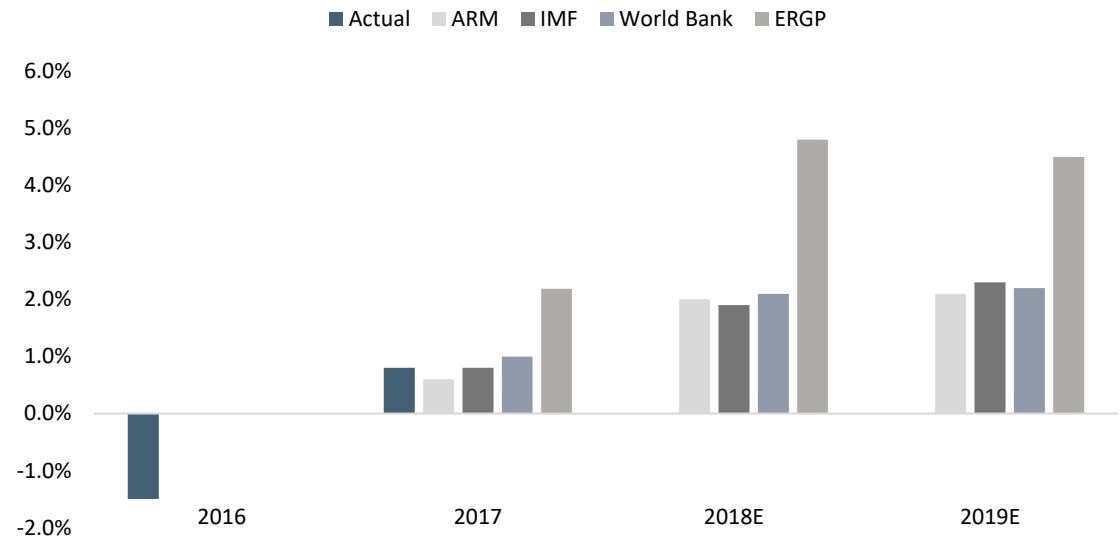
of the new wage bill (given the ongoing discussion between the government and the labour union), we expect an increase in the manufacturing sector output over 2019. Consequently, we expect a sector growth of 2.7% YoY, underpinned by improved output in FBT³ and TAF⁴ subsectors. Overall, coalescing our expectation for each sector translates to an economic growth of 2.1% for FY 18.

Figure 6: Quarterly growth in Services GDP (Actual and Forecast)



Source: NBS, ARM Research

Figure 7: YoY GDP Actual and Forecast



Source: NBS, IMF, World Bank, Budget Office, ARM Research

³ Food, Beverages and Tobacco

⁴ Textiles, Apparel and Footwear

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