

January 10, 2019



Nigeria Strategy Report

H1 2019

Global Economy and Markets

MEA Region: A year of fragile growth

Executive Summary

In our H2 18 strategy outlook, we charted our prospect of stronger economic growth in the SSA bloc on the back of improved agricultural output and industrial activities from smaller regions even as growth in heavy weights, Nigeria and South Africa pick up, while our prognosis for MENA region was an improvement in economic growth across both oil exporters and importers on the back of higher oil output and economic reforms. Our views largely played out as growth in SSA gained momentum in Q3 18 after growth in Nigeria and South Africa faltered in the previous quarter. Meanwhile, higher oil price and production boosted growth in Saudi Arabia and other smaller oil-exporters while economic reforms in Egypt spurred growth on that front. Consequently, SSA GDP is projected to have ended 2018 at 2.7% (2.6% in 2017) while growth in MENA oil-exporting and oil-importing countries is estimated to have printed at 1.4% (2017: 1.2%) and 4.2% (2017: 4.1%) respectively over 2018.

Going into 2019, economic growth in SSA should gather some momentum in the year with GDP expected to expand by 3.4%. Particularly, improved investments and diminished policy uncertainty in the large economies together with sustained strong growth in smaller countries should support growth in the region. Similarly, despite the headwinds from a less favorable global economic environment, domestic factors in particular, policy reforms and government investment should continue to boost growth in the MENA region (+20 bps YoY to 1.9%). Amongst the major risks facing SSA and MENA economies in 2019, political crisis as well as risks over the upcoming elections in various countries is one that could be biting. Thus, the outcome of elections across both regions could make or mar investor's confidence in the countries as witnessed in previous periods.

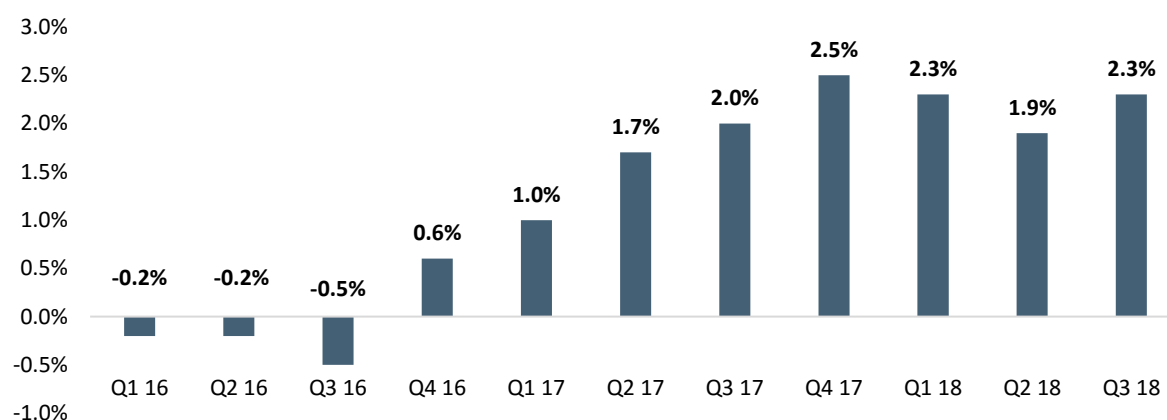
In this report, we look at the major themes that dominated Sub-Saharan Africa and the Middle East & North Africa landscape in 2018 as well as our outlook for 2019

Heavy-Weights prop up growth in SSA

Sub-Saharan Africa (SSA) economy kicked-off on a modest pace in 2018, despite weak growth from power constituents – Nigeria and South Africa. Strong activities in smaller regions largely supported growth in the bloc and this was hinged on favorable weather condition and stable external environment. In the second half of the year, we charted our prospect of stronger economic growth in the SSA bloc on the back of improved agricultural output and industrial activities from smaller regions even as growth in heavy weights, Nigeria and South Africa, pick up. True to our expectation, growth in SSA gained momentum in Q3 18 after faltering in the previous quarter. Consequently, the World bank estimates economic growth in the bloc to have expanded by 2.7% over 2018 (2017: 2.6%).

Cutting to the chase, SSA economy recorded a growth of 2.3% YoY over Q3 18 (Q2 18: +1.9%) largely buoyed by an improvement in the region's heavyweights. For clarity, despite sustained recession in Angola, improved output in Nigeria and South Africa helped lift the region growth for the quarter. In Angola, the abysmal economy performance reflects lower oil production while growth in Nigeria and South Africa came in on the back of improved output in the agricultural and service sectors. In summary, while higher commodity prices supported growth in the mining and oil & gas sectors, favorable weather conditions and recovery in activities braced growth in the agriculture and service sector respectively.

Figure 1: Trend in SSA GDP Growth (%)



Source: World Bank, ARM Research

Parsing through the breakdown, economic growth in Nigeria ticked higher to 1.8% over Q3 18 (Q2 18: 1.5%) following an expansion in the non-oil sector (Q3 18: +2.3%, Q2 18: +2.0%) which helped masked a continued contraction in the oil sector. Precisely, growth in the non-oil sector was largely driven by the recovery in the agriculture sector, after the peak of communal conflict in food producing areas, even as the service sector was supported by the rise in voice and data output that

drove ICT¹ sub-sector. Nigeria's oil sector witnessed a contraction in Q3 18, despite higher oil production in the period, as the high base in prior year following the re-opening of its key pipeline, TransForcados, impacted growth. Elsewhere, after reporting a slow growth for four consecutive quarters, South Africa's economy (Q3 18: +1.1% YoY, Q2 18: +0.4% YoY) picked up slightly in Q3, supported by a rebound in agriculture, communication and manufacturing sectors. However, growth over the period was subdued as challenges in the mining sector and weak construction activity was worsened by policy uncertainty and low business confidence.

Away from South Africa, favorable weather conditions, higher commodity prices and strong industrial activity helped improve growth in Ghana (Q3 18: +7.4% YoY, Q2 18: +5.4% YoY), Kenya (Q3 18: +6.0%, Q2 18: +6.2%), and Cote d'Ivoire (Q2 18: +7.6%, Q1 18: +5.2% YoY). Meanwhile, despite ongoing economic reforms², Angola's economy continued to remain in the doldrums (Q2 18: -7.4% YoY, Q1 18: -4.7% YoY) with lower oil production and contraction in manufacturing output being the major culprit. Lower oil production in Angola reflected reduced investment appetite from international oil explorers given the relatively high cost of production in Angola's offshore fields.

Table 1: Overview of macro indicators among selected African countries

	Nigeria	South Africa	Kenya	Ghana	Angola
Latest Monetary Policy Action	Unchanged	25 bps to 6.75%	Unchanged	Unchanged	Unchanged
GDP Growth (YoY)	1.80%	1.10%	6.00%	9.86%	-7.40%
Avg. Inflation (2018)	12.13%	4.67%	4.68%	9.96%	19.95%
Avg. Inflation (2017)	16.56%	5.28%	8.02%	12.39%	29.84%
Equity Market Performance	-19.50%	-9.24%	-20.34%	-11.28%	NA
Current Account (% of GDP)	2.04%	-3.20%	-5.63%	-4.06%	-2.15%

Source: Bloomberg, World Bank, ARM Research

Higher oil price provides boost to MENA growth

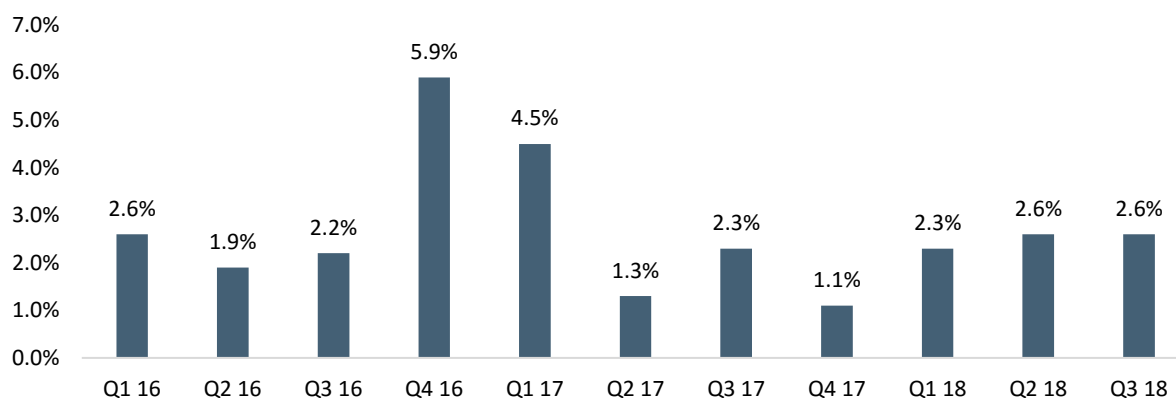
In 2018, our prognosis for MENA region was an improvement in economic growth across the oil exporters and importers. For oil exporters, we anticipated the duo of higher oil price and production to provide support while growth across oil-importers was hinged on the back of economic reforms. In line with our expectation, economic growth expanded modestly, though lower than the previous quarter due to weak performance in some countries. As a result, the World Bank now estimates economic activity in MENA oil-exporting countries to have strengthened to 1.4% over 2018 (2017: +1.2%) on the back of higher oil price and production

¹ Information and Communications Technology

² The Angolan government launched the Macroeconomic Stabilization Programme (MSP) in January 2018, targeting the revitalization of the country's underperforming economy and put an end to the corruption scandals that have blighted it in recent years.

which also strengthened public spending across the governments. On the other hand, growth across MENA oil-importing countries is projected to reach 4.2% over 2018 (2017: +4.1%) as strong growth in Egypt masks weaker and more fragile growth in other countries.

Figure 2: Trend in MENA GDP Growth (%)



Source: World Bank, ARM Research

Over Q3 18, economic growth in MENA steadied at a pace of 2.6% YoY (Q2 18: 2.6% YoY) as poor performance in Iran and Algeria dragged expansion in other countries in the region. Analyzing the sector performance, a combination of higher oil production and prices spurred economic activity across most oil-exporting countries. However, growth on this front was dragged by lower production in Iran and Algeria. On the other hand, economy growth in oil-importing countries received support largely from positive policies across the governments.

Looking through the breakdown, the Iranian economy remained in a gloomy state as economic sanctions continued to disrupt economic activity which hampered business and consumer sentiments. In fact, GDP growth slowed to a 10-quarter low of 1.8% in Q2 (Q1 18: 2.7%) following US sanctions on the country. Similarly, growth in Algeria was frail over Q2 18 (0.7%) largely due to significant contraction in oil production and slowing industrial production (Q1 18: 1.2%). On the positives, economic growth advanced in Saudi Arabia on the back of higher oil prices and crude production (Q3 18: +2.5% YoY, Q2 18: +1.6%). Consequently, the oil sector expanded 3.7% YoY in Q3 (Q2 18: +1.3%). On the flipside, growth in the non-oil sector was sluggish (Q3 18: +2.1%, Q2 18: +2.4%) as the economy continued to recover from the implementation of a Value Added Tax (VAT) and subsidy cuts earlier in January 2018.

Despite consumption expanding at a slow pace (Q2 18: +0.3%, Q1 18: +1.4%), Egypt's economy recorded a mild expansion of 5.4% in Q2 18 (Q1 18: +5.3%) due to support from public investments (Q2 18: +21.9%, Q1 18: +13.5%). The growth in investments continued to reflect economic reforms introduced in 2016. Similarly, economic growth in Morocco picked up in Q3 18 expanding

3.0% YoY (Q2 18: +2.4%) after three consecutive quarters of moderation. Primarily, the higher growth reflected improvements in agricultural output and non-agricultural sectors. Agricultural output, which accounts for 15% of the country's economy expanded 3.1% (Q2 18: +2.5%) on the back of exceptional cereal harvests. Also, expansions in industrial activity and mining drove the expansion in non-agricultural output (+2.8% YoY). On balance, the growth in the MENA region reflects the positive impact of reforms and stabilization policies undertaken in many countries in tandem with a pickup in oil prices and rising external demand over the period.

Table 2: Overview of macroeconomic indicator in some selected MENA countries

	Egypt	Saudi Arabia	Iran	Tunisia	Morocco
Latest Monetary Policy Action	Unchanged	25 bps to 3.0%	Unchanged	Unchanged	Unchanged
GDP Growth (YoY)	5.40%	2.50%	1.80%	2.60%	3.00%
Avg. Inflation (2018)	14.62%	2.48%	19.01%	7.45%	2.01%
Avg. Inflation (2017)	23.54%	-0.85%	9.64%	5.32%	0.75%
Equity Market Performance	-20.5%	-4.8%	+60%	-3.9%	-5.6%
Current Account (% of GDP)	-2.56%	8.40%	1.35%	-9.63%	-4.27%

Source: Bloomberg, World Bank, ARM Research

Weak external position pressure SSA & MENA Currencies

Over H2 18, external pressures largely weighed on currencies across SSA and MENA. While we had expected some resilience across some currencies due to higher proceeds from commodity exports, the magnitude of FPI outflow was however more pressing resulting to FX reserves hitting year-lows. The sell-off across the region reflected rising yields in the US – causing the US dollar to strengthen – as well as crisis in some EM markets (Turkey and Argentina). Furthermore, Eurobond issuance reduced in the second half of the year due to rising external borrowing cost. On current accounts, higher oil price over the period exerted pressure on import bill of oil-importing countries thus, thinning their trade balance while oil-exporters flourished over the period. On balance, most SSA and MENA currencies weakened against the dollar over H2 18. Nonetheless, some of the oil-exporting countries were able to cushion the impact of the sell-off due to support from higher oil revenue. For instance, in the SSA region, the Central Bank of Nigeria remained resolute on defending the currency as the naira only weakened by 0.89%.

Meanwhile, despite higher oil receipts, the Angola Kwanza depreciated (H2 18: -23.85%) as the country continued to pursue its controlled adjustment of the exchange rate with the aim of gradually eliminating the gap between the official exchange rate and the black-market rate.

To mitigate risk of substantial depreciation, the Bank capped the maximum depreciation of the exchange rate against the euro at 2.0% per auction. Elsewhere, stronger dollar and the impact of higher oil price on import bill exerted pressure on Ghana cedis (-1.89%), Kenya shilling (-1.61%) and the South African rand (-2.62%) over the period.

Over in MENA, Saudi Arabia and Egypt took to depleting their FX reserves to defend their respective currencies. While higher oil price provided legroom for the Saudi Arabian Monetary Authority (SAMA)³ to support the Saudi Riyal, the Central bank of Egypt made use of the state-owned banks to supply FX to the market rather than directly intervening to avoid criticism from IMF. In other fronts, the Iranian Rial continued to worsen on the back of further tightening of US sanctions. In fact, the Iranian government in October 2018 had to authorize the central bank to intervene in the FX market in a bid to defend the exchange rate. Elsewhere, higher oil price weighed on import bill of Tunisia and Morocco causing a depreciation of 12.76% and 1.06% in the Tunisian dinar and Morocco dirham respectively. On balance, a combination of tighter global financing conditions, lower current account balance, stronger US dollar amid falling investor sentiment towards emerging market were the major drivers of currency depreciation in both regions.

Table 3: Currency performance against US dollar across SSA and MENA countries

	2018	2017	change	H2 18	H1 18	change
SSA						
Angola kwanza	308.72	166.95	-45.9%	308.72	238.5	-22.7%
Ghana cedis	4.92	4.52	-8.1%	4.92	4.73	-3.9%
Kenyan shilling	101.99	102.85	0.8%	101.99	100.9	-1.1%
Nigerian naira	362.59	359.99	-0.7%	362.59	361.24	-0.4%
South African rand	14.35	11.94	-16.8%	14.35	13.22	-7.9%
MENA						
Saudi Arabia Riyal	3.75	3.75	0.0%	3.75	3.75	0.0%
Egyptian pound	17.91	17.56	-2.0%	17.91	17.88	-0.2%
Morocco dirham	9.56	9.17	-4.1%	9.56	9.45	-1.2%
Tunisian dinar	3.00	2.43	-19.0%	3.00	2.63	-12.3%

Source: Bloomberg, ARM Research

Wave of Monetary Easing takes a break

Entering 2018, slowing price growth and tepid economic expansion across both SSA and MENA gave way for most central banks to loosen policy over the first half of the year. However, over H2 18 central banks took a hawkish stance on the back of sticky inflation and reversal of capital flows. In SSA, the Central Bank of Nigeria held on to its hawkish stance leaving its benchmark rate unchanged at 14%. Particularly, the CBN cited the possibility of inflationary pressure⁴ in the coming months as well the impact of capital reversal and lower oil price on inflation and FX stability.

³ Saudi Arabian Monetary Authority (SAMA) IS the central bank of the Kingdom of Saudi Arabia

⁴ Due to fiscal and political spending ahead of the elections

Similarly, Angola and Kenya left interest rate unchanged at 16.5% and 9% after cutting earlier in 2018. In South Africa, following a more significant pressure, the Reserve Bank of South Africa raised its benchmark repo rate by 25 bps to 6.75% in a surprise move, the first hike since March 2016. The decision was largely reflective of the bank's effort to defend the weakening Rand as well as higher inflation in the country.

Over in MENA, both central banks in Egypt and Morocco held the trigger on policy parameters with the Central Bank of Egypt and National Bank of Morocco leaving rates at 16.75%⁵ and 2.25% respectively. Saudi Arabia on the other hand increased the official repo rate by 25 bps to 3.0% in December following the Fed decision to increase its target range for the federal funds interest rate by a quarter point, to between 2.25% and 2.5%. It is worthy to note that Saudi Arabia shadows the US Fed policy because its currency is pegged to the US dollar.

2019 Growth outlook; Fragile Improvement Ahead

Going into 2019, economic growth is expected to be modest across both SSA and MENA regions. Several externalities facing both regions including, slower growth among its main trading partners, the stronger US dollar, heightened trade policy uncertainty, and tightening global financing conditions will be a challenge for growth. Hence, economic expansion is expected to be modest, but supported by favorable weather condition, rise in domestic demand and improved economic activity. Notably, the World Bank projects economic growth for SSA and MENA to be 3.4% and 1.9% relative to estimated growths of 2.7% and 1.7% over 2018.

A Banner Year for SSA

Economic growth in SSA should gather some momentum in 2019 rising to 3.4% (2018: +2.7%). Particularly, improved investments and diminished policy uncertainty in the large economies together with sustained strong growth in smaller countries should support growth in the region. Nigeria's GDP is expected to expand slightly by 2.1% (2018: 2.0%) over 2019 due to support from agriculture and services sector. On the oil sector, with the coming onboard of the Egina oil field suggesting improved crude oil production over 2019, we believe the impact on overall growth will be muted by the constraints placed on the country's production by OPEC⁶.

Growth in South Africa is expected to recover slowly from 1.0% in 2018 to 1.3% in 2019 as domestic demand is constrained by high unemployment⁷ as well as slow growth in credit

⁵ After cutting its benchmark rate in March 2018

⁶ Organization of Petroleum Exporting Countries

⁷ Unemployment rate is currently at a record high of 27.5% and has continued to dampen consumption in the country.

to the private sector. In Angola, an expected increase in oil production is expected to boost growth to 2.9% in 2019 (2018: -1.8%), along with a pickup in activity in the non-oil sector as reforms⁸ help improve the business environment. Our expectation for an improvement in the oil sector is hinged on the entrance of new oil fields. Particularly, the Angola government has taken several measures to boost oil production which includes establishing a new agency to handle oil concessions, give out tax breaks for the development of marginal fields and new legislation for gas rights.

Excluding Nigeria, South Africa, and Angola, growth in the rest of Sub-Saharan Africa (2018: +4.7%, 2019: +5.4%)⁹ is expected to continue to rise at a solid pace, although with significant variation between country groups. Particularly, economic growth in CEMAC¹⁰ should benefit from higher oil production and an increase in domestic demand. Elsewhere, economic activities are expected to remain resilient in Cote d'Ivoire, Kenya and Tanzania boosted by public investment and strong agricultural output.

MENA outlook: Moderate Growth thru pockets of risk

Economic growth in the MENA region is projected to expand modestly to 1.9% in 2019 (2018: +1.7%). Both oil exporters and oil importers will show steady improvement. Despite the headwinds from a less favorable global economic environment, domestic factors in particular, policy reforms and government investment should continue to boost growth in the region. Oil exporters will significantly benefit from higher government investment although weak performance in Iran and Algeria will be a drag. Particularly, economic growth in Saudi Arabia (2019: +2.4%, 2018: +2.2%) should accelerate in 2019 on the back of strong fiscal stimulus¹¹ and diversification efforts to support the non-oil economy. Elsewhere, Iran's GDP is expected to contract as US sanctions bite, while Algeria's growth is projected to moderate after its budgeted strong increase in government spending in 2018¹² tapers due to lower oil price. On the other hand, growth in the oil importing countries is forecast to rise hinged on policy reforms and a pickup in domestic demand. Growth in Egypt is projected to rise to 5.5% in 2019 (2018: +5.3%), reflecting a recovery in tourism, rising natural gas production, and continued improvements in business confidence due to implementation of an ambitious reform program supported by the IMF's Extended Fund Facility. Similarly, growth in tourism sector should continue to buoy economic activity in Morocco and Tunisia.

⁸ Recently, the IMF approved \$3.7 billion credit aimed at supporting Angola's economic reform programme

⁹ SSA ex Nigeria, Angola and South Africa

¹⁰ Central African Economic and Monetary Community

¹¹ The government recently approved a \$295 billion budget for 2019 – the largest budget in record – showing higher spending in the non-oil sector

¹² The Algerian government budgeted a high 2018 budget to support the non-oil sector ahead of 2019 elections

Political risks clouds SSA and MENA markets

Amongst the major risks facing SSA and MENA economies in 2019, political crisis as well as risks over the upcoming elections takes the center stage. Even before entering the year, we saw a number of headwinds hit some economies. In the case of Nigeria, rising US yields together with election uncertainty saw portfolio flows to the country shrink significantly over the second half of 2018. Similarly, in South Africa the sudden removal of finance ministers and former ANC president Jacob Zuma being replaced by President Cyril Ramaphosa caused significant volatility in the rand.

Elsewhere, in the first week of 2019, Gabon witnessed a fail coup attempt reflecting a deepening political crisis in the country. One of the leading causes of Gabon's crisis is the fact that President Ali Bongo has been absent from the country for over two months now after suffering a stroke while attending a meeting in Saudi Arabia. The constitution requires an election to hold 30-60 days after a vacancy of power has been declared. In order to avoid this, the Constitution court amended the constitution inserting a clause that allows power to be transferred to the Prime Minister or Vice President in the event of the President's temporary unavailability. Going into the rest of the year, the outcome of elections across both regions could make or mar investor's confidence in the countries as witnessed in previous periods.

Table 4: Election Calendar across SSA and MENA

Country	Date
Nigeria	Feb-19
Senegal	Feb-19
Guinea-Bissau	Mar-19
Algeria	Apr-19
South Africa	May-19
Israel	May-19
Malawi	May-19
Botswanan	Oct-19
Mozambique	Oct-19
Tunisia	Oct-19
Namibia	Nov-19
Benin	TBA
Chad	TBA
Mauritania	TBA
UAE	TBA

*To be announced

Fundamental differentiation to dictate currency movement

Over 2019, current account deficit to GDP across SSA is projected to rise slightly to 3.4% (2018: -2.8%) while current account surplus of MENA countries should remain stagnant at 2.6% (2018: +2.6%). However, the story will differ across different countries' fundamentals. Particularly, oil exporters are likely to face pressure on their current account balance due to lower prices over 2019. However, the build-up in FX reserves over 2018 should provide cushion to the impact of lower prices. Elsewhere, firm soft commodity prices should support

current balance of most resource countries. On external factors, we do not envisage the impact of higher rate in developed markets to be as grave as 2018 due to the lesser sequence of interest rate hikes. Hence, we expect tamer disruption to portfolio flows emanating from monetary tightening.

In SSA, given the strong accretion in FX reserves over 2018 (+11% YoY) due to higher oil price, we believe the Central Bank of Nigeria would avail its traditional ammunition to keep FX stable over the year despite a lower current account surplus and FX inflows. However, we believe the distorted interplay of demand and supply at the IEW¹³ and the increased demand at same following the cessation of the interbank window market (reflecting convergence of the NAFEX¹⁴ rate) at the end of 2018 would drive short term volatility in rates and an eventual slight depreciation in the naira. For South Africa, the case is quite divergent for the Rand. Uncertainties ranging from the US-Sino trade war to election concerns ahead of the general elections in May 2019 will prove to be major factors to deal with. On balance, we expect the depreciation in the rand to persist into 2019.

Over in MENA, lower oil price over the year is expected to impact Saudi Arabia current's account balance negatively. However, we believe the country will continue to defend the Riyal as it has always done. Furthermore, despite the murder of Khashoggi, investor sentiments towards the country's risk appetite has been firm. In fact, the country recently raised \$7.5 billion of international bonds this week, with subscription level reach almost 4x. Hence, we anticipate seeing resilience in the Riyal.

¹³ Investors & Exporters Window

¹⁴ Nigerian Autonomous Foreign Exchange Rate Fixing – Quoted rate of the IEW

ARM Securities Contact

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

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

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

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

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

