

January 13, 2020



Nigeria Strategy Report

H1 2020

Global Economy and Markets

After a slowdown in 2019, 2020 growth receives a timely boost

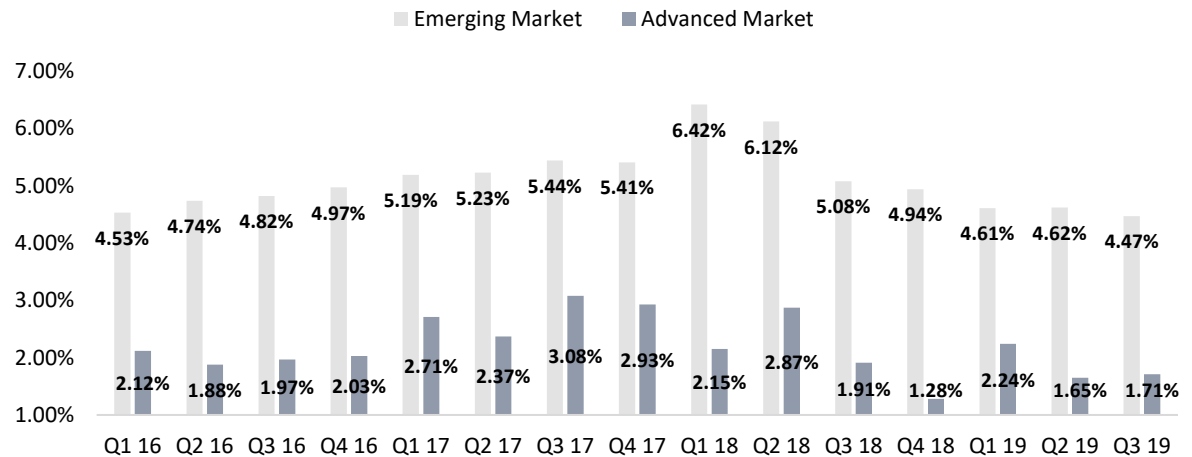
Executive Summary

Over 2019, global growth is poised to moderate to 3% (FY18: 3.6% YoY) stemming from a slowdown in both advanced and emerging markets. In the advanced economies, the effect of the US-China trade war on external sector and domestic demand, as well as dampened business investment in the U.K borne out of BREXIT uncertainty, forms the basis for a slowdown. Accordingly, growth in advanced economies is expected to slow to 1.7% YoY (FY 18: 2.3%). With the impact of the trade war filtering into emerging markets and the proliferation of country specific issues, such as a fall in consumption in India and a contraction in Mexico's industrial sector, growth in the region is expected to fall to 3.9% YoY (FY18: 4.5%).

According to the IMF, global growth over FY20 is expected to pick up slightly to 3.4%. Just like FY19, this will be driven by emerging markets where growth is predicted to print at 4.6% as expansionary monetary policies spur faster growth in the powerhouse economies of India and Brazil. Growth in the advanced economies, meanwhile, is expected to remain flat at 1.7% as improvements in the UK and the EU are dampened by slower growth in Japan and the US.

In our view, recent developments dictate that an upward revision to these estimates may be warranted. The agreement of an initial trade deal between the US and China should ease the strain on global demand and provide a boon to a number of economies. Additionally, Boris Johnson's resounding victory at the UK's general election reduces the Brexit related uncertainty that has plagued the UK, and to a lesser extent the EU.

In this report, we look at the major themes that dominated the global, economic and financial landscape in 2019, as well as our outlook for 2020.

Figure 1: Trend in Global GDP Growth (%)

Source: Bloomberg, ARM Research

Weak trade and business investment dampen growth in advanced economies

Growth in the U.S slowed over 2019 hinged on an interplay of the trade war rhetoric and fading fiscal stimulus – which invariably led to a drag in the private sector investment and weakness in the external sector. On the flipside, we saw increased public sector spending over the first half of 2019 – reflecting efforts by the U.S government to spur consumption. Over Q3 19, GDP growth decelerated to an annualized rate of 2.1% compared to 2.9% in Q3 18. The slowdown emanated largely from deceleration in PCE (2.9% YoY vs. 3.5% YoY in Q3 18) and public sector investment (1.6% YoY vs. 2.1% YoY in Q3 18). The slowdown was further exacerbated by declines in private sector investment (-0.1% YoY vs. +13.7% YoY in Q3 18) and net exports – an offshoot of faster growth in imports (+1.5% YoY) relative to export (+0.9% YoY). On the positive, after six consecutive quarters of contraction, residential investments expanded at an annualized rate of 5.1% (-4.0% in Q3 18).

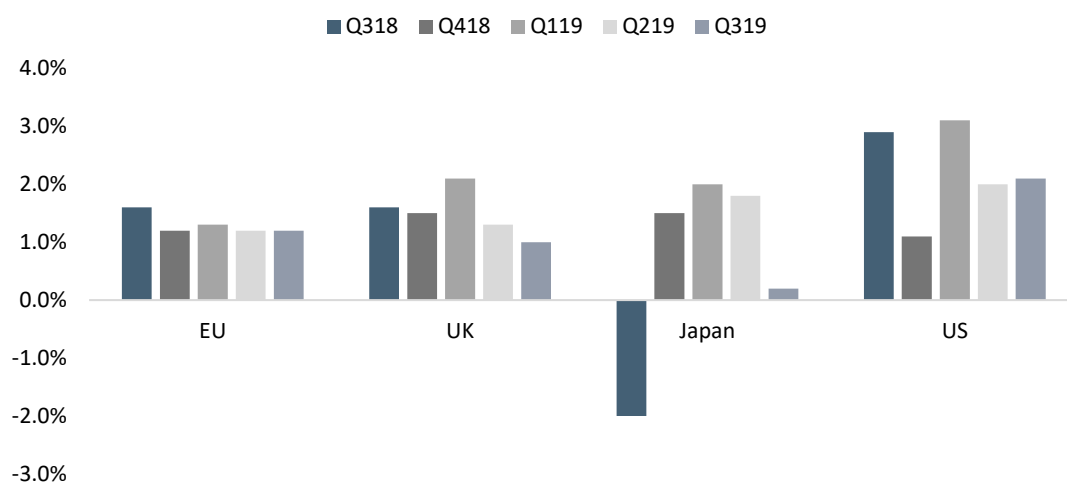
Notably, the concerns on moderating growth coupled with muted inflation rate necessitated the Fed's decision to cut its benchmark rate. For context, the PCE price index which is the primary inflation measure for the FED averaged at 1.5% over 2019 relative to the target of 2%. Consequently, the central bank cut its benchmark rate three times this year from 2.25% to 1.75% and put an end to its balance sheet reduction program. On that note, IMF projects the U.S economy will grow by 2.4% YoY in 2019 which is 50bps lower than 2018.

In the Eurozone, weak industrial production, suppressed investment/ domestic demand, and policy uncertainty in major economies dampened growth in the territory over 2019. After a deceleration in Q2 2019, growth in the third quarter flatlined at 1.2% YoY (vs Q3 18: 1.6% YoY).

The weakened growth in Q3 19 stemmed largely from contraction in key economies – Germany (+0.5% YoY vs. 1.1% YoY in Q3 18), France (+1.4% YoY vs. 1.5% YoY in Q3 18), Italy (+0.3% YoY vs. 0.4% YoY in Q3 18) and Netherlands (+1.9% YoY vs. 2.4% YoY in Q3 18), which cumulatively account for 52% of the bloc's GDP. Across the bloc, slower growth continues to reflect weakness in the external sector, stemming from a slowdown in exports amidst rising imports. Besides weakness in external sector, the growing sovereign debt crisis in Italy also dampened investor sentiment¹ and negatively impacted economic growth. For context, according to the IMF, the Italian government's outstanding debt is the second largest in Europe and third largest in the world at c.\$2.5 trillion (FY 18 public debt to GDP: 132%).

In a bid to boost growth, the ECB lowered its deposit facility rate by 10 basis points to -0.50%, while leaving the rates on the main refinancing operations (MROs) and the marginal lending facility unchanged at 0.00% and 0.25% respectively. Additionally, the asset purchase programme (APP) was restarted on November 1, at a monthly pace of €20 billion, and will continue to run for as long as the ECB feels it necessary. And finally, to provide more favorable bank lending conditions, the ECB reduced the interest rate on its TLTRO²-III to match the average rate applied on Euro system's MROs and extended the maturity to 3years (Previously: 2years). With the ongoing Sino-US trade war clouding the external sector and weakening industrial production, growth in the Eurozone is expected to contract by 70bps to 1.2% in 2019.

Figure 2: GDP growth in developed economies



Source: BEA, Eurostat, ONS, JCO, ARM Research

¹ Over 9M 19, growth in business investment dropped to an average of 2.3% YoY (vs 9M 18 of 3.9% YoY)

² Known as "Targeted longer-term refinancing operations" is a series of cheap loans offered to the banks by ECB in a bid to stimulate lending to the real economy.

Over Q319, the UK economy expanded by 1.1% YoY (Q318: 1.6%), the slowest in nine years. Services, which accounts for approximately 80% of UK's GDP, fell to 1.6% YoY (Q318: 2.4%) mirroring a slowdown in household spending to 1.1% (Q3 18: 1.6% as wage growth³ moderated. In addition, production contracted by 1.3% YoY (compared to an expansion of 0.3% YoY in Q3 19), a reflection of dampened investment in the economy. For context, business investment contracted further in Q3 19 to 0.5% YoY (Q3 18: -0.3% YoY) as continued uncertainty concerning UK's departure from EU prompted many investors to put their investment plans on ice. On Brexit, Prime Minister Boris Johnson's proposal to leave the bloc by the October 31 deadline was hamstrung by Parliament's refusal to back his withdrawal agreement. Eventually, Parliament passed a piece of legislation which forced the Prime Minister to request for an extension to the deadline till January 31st, 2020. Following the failed attempts to garner support for the proposed withdrawal bill, the prime minister called for a snap election on December 12th, which the Conservative Party won with a strong majority. Nonetheless, with this longstanding casting a shadow over the economy for most of the year, the IMF expects growth to slow to 1.2% in 2019 (vs 1.4% in 2018). Given the deteriorating global outlook and the British economy, the MPC left its interest rate unchanged all year at 0.75%. However, for the first time in over three years, votes were cast for a rate cut as a couple members felt the tightening labour market (job vacancies fell 3.8% YoY in Q3) and downside risks from the world economy and Brexit warranted a rate cut. On the other hand, the MPC unanimously agreed to keep the purchase of sterling non-financial investment-grade corporate bonds and UK government bonds at £10 billion and £435 billion respectively.

After growing at an average annualized rate of 2.3% over H119 (H118: 0.8%), Japan's economy slowed to 1.8% in Q3 19, but this was a considerable improvement on the 2.4% contraction in Q318. The YoY improvement between the two quarters was largely down to much stronger private consumption. Private consumption, which makes up about 60% of GDP, increased to 2.2% (Q318: -0.9%) on the back of higher private demand (2.4% vs -2.1% in Q318) as consumers went on a last-minute spending splurge before the higher consumption tax came into effect at the start of Q419. Growth was also supported by a rise in private non-residential investment to 7.3% (Q3: -12.8%) and government spending to 2.7% (Q318: 0.8%). The BOJ, meanwhile, maintained its short-term rate target at -0.1% and pledged it will keep purchasing government bonds such that the 10-year bond yield (long-term rate) will remain at around 0% in an attempt to reach its inflation target of 2% (currently at 0.2%). Notwithstanding the slowdown observed in Q3, we believe GDP growth in 2019 will still come in stronger than the previous year; the IMF forecasts FY 19E growth of 0.9% YoY (2018: 0.8% YoY).

³ Over Q3 19, real wage grew by 3.5% YoY compared to 4.6% YoY in Q318

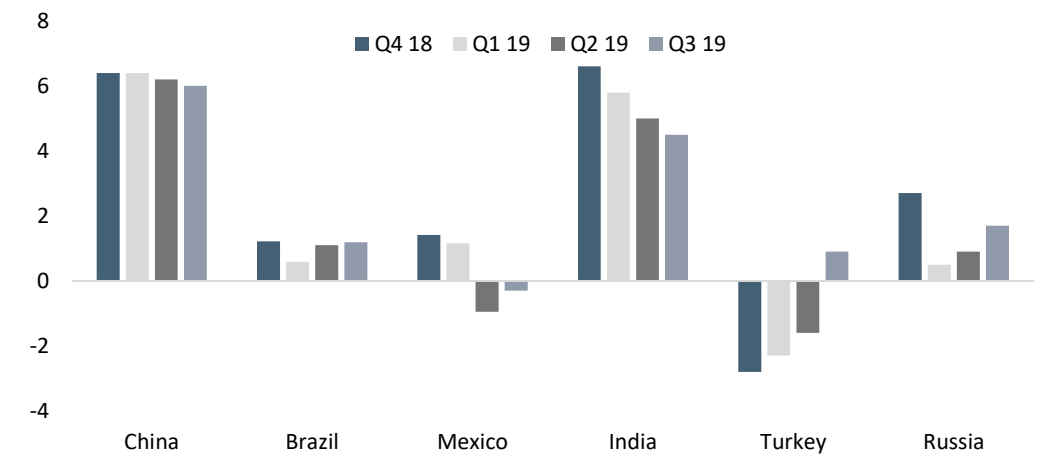
Table 1: Overview of Macro indicators across DM

	EU	UK	Japan	US
Latest Monetary Policy Action	0.00%	0.75%	-0.10%	1.75%
Mean CPI: 2019*⁴	1.10%	1.90%	0.40%	1.74%
Mean CPI: 2018	1.80%	2.50%	1.00%	2.50%
GDP (Q319)	1.20%	1.00%	1.80%	2.10%
GDP (Q318)	1.60%	1.60%	-2.40%	2.90%
Avg Unemployment 2019	7.60%	3.80%	2.50%	3.70%

Source: Bloomberg, ARM Research

Emerging Markets: Growth downtrodden by lingering trade war

After a mixed array of economic data releases for emerging and developing economies (EMDEs) at the start of the year, growth across most of the EMDEs went further south in the second half of the year. At the heart of the frail growth was the lingering Sino-US trade rift which led to weak global demand and tepid investments.

Figure 3: Emerging and developing economies GDP growth (% YoY)

Source: BEA, Eurostat, ONS, JCO, ARM Research

In EM Asia, the Chinese economy slowed through the year, with Q3 2019 GDP growth settling at 6% - its weakest pace since Q1 1992 - amid lingering trade war concerns. The slower growth was broad-based with growth across the primary⁵ (2.7% vs 3.6%), secondary (5.2% vs 5.3%) and tertiary⁶ (7.2% vs 7.9%) industries – printing lower compared to the similar period last year.

⁴ Year to date⁵ Represents agriculture industry⁶ Represents services and other industries not included in the primary and secondary segments

Further breakdown also shows receding growth in consumption and gross capital investment, with contributions to GDP dropping significantly to 61% (vs Q3 18: 74%) and 21% (vs Q3 18: 36%) respectively as at Q3 19. Clearly, constraints on the consumer wallet due to rising inflation⁷ as well as the regulatory crackdown on shadow banking⁸ has led to a pull-back in consumption. This was depicted in the slowed growth in retail sales of 7.63% in Q3 19 compared to 9% in Q3 18. Also, the trade rifts with the US has weighed negatively on China's fixed asset investment which has been moderating since April 2019. Invariably, this has also translated to weakness in industrial production which printed at Q3 19: 5% YoY compared to 5.97% in Q3 18 growth. The trade war – expected to have a phase one resolution by January 2020 -- has tilted more in favor of the US, as China's trade surplus with the US over the first ten months of 2019 has dropped to \$248 billion from \$258 billion in similar period last year.

In a bid to foster growth, the People's Bank of China (PBOC), in August, designated the loan prime rate (LPR)⁹ as the new lending benchmark for new bank loans. This replaced the PBOC's benchmark lending rate and was linked to the medium-term lending facility (MLF) rate which is set during open market operations and determined by broad financial system dynamics. The new 1-year and 5-year LPRs were affixed at 4.25% (prev. 4.31%) and 4.85% (prev. 4.9%), which has since been lowered further to 4.15% and 4.8%, respectively. Effectively, this drove borrowing costs lower. This is expected to support the PBOC's growth target of 6-6.5% by the end of the year, which is also within the IMF's forecast of 6.1%.

Weak economic growth was also the prevailing theme in India, where GDP expanded by only 4.5% in Q3 19 (India calendar: Q2 2020), compared to 5% in previous quarter and 7% over the same period last year. The slowdown – its lowest in 6 years -- mirrored receding growth in consumption (Q3 19: 5.1% vs Q3 18: 9.8%) and fixed capital investment (Q3 19: 1% vs Q3 18: 11.8%) which jointly account for 87% of India's GDP. These offset the increased growth in government expenditure which was up 15.6% YoY (vs Q3 18: 10.9%). In response, the Reserve Bank of India (RBI) cut interest rates five times in 2019 by an accumulated 135 bps to 6.15% in a bid to support growth. A sixth rate cut which was widely expected in December was held off due to increasing inflationary pressures stemming from prolonged rains which pushed food prices higher.

⁷ China's inflation spiked to a 7-year high following outbreak of African swine

⁸ Shadow banking involves non-bank financial institutions who create credit not subject to regulatory oversight.

⁹ The LPR was introduced in 2013 which commercial banks charged their best clients but, since its launch, had failed to reflect market dynamics and was little watched by the markets.

In our view, the economy's unresponsiveness to monetary policy stems largely from the high debt levels which has continued to plague India's economy amid rising non-performing assets (NPAs). This necessitated a \$10 billion capital infusion into the banks by the government, but still left lenders uneager to give loans at lower rates in line with the RBI's cuts. Thus, consumer spending remains constrained. The heightened concerns regarding India's lagging growth informed Moody's revision in outlook in November from 'stable' to 'negative'. Even the RBI recognizes the challenges to growth as it cut its fiscal FY 2020 growth forecast lower to 5% from 6.1%.

Over in EM Europe, economic growth in Russia printed at its highest level so far this year in Q3 19 at 1.9% (Q1: 0.5%, Q2: 0.9%), albeit still slower than the 2.2% posted in similar period last year. The faster growth (compared to H1 19) was supported by an expansion in the wholesale trade (3.8%), agriculture (5.1%) and industry (2.9%). This was driven by the Central Bank of Russia's (CBR) easier monetary policy, wherein interest rate was cut three times in H2 2019. The switch to an accommodative stance was supported by the downtrend in inflation which fell even below the apex bank's target of 4% to 3.8% in October from 5% at the start of the year. In addition, we believe the Q3 GDP was supported by the recovery in oil production after the Druzhba pipeline contamination in H1 2019. On the fiscal front, we saw a slow start to the planned ramp up in 2019 fiscal spend on its "National projects" programme. The six-year programme was introduced after President Putin's re-election in 2018 and is estimated to cost \$406 billion. However, the government has only executed 63% of its planned 2019 expenditure over the first 9 months -- the lowest since 2010. Regardless, rate cuts are expected to support growth in the final quarter of 2019, with the CBR's 2019 GDP forecast ranging between 0.8-1.3% YoY.

Over in Turkey, after three consecutive quarters of contraction – owing to the currency crisis in 2018 – the economy grew by 0.9% YoY in Q3 2019. The industrial (+1.6% YoY) and services (+0.6% YoY) sectors posted recovery from the declines in the previous quarters, while the agricultural sector grew stronger (+3.8% YoY). The recovery in Turkey follows the adoption of a more dovish monetary cycle which the new governor of the Central Bank of Turkey (Governor Murat Uysal) adopted upon his resumption to office in July. The Central Bank has since cut interest rates four times from 24% to 12% in October, amid easing inflation. Inflation has dropped from 20.35% at the start of the year to 10.56% in November driven by the diminishing impact of the currency woes experienced in the past. The Central Bank has since cut interest rates four times from 24% to 12% in December, amid easing inflation from 20.35% at the start of the year to 10.56% in November driven by the diminishing impact of the currency woes experienced in the past.

In Latin America, the Brazilian economy improved in Q3 19, with the economic output expanding by 1.2% YoY (Q2 19: 1.1%). The growth in the third quarter was driven by a rebound in the agricultural sector (+2.1% YoY) following weather conditions which led to improved output. The industrial sector extended its recovery during the quarter (+1.0% YoY) owing to a pickup in mining and construction. To support growth and in response to the moderation in inflation¹⁰, Brazil's central bank adopted an accommodative monetary stance. The apex bank cut its benchmark interest rates three consecutive times by a cumulative 150 bps over 2019 to 5% in October. In 2019, the US government reinstated tariffs on steel and aluminum imports from Brazil in retaliation against Brazil for supplying soybeans and other agricultural products to China. Considering iron ore accounts for a large chunk of Brazil's industrial export, the new development puts its shrinking trade surplus¹¹ at further risk and may subsequently have an adverse impact on growth in extractive industries in 2020.

Mexico's economy slipped into recession in Q2 2019 reflecting slowdown of foreign investments due to policy uncertainties. For context, since the assumption of the new administration in December 2018, public policy decisions such as the cancellation of the international airport dampened investors' confidence. Bulk of the impact was seen in the industrial sector as it comprises sub-sectors such as automotive and aerospace sectors, most of which are foreign owned. Growth numbers revealed the economy shrank in Q2 19 to -0.9% YoY stemming from a contraction in both industrial (-3.0% YoY) and service (-0.1% YoY) sectors. Growth remained in the negatively territory in Q3 2019, albeit on a softer pace, printing at -0.3% YoY as industrial sector moderated -1.4% YoY, while service sector somewhat rebounded by 0.1% YoY. Concerns on the tepid growth informed the Banco de Mexico's shift to a more accommodative stance. Consequently, the central bank cut interest rate four times this year by 100bps bringing the benchmark interest rate 7.25% in December. This was further supported by declining inflation readings (June - October average: 3.24%) which remained within the bank's target of 3%. The Mexican government also embarked on some expansionary fiscal policies to aid economic growth. Precisely, President Manuel Lopez recently announced an infrastructure plan which involves heavy spending of about 859 billion Pesos (\$44 billion), which is expected to boost growth going forward.

Meanwhile, after key revisions to the USMCA (United States, Mexico and Canada) agreement by the US' house Democrats, representatives from Canada, Mexico and US recently¹² signed the amendments to the trade agreement.

¹⁰ From the peak of 4.94% in April to 2.54% in October 2019 (target: 4.25%)

¹¹ Brazil's trade surplus started shrinking since June 2019 to \$3.4 billion in November 2019.

¹² The amendment to USMCA was signed December 10th, 2019.

The revised deal includes an enhanced labour-specific enforcement, removal of 10-year data protection for biologic drugs by pharmaceutical companies and changes on rules regarding steel cars. Following this development, the trade deal was approved by the House of reps¹³ setting it on course for a feasible ratification by the Senate in 2020.

EMDE Growth – The anchor for global growth in 2020

Going into 2020, the IMF sees global growth ticking up higher to 3.4% from an estimated 3.0% over FY19. The pickup in growth will be spearheaded by emerging markets, with improvement across all sub-region – EMDE Asia, EMDE Europe and Latin America are all expected to grow at a stronger pace in 2020 compared to 2019. Consequently, the emerging economies are expected to grow by 4.6% (FY 19E: 3.9%). On the flipside, growth in advanced economies is projected to flatline at 1.7%YoY mirroring uncertainty surrounding the trade hassle between U.S and China. However, an upside to growth is the recently signed phase one trade deal which led to a roll back in some tariffs and a suspension on the tariffs which were expected to kick off on Dec 15.

The EMDE Asia region, which is expected to expand by 6% YoY in 2020 (2019:5.9% YoY) remains the anchor for EMDE growth in 2020. To start, IMF forecasts India will grow at a faster pace of 7% in 2020 from 6.1% in 2019, driven by the RBI's rate cuts and fiscal incentives. However, given the unresponsiveness to RBI's easing policies and the recent Q3 19 GDP numbers, IMF's projections seem far-fetched. Topping it off, even the RBI has cut it's 2020 growth outlook, as earlier stated. Thus, we think it is likely the IMF will revise its forecast downward in the next release. China's growth is expected to slow to 5.8% in 2020 from 6.1% in 2019, stemming from lingering impact of the trade war with the US. However, given recent positive developments on the trade talks with Trump agreeing to sign off on the first phase of the trade agreement, the risk of the trade war might be tamed come 2020. That said, China is still faced with internal struggles by way of a strained consumer wallet following the regulatory efforts made to rein in rising shadow banking. The positive to that is the PBOC appears bent on keeping up with its easing monetary policy to support growth, while still cautious of the laden debt position.

In EMDE Europe, Russia's economic growth is expected to pick up to 1.9% in 2020 from 1.1% in 2019, according to IMF. The key thrust to the economy's growth is expected to stem from the Russian Government's aggressive planned 3-year spend with support from planned tax cuts for Oil E&P companies.

¹³ The House of reps approved the USMCA precisely on December 19th, 2019.

The tax cut is aimed at increasing production from its oil and gas reserves in a bid to offset impact of expected lower prices next year (2020 Russia Forecast: \$55/bbl.). Meanwhile, the recent improvement in Turkey's economy is expected to be sustained going into 2020, as the rate cuts continue to support expansion in both domestic demand and net exports. IMF's forecasts of a 3% growth in 2020 from 0.2% in 2019, with the politically sensitive relations with the US posing a threat to the economy's growth.

In Latin America, expansionary monetary policy, amid receding inflationary pressure, is expected to drive growth recovery in Brazil. In addition, the newly approved pension reform (signed in October 2019) is expected to provide the fiscal stimulus needed to spur growth factors and renew confidence in the Brazilian economy. According to IMF, the pension reform is a crucial step in ensuring the viability of the social security system and the sustainability of public debt. The pension reform which increased the retirement age (for men to 65 and women to 62) is forecast to save the state about \$192 billion over the next 10 years. That said, IMF forecasts a recovery in Brazil's economy by 0.9% YoY in 2019 and 2.0% in 2020 YoY. However, recently imposed tariffs on steel and aluminum on Brazil by the US poses a downside risk to the economy in 2020. Over in Mexico, the economy is projected to recover in 2020 hinged on fiscal expenditure channeled towards investment in infrastructure as well as accommodative monetary policy should the downtrend in inflation persist. On the fiscal end, the implementation of \$44 billion five-year infrastructure plan (an agreement between Mexico's government and private sector) towards transportation, tourism and telecommunications should impact growth positively. This, in addition to accommodative monetary policy by Banco de Mexico is expected to drive growth in 2020. Hence, IMF projects an economic growth of 1.3% in 2020.

Moving over to the advanced economies, in the US, supportive monetary policy environment, effects from the Bipartisan Budget Act of 2019 (BBA 2019) and temporary reprieve from trade tensions are expected to create a floor for dwindling growth over 2020. While the BBA 2019 is expected to increase the level of government spending (through increases in budget caps for both defense and nondefense in FY 2020 and FY 2021), which was a major factor for growth in 2019, the fading effects of the 2017 Tax Cuts and Jobs Act and the further crunch to private sector investment are expected to limit the rate of growth in 2020. On this backdrop, IMF forecasts a growth of 2.1% in 2020, a 30bps deceleration from 2019E. On its policy decision, the U.S Fed left its interest rate unchanged in December and guided to rates being unchanged in 2020.

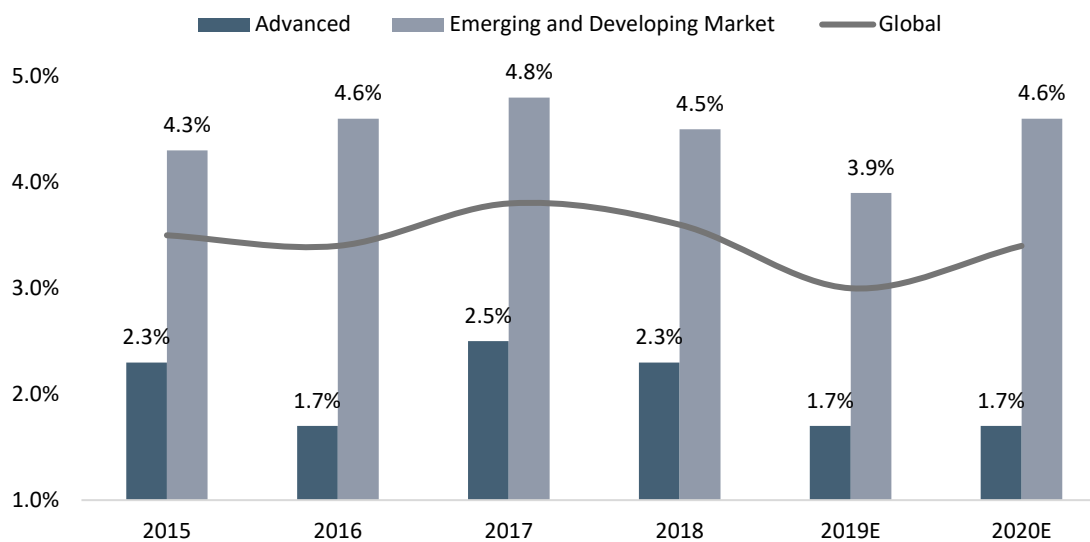
In the Eurozone, both monetary and policy decisions is expected to spur growth by 20bps to 1.4% over FY 2020. Notably, besides the low-cost funding to banks which is expected to spur lending to the real sector, France and Italy also announced plans for tax cuts in a bid to stimulate domestic demand.

The impact of the aforementioned, coupled with a low base in the prior year is expected to support moderate expansion in growth over 2020. In the U.K, growth is expected to print at 1.4% (FY 19E:1.2% YoY) hinged on sizable fiscal expansion expected in 2020, with increased spending allocated to defense, NHS, Brexit preparation and social care.

Further upside to growth is the recently concluded election in which the conservative party won a commanding majority. With the conservative controlling the parliament, we expect the prime minister to garner significant vote for his revised withdrawal agreement and therefore lift the fog of uncertainty over the economy. Consequently, we expect the UK to have an orderly departure from the EU by January 2020. On the monetary side, policy makers expect some “modest and gradual” tightening in the benchmark rate as long as the economy recovers in line with its projections of a pick-up in growth and a drop in inflation to 1.5% YoY (Target: 2%) owing to the temporary effect of fall in regulated water and energy prices.

Finally, for Japan, the 2020 Tokyo Olympics holding in Q3 should provide a temporary boost to consumption and consequently growth, particularly in that quarter. However, the effect of the higher consumption tax should weigh on private consumption despite fiscal measures, such as Y380 billion worth of vouchers for low-income and child rearing families, being put in place to cushion any negative effects of the hike. On that backdrop, IMF expects growth to 0.5% in 2020. Elsewhere, policy rates are expected to remain unchanged as long as necessary to ensure inflation moves closer to the BoJ’s target of 2%.

Figure 4: Trend in global growth and projection (%)



Source: Bloomberg, ARM Research

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