

Nigeria Strategy Report

H1 2020

Global Economy and Markets

MEA Region: Modest growth with positive outlook

Executive Summary

At the beginning of H2 2019, we expected growth across SSA to slow on the back of weakness in the South African economy and slow recoveries in Angola and Nigeria. As expected, economic activities over H2 2019 remain subdued. Specifically, weak economic activities in the three largest economies continued to weigh on the region. In addition, softened global demand, droughts and falling commodity prices took a toll on smaller countries. Over in MENA, we anticipated subdued growth across the oil exporters on the back of oil production cuts, while we expected a modest growth amongst the oil importers led by expansions in Egypt and Tunisia – a fallout of favorable business reforms, ease in political risks and healthy tourism. As expected, growth in the region came in at a modest pace largely supported by growths across the oil-importers. Currencies across the SSA region came under pressure over H2 19 owing to varying factors. On the other hand, the currencies of majority of the oil-importers' in MENA strengthened against the greenback following improved current account balances. In addition, some of the countries began to gain benefits of agreements with IMF, which has seen investors' confidence improve.

Growth across the SSA region is expected to tick higher in 2020 but remain subdued. According to IMF, growth is forecasted to come in at 3.6% in 2020 from 3.2% in 2019. The growth outlook is hinged on the expectation of steady improvement in private consumption/investment and continued support from monetary policy in countries adopting an easing policy. Meanwhile, oil output across the MENA oil exporting countries will be dragged by continued oil production cuts. Nonetheless, increased government spending in some countries will drive non-oil growth and invariably overall economic growth. Consequently, oil exporters are expected to grow by 2.1% in 2020 (2019: -1.3%). For oil importers, real GDP growth is expected to settle at 3.7% from an estimated 3.6% in 2019, largely driven by resilient growth in Egypt. Overall, GDP for the MENA region is expected to come in at 2.7% in 2020 from 0.5% in the previous year.

In this report, we look at the major themes that dominated Sub-Saharan Africa, Middle East and North Africa landscape in 2019 as well as our outlook for 2020.

SSA economy growth cools down

At the beginning of the second half of 2019, we expected growth across Sub-Saharan to slow on the back of weakness in the South African economy and slow recoveries in Angola and Nigeria. As expected, economic activities in the region over H2 2019 remain subdued. Specifically, weak economic activities in the three largest economies continued to weigh on the region. In addition, softened global demand, droughts and falling commodity prices took a toll on smaller countries.

In Nigeria, economic activity remained lackluster. Growth in Q3 2019 came in at 2.28% (Q2 19: 2.12%) on the back of expansions in both the oil (Q3 19: 6.5%, Q2 19: 7.2%) and non-oil sectors (Q3 19: 1.8%, Q2 19: 1.6%). The YoY improvements in the non-oil sector relative to the prior quarter stemmed largely from sturdy output in services and recovery in agriculture sector from its downbeat levels. On the other hand, growth in the oil sector was buoyed by additional production from the Egina Oil field which resumed operations this year.

Elsewhere in South Africa, GDP growth slowed to 0.1% YoY in Q3 19 after expanding by 0.9% YoY in the previous quarter. On a seasonally adjusted basis, the economy contracted 0.6% QoQ in Q3 after avoiding a technical recession in Q2 19 when the economy grew by 3.2% QoQ. On a sectorial basis, the utilities sector remained in recession (-2.4% YoY) following nationwide power blackouts caused by a breakdown in Eskom power plants. In addition, contractions in the manufacturing and mining sectors also weighed on the economy's growth. Given concerns over South Africa's slowing economic growth, Moody's revised its outlook on South Africa's ratings to negative from stable but maintained its credit rating at Baa3.

Angola's economy relapsed into a recession in Q2 19¹, as the GDP contracted 0.1% YoY following a 0.3% YoY contraction in the previous quarter. The oil sector, which accounts for a third of the GDP, continued to drive the overall contraction. Investments in the oil and gas industry has been sparse and existing oil fields have been running dry. Further in Q3 19, lower oil production together with lower oil prices is expected to have weighed heavily on overall activity in the country. Meanwhile, Angola continued to tap into concessionary facilities as the country seeks to diversify its economy. The African Development Bank (AfDB) group approved a \$165 million loan to finance a portion of Angola's three-year economic diversification support programme. In addition, the IMF approved the disbursement of an additional² \$247 million loan to support Angola's reform plan.

Gazing over smaller economies in the region, softened global demand, droughts and falling commodity prices impacted negatively on economic activities. In Kenya, economy activity cooled

¹ Q3 19 GDP figures were not available as at the time of writing

² The lifeline is part of a three-year credit facility of \$3.7bn, agreed in December 2018 to promote deep structural economic and governance reforms.

further in Q3 19 (5.1% YoY, Q2 19: 5.6% YoY) - its slowest expansion since Q3 2017. The agriculture, forestry and fisheries sector, which accounts for approximately one-third of economic activities, slowed to 3.2% from 4.2% in Q2). This reflects the prolonged drought which impacted negatively on production of key crops such as tea and sugar cane. Elsewhere, economic activities slowed down in Ghana over Q3 19 with GDP growth inching down to 5.6% from 5.7% in Q2 19. The third quarter performance chiefly reflected cooling dynamics in the industrial and services sectors, which more than offset an upturn in agricultural activity. Growth in industrial sector output slumped to a three-year low of 5.7% YoY in Q3 (Q2: 6.1 YoY), largely due to faltering mining and quarrying output. Similarly, growth in the services sector moderated on the back of a downturn in retail trade. Meanwhile, in Cote d'Ivoire, growth picked up to a two-year high of 7.6% in the third quarter (Q2: 7.3% YoY). The acceleration was spearheaded by a marked upturn in industrial and agricultural output.

Table 1: Macro indicators among selected Sub-Saharan African countries

	Nigeria	South Africa	Kenya	Ghana	Angola
Monetary Policy Action	Unchanged	-25bps	-5bps	Unchanged	Unchanged
Q3 GDP Growth (YoY)	2.28%	0.10%	5.1%	5.60%	-0.1%*
Avg. Inflation (2019)	11.34%	4.15%	5.14%	8.74%	17.13%
Avg. Inflation (2018)	11.87%	4.70%	4.7	9.83%	19.70%
Equity Market Performance (2019)	-14.6%	8.24%	18.50%	-10.89%	N/A
Current Account (% of GDP) - 2019	-0.20%	-3.10%	-4.70%	-3.60%	0.90%

Source: Bloomberg, ARM Research

Oil-importers lift growth in MENA

In our H2 2019 strategy outlook, we anticipated subdued growth across the oil exporters on the back of oil production cuts, while we expected a modest growth amongst the oil importers led by expansions in Egypt and Tunisia – a fallout of favorable business reforms, ease in political risks and healthy tourism. As expected, growth in the region came in at a modest pace largely supported by improvement across the oil-importing countries.

Growth in Saudi Arabia gave way to continued oil production cuts with GDP contracting for the first time since 2017. Q3 19 GDP (-0.46% YoY) reversed a 0.5% YoY growth in the previous quarter, led by a sharp decline in oil sector output (-6.4%). OPEC's de facto leader continued to over-comply to the stipulated production cuts, driving output lower (Q3 19:

9.5mbpd vs Q3 18: 10.4mbpd). In addition, two of Saudi Arabia's major oil facilities were attacked in September, knocking out roughly half of Saudi Arabia's processing capacity for days. In contrast, the non-oil sector recorded sturdy growth (+4.3%) led by private sector activity. In view of growing concerns over rising geopolitical tensions in the region and deterioration of the Kingdom's fiscal position, Fitch downgraded the nation's credit rating to A from A+ in September 2019.

Similarly, growth in Algeria slowed to a 6-quarter low in Q2 19, expanding only 0.3% YoY (Q1 19: 1.3% YoY) as the contraction in the oil sector continued to weigh on overall economic activity. In addition, the country has been marred with weeks of protest which saw the long-serving President Abdelaziz Bouteflika resign in April. The resignation did little to stop the protesters as they have once again occupied the streets, demanding for sweeping government reforms. The same gloomy trend extends to Iran who has seen US sanctions weigh on growth. Since US pulled out of the 2015 nuclear deal, sanctions were restored in a bid to force Iran to negotiate a broader deal that would also limit its ballistic missile program and regional activities. Most recent of the sanctions was in October 2019, which saw US impose sanctions on the Iranian construction sector and trade in four materials used in its military or nuclear programs.

On the flipside, growth for oil importers remained resilient. Economic activities in Egypt remained strong (Q3 19: 5.6%, Q2 19: 5.7%) on the back of growth across sectors including the agriculture and trade sectors. While breakdown is yet to be released, slowing inflation and the decline in unemployment rate points to stronger private consumption. Through 2019, the Egyptian central bank cut its benchmark rate four times in response to the steady decline in inflation readings; we believe this supported growth. Meanwhile, growth in Tunisia (Q3 19: 1.0% YoY, Q2 19: 1.2% YoY) slowed following a contraction in industrial output, including the textiles sector – which overturned growth in agricultural and service sectors.

Table 2: Overview of macro indicators among selected MENA countries

	Egypt	Saudi Arabia	Iran	Tunisia	Morocco
Monetary Policy Action	-100bps	-25bps	Unchanged	Unchanged	Unchanged
GDP Growth (YoY)	5.60%	-0.46%	1.8%*	1.00%	2.1%
Avg. Inflation (2019)	9.59%	-1.33%	42.11%	6.81%	0.24%
Avg. Inflation (2018)	14.40%	2.44%	20.54%	7.31%	2.00%
Equity Market Performance (2019)	7.10%	7.19%	84.09%	-2.06%	7.11%
Current Account (% of GDP)	-2.60%	5.80%	-0.60%	-10.80%	-4.30%

Source: Bloomberg, ARM Research

Differing fundamentals dominate MEA currencies

Currencies across the SSA region came under pressure over H2 19 owing to varying factors. In South Africa, the Rand lost 3.9% against the USD following concerns over the struggling state-owned electricity company, Eskom. Recently, S&P Global Ratings revised its outlook on South Africa to negative from stable citing the country's low growth and deteriorating fiscal balance due to billions of dollars in bailouts for unprofitable power producer, Eskom.

Elsewhere, the Angolan Kwanza lost a whopping 27.5% of its value in H2 19 with most of the depreciation coming after its central bank stopped the use of a trading band that kept the Kwanza's value within a fixed range in October. The National Bank of Angola had earlier introduced a rule in 2018 that pegged the kwanza to a maximum 2% rate movement at currency auctions to keep rates stable. However, with black market rates trading at a premium of almost 30% to official rates and depleting foreign reserves³, the apex bank was forced to allow the Kwanza trade more freely. This was also done in line with an agreement signed with IMF – a pre-requisite to getting the \$247 million loan. Meanwhile, the Angolan government successfully issued \$3 billion in Eurobonds with demand reaching a maximum \$8.4 billion.

Over in Nigeria, the NGN depreciated slightly by 0.75% at the IEW window as the Central Bank of Nigeria (CBN) duly supplied the FX market amidst sluggish pace of FX inflows and rising outflows. The stable FX picture has been buoyed by the CBN's persisting intervention. The CBN turned a net seller over H2 19 from a net buyer at the Investors' & Exporters Window (IEW) over H1 2019. The lower oil receipts, a rising current account deficit, receding FPI inflows and continued interventions have dented the FX reserves by \$6.0 billion over H2 2019. This has raised concerns on the sustainability of the CBN's interventions going forward.

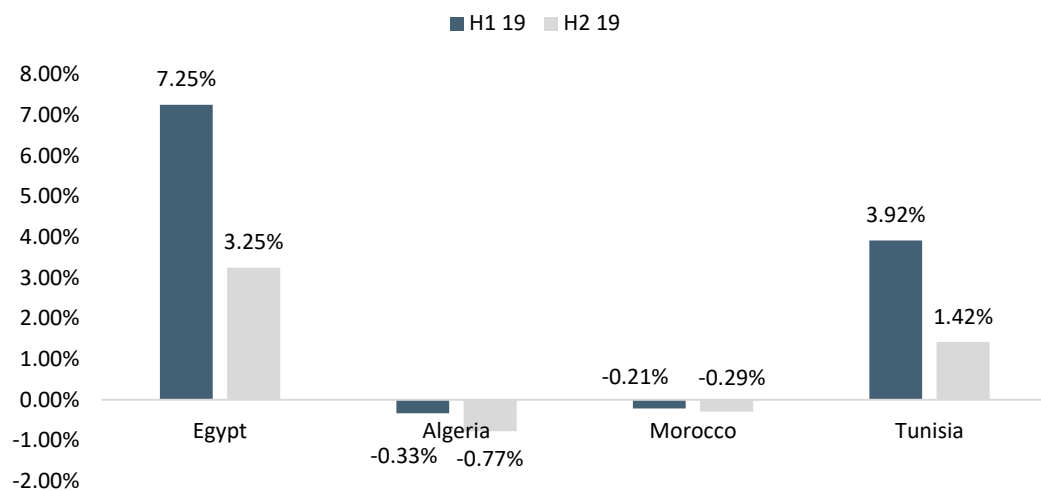
Over in MENA, the currencies of majority of the oil-importers strengthened against the greenback following improved current account balances. In addition, some of the countries began to gain benefits of agreements with IMF⁴, which has seen investors' confidence improve. The Egyptian Pound and Tunisian Dinar gained 3.25% and 1.42% respectively against the USD. For Egypt, the performance in the Pound has largely been boosted by

³ Owing to lower oil receipts following lower oil production and prices

⁴ Egypt finalized a \$12 billion loan agreement it started in 2016 which came with specific reforms such as scrapping energy subsidies and introduction of new taxes. Similarly, Tunisia reached a \$2.9 billion agreement with IMF in 2016 which has seen the country implement several reforms such as cutting energy subsidies.

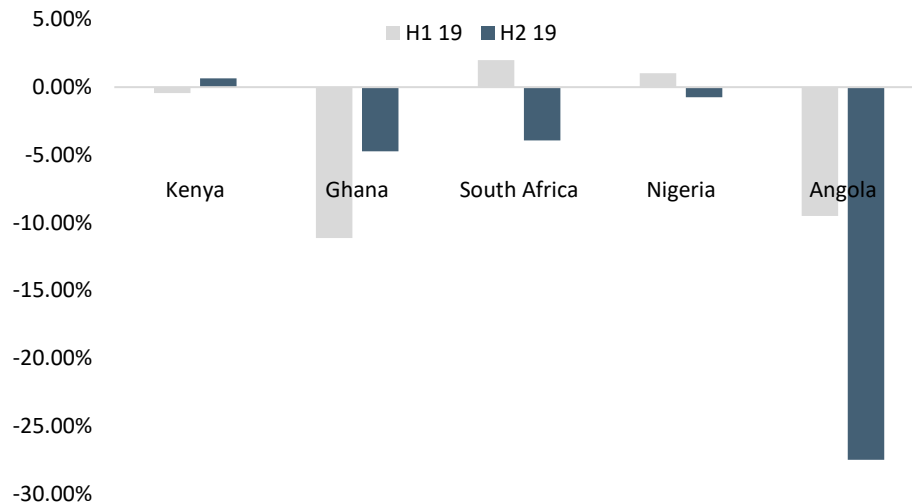
higher foreign inflows via investments in Egyptian treasuries, steadily improved tourism and strong remittances from workers abroad. Similarly, the gain in the Tunisian Dinar has been driven by steady growth in tourism and increased foreign investments. As a matter of fact, Tunisia raised 700 million Euros in a Eurobond issuance earlier in July with subscription level reaching over 3x. Most oil-exporters have their currencies pegged to the USD, hence, currencies across this front were relatively stable. That said, MENA oil-exporting countries benefited from supportive global financial conditions. Interest rate cuts by major central banks, and the inclusion of Gulf Corporation Council countries in global equity and bond indices, boosted debt and equity flows to many countries in the region in 2019.

Figure 1: Currency performance of MENA countries



Source: Bloomberg, ARM Research

Figure 2: Currency Performance of SSA countries



Source: Bloomberg, ARM Research

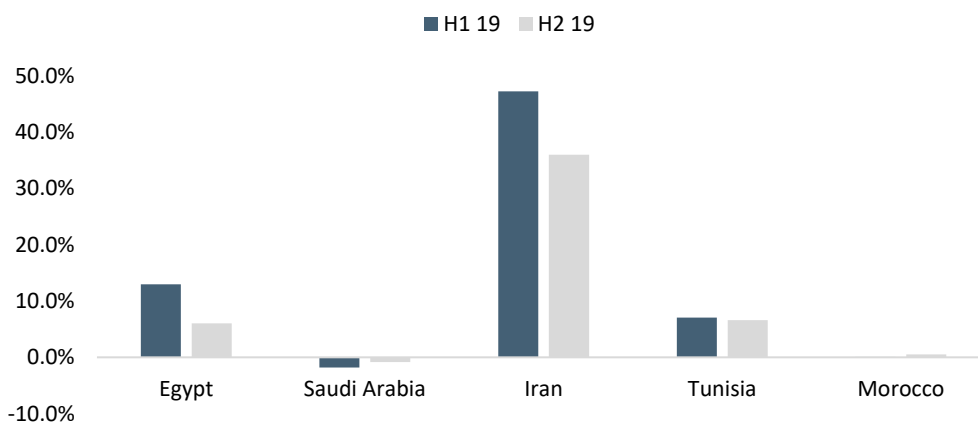
Inflation pressure withers off

Headline inflation continued to moderate in H2 2019 across several countries in the SSA region. In South Africa, headline inflation moderated to 3.94% (H1 19: 4.33%) – the lowest since December 2010. The decline came on the backdrop of a slowdown in cost of food & non-alcoholic beverages and a drop-in transport prices. This offset impact of rising electricity prices and a weaker rand. The decline brought inflation closer to the lower band of the SARB's 3-6% target and supports the call for rate cuts at its January 2020 meeting.

Elsewhere, despite introduction of VAT for the first time in October and large depreciation of the Angola Kwanza, consumer prices have remained benign in Angola, moderating 80 bps over H2 2019 to 16.64% given the high base in the previous year. Inflation readings was sticky in Nigeria with headline inflation increasing by 4 bps to 11.36% over the second half. This is largely attributed to jump in food prices following closure of Nigeria's road border in August. Over in Ghana, headline inflation moderated over H2 19 (-110 bps to 8.14%) due to a rebasing of the Consumer Price Index in August. Over the same period, Public Utilities Regulatory Commission of Ghana hiked electricity and water tariffs, but the effect was overshadowed by the rebase done in August.

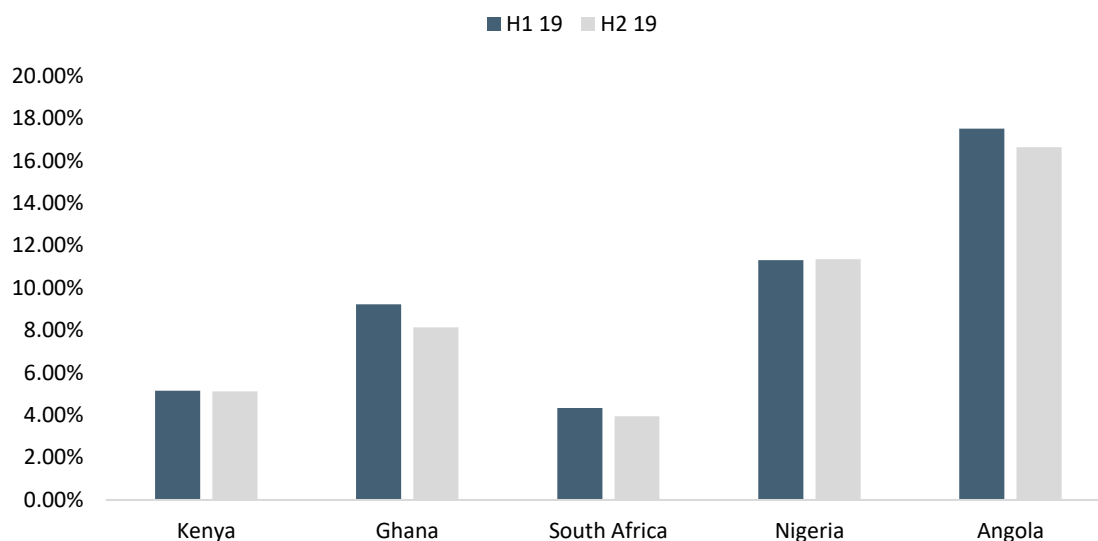
Similarly, headline inflation in MENA moderated with major improvement recorded in Egypt and Iran. For the former, headline inflation averaged down to 5.54% (H1 2019: 12.97%) with inflation even touching a 14-year low in October 2019 (3.1%). The lower inflation reading is largely favored by a recovery in the Egyptian Pound following a devaluation in 2016. Lastly, headline inflation in Iran declined by 1124 bps over H2 2019 due to base effect from last year pressure⁵.

Figure 3: Inflationary trend in selected MENA



Source: Bloomberg, ARM Research

⁵ Sanctions from US

Figure 4: Inflationary trend in selected SSA

Source: Bloomberg, ARM Research

Treading an accommodative path

Central banks across SSA took a cue from major central banks and adopted a more accommodative monetary policy stance in a bid to boost economic growth. While most monetary authorities left policy parameters unchanged, some banks cut their benchmark rates while others even adopted unorthodox policies to boost growth.

Starting with the latter, the Central Bank of Nigeria (CBN) embarked on a journey of boosting growth in the real sector via non-traditional means. The CBN directed Deposit Money Banks (DMBs) to maintain a minimum loan to funding requirement of 60% which was later revised to 65%. In addition, the CBN banned non-bank locals (individuals and corporates) from participating in CBN's regular auctions in a bid to steer liquidity to the private sector. As a result, the thin gap between the OMO rate and T-bills rate widened to over 800bps (H1 19: 119 bps) due to increased demand for T-Bills papers which further drove T-Bills yields lower. In our view, we think the CBN has successfully disintegrated the transmission between the OMO rates and T-Bills rate. While keeping OMO rates elevated for FPIs, the CBN has indirectly forced T-Bills yields lower even below headline inflation.

In Kenya, the Central Bank of Kenya slashed⁶ its benchmark rate by 5 bps to 8.5% in order to spur economic activity. This is coming after the country recorded its slowest GDP expansion in Q3 2019

⁶ during its November meeting

(5.1% YoY, Q2 19: 5.6% YoY) since the third quarter of 2017. The slow growth has been due to lower agricultural output⁷ and considerably weak private sector investment. Furthermore, the Kenyan parliament agreed to ditch an interest rate limit that was introduced in 2016 to curb high borrowing costs. The cap was intended to address poor affordability and availability of credit to working people. However, the reverse had been the case with the cap discouraging banks from creating credit to the private sector. This kept a lid on economic growth and even weakening the effectiveness of monetary policies. Elsewhere, in a widely expected move, the South African Reserve Bank cut its benchmark repo rate by 25bps to 6.5% in July with the committee noting the moderating inflation trend.

Over in MENA, moderating headline inflation gave monetary authorities enough justification to lower rates. In Egypt, the Central Bank of Egypt cut its benchmark interest rate three consecutive times following moderating trend in headline inflation which touched a 14-year low in October. Meanwhile, most countries in the gulf region⁸ manage currency pegs and thus lack independent monetary policies. In Saudi Arabia, the Saudi Arabian Monetary Agency cuts its repo rate by 25bps to 2.25% during its October meeting, after US policymakers cut its target range by the same margin.

Modest growth with positive outlook

Growth across the SSA region is expected to print higher in 2020 but remain subdued. According to IMF, growth is forecasted to come in at 3.6% in 2020 from 3.2% in 2019. The region's growth outlook is hinged on expectations of a steady growth in private consumption/investment and continued support from monetary policy in countries adopting an easing policy. Driver for growths across specific countries varies largely depending on degree of diversification, policy uncertainty and debt vulnerabilities.

The IMF expects growth in Nigeria to come in higher at 2.5% in 2020 compared to a 2.3% growth in 2019. This is expected to be buoyed largely by the non-oil sector, while the oil sector grows at a slower pace. The CBN's expansionary policies are expected to drive growth in the non-oil sector. Precisely, sturdy output in services and regained momentum in manufacturing and Agriculture sectors should bolster growth.

Over in South Africa, growth is projected by IMF to remain subdued, increasing only 1.1% from 0.7% in 2019. This is hinged on expectations that constraints in the power sector might ease and provide some support to the economy. That said, the challenges to growth remain

⁷ Accounts for 26% of Kenya GDP

⁸ Saudi Arabia, UAE, Qatar, Kuwait, Bahrain and Oman

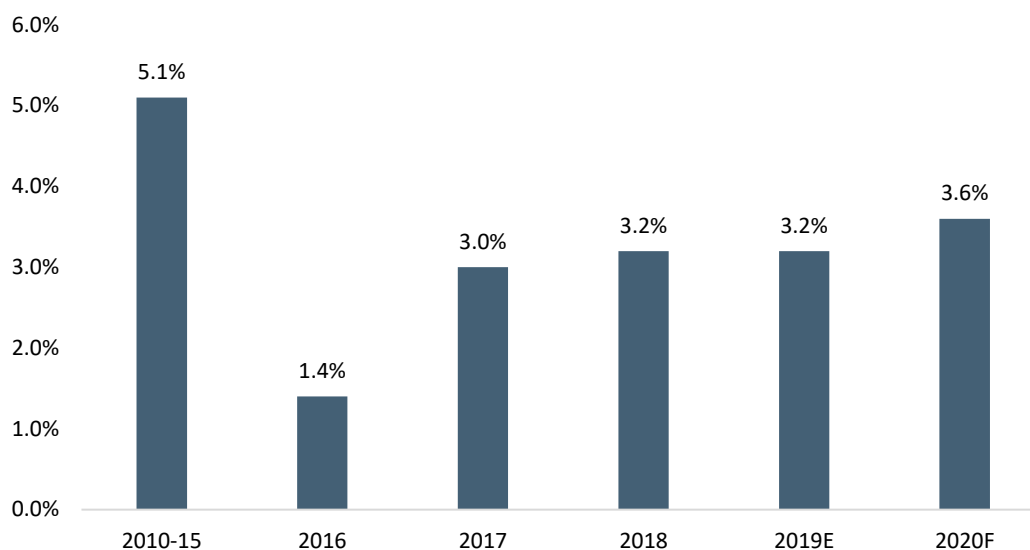
high; particularly the nation's fiscal front and the possibility of Eskom condition becoming worse.

Economic activity in Angola should recover next year (2020: 1.2%, 2019: -0.3%), as domestic demand likely improves. Ongoing economic reforms, political stability and continued IMF support should strengthen consumer demand and support investment activity.

Drilling down to smaller economies, GDP is expected to continue to grow rapidly at about 5.5% (excluding Ethiopia) in 2020. Drivers for growth is expected to differ across the countries. Specifically, growth momentum in Côte d'Ivoire is expected to flatline at 7.5% in 2020 spurred by higher private investment. Elsewhere, strong consumer demand is expected to support growth in Kenya (2020: 5.6%, 2019: 6.0%).

Average inflation in the SSA region is expected to ease further from 8.4% in 2019 to 8.0% in 2020, but there are wide differences again across countries. Most of the moderation is expected to come from the smaller economies. For context, headline inflation in Kenya is projected to moderate to 5.3% in 2020 (2019: 5.6%) reflecting improvement in food supply following the drought experienced in 2019. Over in Ghana, inflation should decline to 9.2% in 2020 (2019: 9.3%) as rebasing effect and impact of electricity tariff hike in 2019 fades out. On the other hand, the two largest economies – Nigeria and South Africa are set to experience higher inflation reading over 2020. In Nigeria, average inflation is projected by the IMF to advance higher to 11.7% in 2020 (2019: 11.3%). This forecast is hinged on: (i) extended border closure which should impact food prices and (ii) increase in electricity tariff which should weigh on core price. Elsewhere, inflation in South Africa is expected to increase to 5.2% over 2020 (2019: 4.4%) on the back of expected increase in electricity tariffs. The increase in electricity tariff is expected to moderate the funding shortage of the State-owned power utility firm, Eskom.

On external positions, average current account deficit is expected to widen in 2020, reflecting larger deficits in oil exporters (due to lower projected oil prices and production cut) and in countries suffering from weather-related shocks. In Angola, the IMF forecasts its current account to GDP to contract to -0.7% (2019: 0.9%) largely on the back of low oil production. This is expected to impact negatively on the country's FX reserve (\$12.6 billion) which has declined by almost 50% in just a year. Similarly, in Nigeria, rising imports, services deficit and low FPI flows is expected to weigh on the country's external balance. However, we expect the apex bank to continue its intervention, which should keep the naira stable over 2020.

Figure 5: Trend in SSA growth (%)

Source: IMF, ARM Research

An expected pickup in MENA growth

Oil output across the MENA oil exporters is expected to be weighed by continued oil production cuts. As a matter of fact, the OPEC+ countries agreed to an additional production cut of 500,000bpd in a bid to support global energy prices. Nonetheless, increased government spending in some countries will drive non-oil growth. Particularly, the implementation of ongoing infrastructure projects and improved credit conditions will help support growth. Consequently, oil exporting countries are expected to grow by 2.1% in 2020 (2019: -1.3%).

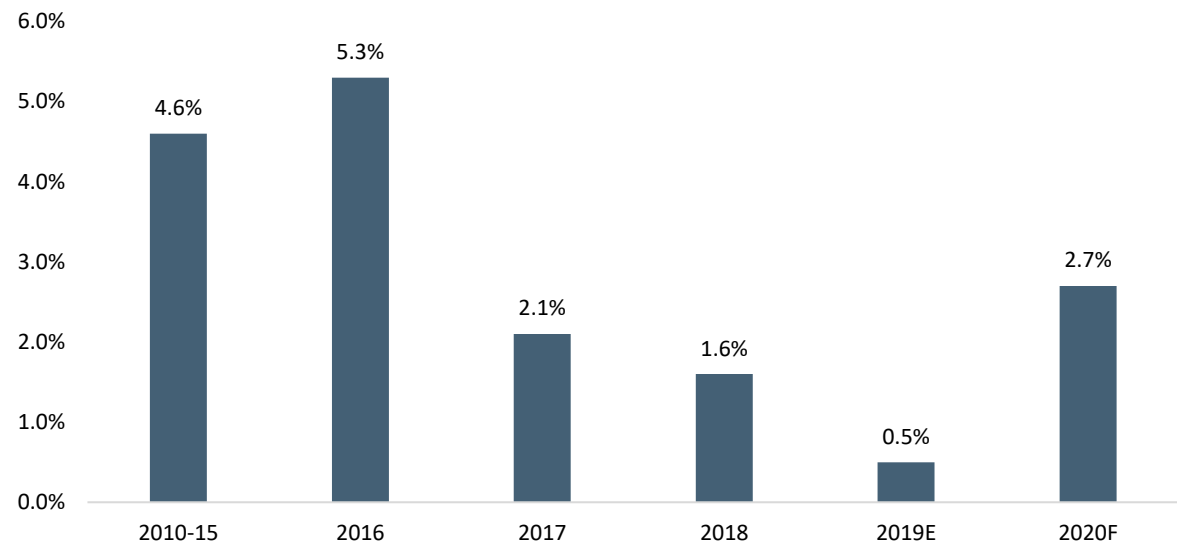
Specifically, in Saudi Arabia, GDP growth is projected by the IMF to pick up to 2.3% in 2020 after contracting 0.7% in 2019. The strong pace of growth in the non-oil sector is expected to keep up in the coming year, while the oil sector stabilizes. In Algeria, growth is expected to moderate to 2.4% in 2020 from 2.6% in 2019. The lingering political turmoil in the region is expected to leave growth stunted in 2020. For clarity, the former prime minister of Algeria's old political guard was declared President in December in a controversial vote marred by protests and apathy, signaling that the political turmoil is far from over in the North African nation. Elsewhere, output in Iran is expected to shrink further as US sanctions have continued to tighten.

For oil importers, real GDP growth is expected to remain around 3.7% from an estimated 3.6% in 2019, largely driven by resilient growth in Egypt. Economic growth in Egypt should stabilize in 2020. Particularly, higher government spending, improved ease of doing business

and lower interest rates should support fixed investment growth. Overall, GDP for the MENA region is expected to come in at 2.7% in 2020 from 0.5% in the previous year.

Looking ahead, current account deficits for the MENA countries are likely to stay broadly unchanged on the back of gloomy outlook for oil price. Elsewhere, inflation is forecast to stabilize over the medium term as level effects (particularly those from exchange rate depreciation) fade.

Figure 6: Trend in MENA growth (%)



Source: IMF, ARM Research

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>

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