

Nigeria Strategy Report

H1 2020

Domestic Economy and Policy Environment

GDP: Economic growth should remain anemic, flatlined at 2.2%

Executive Summary

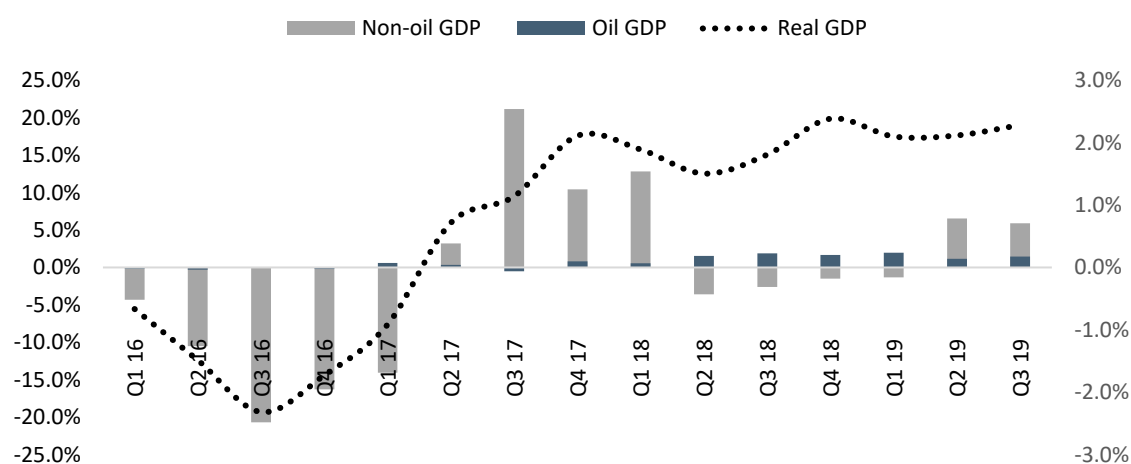
The growth momentum remained positive over 2019, with Q3 19 GDP growth of 2.28% augmenting the trend over the first half of the year. Ergo, the economic output expanded by 2.2% YoY over the first nine months in 2019 with support stemming from both the oil and non-oil sectors. Specifically, improved average crude production at 2.02mbpd (9M 18: 1.92mbpd) drove the expansion in the oil sector (+4.1% YoY) while growth in the non-oil sector (+2.0% YoY) mirrors improved output from both the agriculture and services sectors. Over the last quarter of 2019, we project crude production would print at 2.06mbpd (Q4 18: 1.91mbpd), which translates to 7.9% YoY growth in oil GDP. For the non-oil territory, improvement in services, agric and manufacturing sectors informs 1.9% YoY growth in non-oil GDP. Consequently, we expect the economy to grow by 2.4% YoY in Q4 19 which translates to a FY 19 real GDP growth rate of 2.2%.

Central to growth over 2020 is an anemic pick-up in economic output, with the non-oil sector still the fulcrum. Oil sector at the other end is expected to slow as crude production gradually peaks. On a general note, though recent policies by the apex bank have been directed towards increased lending to the real sector, we do not expect an immediate passthrough to the economy. Our stance is hinged on banking sector's averse nature towards lending to the real economy as well as persistent infrastructural deficit yet to resolved by the FG. On that note, we expect economic growth over 2020 to flatline at 2.2% YoY- which is our base case.

In this report, we focus on development in the domestic environment, highlighting our views on the drivers for growth over 2020.

Q1 19 GDP: Strong start to the year but not great

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Figure 1: Growth in Real GDP vs contribution from Oil and Non-oil sectors

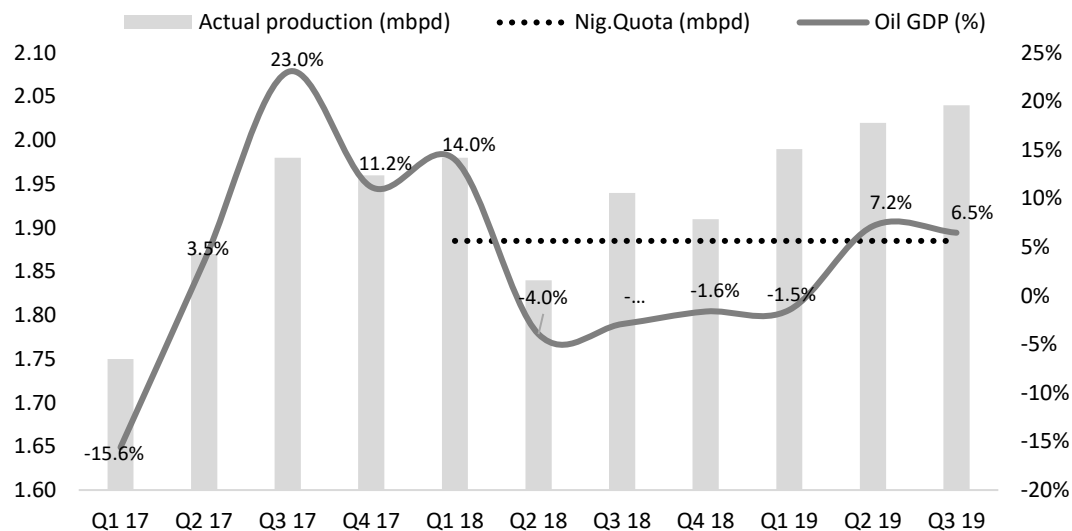
Source: NBS, ARM Research

Oil sector exits recessionary waters

After reporting a contraction in Q1 19 – an extension of pipeline leakages which beset the oil sector since Q2 18 - we saw a recovery in Q2 19 with support stemming from new production at the Egina oil field. Consequently, crude production crossed the 2mbpd threshold and maintained the momentum in Q3 19 touching 2.04mbpd. As a result, oil GDP expanded by 6.5% YoY in Q3 19. Cumulatively, Nigeria added a total of 97,000 barrels to its daily crude production over the first nine months of 2019, taking its output to 2.02mbpd (9M 18: 1.92mbpd). Accordingly, oil GDP expanded by 4.1% YoY (9M 18: 2.4% YoY). Going off on a tangent, the increased production shows Nigeria's continued noncompliance with the required OPEC cut. We recall OPEC and its allies included Nigeria and Libya in the production agreement in 2018, aimed at reducing the

organization’s production level by 1.2mbpd in a bid to support crude oil prices. Full compliance with the agreed cut should have taken Nigeria’s crude production to 1.885mbpd (incl.200kbpd condensates). Therefore, at over 2mbpd production, we recorded zero compliance over the first nine months of 2019.

Figure 2: Trend in oil production vs Nigeria’s Quota and oil GDP

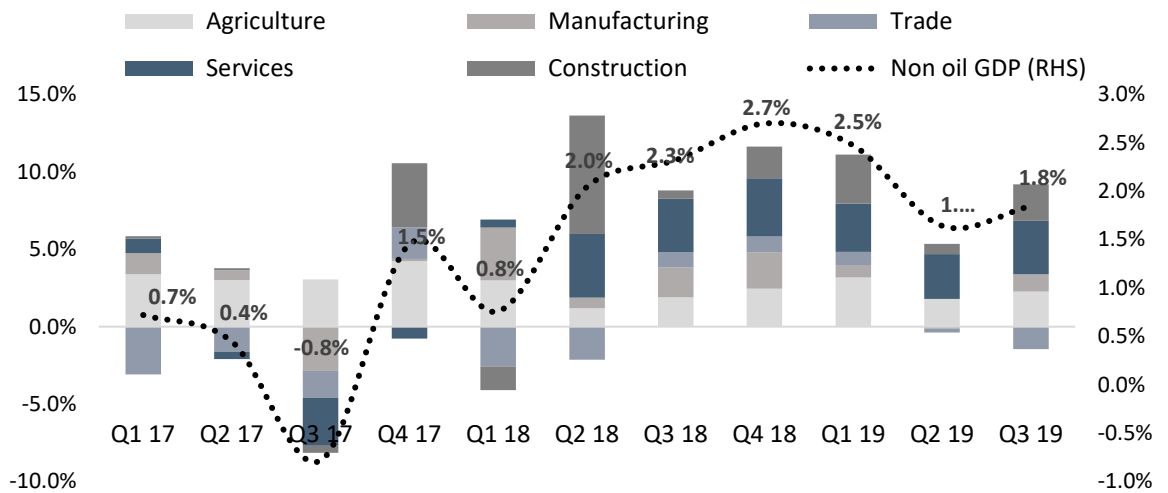


Source: NBS, ARM Research

Non-oil sector maintained its solid momentum

After a strong start to the year, activities in the non-oil sector moderated over in Q2- reflecting a slowdown in services, construction as well as a contraction in manufacturing sectors. On the former, moderate growth in subscriber base and in turn ICT drove the slowdown, with muted capex spend slowing activities in the construction sector. Elsewhere, intense competition from both domestic and foreign goods muddled activities in the manufacturing sector. Further pressure on the non-oil sector stemmed from a return to contractionary trend in the trade sector, despite improved FX stability and liquidity. However, activities picked slightly in Q3 19 hinged on regained momentum in services sector and sturdy output in Agric. The improvement in Agric mirrors FG’s effort in curbing the squabble in the northern region. Nonetheless, the strong outturn in Q1 19 left non-oil sector growth at 2% YoY for the nine-month period – slight uptick from 1.7% YoY recorded over similar period in the prior year.

Figure 3: YoY growth in the non-oil sector

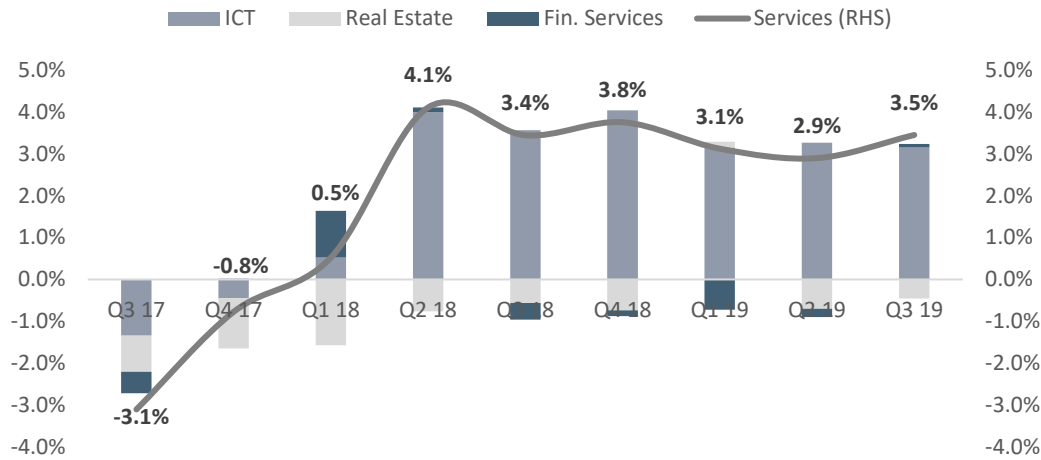


Source: NBS, ARM Research

Asides ICT, softening pressure in real estate upholds Services sector

Expansionary trend in the services sector which started in the prior year slowed to 3% over Q2 19 buoyed by a mild moderation in ICT segment. However, the sector regained its momentum in Q3 expanding by 3.5% YoY with support stemming from the ICT, real estate and financial services segments. Accordingly, the services sector expanded by 3.2% YoY over 9M 19 (9M 18: 2.7% YoY) with improved outturn in ICT and slower contraction in real estate segment leading the pack. On the former, increased data and voice subscriptions, borne out of incessant promotional offers spurred expansion in ICT with active subscribers expanding by 11.2% YoY to 175 million subscribers. Meanwhile, the slower contraction in real estate mirrors increased focus in the affordable housing segment for middle income earners, in our view. Further supporting the improved outturn is the financial services which took a different turn in Q3 19. We recall the financial services swerved into recession in the early part of 2019, hinged on sector-wide reluctance to grow loans. Albeit, recent directive by CBN to banks on an increment in minimum loan -to -deposit ratio to 65% gave support to the sector. To buttress, the banking sector grew loans by ₦817 billion over the review period (9M 18: 249.7 billion). Consequently, the contractionary trend in financial services took a break, with the segment expanding by 1.1% YoY.

Figure 4: Trend in Services GDP and key sub-components

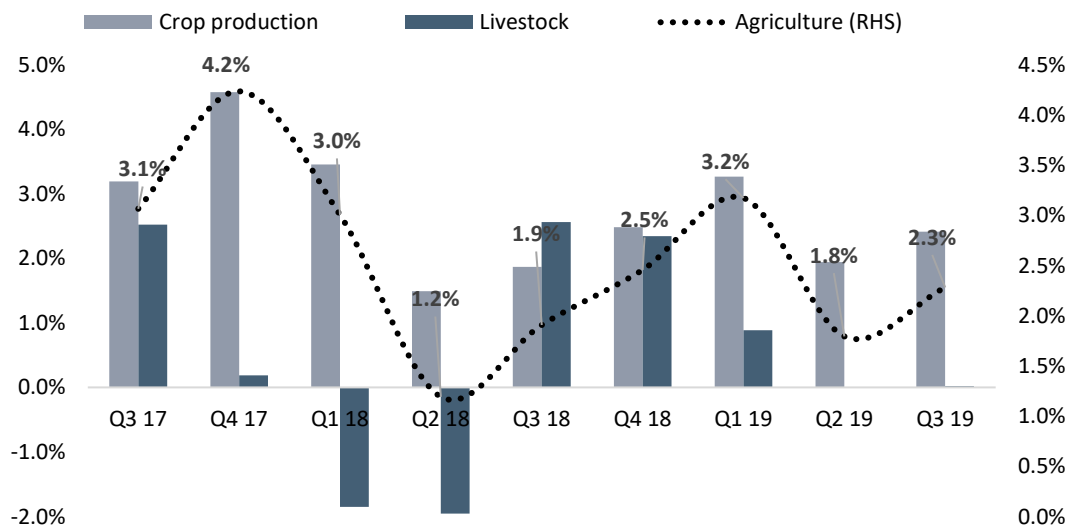


Source: NBS, ARM Research

Agric: Output improves on tapered conflict

Activities in the Agric sector took a different turn over the first nine months of 2019 relative to 2018, following an improvement in crop production. We recall crop production for most part of 2018 was muddled by conflict in the northern region. Albeit, efforts reined in by FG as well as steps taken by some state governments against armed bandits, particularly Zamfara helped mitigate the tussle. Accordingly, the Agric sector grew by 2.3% YoY over Q3 19 (vs Q3 18: 1.9% YoY) which in turn translates to nine-month sector growth of 2.4% YoY (9M 18: 2% YoY).

Figure 5: Trend in Agric GDP and key sub-components



Source: NBS, ARM Research

Intense competitive landscape muddles growth in the manufacturing sector

2019 was a tough year for the manufacturing sector muddled by the confluence of increased competition and election - driven slowdown over Q1 19. Accordingly, the sector only expanded by 0.6% YoY over the 9M19, compared to 2% recorded over similar period in the prior year. Specifically, the downturn was observed amongst the key sub-segment – food and textile production – which jointly account for 68% of the sector output. Taking a cue from the food producers within our coverage, the telling impact of electoral activities and competition was evident in sales numbers reported which either contracted or slowed over the review period. Accordingly, food production (FBT¹) slowed to 2% YoY (9M 18: 3.2%). Also, following the FX restriction on textile imports in March, the textile industry contracted over Q2 and Q3 – bucking the expansionary trend observed in prior ten quarters. For us, while the policy was expected to have a positive effect on the sector, its premature implementation – given the smuggling challenges was still apparent led to the contraction. Consequently, the textile industry contracted by 0.5% YoY over nine-month 2019 compared to an expansion of 2% YoY recorded over similar period in the prior year. Though, food production improved slightly in third quarter - contraction in textiles and a slowdown in cement led to a manufacturing sector growth of 1.1% YoY (Q3 18: 1.9%).

Elsewhere, growth in the construction slowed to 2.07% YoY over 9M 19 (vs 9M 18: 2.22%). We believe the moderation is not unrelated to reduced CAPEX spend which printed at ₦372 billion (9M 18: ₦398 billion). At the other end, trade contracted by 0.2% YoY, albeit an improvement from -1.24% reported over 9M 18.

With no key catalyst in near term, it's same old story.

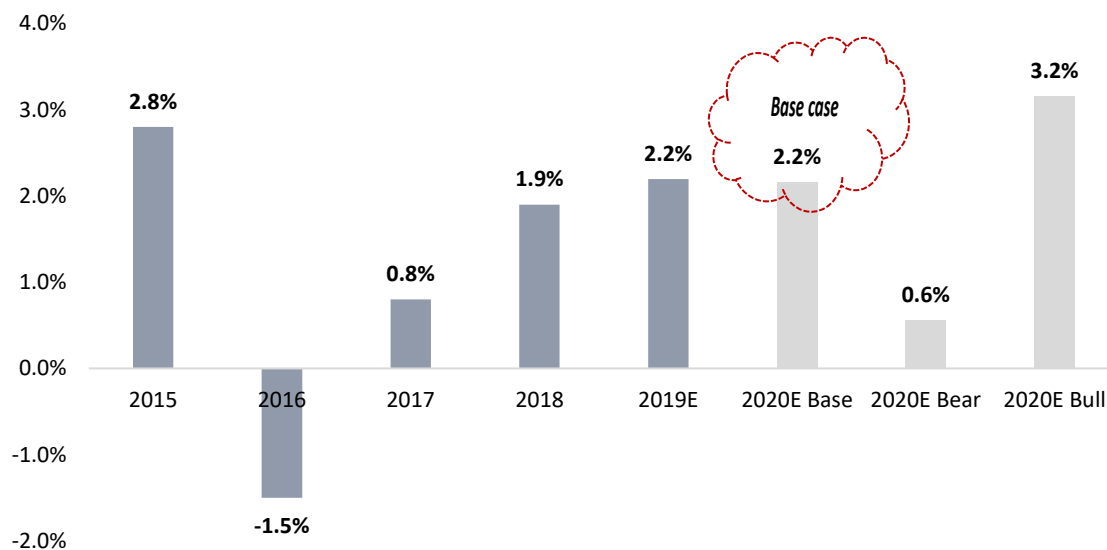
Central to growth over 2020 is an anemic pick-up in economic output, with the non-oil sector still the fulcrum. Oil sector at the other at the other end is expected to slow as crude production gradually peaks. On a general note, though recent policies by the apex bank have been directed towards increased lending to the real sector, we do not expect an immediate passthrough to the economy. Our stance is hinged on banking sector's averse nature towards lending to the real economy as well as persistent infrastructural deficit yet to be resolved by the FG. On that note, we expect economic growth over 2020 to flatline at 2.2% YoY- which is our base case.

For our bull case scenario, better than expected output in services, increased private involvement in Agric and zero compliance to OPEC cuts informs our growth estimate of 3.2% YoY.

¹ Food, beverages and tobacco

While our bear case mirrors intense conflict in the northern region and in turn Agriculture, moderate activities in ICT and full compliance with OPEC agreed cuts informs the growth estimate for our bear case at 0.6% YoY.

Figure 6: Annual real GDP growth



Source: NBS, ARM Research

Starting out with non-oil sector, sturdy output in services and regained momentum in manufacturing and Agriculture sectors are pivotal to our growth estimate over 2020. On the former, incessant promotional offers by key stakeholders is expected to spur growth in subscriber base, particularly data subscribers and invariably ICT segment. For context, our checks revealed lower data pricing across the three key network providers by offering higher data for similar prices. On that note, using the 5-year cumulative annual growth rate (2015 - 2019) - we expect active subscribers to print at 188 million by 2020. Still in the services sector, we see a slower contraction in real estate and mild improvement in financial services. In real estate, our stance is hinged on continued focus on affordable housing with renewed attention on mortgages. While the adverse nature of the banking sector towards real sector lending informs a mild growth in the segment. Ergo, we expect the services sector to grow by 3% YoY (2019: 2.8% YoY).

In the manufacturing terrain, while competition from imported goods would persist – the absence of election driven slowdown we saw in Q1 19 coupled with sturdy output in the cement space supports our stance for regained momentum over 2020. On food and textile production, we think the border closure would only give mild support to the competitive environment.

On food, besides smuggled goods, the market is saturated with both domestic and legally imported goods – thereby tapering the policy impact. On textiles, persistent infrastructural deficit despite increased lending to the sector supports our stance of a mild pick-up. While for cement, increased focus on the export with new terminals coming on board supports our stance for improved segment output. Therefore, with FX being stable and available at current levels, improved focus on export growth and mild support from border closure, we expect the sector to grow by 2% YoY over 2020 (FY 19: 0.7% YoY).

Furthermore, reduced flooding risk and improved output during main harvest season which invariably translates to higher market supplies forms our basis for an improvement in the Agric sector. Besides, the low base in 2019 coupled with support from private sector participation in farming activities gives credence to improved output in 2020. According to FEWSNET, 2020 rainfall is expected to begin normally across the country and harvest would remain above average. Though, conflict in northwest and central areas is expected to persist, we believe continued efforts by FG to mitigate its impact poses further upside the sector growth. On that note we expect the Agric sector to grow by 3.5% YoY over 2020 (FY 19E: 2.6% YoY). On that note the non-oil sector is expected to expand by 2% YoY (FY 19E: 1.8% YoY).

On the flipside, growth in the oil sector is expected to slow as crude production gradually peaks at 2.2mbpd - highest production level attained over the last five years. With increased focus on compliance to the OPEC cut, we do not foresee significant growth in the oil sector. Full compliance means Nigeria's production would be capped at 1.97mbpd (including Condensates) and a contraction of 0.3% YoY over 2020. However, for our base case, we expect partial compliance and increased production of condensates to make up for the loss in crude production. On that note, daily average crude production is expected to print at 2.1mbpd which translates to our 2020 growth estimate of 3.6% YoY (FY 19E: 6.3% YoY).

Overall, coalescing our expectation for both oil and non-oil sectors translates to an economic growth of 2.2% for FY 2020.

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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