

Nigeria Strategy Report

H2 2018

Domestic Economy and Policy Environment

Growth to run above 2%, but nearing a cyclical peak

Executive Summary

Amidst improved activities in the oil sector and resilient growth in Agric, the Nigerian economy grew by 1.95% YoY in Q1 18 (Q4 17: 2.1% YoY). The reported numbers missed our estimate of 3.1% hinged on the surprising contraction in trade and construction sectors. Drilling to the sub components, oil sector growth (14.8% YoY) was a core component in driving growth, accounting for 64.5pps. On the non-oil leg, the Agric (3%), Manufacturing (3.4%), and Services (0.5%) sectors led the improved picture in the non-oil domain to drive a 0.8% growth YoY.

Over 2018, contrary to the oil led growth seen in Q1 18 – we foresee the non-oil sector to be the major driver for growth over the rest of the year and thus revise our growth projection for 2018 to 2.1%. First off, we revise our oil sector growth to 5.8% (previously: 8.5% YoY) due to revised volumes for Q2 2018 to 1.89mbpd due to temporal closure of trans-forcados in May. On the non-oil leg, we now revise our forecast higher to 1.8% (previously: 1.3% YoY), hinged on development mainly in the Agric, Services and Manufacturing subsectors. Thus, given the rosy picture in the non-oil domain and its contribution¹ to overall economic activities – the Nigerian economy is set to ride on the wings of non-oil growth in 2018.

From where we stand, the economic picture looks bleak in 2019 as growth is expected to slow relative to current year. First off, our expectation of crude production (2mbpd) sets a high base for oil sector growth in the coming year – leaving the non-oil as pioneer for 2019 growth. That said, as with prior years, we are majorly positive on Agric in the short term. Hence, with little government support to the other non-oil sectors, growth in that territory would be slow. Given its contribution to overall economic growth, the year 2019 economic picture holds little promises relative to current year.

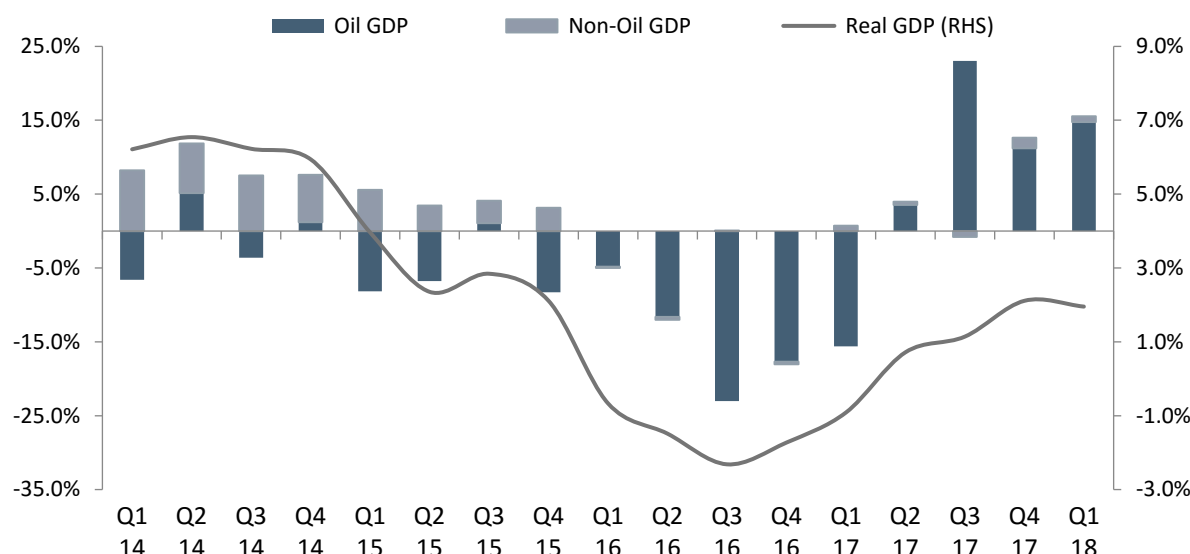
In this report, we focus on development in the domestic environment, highlighting our views on the drivers for economic growth over 2018

¹ Accounts for 90% of economic activities as at Q1 18

Q1 18 GDP growth pivoted on oil and Agric Output

Amidst improved activities in the oil sector and resilient growth in Agric, the Nigerian economy grew by 1.95% YoY in Q1 18 (Q4 17: 2.1% YoY). The reported numbers missed our estimate of 3.1% hinged on the surprising contraction in trade and construction sectors. Drilling to the sub components, oil sector growth (14.8% YoY) was a core component in driving growth, accounting for 64.5pps. On the non-oil leg, the Agric (3%), Manufacturing (3.4%), and Services (0.5%) sectors led the improved picture in the non-oil domain to drive a 0.8% growth YoY.

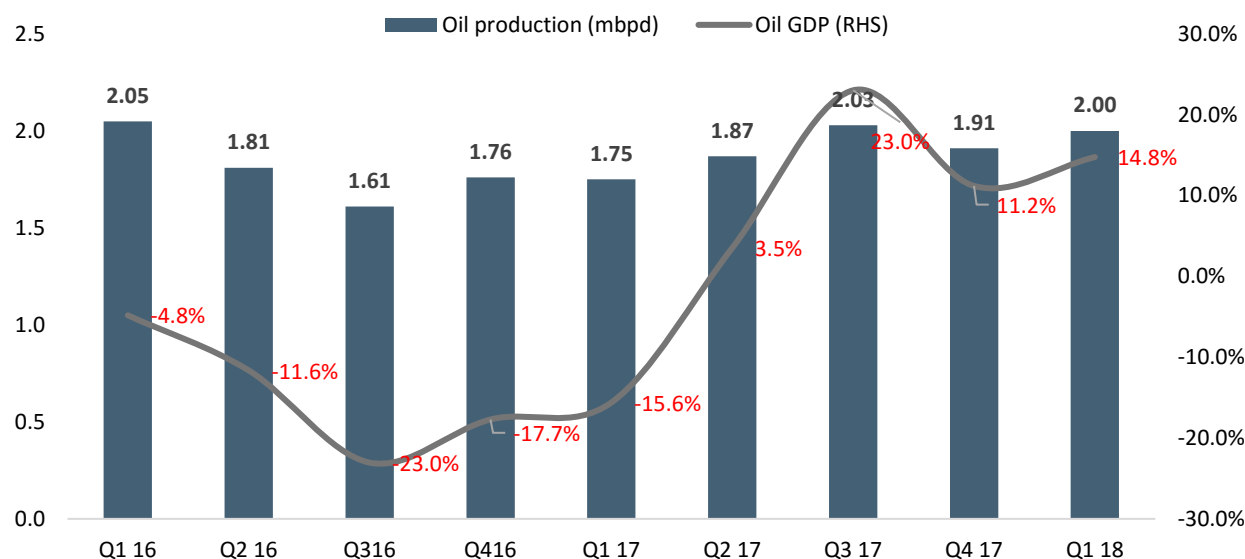
Figure 1: Trend in YoY GDP growth



Source: NBS, ARM Research

A quick dive on crude oil shows crude production maintained its uptrend, with Q1 18 output printing at 2mbpd (+14.3% YoY) hinged on base effects from low production in Q1 17 (1.75mbpd) as well as resumption of export activities at the trans forcados pipeline. According to the NNPC (monthly report for Q1 18), the increase in production reflects efforts put in place to resuscitate vandalized pipelines. Accordingly, the oil sector reported a growth of 14.8% YoY in the period under review.

Figure 2: Trend in Crude Production (mbpd)

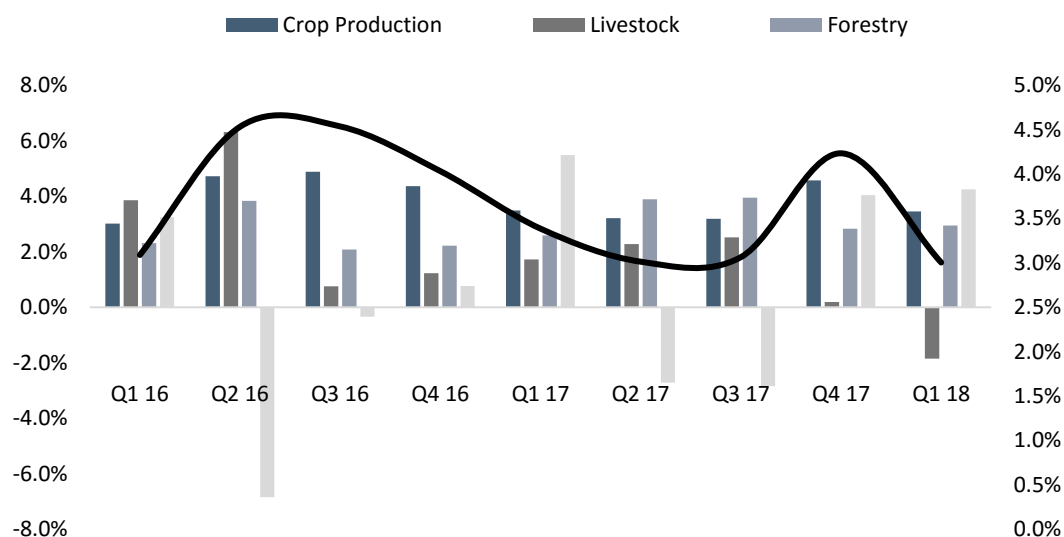


Source: NNPC, NBS, ARM Research

Herders conflict muddles growth in the Agric Sector

As earlier stated, growth in the non-oil sector was braced by sustained growth in Agriculture and Manufacturing sectors, as well as recovery in Services sector. On Agriculture, which grew by 3% YoY, growth reflected increase in crop production (+3.5% YoY). According to FEWSNET, improved crop production is largely hinged on government support through the Anchor Borrowers Program which has contributed to farmers access to improved inputs. More so, fishing and forestry subsectors expanded by 4.2% and 2.9% YoY respectively. On the flip side, livestock subsector contracted by 1.9%, the first in 20 quarters. In our view, the contraction resonates with worsening pastoralists conditions borne out of cattle rustling and dry spells in the north – with Benue, Kaduna, Nasarawa, plateau and Zamfara being the most affected states as revealed by FEWSNET.

Figure 3: Trend in Agric GDP growth and Sub Components

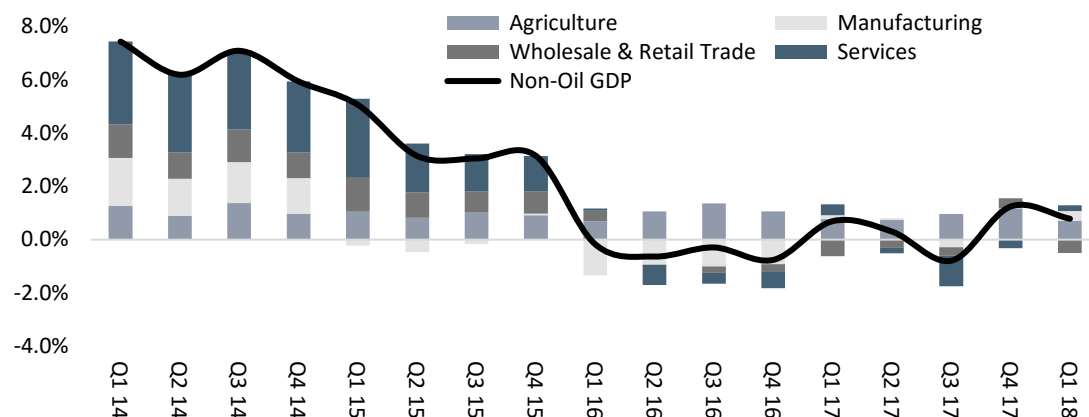


Source: NBS, ARM Research

The manufacturing sector grew by 3.4%, buoyed by the robust growth reported in the food beverage & tobacco (FBT), Textiles, Apparel & Footwear (TAF) and cement subsectors². For us, we believe the improved dollar liquidity reinforced activities in FBT and TAF subsectors as the strain on consumer spending still exists whilst improved private spending buoyed demand for cement sub sector. For context, industry cement volumes rose by 7% YoY based on our estimate. On another end, the services sector grew by 0.5% YoY, reversing the contractionary trend which started since Q2 17 hinged on higher output in ICT (1.6% YoY), Finance & insurance (13.3% YoY), and transport (14.4% YoY) sub sectors, which accounts for a combined 57.9%. Firstly, within ICT, telecommunication subsector was the major driver as the growth in data services (+11.2% YoY to 100 million subscribers) offset the impact of a downturn in voice calls (-3.6% YoY to 148 million active subscribers). On financial services, output growth is explained by higher revenue from non-core banking operations such as fee income.

² The sectors grew by 5.5% YoY, 1.9% YoY and 5.3% YoY respectively

Figure 4: Attribution Analysis of the Non-Oil Sector growth.

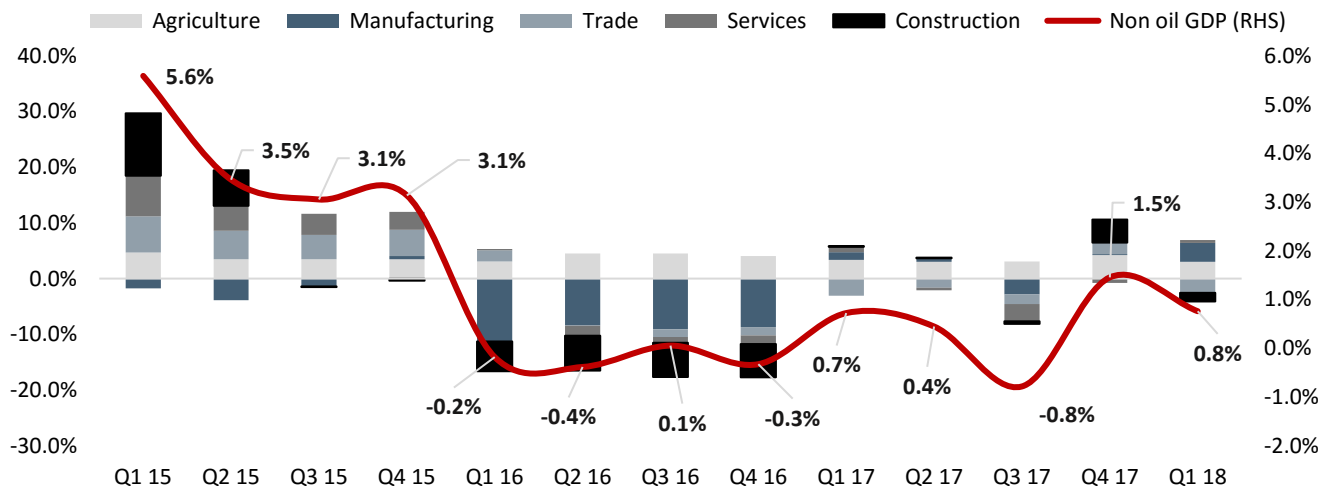


Source: NBS, ARM Research

Again, Trade and construction plummets to Negative Territories

The trade sector contracted by 2.6% after reporting a robust growth of 2.1% in Q4 17. Whilst the dollar availability had enhanced trade with foreign countries, we perceive a slowdown in domestic demand was a major driver for the contraction in this sector – a reflection of the strain on consumer income. On other font, activities in the construction sector decelerated by 1.5% YoY owing to muted government spending in the review period.

Figure 5: Trend in non-oil subsector growth vs overall Non-Oil GDP growth



Source: NBS, ARM Research

Non-Oil Sector – Front runner for 2018 growth

At the start of the year, we had maintained a cautious stance on growth with a forecast of 1.9% over 2018 hinged on the expectation of improved activities in the Agric and Oil sectors despite headwinds in services and muted growth in the manufacturing sector. However, the numbers reported in Q1 18 reveal the headwinds previously captured has gradually fizzled

out. Consequently, contrary to the oil led growth seen in Q1 18 – we foresee the non-oil sector to be the major driver for growth over the rest of the year and thus revise our growth projection for 2018 to 2.1%.

Starting off with the oil sector, while there was a slowdown in production in Q2 18 hinged on temporal closure of trans-forcados in May—commencement of production activities at the egina oil field³ as well as the re-opening of trans-forcados which occurred in June—is expected to boost production in the second half of 2018. Consequently, we forecast an average crude production of 2mbpd for FY18 which translates to a growth of +5.8% YoY (previously: 8.5% YoY). For clarity, we estimate the country's crude production would print at 1.94mbpd in H1 18 and 2.06mbpd in H2 18.

On the non-oil sector, wherein we forecast a growth of 1.8% YoY (prior: 1.3% YoY), Agric and Services are set to be the major driver for growth in coming quarters. On the former, we expect a sector growth of 3.3% YoY for FY 18 hinged on continuous support from the government directed towards farmers and favorable rainfall, with limited impact of flooding as reported by FEWSNET⁴. However, our estimate is slightly lower than FY 17 growth of 3.4% as we expect a sustained contraction in livestock this year. For context, while the start of the rainy season has welcomed availability of water and pasture, the incessant cattle rustling and conflict between the herdsmen & farmers guides to a more cautious outlook in the sub sector. The services sector at the other end would likely benefit from improved activities in both the ICT and financial services subsector via increased data penetration and non-interest revenue on financial transactions. For context, with tele-density⁵ for data services currently at 73%, relative to voice calls of 116.26%, the sub sector growth is likely to stem from improved data penetration. Consequently, we expect a sector growth of 1.3% YoY. Elsewhere, the manufacturing sector is expected to grow by 2.6% YoY, hinged on improved FX availability as the apex bank continues to take actions to avoid any currency shock.

Notwithstanding the contraction seen at the start of the year in construction and trade, we expect a mild pick up in activities. First off, the passage of the 2018 budget is expected to aid payments for ongoing construction projections which should help spur activities in the sector which combined with improved activities in the private sector drives our view of +0.5% YoY growth in the sub sector.

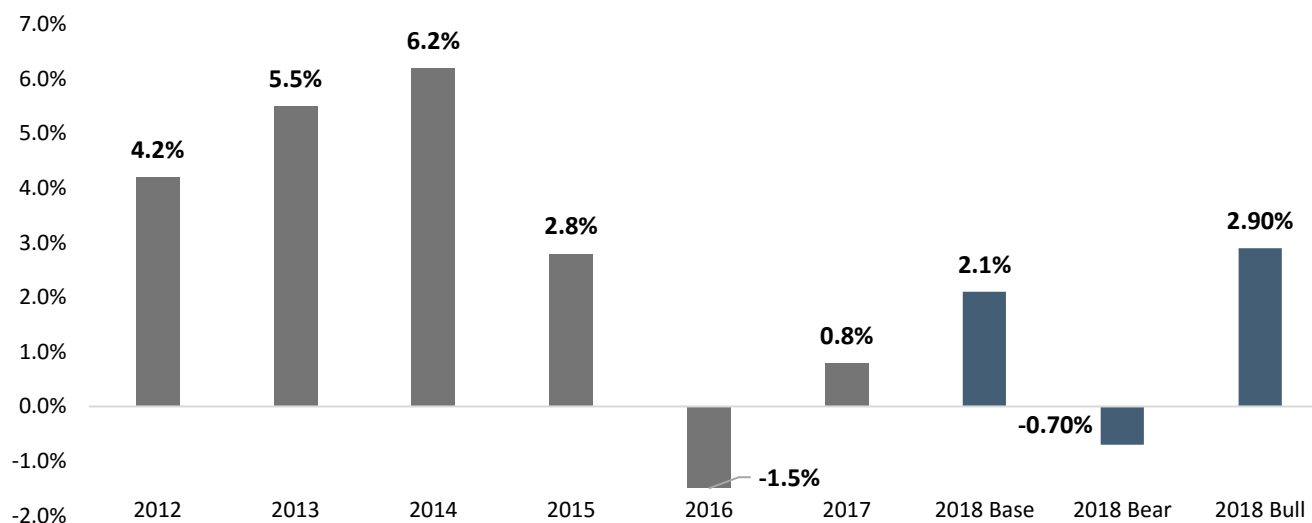
³ The oil field is expected to produce a peak production rate of 200kbpd

⁴ According to FEWSNET, rainfall duration is likely to be within normal levels with usual seasonal flooding in the flood prone areas

⁵ Tele-density serves as a measure for industry penetration

Away from construction, trade sector is expected to grow by 0.1%, hinged on a mild pick up in domestic demand even as we do not expect any currency shock over the rest of the year. Coalescing our expectation for each sector translates to a non-oil sector growth of 1.8% for FY 18. Given the rosy picture in the non-oil domain and its contribution⁶ to overall economic activities – the Nigerian economy is set to ride on the wings of non-oil growth in 2018.

Figure 6: Annual Real GDP Growth



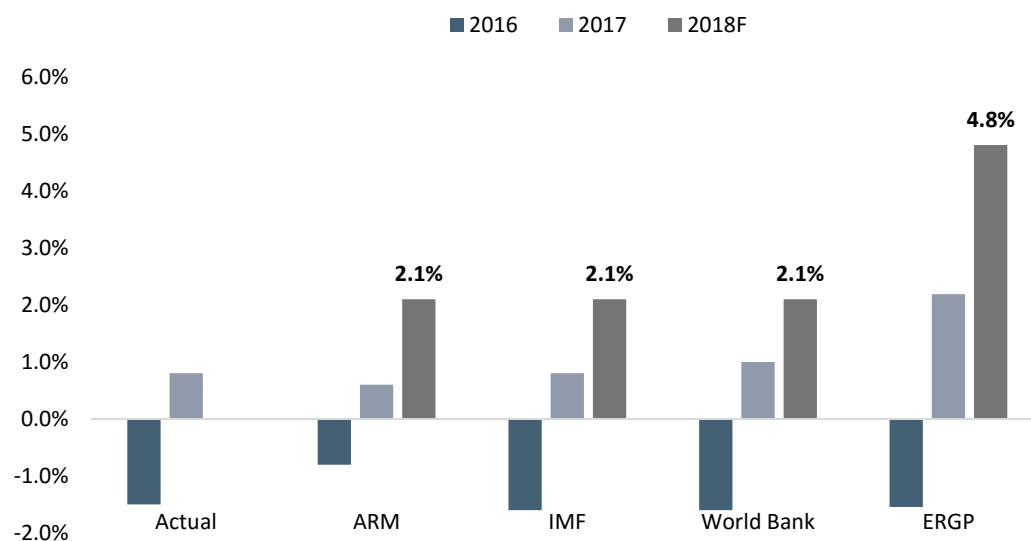
Source: NBS, ARM Research

Having examined different scenarios, we forecast an economic growth of 2.9% YoY under our bull case hinged on production estimate of 2.1mbpd and increased government support to major sectors, such as Agriculture, Services and Manufacturing sectors. However, the downside to the forecast remains the resumption of militant activities, muted government support to the farmers as well as sustained deceleration in services sector which forms our bear case estimate of -0.7% YoY.

From where we stand, the economic picture looks bleak in 2019 as growth is expected to slow relative to current year. First off, our expectation of crude production (2mbpd) sets a high base for oil sector growth in the coming year – leaving the non-oil as pioneer for 2019 growth. That said, though the government has shown more interest in diverting funds to other sectors of the economy – as with prior year it's the Agricultural sector that has enjoyed the benefits so far. Hence, with little government support to the other non-oil sectors, growth in that territory would be slow. Given its contribution to overall economic growth, the year 2019 economic picture holds little promises relative to current year.

⁶ Accounts for 90% of economic activities as at Q1 18

Figure 7: YoY GDP Actual and Forecast



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

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