

July 22, 2019



Nigeria Strategy Report

H2 2019

Global Economy and Markets

Wobbly growth picture, more tilted to the downside

Executive Summary

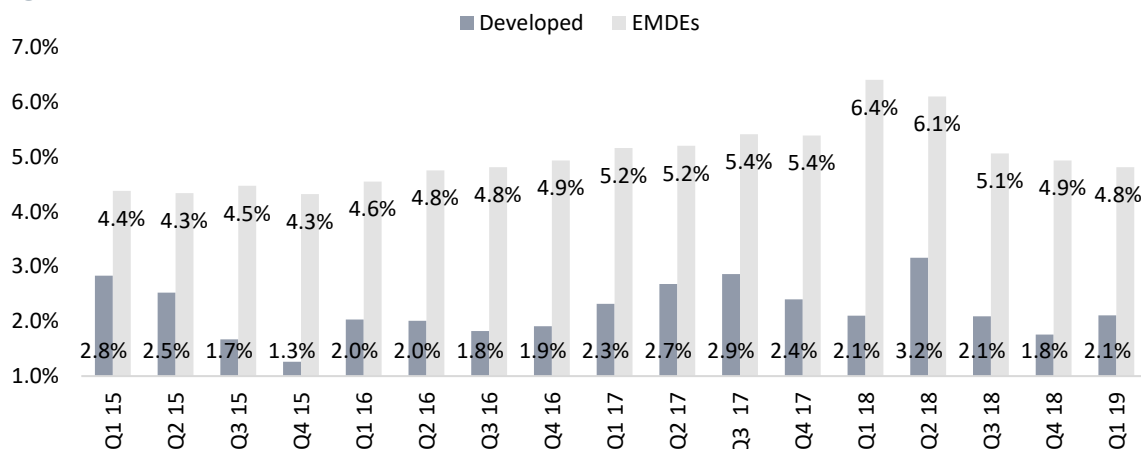
Negating rhetoric at the beginning of the year of a broad-based deceleration in growth across Developed Markets (DMs) and stagnant growth in Emerging and Developing Economies (EMDEs), economic growth in DMs surprised over the first quarter of 2019 – expanding 2.1% YoY compared to 1.8% in Q4 18 –, while growth in EMDEs decelerated by 10bps to 4.8% YoY. For advanced economies, the resilient growth was underpinned by persisting accommodative monetary and fiscal conditions which supported household spending and investment in U.S, U.K and the Eurozone. Elsewhere in EMDEs, the sluggish growth emanated from cutback in investment especially in oil importing countries and the knock-on effect of the lower commodity prices on oil exporting countries.

Notwithstanding the strong outturn at the start of the year, global growth is expected to moderate to 3.3% over 2019 (2018: 3.6%) reflecting the impact of unresolved trade tensions between U.S and China, possibility of destabilizing policy developments in the U.K, the lag impact of persisting lower commodity prices and renewed financial turmoil in EMDEs. Being a delicate year for the global economy, the policy environment (both monetary and fiscal) is expected to be largely accommodative across DMs and EMDEs. That said, growth in DMs is expected to print at 1.9% YoY (FY 18: 2.3% YoY) while growth in EMDEs is projected to slow to 4.8% YoY (FY 18: 4.9% YoY).

In this report, we look at the major themes that dominated the global, economic and financial landscape over H1 19, as well as our outlook over the rest of the year.

Heightened tensions muddle global growth

At the start of the year, the slowdown across the global economy witnessed over the second half of 2018, had informed expectation of stagnant growth coming into 2019 with IMF projecting global GDP growth to match the level over 2018. Specifically, US Fed's guidance of rates hike over 2019, the reduction in the assets purchase programme of the ECB amidst uncertainties emanating from the UK's divorce from EU had necessitated our expectation of a deceleration in growth in advanced economies by 30bps YoY to 2.1%. Growth in Emerging market and developing economies (EMDEs) on the other hand was projected to remain stagnant at 4.7% YoY, following expectation of recoveries in Latin America, Sub-Saharan Africa and Saudi Arabia, the confluence of which was expected to more than outweigh the impact of lower crude oil prices on oil exporting countries. However, output in advanced economies expanded by 2.1% over the first quarter of 2019 – compared to 1.8% recorded in Q4 18, while growth across emerging economies decelerated by 10bps to 4.8% YoY. For advanced economies, the resilient growth was underpinned by persisting accommodative monetary and fiscal conditions especially in US, UK and the Eurozone. Elsewhere in EMDEs, the sluggish growth emanated from cutback in investment especially in oil importing countries and the knock-on effect of the lower commodity prices on oil exporting countries.

Figure 1: Trend in Global GDP Growth (%)

Source: Bloomberg, ARM Research

Accommodative policy environment spur growth in DMs

Coming off a deceleration in Q4 18, GDP growth strengthened in the US over the first quarter of 2019 to an annualized rate of 3.1% YoY (Q4 18: 2.2% YoY), negating discussions of looming recession at the start of the year. The higher than expected growth emanated from strong growth in private domestic investment (a fallout of inventory buildup), increase in net exports¹

¹ Following increased export of 4.5% YoY relative to a decline in imports by 2.5% YoY

and higher government spending on defense. On the other end, Personal Consumption Expenditure (PCE)² – which serves as a gauge of consumer demand – decelerated to 1.3% YoY (Q4 18: 2.5% YoY). However, recent data showed recovery in consumer demand, with consumer confidence index³ for the month of April and May printing at 129.2 (+4.1% MoM) and 134.1(+3.8% MoM) index points respectively, relative to the decline observed in January (-6.2% MoM) and March (-5.6% MoM).

In the Eurozone, real GDP expanded by 1.2% YoY (same as the prior quarter) supported by fiscal measures in some member states and improved household spending⁴. On the former, household spending across the region was supported by growth in wages and employment, favourable financing conditions and muted inflation. For context, wages expanded by 2.5% YoY (Q4 18:2.3% YoY) and the rates of employment grew by 1.3% YoY. Amongst the large Eurozone economies, Spain sustained its lead, expanding by 2.4% YoY (Q418: 2.3% YoY), while growth in France expanded by 1.2% (unchanged from the prior quarter) despite continued protest over fuel price increase and high cost of living during the period. In Germany, notwithstanding the impact of global trade tensions on the export sector, growth in the construction and manufacturing, and investment supported growth over the period with GDP expanding 0.7% YoY (Q4 18: 0.6%). To add, the Italian economy exited recession with growth printing at 0.1% due to improvement in industrial and agricultural sector. While this is positive, the country's outrageous debt levels at elevated yields still places a strain on the country's potential growth as it crowds out activities in the private sector. To buttress, at the end of 2018, country's public debt closed out at a ca.\$2.0 trillion – the second highest in Europe.

Economic growth in Britain strengthened over Q1 2019 by 1.8% YoY⁵ (1.2% in Q4 18), propelled by a strong performance in the services sector which grew 2% YoY (Q4 18: 0.5% YoY). Notably, compared to the prior quarter, the manufacturing sector expanded 1.2% YoY (Q4 18: -0.7% YoY) to support the overall growth. On the political clime, compared to expectation of a full resolution of BREXIT over Q1 2019, further drag on negotiation beclouded activities in the economy with the new exit date now tentatively extended until end of October 2019. Further complicating the process, is the resignation Theresa May, which further heightened uncertainty in the polity.

² Consumption accounts for two-thirds of the overall economy.

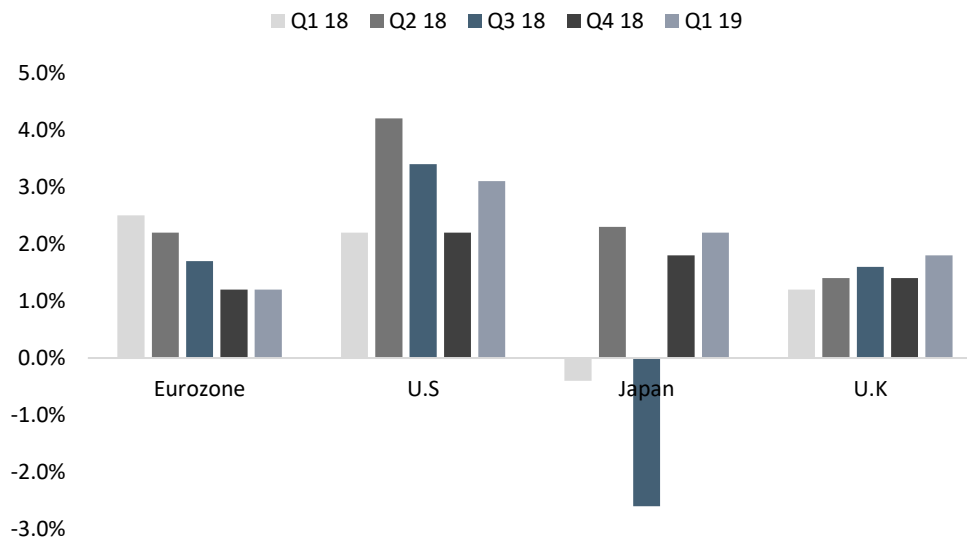
³ Consumer confidence is a leading indicator used in predicting consumer spending

⁴ Each expanding by 1.1% YoY over the review period

⁵ The fastest pace growth since Q3 17

Similarly, economic activities in Japan expanded by an annualized rate of 2.2%, a pickup from 1.8% recorded in Q4 18. The outing reflects an expansion in net exports and improvement in public investment. For clarity, imports over the period declined sharply by an annualized rate of 17.2% YoY, overshadowing the 9.3% decline in exports. Further supporting growth is the 4.7% expansion in public investment, bucking the contractionary trend observed over 2018 which together masked the slowdown in private and public consumption.

Figure 2: GDP growth in developed economies



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

Monetary Policy clime still accommodative but fading

Coming into the year, hawkish tone in monetary policy in advanced economies dominated discussions as the downside risk to global growth. However, the sharp drop in commodity prices – which necessitated moderation in energy prices across advanced and oil importing EMDE economies – coupled with the impact of the retaliatory trade developments, informed a change in the rhetoric with monetary policy remaining largely accommodative over H1 2019. In the US, at the end of 2018, the Fed had guided to two rate hikes over 2019. However, the subdued inflation rate⁶ and the risks to current rate of economic expansion necessitated a dovish stance by the US Fed, with a revised statement suggesting possible cut in the fund rate over H2 19. In the Eurozone, policy rates remained neutral with ECB introducing new series of its quarterly targeted long-term refinancing operations (TLTRO -III) set to kick off in September 2019 and ending in March 2021 – with the sole aim of encouraging private sector lending. Under this new structure, counterparties (non-financial private sector) will be entitled to borrow up to 30% of the bank's stock of eligible

⁶ With May headline inflation rate of 1.8% YoY and core PCE index of 1.6% below 2% target

loans as at 28 February 2019 at 10bps above the average rate applied to its MRO⁷ over the life of the loan. Consequently, the earliest rate adjustment is now projected in the first half of 2020 (previously 2019). In U.K, decelerating business investment following continued uncertainty surrounding BREXIT, coupled with concerns on inflation left the policy committee with no choice than to remain accommodative over H1 19. Accordingly, That said, the policy rate remain at 0.75% with purchases of investment grade corporate bonds and UK government bonds also unchanged at £10bn and £435bn respectively. Going by recent projection of the Bank of England, the earliest upward adjustment to its monetary policy is now expected in Q4 2021 consequent on assessment of the impact of final resolution on Brexit. Similarly, BOJ reiterated its stance to support growth amidst the unassertive impact of its consumption tax hike. Consequently, the bank left its target yield for the 10-year bond at 0%.

Table 1: Overview of Macro indicators across DM

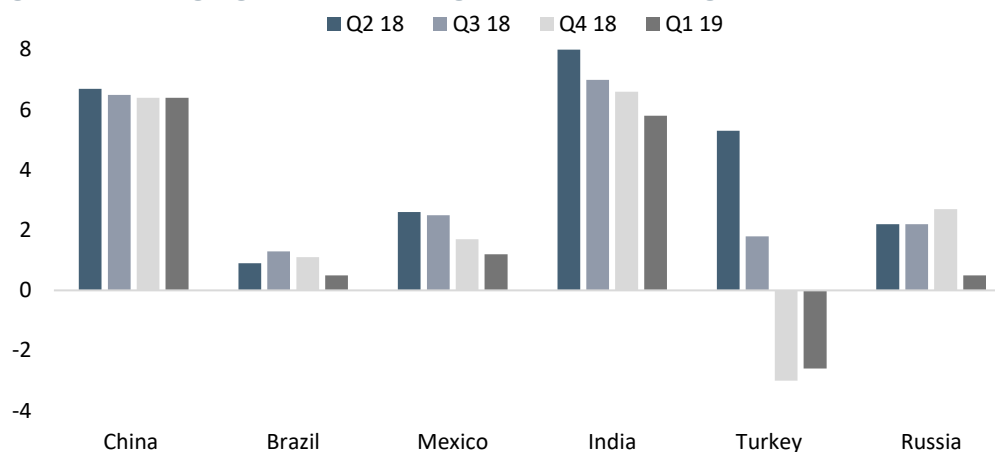
	US	Euro Area	UK	Japan
Latest Monetary Policy Action	2.5%	0.0%	0.8%	-0.1%
Mean CPI: 2019	1.7%	1.4%	1.9%	0.5%
2018	2.5%	1.8%	2.5%	1.0%
GDP (Q1 2019)	3.1%	1.2%	2.2%	0.9%
GDP (Q1 2018)	2.2%	2.5%	-0.4%	1.3%
Avg Unemployment 2019	3.8%	7.7%	3.9%	2.4%

Source: Bloomberg, ARM Research

Slow growth across emerging economies – Trade war at play.

Growth in emerging and developing economies started the year sluggish, as most showed high susceptibility to the intensified trade rifts between the US and China, among other factors. The slowdown in global merchandise trade (forecast to decline 2.9% YoY in 2019) has weakened demand and led to constrained growth in exports among emerging economies which are largely export-driven.

⁷ Main refinancing operations

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

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

Starting with EM Asia, after two quarters of deceleration following the government's clampdown on shadow banking – which reduced available private sector credit – as well as trade conflicts with the US, China GDP growth in the first quarter exceeded consensus estimate to print 6.4% (down from 6.8% in Q1 18). Closer look at the numbers showed growth across components compared to similar period last year – Secondary Industry⁸ (-20bps YoY to 6.1%), Primary⁹ (-50bps YoY to 2.7%) and Tertiary industries¹⁰ (-50bps YoY to 7%). While the ongoing trade negotiations continue to weigh on business investment, the current account balance has managed to stay positive, with the surplus in the first five months of the year widening to \$130 billion, from \$94 billion in similar period last year. Notably, compared to 0.4% YoY growth in exports to \$958 billion, imports decreased by 3.8% YoY to \$828 billion. However, sentiments turned positive after the two world leaders met at the G-20 meeting in June and jointly decided to continue trade talks, suspending any further increase in tariffs. That said, the second quarter does not appear all rosy for China as leading indicators point to weak growth over the quarter, with GDP growth consequently slowing to 6.2% YoY. For The slowdown in economic activities informed the People's Bank of China's (PBOC) decision to adopt a more accommodative monetary stance earlier in the year and also led to more expansionary fiscal policies with recent tax cuts (implemented in March) which cut across Value Added Tax (VAT), as well as reduced personal income tax. Over in India, the Ministry of Statistics released the Jan-Mar 18/19¹¹ GDP data which showed India's economy grew by 5.8% – the slowest pace in a decade – following deceleration in gross fixed capital formation (which typically makes up ~30% of GDP) to 3.6% from 11.83% in the previous quarter, widened trade deficit (with import

⁸ Construction and manufacturing⁹ Agriculture¹⁰ Service sector¹¹ India's fiscal period is from April to March

expanding at a faster pace of 13% YoY, compared to export of 11% YoY) and slower consumer spending. Overall, full year growth for 2018/2019 printed at 6.8% (vs 7.0% in 2017). For clarity, while the slowdown in the external sector largely reflects the residual impact of trade tensions, the slowdown in private consumption largely emanated from tighter financial conditions which more than offset the increased government spending in a run-up to the election. To support growth in the 2019/2020 financial year, the Reserve Bank of India (RBI) over the last three meetings (latest in June) lowered benchmark interest rate by 75bps to 5.75%¹².

Over in EM Europe, GDP growth in Russia slowed to 0.5% YoY in Q1 2019 (Q4 18: 2.7%) driven by broad slowdown across the three major constituents – gross fixed capital formation (-3.1% YoY vs. Q4 18: 3%), consumption expenditure (-80bps to 1.2%) and government expenditure (-10bps to 0.2%). The slowed growth in consumption stemmed from hike in VAT from 18% to 20% (kicked off on the 1st of January 2019) which constrained purchasing power, with headline inflation averaging 5.16% (Jan - May 2019), higher than 4.3% in December 2018 and above the Bank of Russia target of 4%. On the other hand, the high base of capital formation in 2018 due to World Cup related projects and the delay of key projects earmarked for 2019 due to slow-down in crude oil prices further magnified the slowdown. That said, the Bank of Russia's concerns regarding growth outweighed inflationary concerns, with the bank adopting a dovish stance, cutting rates by 25bps to 7.5% at its last MPC meeting. The central bank also guided to further rate cuts in the second half of the year. Meanwhile, economic indicators emitted adverse signals in Q2 19 as business conditions declined in both April and May. For context, April PMI grew at a slower pace, printing at 51.8 pts (March: 52.8 pts), while May PMI contracted further to 49.8 pts – first contraction in 9 months.

Elsewhere, Turkey slipped into recession after reporting its second consecutive GDP contraction (-2.6% YoY) in the first quarter of 2019 reflecting contraction in major sectors including, construction (-10.9% YoY), industrial (-4.3% YoY) and services (-4.0% YoY) sectors, all of which more than offset growth in the agricultural sector (+2.5% YoY). Leading indicators also depict gloomy performance in Q2 2019, with the Manufacturing PMI readings from April to June still printing below the 50-mark, as well as the manufacturing production (-4.2% YoY), industrial production (-4% YoY) and mining (-9.3% YoY). However, on the positive, following central bank's rein on rising consumer prices via monetary policy tightening, headline inflation dropped 458 bps YtD to 15.72% in June.

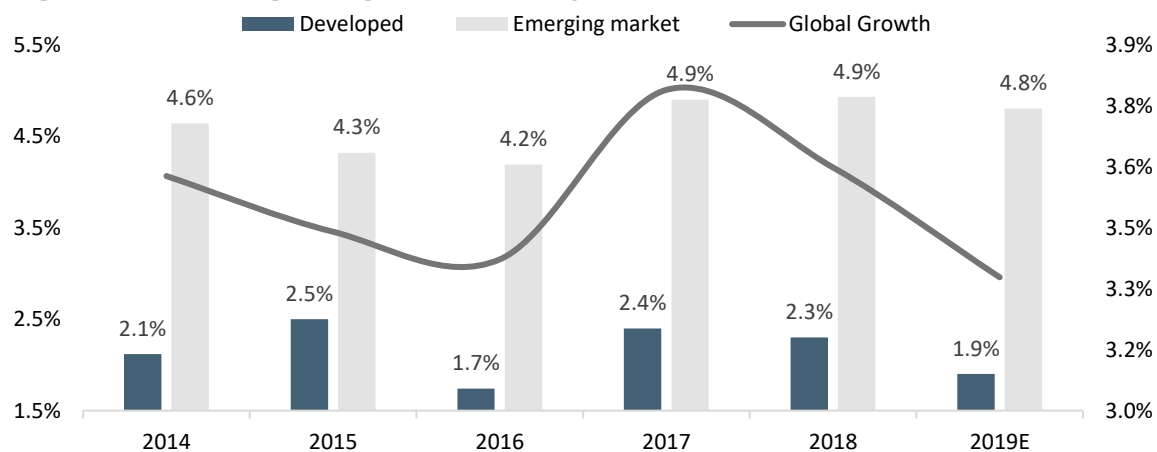
¹² This is despite rising pressure on inflation since beginning of the year (Jan: 1.97% - Mar: 3.05%), albeit within the RBI's guidance (April: 2.92%, RBI new guidance: 3%-3.1%).

In Latin America, economic growth in Brazil slowed to 0.5% YoY in Q1 2019 from 1.01% in previous quarter, reflecting weaker expansion in household consumption (1.4% vs Q4 18: 1.5%) and investment (0.86% vs Q4 18: 3.03%). On a quarterly basis, Brazil recorded its first contraction in two years, dropping by 0.2% QoQ in Q1 2019, after a lukewarm 0.1% QoQ growth in Q4 2018. Notably, the faltering growth was necessitated by the crowding out of the private sector (with government debt to GDP printing at 77% in 2018) and lull in consumer spending which dragged overall private sector investment. Also, the shutdown of mining operations following the Vale Dam burst in January further espoused overall weakness of the economy. Similarly, in Mexico, GDP growth slowed to 1.2% YoY (Q4 18 GDP: 1.7% YoY) due to flat growth in private consumption as well as further contraction recorded in investments (-0.9% YoY vs -2.2% in Q4 18). Largely, the toll on consumer spending, services and industrial output is reflective of the weak external demand following global trade disputes and uncertainty over trade relations with the US (particularly the United States-Mexico-Canada Agreement).

Wobbly growth picture, more tilted to the downside

Notwithstanding the strong outing to the year, recent escalation of trade tensions between US and China, uncertainties emanating from the UK divorce from the EU and the reduction in ECB's asset purchase programme are expected to constrain growth rate in the advanced economies with IMF downgrading growth in the region from 2.1% earlier in the year to 1.8% (FY 18: 2.2% YoY). For the EMDEs, the impact of lower commodity prices on oil exporting countries have further tilted growth to the downside. Consequently, compared to an estimate of a stagnated growth earlier in the year, global output growth is now forecast to decelerate by 30bps to 3.3% YoY in 2019 (FY 18: 3.6%), according to IMF.

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



Source: Bloomberg, ARM Research

Heightened tensions to drag growth across advanced economies

Starting with U.S, while trade negotiations between US and China proceeded to an advanced stage at the recently concluded G20 meeting, a definitive agreement is yet to be reached. Notably, while US relaxed the threat of further tariff hikes, the risk of a fall-out of the negotiation continues to cloud the rate of investment growth in the US. Coupled with diminishing effect of 2018 fiscal stimulus (i.e. the tax cuts which took effect in 2018), growth in the US is expected to decelerate to 2.3%, 60bps moderation when compared to the prior year. The Japanese economy is expected to expand by 1% YoY (revised from 0.9%) in 2019 which is 20bps higher than prior year – supported by continued fiscal support as well as measures put in place to mitigate the impact of the 25% increment in consumption tax hike which comes into effect in October 2019. The consumption tax is projected to support government expenditure on free early childhood education as well as provide benefits for low-income pensioners. To limit the effect of the consumption tax, on private investment and consumption, the BOJ introduced a total of ¥380.8 billion in form of vouchers for low-income or child-rearing households to encourage home buying.

In the Eurozone, growth is expected to moderate by 60bps to 1.3% YoY as major economies in the territory battle with suppressed demand and policy uncertainty. Weak industrial production, investment and domestic demand is expected to leave growth in Italy and Germany subdued. Further amplifying Germany's benign growth picture is the low level of foreign demand borne out of the ongoing trade tensions. In Italy, the elevated yields on government securities and debt levels is expected to constrain investment and consumer demand. Within the Zone, growth estimate for the UK was revised downwards by 20bps to 1.2% YoY (Vs. 1.4% YoY in the prior year), due to the prolonged uncertainty surrounding the UK's withdrawal from the EU. The form that Brexit takes going forward is now even more unclear and will depend largely on the Conservative party leader and Prime Minister following the exit of Theresa May. Currently, former Mayor of London and ex-Foreign Secretary, Boris Johnson (the frontrunner for the role) wants to leave the EU on 31 October, with or without a deal, with Jeremy Hunt being the opponent. To weigh on the uncertainty emanating from the Brexit situation and the corresponding negative effects, the British government announced a fiscal stimulus in its 2019 budget, focused on encouraging capital investment by local authorities and higher consumption by the household.

Bleak outlook across EMDEs

Going into H2 2019, rippling effect of the lingering (although receding) trade rifts between the super-powers, amongst other factors, continue to set the trajectory for growth across

emerging and developing economies. While Central banks in EMDEs have largely been accommodative, coupled with fiscal supports, the risks to growth in EMDEs persist.

Growth outlook in China remains weak, with IMF's latest forecast in April pointing to lower growth of 6.2% in 2019 and 6.0% in 2020. The trade rifts with the US as well as the shift to a more sustainable growth model -- which involves moderating the pace of accumulated debts, thus reducing available credit – remain headwinds to growth. However, the recent hold off of additional tariffs by the US in June as well as the accommodative monetary and fiscal policies will lower the downsides to growth. Meanwhile, growth in India is expected to strengthen to 7.3% and 7.5% over 2019 and 2020, fueled by President's Modi's welfarism which is expected to spur fiscal spending, as well as the now loose monetary policy stance of the RBI.

In Latin America, optimism regarding Brazil's economic growth is largely contingent on the enactment of the new pension reform bill by the incumbent President Bolsonaro, amidst persisting political turmoil. The reform which seeks to halt the persisting deficit in the pension industry by increasing the required age for retirement and to also increase the condition for the number of years required before retirees can access their pensions, is expected to help reduce the country's public debt. That said, IMF projects Brazil's growth will pick up to 2.1% and 2.5% over 2019 and 2020, respectively. In Mexico, economic growth is forecast to slow over 2019 emanating from uncertainties surrounding key policy decisions by the new administration. Furthermore, decelerating US economy (Mexico's leading export partner, accounting for ~80% of exports) is expected to adversely impact export demand. In addition, the signed USMCA (United States-Mexico-Canada) agreement, which could impact trade in agricultural products, automobiles, textiles and apparel, is yet to be ratified, placing a cap on trade relations with its biggest trade partner. That said, IMF projects Mexico's economic growth will moderate to 1.6% in 2019 and 1.9% in 2020.

In Russia, downturn in oil output stemming from supply cuts in a bid to comply with OPEC quotas as well as the recent contamination of Russian Crude oil flowing through Druzhba Pipeline have necessitated downward revision to growth over 2019. More so, with the downturn in global oil prices relative to last year, IMF projects GDP growth of 1.6% in 2019 (2018: 2.3%). Meanwhile, Turkey's economy is expected to remain depressed for the rest of 2019, with IMF's forecast of a 2.5% contraction in 2019, compared to 2.6% growth in 2018. Furthermore, threats to the Lira resurfaced following the termination of appointment of the central bank chief by President Erodgan who has continually called for drop in interest rates, threatening the apex bank's independence.

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