

July 22, 2019



Nigeria Strategy Report

H2 2019

Global Economy and Markets

MEA Region: Neither booming nor collapsing

Executive Summary

In our H1 19 outlook, we laid out our expectations for growth in Sub-Saharan Africa (SSA) underpinned by recovery in powerhouse constituents (such as South Africa, Nigeria and Angola) and sustained growth in smaller countries. So far, only the latter part of this forecast played out precisely as we thought, with Ghana and Ethiopia recording strong growth figures in the first quarter of the year. Growth in the larger economies, however, was much slower than anticipated, with weakness in the oil sector tripping off recovery in Nigeria and Angola, with growth SSA region estimated to have slowed to 2.0% in Q1 19 compared to 2.8% over Q4 18. Elsewhere, growth across MENA has been largely mixed albeit to the downside, due to drag from oil exporting countries, with Q1 19 GDP settling at 3% YoY compared to 3.2% YoY in Q4 18.

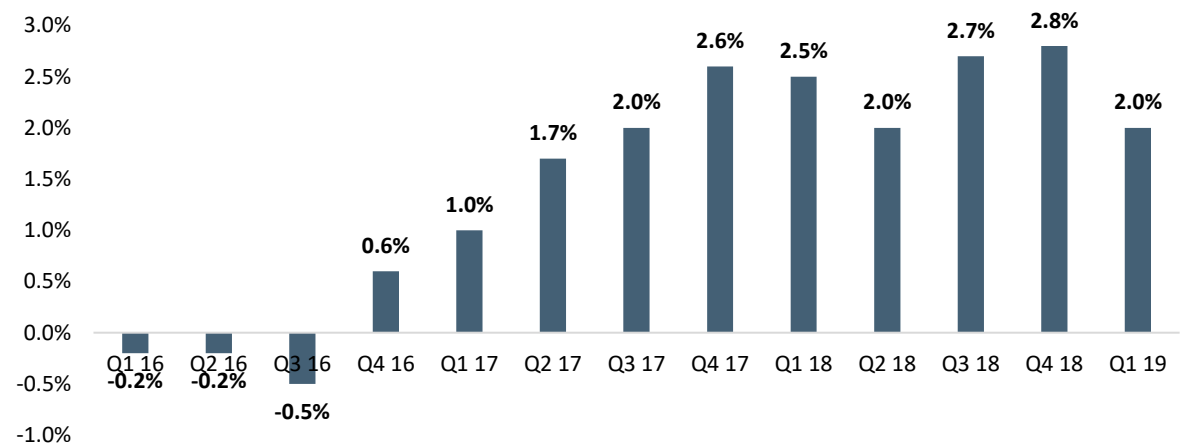
Our outlook for 2019 is now bleaker than it was at the start of the year with full year growth estimate for SSA now at 2.9%, a downward revision from 3.4% earlier in the year. Slower demand from major trade partners, persisting policy uncertainty and domestic growth bottlenecks are major headwinds to economic growth in the region. Over in MENA, we see growth for FY 19 decreasing slightly to 1.3% (FY18: 1.4%) following moderation in oil exporting countries, which is expected to more than outweigh modest growth in across oil importers.

On external positions, current account deficit in the SSA region is projected to widen, primarily reflecting a larger deficit in non-resource intensive countries and oil-exporting countries. For the oil-exporting countries, the voluntary partial compliance with the OPEC+ agreement and the impact of lower crude oil prices on the value of trade is expected to compound the deficit worries. Elsewhere, lower projected oil prices will also weigh on current account balances across MENA economies, adding to pressure of further oil production cuts. However, the better financing conditions in the region and increased Eurobond issuances should help support external positions.

In this report, we look at the major themes that dominated Sub-Saharan Africa, Middle East and North Africa landscape in H1 2019 as well as our outlook for the rest of the year.

Power-house economies drag SSA growth

Defiling expectation at the start of the year, economic growth as captured by Q1 19 numbers showed that economic activities remained fragile across Sub-Saharan Africa (SSA). Notably, while growth has been robust in smaller economies, due to renewed public investment and robust consumption, growth has been rather disappointing for the three largest economies – Angola, Nigeria and South Africa – emanating from slowdown in crude oil prices and production, and structural issues over the period. Accordingly, it is estimated that economic growth in the SSA region printed at 2.0% relative to 2.8% over Q4 18.

Figure 1: Trend in SSA GDP Growth (%)

Source: Bloomberg, ARM Research

Starting out with the largest economies, Nigeria's GDP slowed to 2.0% over Q1 19 (Q4 18: 2.4%) mirroring sustained weakness in the oil sector as policy uncertainty continues to constrain investment in new capacity. Unsurprisingly, the oil sector contracted for the fourth consecutive quarter (Q1 19: -2.4%, Q4 18: -1.6%), with weak domestic demand and a challenging business environment suppressing growth in the non-oil sector (+2.5% YoY vs. Q4 18: 2.7% YoY). In a rarely seen turn of events, the South African economy showed no growth in Q1 19 (Q4 18: 1.1%) as continued policy uncertainty and rolling power blackouts¹ hampered economic activities over the quarter. Emphatically, contraction in the mining, agriculture and construction sectors completely offset soft growth in the finance and manufacturing sectors. After bouncing back from recession in Q4 18, growth in Angola slowed over Q1 19 as further deterioration in the oil industry weighed on growth in the quarter. However, the country continued to progress on its reform program supported by the IMF. Late last year, the IMF approved a three-year extension of its arrangement with Angola amounting to \$3.7 billion

¹ Power cuts, coined "load-shedding" by state-owned Eskom, disrupted economic sentiment.

In the smaller economies, growth has been steady with varying growth catalysts. In Ghana, rising activities in the services and industrial sector, kept growth solid at 6.7% YoY (Q4 18: 6.8% YoY) over the first quarter of 2019. The services sector which accounts for the largest share of GDP expanded by 7.2% (Q4 18: 5.8%), the fastest pace since Q4 2015, led by the information and communication sub-sectors which was up 37% (Q4 18: 12.3%) – a fallout of increased number of subscribers. The industrial sector accelerated by 8.4% YoY (Q4 18: 8.9%) spurred by the mining & quarrying sub-sector which grew by 20.9% (Q4:18: 20%). Elsewhere, sustained public investment and improved business sentiment supported growth in Ethiopia with GDP growth for its fiscal year end printing at 9.2% YoY (2017/2018: 7.7% YoY). However, growth eased in both Rwanda (Q1 2019: 8.4%, Q4 2018: 9.6%) and Kenya (Q1 2019: 5.6%, Q4 2018: 5.9%). On the former; slower trade sector performance, transport together with lackluster real estate activities resulted in momentary deceleration. While in the latter, impact of delayed raining season hampered activities in the agricultural sector as growth slowed to 5.3% (Q1 18: 7.5%).

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

	Nigeria	South	Kenya	Ghana	Angola
Monetary Policy Action	Unchanged	-25bps	Unchanged	Unchanged	-25bps
Q1 GDP Growth (YoY)	2.0%	0%	6.00%	6.7%	-0.4%
Avg. Inflation (2019)	11.32%	4.3%	5.05%	9.28%	17.64%
Avg. Inflation (2018)	11.87%	4.7%	4.7	9.83%	19.70%
Equity Market Performance	-6.87%	9.2%	6.67%	-6.77%	N/A
Current Account (% of GDP)	2.1%	-3.5%	-5.4%	-3.2%	1.3%

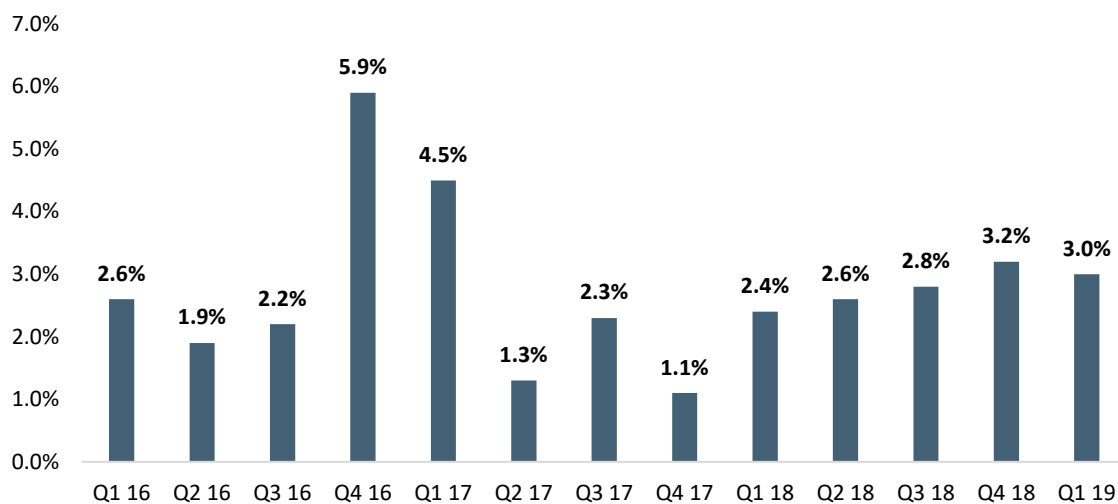
Source: Bloomberg, ARM Research

Swing and lows across MENA

At the start of the year, we charted our outlook for economic growth across the MENA region with a projection for softer growth across the region over 2019. We noted that both oil exporters and oil importers will show steady improvement, largely anchored on policy reforms and government investment, the duo of which we stated would outweigh headwinds from a less favorable global economic environment. Irrespective, Q1 19 GDP growth of 3.0% YoY in the MENA region came in lower than the level over Q4 of 3.2% YoY. The deceleration emanated largely from oil exporting countries following faster reduction in oil outputs in compliance with the OPEC quota and material contraction in Iran which weighed

on the overall growth in the bloc. On the other hand, growth among the oil importers was quite impressive led by the largest economies in the bloc.

Figure 2: Trend in Trend in MENA GDP Growth (%)



Source: Bloomberg, ARM Research

Examining growth trends across oil exporters, Saudi Arabia's GDP slowed to 1.7% YoY in Q1 19, a deceleration from a record high (highest rate since Q4 2017) achieved in the previous quarter of 3.6% YoY. The moderation stemmed from strict compliance with the OPEC+ deal which saw the Kingdom pump 700,000bpd less than what was pumped in Q4 18. Nonetheless, increased public spending helped support the non-oil sector. Similarly, growth in Algeria was hampered by reduction in crude oil production. Following stricter sanctions on Iran, growth in the economy continued to stall with GDP contracting by 4.9% YoY in its fiscal year ending March 2018.

On the other side, GDP growth for Egypt came in at 5.6% (Q4 18: 5.5%) on the back of strong investment and increased natural gas output. Over in Morocco, growth decelerated marginally to 2.8% YoY (Q4 18: 2.9% YoY) largely due to a downturn in the agricultural sector following exceptional harvest last year. Nonetheless, it was not a bad outing as investments rebounded and private consumption increased over the same quarter. Elsewhere, Tunisia's economic growth slowed to 1.1% YoY over Q1 19 (Q4 18: 2.1%), the weakest expansion since Q4 2016, due to declines in agricultural and industrial output, as well as a weak external sector.

Table 2: Overview of macro indicators among selected MENA countries

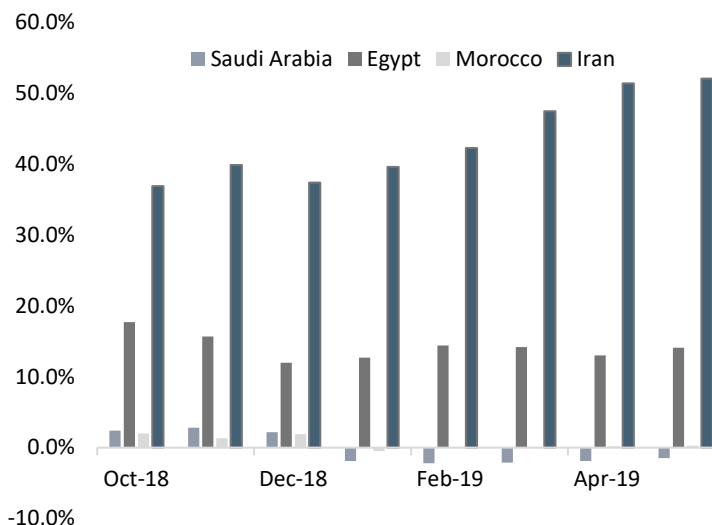
	Egypt	Saudi	Iran	Tunisia	Morocco
Monetary Policy Action	Unchanged	Unchanged	Unchanged	Unchanged	Unchanged
GDP Growth (YoY)	5.6%	1.7%	-4.9%	1.1%	2.8%
Avg. Inflation (2019)	12.97%	-1.92%	46.6%	7.03%	-0.02%
Avg. Inflation (2018)	14.4%	2.44%	20.54%	7.31%	2.0%
Equity Market	15.19%	12.58%	14.62%	-0.61%	-1.87%
Current Account (% of	-2.4%	8.3%	1.3%	-11.2%	-4.5%

Source: Bloomberg, ARM Research

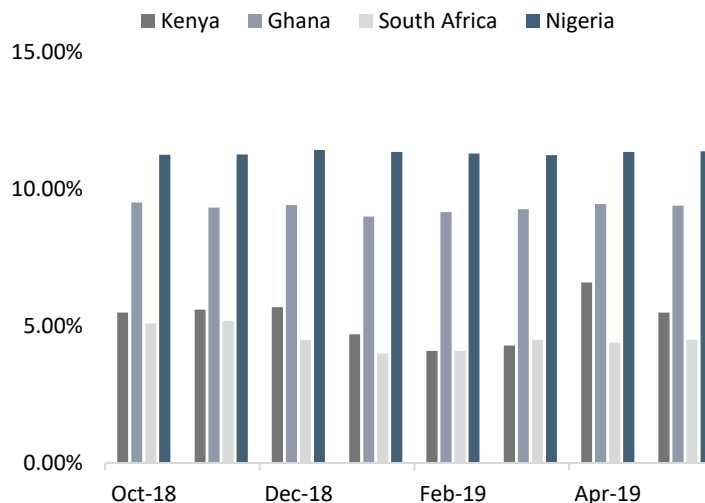
A tale of moderation and deflation

Inflation pressures receded over the first half of 2019 at varying degrees across SSA and MENA. Starting with MENA, Tunisia and Algeria headline inflation moderated 40bps and 50bps respectively compared to H2 2018. The decline in both countries is reflective of moderating food prices as well as passthrough of lower crude oil prices. Elsewhere, inflation in Egypt (H2 18: 14.8%, H1 19: 13.0%) continued to moderate as the passthrough of higher energy prices in 2018 gradually fades. By a similar degree, inflation in Morocco trended lower (-170bps) following lower food prices and weak domestic demand in the country. More notably was a change of inflation trend in the Gulf region, with the three largest economies now faced with glaring deflation. In contrast to larger economies experiencing widespread deflation across sectors, price declines in the Gulf region was triggered largely by the real estate sector, reflecting the large buildup of supply in previous periods. Elsewhere in Iran, price pressure persisted over the first half of 2019 (H1 19: 46.6%, H2 18: 31.3%) following the re-imposition of sanctions on oil exports last November, causing further depreciation in the country's parallel market exchange rate.

Over in SSA, the moderation in headline inflation was quite modest. Average inflation rate in South Africa fell 65bps to 4.3% over H1 19 largely due to slowdown in core prices as the high base from last year's increase in value-added tax faded. Despite continued depreciation in the Angola Kwanza, inflation in the country moderated 100bps to 17.64%, coming from a high base in the previous year. Meanwhile, headline inflation pushed higher in Nigeria (11.32%) by 5bps largely on the back of pressures on food prices.

Figure 3: Inflationary trend in selected MENA

Source: Bloomberg, ARM Research

Figure 4: Inflationary trend in selected SSA

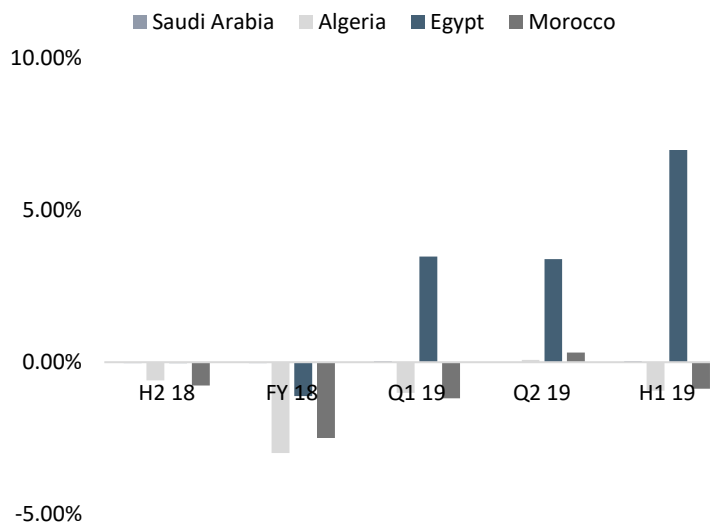
Source: Bloomberg, ARM Research

Currency performances a mixed bag

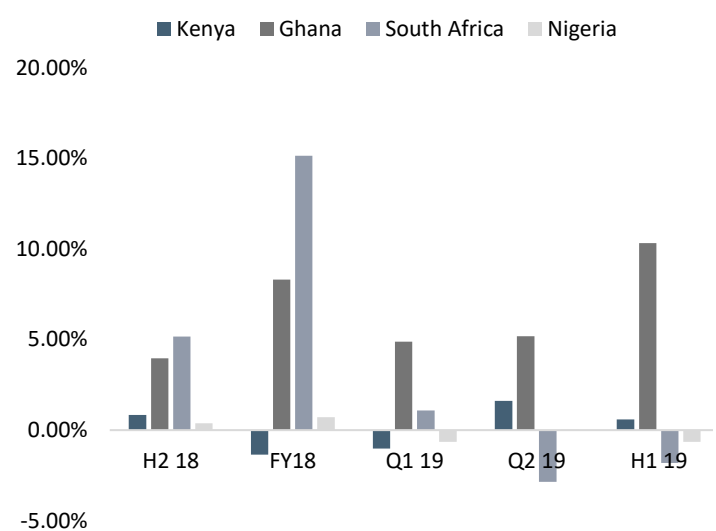
Currencies across both SSA and MENA recovered slightly in H1 19, shedding the impact of wide sell-off of foreign investments across EM markets in H2 18. Over H1 19, improved current account balances and FX inflows provided support to several currencies. To start with, the Egyptian Pound – one of the top performers – gained 7% YTD against the greenback. To buttress, as part of its economic reform, the Central Bank of Egypt terminated its Forex repatriation mechanism which guaranteed foreign investors repatriation of funds, allowing every single inflow coming into the country to reflect on interbank liquidity. Elsewhere, the Tunisian Dinar recorded gain of 1.2% (2018: -17.4% YoY) following improved current account balance and more importantly, higher FX inflow from soft loans including a \$245 million loan payout from IMF and a \$500 million loan from Saudi Arabia. In other fronts, aided by a solid FX reserve (\$506.1 billion) the Saudi Arabian Monetary Authority continued to peg the Riyal against the US dollar at 3.75 SAR. Meanwhile, increasing political uncertainty and low oil output continue to worsen Algeria's current account, depleting FX reserves to \$74.6 billion from a peak of \$195 billion in 2013. Consequently, the Algerian dinar weakened further by 94bps over H1 19 (2018: -3% YoY). Similarly, the Iranian Rial continued to weaken against the greenback as sanctions bite harder.

Over in SSA, currency movements differed with most currencies depreciating against the US dollar as a result of larger current account deficits. Furthermore, international bond issuance has been slow to recover after weakening over H2 2018. In Southern part of Africa, the Angolan Kwanza (H1 2019: -9.23%, H2 2018: -19.06%) remained under pressure with the country's FX reserve dwindling on the back of lower oil output and revenue. In a bid to support the economy, the government recently formalized a financing programme of \$3.7 billion with IMF spanning three

years. Elsewhere, the South African rand weakened over Q1 19 (-1.1%) before recovering in Q2 19 (+1.4%). Over in Ghana, the Cedis fell 8.6% against the greenback, as its current account deficit continued to widen as interest payments on FCY obligations remains elevated. Meanwhile, the Nigerian Naira on the other hand was stable, appreciating 1.04% over H1 19. Importantly, the country's current account balance returned to a surplus with FPI flows into the country touching record highs. In the eastern part of Africa, the Kenyan Shilling maintained same trend, depreciating by 5bps YtD.

Figure 5: Currency performance of MENA countries

Source: Bloomberg, ARM Research

Figure 6: Currency Performance of SSA countries

Source: Bloomberg, ARM Research

Dovish with delayed transmission

Taking a cue from the dovish tone of major central banks across DMs, as growth concerns and trade tensions take a center stage, central banks across both SSA and MENA region adopted a dovish stance, a new development when compared to H2 2018. In MENA, the Central Bank of Egypt cut its benchmark interest rate by 100bps to 15.75% at its first meeting in the year, capitalizing on improving FX, capital flows and inflation dynamics. After hiking rates at the beginning of the year to curb rising inflation, the Central Bank of Tunisia held rates at its last three meetings in a bid to support growth. Elsewhere, with its currency pegged to the US dollar, the Saudi Arabian Monetary Authority left its benchmark rate unchanged.

Over in SSA, in a surprise move, the Central Bank of Nigeria cut its benchmark rate by 50bps to 13.5% at its second meeting in the year with the monetary authority expressing its satisfaction on price stability and a recalibration of monetary policy to be more growth friendly. Similarly, the Bank of Ghana unexpectedly cut its benchmark rate at its first meeting of the year by 100bps while the Bank of Angola adopted a more dovish stance cutting its

benchmark rate by a total of two times² this year. In a similar manner, the Reserve Bank of South Africa cut its benchmark repo rate by 25 bps for the first time since March 2018 with the committee expressing a more sanguine inflation outlook.

Outlook no longer as cheery

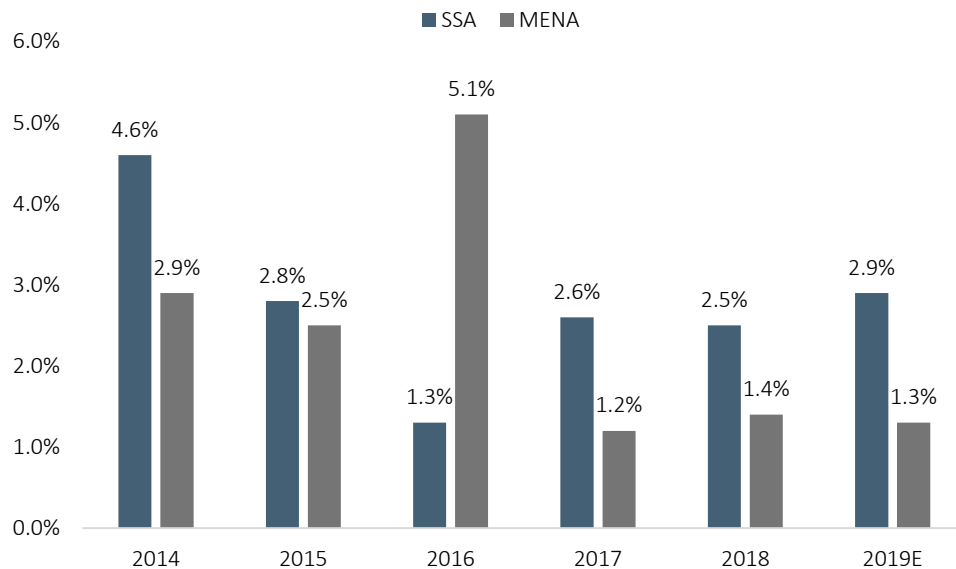
As mentioned earlier, the recovery in SSA has been disappointing largely reflecting sluggish growth in the three-powerhouse. Against this backdrop, the World Bank now project GDP growth over 2019 to expand slightly from 2.5% YoY in 2018 to 2.9% (Previously: 3.4% YoY) this year. The slower growth is mainly reflective of expected weak growth in South Africa and slow recoveries in Angola and Nigeria. Particularly, weakening external demand from major trade partners, persistent policy uncertainty and domestic growth bottlenecks are major headwinds to growth in the region. Nigeria's growth is expected to expand modestly at 2.1% YoY (2018: 1.8% YoY) reflecting supply disruptions in the oil sector and a lack of much-needed reforms to spur new capacity. In South Africa, possibility of further power supply disruption will continue to sap economic sentiment and eventually weigh on spending and investment. That said, growth is expected to tick higher at 1.1% over the year (2018: 0.8% YoY). Despite exiting recession in Q4 18, Angola's chronic dependence on the oil sector will continue to limit overall growth amid volatile global crude oil prices and weak domestic production. Nonetheless, improved domestic demand together with ongoing economic reforms should support mild recovery in the economy by 1.0% YoY (2018: -1.7% YoY). Growth in other regions – SSA (excluding Angola, Nigeria and South Africa) is expected to come in robust, rising from 4.4% YoY in 2018 to 4.6% YoY.

Economic growth in the MENA bloc is expected to remain subdued over 2019. Among oil exporters, oil production cuts and a contraction in economic activity in Iran due to U.S. sanctions will weigh on activity. Nonetheless, strengthening non-oil activity should partially offset lackluster oil sector with growth projected to decrease to 0.7% YoY (2018: 0.9% YoY). On the other hand, growth is expected to improve modestly amongst the oil importers led by expansions in Egypt and Tunisia – reflecting favorable business reforms, ease in political risks and healthy tourism. Growth in Saudi Arabia is expected to slow to 1.7% YoY (2018: 2.2% YoY). Particularly, large oil production cuts are expected to weigh on growth, although the economy will benefit from stronger public spending and recovery from the introduction of VAT in the prior year. Algeria's growth (2019: +1.9% YoY, 2018: +1.5% YoY) is expected to remain subdued as an expected return to fiscal consolidation weighs on non-oil activity. Elsewhere, Iran's GDP (2019: -4.5% YoY, 2018: 1.9% YoY) is expected to contract further as US sanctions bite. Conversely, growth in Egypt is projected to advance 5.7% YoY (2018: 5.4%) as its reform programme with the IMF continues to

² The Bank of Angola cuts its benchmark rate by a further 25 bps in May following a cut earlier in January

support business activity. Particularly, private and government consumption, together with fixed investment is expected to continue rapidly. Similarly, in Tunisia, growth in the tourism sector is forecast to support GDP growth by 2.7% YoY (2018: 2.5% YoY). Elsewhere, growth should slightly slow in Morocco (2019: 2.9% YoY, 2018: 3.0% YoY), as lower harvest over H1 19 is expected to weigh on the agricultural sector. Nonetheless, strong tourism and robust private consumption will soften the rate of deceleration.

Figure 7: Trend in SSA and MENA growth (%)



Source: World Bank, ARM Research

Inflation heads southwards

The moderation in inflation since the start of the year across both SSA and MENA regions is expected to extend over the rest of the year. In SSA, average inflation in the region is projected by the World Bank to decline to 8.1% in 2019 from 8.5% in the previous year. Much of the decline reflects a pass through of lower oil prices and lower food prices which is expected to offset the lingering effects from past exchange rate depreciation. Similarly, following a temporary rise last year, average inflation in the MENA region is expected to moderate as the impact of the introduction of VAT (Saudi Arabia and UAE) and exchange rate depreciation (Iran, Libya) in the previous year fade off. On external positions, current account deficit in the SSA region is projected to widen, primarily reflecting a larger deficit in non-resource intensive countries and oil-exporting countries. For the oil-exporting countries, the voluntary partial compliance – of some countries – with the OPEC+ agreement and the impact of lower crude oil prices on the value of trade is expected to compound the deficit worries. Overall, the range of current account imbalances is expected to vary widely

across countries. Elsewhere, lower projected oil prices will also weigh on current account balances across MENA economies, adding to pressure of further oil production cuts. However, due to better financing conditions in the region, increased Eurobond issuances should help support external positions. With a dovish tone set by global monetary authorities, we expect most policy setters to further ease policy in a bid to stimulate growth and amid abating inflation.

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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