

January 10, 2019



Nigeria Strategy Report

H1 2019

Global Economy and Markets

Global Growth: New Year, Same Rhetoric, Matching Growth

Executive Summary

Although the global macroeconomic climate has been hitting patches of turbulence over the past few months, the devastation appears largely one sided. Economic growth in Developed markets (DMs) weakened slightly on concerns about sluggish growth in personal consumption expenditure – fallout of trade rhetoric and currency induced contraction in external demand mainly from the Eurozone, UK and Japan. For Emerging markets (EMs), growth momentum strengthened underpinned by the knock-on effect of higher commodity prices and stronger private capital investment. Consequently, global GDP is projected to have printed at 3.7% over 2018 same with 2017 growth with support coming from strong growth at the start of the year. Particularly, growth in DMs is estimated to have decelerated by 10bps to 2.3% (2.4% in FY 17) while growth in EMs is estimated at 5.0% from 4.9% in FY 17.

Over 2019, reflecting the fading impact of accommodative monetary policy in DMs and recovery in commodity prices which supported far more stronger growths in EMs, global growth is now projected to remain at 3.7%. Akin to 2018, we believe the impact of additional rates hike in US, the reduction in the assets purchase program by the ECB amidst uncertainties emanating from the UK divorce from the EU will limit the scope of growth in DMs over 2019 (IMF 2019F: -30bps YoY to 2.1%). Whereas in EMs, though the ongoing trade spat between US and China could be a snag to EM growth, expected recoveries in Latin America, Sub-Saharan and Saudi Arabia is expected to leave growth in EMs unchanged at 4.7.

In this report, we look at the major themes that dominated the global economic and financial landscape in 2018 as well as our outlook for 2019.

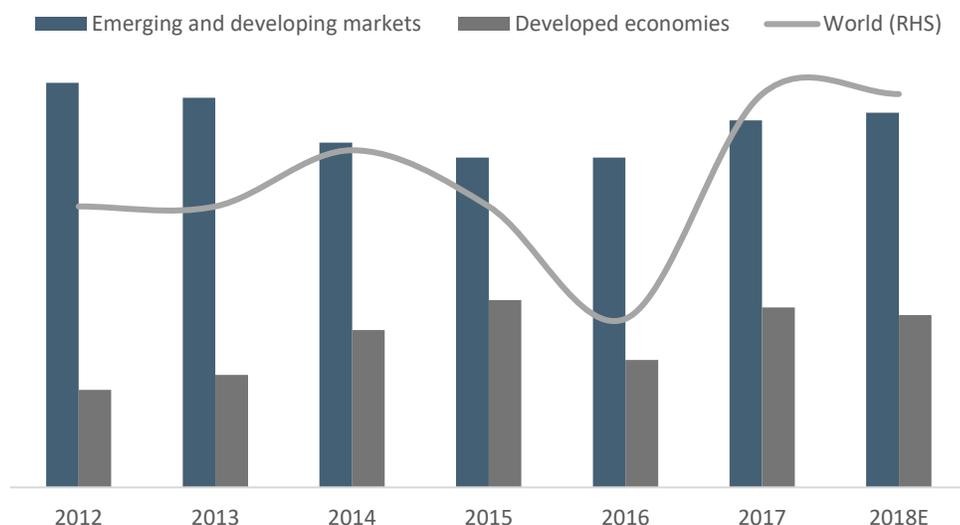
A case of two divide

Coming into 2018, the troika of monetary policy normalization in US and UK, fading effect of accommodative monetary policy in Japan and EU, and the fallout of trade protectionism clouded the outlook for global GDP growth. Despite the concerns, we had stated that global growth would remain resilient with our thesis largely driven by expectation of stronger growth in emerging and developing countries (EMs) – premised on higher commodity prices and recovery in developing economies. The foregoing was expected to offset the impact of monetary policy normalization in developed economies (DMs). Expectedly, economic numbers over the first half of the year across the globe came out strong to settle at 3.4% YoY in Q1 and Q2, tracking higher relative to corresponding quarters of prior year by +50bps and +60bps respectively. The global growth was hinged on stronger than expected growth in EMs¹ in Q1 18 and a swift recovery in DMs² over Q2 18. That said, the global economy decelerated over the 2nd half of the year, following softness in crude oil prices amidst stiffened trade rhetoric which drove contraction in global trade and investment with global growth estimated to have contracted 20bps QoQ to 3.2% over Q3 18.

Consequently, global GDP is projected to have stagnated at 3.7% over 2018 (FY 17: 3.7%) with support coming from strong growth at the start of the year. Particularly, growth in DMs is estimated to have decelerated by 10bps to 2.3% (2.4% in FY 17) while growth in EMs is estimated at 5.0% from 4.9% in FY 17. The slower growth in developed nations was driven by sluggish growth in personal consumption expenditure, fallout of trade rhetoric and currency induced contraction in external demand which have slowed growth in EU (2.0% vs 2.4% in FY 17), UK (1.4% vs 1.7% in FY 17) and Japan (1.7% vs 1.1% in FY 17) to more than outweigh the economic expansion in US (2.9% vs 2.2% in FY 17). For emerging nations, stronger growth was largely underpinned by the knock-on effect of higher commodity prices, improved global trade on consumer spending and stronger private capital investment which supported growth in Russia (1.7% vs 1.0% in FY 17), India (7.3% vs 6.7% in FY 17), Brazil (1.4% vs 1.0% in FY 17), and Sub-Saharan Africa (3.1% vs 2.7% in FY 17).

¹ (Q1 18: +5.5% and Q2 18: +5.3% YoY)

² (Q1 18: 2.0% and Q2 18: 3.2% YoY)

Figure 1: Trend in Global GDP Growth (%)

Source: IMF, ARM Research

Monetary policy and trade protectionism falters growth in DMs.

After an impressive growth of 4.5% YoY in Q2 18, growth in US decelerated to 3.4% in Q3 18 – according to third estimate released by the US Bureau of Economic Analysis – albeit ahead of consensus expectation. The slower growth over Q3 was driven by deceleration in fixed investment spending (1.1% YoY vs 6.4% YoY in Q2 18), personal consumption expenditure (3.5% YoY vs. 3.8% YoY in Q2 18), while net exports subtracted ~2.1% from the top-line GDP, due to a decline in exports by 4.9% decline and a 9.3% expansion in imports. However, the persisting show of economic strength in the face of global trade rhetoric in 2018 was driven by strong growth in real personal consumption expenditures (PCE) and government spending. Notably, over the first nine month of 2018, PCE grew by 6.6% YoY as the impact of reduction in tax rates during the year supported real disposable income (+7.9 YoY in 9M 18), while government spending grew at the highest pace in more two years in Q3 18 by 2.6% YoY (9M 18: +6.8% YoY) reflecting the increased expansionary fiscal policy.

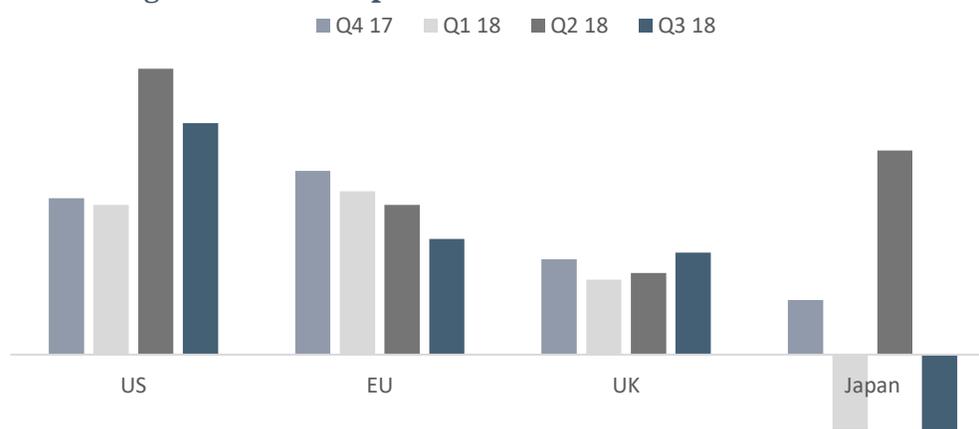
Elsewhere, the fading impact of the accommodative monetary policy became more noticeable in the Euro area in Q3 18 (+1.6% YoY vs. 2.2% YoY in Q2 18) as the economy grew at the slowest pace in fifteen quarters. The weakened momentum stemmed largely from contraction in key economies which cumulatively account for 52% of the bloc's GDP. Majorly, Germany (+1.2% YoY vs. 1.9% YoY in Q2 18), France (+1.4% YoY vs. 1.6% YoY in Q2 18), Italy (+0.7% YoY vs. 1.2% YoY in Q2 18) and Netherlands (+2.4% YoY vs. 2.9% YoY) in Q2 18 all recorded slower output (the four countries cumulatively account for 52% of EU's GDP). Slower growth in Germany resulted from bottlenecks in car production due to the introduction of new pollution standard which some German car models have not yet gained

regulatory clearance while protests and violence over increase in fuel tax slowed economic activities in France. In Italy and Netherlands, it was a case of slowdown in business investment as demand for machinery, equipment investment and construction investment contracted during the period. Following the stiff deceleration over the third quarter, the rate of growth has been revised downward by 40bps to 2.0% in 2018.

Elsewhere in Europe, the growth momentum in UK was sustained in Q3 18, expanding by 1.5% YoY from 1.2% growth reported in Q2 18. The growth picture was driven by stronger output in services and construction sectors. For context, breakdown by sectors revealed that the services sector, which accounts for 80% of the country's economic output, grew by 1.7% YoY and was reflective of increased spending by household and tourist. Irrespective, reflecting the weather induced slowdown in economic activity in the first quarter of the year, as well as the expected continued weakness in business investment, IMF revised GDP growth estimate lower by 20bps to 1.4% for 2018 (+1.7% in 2017).

In a twist to recent development in advanced economies, the Japanese economy contracted in third quarter of 2018 by 1.2% YoY (compared to 3% growth in prior quarter). The negative outing over the quarter largely reflects the spate of natural disasters that plagued the economy in the review period as well as decline in exports (-7.1% YoY). On export, the decline reflected weakening external demand for automobiles and technology products, a fall-out of the ongoing trade war as china remains its second largest trading partner, after U.S. For context, the Chinese economy sources most of its automobile parts and electronics from Japan, with China accounting for 19% of total exports in 2018. Elsewhere, both the private and public sector recorded contraction in Q3, with private consumption and capital expenditure (first since Q4 16) declining 0.5% YoY and 0.9% YoY respectively. With 2018 now in the books, IMF has revised GDP growth estimate lower by 10bps to 1.1% (FY 17: 1.7% YoY) to reflect the contraction seen in Q1 and Q3 18.

Figure 2: GDP growth in developed economies



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

Divergent fortunes across various EM economies

Over the second half of 2018, economic growth across EMs were divergent. Whereas heightening trade protectionism across the globe and widening trade deficit kept economic activities subdued in some countries, specific idiosyncratic factors kept economic growth afloat in others.

First off in EM Asia, after a pleasant start to the year wherein Q1 and Q2 growth stood at 6.8% and 6.7% accordingly, China's growth slowed over Q3 with GDP printing at 6.5%. The slowdown reflects pass through of government deleveraging exercise aimed at reducing China's elevated debt levels³ and on-going trade conflict with the US, both of which weighed on investment and consumption spending. Furthermore, while trade tensions have not yet resulted in a weakening of import and export growth, they have rattled business sentiment and stock markets. Consequently, reflecting the deceleration in growth over Q3 and weakness in PMI for October, IMF projects a 30bps slowdown in 2018 GDP to 6.6% YoY compared to 6.9% YoY in 2017. In a related development, over Q3 18, India reported its slowest GDP growth in three quarters of 7.1%, weighed down by a slower growth in finance, insurance and real estate sub-segments, a fallout of tighter credit conditions. For context, following the confluence of widening trade deficit (+47% YoY to \$49.4 billion), and outflow of portfolio investments, India suffered currency weakness (-8% in H2 18) which forced the Reserve Bank of India to raise interest rate by 25bps to 6.5% in the period.

In Latin America, the Brazilian economy looks set to deliver a stronger growth after exiting a two-year recession in 2017. The economy recorded the strongest GDP growth in three quarters in Q3 18 of 1.3% driven by demand side components - household consumption (+1.4% YoY), Government spending (+0.3% YoY) and Gross fixed investment (+7.8%). Notably, this came in despite heightened political tension ahead of the keenly contested Presidential election in October 2018 that eventually produced **Bolsonaro** as the eventual winner. In other climes, Mexico's economy continues to show resilience with Q3 18 GDP printing at 2.5% (vs 2.6% in Q2 18) following faster growth across major sectors of the economy. For context, industrial sector rebounded to grow by 0.5% YoY⁴. Primary sector recovered 0.8% YoY⁵ while the Services sector grew 0.8% YoY⁶. In other climes, Argentina's economy has been laced with elevated borrowing costs, government spending cuts, inflationary concerns and a drought that impacted on the agricultural sector which resulted in the peso becoming the world's worst-performing currency this year. In fact, IMF now projects a -2.6% YoY contraction in GDP over 2018.

³ Debt to GDP: 47.6% in 2017 vs 44.3% in 2016

⁴ -0.3% YoY in Q2 18

⁵ -2.1% YoY in Q2 18

⁶ -0.2% YoY in Q2 18

In EM Europe, after two consecutive quarters of GDP growth, the Russian economy lost steam in the third quarter as growth slowed by 60bps to 1.3% YoY in Q3 18. The slowdown emanated from contraction in Agriculture and construction sectors. On the former, following weak grain harvest as well as bad climatic conditions, the agricultural sector declined 6.1% YoY in Q3 18 while construction sector contracted 0.4% YoY over the same period. However, leading indicators in October points to a rebound in Q4 18 as Industrial production accelerated +3.7% YoY while Manufacturing PMI improved to a six-month high of 51.3 points in October, with IMF maintaining estimate of 20bps expansion to 1.7% YoY over 2018. Meanwhile in Turkey, after a solid outing in Q2 2018 (+5.2% YoY), the economy appeared to have slowed sharply over the third quarter as weakness in currency and inflationary pressure constrained manufacturing and services sector. Concisely, PMI reading over the third quarter is now averaging 46 points (vs 50.9 points over H1 18) and consensus estimate now suggest a significant deceleration in growth to 2.2% over Q3 18.

At the crux of Turkey's macroeconomic woes was the depreciation of the lira (-24% YTD) which crippled economic activities over the period. The run on the lira began with the eruption of a dispute with U.S, and the perceived lack of independence of Turkey's Central bank following President Erdogan's incessant interference with monetary policy decisions, the combined of which exacerbated FPI exit from Turkey, leaving the country in dearth of US dollars with pass through inciting stark depreciation in the Lira (-60% YTD in August) and pushed inflation to a five year high of 25.2%. Accordingly, IMF now projects GDP growth of 3.5% for 2018 compared to 7.4% in 2017.

Monetary Policy: Accommodative with a fading effect

Monetary policy remained largely accommodative in developed economies, save for the US wherein the Fed continued its tight monetary stance with additional four more rates hike over 2018⁷ which took the benchmark rate from 1.50% in Jan-18 to 2.50% at its last meeting in December. The tightening stance was due to strong growth in disposable personal income, tightening job market (unemployment rate at a low of 3.7%) and inflation rate rising to 2.2% at the end of November. Furthermore, in its economic projections (the Dot Plot) in December, the Fed lowered its forecast for the federal funds rate to two more rate hike in 2019 with the benchmark rate expected to near 2.9% by the end of next year⁸. In the U.K, while the Bank of England raised its policy rate for the first time in 2018 to 0.75% in Q3 18, it maintained its corporate and government bond purchases at £10 billion and £435 billion respectively.

In the Euro area and Japan, key policy rates were left unchanged. The BOJ further reiterated its target of driving the 10-year bond yield to zero percent and revised its inflation expectation for the year lower to 0.9% from 1.1%. On non-standard monetary policy measures, the ECB has stated

⁷ following three rate hikes implemented in 2017

⁸ compared to 3.1% projected at its September Dot Plot

has stated earlier in the year that the planned reduction in its monthly net asset purchases from €30 billion to €15 billion in October with an end in December. Starting 2019, the ECB intends to reinvest the principal payments from maturing securities purchased under the program for an extended period to continue to keep the economy well lubricated.

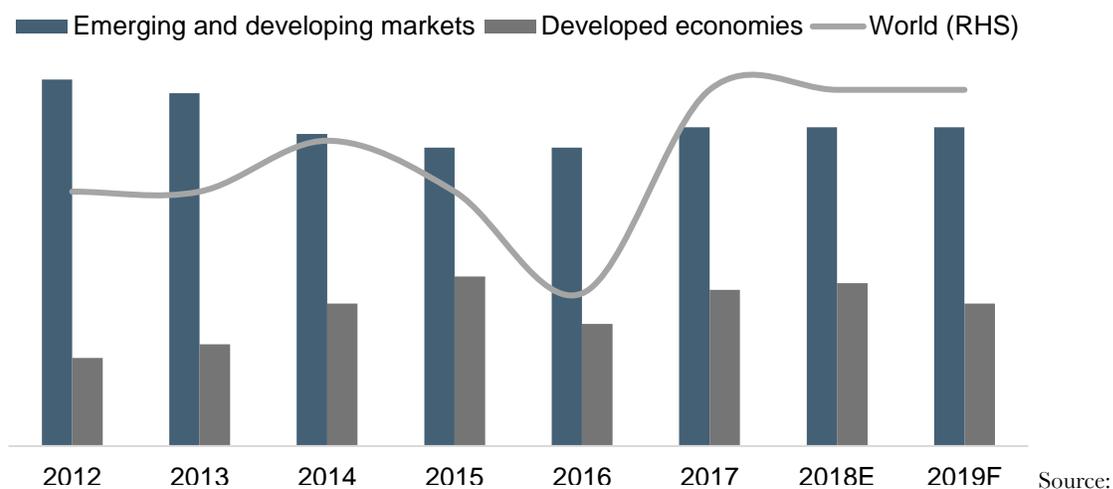
Table 1: Overview of macro indicators across DM

	US	Euro area	UK	Japan
Latest Monetary Policy Action	1.25% - 1.50%	Unchanged	+0.50% to 0.75%	Unchanged
Mean CPI: 2018	2.5%	1.73%	2.5%	1.1%
2017	2.1%	1.54%	2.7%	0.5%
GDP (Q3 18)	3.4%	1.7%	1.5%	-1.2%
GDP (Q3 17)	2.8%	2.8%	1.9%	3.0%
Avg Unemployment 2018	3.8%	8.0%	4.1%	2.4%

Source: Bloomberg, ARM Research

Global Growth: Receding from a peak

After two consecutive years of stronger growth propelled by accommodative monetary policy in DMs and recovery in commodity prices which supported far more stronger growths in EMs, global growth is now projected to stagnate in 2019 as we believe growth has hits its zenith across DMs and EMs. On the former, we believe the impact additional rates hike in US, the reduction in the assets purchase programme of the ECB amidst uncertainties emanating from the UK divorce from the EU will limit the scope of growth in DMs over 2019, with IMF now projecting growth to decelerate 30bps YoY to 2.1%. For EMs, the support from increase in commodity prices which supported growth in 2018 is expected to fade. Also, with crude oil prices starting 2019 at a year low, the prospects of significant growth in oil exporting countries is limited. However, following expected recoveries in Latin America, Sub-Saharan (especially South Africa whose growth is expected to be stronger at 1.4% vs. 0.8% in 2018) and Saudi Arabia, growth in EMs is projected to remain steady at 4.7% YoY. Overall, global GDP growth is projected to remain stagnant at 3.7% YoY in 2019.

Figure 3: Trend in global growth and projection (%)

Source: IMF, ARM Research

In US, the hawkish monetary policy environment and the fading effect of the fiscal boost are expected to soften growth. However, we believe the economic fundamental and the strong growth recorded over 2018 were well beyond the natural rate of growth dictated by the fiscal and monetary stimulus alone, as such, we expect a slower contraction in growth over 2019. On this backdrop, IMF forecasts a growth of 2.5% in 2019, a 40bps deceleration from 2018E of 2.9% albeit a further moderation in unemployment rate to 3.5% (FY 2018E: 3.8%). Accordingly, we believe the prospect of faster wage growth will further amplify the rate of growth in core inflation in 2019 with FOMC likely to press harder on the pedal and deliver on its projection of two more hikes in 2019 to a terminal rate of 2.75% - 3.0%.

GDP growth in the EU is expected to contract further in 2019 to 1.9% (FY 2018E: 2.0%) stemming largely from a range of risks which have bedeviled outlook for 2019. Firstly, ongoing budget crisis in Italy, if not resolve before the end of the year, could see Italy battle with recession in the coming year. While a spillover could be manageable, a financial contagion could have greater impact across the EU. On another note, the threat of auto tariffs by the US government and trade barriers from a UK's exit could further subdue growth in the EU. Elsewhere, notwithstanding the outcome of the vote by the house of commons and parliament on the draft withdrawal deal, medium term growth in the UK is expected to drag as the anticipated barriers to trade from a divorce from EU is expected to weaken export demand. However, reflecting the strength of services and construction sectors, IMF estimates GDP growth to come in higher in 2019 by 10bps to 1.5% YoY.

In Japan, the economy is estimated to witness a deceleration in GDP growth over 2019, with IMF projecting 0.9% (20bps lower than 1.1% estimate for 2018) growth. The slower growth estimate stemmed from unfavourable demographics, decline in labour force and as well as the anticipated impact of the hike in consumption tax from 8% to 10% in October 2019. Although, the impact of the consumption tax on the overall economy will be muted by government plans to put in certain

social economic reforms in other to avoid a repeat of the recession in 2014 where a similar hike placed a drag consumer spending.

Softer EM growth outlook on the horizon

Going forward, growth prospect for major Emerging market economies appear less optimistic as we expect the free fall in crude oil prices over the second half of 2018 to persist over 2019 with significant impact on oil exporters. Also, tighter financial conditions in the US which continues to threaten currency stability in most EM countries could further depressed economic activities across EMs. As a result, IMF now expects growth in EM to be flat at 4.7% YoY over 2019.

In China, the pace of economic expansion is expected to decelerate further with the IMF predicting that China's economy would grow 6.2% in 2019 – its slowest rate since 1990, on account of escalating trade war with the United States. More so, the ongoing deleveraging exercise in China could further dampen investment and consumption spending going forward. Elsewhere, the recent dip in crude oil prices provides some cheer for India's economic growth as domestic demand is expected to pick up on the back of a stronger rupee and ease in monetary conditions following dissipating inflationary concern with growth now expected to come in 10bps higher in 2019 to 7.4% YoY.

Elsewhere in Latin America, the political uncertainty that took a toll on Brazil's economy in 2018 appear to have receded. As a result, Brazil's economy is expected to turn a corner with IMF projecting a 2.4% YoY growth over 2019. This view is hinged on expectation that the newly elected President will forge ahead with proposed reform plan aimed at rescuing Brazil from the mire. Elsewhere, although the prospect for lower crude oil prices going into 2019 should stoke a hard landing for Mexico's economy, economic benefits following the new NAFTA agreement (in November 2018) provides some cheer. The new deal made several changes to the former agreement with the most noticeable impact being that auto companies will now manufacture at least 75% of the car's components in Canada, Mexico, or the United States. In consonance with our views, IMF now projects a 2.5% YoY (vs 2% YoY in 2018) growth over 2019. However, we remain less optimistic on growth prospect in Argentina following subsisting elevated debt levels, inflationary concerns and currency weakness which continues to dampen flow of foreign investment into the economy.

In EM Europe, the recent plunge in crude oil prices poses threat to Russia's economic growth over 2019, with GDP growth expected at 1.8% YoY. Our view largely reflects Russia's reliance on oil revenues which makes up ~40% of total budgeted federal revenues. In addition, the new wave of sanctions for US dubbed the 'bill from hell' which includes restrictions on new Russian sovereign debt transactions, energy and oil projects and Russian

uranium imports could slow down economic activities. Over in Turkey, economic growth is expected to remain soft as tighter monetary policy places a lid on growth in private consumption as well as fixed investment. Furthermore, the possibility of geopolitical tensions poses significant downside risk to Turkey's economic growth.

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