

Nigeria Strategy Report

H1 2021

Domestic Economy and Policy Environment

Gross Domestic Product H1 2021 - The exit from a recession

Executive Summary

Extending the pattern in H1 20, when output contracted by -2.1% YoY induced by the COVID-19 pandemic, the economic landscape deteriorated further in Q3 20 with GDP contracting by 3.62% YoY, taking Nigeria's economy into a recession. Consequently, over the first nine months in 2020, Nigeria's economic output shrank by 2.62% reflecting declines in both the oil and non-oil sectors. Specifically, lower crude oil production of 1.85mbpd (9M 19: 2.02 mbpd) drove the contraction in the oil sector (9M 20: -5.2% YoY), while moderations in the non-oil sector (9M 20: -2.3% YoY) reflects declines across the Manufacturing, Trade, Services and Construction sector. Over the last quarter of 2020, we project crude production would print at 1.7mbpd (Q4 19: 2mbpd), which translates to a 15% YoY contraction in oil GDP. For the non-oil territory, improvement in Services, Construction, and Agricultural sectors, as well as slower contraction in Trade and Manufacturing sectors informs our projection of a 1% contraction in non-oil GDP. Ergo, we expect the economy to shrink by 1.98% YoY in Q4 20, which translates to a FY 20 real GDP contraction rate of 2.46% YoY.

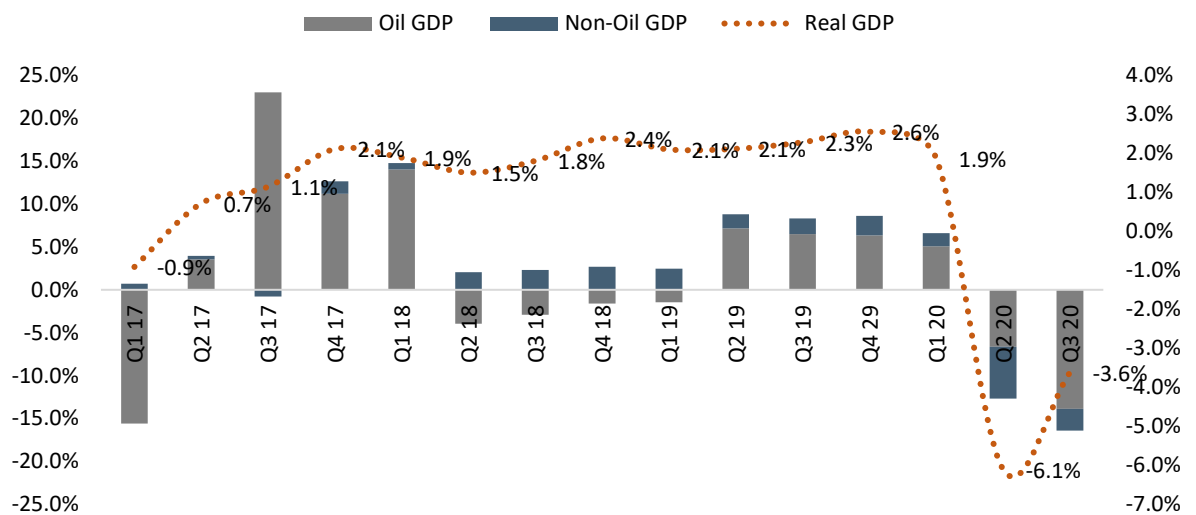
Central to growth over 2021 is a gradual recovery in economic activities 2021 as well as the favorable base effect in both the oil and non-oil sectors. For starters, barring any shock in 2021, we expect a recovery in the oil sector over FY 2021, hinged on the easing of OPEC production cut. Likewise, on the non-oil leg, we anticipate a recovery across Manufacturing, Construction and Services sectors, while the Agric sector is expected to improve over 2021, barring any lockdown. On the other hand, we foresee a slower contraction in Trade sector, as the reopening of the land borders in January 2021 should provide respite for this sector. Hence, barring a second lockdown, which could occur due of the second wave of the pandemic, we expect the Nigerian economy to grow by 1.5% 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 2021.

Q3 2020 GDP: A recession is confirmed

Extending the pattern in H1 20, when output contracted by -2.1% YoY induced by the COVID-19 pandemic, the economic landscape deteriorated further in Q3 20 with GDP contracting by 3.62% YoY, taking Nigeria’s economy into a recession. Consequently, over the first nine months in 2020, Nigeria’s economic output shrank by 2.62% reflecting declines in both the oil and non-oil sectors. Specifically, lower crude oil production of 1.85mbpd (9M 19: 2.02mbpd) drove the contraction in the oil sector (9M 20: -5.2% YoY), while contractions in the non-oil sector (9M 20: -2.3% YoY) reflects declines across the Manufacturing, Trade, Services, and Construction sector. Over the last quarter of 2020, we project crude production would print at 1.7mbpd (Q4 19: 2mbpd), which translates to a 15% YoY contraction in oil GDP. For the non-oil territory, improvement in Services, Construction, and Agricultural sectors, as well as slower contraction in Trade and Manufacturing sectors informs our projection of a 0.7% contraction in non-oil GDP. Ergo, we expect the economy to shrink by 1.7 YoY in Q4 20, which translates to a FY 20 real GDP contraction rate of 2.4% YoY.

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



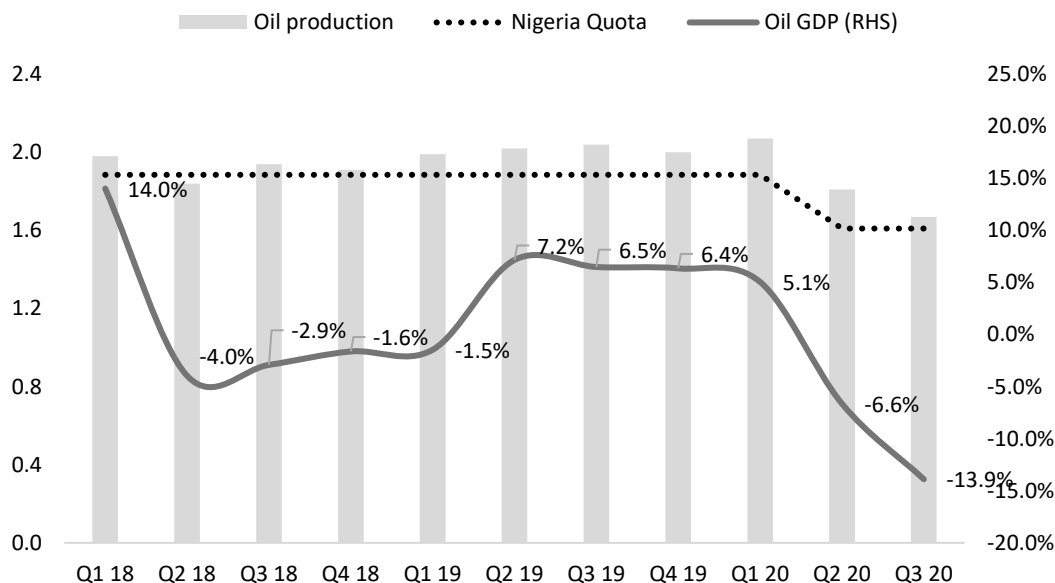
Source: NBS, ARM Research

A higher level of compliance sends oil sector to the deeps

As earlier stated, since Q2 2020, oil production steeply declined mirroring the need to comply with OPEC required production cuts, induced by the adverse impact of the pandemic on global oil demand. Looking at Nigeria’s oil production of 1.81mbpd in Q2 20, and 1.67mbpd in Q3 20 (including condensates), revealed a higher level of compliance to the agreed cuts. To shed more light, while the agreed production cut was eased to 7.7mbpd in August 2020, from 9.7mpbd in May 2020, Nigeria compensated for lack of full compliance with the previous limit.

Consequently, Nigeria recorded a higher level of compliance with crude oil production (excluding condensates) printing at 1.478mbpd in Q3 2020, relative to 1.617mbpd in Q2 2020, according to OPEC latest numbers. Hence, oil GDP contracted by 6.6% in Q2 20 (Q2 19: 7.2% YoY), and further by 13.9% in Q3 20.

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



Source: NBS, ARM Research

Weaknesses across subsectors anchor Services GDP into a recession

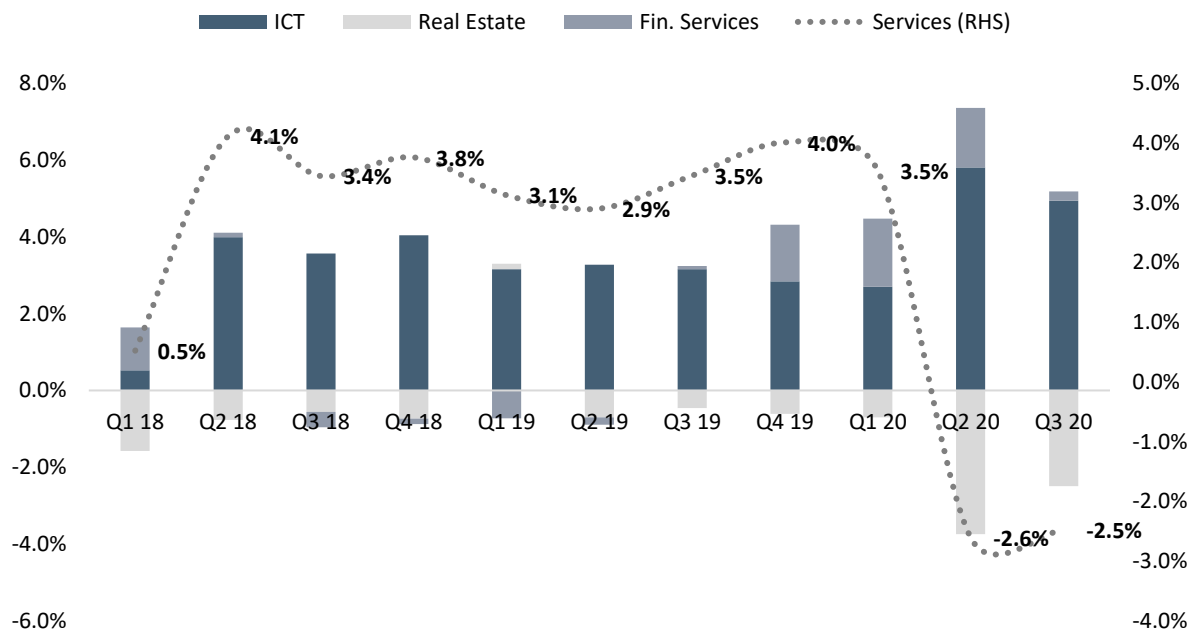
We begin with the services sector¹ which is the largest component of non-oil GDP. Precisely, continued declines across Transport (-43% YoY), Real Estate (-13% YoY), Education (-20.7% YoY), Accommodation and food services (-22.6% YoY), cumulatively accounting for 43.8% of overall GDP dragged the services sector growth into a negative territory (Q3 20: -2.47% YoY). In our view, the COVID-19 pandemic which led to imposition of guidelines in other to curb the spread of the virus, weighed heavily across these subsectors. To buttress, while Q3 2020 data is unavailable, latest numbers from NBS showed compensation of employees declined by 6.78% YoY² while private consumption expenditure moderated by 0.08% YoY. Notably, contractions across these subsectors more than outweighed growth in ICT (+14.6% YoY), Financial sector (+6.8% YoY), Health Services (+2.8% YoY) and Public administration (+3.6% YoY) in Q3 2020. On ICT, we believe the continued increase in use of internet

¹ 33.8% of non-oil GDP

² In Q2 2020

services spurred growth, as voice subscriptions grew by 15% YoY to 202.6 million subscribers, while data subscriptions grew by 21.7% YoY to 149.5 million subscribers. Meanwhile, the base effect which led to the double-digit growth in the finance sector since Q4 2019, filtered out of GDP numbers, leading to a slower growth (+6.8% YoY) over Q320. Unsurprisingly, health and social services sectors showed resilience in Q3 20 (+2.8% YoY – highest growth since Q4 15), as it remains a key sector in the fight against the pandemic.

Figure 3: Attribution analysis of services GDP sector and key sub-components

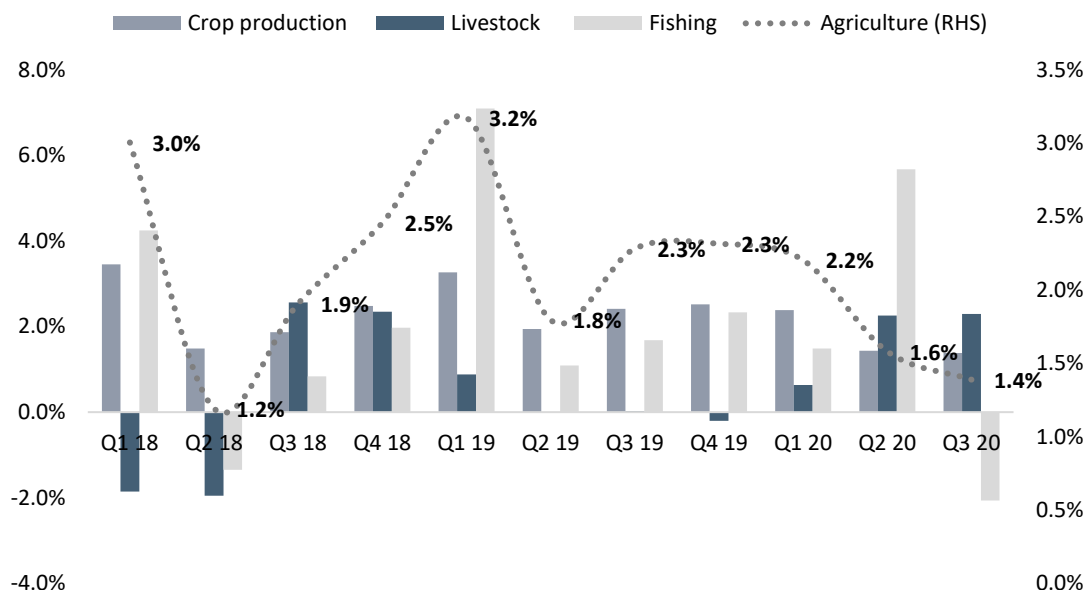


Source: NBS, ARM Research

Agricultural sector remained resilient despite the shocks

The Agric sector remained resilient, advancing by 1.39% YoY, albeit at a slower pace relative to the prior quarter (Q2 2020: 1.58% YoY). For context, the slower growth reflects a contraction of 2.1% YoY in the fishing subsector relative to a growth of 5.7% YoY in Q2 2020. Meanwhile, growth in other subsectors including crop production (Q3 2020: +1.4% YoY) and livestock (Q3 2020: +2.3% YoY) remained flat compared to the prior quarter. We believe below-average access to inputs, amongst other factors curtailed growth in Agricultural activities during the period under review.

Figure 4: YoY Agric GDP growth vs Crop production, Livestock & Fishing



Source: NBS, ARM Research

The rubbles of the pandemic remain in the Manufacturing and trade sectors

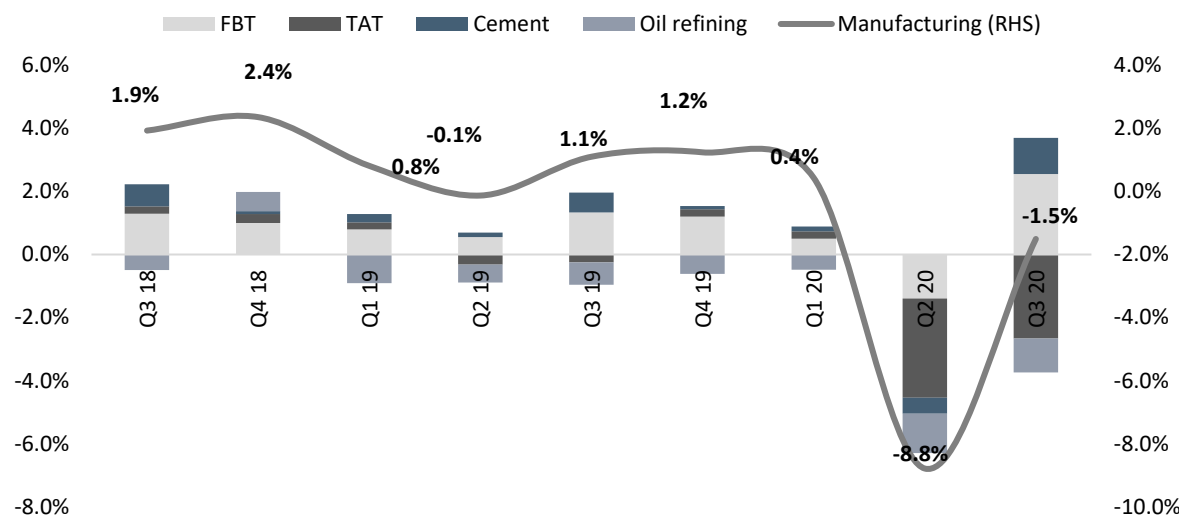
The manufacturing sector contracted 1.5% YoY in Q3 2020 albeit, at a slower pace relative to the previous quarter (Q2 2020: -8.8% YoY). Recoveries were seen across the cement (+12% YoY vs Q2 2020: -5.6% YoY) and FBT⁵ (+5.6% YoY vs Q2 2020: -3.0% YoY), while chemical and pharmaceutical subsector recorded a sturdy growth of 6.6% YoY – the highest growth since Q1 16 as the subsector took the central stage in the fight against the COVID-19 pandemic. We believe growth across these sectors mirrored a pickup in production activities. Taking a cue from cement companies within our coverage, we believe higher output in cement sector reflects improvements in Construction activities due to the easing of Covid-19 restrictions during the period. On the contrary, we saw lingering contractions across other subsectors such as TAF⁶ (-12.1% YoY), Oil refining (-68.3% YoY), Non-metallic (-12.2% YoY) amongst other subsectors, albeit slower relative to the prior quarter. We believe production activities in these sectors were slower relative to other sectors. For context, purchasing managers index (PMI) showed TAF printed at 49pts, below the 50-index point benchmark in Q3 2020 (Q1 20: 54.1pts, Q2 20: 35.6pts). Meanwhile, oil refining subsector

⁵ Food, beverage and Tobacco

⁶ Textile, Apparel and Footwear

saw a steeper contraction (Q3 2020: -68.3% YoY vs Q2 20: 67.7%) reflecting as zero utilization of these local refineries.

Figure 5: Attribution analysis of Manufacturing sector GDP and key sub-components



Source: NBS, ARM Research

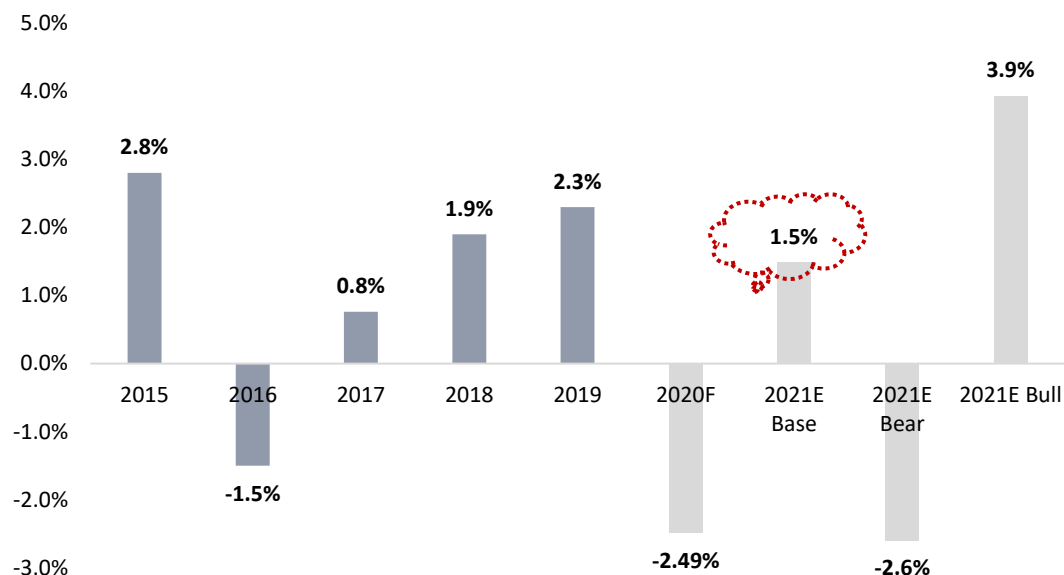
As earlier stated, resumption in construction activities following the easing of Covid19 restrictions resulted in a recovery building and construction sector (Q3 20: 2.8% YoY vs Q2 20: -31.8% YoY). Elsewhere, trade sector contracted by 12.1% in Q3 2020, as the confluence of border closure and devaluation in Naira adversely affected the sector. For context, over H2 2020, the CBN devalued the Naira at the official window to ₦381/\$ in July 2020 (previously: ₦361/\$) and ₦393/\$ at the IEW (previously: ₦385/\$) owing to the ripple effects of the pandemic on the foreign reserves. Consequently, the Naira depreciated by 13.6% to ₦468/\$ on average at the parallel market (H1 2020: ₦404.7/\$).

The exit from a recession – a fallout of base effects and revival in economic output

Central to growth over 2021 is a gradual recovery in economic activities 2021 as well as the favorable base effect in both the oil and non-oil sectors. For starters, barring any shock in 2021, we expect a recovery in the oil sector over FY 2021, hinged on the easing of OPEC production cut. Likewise, on the non-oil leg, we anticipate a recovery across Manufacturing, Construction and Services sectors, while the Agric sector is expected to improve over 2021, barring any lockdown. On the other hand, we foresee a slower contraction in Trade sector, as the reopening of the land borders in January 2021 should provide respite for this sector. Hence, barring a second lockdown – which could occur due of the second wave of the pandemic, we expect the Nigerian economy to grow by 1.5% YoY – which is our base case. Meanwhile, our bear case estimates of a 2.6% YoY

contraction mirrors a freeze in economic activities owing to the second wave of the pandemic. Our assumption factors in a slower growth across sectors and a higher crude oil production cut. For our bull case scenario, better than expected outturn across all sectors and higher crude oil production should result in a higher growth of 3.9% in FY 2021.

Figure 6: Annual real GDP growth and forecast



Source: NBS, ARM Research

Dissecting our expectations on each sector, we expect a rebound in the oil sector by 4.5% YoY over FY 21 (FY 20E: -7.8% YoY) with a production estimate of 1.89mbpd (2020E: 1.81mbpd). Precisely, while OPEC+ have agreed to maintain production cuts in January 2021, Nigeria is still expected to compensate for excess production until Q1 2021. Hence, over Q1 21, we anticipate an average crude oil production of 1.75mbpd (including condensates). In subsequent quarters, we expect a gradual ease in crude oil production cuts, falling within the range of 1.85mbpd – 1.95mbpd in Q2 and Q3 2021. In the last quarter, we anticipate a pickup in production to 2mbpd, where we believe the spread of the virus will have been curtailed and the vaccine will be widely available. In addition, we believe a favorable base effect precisely from Q2 21, is expected to drive growth numbers northwards in the oil sector.

Similarly, in the non-oil sector, we expect a recovery of 1.3% YoY (FY 20F: -2.0%), stemming from a rebound across various sectors. Starting with Agric sector, barring a second lockdown in 2021, we expect a pickup in farming activities to spur growth. According to FEWSNET,

while continued impact of the pandemic poses a risk, improved engagement in farming activities relative to 2020, as well as the loan payment moratorium granted by the CBN to flood-affected households are expected to drive growth in the coming year. That said, we expect the Agric sector to grow by 2.1% YoY over FY 2021. (FY 2020E: 1.7% YoY).

On services sector, we expect a continuous momentum in the ICT sector owing to the continued use of internet services, albeit at a slower pace. Precisely, relative to 2020 where we witnessed a sharp rise in active subscribers to an average of 194 million¹² (+10% YoY) – a fallout of the lockdown and remote working practices -, we foresee a slower growth of subscribers owing to the high base from FY 2020. Against this backdrop, we expect active subscribers to print at 212 million by FY 2021 (FY 2020E: 197 million subscribers), which translates to a 7% YoY growth during the period. On the finance segment, we believe some of the intervention funds created by the CBN including the ₦300 billion Targeted Credit facility (TCF) for affected households and SMEs, amongst others would spur growth. Albeit we anticipate a mild growth in 2021 owing to high base in the first two quarters of 2020.

Meanwhile, we forecast slower contraction in Real Estate relative to 2020 as economic activities starts to improve. Our stance is hinged on a gradual pickup in real estate development as we expect the improved corporate profitability and individual income to provide some respite in this segment. In addition, an increase in aggregate capital expenditure⁸ in 2021 to ₦3.85 trillion (2020: ₦2.3 trillion) should filter through real estate ancillary sectors – buildings and cement, thus curtailing pressures in real estate sector. Coalescing these factors, we expect the services sector to grow by 1.0% YoY over FY 2021 (FY 2020E: -0.41% YoY).

In the Manufacturing sector, we expect a rebound in production activities in addition to the favorable base effect to drive growth across subsectors. To buttress, barring any lockdown in 2021, we predict a better outturn in production activities relative to 2020. In addition, the base effect from Q2 2020 is projected to spur overall growth upwards. Specifically, we believe improved production activities across sectors such as the FBT and textile sectors will translate to a moderate growth in 2021. On cement, our expectation of higher exportation owing to the reopening of the Nigerian land borders in January 2021, as well as improved construction activities informs our stance of a rebound in output.

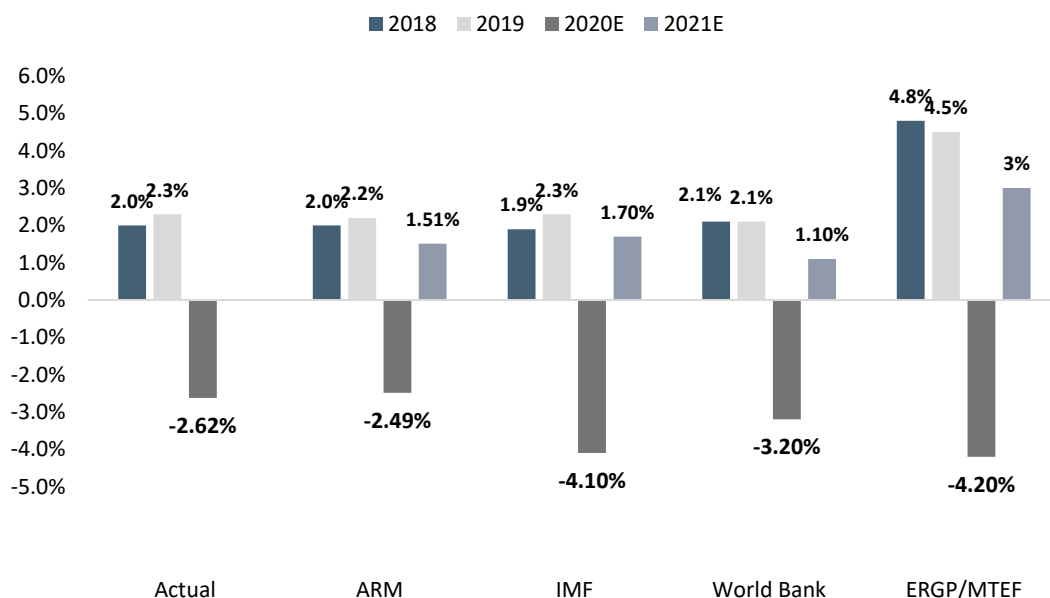
On oil refining sector, with no specific date in sight for the completion of the rehabilitation exercise, we project a contraction in 2021, albeit slower, relative to 2020. Our stance is hinged on favorable base effect as well as NNPC's collaboration with private sector to boost Nigeria's refining capacity.

¹² Q1 to Q3 2020 average

That said, we expect a lower contraction over FY 2021. Overall, we expect manufacturing sector to grow by 3.3% YoY (FY 20E: -2.6% YoY) mirroring better production output and favorable base effect. Meanwhile, the reopening of the land borders informs our projection of a 1.25% YoY contraction in the trade sector (FY 2020E: -10% YoY). Tying our views on both the oil and non-oil component of growth, we forecast a real GDP growth of 1.5% in 2021 which is the base case.

In playing out other scenarios, we assume a real GDP growth of 2.4% as the bull case based on the expectation that oil production touches 1.95mbpd and better than expected growth in Agric, services Manufacturing, Trade and Construction sectors. In terms of the downside, we presuppose the imposition of a second lockdown in 2021 due to the second wave of the pandemic, which will adversely impact sectoral performances. In addition, we factored in lower crude oil production of 1.67mbpd, feeding into the negative forecast of -2.6%, which is our bear case scenario.

Figure 7: YoY GDP growth forecast (ARM vs IMF, World bank and ERGP/MTEF)



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

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