

July 15, 2020



Nigeria Strategy Report

H2 2020

Domestic Economy and Policy Environment

Gross Domestic Product H2 2020 – A Recession Looms

Executive Summary

The fragility of Nigeria's economic growth became more apparent this year, following the outbreak of covid-19. Highlighting the absence of catalysts at the start of the year to stimulate an economic expansion, we expected growth to flatline at 2.3% YoY. However, the emergence of the novel COVID-19 virus threw a curveball to all sectors of the economy. Pertinently, the imposition of containment measures by the government in three key states such as the lockdown led to a halt in production of non-essential services and invariably crippled activities in the non-oil sector. Also, the pandemic adversely impacted the oil sector, as a sharp drop in global demand and minimal storage capacity left the country with a lot of unsold cargoes, placing a cap on crude production.

Given these developments ensued at the rear of Q1 2020, the economy still expanded over the aforementioned period by 1.87% YoY, albeit slower than the outturn of 2.55% YoY recorded in Q4 19. While improved average crude oil production at 2.07mbpd (Q4 19: 2.0mbpd) during the review period spurred growth in the oil sector to 5.1% YoY, the non-oil sector anchored the slowdown in overall GDP.

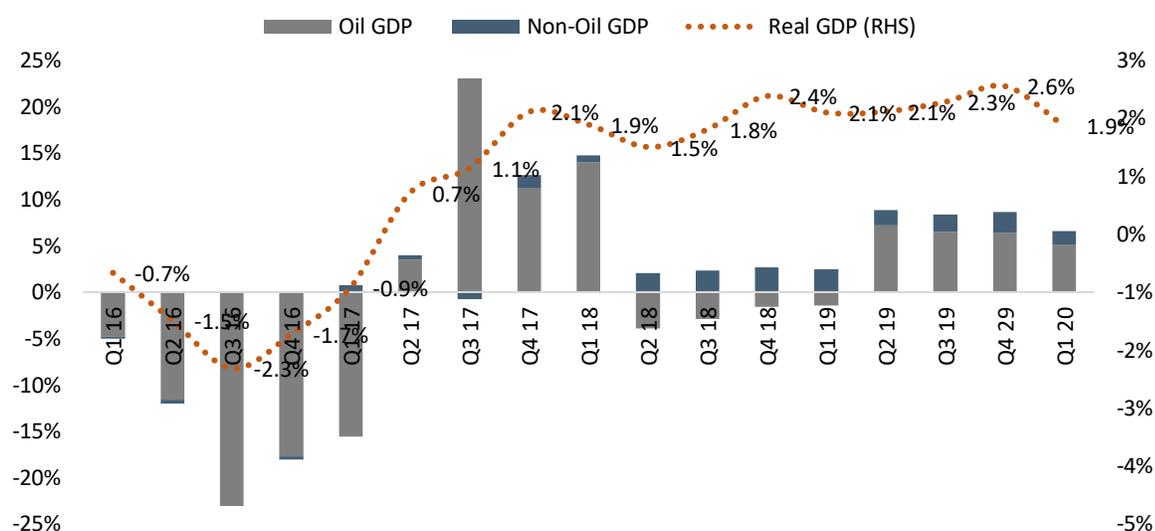
As stated above, the emergence of the pandemic in Nigeria and its impact on economic activities towards the end of Q1 2020, changed the narrative for 2020 growth estimates. For starters, we expect the oil sector to contract in FY 2020 hinged mainly on the need to comply with OPEC production cut. Similarly, we expect contractions in Trade and Construction sectors and a slowdown in services and Agric. On a subsector basis, save for ICT (2020 forecast: +9% YoY), we expect to see contractions or a slowdown across all subsectors. Our stance is hinged on the interruption in the production of non-essential services, restriction in movement domestically and globally as well as technical devaluation of the Naira. On that note, barring a second wave of the pandemic, we expect the Nigerian economy to contract by 1.6% 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 2020.

Q1 2020 GDP: A pre-pandemic glimpse into Nigeria’s Economy

The Nigerian economy expanded by 1.87% YoY in the first quarter of 2020, albeit slower relative to the prior quarter (Q4 19: 2.55%). While improved average crude oil production at 2.07mbpd (Q4 19: 2.0mbpd) during the review period spurred growth in the oil sector to 5.1% YoY, the non-oil sector anchored the slowdown in overall GDP. Precisely, slowed growth in the non-oil sector (Q1 2020: +1.5% YoY vs Q4 19: 2.3% YoY) mirrored a moderation in manufacturing (+0.4% YoY vs Q4 19: 1.2% YoY) and a steeper contraction in trade sectors (-2.8% YoY vs -0.6% in Q4 19). Meanwhile, Services, Agric and Construction sectors maintained momentum, expanding by 3.5% YoY, 2.2% YoY, and 1.69% YoY respectively.

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

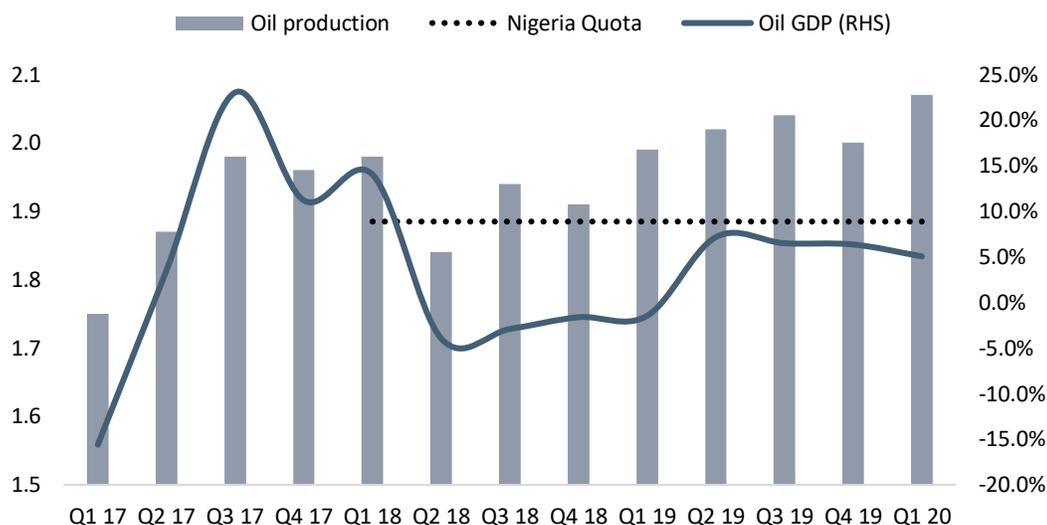


Source: NBS, ARM Research

Oil Sector maintained the momentum

As earlier stated, oil production came in higher over Q1 2020 reflecting output at Egina which has left the country’s overall production hovering around the 2.0mbpd mark since Q2 2019. Consequently, oil GDP expanded by 5.1% YoY during the quarter, albeit slower relative to the prior quarter (Q4 2019: 6.4% YoY). The slower growth basically reflects improved crude oil production in Q1 19 as output from Egina began to trickle in, compared to Q4 18 where crude oil production averaged 1.91mbpd in its absence. Taking a look at the production level of 2.07mbpd, however, shows Nigeria’s continued noncompliance with the required OPEC cut. As we stated in our H1 2020 report, compliance with the agreed cut should have taken Nigeria’s crude oil production to 1.885mbpd (including 200kbpd condensates).

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



Source: NBS, ARM Research

Financial and ICT subsectors bolstered Services sectors

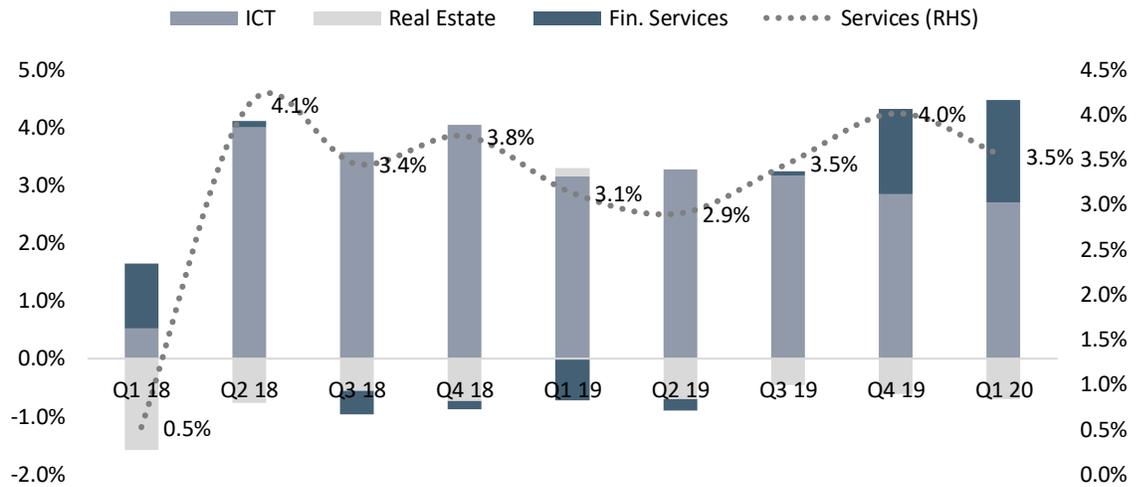
Starting off with the largest component of the non-oil GDP, the services¹ sector maintained its resilience, buoyed by growth in financial services and ICT subsectors in Q1 20. On the former, we saw continuous output in financial services subsectors which increased significantly by 20.8% YoY - the highest recorded in the last five years. This clearly reflected the banking sector's drive to meet the 65% LDR² requirement (previously 60%). You will recall the CBN enforced the implementation of a minimum LDR of 60% in July 2019, and subsequently increased the LDR to 65% in September 2019, in order to spur lending to the real sector. To emphasize, latest data from the NBS showed a total of ₦936.7 billion worth of loans were created by Deposit Money Banks over Q4 19.

Further supporting the higher output in the service sector was the transport (+2.85 YoY) and continuous output in ICT (+7.6% YoY) subsectors. Particularly, increased promotional activities amongst the Telco's continued to drive growth. For context, voice subscribers grew by 8% YoY to 187.6 million in Q1 2020. Additionally, the continuous rise in smartphone subscriptions and increase in data usage resulted in double-digit growth (+15% YoY) in data subscribers to 132.3 million. Overall, the expansions in financial services, ICT and Transport subsectors muted the contraction in real estate (-4.8% YoY).

¹ 38% of non-oil GDP.

² Loan to deposit ratio.

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

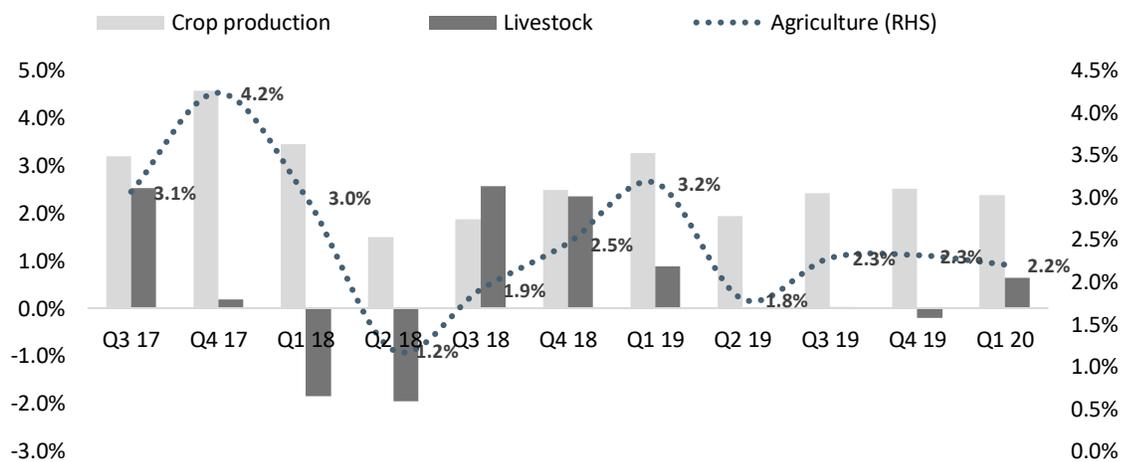


Source: NBS, ARM Research

Growth in Agriculture sector perpetuates

Growth in the agricultural sector remained resilient, advancing by 2.2% YoY in Q1 20, albeit slower relative to the prior quarter (Q4 2019: 2.3% YoY) – a fallout of the buoyant harvest in Q4 19. Expansion in the sector mirrored growth in crop production as carryover stocks from the prior harvest season fueled market supplies, according to FEWSNET. Particularly, production of staple cereal such as cowpea (beans), maize, millet and sorghum increased during the review period. This was evidenced in crop production subsector which grew by 2.4% YoY. Similarly, other subsectors including livestock, forestry and fishing recorded growth of 0.63%, 1.7% and 1.5% YoY, respectively.

Figure 4: Trend in Services GDP and key sub-components



Source: NBS, ARM Research

Manufacturing and trade sectors posted a drag on Non-oil sector

The manufacturing sector maintained status quo, as it continued to be dragged by immense competition among producers, particularly in the FBT³ subsector which accounts for 46% of the sector. Taking a cue from the food producers within our coverage, stiff competition within the industry persisted in Q1, thus inflating pressures on topline. We believe the frail trend in FBT contributed to declining revenue across listed FMCG⁴ in recent financial results. Accordingly, food production (FBT) slowed to 1.1% YoY in Q1 2020, relative to 2.7% in the prior quarter. In addition, oil refining subsector continued to contract (Q1 2020: -53% YoY vs Q4 19: 25.7%) as zero capacity utilization of local refineries contributed to the slowdown in manufacturing output. The moderation in the above-mentioned sub sectors more than outweighed the outturn in cement (Q1 2020: +1.7% YoY vs 1.1% in Q4 2019) and TAF⁵ subsector which flatlined at 1.0% YoY. Against this backdrop, the manufacturing sector slowed to 0.4% YoY (vs Q4 2019: 1.2%).

Likely reflecting the early passage of the 2020 budget⁶ and the implementation rate of 29% for capital expenditure in Q1 2020 (vs Q1 19: 0% implementation rate), the construction sector grew by 1.7% YoY in Q1 2020 (vs Q4 19: 1.3% YoY). Also, we believe the improved construction activity filtered through the cement sector performance which saw an expansion, as highlighted above. Elsewhere, we witnessed a steeper contraction in trade sector by 2.8% YoY (vs Q4 19: -0.6%). In our view, the contracting trade sector mirrored Naira devaluation at both the parallel market and the IEW in March 2020. For context, for the month of March, the Naira depreciated to an average ₦385/\$ at the IEW (February: ₦365/\$), and ₦374/\$ in the parallel market relative to ₦359/\$ in February.

2020 GDP: Recession looms

Clearly, the outbreak of Covid-19 and its impact on economic activities towards the end of Q1 2020, changed the narrative for 2020 growth estimates. For starters, we expect the oil sector to contract in FY 2020 hinged mainly on the need to comply with OPEC production cut. Similarly, we expect contractions in Trade and Construction sectors and a slowdown in services and Agric. On a subsector basis, save for ICT (2020 forecast: +9% YoY), we expect to see contractions or a slowdown across all subsectors. Our stance is hinged on the

³ Food, beverage and tobacco.

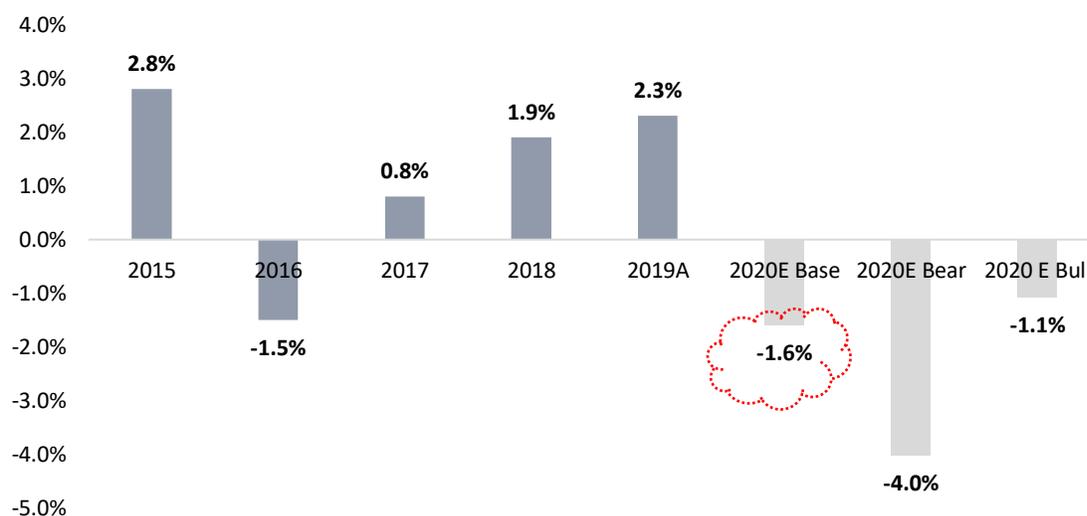
⁴ Fast moving consumer goods.

⁵ Textile, Apparel and Footwear.

⁶ The initial 2020 budget was passed on 5th December 2019.

interruption in the production of non-essential services, restriction in movement domestically and globally as well as technical devaluation of the Naira. On that note, barring a second wave of the pandemic, we expect the Nigerian economy to contract by 1.6% YoY – which is our base case. While our bear case estimate of -4.0% YoY mirrors the occurrence of a second wave of the pandemic. Our assumption factors in a further devaluation in Naira, a steeper contraction or slowdown across all sectors and full compliance to OPEC production cuts. For our bull case scenario, better than expected output across all sectors towards the end of the year could result in a slower contraction of 1.1% YoY in FY 2020.

Figure 5: Annual real GDP growth and forecast



Source: NBS, ARM Research

Taking a closer look at the sectors, we expect the oil sector to contract by 9.4% YoY over FY 20 (2019: +4.6% YoY) with production estimate of 1.82mbpd (2019: 2.01mbpd). This is hinged on the adverse impact of the pandemic on crude oil demand, fused with the need for full compliance with the agreed OPEC cut of 0.41mbpd to 1.49mbpd on average⁷ (excluding condensates). On that note, we foresee a higher level of compliance in Q2 and Q3 with crude oil production expected to average 1.70mbpd within the period. In the last quarter, barring a second wave of the pandemic, we expect a marginal pick up to 1.80mbpd, where we believe the spread of the virus will have been curtailed. Similarly, in the non-oil sector, we expect a contraction of 0.8% YoY (previous estimate: 2.1%) stemming from an anticipated slowdown across all sectors. On agriculture, we believe the

⁷ Average quota over the rest of FY 2020 (May to December 2020)

continuation of farming activities should drive growth, albeit at a slower pace relative to the prior year. In our view, restriction in movement which bred shortages of labour, fertilizer as well as the challenges with transport logistics are likely to disrupt farmers' access to markets, and consequently curb productive capacities. According to FEWSNET, most households are expected to face difficulty engaging in a normal level of agricultural activities and cultivation due to COVID 19 income related issues and market constraints. In their report, areas planted for crops as well as the main harvest is likely to stay below average in most areas for FY 2020. That said, we expect the Agric sector to grow by 1.77% over 2020 (FY 2019: 2.4% YoY).

On services sector, while ICT remains the powerhouse for growth given the increased use of internet services during and after the lockdown, we expect a significant slowdown in services sector due to slowdown or contraction across other subsectors. On ICT, we believe increased consumption of internet services by mass segments as most people work from home would spur growth in ICT. Taking a cue from MTN Nigeria, Consumer Business Unit – which comprises subscriptions from youths, high value and Mass segments- contributes roughly 86% on average to overall revenue. Meanwhile, Enterprise Business Unit (represents subscriptions from corporate and SME) and Wholesale Business Unit (serves customers who buy MTN telecom products in bulk with the intention to re-sell these products to their external clients) constitutes 14% of total revenue. That said, we expect active subscribers to print at 192 million by FY 2020 (FY 19: 177 million subscribers), which translates to a 9% YoY growth in FY 2020.

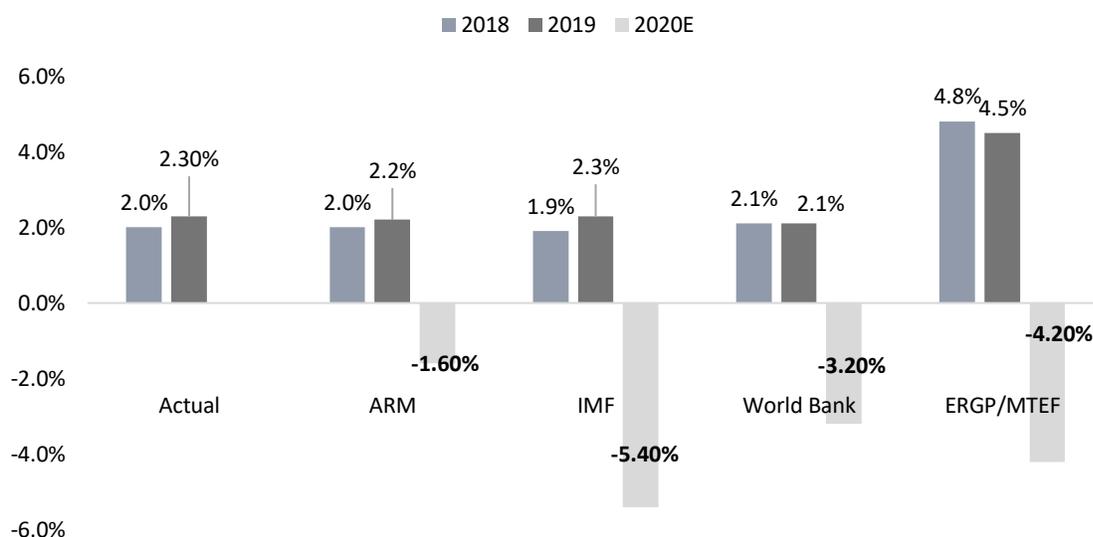
On the finance segment, we foresee a mild growth in 2020 owing to stimulus package and low base in the first two quarters of 2019. For context, while banks remain cautious in growing their risk asset, the federal government's stimulus package of ₦1.1 trillion low-cost loans via the apex bank informs our expectation for a mild growth in the segment. On the contrary, we expect a bleak outlook in real estate owing to the adverse impact of the pandemic. Our stance is hinged on a slowdown in real estate development as we expect the shortfall in corporate profitability and individual income to adversely impact growth in the segment. In addition, a cutback in capital expenditure⁸ in 2020 revised budget by ₦235 billion to ₦2.3 trillion should filter through real estate ancillary sectors – buildings and cement, thus inflating pressures in real estate sector. Coalescing these factors, we expect the services sector to slow to 1.63% YoY over FY 2020 (FY 2019: 3.4% YoY).

⁸ Capital Expenditure (Exclusive of Transfers)

In the manufacturing sector, we expect disruption in production value chain to weigh heavily across subsectors. To buttress, recent key indicators suggest a weak performance in business activities as the manufacturing PMI data contracted to 41.8pts⁹ in Q2 2020, below the 50pts benchmark. The slack in manufacturing reflects declines in production level, new orders, employment level and raw material inventories. In addition, given the susceptibility of the manufacturing sector to foreign exchange, the technical devaluation across all windows by the CBN late Q1 2020 is expected to be detrimental to the sector’s performance. On food production, coupled with the above stated factor, we think continued competition within the industry will put more burden in FBT. Meanwhile, we expect moderate growth in textile sector, following the mandatory use of face mask by the government. On cement, curtailed exports owing to restrictions across countries and halted construction activities informs our stance for a slower segment output. In addition to this, currency devaluation should increase the cost of production as cement producers still import gypsum¹⁰ as well as their plant spare parts.

Overall, the confluence of currency devaluation, slowdown in exports and curtailed production activities relative to 2019 informs our estimate of -3.5% YoY (FY 19: 0.8%) in the manufacturing sector. Overlaying the actual Q1 2020 numbers with our downward adjustment to various sectors translates to FY 2020 contraction estimate of 1.6% YoY (Previously: +0.5% YoY), reflecting the contraction in both the oil and non-oil sectors.

Figure 6: YoY GDP growth forecast (ARM vs IMF, World bank and ERGP/MTEF)



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

⁹ April and June 2020 average.

¹⁰ Gypsum is a sulfate mineral used in cement production.

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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