

July 12, 2018



Nigeria Strategy Report

H2 2018

Global Economy and Markets

A tale of resolve and recovery across MEA

Executive Summary

In our H1 2018 Strategy report, we had posited that growth in SSA will remain resilient on the back of strong momentum in smaller economies which should neuter downside risk in powerhouse constituents such as South Africa, while we opined that growth in the MENA region will be driven by sturdy performance in Egypt. Our views largely played out as buoyant growth among economies such as Kenya, Ghana and Cote d' Ivoire supported activities in SSA despite drags in South Africa and Nigeria. Meanwhile, the impact of economic reform continued to bode well for growth in Egypt even as low rainfall impacted growth in Morocco.

For currency and inflation, our prognosis was that higher foreign exchange flows from commodity export will support currency defense with the attendant impact keeping a tight lid on inflation. Whilst our views materialized through Q1 18, we witnessed slight deviation from our outlook as rate normalization in the U.S propelled local assets sell-off with knock-on effect spiking mild currency depreciation across the region over Q2 18. Irrespective, the positive impact of high base from last year continued to stoke inflationary deceleration in SSA even as structural shocks such as implementation of VAT in Saudi Arabia and energy price increases in Egypt triggered renewed inflationary fear.

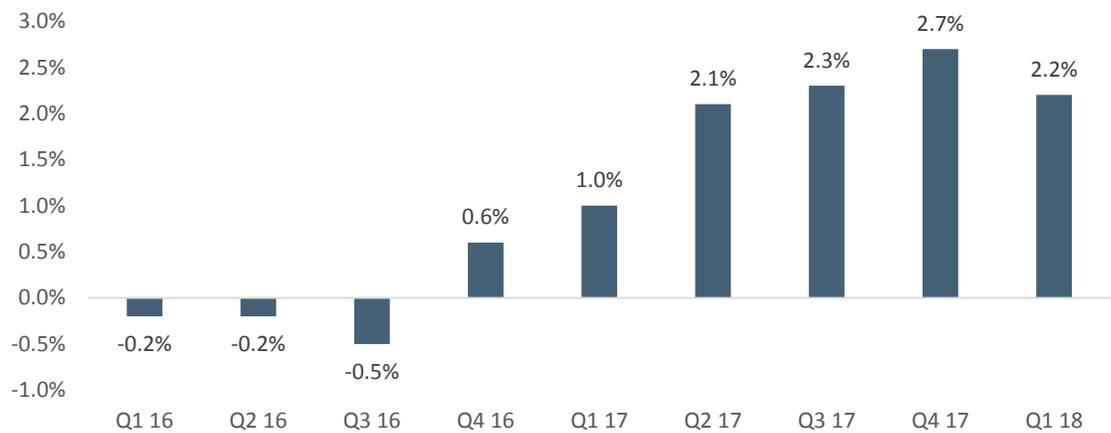
For the rest of the year, we expect economies in SSA to remain strong on the back of higher commodities prices, improved agricultural output from favorable weather conditions and robust consumer spending – in the face of moderating inflation, while the impact of economic reform will continue to drive growth in MENA region with Saudi Arabia expected to exit recession on the back of marked growth in non-oil sector.

In this report, we look at the major themes that dominated the Middle East & North Africa landscape in H1 2018 as well as our outlook for the rest of the year

SSA growth shrugs off weak data from power-houses

Sub-Saharan Africa’s (SSA) economy growth story was kept afloat by higher commodity prices, favorable weather condition, stable external environment and pass-through from global growth. Despite weak growth from power-constituents – Nigeria and South Africa, robust activities in other smaller divisions drove SSA’s growth higher by 2.2% YoY in Q1 2018 (Q1 17: 1.0%), according to the IMF. Notably, positive performance was particularly evident in economies such as Angola, Ghana, and Kenya.

Figure 1: Trend in SSA GDP Growth (%)



Source: World Bank, ARM Research

In terms of the drags, South Africa’s growth picture remained fragile as Q1 18 GDP of 0.8% YoY underperformed (Q4 17: 1.5% YoY and Q1 17: 1.1% YoY) weighed by declines in manufacturing (-0.8%), construction (-0.2%) and Electricity, Gas, and Water (-1.4%) sectors which offset the growth seen in agriculture and mining sectors of 6.9% apiece. For Nigeria, it was a case of slow but steady recovery¹. Specifically, Q1 18 GDP (+1.95% YoY) was an oil-led growth (+14.8% YoY)² as non-oil GDP (+0.8% YoY) remained largely subdued on the back of contraction in trade and construction GDP even as service GDP³ exited recession. However, the impact of higher oil production and favorable weather condition largely propelled growth in Ghana and Kenya. To the former, Q1 18 GDP growth of 6.8% YoY (Q1 17: 6.7%) is reflective of the expansion in oil & gas production, while growth in Kenya (5.7% YoY) was driven by the agriculture sector (+5.2% YoY vs. Q1 17: 1.0% YoY), following favorable weather conditions. On balance, whilst the region’s heavyweights have significantly dragged growth, cheery activities across other smaller constituents largely kept recovery story intact.

¹ Q 18: 1.95% YoY%, Q4 17: 2.1% YoY,

² Oil GDP contributed circa 64.5pps to overall GDP growth

³ Trade (-2.6% YoY vs Q1 17: -3.1% YoY), Construction (-1.5% YoY vs Q1 17: 0.1% YoY), Service (0.5% YoY vs Q1 17: 1.0% YoY)

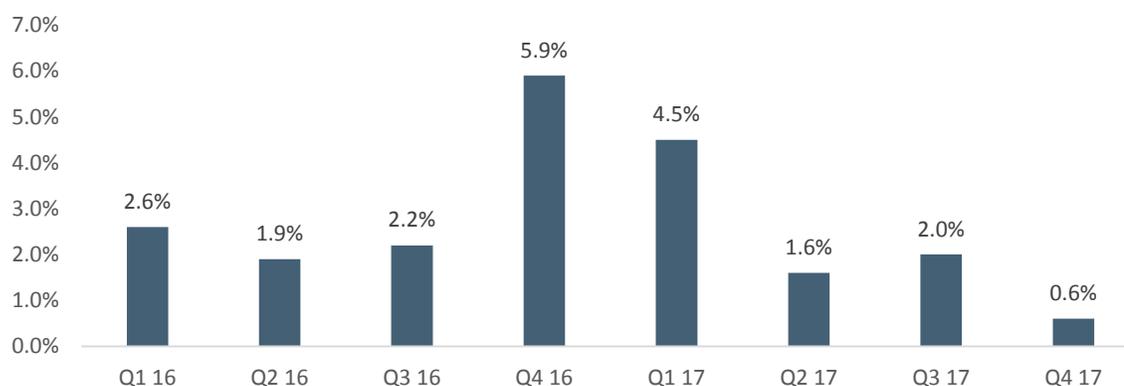
Table 1: Overview of macro indicators among selected African countries

	Nigeria	South Africa	Kenya	Ghana
Latest Monetary Policy Action	Unchanged	Unchanged	Unchanged	-100bps to 17%
GDP Growth (YoY)	Q1 18: +1.95%	Q1 18: +0.8%	Q3 17: +4.4%	Q1 18: +6.8%
Avg. Inflation (2018)	13.8%	4.2%	4.3%	10.1%
Equity Market Performance	1.25%	-5.11%	3.81%	11.60%
Current Account (% of GDP)	2.46%	-2.30%	-6.40%	-4.50%
Unemployment	18.80%	26.70%	7.40%	2.40%

Source: Bloomberg, CBN, NBS, Reuters, ARM Research

Oil exporters stutter growth in MENA region

Middle East & North Africa (MENA) region witnessed fragile growth in Q4 2017 of 0.6%, the slowest pace in four quarters, as weak performance from oil producers (which accounts for ~67% of the regions GDP) – a fallout of OPEC production cut – dragged overall output. However, oil importers gained steam in Q4, specifically Egypt, as stable external sector balances, economic reforms and higher public investment continues to support growth. Precisely, Saudi Arabia's economy further contracted for the fourth consecutive quarter in Q4 17 (-1.2% YoY vs. Q4 16: 2.1% YoY) underpinned by a sharp decline in the oil sector (-4.3% YoY). For Iran, economic activities grew by 4.4% YoY in the first three quarters (Mar – Dec 17) of the current fiscal year, on the back of improvement in non-oil GDP. We note that oil-led growth in Iran has particularly maxed out following ramp up in crude production in 2016 underpinned by the Tehran's nuclear power deal which removed most sanctions originally imposed by world powers. Elsewhere in Morocco, whilst manufacturing and non-agriculture sectors surged, overall growth weakened in Q1 18 to 2.9% YoY (Q1 17: 3.8%) on the back of moderation in agriculture sector (-0.5% YoY).

Figure 2: Trend in MENA GDP Growth (%)

Source: World Bank, ARM Research

On a positive note, economic growth in Egypt remained resilient despite weak performances across MENA region. Specifically, the impact of economic reform continued to play out

positively in Egypt as Q2 17/18 (October – December) GDP numbers expanded by 5.2% YoY (Q1 17/18: +4.3% YoY) touching the highest level seen in 6 years. Overall, even as activities remained buoyant in Egypt, slowdown in Morocco and Iran coupled with prolonged recession in Saudi Arabia left the region’s economic activities on a tightrope.

Table 2: Overview of macroeconomic indicator in some selected MENA countries

	Saudi Arabia	Iran	Egypt	Tunisia
Latest Monetary Policy Action	+25bps to 2.5%	Unchanged	Unchanged	Unchanged
GDP Growth (YoY)	Q4 17: -1.2%	Q1 17/18: 3.4%	Q2 17/18: 5.2%	Q1 18: 1.0%
Avg. Inflation (2018)	2.8%	8.8%	14.5%	7.5%
Equity Market Performance	14.45%	*15.1%	6.91%	6.91%
Current Account (% of GDP)	2.67%	4.30%	-6.49%	-9.15%
Unemployment	12.80%	12.10%	12.60%	15.40%

Source: Bloomberg, CBE, CBI, Reuters, ARM Research

Differing Inflation paths across the MEA region

The impact of responsive monetary policies, together with the high base of last year, helped tame inflationary pressure across SSA while consumer price movement followed divergent pattern in MENA region.

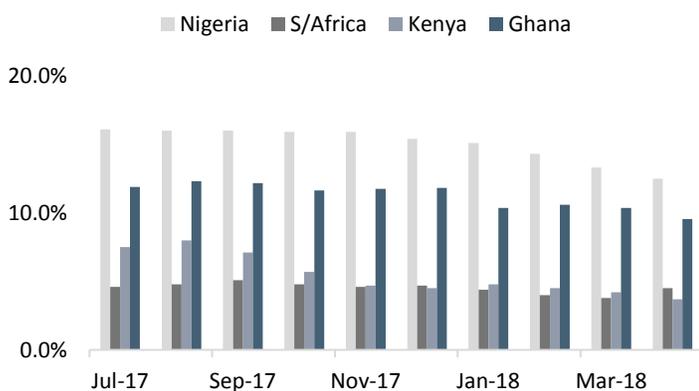
For SSA, Kenya’s inflation sustained its deceleration over 2018 with April data reaching multi-year low of 3.7% YoY. Though inflation ticked up in May (+97bps to 3.95% YoY), driven by surge in prices of food and alcoholic beverages, the continued recent consumer price temperance was on the back of weather-induced high base of 2017. The high base impact also played out in Nigeria wherein inflation witnessed moderation over the first five months of 2018 (-290bps to 12.5% YoY). Elsewhere, pass-through from receding drought initially softened South Africa’s inflationary worries as March headline inflation (3.8% YoY) reached its lowest level in seven years⁴. However, inflationary concern resurfaced in recent times (April: +70bps to 4.5% YoY) following the twin impact of the implementation of the “sin tax”⁵ and 1ppt increase in VAT which came into effect in April.

To stem widening fiscal deficit and subsequently boost non-oil revenue, Saudi Arabia jerked up energy prices and introduced VAT on some items with attendant impact on consumer prices in January (+410bps to 2.95%). For context, inflation averaged 2.8% YoY over Q1 18, from deflation

⁵ Excise duties on tobacco and alcoholic beverage was increased from 6% to 10%

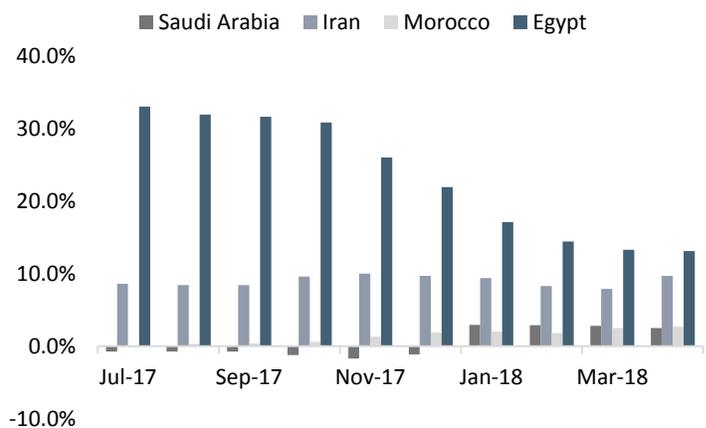
in prior quarter of -1.36% YoY, with tobacco and transport prices seen as the biggest driver. For Iran, nonetheless its currency pressure, inflation has largely played within the upper single digit levels for most part of the year – May inflation jumped +180bps to 9.7% YoY driven by pass through from higher energy inflation. Furthermore, whilst the positive impact of high base of 2017 remained the driver of inflationary decent in Egypt with May print shedding 170bps to 11.4% YoY (May 17: 29.7% YoY), we highlight that inflation upsurge in Morocco persisted (YTD: +80bps to 2.7% YoY) due to higher food prices.

Figure 3: Inflationary Trend in selected SSA



Source: Bloomberg, ARM Research

Figure 4: Inflationary trend in selected MENA



Flight to Safety stoke looming currency risk

In our H1 18 strategy report, we had posited that higher proceeds from commodity export will leave currencies stable thereby keeping a tight lid on inflation. True to that, most countries in SSA saw improved current account balance following sustained upsurge in commodity prices. In addition, Eurobond issuance (H1 18: \$12.7 billion) also supported the balance of payment picture. Against that backdrop, most SSA’s currencies strengthened over Q1 18. Specifically, improved external balance drove currency appreciation in South Africa (+4.4%), Ghana (+3.7%) and Kenya (+1.9%) over the period, while Naira was flat (+0.3%) as improved oil proceeds helped maintain currency stability over the period. However, many SSA currencies depreciated over Q2 18 as the impact of rate normalization in the U.S prompted recent EMs assets sell-offs - South Africa (-6.8%), Nigeria (-0.35%) and Ghana (-4.6%).

Away from SSA, Iran’s currency crisis worsened with Rial losing 23% of its value over H1 18 following the withdrawal of President Trump from the Iran nuclear deal. The dollar illiquidity drove a 43% premium between official and parallel market rates.

To stem the scale of things, Iranian government, in April, set the official rate at 42,000/\$ and instilled control measures on FX demand⁶. Elsewhere, we saw stability across other countries with Saudi government seemingly hell bent on defending its currency amidst pressured fiscal position while Egyptian pounds (H1 18: -0.3%) continued to reap the pecks of FX liberalization.

Figure 5: Currency performance of SSA countries

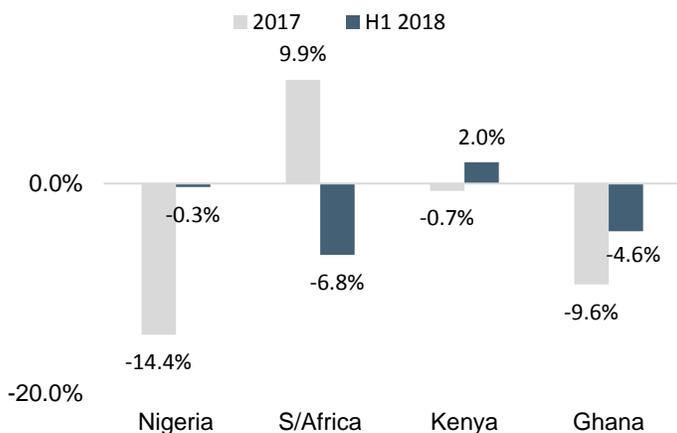
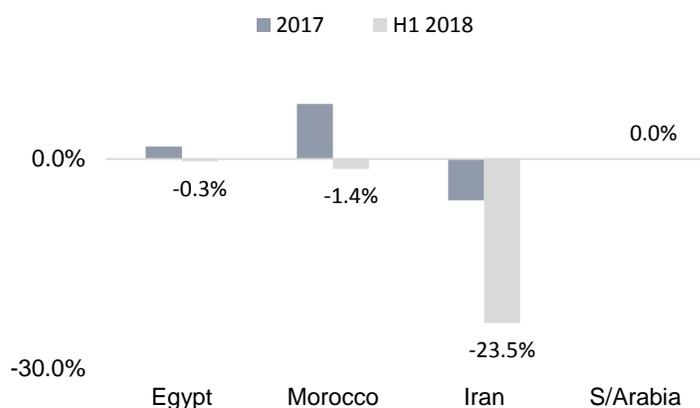


Figure 6: Currency Performance of MENA countries



Source: Bloomberg, ARM Research

Monetary Policies at variance across board

Monetary policies both in SSA and MENA regions also followed different patterns over 2018. For instance, inflationary pressure resurfaced in some part of MENA region which triggered tight monetary policies while growth concerns stirred accommodative policy in the Southern Africa parts. On other climes such as the West of Sahara, whilst inflation had moderated which should have ultimately prompted accommodative policies, authorities had dreaded pulling the trigger on the back of currency worries which could rekindle inflationary pressure. First off, in SSA, monetary policy committee in Nigeria⁷ and Angola⁸ left environment tight, irrespective of moderating inflation, with the committee of the former citing risk to currency as its justification. Meanwhile, against the backdrop of economic slowdown and lower inflation⁹, South Africa and Kenya’s central banks cut benchmark rates by 25bps to 6.5% and 50bps to 9.5% respectively.

In MENA region, with inflation touching its lowest level in 26 months, Central Bank of Egypt cut benchmark interest rate by 200bps to 16.75% between February and March – first time since currency floatation. For Saudi Arabia, in the wake of massive capital flight, Saudi Arabia policy committee raised benchmark repo rate by 25bps to 2.5% in its June meeting to stem the impact of

⁶ The government unified its two-tier FX sales system and set a new exchange rate with the mandate to clampdown illegal FX trading

⁷ 14%

⁸ 18%

⁹ South Africa Central Bank’s Inflation target band (3% - 6%)

outflows on currency. For Morocco, even as inflationary pressure resurfaced, Bank-Al-Maghrib kept rate unchanged over the review period in effort to support economic growth.

Improving external balances underpins sturdy growth outlook

For the rest of the year, economy in SSA is expected to remain strong on the back of higher commodities prices, favorable weather conditions and improved consumer spending – amidst moderating inflation. The upbeat growth further underpinned IMF's growth forecast for SSA of 3.4% (FY 17: 2.8% YoY) emanating from modest pickup in Nigeria (+130bps to 2.1% YoY) and South Africa (+20bps to 1.5% YoY). To the former, sustained growth in oil GDP and agriculture sector as well as recovery in services sector is expected to keep growth picture upbeat. For South Africa, IMF revised its growth forecast to 1.5% YoY (previously: +0.9% YoY) on expectation of better economic reforms under the new government of Ramaphosa. To add, continued recovery in the agriculture and mining sectors is expected to jolt output. Growth in the rest of SSA is projected to remain strong with Cote d'Ivoire (+7.4% YoY), Senegal (+7.0% YoY) and Ethiopia (+8.5% YoY) expected to lead the way on the back of favorable weather conditions and improved consumer spending.

With economic reforms expected to be consolidated in the MENA region, growth is projected to improve going into the rest of the year. IMF forecasts MENA's economic growth to print at 3.0% YoY (FY 17: 1.3% YoY) driven by uptick in Saudi Arabia (+1.7%) and Egypt (+5.2%). Specifically, Saudi Arabia is expected to exit recession following moderate recovery in crude oil production and higher oil prices. To add, economic growth is also expected to be supported by non-oil GDP as the impact of structural reforms kicks in. For Egypt, growth is forecast to remain strong on the back of resilient private consumption and investment. On the downside, Morocco's GDP is projected to slow driven by agriculture sector as lack of rainfall drags agriculture output.

On currency, whilst we expect rate normalization to remain the key driver of FPI outflows in SSA and MENA region, we believe higher proceeds from commodity exports will support currency resilience through the rest of the year. Evidently, despite the recent sell-offs in Nigeria, we believe the apex bank has enough ammunition to keep the naira stable. Elsewhere, Saudi Arabia's government is clearly thickheaded to currency devaluation despite external imbalances, even as the impact of Iran's government tactics of 'stability by the gun' will significantly weather the storm and by extension, stem the rot. Furthermore, nonetheless widespread economic reforms in the MENA region, we expect pass-through from currency stability to keep a tight lid on inflation even as we believe the positive impact of high base effect of prior year will continue to drive inflationary deceleration in SSA.

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