

Nigeria Strategy Report – H2 2017 Excerpts

Review of Global Economy and Markets

Economic Snapshot

May 2017 Inflation Data/Indices			
	MoM	YoY	Prev YoY
Headline	1.9%	16.3%	17.3%
Food	2.5%	19.3%	19.3%
All Items Less Farm	1.2%	13.0%	14.8%
Imported food	1.3%	14.9%	16.9%
Energy	1.3%	16.3%	18.8%
Currency Markets			
	Latest	Daily Chg	YTD
USDNGN	305.9	0.0%	0.0%
EURNGN	322.5	3.0%	2.7%
GBPNGN	372.3	4.4%	4.8%
JPYNGN	261.0	3.3%	3.0%
Monetary Aggregates – April 2017			
	(₦bn)	MoM	YoY
M2	21,713	-1.4%	4.8%
CPS	21,943	-1.5%	13.2%
NCG	5,592	7.5%	42.2%
NFA	7,262	-4.1%	43.2%
NDC	27,535	0.2%	18.1%
External Position			
	Latest	QoQ	YoY
Trade Balance (\$'mn)	185.73	-21.5%	N/A
External Reserves (\$'mn)			
	30,323	0.95%	3.68%
Foreign Debt (\$'mn)			
	13,808	21.1%	23.3%
Growth Data – Q1 2017			
	(₦bn)	%of total	YoY
Real GDP	15,861	100%	-0.5%
Agriculture	3,385	21.3%	3.4%
Oil	1,411	8.9%	-11.6%
Services	5,975	37.7%	1.0%
Wholesale and Trade	2,819	17.8%	-3.1%
Manufacturing	1,543	9.7%	1.4%

African Economies: on Course for Divergent Fortunes

SSA's growth recovery should be much slower

Given recently released data and forecast, Sub-Saharan Africa (SSA) is on course for a modest recovery in 2017 led by ongoing recoveries in some of its major economies¹. Specifically, powerhouse constituent—Nigeria—posted its slowest GDP contraction in four quarters in Q1 17 (-0.5% YoY) following slower contraction in crude production (Q1 17: -11% YoY to 1.83mbpd; Q4 16: -20% YoY to 1.76mbpd) and currency-led rebound in non-oil GDP (YoY: Q1 17: +0.7%; Q4 16: -0.3%) while its balance of trade extended its surplus position to a second consecutive quarter.² In similar vein, Angola is expected to ride the OPEC-induced crude price rally to a position of relative comfort in the near term while its government ramps up spending ahead of the country's election. In addition to this, growth is still expected to hover around 5% and 7.5% in several western and eastern African countries.

Irrespective, current growth expectation for the region is less sanguine relative to predictions in January with the IMF cutting its SSA growth forecast 20bps to align with World Bank's estimate of 2.6% YoY over 2017. In justifying the downward revision, the IMF noted that many SSA commodity exporters were yet to fully adjust to lower commodity revenues—which continue to lag previous years' levels despite the recent gains in some commodity prices.

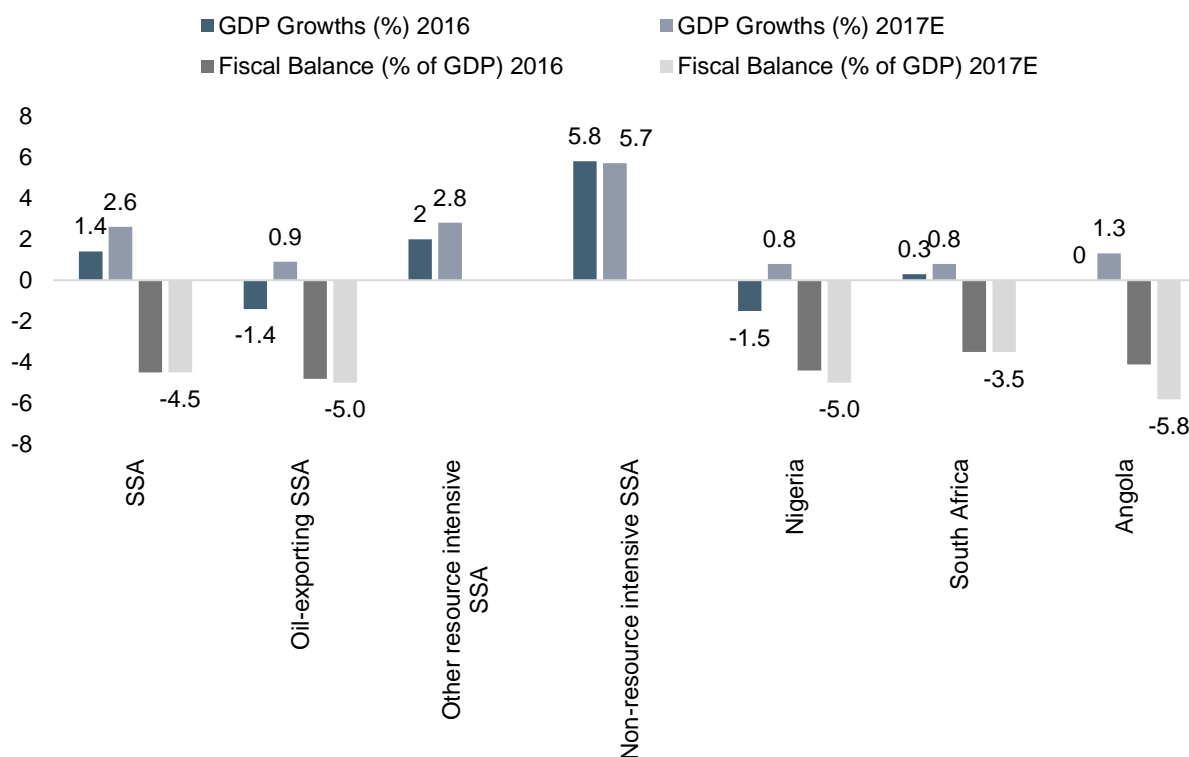
¹ SSA experienced its slowest growth in two decades in 2016.

² The country's trade balance is now 7% wider (at ₦719 billion) relative to the prior quarter and represents a stark departure from the Q1 16 deficit of ₦253 billion.

Taking oil exporting SSAs as a case in point, the cumulative impact of narrower oil revenue has since rubbed off on their non-oil sectors with most of the countries still struggling with fiscal deficits despite the slight reprieve from the OPEC-induced rise in crude oil price. Elsewhere, the largest non-resource-intensive SSAs are also expected to struggle to sustain growth through higher public capital spending as they did in past periods due to rising public debt and slowing credit cycle—with the need for fiscal consolidation³ still obvious. The admissions notwithstanding, the IMF's expectation still appears optimistic, in our view, given its sanguinity over goings-on in South Africa. Specifically, while the IMF had predicted moderate recovery for South Africa in 2017, the economy has showed little signs of improvement in recent months with the latest GDP release indicating a nosedive into a second recession in a decade (Q1 17: -0.7% YoY; Q4 16: -0.3% YoY). To underscore the scale of this concern, all sectors of the economy apart from agriculture and mining contracted in Q1 17. In addition to this, a low consumer confidence in the gold-rich country and two major credit rating downgrades in April suggest that meaningful turnaround in economic fortunes is unlikely to materialize even in Q2 17. This is even as energy inflation—most evident in surging coal prices (+58% higher in the last six months)—keeps upside risk to inflation intact with sociopolitical instability remaining largely endemic in the country. To the latter, we note that the South African president survived various votes of no confidence with the latest round of crisis seeing even the ruling African National Congress call for an investigation into allegations of corruption levelled against him. That said, we see enough in other leading economies to suggest that a rebound (north of 2% YoY) is still on the cards for the region.

³ Policies undertaken by Governments (national and sub-national levels) to reduce deficits and accumulation of debt stock.

Figure 1: Growth and fiscal expectations across SSA



Source: IMF, ARM Research

Several flies in fledging North African ointment

Growth picture remained largely mixed in North Africa with recent recovery in Tunisia and Morocco at one extreme. The former's growth (Q1 17: +2.1% YoY)⁴ was linked with increases in its mining/phosphate production, agriculture, and tourism (~8% of GDP), with the recovery in tourism reversing two years of sharp drops caused by militant attacks on foreign visitors. However, Tunisia remains burdened by high public debt and twin deficits⁵, with the trade deficit component of the latter driven by relatively sluggish exports (+7% YoY to \$3.24 billion) which was more than offset by a sharp jump in the country's imports (+20% YoY to \$4.93 billion). According to the country's National Institute of Statistics (INS), the jump in imports was driven by high energy and refined product imports in the review period. For further context, the scale of the country's trade deficit also fueled speculations of

⁴ Reuters

⁵ Current account and trade deficits

a possible imposition of import restrictive policies. For Morocco, the economy looks well on course to meet IMF's growth estimate of 4.4% YoY for 2017 (2016: +1.5% YoY) after its first quarter GDP reading came in only 10bps shy of the mark. The country's Q1 17 growth was reflective of a 12.9% YoY surge in agricultural⁶ output—an offshoot of favourable rainfall in the review period. Elsewhere in North Africa, Egypt's economy is believed to have expanded 3.9% YoY in Q1 17⁷ (vs. 3.8% YoY in Q4 16) as influx of investment capital greeted the country's tilt to currency floatation towards the close of last year. Whilst the attendant rise in currency-induced inflation narrowed consumer discretionary incomes across the country with the aforementioned growth still lagging 2016 levels by 40bps, positive knock-on effect of the depreciated currency led to strong growth in exports (+15% YoY to \$5.52 billion). In a further positive, the country's imports have also narrowed (-29% YoY to \$12.1 billion) as the populace turn their attention to relatively cheaper domestic products, leaving its national trade deficit much narrower (-46% YoY to \$6.59 billion) over the review quarter.

In Algeria, the economy's reliance on oil and gas sector was again underscored by a 4% YoY GDP growth in Q4 16 (FY 16: 3.8% YoY) that was largely pinned to recovering hydrocarbon⁸ production. Whilst sustained gains in energy prices over the last few months should ordinarily have firmed up expectations for the coming period, fresh moderation in hydrocarbon production suggests that the country could struggle to maintain its strong growth from the last quarter of 2016. In addition to this, slow implementation of pro-market policies continues to pull back Services and other non-hydrocarbon sectors. On a slightly positive note though, the government has maintained a tight restraint on spending and this could see Algeria's fiscal deficit contract to below 5% in 2017. In addition to this, Algeria's recent agreement with the IMF over the potential distribution of the second tranche of the Extended Fund Facility (EEF) worth around \$308 million represents a silver linen. By way of linkage, we note that Algeria's restraint on spending—which have taken the form of cut in public sector wage bill and reduction in energy subsidies—were associated requirements for obtaining the funds.

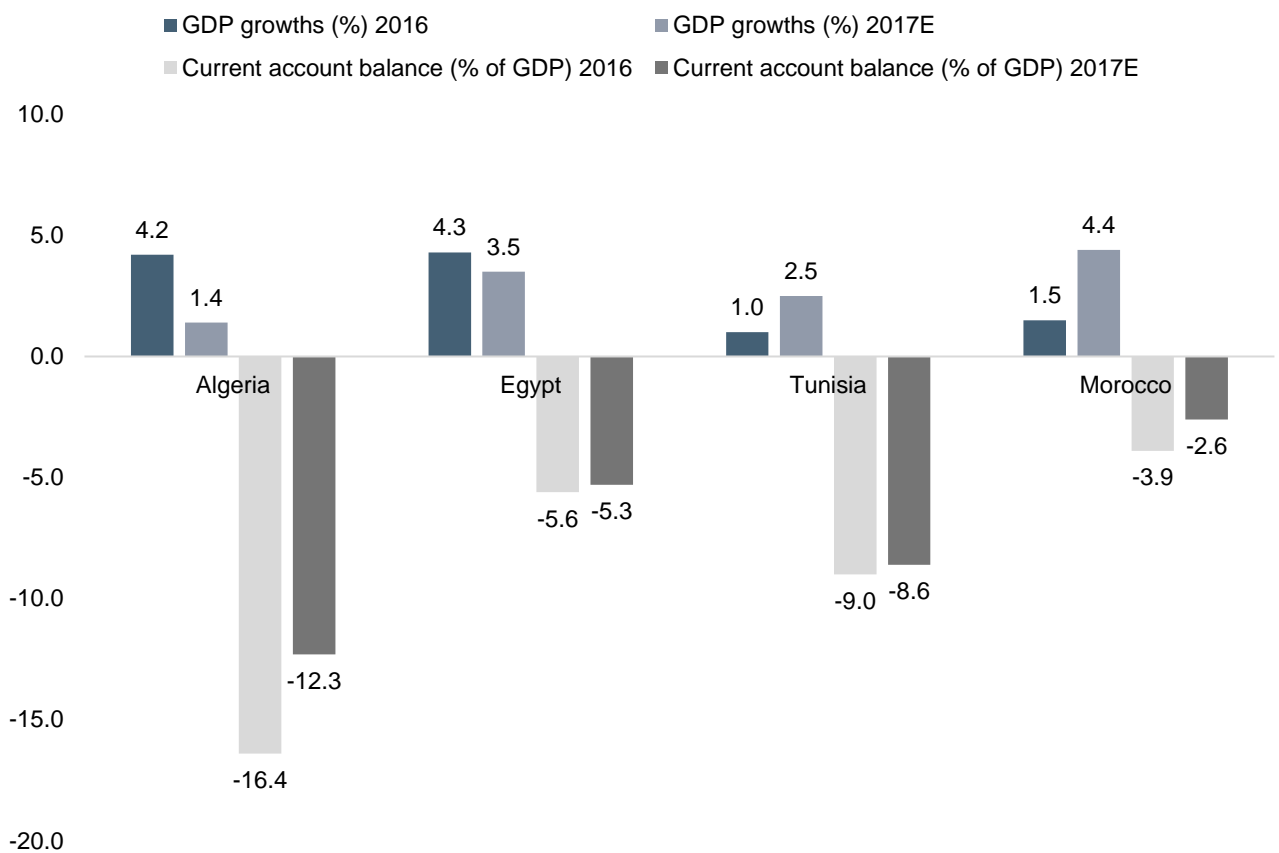
⁶ Agriculture constitutes 15% of Morocco's economy

⁷ Focus economics

⁸ 60% of budget revenues, 30% of GDP, and over 95% of export earnings

Whilst positive footprints are gradually creeping into the region—albeit at varying degrees across constituent countries, Libya’s economic conundrum have remained largely intact as its persistent political crisis and unsteady oil production continue to restrict average economic growth in North Africa. To be clear, despite its exemption from OPEC crude production cut and prior reports of the recapture of eastern ports and reopening of oil pipelines, Libya’s crude production has maintained a steady downtrend since February 2017 (-19% to 550t/bd) to taper expectations for solid growth rebound in 2017.

Figure 2: Growth and current account expectations across North Africa



Source: IMF, ARM Research

African currencies and inflation: variables inseparable?

According to IMF, high inflation in SSA (i.e. in Angola and Nigeria) reflected currency conundrum resulting from external imbalances while fresh La Niña whether shocks underpinned growing drought in east African nations of Ethiopia, Kenya, South Sudan, and Tanzania with knock-on effect dragging food prices higher. Thus,

the IMF have left the region's forecast inflation at double digit for the second successive year (2017: -70bps to 10.7% YoY), despite inflation expectation of below 3% across WAEMU and CEMAC countries.

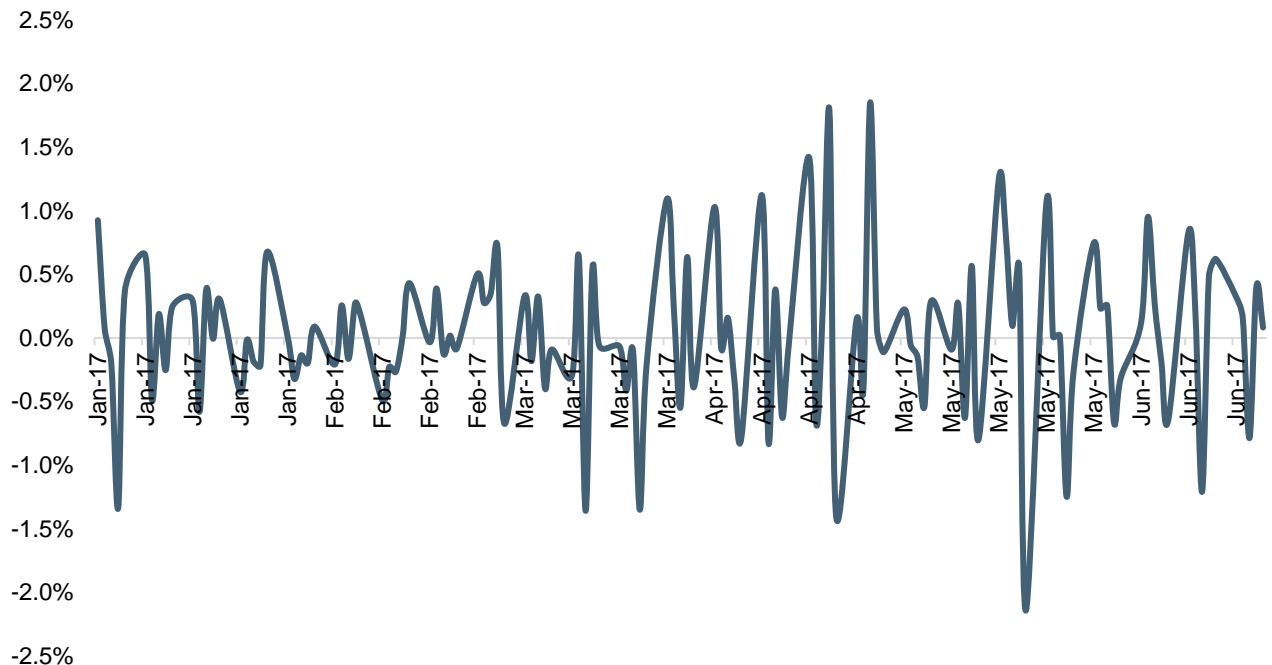
Whilst a few SSA countries, in response to unfavorable terms of trade and tighter external financing conditions, allowed their currencies to depreciate at the expense of some pass-through to inflation to help absorb external pressures, others were notable for their resolve to protect their embattled currencies despite weakening fundamentals. At the heart of the latter category is Angola, a clime wherein the authorities held strongly to a priority list for foreign exchange access at the official rate and an even stricter limitation on foreign currency for travel. Consequently, the ensuing scarcity of foreign currency widened the parallel market spread from 5 to 10% in mid-2014 to around 130% at the end of March 2017. This has, in turn, left inflation at elevated levels (32.58% YoY in April) even though ongoing monetary tightening has seen slight moderation from historic highs in December (41.12% YoY). While Angola represents one extreme of the SSA currency and inflation story, Nigeria is beginning to tilt to the other extreme with its central bank's: relaxation of the 60:40 FX allocation rule in favor of manufacturing companies; reduction of the tenor on its currency forwards to 60-days (vs 180-days previously); and an eventual launching of the Importers and Exporters Window where rates are market determined; being prominent features of another surprise turnaround towards pro-market currency policies. Specifically, aided by sustained dollar sales across segments of the market, the introduction of the I&E window has led to substantial naira gains at the country's parallel market with interbank rates also hobbling around a comfortable ₦305/\$ range.

Despite the currency gains, Nigeria's inflation has maintained its upward trend with both MoM food and core inflation readings accelerating 119bps and 54bps to 2.54% and 1.17% January through May. Importantly, though an appreciating naira retains the potential to taper demand pressures from neighboring West Africa as well as sustain the downward trajectory of imported food inflation, structural set-backs such as soaring cost of transport have broadly limited pass-through to domestic farm produce prices and headline inflation numbers. In South Africa, inflation rose for the first time in 2017 in May (+10bps from prior reading to 5.4% YoY/0.3% MoM)

following a quickening in prices of food, non-alcoholic beverages, and transport. Unlike Angola where currency movements have been determined by broadly subdued commodity prices, South Africa's currency trajectory (+5.9% YTD) has reflected positive sentiments from recent gains in gold prices and a recovery from a 2016 drought which offset a combination of unpredictable political twists and concerns in China—South Africa's largest export trade partner.

Away from SSA, Egypt has offered the most compelling narrative on the currency front in North Africa. Precisely, Egypt has successfully transformed the anxiety over the sustainability of its surprise adoption of flexible currency regime in November 2016 to optimism with foreigners buying over \$3.3bn worth of Egyptian treasuries in the first fifteen days of March alone. This has in turn resulted in improved dollar liquidity in the economy with the Egyptian pound currently flat YTD. Having gone a step further on its search for funding to obtain \$4 billion via Eurobond issue in January, the country's currency has also appreciated at the parallel market just as its rising remittances lent further support to an improving FX market environment.

Figure 3: Movements in ARM Africa currency volatility index



Source: Bloomberg, ARM Research

On balance, the IMF projects improvements in current account balances across SSA in 2017 following recovery in commodity prices with SSA oil exporters in pole position to benefit. Of note, OPEC's nine-month extension of its November's production cut deal appears to have provided a much-needed relief to SSA oil exporters in the form of higher crude prices. This should be aided by pass-through from gradual implementation of pro-market policies in climes such as Nigeria, wherein improvements in FX liquidity have been observed following the introduction of the IEW and its apex bank's sustained sales of dollars at segments of the market. In North Africa, Egypt's pro-market policies appear to be generating desired responses from portfolio investors as well with the March influx into the country's bond market a case in point. This is even as Morocco leverages on its resurging agriculture which has already underpinned its strong growth in Q1 17. Thus, although patches of weaknesses are still expected in Libya and Algeria, mean growth in North Africa should remain strong in 2017.

African equity markets on a bullish run

In line with expectations for growth rebound across Africa, equity markets closed H1 17 on a positive note following strong rebound in commodity prices. This trend has also been largely sustained YTD. Notably, S&P All African Index climbed 10% YTD as gains in countries such as Ghana (+14%), Egypt (+8%), Nigeria (+25%), Morocco (+5%) and Tunisia (+7%) outweigh heavy losses in climes like South Africa (-20% YTD). The bullish equity performance in Nigeria reflects positive sentiments stoked by the CBN's launch of the IEW and overall improvement in dollar liquidity in the country. Similarly, Egyptian market gains have come on the back of its November 2016 tilt to fully floating currency regime that was equally well received by foreign portfolio investors. To buttress, the EGX 30 has appreciated 16% since the advent of the country's new FX market regime. Elsewhere, narrowing TB rates was believed to have increased appetite for equities in Ghana towards mid-June. In addition to this, momentum in Morocco may have had some support from its ongoing Agriculture rebound. Overall, we expect this bullish trend to subsist for the rest of 2017.

All rights reserved. Unauthorised use, reproduction, distribution or disclosure of this document is strictly prohibited.

This material has been issued by Asset & Resource Management Company Limited (“ARM”), a Company regulated by the Nigerian Securities and Exchange Commission. The analyst(s) primarily responsible for preparing this research report, in whole or in part, certifies that with respect to each security or issuer covered; all of the views expressed accurately reflect his/her personal views about the subject securities and issuers and no part of his/her compensation was, is, or will be, directly or indirectly, related to the inclusion of specific recommendations or views in the report.

This research report is based on information from sources that ARM and its analysts believe to be reliable. Neither ARM nor any of its research analysts, nor any member of the ARM Group, gives any representation or warranty, express or implied, or undertaking of any kind or assumes responsibility or liability of any kind with respect to the accuracy or completeness of the information set out in this report or any third party’s use (or the results of such use) of such information. This report is provided solely for informational purposes and is not to be construed as providing advice, recommendations, or endorsements of any kind whatsoever. The investments and strategies discussed here may not be suitable for all investors; counsel of investment advisor should be obtained with regard to such investments and or strategies. This research report is not a replacement for advice from an accountant, lawyer, personal finance advisor or other category of investment advisor. The investments discussed in this report may oscillate in price or value. Opinions and information provided are made as of the date of the report issue and are subject to change without notice. This research report is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Reference herein to any specific security or financial instrument does not necessarily constitute or imply its endorsement or recommendation by ARM, its directors, officers, employees or designated agents. Members of ARM may act as broker, advisor or lender, or make a market in any investments or issuers referenced in this report. Further information on any of the securities discussed herein may be obtained upon request to ARM. By accepting this document, you agree to be bound by the foregoing limitations.