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Nigeria Strategy Report – H1 2018 Excerpts

Africa Economy and Markets

Africa Economy back from the Brink

We expect continued rebound in commodity prices to drive SSA growth, while the receding impact of political crises and favourable weather condition should support growth in North Africa.

Contents

Given recently released data and estimates, Africa's economy is back from the brink and on course for a modest recovery in 2017 as higher global commodity prices supported growth in Sub-Saharan Africa (SSA) while fiscal consolidation was responsible for the modest growth seen in the North. Specifically, after increasing at its slowest pace in 2 decades in 2016 (+1.4% YoY), IMF estimates SSA growth at 2.6% YoY following strong rebound in Nigeria, South Africa (SA) and Angola. Whilst higher crude production and prices propelled oil sector growth in the two largest oil exporting nations in Africa, the impact of receding drought drove improved performance of the agricultural sector which in turn supported growth in SA. Elsewhere, fiscal consolidations and reforms appears to be yielding fruit in North Africa with sharp recoveries seen in Egypt and Morocco as cut down in energy subsidies and a reduced public wage bill supported foreign investment in the former.

SSA growth rides on commodity prices

The central theme across SSA was the rebound from the trough of 2016 on the back of higher commodity prices and production, favourable external conditions, as well as robust agriculture output. Major economies of Nigeria and SA, pulled out of recession even as Angola and Ghana sustained growth. The positive picture in the countries neutered slower growth across East Africa underpinned by politics-induced pullback as well as drought. For context, Nigeria's economy reverted to growth for the second consecutive quarter in Q3 2017 (+1.4% YoY, Q2: +0.7% YoY) largely hinged on recovery in crude oil production, resilience in the agriculture sector as well as improved external balance. Elsewhere, despite political uncertainty and fiscal challenges in SA prompting credit downgrade to junk status, SA's economy showed fortitude, expanding by 0.8% YoY in Q3 17. The growth was supported by recovery in the agricultural sector (+19.6% YoY)—a fall-out of receding drought in the region. Furthermore, expansion in mining and quarrying sector (+3.2% YoY) further supported growth. Elsewhere, the combined impact of higher crude oil prices and production supported growth in Angola and Ghana even as receding political tensions in the former, following the election of the new president in the period, supported the growth picture. Accordingly, growth in Angola and Ghana printed at 1.3% and 9.3% YoY accordingly. On the downside, the impact of prolonged political crisis and adverse weather conditions on investment, external indicators and agriculture sector slowed down growth in Kenya. For context, Q3 2017 GDP growth of 4.4% YoY— slowest expansion in sixteen quarters— reflected sharp moderation in key sectors – Finance and Insurance, Manufacturing, Construction, and Agriculture[1].

Fiscal consolidation boost growth across North Africa

In line with performance across SSA, economic recovery in the Northern African region remained unperturbed but still trailing 2015 levels as widespread fiscal consolidation and economic reforms drove an upsurge in foreign investment. Specifically, IMF-backed reforms in Egypt appears to be yielding positive results as cut back in energy subsidies and public wage bills moderated fiscal deficit to 5.4% of GDP over H2 17 (H2 16: 6.4% of GDP). To add, economic activities in Egypt expanded by +5.2% YoY in Q1 17/18 (July-Sept) largely driven by sharp expansion in the agriculture sector (+17.4% YoY). In Morocco, economic growth continues to recover from its 2016 trough. Whilst non-agriculture activities appeared benign in the review period, sharp rebound in the agricultural sector (+17.4% YoY) supported overall GDP higher by 4.8% YoY. Elsewhere, despite weather-induced drag in agricultural activities, steady recovery in the oil and gas sector (+450bps to 7.1%YoY) continued to boost activities in Algeria as Q1 17 GDP

[1] Finance and insurance (+2.4% YoY vs. Q3 16: 71% YoY), Manufacturing (+2.1% YoY vs. Q3 16: 4.4% YoY), Construction (+4.9% YoY vs. Q3 16: 7.8% YoY) and Agriculture (+3.1% YoY vs. Q3 16: 3.8% YoY)

improved 3.7% YoY. Algeria's significant trade deficit prompted the government to place a temporary ban on importation of products tagged 'non-essential' items which reduced trade deficit by 35% YoY to $9.4 billion over the first 10 months of 2017. The statistical bureau of the country (ONS) explained that overall exports rose 17.1% YoY to $28.7 billion underpinned by a 18% YoY jump in oil and gas exports stemming from higher crude prices. Imports also declined by 1.8% YoY to $38.2 billion, thereby reducing the country's trade deficit. Rounding up, notwithstanding subsisting downturn in Libya due to political crisis and domestic terrorism, fiscal-induced growth in other oil exporting countries supported continued rebound in the region.

Table 1: Overview of macro indicators in some selected African countries

	Nigeria	S/A	Kenya	Egypt	Tunisia	Morocco
Latest Monetary Policy Action	Unchanged	-25bps to 6.75	Unchanged	+200bps to 18.75%	+25bps to 5.0%	Unchanged
GDP Growth (YoY)	Q3 17: +1.4%	Q3 17: +2.0%	Q3 17: +4.4%	Q1 17/18: +5.2%	Q3 17: +2.1%	Q2 17: +4.8%
Avg. Inflation 2017	16.7%	5.3%	8.02%	29.6%	3.7%	1.6%
Equity market performance (YTD)	+43.7%	+18.7%	+29.1%	+22.2%	+14.3%	+7.1%
Current account deficit (% of GDP)	1.9%	-2.9%%	-4.8%	-5.4%	-3.5%	-4.0%
Unemployment	13.9%	27.7%	11.0%	12.4%	15.3%	10.6%
Net Debt (% of GDP)	20.2%	47.6%	51.9%	94.5%	62.4%	62.3%

Source: Bloomberg, ONS, NBS, CBN, CBE, BAM, Reuters, ARM Research

Monetary policy on divergent paths

Over 2017, monetary policies have been divergent across SSA albeit effective in solving varying degrees of external imbalances and economies challenges. To some extent, currency and inflationary concerns had triggered the implementation of contractionary monetary policy while growth concerns set off accommodative monetary policy in other countries. Specifically, policy atmosphere was largely tight in Angola and CEMAC[2] region. After declining for much of the year, inflationary pressures resurfaced in Angola in October which forced the apex bank to raise its policy rate in November (+200bps to 18% YoY). Also, in a bid to attract portfolio flows and stem the depletion of its external reserves, the CEMAC region raised its policy rate by 50bps in March to 2.95%. Elsewhere, IMF also reported that BEAC[3] clamped down on its statutory advances to member countries with

[2] Central African Economic and Monetary Community

[3] Banque des Etats de l'Afrique Centrale (Cameroun, Central African Republic, Chad, Equatorial Guinea, Gabon and Congo)

the knock-on effect largely keeping system liquidity tight in the review period. Furthermore, monetary policy environment in Nigeria remained tight for most part of 2017 due to the impact of subsisting inflationary pressures and currency concerns .

On the opposite side, against an unclear outlook for growth, some SSA countries chose to pursue accommodative policies. Firstly, in SA, the South Africa Reserve bank cut benchmark rate in July 2017 by 25bps to 6.75% on the back of sluggish growth and moderating inflation reading, while Namibia followed suit by reducing its MPR equally by 25bps to 6.75%. In the same vein, Ghanaian central bank returned to the dovish[4] monetary policy amidst declining headline inflation, while monetary policies Tanzania[5], Kenya and Uganda[6] remained accommodative against a backdrop of subsisting growth concerns.

Across North Africa in the wake of liberalized monetary policy which triggered a wave of currency depreciation and upsurge in inflation, most Apex Banks in the region moved to tighten the lid on price pressures. Precisely, Egypt and Tunisia adopted a hawkish monetary policy with two rate hikes over 2017. First off, the Central Bank of Tunisia hiked its benchmark interest rate successively by 50bps and 25bps in April and May respectively to 5.0%. The move emanated from mounting inflationary pressures and growing current account deficit-an offshoot of currency depreciation. Meanwhile, Central Bank of Egypt (CBE) was more aggressive in its rate hike, taking the benchmark rate higher by 400bps between May and July as the impact of depreciating Egyptian Pounds continued to mount pressure on inflation. While the benchmark rate remained unchanged in Morocco through 2017, Bank Al-Maghrib (BAM) has guided to higher rates going into next year as the impact of rising commodity and food prices becomes more telling on headline inflation.

Inflationary pressures moderates in SSA but resurfaces in the North

Despite weather-induced surge in food prices across most East African countries over the first half of 2017, headline inflation gradually receded in the latter part of the year. In November, inflation touched 4.73% YoY in Kenya from a high of 11.7% YoY in July largely driven by moderation in the food and non-alcoholic drink basket. Meanwhile, Tanzania (H2 17: -1.2pps to 4.0% YoY) and Malawi (H2 17: -2.5pps to 7.7% YoY) also

[4]Ghana's central bank cut MPR by 100bps to 20%
[5] Bank of Tanzania cut rate in March (-400bps to 12%) and August (-300bps to 9%)
[6] Bank of Uganda cut MPR in October (-50bps to 9.5%)

witnessed subsiding inflationary pressures as the impact of drought hit rock bottom. Correspondingly, inflation reading across other SSA regions (West and South) has also significantly moderated. For evidence, Nigeria's headline inflation fell to a 17month low in October largely driven by persisting temperance in the core basket despite pressure on the food front. In the same manner in Angola and Ghana, the perks of tightening monetary policy was evident with headline inflation in the former falling to a record low of 26.25% YoY[7] in October (January 39.7% YoY) as moderation in the non-food component largely neutered rising food prices.

In North Africa, inflation trended upward in recent months following a widespread effort to cut back on budget and trade deficit which saw most countries reduce subsidies on energy and food, while others placed temporary bans on importation of some food item with the knock-on effect causing shortages and higher prices for domestic items. Inflationary pressures were evident in Sudan and Algeria as both governments recently approved import restrictions with the former announcing the ban of 19 food and other items in October, citing currency defence and subsisting inflationary pressures as its justification. Meanwhile, currency-induced pressures drove Tunisia's headline inflation to a 42-month high in December (H2 17: +80bps to 6.4% YoY), while Morocco inflation resumed upsurge over the second half of the year adding +1.4pps to 1.3% YoY in November.

Bucking the trend was Egypt whose headline inflation had surged over much of H1 17 (+4.9pps to 32.95% YoY) after the government hiked energy and electricity prices by 50% and 42% respectively in an effort to cut down on excessive spending. However, inflation has now turned the corner reflecting positive impact from high base effect in 2016. Precisely, a sharp decline in the core basket drove the recent downtrend in inflation which rose at its slowest pace since the country's switch to a market determined foreign exchange market (+21.9% YoY in December)[8]

[7] Reuters
[8] Bloomberg

Figure 1: Inflationary trend in select SSA countries

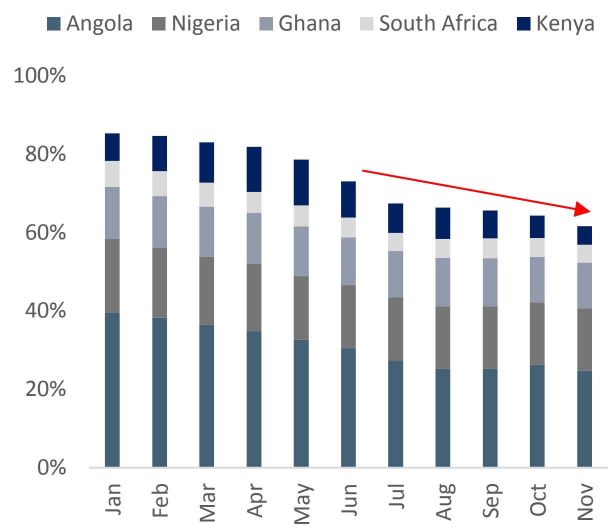
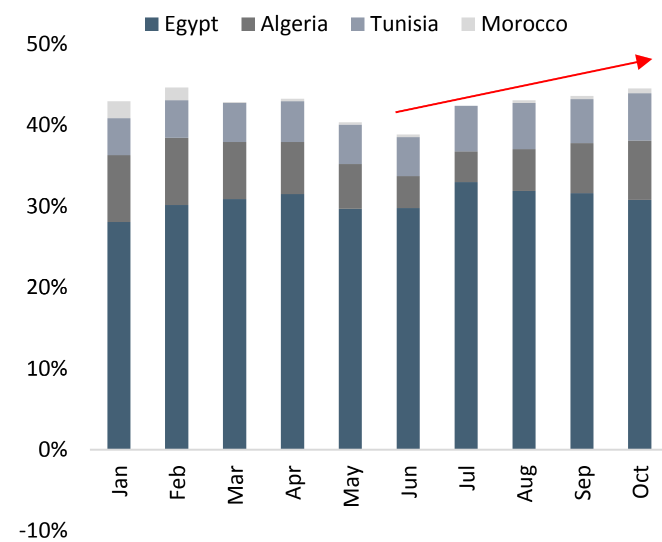


Figure 2: Inflationary trend in select North African countries



Source: Bloomberg, ARM Research

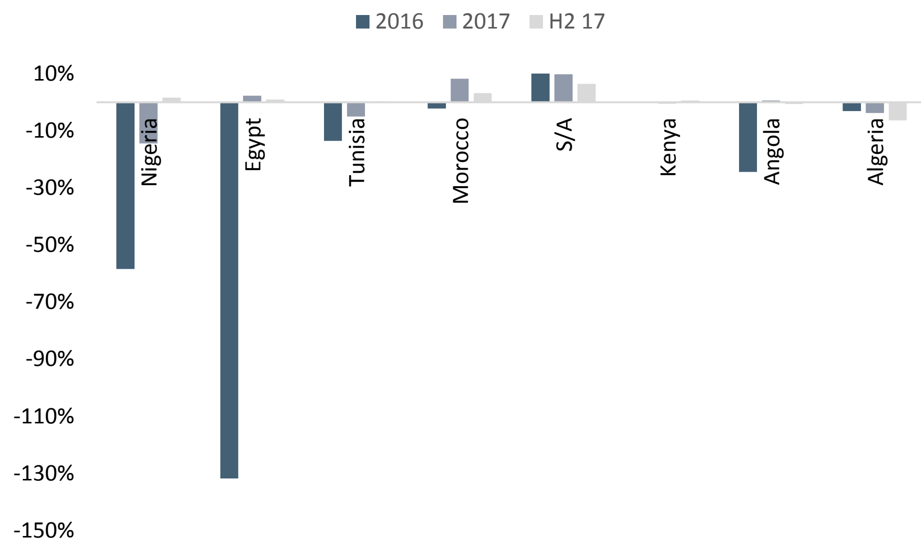
Africa Currencies: Stability seen across board

For much of 2016, low commodity prices had weighed on export proceeds which extended to current account balances. However, the rumbling effect of improved commodity prices, provided some respite for SSA current account position over 2017. The IMF estimated SSA's current account deficit at 3.4% of GDP (2016: 4.2%), while mean current account deficit for North Africa is projected to improve to 5.0% of GDP (2016: 11.1%) in 2017 following renewed efforts to considerably cut down on import bill. Furthermore, despite rate normalization in developed economies, the impact of improved fundamental picture and elevated domestic interest rates drove a sharp jump in capital flows (Eurobond issuances increased by 14.4% to $11.1 billion). Against this backdrop, many African currencies were stable over H2 17. Specifically, investors' excitement over FX liberalization policies drove stability in the currency market in Egypt (H2 17: +1.0%) and Nigeria (H2 17: +1.7%)[9]. Meanwhile, import restrictions and policy rate hike supported the Tunisian Dinar (+0.3%) against USD. Angola's move from currency peg to a trading band drove a

[9] August to December

steep decline in the Kwanza which lost 10% against USD and Euro after trading largely flat over the second half of the year.

Figure 3: Currency performance of selected African countries



Source: Bloomberg, ARM Research

Economic growth to tilt towards pre-2016 levels

Going into 2018, the IMF has projected a further improvement in SSA growth (2018: +80bps YoY to 3.4%YoY). This growth is largely linked to Nigeria (+3.4% YoY) and Angola (+1.6% YoY). Whilst we see risk in SA (+1.6% YoY) as the sharp recovery in the mining and agricultural sectors is expected to normalize in 2018, strong momentum from smaller constituents such as Kenya (+5.5% YoY), Ghana (+8.9% YoY) and Congo (+3.0% YoY) will neuter the political-induced downside risk in South Africa.

For currency, higher proceeds from commodity exports will leave currency stable with immediate impact keeping a tight lid on inflation. Meanwhile, Angola's recent FX liberalization could drive significant currency depreciation. Elsewhere in North Africa, a sharp rebound in Libya (+31.2% YoY) will support growth following the receding impact of domestic terrorism which had adversely impacted on the oil and gas sector. In addition, continued recoveries in Egypt (+4.5% YoY) and Tunisia (+3.0% YoY) is projected to bolster growth. Specifically, Tunisia is expected to benefit from favourable weather conditions while higher consumer spending is projected to drive growth in Egypt as the impact of currency-induced inflationary pressure recedes. Furthermore, despite lower spending on subsidies spending which should exert pressures on inflation, import restriction will continue to drive reduced fiscal deficit. On balance, growth concerns should drive expansionary monetary policies in SSA, while we expect inflationary worries to keep tight policy intact in the North.

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