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Nigeria Strategy Report – H2 2017 Excerpts

Key Developments in Domestic Economic and Policy Environment

Economic Snapshot

June 2017 Inflation Data/Indices	MoM	YoY	Prev YoY
Headline	1.6%	16.1%	16.25%
Food	2.0%	19.9%	19.3%
All Items Less Farm	1.3%	12.5%	13.0%
Imported food	1.6%	14.2%	14.9%
Energy	0.75%	14.2%	16.3%

Currency Markets	Latest	Daily Chg	YTD
USDNGN	305.3	0.2%	0.3%
EURNGN	355.6	0.1%	13.6%
GBPNGN	398.0	-0.3%	8.1%
JPYNGN	2.754	0.1%	8.7%

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%

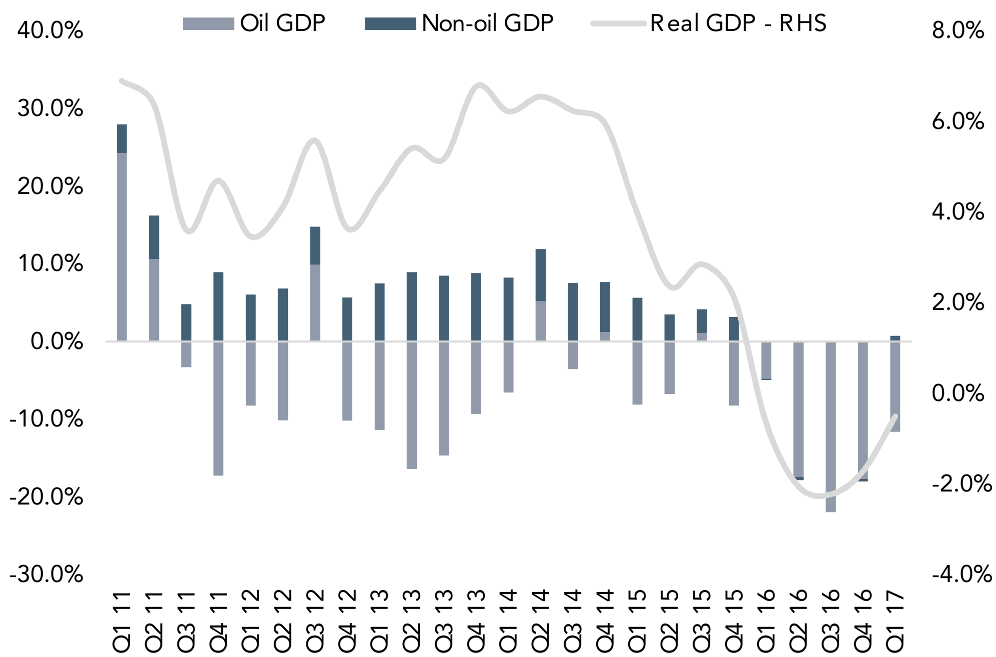
Growth Data – Q1 2017	(₦'bn)	%of total	YoY
Real GDP	15,861	100%	-0.5%
Agriculture	3,385	21.3%	3.4%
Oil	1,411	8.9%	-11.6%
Services	5,975	37.7%	1.0%
Wholesale and Trade	2,819	17.8%	-3.1%
Manufacturing	1,543	9.7%	1.4%

Nigerian GDP: Recovery Signal Speaks

Non-oil rebound cascades to slower contraction in Q1 17

Extending the trend from 2016, when output shrank 1.5% relative to 2015—encapsulating four quarters of YoY contraction, real GDP contracted 0.5% YoY in the first quarter of 2017. However, this reading was not only an improvement from the -1.3% YoY contraction registered during the preceding quarter but was also the smallest contraction since the trend began. The improvement appears to buttress our view, premised on PMI-strengthening, and as expressed in our H1 17 strategy report, that Nigeria might be coming out of recession in Q2 17. Drilling to the underpins of the recovery, whilst oil GDP recorded a narrower contraction (YoY: Q1 17: -11.64%; Q4 16: -17.7%), the lowest since Q2 16, an outright recovery in non-oil GDP (YoY: Q1 17: +0.7%; Q4 16: -0.3%) proved the boost. The growth in non-oil was driven by Agriculture (Crop Production: 3.5% YoY in Q1 17), Manufacturing (Q1 17: 1.4% YoY) and Services (Q1 17: 1.0% YoY).

Figure 1: Trends in YoY growth in real GDP, oil GDP and non-oil GDP

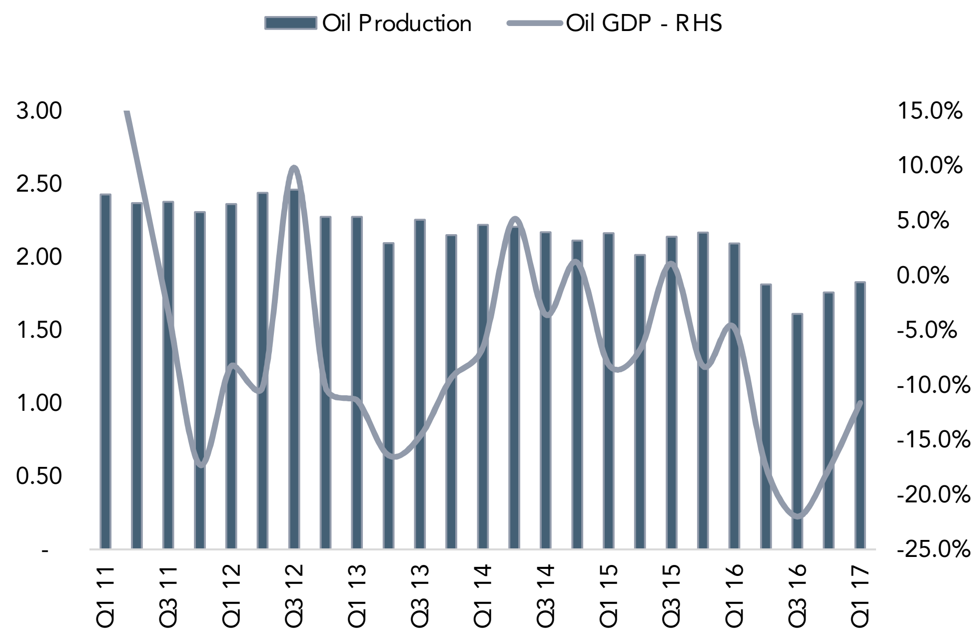


Source: NBS, ARM Research

Oil GDP sustains recovery as brass pipeline comes on stream

The second consecutive quarter of narrower contraction in oil GDP achieved in Q1 17 reflects 3.9% QoQ recovery in oil production to 1.83mbpd (Q1 16: 2.02mbpd). The production boost was largely owed to the lifting of force majeure on Brass terminal (120kbpd) in February 2017 as well as lower pipeline vandalism (-67% on average from 2016 to 2017). On the latter, we think FG's conciliatory efforts have calmed the activities of Niger-Delta militants, who are set to receive higher amnesty payments in 2017 (over two-fold YoY to ₦77 billion) going by the recently passed budget. Regardless, the lower production relative to corresponding quarter in 2016 continues to hinge on the force majeure on Forcados pipeline (330kbpd) which lingered over the review period alongside temporary shut-in of the Nembe Creek Trunk Line causing a shut-in planned production of 232kbpd in March 2017.

Figure 2: Trend in Oil Production and Oil GDP



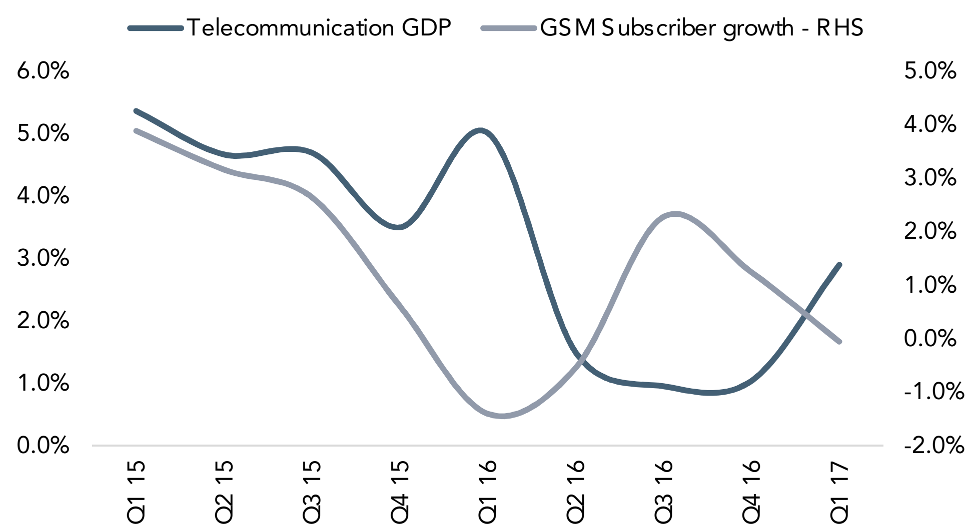
Source: NNPC, NBS, ARM Research

Recovery in ICT shoves Services GDP out of recession.

Starting off with the largest component of non-oil GDP, Services recorded positive growth (1% YoY) after three consecutive quarters of contraction, on the back of 2.7% YoY acceleration in ICT sub-sector (33% of Services). The improvement in ICT largely reflected activities in the Telecommunications sub-sector where the 3.12% YoY growth in Mobile GSM subscribers to 152 million people and incorporation of 98 thousand subscribers from Voice over Internet Protocol technology (VoIP) from NTEL and Smile supported a 2.9% YoY growth. Strong growth was also recorded in smaller sub-divisions such as Transport (+10.5% YoY) and Arts, Entertainment & Recreation (+11.7% YoY) which more than offset sustained contraction in Real estate (-3.1% YoY). Though the latter contracted for a fifth consecutive quarter, it maintained the theme of improvement by shrinking at a slower pace and with ancillary sectors—building & construction and cement—improving after successive quarters of downtrend, outlook appears brighter. Nonetheless, sluggishness lingered across all its sub-segments in the current period - urban office rentals remained under pressure as shrinking corporate profitability reduced take-up.

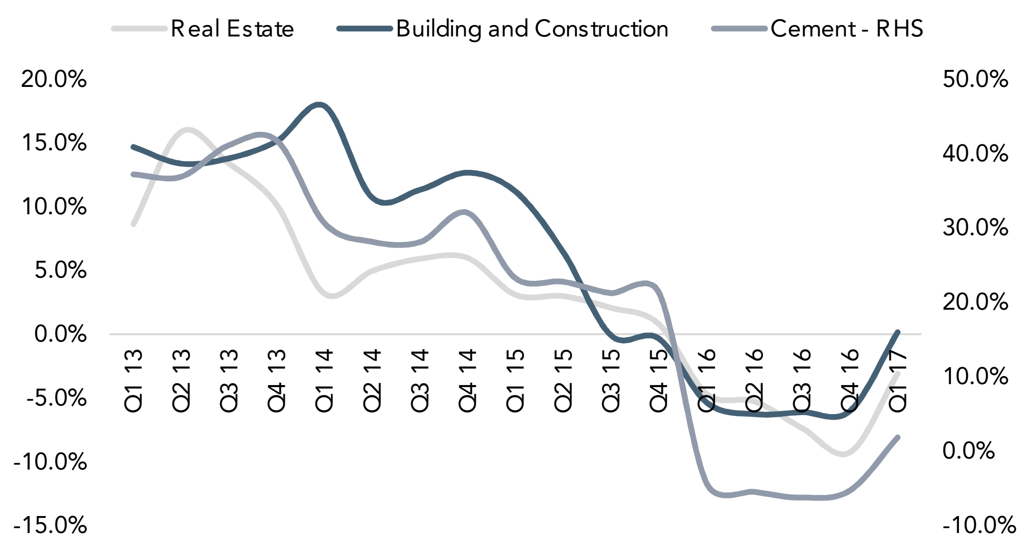
Away from real estate and ICT, growth in the financial services sector (8.4% of Services) slowed to 0.7% YoY largely due to weak activity in the banking sector. Here, the deadbeat macroeconomic picture and concerns over capital adequacy drove muted loan growth, ex NGN depreciation, as banks adopted a highly selective approach to loan origination.

Figure 3: Telecommunication GDP and GSM Subscriber Growth



Source: NCC, NBS, ARM Research

Figure 4: Trends in Real Estate, Building & Construction, and Cement GDP

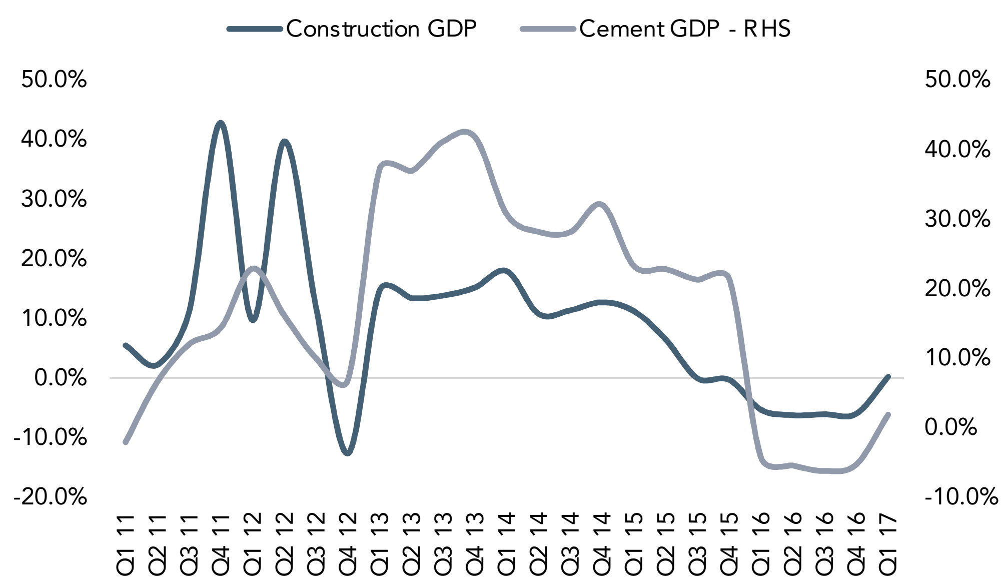


Source: NBS, ARM Research

Improved FX supply wedged the rebound in Manufacturing Sector

After recording four straight quarters of contraction, manufacturing sector grew 1.4% YoY, reflecting an improved FX supply which stimulated the importation of critical raw materials. Particularly, gains in this sector were driven by the Food, Beverage, and Tobacco (+4.1% YoY), Textile and Footwear (+1.2% YoY), and Cement segments (+1.8% YoY) which jointly constitute 76% of the sector's output. PMI data also shows an expansion in production level (Q2 17: 58.60), new orders (Q2 17: 50.30) and raw material inventory (Q2 17: 50.70) all signs of business confidence which we attribute to improved FX liquidity.

Figure 5: Growth Trend in Construction and Cement GDP

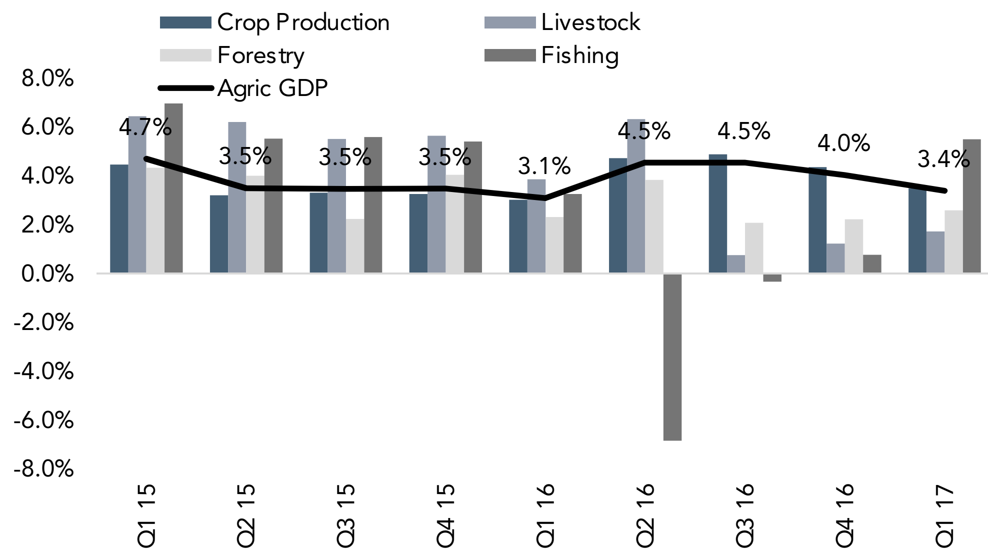


Source: NBS, ARM Research

Agriculture sustains sturdy growth to support non-oil GDP

Agriculture GDP growth remained robust (3.4% YoY) in the review period, reflecting gains in crop production (Q1 17: 3.5% YoY) which accounts for about 92% of agriculture, livestock (Q1 17: 1.7% YoY), forestry (Q1 17: 2.6% YoY) and fishing (Q1 17: 5.5% YoY). Growth in crop production was supported by increased government support (cheap financing, provision of farm inputs), rising export demand and attractive pricing. These all combined to stimulate increased cultivation activities while the fisheries division also recorded its strongest growth in six quarters.

Figure 6: Trends in Agric GDP growth and sub-components



Source: NBS, ARM Research

Overall, the combined impact of improved aggregate supply—a reflection of increase in oil production and improved dollar liquidity for imports of critical foreign inputs—as well as higher fiscal spending supported the rebound in non-oil GDP in the first quarter of 2017.

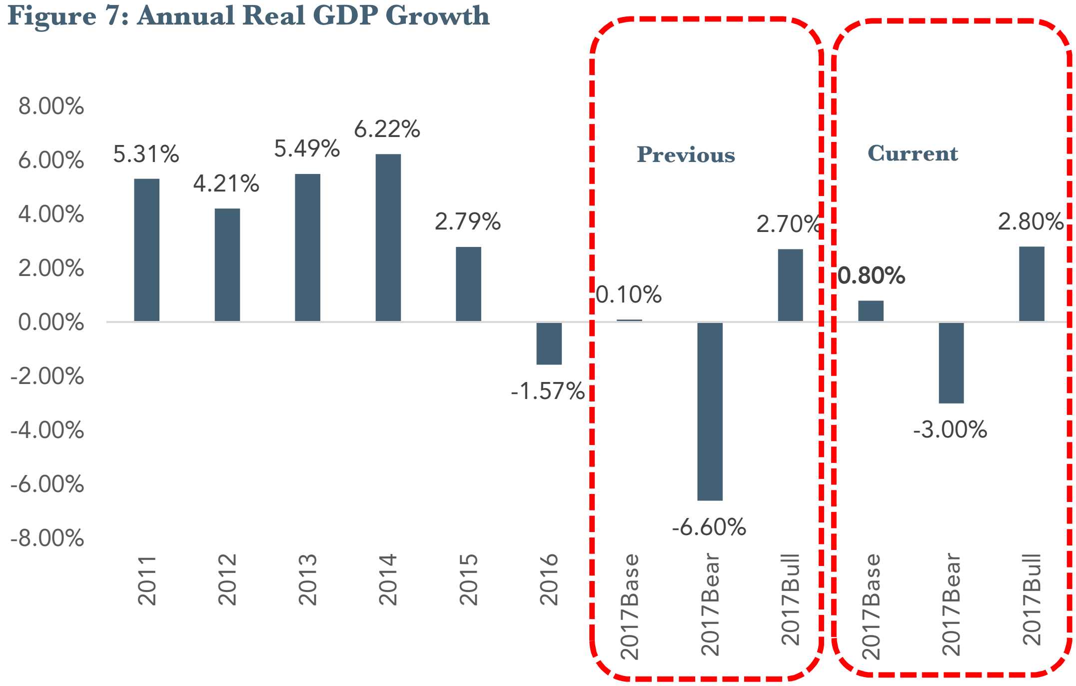
Nigeria to exit recession in 2017 as non-oil sustains growth and oil production stabilizes

For the rest of the year, our views on oil production and sustained momentum of non-oil sector remains central in clarifying our outlook. For oil GDP, the recent opening of the Trans-Forcados pipeline, which is expected to add circa 200kbpd to current production raises the prospect of an average oil production of 1.9mbpd over H2 17. Supporting this view is the likely temporal nature of the closure of Nembe Creek Trunk Line and Qua Iboe as well as the reopening of the 250kbpd Bonga which both indicate potential for even higher production over the rest of the year. Critically, sustained improved engagement with host oil communities to which we attributed the sharp reduction in pipeline vandalism should help production gains from lifting of force majeure crystallize to tangible output increase. However, owing to the shortfall in Q1 17, potential turnaround maintenance on subsisting terminals, as well as risk of security concerns in the Niger Delta region, we adopt a more cautious estimate of 1.9mbpd over 2017 from 2016 average of 1.81mbpd.

Examining likely developments on the non-oil side, in light of FG's thrust of boosting non-oil sectors, with agriculture on the front burner, we think the ongoing support would be sustained. Against this backdrop, as well as favorable pricing environment which should support cultivation activities, we expect the agriculture sector to benefit from the harvest seasons (dry in Q2 and main in Q4) with FEWSNET already noting above average output from the early harvest season which commenced in April. Elsewhere, despite the combined effect of high interest rate environment and constrained consumer income which should remain a drag on output, we expect improved FX sales and increased power supply to sustain the growth in manufacturing activities over the rest of the year. Similarly, the manufacturing PMI which touched 52.9 in June relative to 52.5 in May echoed improvement in the sector, as impact of the improvement in FX liquidity was evident in the performance of the Manufacturing sub-sectors as 10 of the 16 subsectors expanded in June.

Additionally, whilst weak consumer purchasing power is expected to inhibit growth in the real estate sector, higher YoY mobile subscription base should sustain the positive trend in the telecommunications segment and by extension the ICT sub-sector. On balance, growth momentum in ICT should support tepid growth in the Services sector. Overall, given the huge contribution of Agriculture sector and improvement in Manufacturing (-0.8% Q4 16: +0.1% Q1 17 - reversing the negative trend seen in 2016) and non-manufacturing divisions, we expect sustained growth in the non-oil GDP. Consequently, given the expected increase in oil production and sustained growth in agriculture and manufacturing, we now expect the economy to rise 0.8% YoY (prior estimate: +0.3%YoY) over the year, with the first quarterly YoY growth expected in Q2 17. The upward revisions projections stemmed from improvement in the non-oil segment (previous forecast: 0%) as FX challenges appear to be dissipating whereas we had forecasted them to persist.

Figure 7: Annual Real GDP Growth



Source: NBS, ARM Research

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