MACROECONOMIC REVIEW FOR OCTOBER 2019

The Nigerian Economy Recovers Slowly but remains Fragile

October 2019

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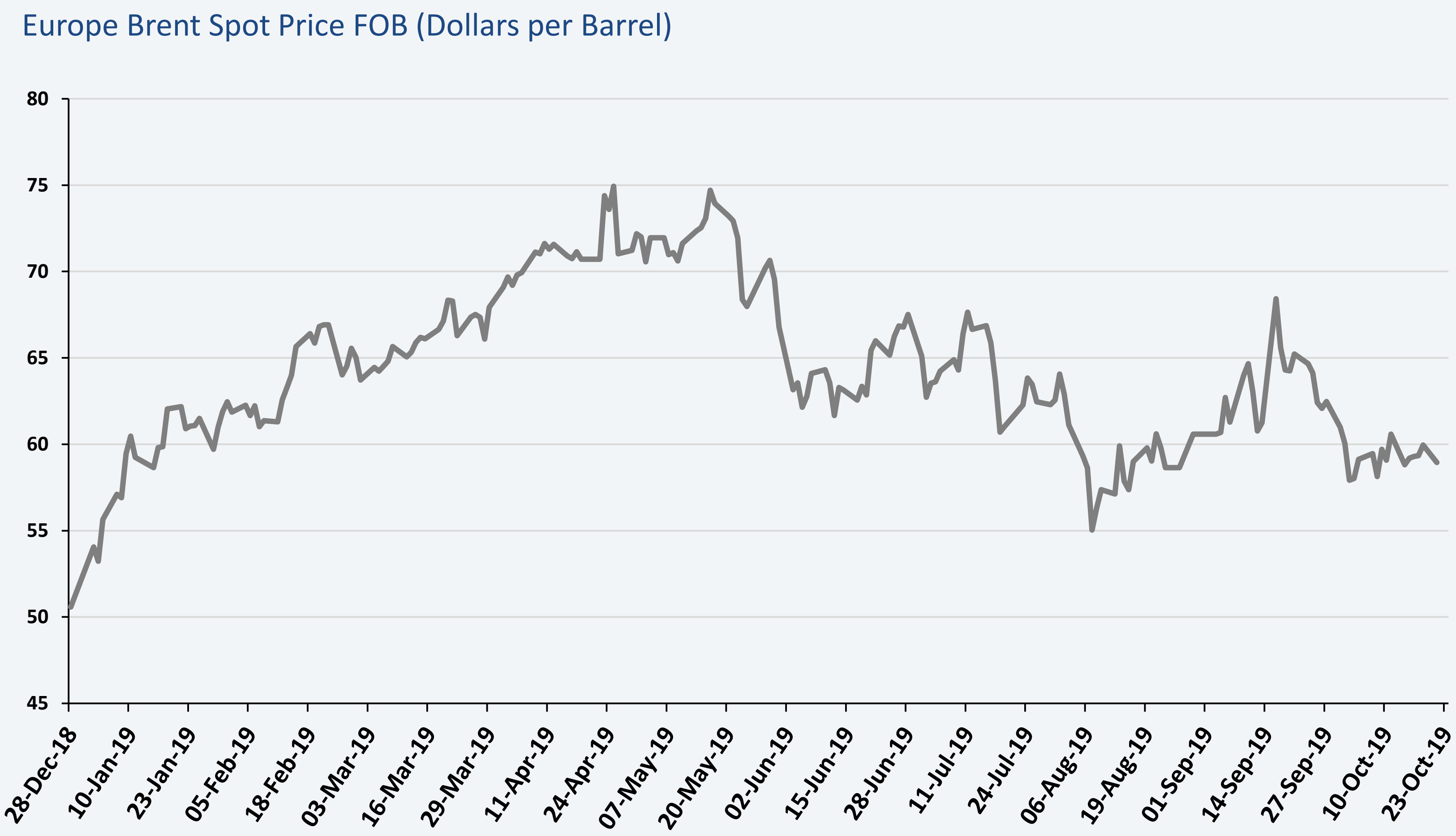
SECTION 01

Global Oil Price Movement

Sloppy oil market could be woeful for Nigeria



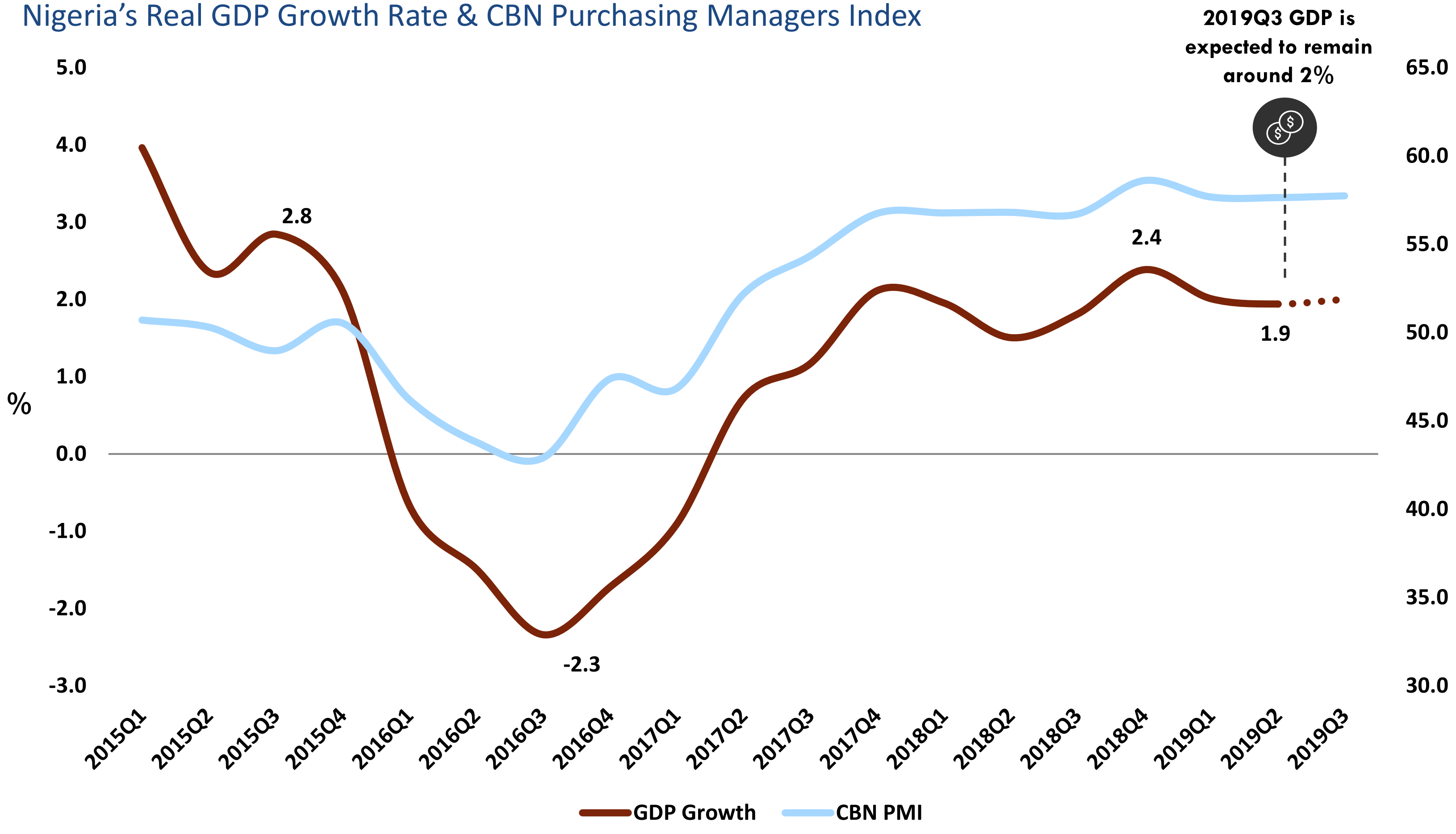
- **Crude oil price has averaged US$64.3 per barrel so far in 2019.**
- **Crude oil price peaked at $68.4 in September due to the attack on Saudi Arabia's two processing facilities, which accounts for 5% of global oil supplies.**
- **But oil prices closed bearish in October due to the US-China trade war concerns, and pressure from growing U.S. oil inventories.**
- **However, optimism around a possible Brexit deal and OPEC's declaration to uphold stability may be positive for oil prices.**
- **For Nigeria, oil price currently trades below the 2019 budget benchmark of US$60 pb.**
- **Nigeria is also less likely to meet its production target of 2.3 million bpd and by effect, its oil revenue target.**

Data Source: US Energy Information Administration

The Nigerian Economy
- Key Macroeconomic Trends

PMI movement suggests GDP Growth in 2019Q3 will be stagnant

Nigeria's Real GDP Growth Rate & CBN Purchasing Managers Index

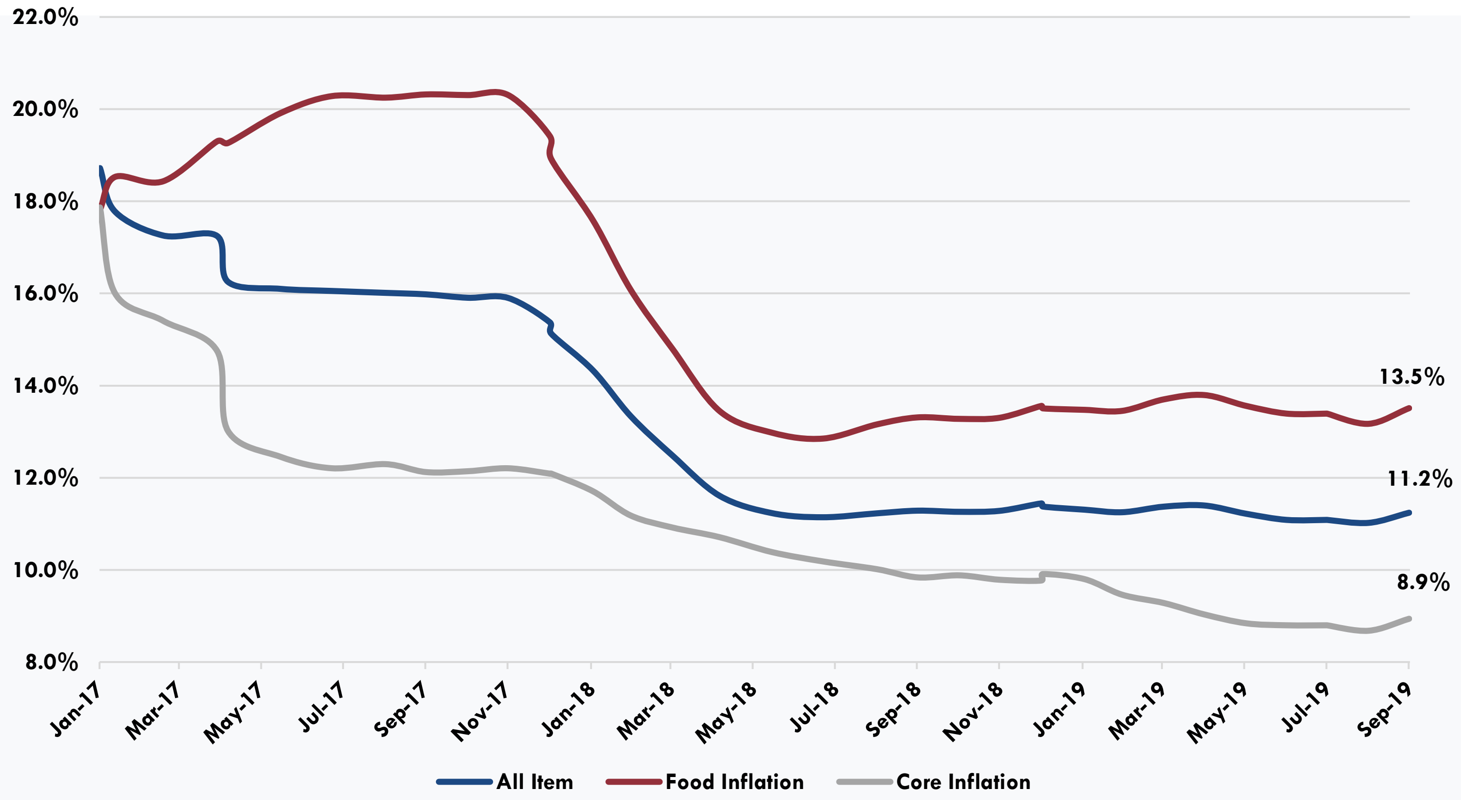


Data Source: National Bureau of Statistics & CBN

- The Purchasing Managers Index (PMI), which indicates changes in the level of business activities, stood at 58 points in September 2019 (August 2019: 58.8).
- This indicates that the economy expanded in the third quarter; albeit marginally.
- Growth in PMI was triggered by increase in inventories, new orders and employment levels.
- On the flip side, there were declines in export and import orders which affected overall business activities.
- This slowdown in activities will be reflected in 2019Q3 GDP growth, which is expected to hover at 2%.
- Overall, GDP growth is expected to be slightly above 2.0% in 2019, higher than 1.9% in 2018.

Inflation Rate edges up to 11.24% as inflation pressures heighten

Nigeria's Average Inflation Rate



Data Source: National Bureau of Statistics

- For the first time since May 2019, year-on-year Inflation rate increased to 11.24% in September 2019 (August: 11.02%).
- On a month-on-month basis, average prices rose by 1.04% in September from 1% in August.
- Increases were recorded for both food (13.5%) and non-food (8.9%) inflation; albeit more significant for food inflation.
- Food inflation was triggered by increases in prices of Bread and cereals, Oils and fats, Meat, Potatoes, Yam and other tubers, Fish and Vegetables.
- While Inflation has moderated in the first nine months of 2019, inflationary pressures are imminent in the remaining part of the year.
- These pressures would stem from higher government spending, potential tax increase and the recent closure of the land borders. However, real interest rate is expected to remain positive in 2019.

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Inflation Pressure Points in 2019Q4 and 2020

In addition to the challenges of infrastructure deficit, power supply outages and high borrowing cost, the following are some pressure points for inflation in coming months.

Government Spending Plan

N10.3 trillion

- The Federal Government of Nigeria (FGN) proposed a budget of N10.3 trillion for 2020.
- This represents the highest spending plan ever.
- Early passage and improved implementation could trigger inflation in 2020.

Proposed VAT Increase

5% to 7.5%

- To meet its revenue projection, the government plans to increase Value Added Tax (VAT) to 7.5%.
- FGN is expected to receive N293 billion from VAT as contained in the 2020 proposed budget.
- VAT increase could lead to higher prices via the pass-through effect.

Festive Period

Nov./Dec.

- Consumer demand is expected to increase in the fourth quarter of the year especially as the festive season approaches.
- This, coupled with the border closure, will result in inflationary pressures, particularly in the months of November and December.

Border Closure

Oct. 2019

- In October 2019, the government announced full closure of land borders, citing non-compliance of neighboring countries with ECOWAS protocols on transit of goods.
- Although, almost 99% of Nigeria's formal trade is done via air and sea according to data from the NBS, informal trade is largely done across land borders. The closure is expected to have implications on food prices and core inflation.

Inflation Pressure Points in 2019Q4 and 2020

Minimum Wage

N30,000

- The Federal Government agreed to labour demands to increase minimum wage from N18,000 to N30,000 per month.
- According to government officials, FGN would require an additional N580 billion to achieve the new wage bill.

Toll Gates

Oct. 2019

- In October, the Federal Government announced plans to re-introduce tolls on major highways in the country.
- The motive behind such move is to ensure funds are generated for proper maintenance of the tolled infrastructure.
- This is expected to have implications on inter-state transport fares, depending on the magnitude of the tolls.

Online Tax

5%

- The Federal Government is considering a 5% tax for online purchases that involve the use of debit cards.
- If implemented, this could trigger increase in prices for the affected products.

Excise Duty

Oct. 2019

- In October, the Minister of Finance, budget and National Planning announced plans to introduce excise duty on specific items such as carbonated drinks.
- This is in a bid to improve non-oil revenue collection to fund the country's budget.
- This is expected to result in higher prices and/or lower consumers' purchasing power.

What are the potential impacts of the Closure of Land Borders on Inflation?

- In August 2019, the Nigerian government ordered partial closure of land borders to curtail smuggling of rice and other products into the country. In October 2019, the government announced full closure of land borders, citing non-compliance of neighboring countries with ECOWAS protocols on transit of goods.

- The border closure creates an opportunity for local producers of commodities such as rice, vegetable oil, palm oil and other agricultural produce to increase production and meet local demand. Local rice producers will take advantage to increase production.

- However, in the short term, and especially given the supply-demand gap of these commodities as well as the time required to cover this gap, shortages are expected, and as a result, higher prices.

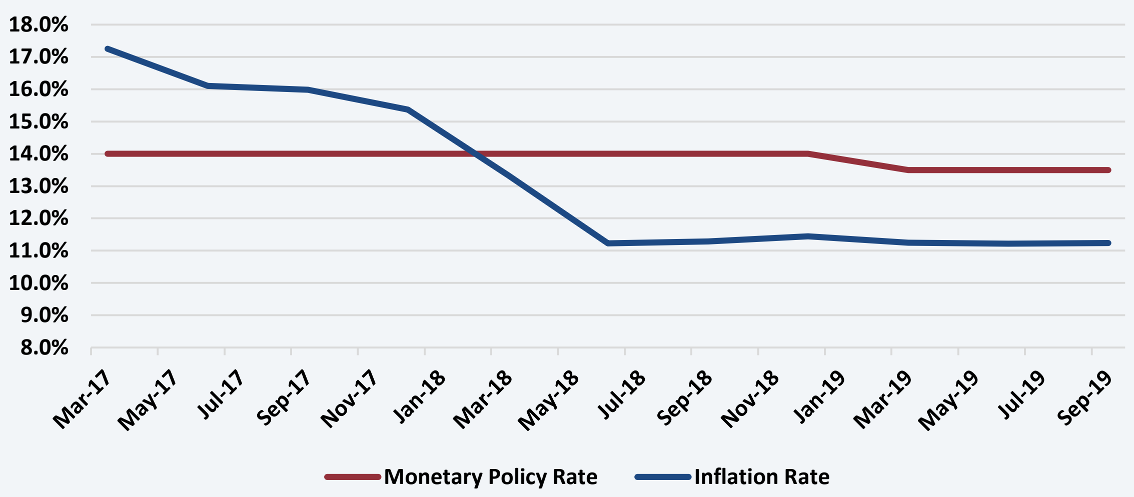
- For rice in particular, the USDA estimates local demand at 7.3 million metric tonnes (MT) while local production stands at 4.8 million MT per annum. Although production has significantly increased in the last 4 years, the supply-demand gap still remains huge and will be exacerbated by the recent border closure.

- Already, the price of 50kg bag of rice has increased significantly from N14,000 before the border closure to about N25,000 in October. Even local producers have taken advantage of the situation to increase price.

- Given that rice is a popular staple food across Nigeria, this is expected to trigger food inflation in coming months.

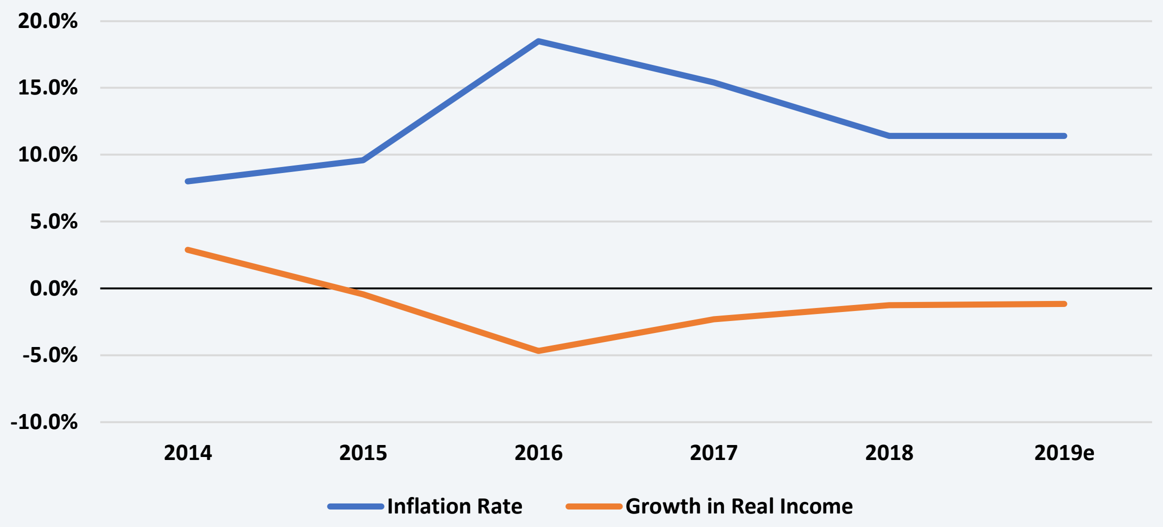
Why Inflation Matters

Real Interest Rate: Inflation vs Benchmark Interest Rate



- Inflation rate has trended downwards from the first quarter in 2017 to 11.2% in mid 2018 and remained stable thereafter.
- Real interest rate became positive in March 2018.
- The recent increase in inflation rate, though marginal, coupled with inflationary pressures are huge concerns for monetary authorities.
- This suggests that the Monetary Policy Rate (MPR) is less likely to be reduced, but more likely to be increased to maintain a positive real interest rate.

Inflation vs Consumer Purchasing Power



- Fall in crude oil price and foreign exchange crisis led to higher prices in 2016 as inflation peaked at 18.6% during the year.
- Real income, measured by Real GDP per capita, also dipped in 2016 with a negative growth of 4.7%. Higher prices had negative implications on consumer spending, companies earnings, employment and overall output.
- Recent happenings suggest that Inflation is expected to surge in coming quarters. With real GDP growth of 2% in 2019 which is lower than projected population growth rate, real GDP per capita is expected to decline in 2019 with adverse effect on consumer spending.

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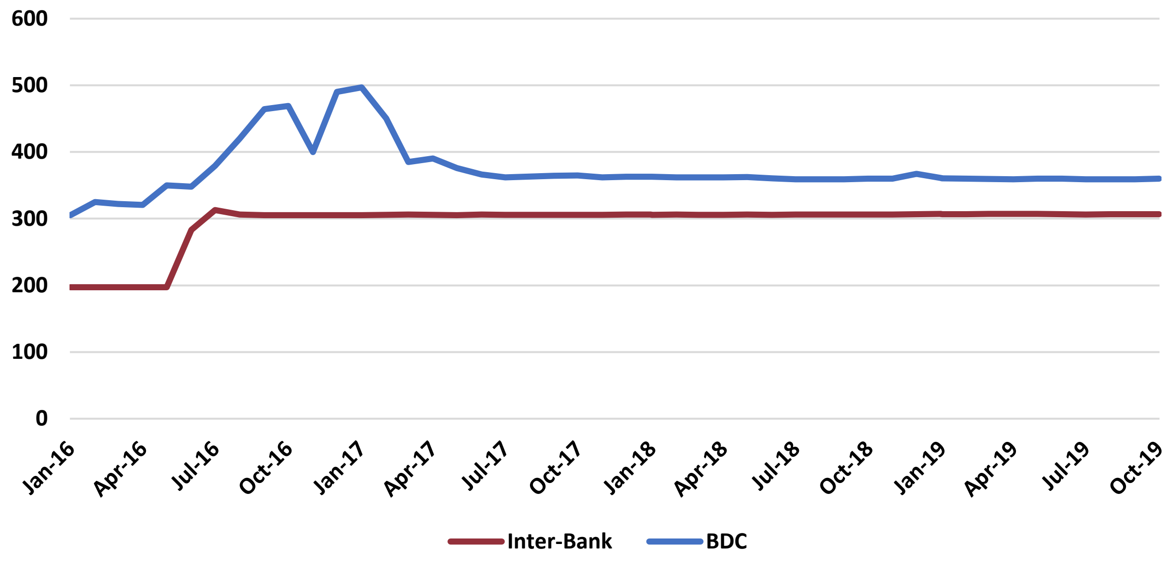
Data Source: National Bureau of Statistics & Central Bank of Nigeria

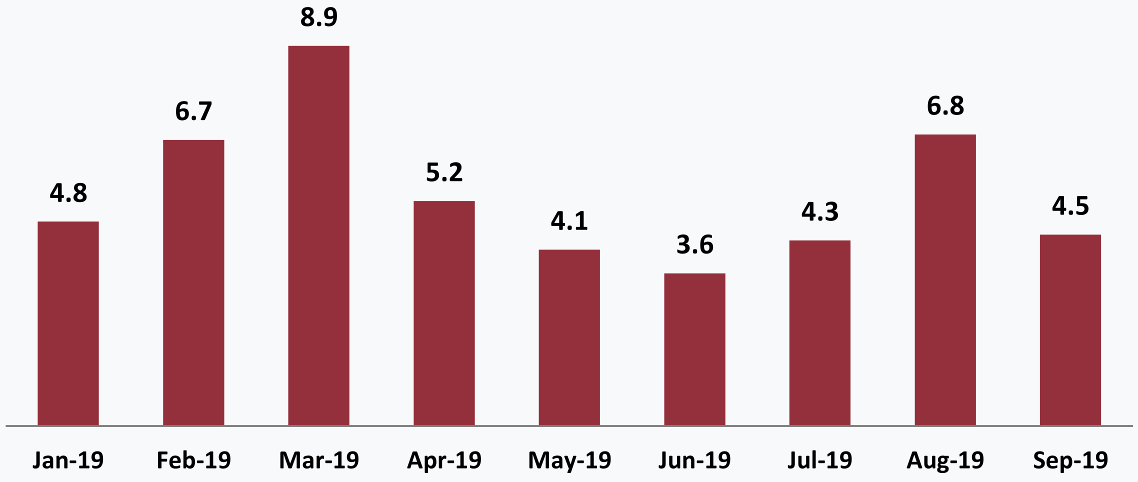
Exchange Rate remains stable at the expense of declining External Reserves

Exchange Rate (Naira per US$)



- FX Rates have remained stable across the official markets in 2019. Rates opened the year at N307/US$ and N361/US$ at the Interbank and BDC markets respectively.
- In October 2019, rates closed the month at N306 and N360.
- Relatively stable oil prices and CBN interventions helped sustain stability in exchange rates.
- However, pressure on the Reserves is expected to translate into exchange rate fluctuations, especially in the parallel market.

IEFX Turnover ($ Billion)

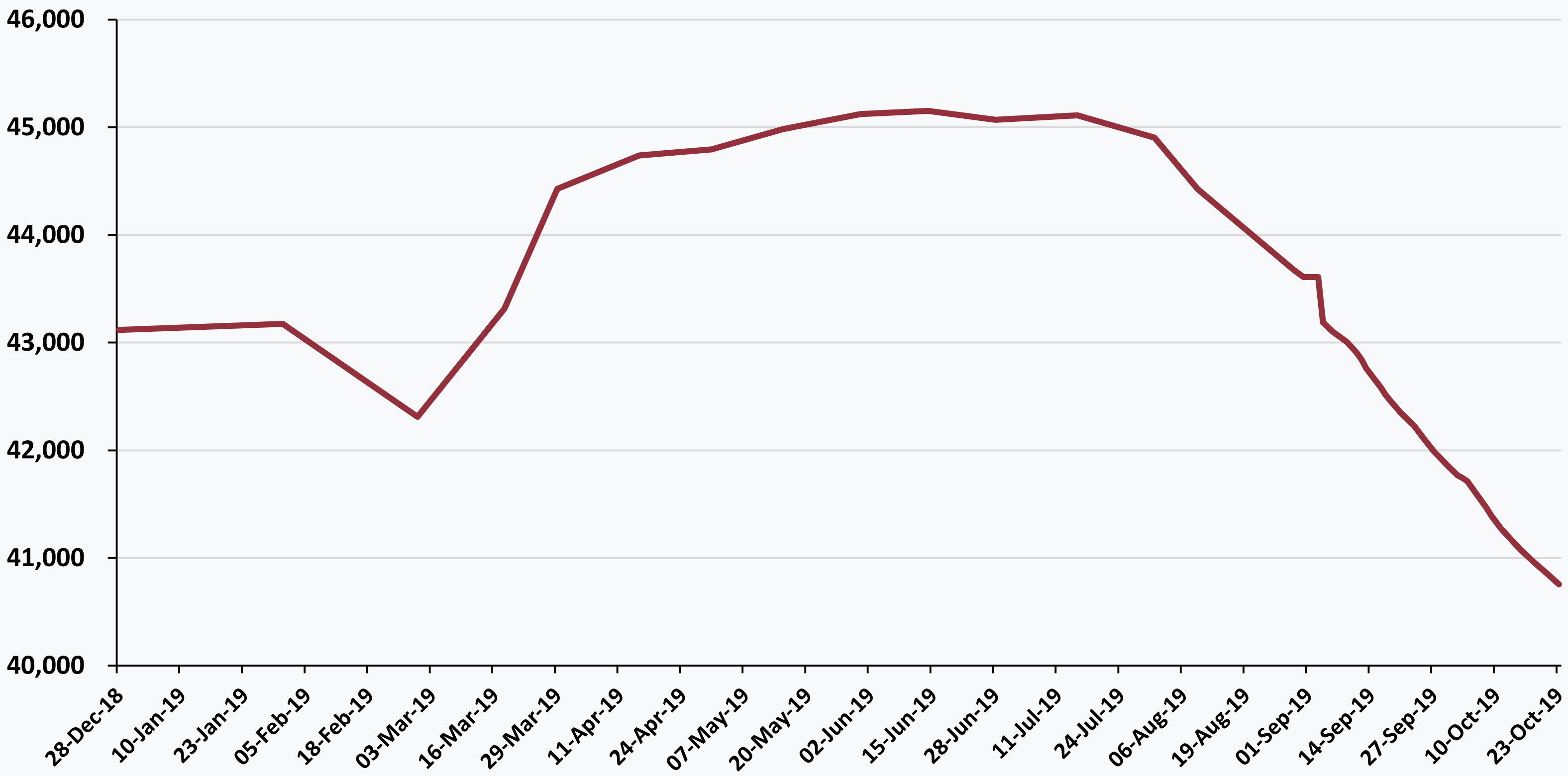


- IEFX turnover in September 2019 declined by 34% to US$4.5 billion, relative to August ($6.8 billion).
- The Naira traded within N357/US$ and N364/US$ band in the last week of September.
- In the forwards market, the Naira traded at 365.9 and 372.7 for 1-month and 3-month contracts, respectively.
- This signals future expectations of depreciating exchange rate.

Data Source: CBN, FMDQ

External Reserves have trended downwards since July but no devaluation in sight

Nigeria's External Reserves (US$ million)



- **External Reserves reached a 21-month low of US$40.7 bn on Oct 24 2019.**
- **Reserves have experienced a 5.4% year-to-date decline (Jan-Oct 2019) and are heading towards the US$40 bn mark.**
- **The decline in Reserves is largely as a result of**
  - **FX market interventions by the CBN**
  - **Nigeria's external debt service payments**
  - **FX outflows and other direct payments.**
- **We expect continued pressure on the Reserves, especially given high demand for FX and external debt servicing obligations. However, stable oil price will slow down the decline in Reserves.**
- **There is no likelihood of a devaluation in 2019 as the CBN will continue to intervene in the FX markets.**

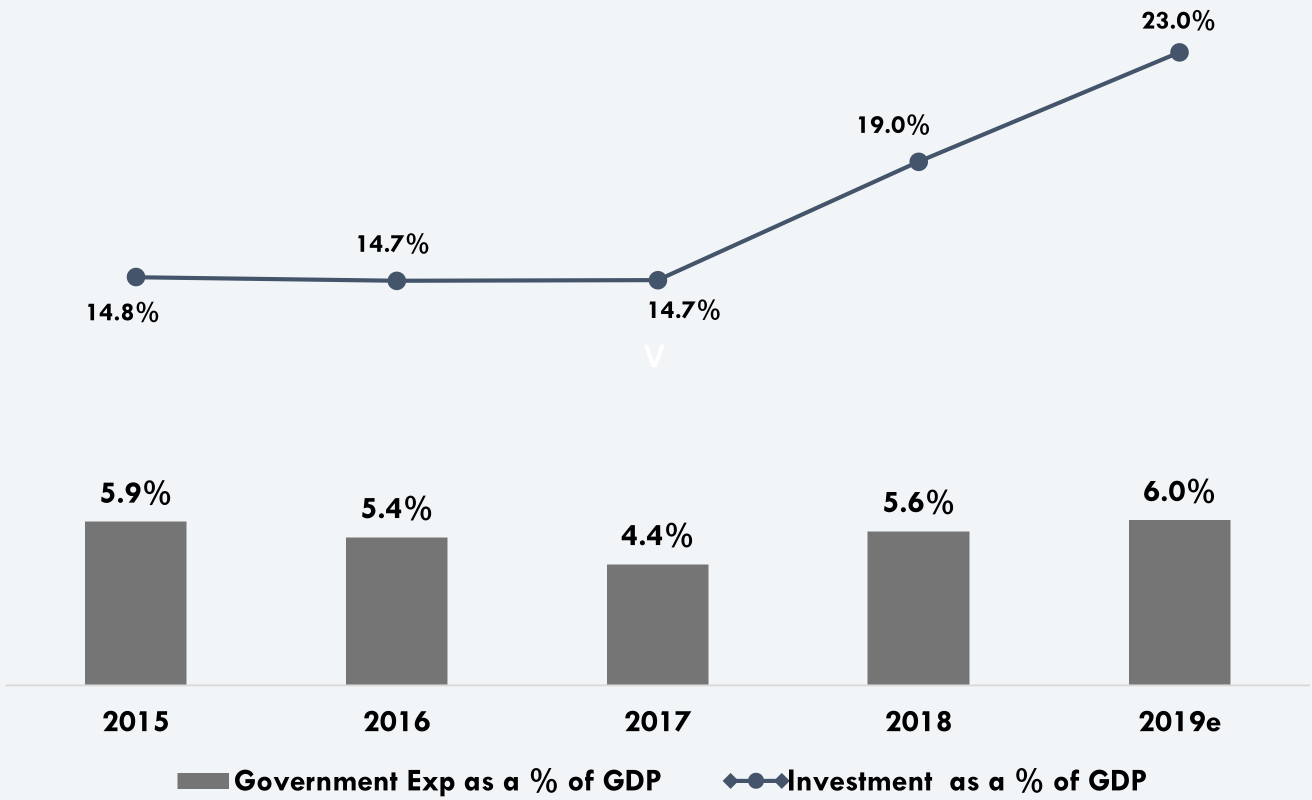
Data Source: CBN

SECTION 03

Nigeria's Investment Climate

What type of Investment is driving growth?

Government expenditure and Private Investment as a % of GDP

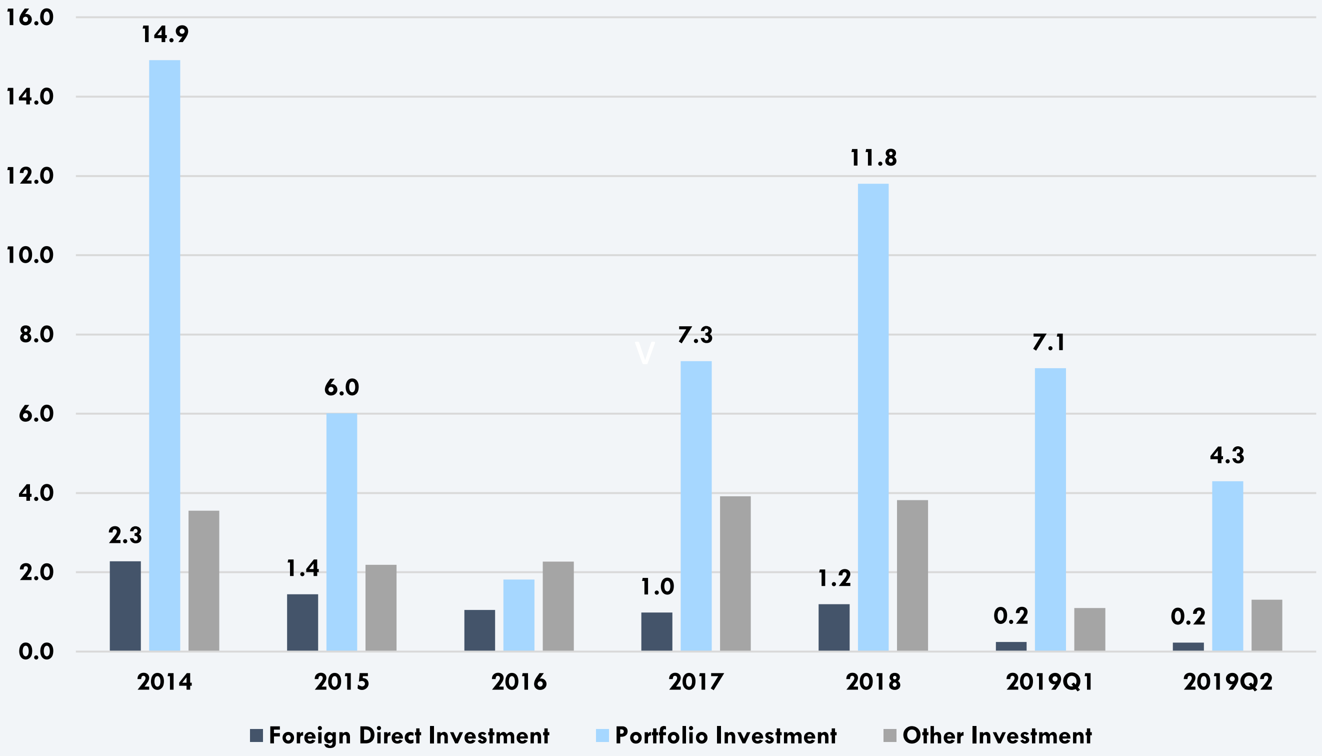


- Nigeria's GDP is largely driven by household consumption which accounts for approximately 70% of GDP.
- Private investment has been on an upward trend, accounted for 19% of GDP in 2018 and it is estimated to average 23% in 2019. Actual figure in 2019Q1 showed a share of 25%.
- Growth in private sector investment is triggered by spending on Transportation, Machinery & Equipment and Non-Residential Building which displayed a – Y-on-Y growth of 203%, 99% and 67% respectively in 2019Q1.
- Investment remains a key component to boosting economic growth due to its multiplier effect.
- Government expenditure accounted for 5.6% of GDP in 2019Q1.

Data Source: National Bureau of Statistics

How has Nigeria fared with respect to Capital Inflows- FDI and FPI?

Nigeria's Investment Inflows in US$ billion- FPI dominates inflows

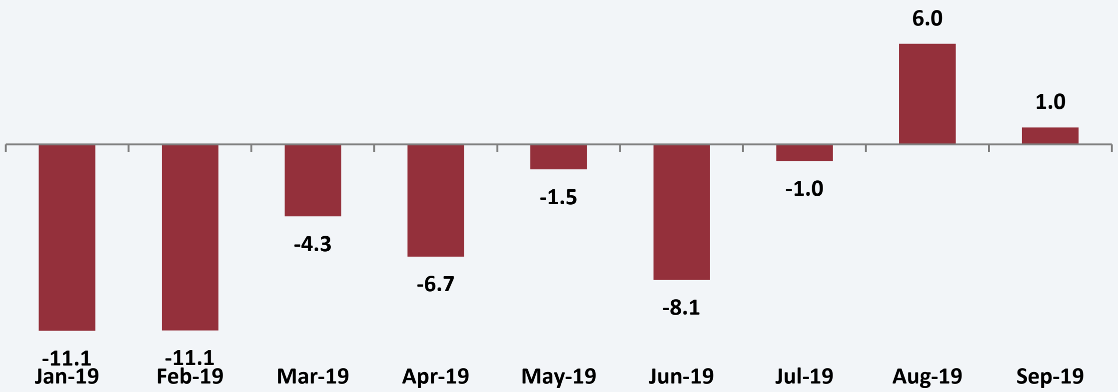


1. In 2019Q2, total investment inflows was US$5.8 billion. This represents an increase from US$5.5 billion recorded in 2018Q2 but a decline of 31% from 2019Q1 .
2. Total investment inflows has hit US$14.3 billion in the first half of 2019; higher than 2017 figure and US$2.5 billion short of 2018 inflows.
3. Foreign Portfolio Investment is the main driver of Investment inflows. FPI was US$4.3 billion in 2019Q2 and accounted for 74% of total investment inflows.
4. FPI in 2019 is set to increase beyond 2018 level. Already, in the first half of 2019, Nigeria has attracted US$11.4 billion worth of FPI, which is almost equal to US$11.8 billion inflows of 2018.

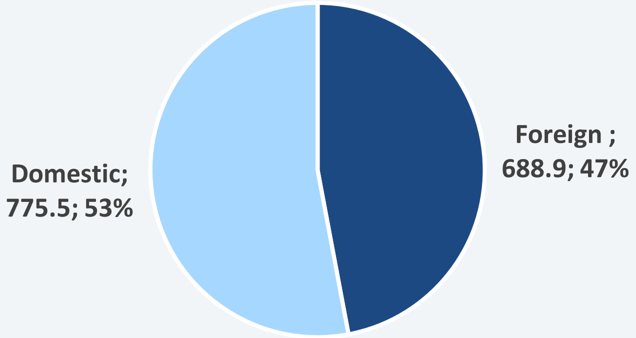
Data Source: National Bureau of Statistics

Foreign Participants dominate Market on the NSE in 2019Q3

Net Foreign Inflows (N'Billion)



Domestic and Foreign Participation on the NSE, from Jan - Sept. – N' Billion

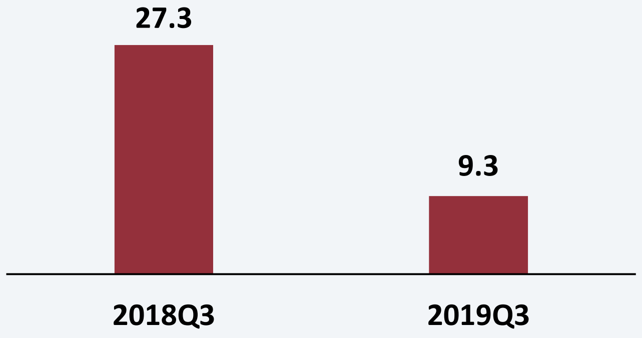


- For the first time in the year, foreign portfolio inflows exceed outflows in August and September 2019.
- Net inflows was positive at N6 billion in August but declined to N1 billion in September.
- Total transaction on the Nigerian bourse rose by 16% to N141.5 billion in September from N122 billion in August – largely as a result of the surge in foreign portfolio investment during the period.
- Foreign transactions outperformed domestic participation for the 3rd consecutive month in September.
- Although, YTD, Domestic transaction at N775 billion is higher than foreign inflows at N689 billion .
- Foreign interest can be largely linked to the current valuation of most stocks - which are at rock bottom. However, high yields in the debt market continue to weigh on the attractiveness of the equity market.

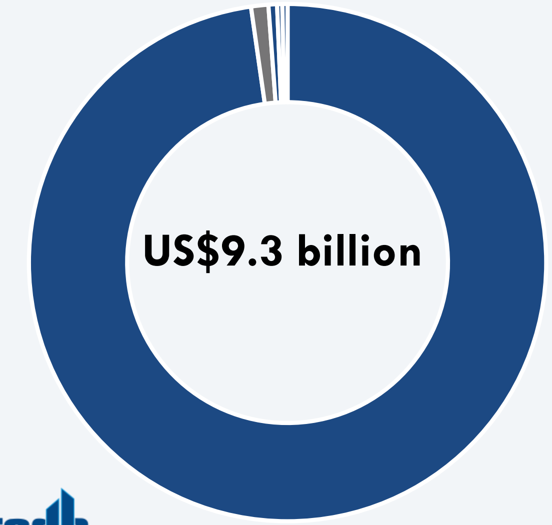
Data Source: NSE

Recent Investment Announcements suggest opportunity areas

Investment Announcements in Nigeria 2019Q3 vs 2018Q3 (US$ Billion)



Investment Announcements in 2019Q3 by Sector



	US$ bn	Share
Mining & Quarrying	9.08	97.7%
Information & Communication	0.10	1.1%
Finance & Insurance	0.05	0.5%
Transport & Storage	0.03	0.3%
Others	0.03	0.3%
Total	9.29	

- Investment announcement in the third quarter of 2019 was US$9.3 billion. This represents a significant decline from US$27.3bn in 2018Q3.
- Mining & Quarrying continues to dominate, accounting for 98% of total investment announced.
- ICT announcements totaled US$100 million in the quarter.
- 98% of announced investments were from local investors while 87% targeted offshore Mining & Quarrying industry.
- For the first time in the year, Manufacturing sector did not make the top four sectors as recorded in Q1 and Q2.
- From Jan to Sept. 2019, a total of US$24.4 billion worth of investment was announced, targeting 56 projects.

Data Source: Nigerian Investment Promotion Council

What is the Outlook on Investment?

- FPI will continue to drive investment inflows into Nigeria. Money market instruments will continue to account for the largest share. However, declining External Reserve could limit foreign investment inflows into the country as investors would be wary about stability of rates and ease of exit.

- Despite this concern, we expect inflows in 2019 to be higher than the US$12.2 billion in 2018 as investors seek to take advantage of the relatively higher yields in the Nigerian market.

- Given the recent restriction of non-bank financial institutions in OMO operations, we expect yields to moderate as we anticipate more inflows into the secondary market.

- Looking at the real sector, from a demand perspective, the CBN Consumer Expectation Survey for 2019Q3 shows that overall buying intention index in the next twelve months stood at 36.2 index points.

- This indicates that most consumers do not intend to buy big- ticket items such as consumer durables, motor vehicles and house & lot in the next 12 months.

- Low consumer demand in the short to medium term triggered by expectations of higher prices and will have implication on future investment decisions in the real sector.

What is the Outlook on Investment?

- The closure of land border is expected to have mixed impact on investments and trade. The introduction of such policy without embarking on measures to improve local capacities would only result in higher prices and firms' redundancy.

- Already, several local firms involved in exports via land borders have shut production plants, with piled-up inventory. This is expected to negatively affect investments.

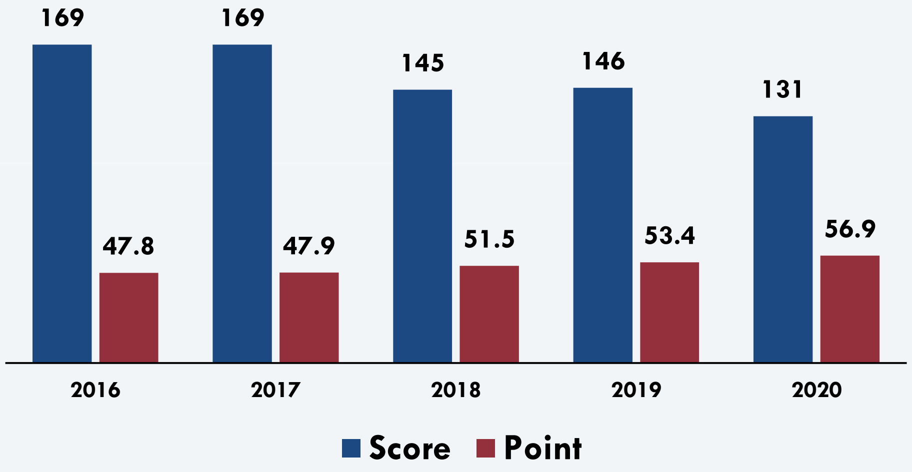
- In addition, closure of land border without commensurate and prior investment in ports infrastructure and implementation of port reforms would lead to increased pressure on the existing ports, and result in reduced trade volumes.

- On the positive side, real investors will take advantage of the border closure and make investments in the production of strategic products such as rice and poultry products.

What are the government's reforms to improve the investment climate?

EASE OF DOING BUSINESS

On the latest World Bank Doing Business Rankings released on October 24, Nigeria improved 15 places to 131st position, from 146th



- Nigeria was ranked among the top 10 improvers globally along side China, India, Saudi Arabia, Togo.
- Nigeria's score also increased significantly to 56.9 points.
- Nigeria is ranked as the 18th African country on the list.

Nigeria showed improvement in 6 out of 10 evaluation criteria:

- ✓ Starting a business
- ✓ Dealing with construction permits
- ✓ Getting electricity
- ✕ Getting credit
- ✕ Protecting minority investors
- ✓ Registering property
- ✓ Trading across borders
- ✓ Enforcing Contracts
- ✕ Paying taxes
- ✕ Resolving insolvency

- Best score in staring a business – 86.2%.
- Least score in trading across borders – 29.2%.
- Current closure of land borders could exacerbate this score, weighing on foreign investors' perception and investments.

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What are the government's reforms to improve the investment climate?

IMPROVE PRIVATE SECTOR LENDING

On September 30, 2019, the CBN released regulatory measures to improve Banks' lending to the Real Sector, increases LDR to 65%

- Earlier in July, the CBN announced Loan to Deposit Ratio (LDR) target for all Deposit Money Banks (DMBs) at 60%.
- In September, LDR target was reviewed upwards from 60% to 65% and all DMBs are required to attain the minimum LDR of 65% by December 31, 2019. Priority areas include MSMEs, Retail, Mortgage and Consumer lending.
- The upward review is following the 5.3% increase in credit to the private sector from N15.6 trillion in May to N16.4 trillion in September.
- According to the CBN, failure to meet the above minimum LDR by the specified date shall result in a levy of additional Cash Reserve Requirement equal to 50% of the lending shortfall implied by the target LDR. The CBN debited N500bn from banks that failed to meet the 60% target in September.
- While this move is expected to further stimulate lending to key sectors of the economy, it could also result in a lower lending rate to businesses.
- However, forcing banks to lend to businesses, especially given the slow economic recovery has the potential to add pressures on banks, and therefore, raise non-performing loans.

SECTION 04

Fiscal and Monetary Policies

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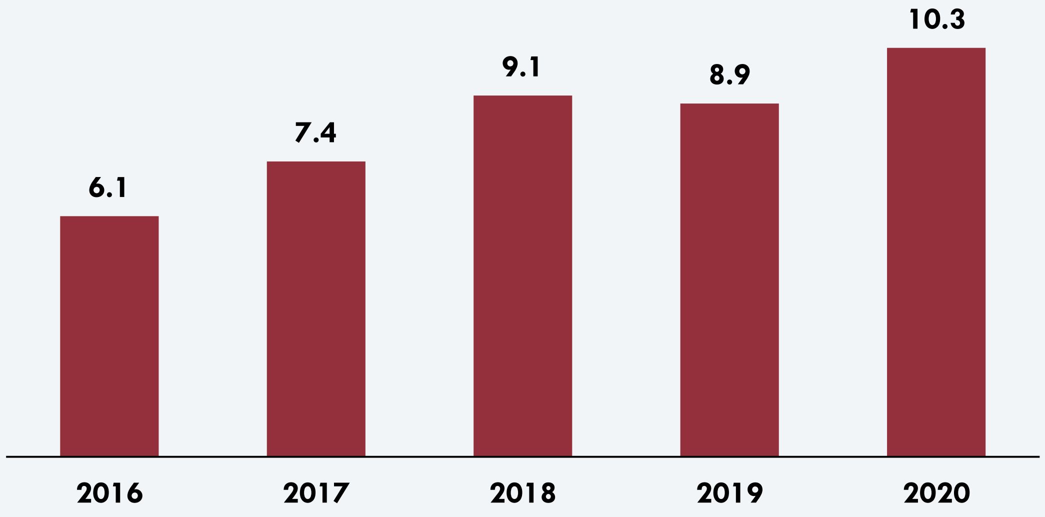
FGN pursues fiscal expansion with N10.3 Trillion 2020 Budget

FGN Total Budget (Trillion Naira)



Key Budget Assumptions

- Crude oil production - 2.18 million barrels per day
- Estimated crude oil price - $57 per barrel
- Exchange rate - N305/$1
- Projected GDP growth rate – 2.93%
- Fiscal Deficit – N2.18 trillion

- The 2020 proposed budget was N10.3 trillion, 16% higher than the approved 2019 budget of N8.9 trillion. This represents the highest ever spending plan of the Federal Government.
- The government's spending plan of N10.3 trillion consist of Non Debt Recurrent expenditure of 47%, Debt Services of 27%, Capital Expenditure of 21% and Statutory Transfer of 5%.
- Proposed revenue totaled N8.1 trillion which consists of N2.64 trillion Oil Revenue (32%) and Non-Oil Revenue of N5.5 trillion (68%).
- Non-oil revenue will include income from the proposed VAT increase as well as other non-oil taxes and tariffs.
- Despite the proposed VAT increase, Revenue projection of N8.1 trillion is overly ambitious and likely to be unmet especially with possible shortfall in crude oil production and expected slow implementation in the collection of newly imposed VAT.
- Fiscal deficit is N2.18 trillion in 2020. The deficit will be funded largely by domestic and external borrowings.

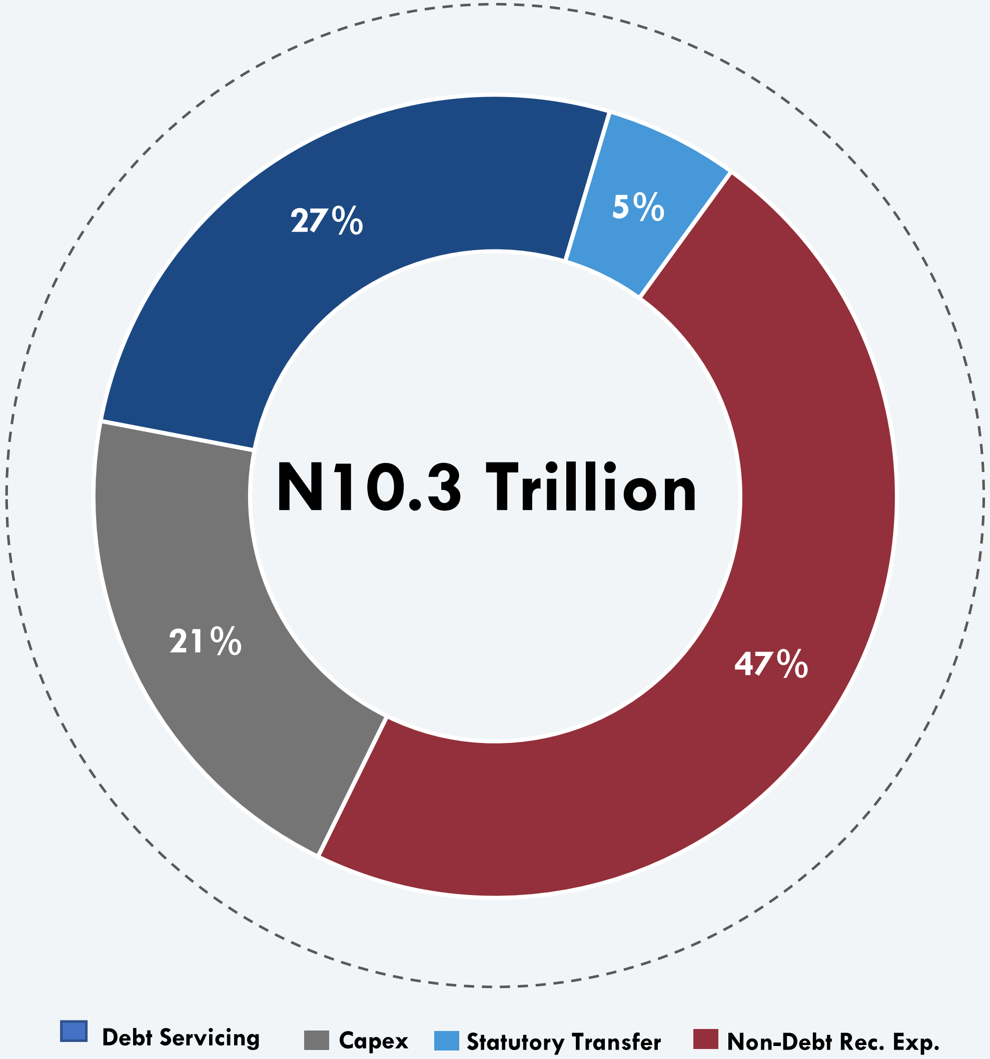
Recurrent Expenditure rises significantly, Capex remains stable

Debt Servicing
N2.7 trillion

Accounting for 27% of total expenditure, Debt Servicing is 22% higher than N2.3 trillion approved in 2019 budget. 74% of the N2.7 trillion will be used to service domestic debts

Capital Expenditure
N2.1 trillion

Capital Expenditure increased marginally by 2% in the proposed 2020 budget. Capex accounts for 21% of total budget. Early budget passage could result in higher implementation rate of capex



Statutory Transfer
N557 billion

Statutory Transfer accounts for 5% of the proposed budget. It increased by 11% in the proposed budget to N557 billion

Non-Debt Recurrent
N4.9 trillion

Non-Debt Recurrent Expenditure accounted for 47% of total spending in the 2020 budget to reach 4.9 trillion. Personnel and pension costs stood at N3.6 trillion representing 74% of non-debt recurrent expenditure, arising from the agreed minimum wage

Key Sectoral Capital Allocations in the proposed 2020 Budget

Transportation
N123 billion

Power
N127 billion

Defence
N100 billion

Works and Housing
N262 billion

Agriculture
N83 billion

Capital allocation in the proposed 2020 Budget targets existing infrastructure project to ensure completion

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Data Source: Budget Office of the Federation

research@fsdhgroup.com

The proposed 2020 Budget and the Economy

- Early presentation of the 2020 budget is a welcomed development. If the budget is approved before the budget year begins, this could result in improved budget performance, particularly capital budget.
- The proposed 2020 budget is largely ambitious both in terms of spending plans and projected revenue.
- One major concern is meeting revenue targets to fund the budget. Oil only accounts for 32% of total budgeted revenue in 2020, suggesting that more pressures will be exerted on major non-oil revenue generating areas.
- To meet revenue projections, the federal government will implement an increase in VAT and other forms of taxes which could trigger inflation and reduce purchasing power of consumers.
- In addition, slow implementation/collection of newly imposed VAT and other taxes is expected to play out in 2020.
- Revenue drive should be implemented with caution to limit undue pressure on businesses and consumers, especially given the slow economic recovery with GDP growth below 2%.

The proposed 2020 Budget and the Economy

- We note the significant increase in recurrent expenditure from N6.8 trillion to N8.2 trillion. Personnel costs including overhead and pensions increased to N3.6 trillion and accounts for 74% of non-debt recurrent expenditure.

- The new minimum wage was partly responsible for this increase. This is expected to create inflationary pressures in the short to medium term from the year 2020.

- The marginal increase in capital expenditure when compared with 2019 approved budget figures is a concern.

- Given the country's huge infrastructure deficit, it is crucial to prioritize capital spending to improve budget performance and ease doing business in Nigeria.

- With the revenue target likely to be unmet as well as the challenges in the procurement system, only about 55% of capital budget will be implemented i.e. N1.2 trillion would be injected into the economy for capital projects in 2020.

The proposed 2020 Budget and the Economy

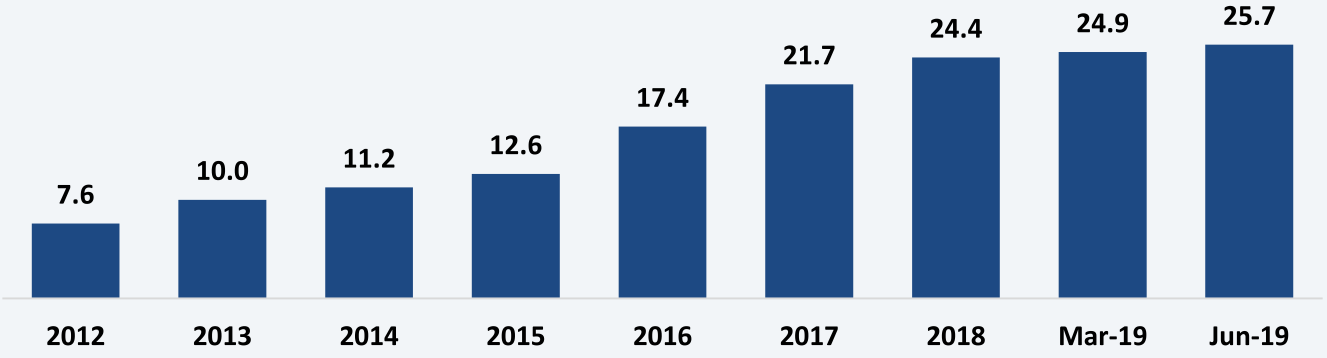
- **Debt servicing as a percentage of budgeted revenue stood at 33% in the 2020 proposed budget.**

- **However, actual debt servicing as a share of actual revenue rose to 54% in 2018 and this trend of high debt servicing to revenue ratio is expected to continue at least into 2020, until revenue collection improves.**

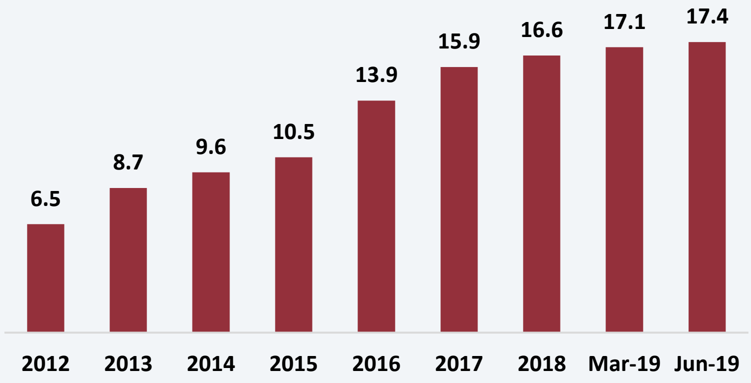
- **The Budget deficit of N2.18 trillion is to be financed mainly by domestic and external borrowing. Deficit remains below the stipulated 3% to GDP limit in the Fiscal Responsibility Act. The increased borrowing is expected to shore up liquidity in the fixed income market.**

Does Nigeria's rising public debt pose a risk for the economy?

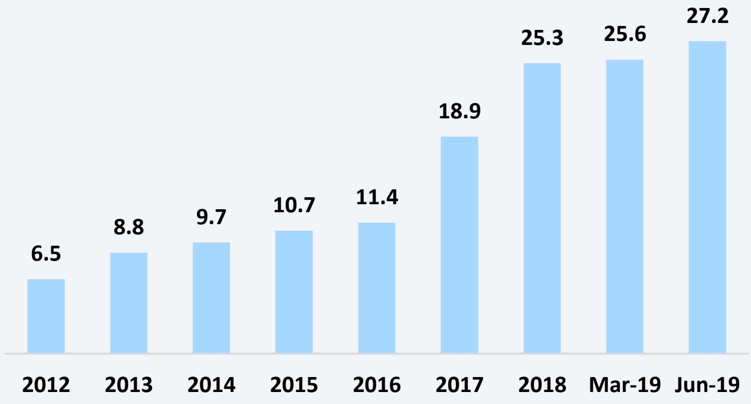
Nigeria's total Public Debt Stock (Trillion Naira)



Nigeria's Domestic Debt (Trillion Naira)



Nigeria's External Debt (US$ Billion)



Public Debt rises to N25.7 trillion in 2019Q2

- Nigeria's public debt stock has increased by 104% over the last 4 years to N25.7 trillion.
- Growth in overall debt has been fueled by external loans which has almost tripled from US$10.7 billion in 2015 to US$27 billion in June 2019.
- Unfortunately, revenue growth has slowed consistently and fallen below budgetary targets.
- As a result, actual debt servicing cost as a share of government revenue increased to 54% in 2018, from 44.6% in 2016 and is more likely to increase.
- With Nigeria's low revenue profile, public debts could be approaching unsustainable levels.
- The conundrum for the government, therefore, is to aggressively raise non-oil revenues by taxing an economy that is recovering, thereby creating pressures on citizens and businesses.

Data Source: Debt Management Office

Rising debts and debt servicing costs trigger aggressive revenue drive

Although Nigeria's debt to GDP ratio remains low at 19%, actual debt servicing cost as a share of government revenue remains high.

Over the years, Nigeria has had a weak revenue profile, which has led to increased borrowing to fund the budget. To address the revenue challenge, the government has opted to increasing VAT and other taxes.

While the current revenue drive will positively impact the FG budget, there are concerns that it would create pressure on citizens and businesses, especially when the economy is still recovering.

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Monetary Policy Outlook

In September 2019, the CBN MPC held its fifth meeting of the year 2019. Key decision of the Committee include:

- Retain the MPR at 13.5 per cent;
- Retain the asymmetric corridor of +200/-500 basis points around the MPR;
- Retain the CRR at 22.5 per cent; and
- Retain the Liquidity Ratio at 30 per cent.

This was based on the following considerations:

- Moderation of of Inflation rate in August
- Pressure on External Reserves
- Improvement in financial soundness indicators
- Supply of credit to MSMEs
- Slow growth in overall credit to the private sector
- The need to intensify job creation efforts
- Government current drive to increase VAT

Expectation from next MPC meeting

Key Considerations

- Reserves are declining (21-month all time low- US$40.8bn)
- Inflationary pressure is high
- Increasing FX demand
- Foreign investment inflows have slowed

These factors would create pressure on the Committee to consider raising the benchmark interest rate.

- However, there is the consideration to stimulate the economy in the face of slow growth; and
- The need to stimulate lending to the private sector

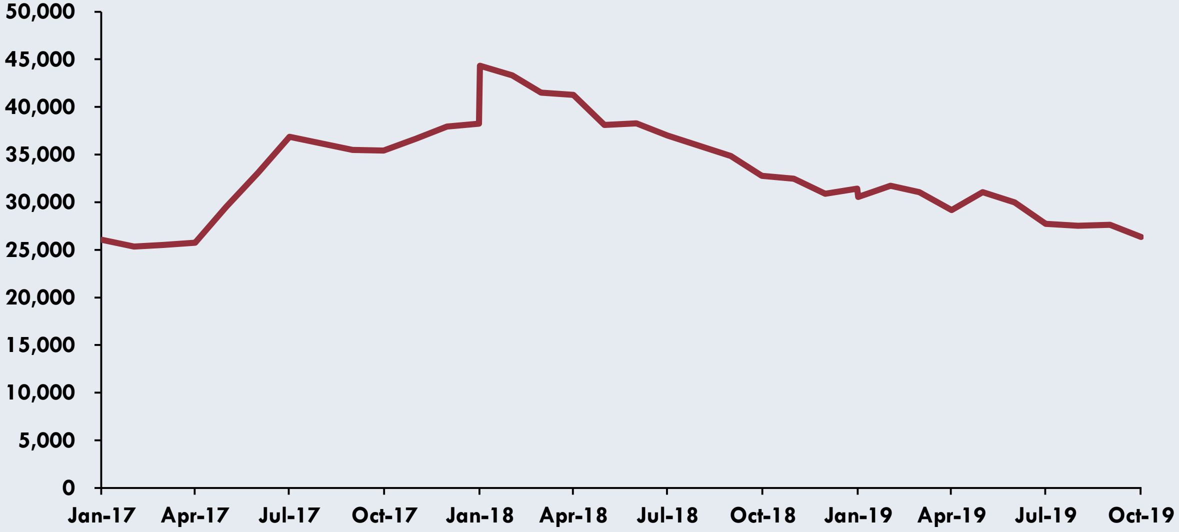
We believe the CBN MPC will maintain rates at the next meeting

Data Source: Debt Management Office

Money and Capital Market Update

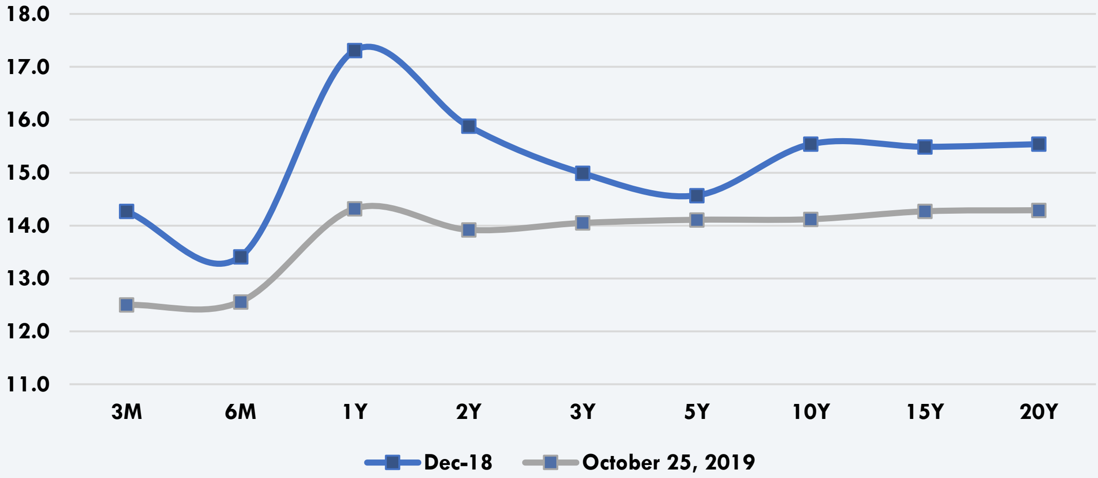
Equities market improved slightly in September; Liquidity improves in the fixed income market

NSE All Share Index



- Nigerian bourse showed a glimpse of recovery in September, expanding marginally by 0.4%, compared to the previous month.
- This was short lived in October as the market returned to its bearing trend, losing 4.6% of its value within the month of October – this widened YTD losses to 14% (as at October 25, 2019)
- Investors remained unimpressed with the stellar performance of most companies, especially the banking stock. Banking index has lost 21.1% of its value so far in 2019, despite banking stocks being the most liquid on the NSE
- Similarly, average volume and value of trades corroborate market sentiments.

Yields on securities (%)



- So far in 2019, the fixed income market has leaned towards a bullish posture, as foreign portfolio investment inflows into the country significantly improved in H1 2019.
- As at October 25, yields moderated across all tenors, when compared with yields in December. This also signals sustained interest of both domestic and foreign investors, in both short and long term securities, especially given the weak performance of the equities market.
- FGN bonds for 5, 10 and 30 year tenors issued in September and October were oversubscribed.

Data Source: NSE, FMDQ

Money and Capital Market Update

Liquidity in the fixed income market will force rates to moderate

Nigerian equities remain one of the cheapest EM equities with P/E ratio of 7.09x. Several bellwether stocks in Banking, Consumers and Industrials remain well below fair value and trading close to 52-week lows. Going forward, liquidity of stocks will drive performance as market will continue its choppy trading based in bargain hunting.

In the fixed income market, the CBN recently limited access to OMO auctions to banks and foreign investors. We believe that this move was partly triggered by the need to boost foreign inflows in order to support the declining External Reserves. Following this, we expect yields to moderate slightly towards the end of the year as funds will flow into the secondary market.

Despite expectations of lower yields relative to previous months, we expect inflows of FPI in coming months; albeit lower than previous quarters. FPI would likely target short term instruments. Also, declining Reserves occasioned by increasing FX demand and poor inflows as well as imminent inflationary pressure rule out the likelihood of Monetary Policy Rate cut in 2019.

Conclusion

Economic outlook is bleak with pressures on Output, Reserves & Prices

Nigerian economy is expected to grow at around 2% in 2019. This will be lower than the 2019 target of government's ERGP of 4.5%. Growth will remain below population growth of 3.1%, with implications on real income per capita.

Growth will continue to be driven by the Services sector- Telecoms and Transport will play a major role in driving growth.

ECONOMIC GROWTH

Recent land border closure is expected to marginally affect agricultural and manufacturing output, trade figures and prices.

For output, local producers could take advantage of the border closure; however, there are still pertinent supply-side challenges of infrastructure, logistics and quality of produce.

- Evidently, for firms that rely on imported inputs via the land border, the closure has resulted in higher production costs.
- Some textile firms in Kano have shut down operations with large pile of inventories due to the inability to export to other African countries via the border. These will have implication on outputs in the fourth quarter of 2019.

Economic outlook is bleak with pressures on Reserves, Prices & Output

A GOVT REVENUE & PRICES

Government's aggressive revenue drive is expected to lead to price increase in the short to medium term following significant increase in inflation pressure points- VAT increase, Toll increase, planned introduction of communications tax, land border closure, etc.

B FOREIGN INVESTMENT INFLOWS

FPIs is expected to continue to outperform FDI inflows in the short to medium term. FDI inflows depends largely on big pocket issues such as security, infrastructure, certainty, power supply, among other factors. FPI inflows will continue to target short term instruments.

C GOVT. SPENDING & REGULATION

Government policies, reforms and expenditure plans will have significant positive impact on the economy. However, there is need to improve spending efficiency; speed up the pace of reforms and expand its scale to support key economic sectors.

What risks should we watch out for in the short to medium term?

	Risk	Description	Implication
1	Policy uncertainty- Introduction of ad-hoc and uncoordinated policies	In the past few months, we have seen the closure of land borders, CBN policy on OMO, etc. We could continue to witness the introduction of adhoc policies that will heighten uncertainty and toughen the business climate	Rise in uncertainty and slow growth in both domestic and foreign investments as well as pressure on Reserves
2	Higher prices	There are numerous inflation pressure points arising from implementation of minimum wage, border closure, VAT and other tax increase.	Higher government revenue but lower consumer purchasing power which could slow down investments
3	Rising debt levels	Total public debt has steadily risen to N26 trillion (US$84 billion) as at June 2019 and is more likely to increase going forward. This has implication on debt servicing costs.	Nigeria could be trapped in unsustainable debt circles; higher interest rate and pressure on Reserves
4	Insecurity	Security concerns in some parts of the country	Security concerns could have implication on food prices, inflow of investments, movement of people, etc.

Macroeconomic Projections

Macroeconomic Projection

	2016	2017	2018	2019f
GDP Growth	-1.6%	0.8%	1.9%	2.3%
Inflation	15.6%	16.5%	12.1%	11.4%
Exchange Rate (N/US$)	490	363	358	358
External Reserves (US$ Billion)	27.0	39.4	43.1	42
Monetary Policy Rate	14.0%	14.0%	13.5%	13.5%
Investment as a % of GDP	14.9%	14.8%	17.0%	23%