MACROECONOMIC REVIEW FOR 2019 & OUTLOOK FOR 2020

Navigating through the era of slow growth

December 2019

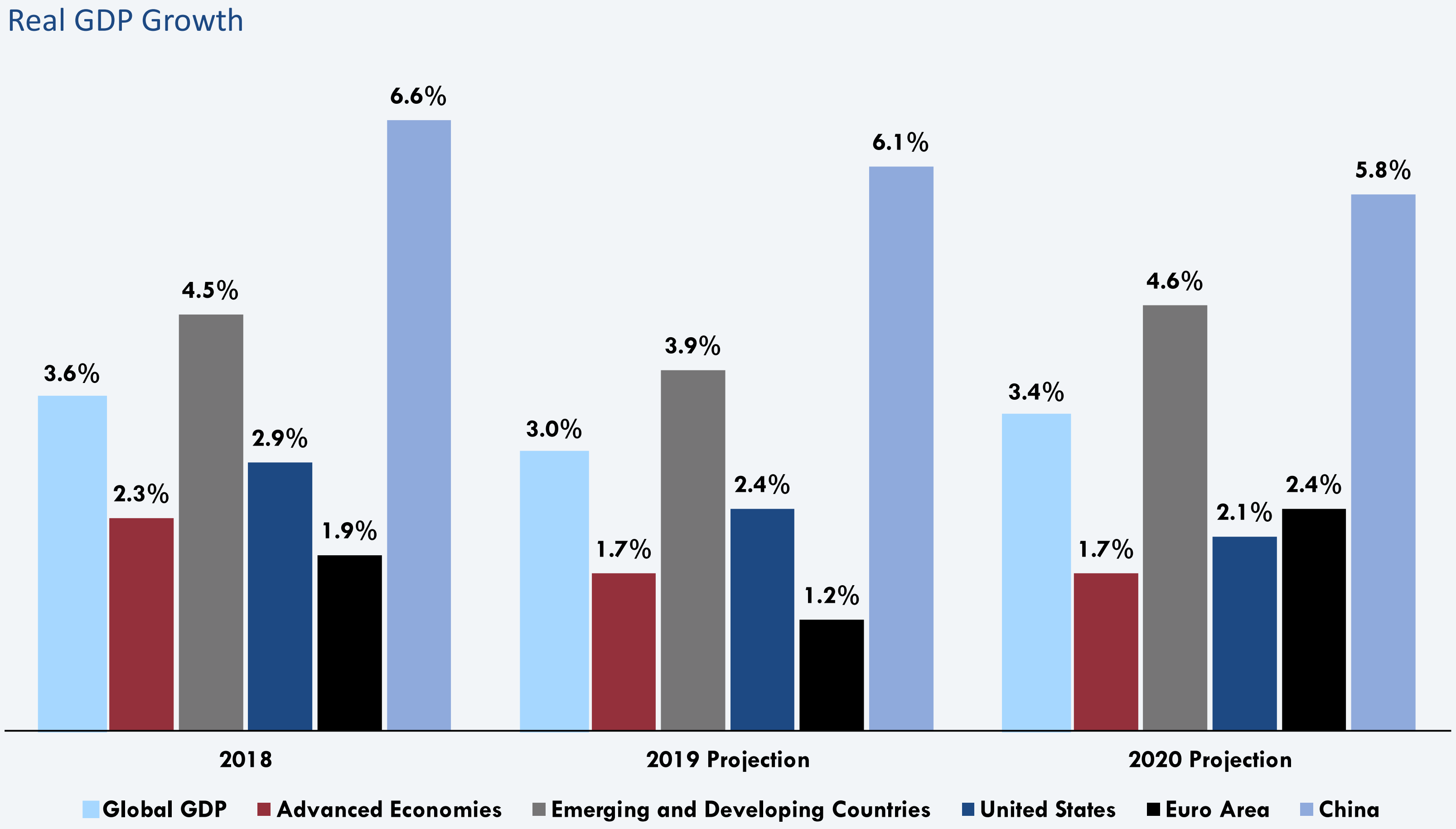
CONTENTS

fsdh RESEARCH

SECTION 01

Global Economic Update

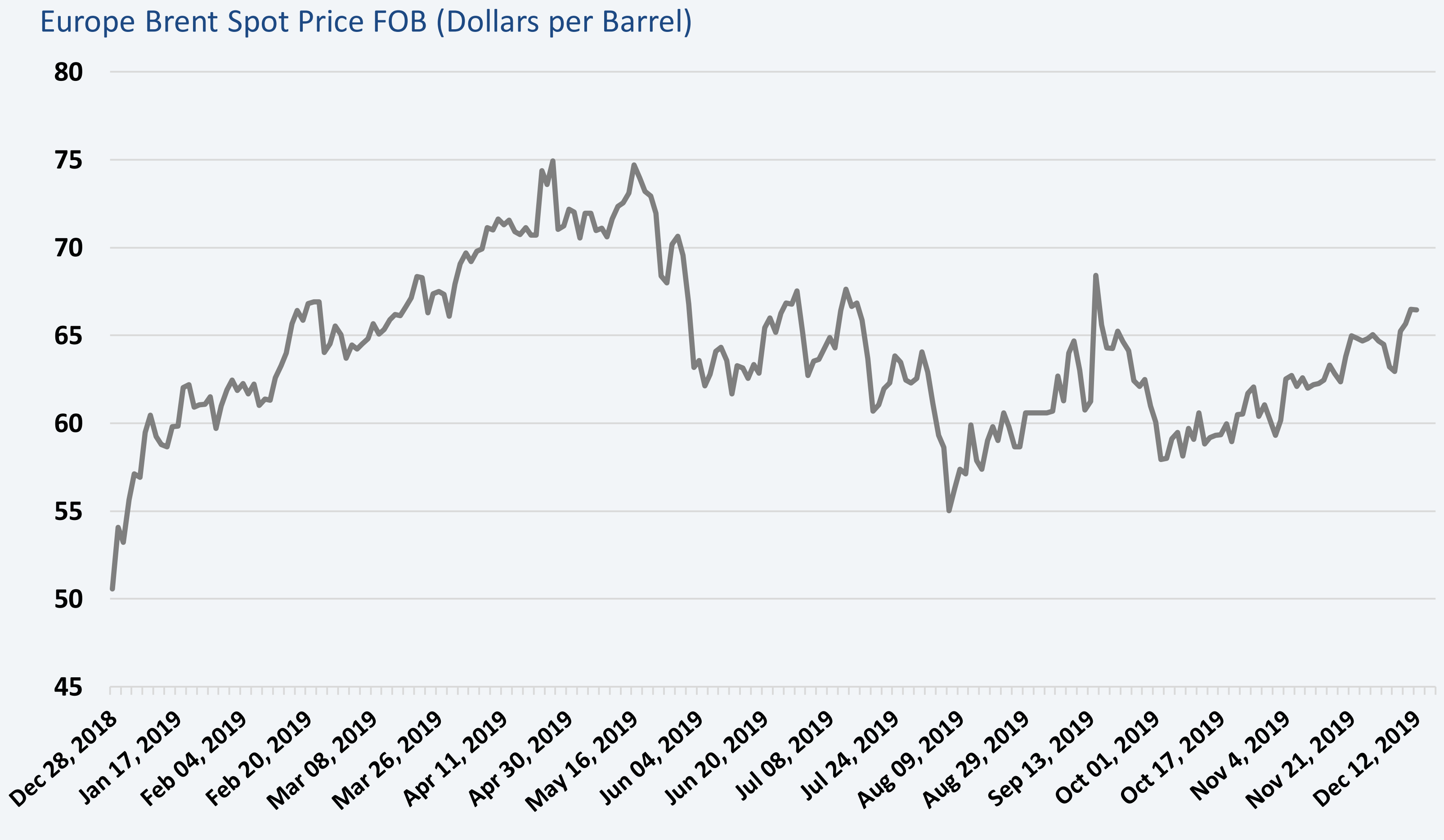
Global Growth slowed in 2019 but 2020 forecast appear optimistic



- In 2019, global GDP grew by 3% with growth led by China and other emerging and developing countries.
- Although growth projection for 2019 is an improvement over 2018, several factors limited overall GDP expansion in the year:
  - Slowdown in industrial output,
  - Growing tension between the US and China on Trade and Technology, and
  - Slowdown in demand in China were significant in affecting overall output.
- For 2020, global GDP growth is expected to average 3.4%.

Data Source: IMF

Oil price movement was volatile in 2019



- **Crude oil price started the year at US$53 per barrel (pb) and peaked at US$75pb in April. So far in 2019, crude oil price has averaged US$64.1 pb which is above the US$60 2019 FGN budget benchmark.**
- **But oil prices closed bearish in October due to 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 going into 2020.**
- **Average oil price for 2020 is likely to remain above the US$57 pb benchmark in the 2020 budget.**

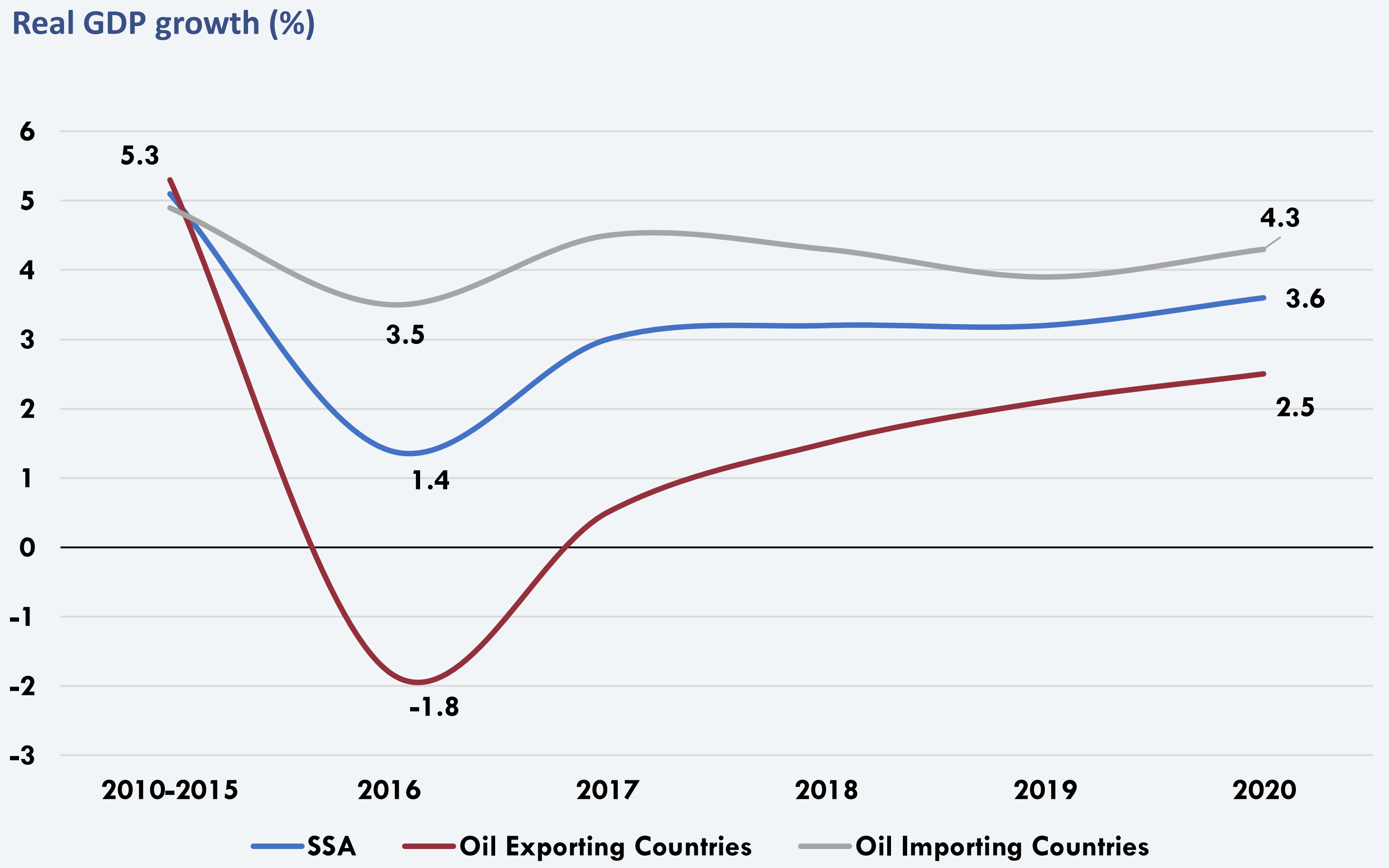
Data Source: US Energy Information Administration

Global Factors – Oil may steady but trade growth remains weak for 2020 Q1

- **Investment outlook for 2020 will remain cautious**
- **No major cuts in US rates**
- **US-China trade talks may lead to short term gains in commodity prices but the uncertainty of the outcome will continue to weigh heavily on global trade**
- **Extractive industry- for natural resource-dependent countries, crude oil and other mineral commodities will continue to influence economic performance.**

Sub-Saharan Africa Review

SSA's Growth driven by non-resource intensive countries



Data Source: IMF

- Africa has maintained a steady growth in output in the last 3 years with growth averaging 2.7% .
- The non resource intensive countries have recorded much higher growth during this period led by Ethiopia, Rwanda and Senegal.
- The oil exporting countries have experienced a weak growth trajectory, largely as a result of exposure to external fluctuations of commodity prices.
- Many of the oil exporting countries- Nigeria, Angola, slipped into a recession in 2016 and are still on the recovery path.
- Growth is expected to increase further to 3.6% in 2020 driven by the non-resource intensive countries.

Growth Drivers in SSA

- Expansion in demography.
- Rising consumer spends.
- Inflow of private investments (Cote d'Ivoire, Rwanda, Senegal).
- Productivity growth in the agricultural sector (Benin), and public investment (Mauritius, Rwanda).
- Extractive industry- for natural resource-dependent countries, crude oil and other mineral commodities continue to influence economic performance.
- Growth of key sectors such as telecommunication, Trade, financial services and construction.

Investing in Africa

- Top Countries: Nigeria, South Africa, Kenya, Ethiopia, Rwanda, Angola, Ghana, Ivory Coast and Senegal

- Countries for large investment: Nigeria, South Africa, Kenya, Ethiopia, Angola, Mozambique

- Few Sectors dominate large ticket investments : Oil & Gas industrialisation (Mozambique, Nigeria, Ethiopia, Ghana) ; Industrial Park (Ethiopia); Infrastructure – mostly by Chinese state-owned entities-Ports, Railways (several countries across the region)

- Opportunities exist in many sectors: logistics, Banking & Technology, Telecommunications, Industrial real estate, Education and Healthcare

SECTION 03

The Nigerian Economy in 2019

Economic Snapshot: Nigeria in 2019

209million
Population (2019est.)

US$493billion
GDP- 2019est.

2.3%
GDP Growth (2019est.)

11.4%
Average inflation rate

360N/US$
Exchange Rate

10%
Average 91-day Tbill Rate (Jan-Nov)

US$84billion
Total Public Debt (June 2019)

US$19.7billion
Foreign Investment Inflow (Jan-Sept)

US$43.2billion
Average External Reserves (Jan-Dec)

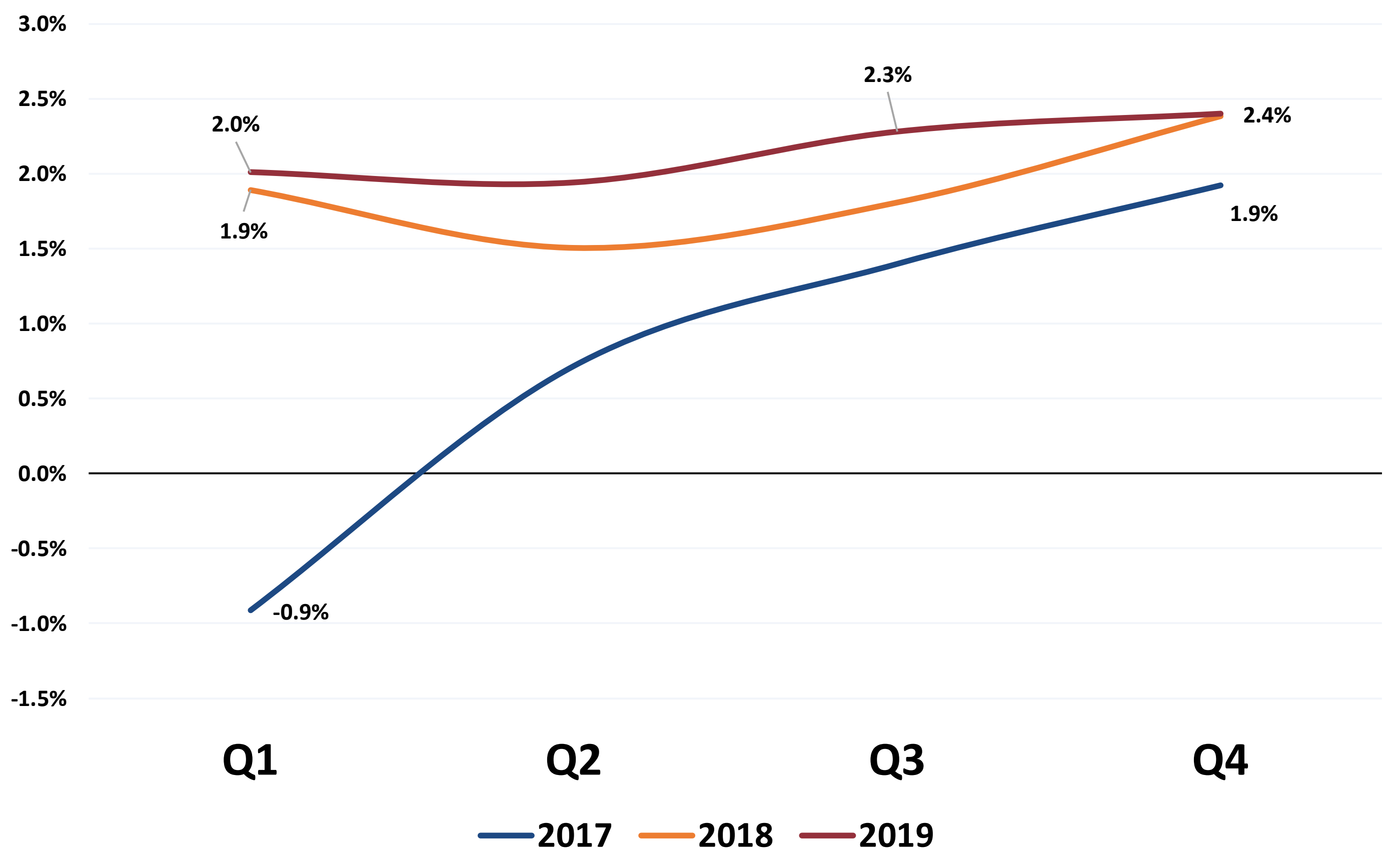
13.5%
Monetary Policy Rate

fsdh RESEARCH

Data Source: Various Sources

Slow economic recovery continued in 2019

Nigeria's GDP Growth Rate

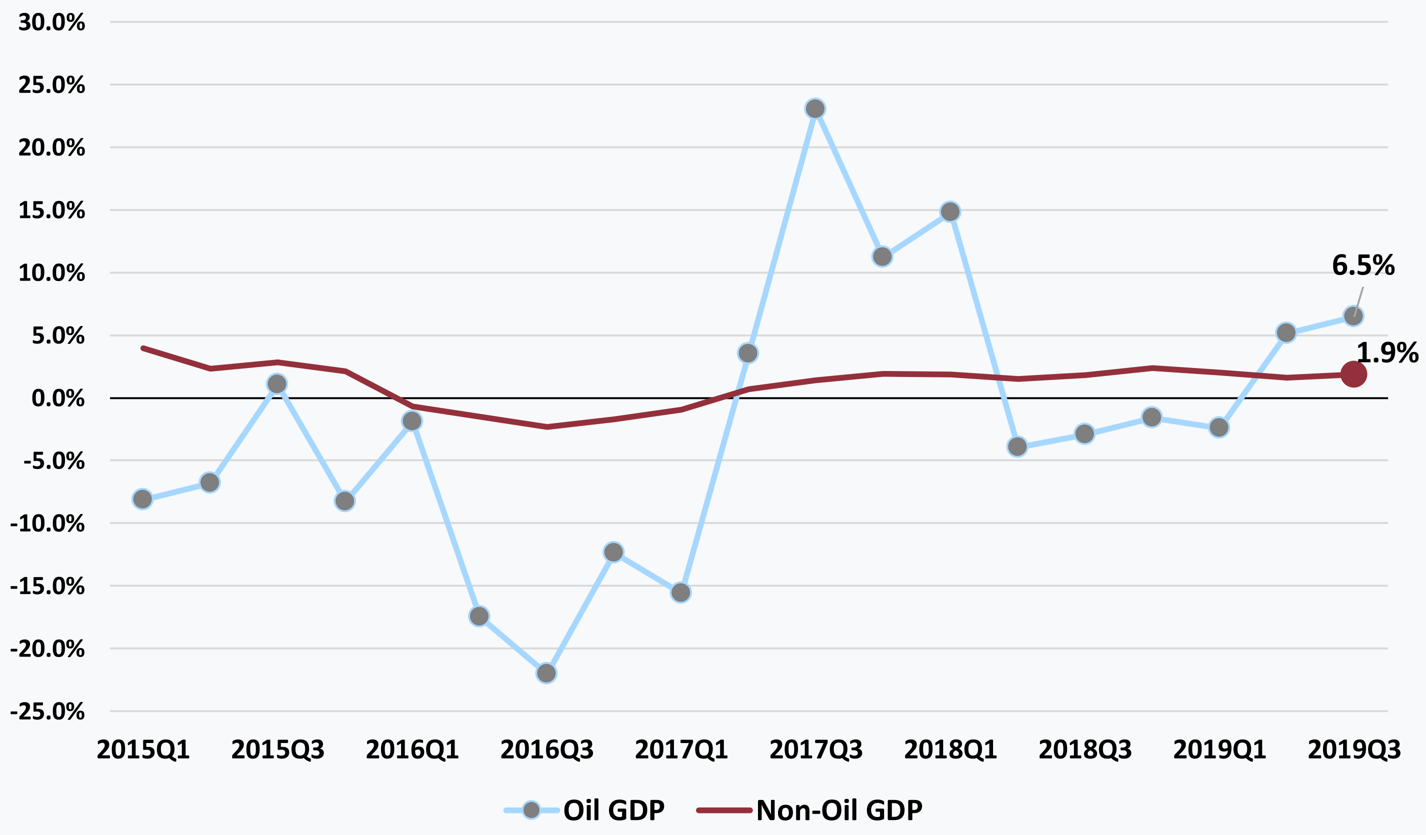


Data Source: National Bureau of Statistics

- **The Nigerian economy continues to improve; albeit on a slow growth trajectory.**
- **Real GDP expanded by 2.3% in the third quarter of 2019. This represents the second highest quarterly GDP growth since 2015.**
- **Growth is expected to average 2.3% in 2019. This is also the highest annual growth rate since 2015.**
- **The Oil sector continues to influence overall GDP growth. The sector grew by 6.5% in the third quarter, largely due to improvement in crude oil output.**
- **The Non-oil sector grew by 1.9% due to slow growth of major sectors like Manufacturing as well as decline of key sectors such as Trade and Real Estate.**

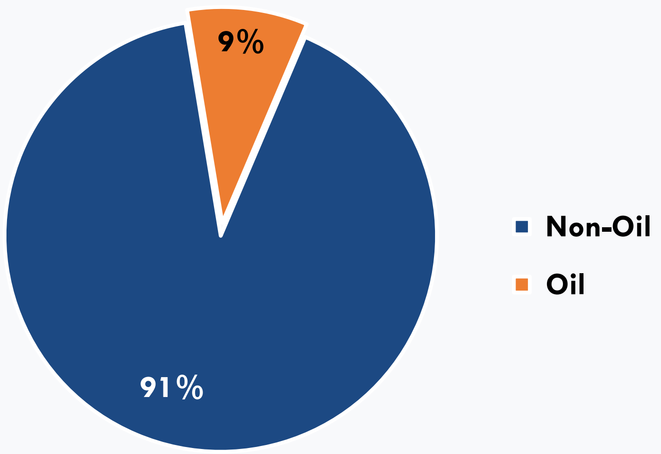
Oil GDP recovers, pulls overall output in 2019

Growth of Oil & Non-Oil GDP



Data Source: National Bureau of Statistics

Share of Oil & Non-Oil GDP in 2019Q1-Q3

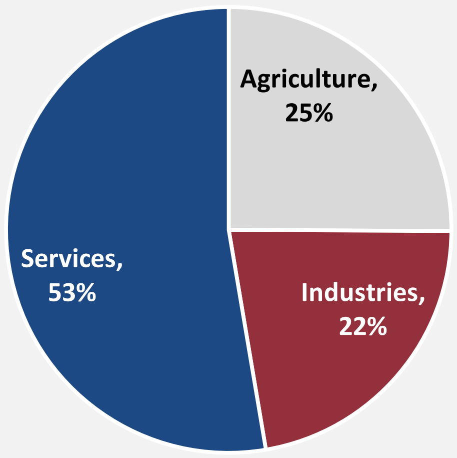


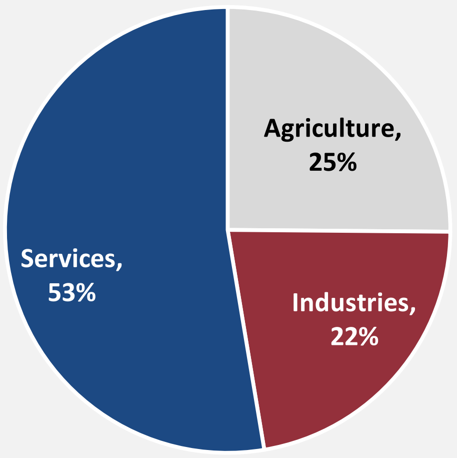
- **In the last two quarters of 2019, the oil sector expanded faster than the non-oil sector.**
- **Expansion in the oil sector is mainly due to improvement in crude oil production.**
- **Oil sector's share of the economy stood at 9% in the first nine months of 2019.**
- **This share is expected to remain the same in 2020.**

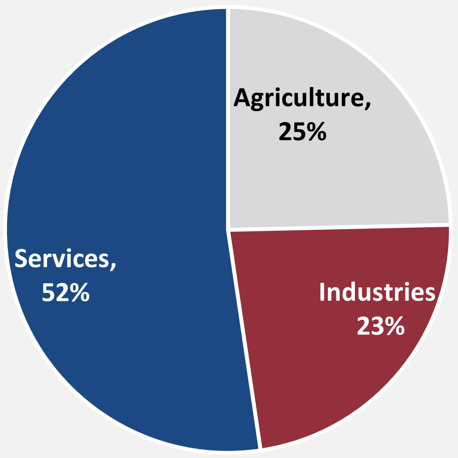
fsdh RESEARCH

No major structural change in the economy in the last 3 years

2017	2018	2019Q1-Q3





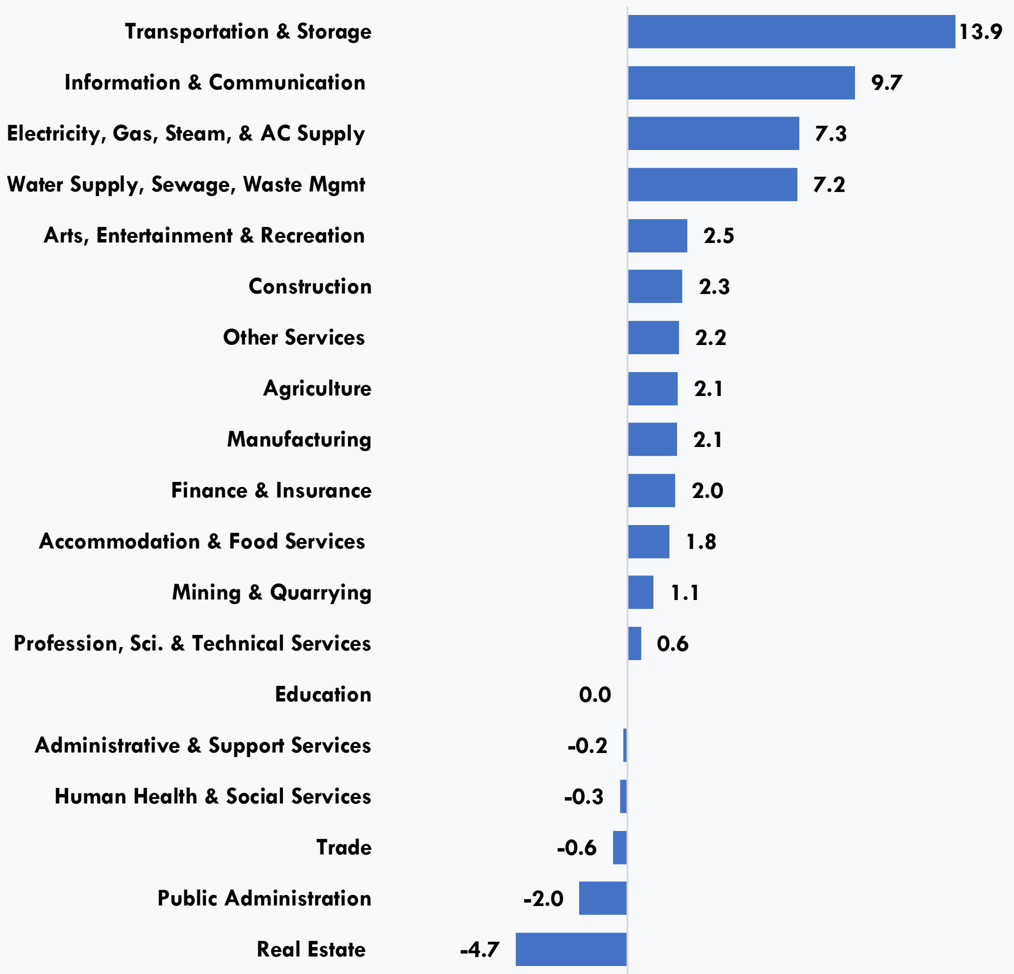


- **Over the last 3 years, the share of the economy has remained the same.**
- **Within Agriculture, crop production accounts for 90% of the sector's output. In Mining and Quarrying, crude oil accounts for 98% of total output. Manufacturing accounts for 9% of total GDP and 40% of industrial GDP.**
- **The focus for 2020 should be to accelerate growth and restructure the economy in favour of the industrial sector, particularly manufacturing.**

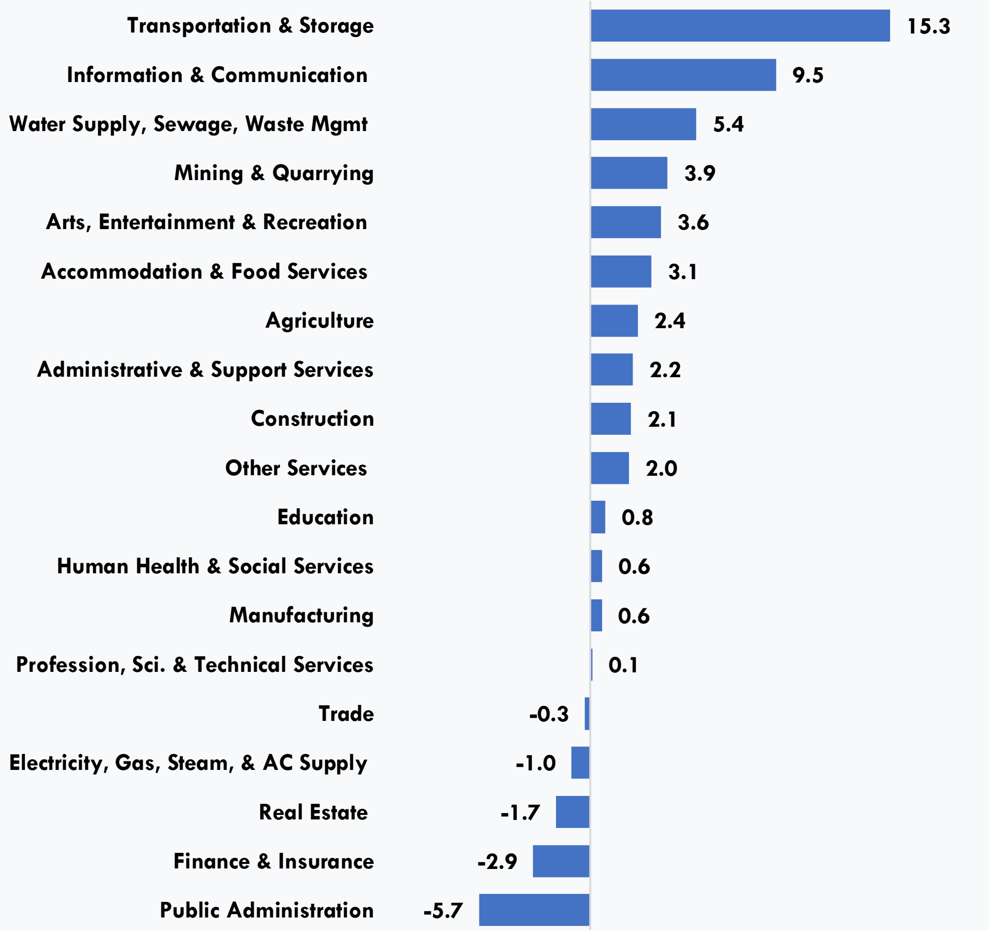
Data Source: National Bureau of Statistics

Fast growing sectors/declining sectors (%)

2018



2019Q1-Q3

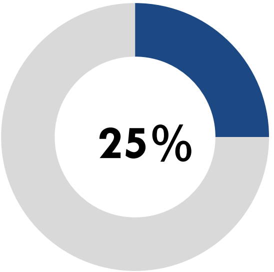


In 2019, four sectors retained their spots among the five fastest growing sectors. Mining & Quarrying made a new entry into the top five. Electricity dropped out. From the bottom, Trade, Real Estate and Public administration continue to underperform.

fsdh RESEARCH

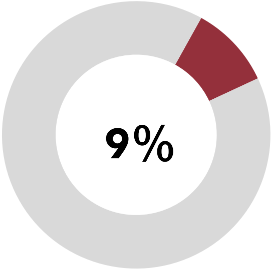
Data Source: National Bureau of Statistics

Key growth drivers and opportunity areas



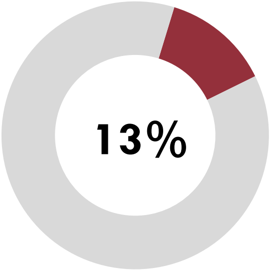
Agriculture

Accounts for 25% of GDP and grew by an average of 2.4% from 2019Q1-Q3. Major opportunity areas include crop production (rice, maize, cassava), livestock and fishery.



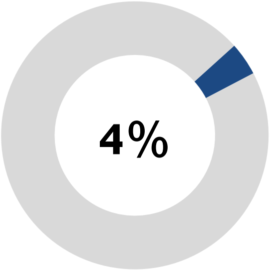
Manufacturing

The sector accounts for 9% of GDP and grew by 0.6% in 2019Q1-Q3. Key growth drivers include food & beverage and cement. Agro-processing has huge untapped potential.



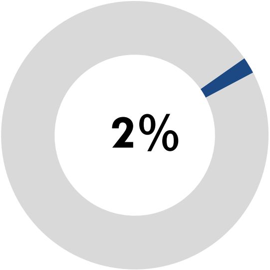
ICT

ICT's share of the economy is 13%. The sector expanded by 10% in 2019 (Q1-Q3) and is one of the fastest growing sectors. Growth of the sector is driven by activities in the Telecoms subsector.



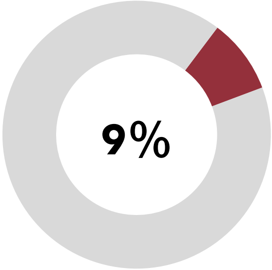
Construction

Construction accounts for 4% of GDP. With a proposed N10.3 trillion FGN 2020 budget, this is expected to impact the sector positively.



Transport & Storage

Although the sector accounts for 2% of GDP, it was the fastest growing sector in 2019Q1-Q3. The sector has experienced significant inflow of investments in the last three years (Opay, Bolt, etc.), leveraging technology.



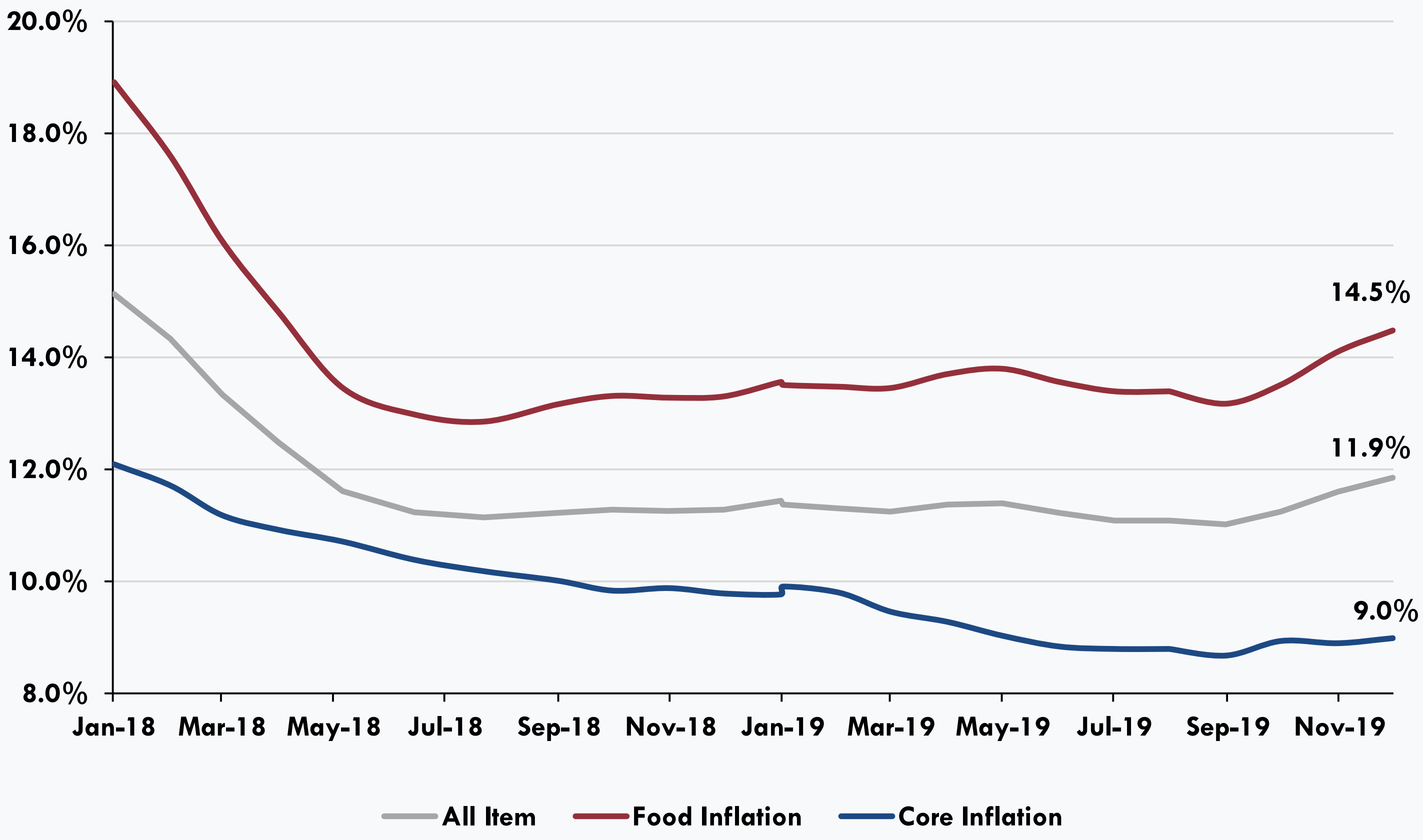
Mining & Quarrying

Mining and Quarrying accounts for 9% of GDP and is the fourth fastest growing sector in 2019Q1-Q3. Growth in the sector was driven by increased oil output.

Data Source: National Bureau of Statistics

Inflation moderates in 2019 but inflation pressures heighten towards year-end

Nigeria's Average Inflation Rate



Data Source: National Bureau of Statistics

- **From January to November, Inflation rate has averaged 11.34%, lower than 12.2% recorded in full year 2018.**
- **Inflation moderated within the first seven months of 2019. The policy to close all land borders which was implemented from August led to an increase in prices.**
- **Inflation rate rose from 11.1% in July to 11.6% in October and 11.85% in November.**
- **Increase in inflation was triggered by higher prices of food items such as Rice, Bread and cereals, Oils and fats, Meat, Potatoes, Yam and other tubers, Fish and Vegetables.**
- **Inflation is expected to average 11.4% in 2019 full year.**
- **Looking forward, inflationary pressures stem from higher government spending, potential tax increase and the closure of the land borders.**

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 2020.

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.
- The closure is expected to have further implications on food prices and core inflation.

Inflation Pressure Points in 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 possible introduction of 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.

Closure of Land Borders

- 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.

- In November 2019, the Nigerian government engaged with officials of Niger and Benin Republic on the land border closure.

- The government prescribed some conditions that must be met by the two countries before the land borders would be opened. Some of the conditions include:
    - Compliance with rule of origin
    - Compliance with agreed packaging standards and rules
    - Dismantling of warehouses around the borders.

- The closure, according to the Director General of Nigeria Customs Service, is expected to last till January 31st 2020, pending compliance with the above conditions.

- This policy stance could be viewed as a setback in promoting free trade in Africa, especially given Nigeria's recent commitment to the AfCFTA agreement.

What are the impacts of the closure of land borders?

Positive Impacts

- Rice production increases: Closure of land borders curbed smuggling and was an incentive for local rice producers to increase output.
- Reduction of Smuggling: A significant number of trade across the land borders are informal and some of the goods traded are illegal.
- Government Revenue: According to the Customs Service, land border closure led to an increase in government revenue as importers traded via the seaports.
- Better Trade: Nigerian government has held meetings with officials of Niger and Benin Republic and proposed conditions that these countries must adhere to.

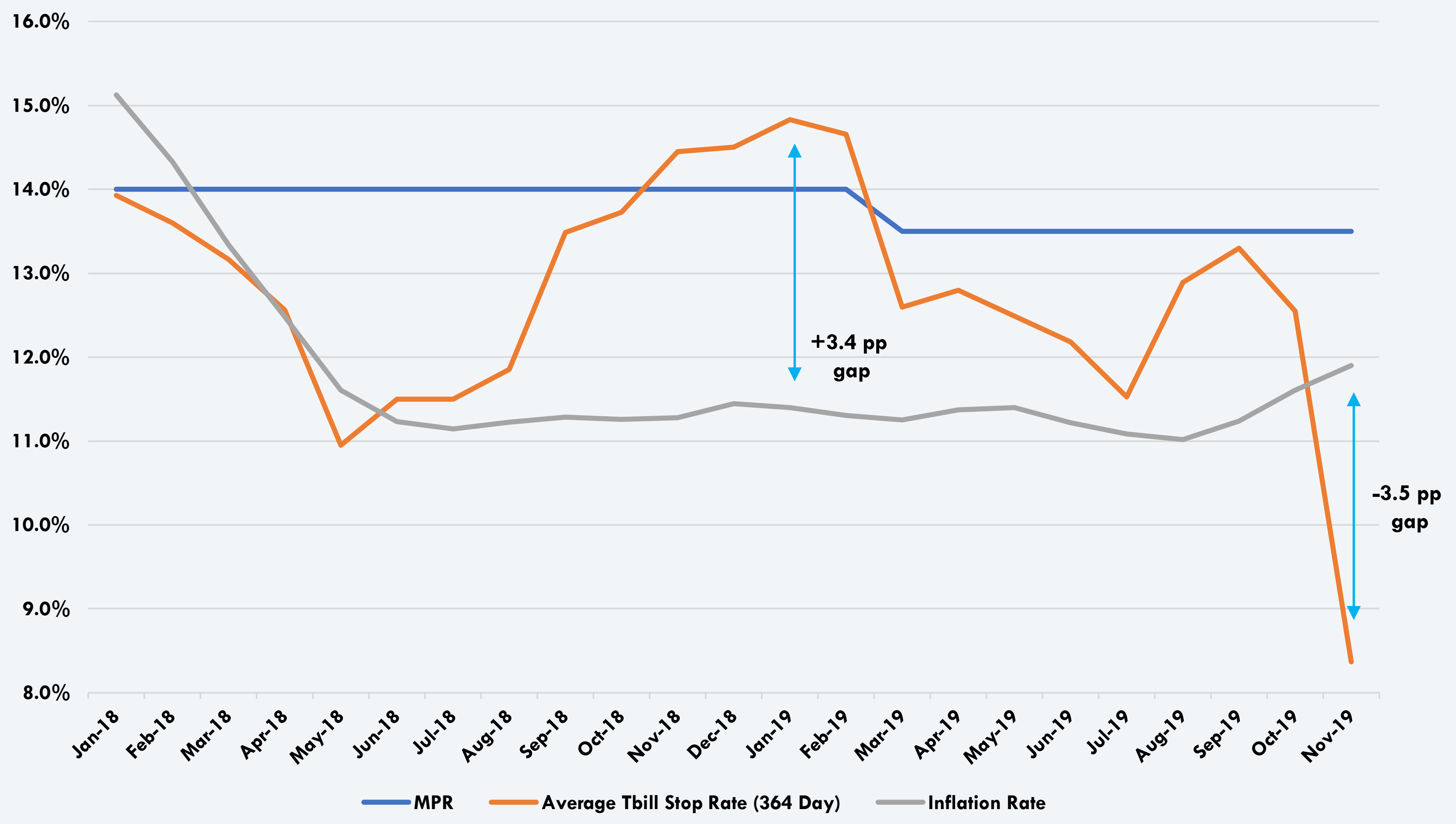
Negative Impacts

- Decline in Exports: Some producers in Kano, Aba and other parts of the country that export to neighbouring countries were affected.
- Increase in price of rice & poultry products: Rice producers took advantage of the market gap to increase prices and make abnormal profits.
- Increase in food Inflation: The rise in overall inflation rate is connected with increase in the price of rice, given that it is a staple food in Nigeria.
- Constrained Choices: Consumers in Nigeria are forced to purchase local rice at higher prices and relatively lower quality.

Closure of land borders was largely responsible for the increase in inflation rate from 11.2% in September to 11.9% in November 2019. The price of 50kg bag of rice has increased significantly from N14,000 before the border closure to about N25,000 in October. Local producers of rice and other affected commodities continue to take advantage of the supply-demand gap to increase price.

Real Interest Rate enters negative in November

Real Interest Rate: Inflation vs Interest Rate



- Inflation rate has trended upward for two consecutive months to reach 11.9% in November.
- When compared with the MPR, upward movement in Inflation rate narrowed real interest rate margin to +1.6 percentage points (pp) in November from +2.5 in August.
- For the 364-day Treasury bill, real interest rate margin which was +3.4 percentage points in January 2019 fell to +0.9 in October and -3.5 in November owing to falling interest rates and rising inflation.
- The increase in inflation rate coupled with inflationary pressures are huge concerns for monetary authorities going into 2020.

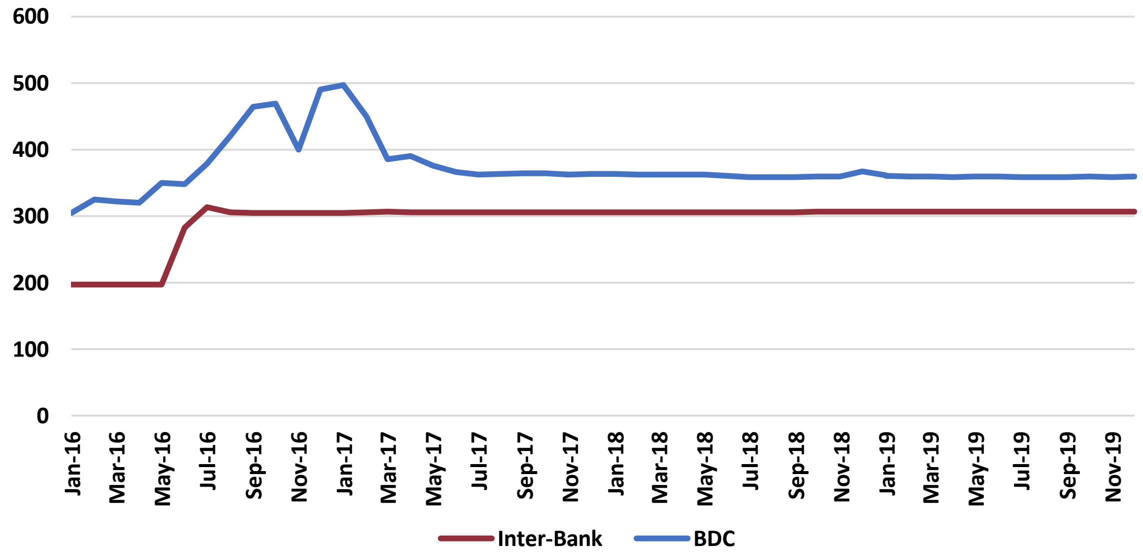
*pp - percentage points

FSDH RESEARCH

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

Exchange Rate remains stable at the expense of declining External Reserves

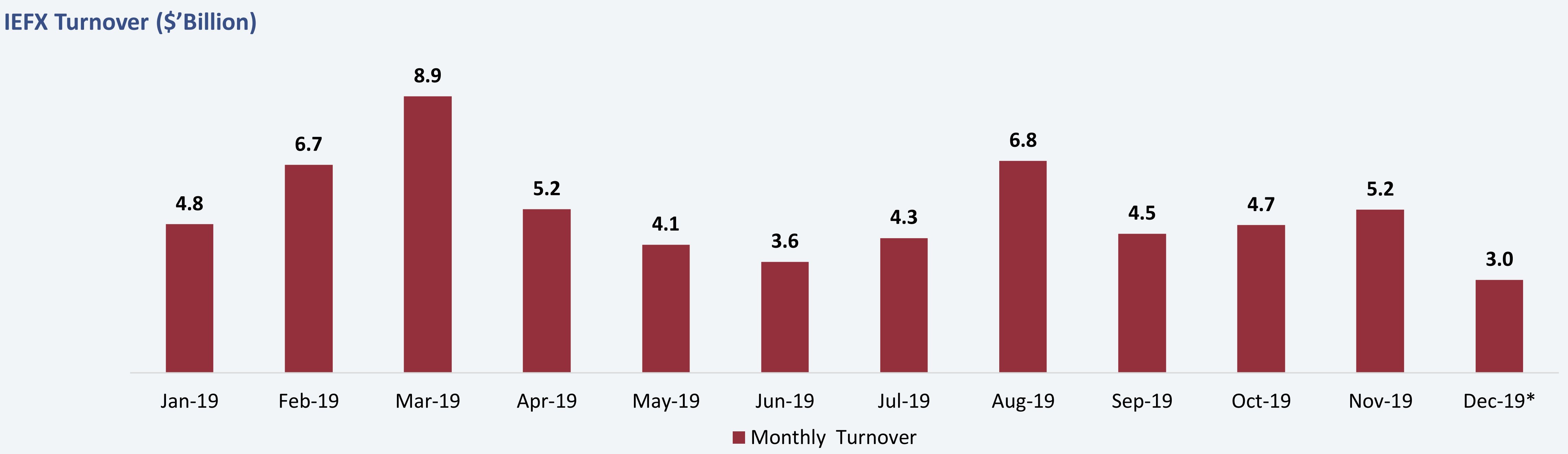
Exchange Rate (Naira per US$)



Data Source: CBN, FMDQ

- **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 November 2019, rates closed the month at N306 and N360.**
- **Relatively high oil prices and CBN interventions sustained stability in exchange rates.**
- **However, pressure on the Reserves is expected to translate into exchange rate fluctuations, especially in the parallel market.**

IEFX Turnover remained resilient in 2019



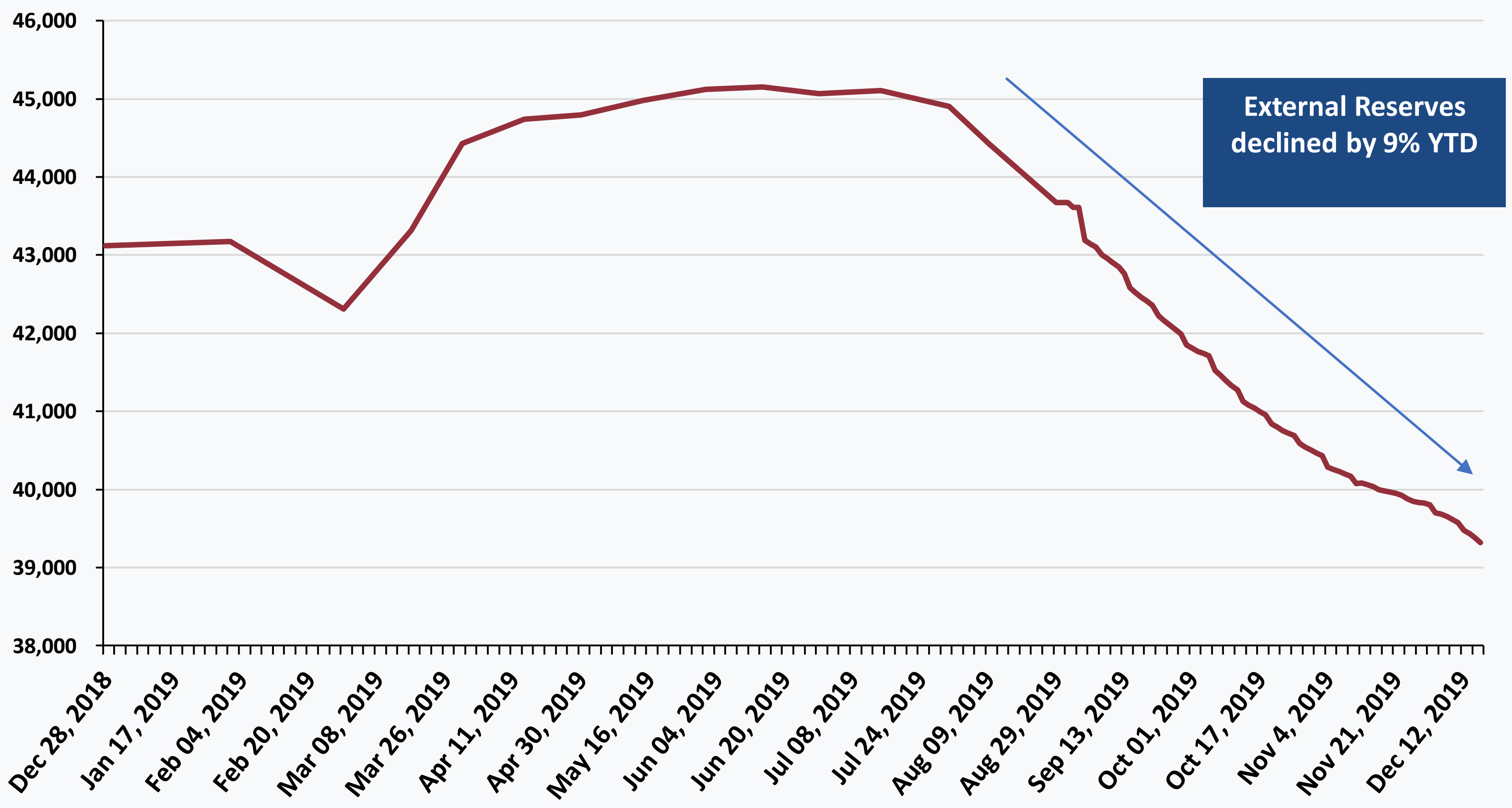
- **IEFX turnover in November rose by 10.5% to US$5.2 billion, relative to October (US$4.7 billion)**
- **As of December 13, 2019, annual turnover for 2019 was US$61.7 billion, surpassing FY2018 turnover of US$59.9 billion**
- **The FX market traded within a band of N362.5/US$ and N366.8/US$ during the year**
- **The CBN continued to intervene in the FX market, to ensure stability and allay investors' fears**
- **This is likely to continue in 2020 – however, the CBN would revisit its decision if reserves were to fall below $30 billion mark**

fsdh RESEARCH

*Data Source: FMDQ; * As at December 13 2019*

Gains in External Reserves were eroded in the later part of the year

Nigeria's External Reserves (US$ million)



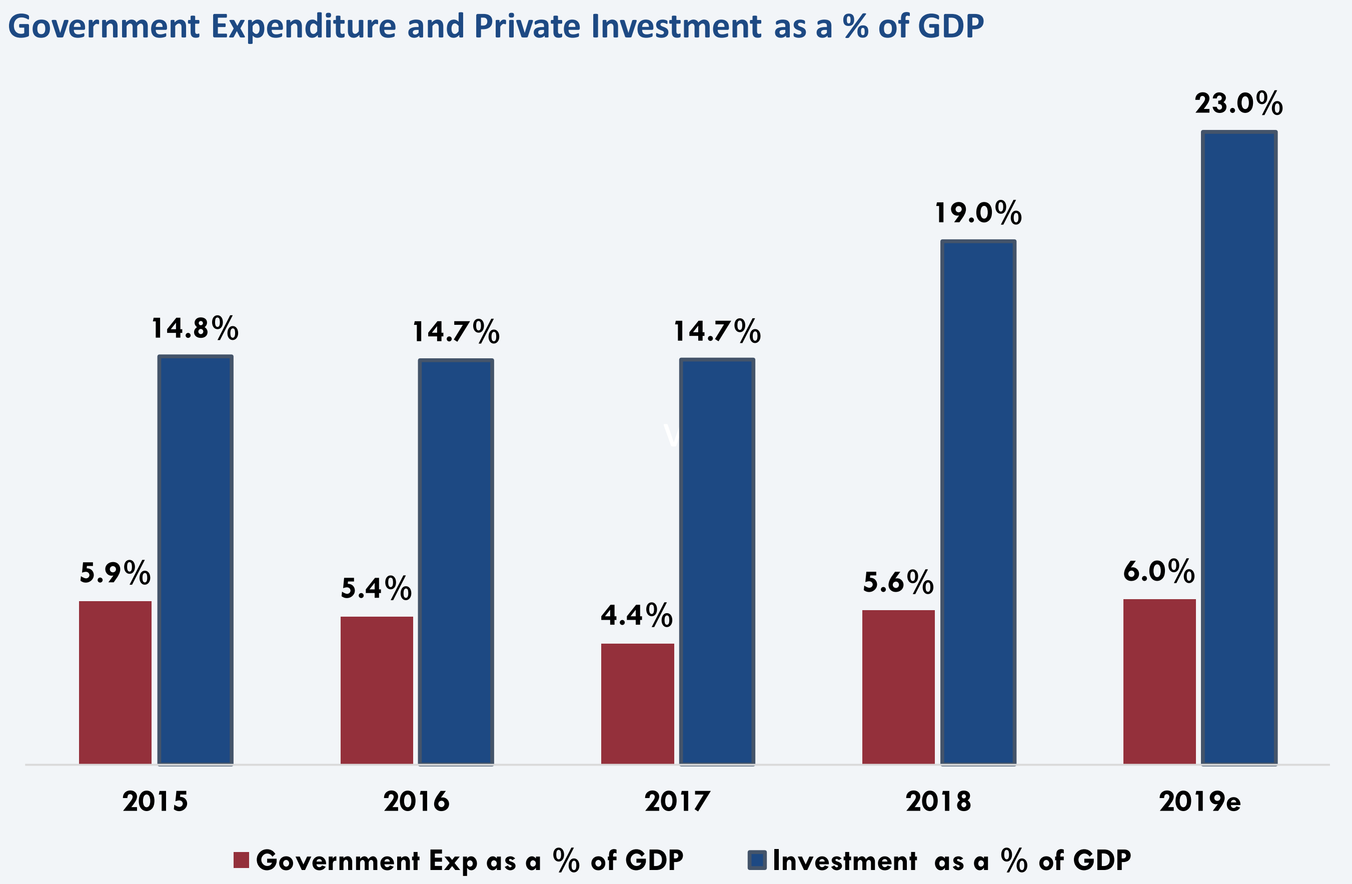
- **External Reserves reached a 23-month low at US$39.3 billion on December 12, 2019.**
- **Reserves have experienced a 9% year-to-date decline (Jan-Dec 2019) and is currently below the US$40 billion mark.**
- **The decline in Reserves is largely as a result of**
  - **FX market interventions by the 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 and improved oil production could slow down the decline in Reserves in 2020.**
- **Further pressure on the reserves would mean the likelihood of a devaluation in 2020 as reserves approach the US$30 billion mark.**

Data Source: CBN

SECTION 04

Nigeria’s Investment Climate

Share of Private Investment in GDP increased in 2019Q1



- 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.

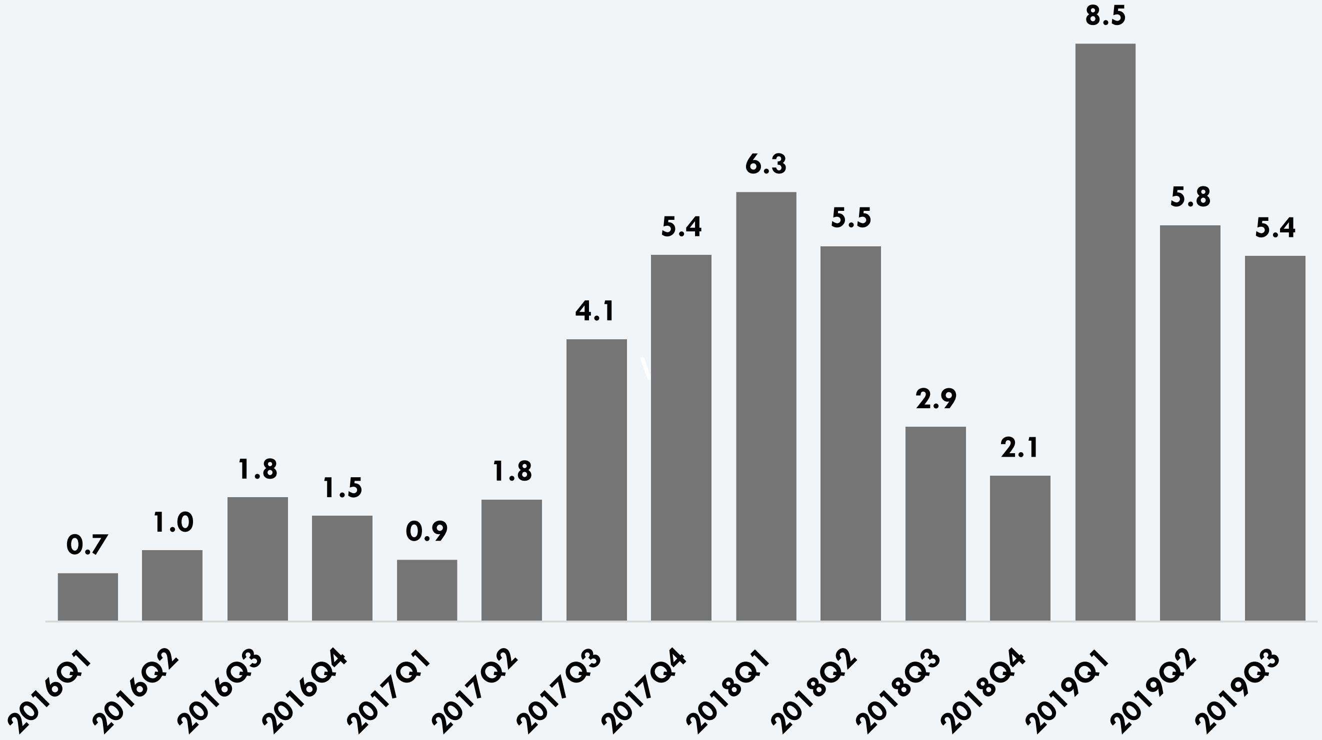
- Government expenditure accounted for 5.6% of GDP in 2019Q1.

Data Source: National Bureau of Statistics

SECTION 04

Capital Inflows were higher in 2019, but maintained downward trend from Q2

Nigeria’s Foreign Investment Inflows in US$ billion



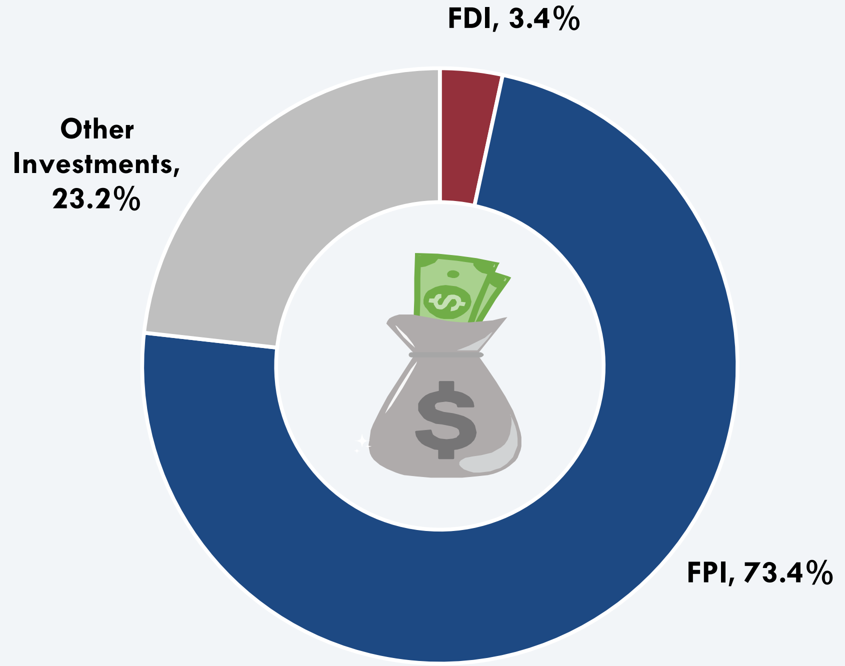
Data Source: National Bureau of Statistics

Total Investment Inflows hit US$19.7bn as at 2019Q3

1. As we predicted earlier in the year, total investment inflows as at 2019Q3 was already higher than the US$16.8 billion achieved in full-year 2018.
2. Growth in Investment Inflows was driven by portfolio investment as investors took advantage of the high interest rate in the early part of the year.
3. Despite the impressive performance in 2019 relative to the previous year, foreign investment inflow continued its downward trend on a quarter-on-quarter basis.
4. The inflow of US$5.4 billion in 2019Q3 marked the lowest so far in 2019 but was 88% higher than 2018Q3.
5. The decline experienced on a quarter by quarter basis was largely as a result of reduced confidence on the economy and the fall in interest rate during the year.

FPI continues to dominate total Investment Inflows

Breakdown of Foreign Investment Inflows - US$19.7 billion (2019 Q1 – Q3)



FPI totaled US$14.4 billion in the first three quarters of 2019. This represents the highest inflow since the recession in 2016. Money market instruments accounted for 80% of FPI inflows.

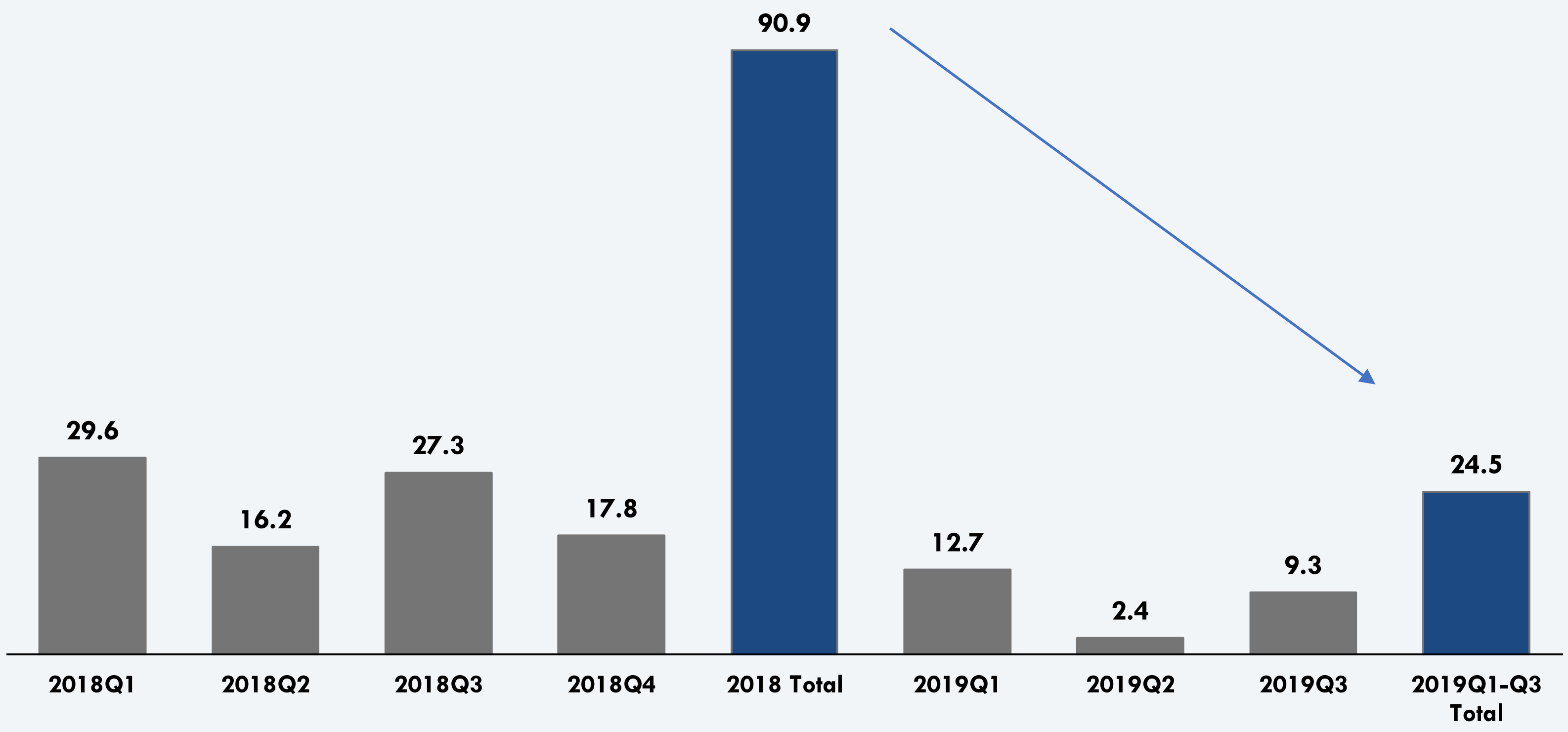
FDI inflows stood at US$666 million from Jan – Sept 2019. This represents 3.4% of total inflows. Nigeria's FDI inflows in 2019 will remain below US$1 billion, far below that of peer countries.

Other Investments has maintained an upward momentum in the last three quarters. It increased to US$4.6 billion in the first nine months of the year. Loans accounted for 75% of Other Investments.

Data Source: National Bureau of Statistics

Investment Announcements decline in 2019

Investment Announcements in Nigeria (US$ Billion)



- Investment announcement for 2019 Q1 – Q3 stood at US$24.5 billion targeting 56 projects.
- Overall investment announced in 2019 will significantly fall below the US$90.9 billion achieved in 2018.
- Uncertainty in the policy environment is one major factor for the decline in announcements.
- Mining & Quarrying continues to dominate, accounting for 88% of total investment announced from 2019Q1 to Q3.
- Manufacturing accounted for 9%.
- Significant efforts are required to ensure transition of announcements into actual investments.

fsdh RESEARCH

Data Source: Nigerian Investment Promotion Council

Investment announcements by Sector (Jan to Sept. 2019)

Mining & Quarrying dominates

- Announced investments mainly targeted the oil and gas industry- offshore investments.
- As the economy recovers, some key sectors to watch include Oil and Gas, Solid Minerals, ICT, Entertainments, Retail Trade and Manufacturing- textiles, food and beverage and agro-processing.

Sector	Amount of Announcements – Jan – Sept 2019 (US$ billion)	Note
Mining & Quarrying	21.4	The sector accounted for 88% of total investment announced. It had a share of 9% of GDP and was the fourth fastest growing sector in 2019Q1-Q3. Activities in the sector is dominated by Crude Petroleum and Natural Gas. Nigeria has massive untapped potential in the Gas and Solid Minerals subsectors.
Manufacturing	2.2	Manufacturing sector accounted for 9% of GDP in 2019Q1-Q3. The sector grew by 0.6% in in the first nine months of 2019. Major opportunity areas include food and beverage, textiles, agro-processing sectors.
Financing and Insurance	0.3	Finance and Insurance accounted for 3% of GDP and remains a key enabler of growth across major sectors. Banking, micro-insurance, financial services are opportunity areas.
Information and Communications	0.3	This sector accounted for 9% of Nigeria's GDP in 2019Q1-Q3 and is dominated by Telecommunications, which accounted for 73% of its output. Fast growing subsectors include Outsourcing, Technology, Motion Pictures, Sound recording and Music production.
Others	0.3	
Total	24.4	

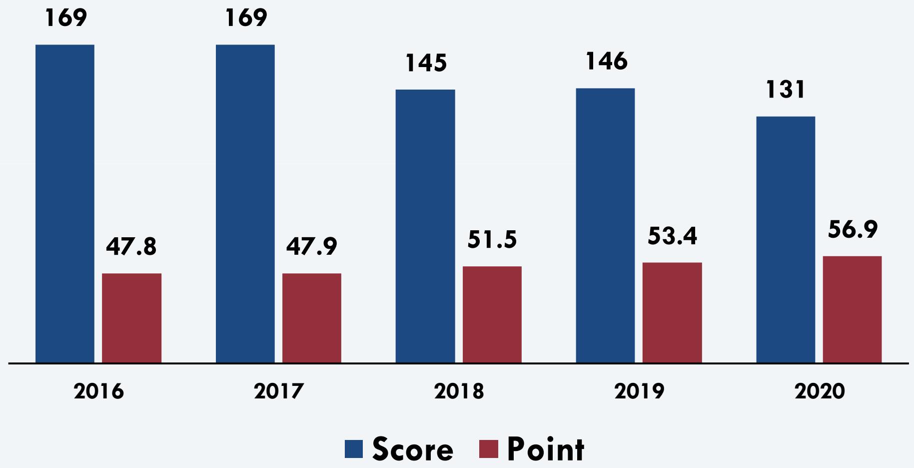
Data Source: Nigerian investment Promotion Commission

fsdh RESEARCH

Efforts in improving the business climate in 2019 paid-off

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 affect scores on trading across borders, weighing on foreign investors' perception and investments.

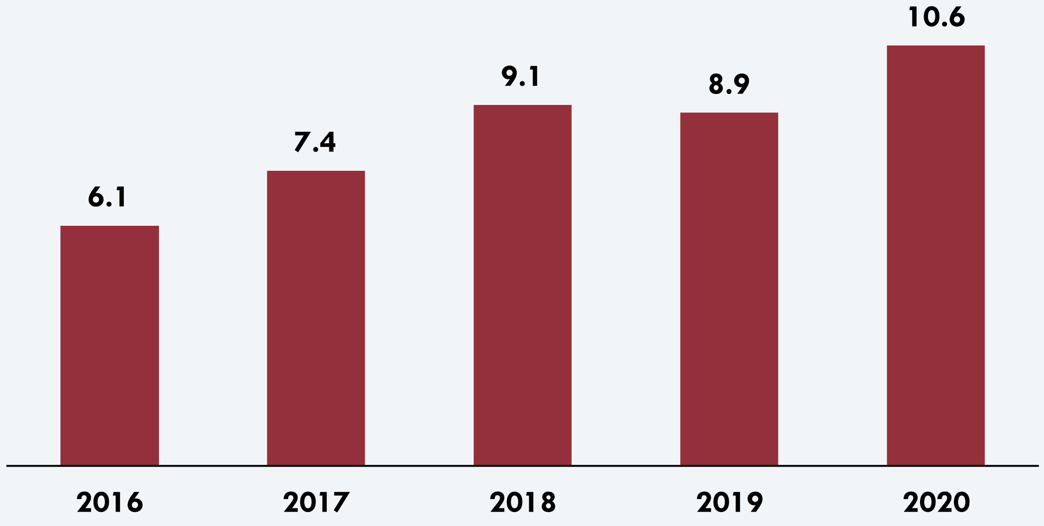
Investment Outlook for 2020

- FPI will continue to drive investment inflows into Nigeria. Money market instruments will continue to account for the largest share. However, declining External Reserve would limit the volume of foreign investment inflows into the country as investors would be wary about stability of rates and ease of exit.
- The restriction of non-bank financial institutions in OMO operations has led to a decline in yields of short-term government securities. Yields are expected to remain low for the most part of 2020.
- Change in OMO policy is forcing pension funds back into blue chips …we suspect pension funds are largely focused on high-yielding banks
- More activity in the equities market is likely in 2020 as the T-bill yield collapse has forced a fresh look at equities
- 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.
- 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.

Fiscal and Monetary Policies

President signs N10.6 Trillion Budget for 2020

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%
- Inflation Rate- 10.8%
- Fiscal Deficit – N2.28 trillion

- On Tuesday December 17, the President signed into law the 2020 appropriation bill.
- The budget size was N10.6 trillion, 19% higher than the approved 2019 budget of N8.9 trillion. This represents the highest ever spending plan of the Federal Government.
- This consist of Non Debt Recurrent expenditure of 46%, Debt Services of 26%, Capital Expenditure of 23% 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 N2.28 trillion in 2020. The deficit will be funded largely by domestic and external borrowings.

Data Source: Budget Office of the Federation

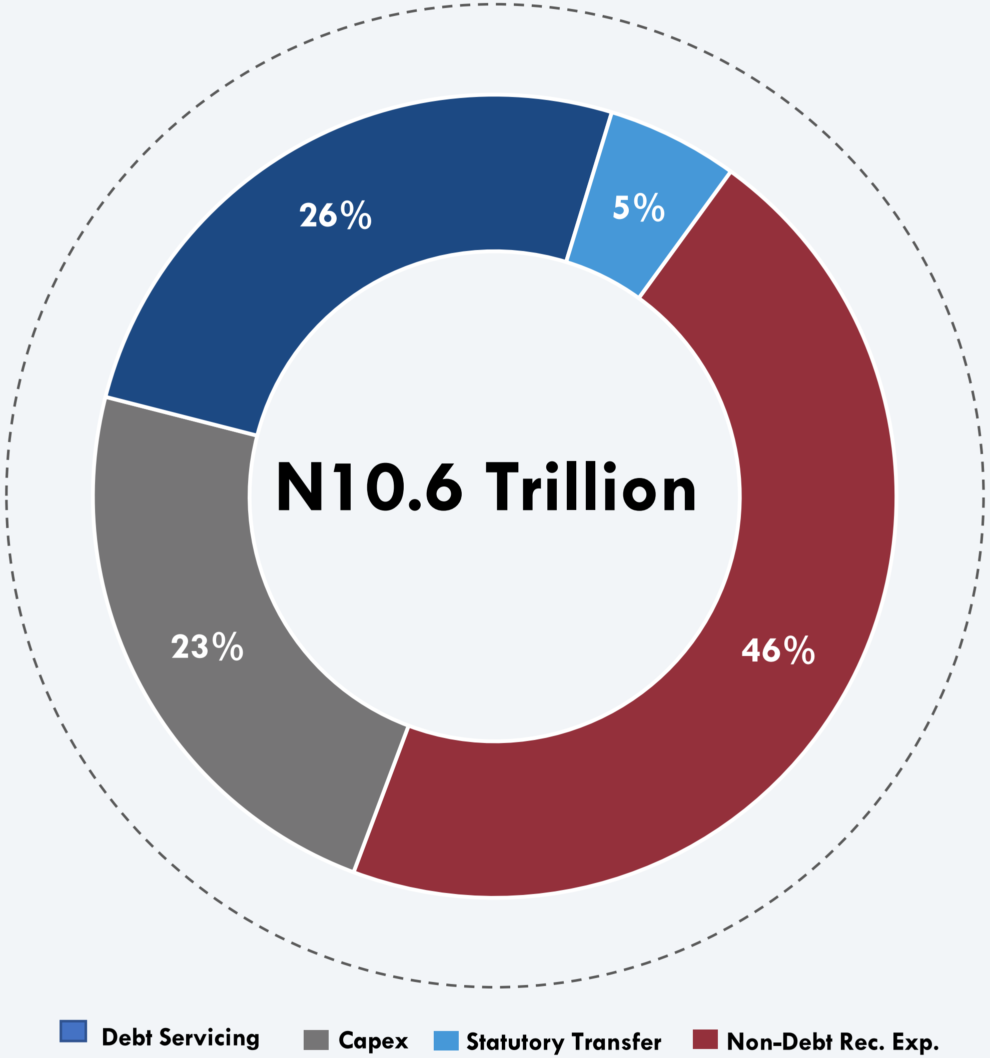
2020 Budget Breakdown

Debt Servicing
N2.7 trillion

Accounting for 26% of total expenditure, Debt Servicing is 17.4% higher than N2.3 trillion approved in 2019 budget. 74% of the N2.7 trillion will be used to service domestic debts

Capital Expenditure
N2.5 trillion

Capex accounts for 23% of total budget. Early budget passage would result in higher implementation rate of capex



Statutory Transfer
N561 billion

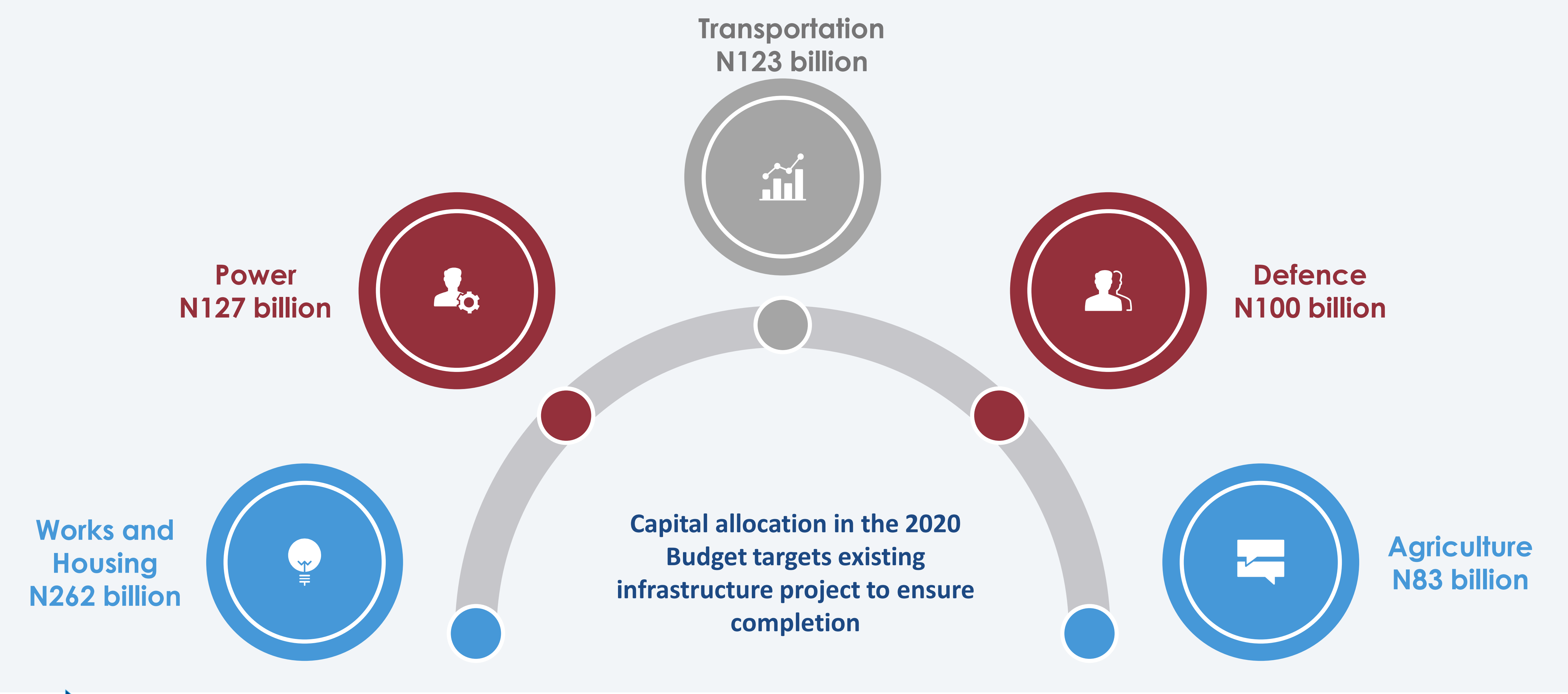
Statutory Transfer accounts for 5% of the proposed budget. It increased by 11% in the proposed budget to N557 billion

Non-Debt Recurrent
N4.8 trillion

Non-Debt Recurrent Expenditure accounted for 46% of total spending in the 2020 budget. Personnel and pension costs stood at N3.6 trillion representing 74% of non-debt recurrent expenditure, arising from the agreed minimum wage

Data Source: Budget Office of the Federation

Key Sectoral Capital Allocations in the 2020 Budget



Data for capital allocations as presented prior to the signing of the budget

Data Source: Budget Office of the Federation

The 2020 Budget and the Economy

- Early presentation of the 2020 appropriate bill is a welcomed development. The bill was signed into law in December before the budget year began and this could result in improved budget performance, particularly capital budget.

- The 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. Crude oil revenue 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 achieve revenue projections, the federal government will implement an increase in VAT and other forms of taxes which could trigger higher prices 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 just above 2%.

The 2020 Budget and the Economy

- We note the significant increase in recurrent expenditure in the budget. 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.

- 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, we expect that only about 60% - 65% of capital budget will be implemented i.e. about N1.6 trillion would be injected into the economy for capital projects in 2020.

- 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.

- Other forms of raising revenue such as the sale of dormant government assets should be considered.

- The Budget deficit of N2.28 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.

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.

Monetary Policy Review and Outlook

The CBN Monetary Policy Committee (MPC) held six meetings in 2019. In its second meeting in March, it reduced Monetary Policy Rate from 14% to 13.5% citing the need to support growth amidst declining inflation.

At the last meeting held in November, the Committee took the following decision:

- 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:

- Weak outlook on crude oil price
- Increased inflation rate in October – 11.6%
- Sustained economic growth in 2019Q3- 2.3%
- Expansion of the manufacturing sector in 2019Q3
- Pressure on external reserves – US$ 39.9 billion as at Nov 25th
- Need to improve fiscal buffers and efficiency in public expenditure
- Improved growth of credit to the private sector.

Our Expectation from next MPC in 2020

- The MPC will maintain its wait and see approach given inflation expectations and the need to stabilize exchange rate and external reserves
- The CBN will remain very active outside the MPC; using monetary policy tools such as LDR, OMO, FX restrictions and interventions to stimulate lending to the real sector and propel economic growth.

Key Considerations for 2020

- High inflation expectation and market liquidity
- Declining external reserves
- Slower than expected GDP growth
- Foreign investment flows
- Crude oil output and revenue
- Quality of banking assets and capital adequacy
- Government spending plans

LDR policy increases loan growth but could raise NPLs in 2020

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%

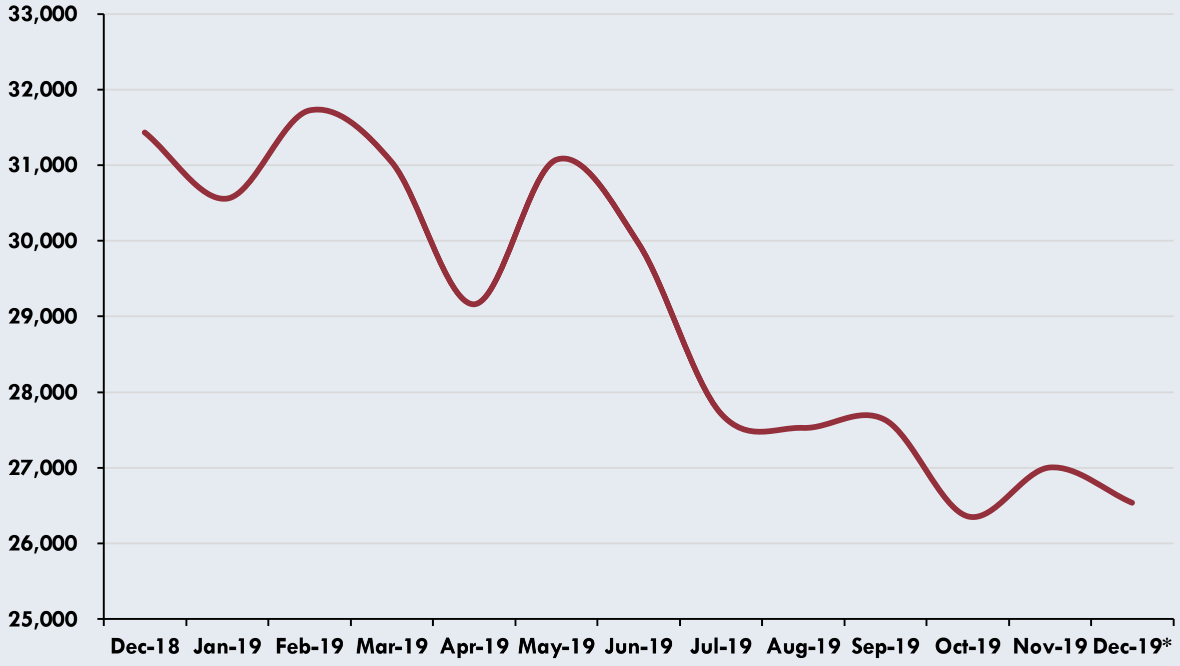
- Earlier in July, the CBN announced Loan to Deposit Ratio (LDR) target for all Deposit Money Banks (DMBs) at 60%.
- In September, LDR target was reviewed upwards from 60% to 65% and all DMBs are required to attain the minimum LDR of 65% by December 31, 2019. Priority areas include MSMEs, Retail, Mortgage 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 in 2020 when some of these loans become due.

SECTION 06

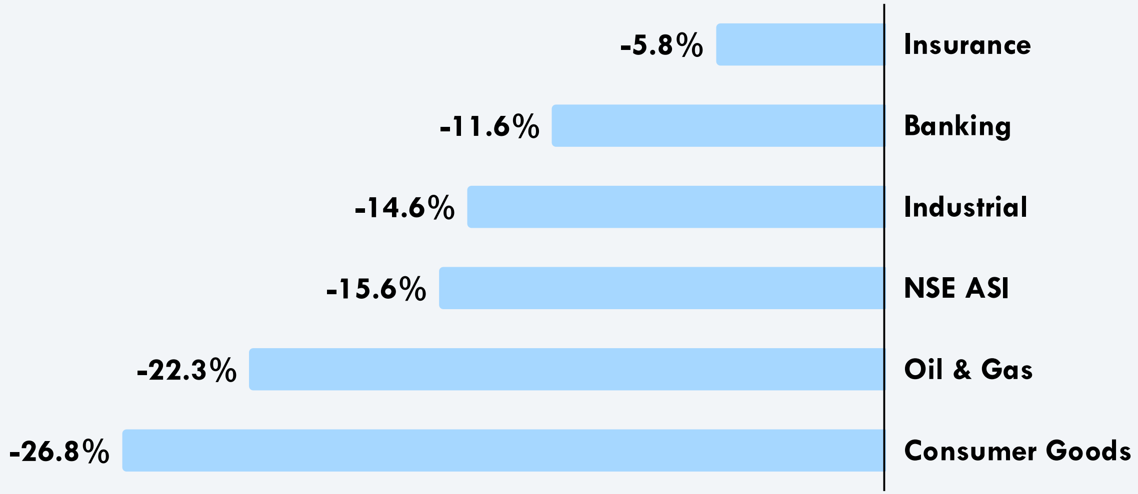
Capital & Money Market Performance

Capital Market Update

NSE All Share Index



Sector Performance (YTD)



- The Nigerian equities market has been on a bearish trend for the past 22 months with YTD loss at 15.6% as at December 13, 2019. The market experienced upsurge between January and February as well as April and May.
- Nigeria's equity market witnessed an improvement in November, as NSE ASI rose by 2.4%, compared to the previous month. Low yields in the fixed income market positively impacted the Nigerian stock market.

- As at Dec 13, the market had recorded 7 days of loss against 2 days of gains in the month. The performance of all sub-sector indices mirrors the NSE ASI, as all indices recorded negative growth (YTD).
- Consumer goods index led the decliners, losing more than a quarter of its value, while the insurance index lost 5.8%, as most insurance stocks were already trading at rock-bottom prices.

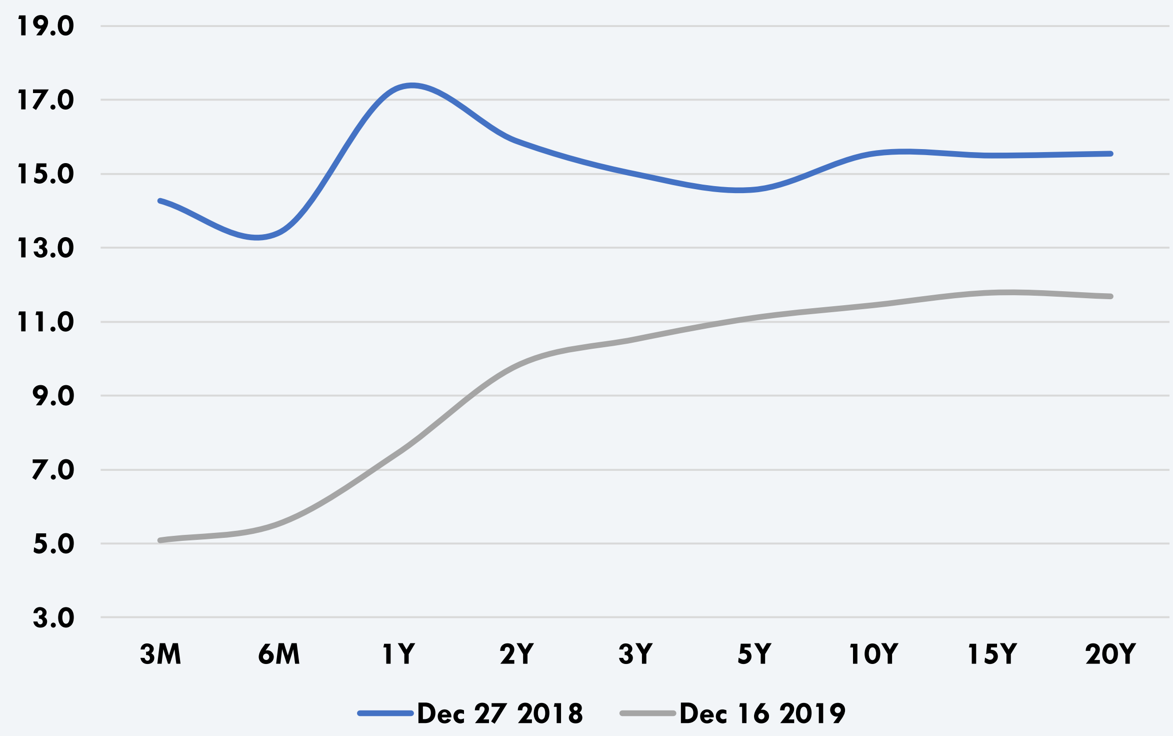
Data Source: NSE

SECTION 06

Fixed Income Update

Yields decline significantly across all tenors

Yields on securities (%)



- The year 2019 began with higher yields on government securities across all tenors.
- Excessive liquidity in the markets occasioned by CBN policy to exclude non-bank financial institutions from the purchase of OMO led to a decline in yields in the later part of the year.
- As at December 16, yields had moderated across all tenors.
- FGN bonds for 2 years had yields below 10% while 5 year bonds had yields of about 11%.
- Lower yields are expected to persist in 2020.
- Lower yield in the fixed income market could also increase the risk appetite of foreign capital investors, in favour of equities.

fsdh RESEARCH

Data Source: FMDQ

Conclusion

Slow growth expected to persist with pressures on Reserves & Prices

Economic Growth

The economy recorded slow but improved growth in 2019. Some major risk to growth include possible lower consumer spending, slow growth of the oil sector and slower growth in private sector investments.

Exchange Rate & External Reserves

External Reserves faced significant pressures in 2019 owing to rising FX obligations. This is expected to continue going into 2020. Fears of Naira devaluation could heighten as Reserves approach US$30 billion.

Investment Inflows

FPIs continued to drive investment inflows into the country as investors target short term instruments. FDIs showed a disappointing performance in 2019, despite Nigeria's huge economic potential. This suggests weak confidence of foreign investors on the economy.

Inflation

Closure of land borders resulted in a surge in inflation rate from September. The increase in VAT and other taxes/charges could trigger higher prices in coming quarters

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

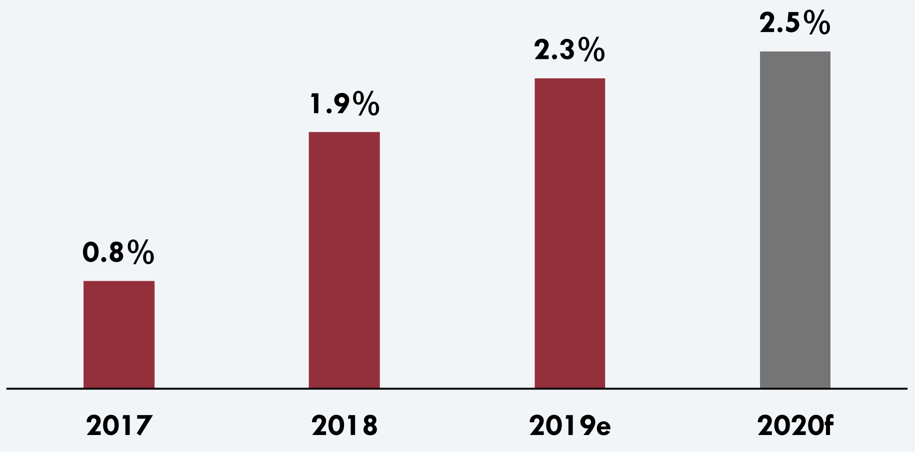
	Risk	Description	Implication
1	Policy uncertainty- Introduction of ad-hoc and uncoordinated policies	In the past few months we have seen the closure of land borders, CBN policy on OMO, etc. We could continue to witness the introduction of adhoc policies that will heighten uncertainty and toughen the 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; with 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.

SECTION 08

Macroeconomic Outlook and Projections

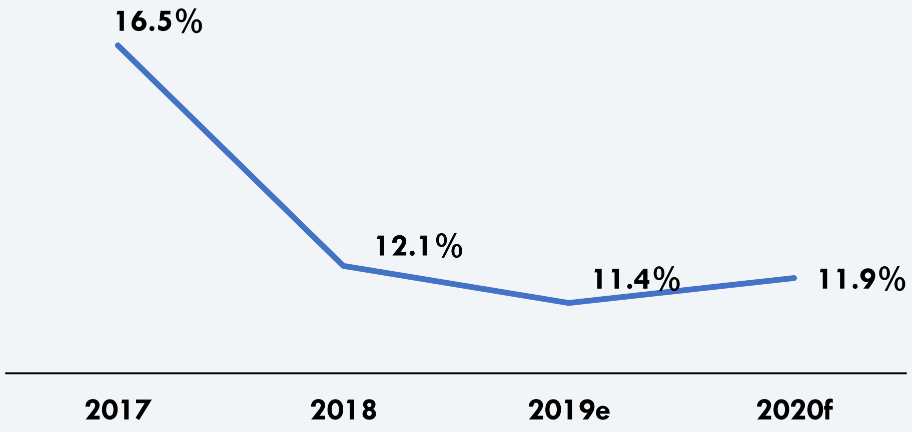
Growth & Inflation

Nigeria's real GDP Growth Rate



- GDP growth is expected to average 2.5% in 2020 driven by higher consumer and government spending and improved lending to businesses as a result of the LDR.
- From a sectoral point of view, ICT and Transport are expected to significantly expand, while operation of the Dangote refinery will shore up manufacturing output in 2020.
- Downside risks: Tough operating environment, policy uncertainty and imposition of several taxes.

Nigeria's Average Inflation Rate

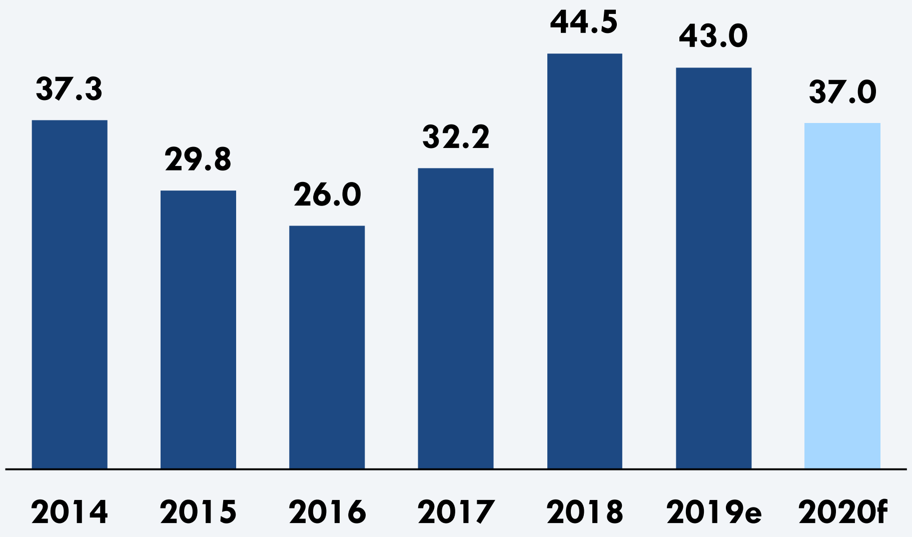


- Inflation rate is expected to average 11.9% in 2020 driven by land border closer, VAT introduction, taxes and other charges.
- Key challenges such as infrastructure deficits, power outages, high cost of finance and logistics cost will persist in 2020 and will result in higher production costs and in turn lead to higher prices in the year.
- The negative real interest rate achieved in November is a major concern for monetary authorities. The imminent inflationary pressure raises the likelihood of an increase in interest rates in 2020 to ensure positive real interest rate.

fsdh RESEARCH

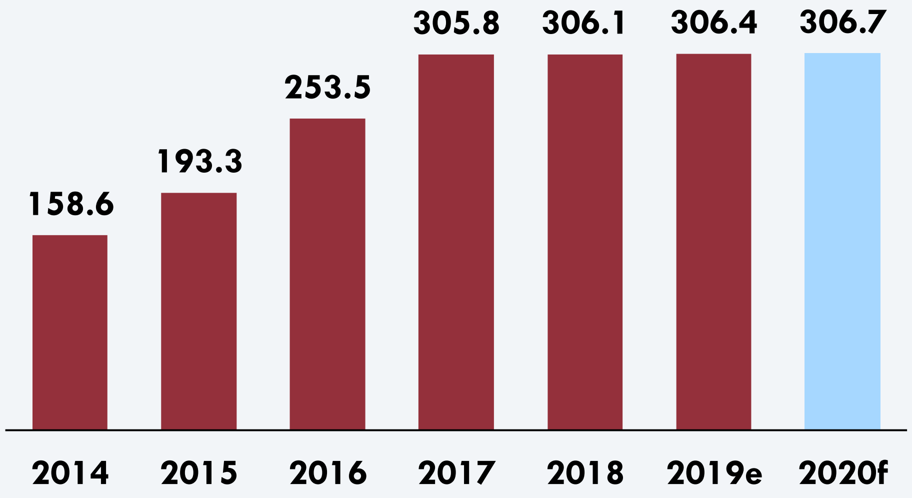
External Reserves & Exchange Rate

Nigeria's Average External Reserves (US$ Billion)



- Although oil price is expected to remain stable in 2020, Reserves will face further pressure in 2020 on the backdrop of higher FX demand triggered by imports and external payments obligations.
- We expect Reserves to average US$ 37 billion in the year. Slower FPI inflows would persist particularly in the early parts of the year, given the low interest rate environment.

Nigeria's Average Exchange Rate (N/US$



- The CBN is expected to continue to defend the naira to ensure exchange rate stability. The CBN will continue its FX restriction policies to limit the amount of FX outflows in the year.
- There is no likelihood of a devaluation of the Naira unless reserves fall between US$25 and US$30 billion.
- Taking a cue from past experience, the last devaluation occurred when External Reserves fell to about US$25 billion in 2016.

Economic outlook for 2020

GOVERNMENT REVENUE

- Government's aggressive revenue drive will result in an increase in non-oil revenue in 2020 to fund the budget. Revenues from taxes as well as other charges will improve overall revenue; however, revenue gaps due to slow collection rates will persist.

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 a stable policy environment, improved security, infrastructure, power supply, among other factors. FPI inflows will continue to target short term instruments.

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.

Macroeconomic Projections for 2020

	2016	2017	2018	2019e	2020f
GDP Growth	-1.6%	0.8%	1.9%	2.3%	2.5%
Average Inflation Rate	15.6%	16.5%	12.1%	11.4%	11.9%
Average Exchange Rate (N/US$)	490	363	358	358	380
Average External Reserves (US$ Billion)	27.0	39.4	43.1	43	37
Monetary Policy Rate	14.0%	14.0%	13.5%	13.5%	14%
Private Investment as a % of GDP	14.9%	14.8%	17.0%	23%	25%

Secure The Future of **Your Wealth** Today