MACROECONOMIC OUTLOOK FOR 2020

Accelerating Growth in the New Decade

January 2020

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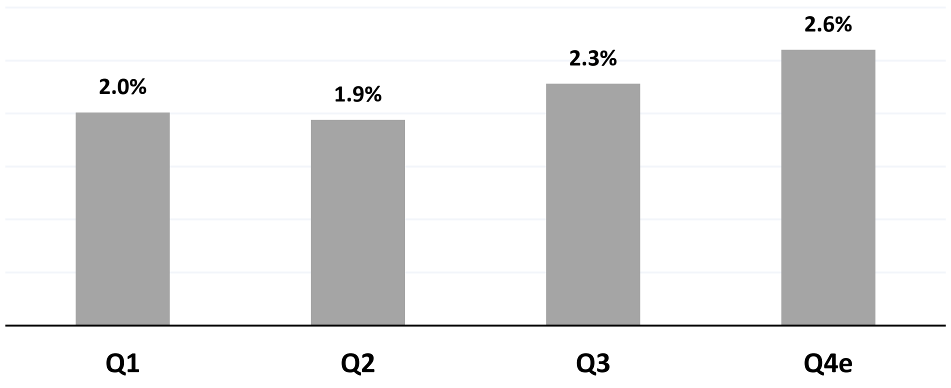
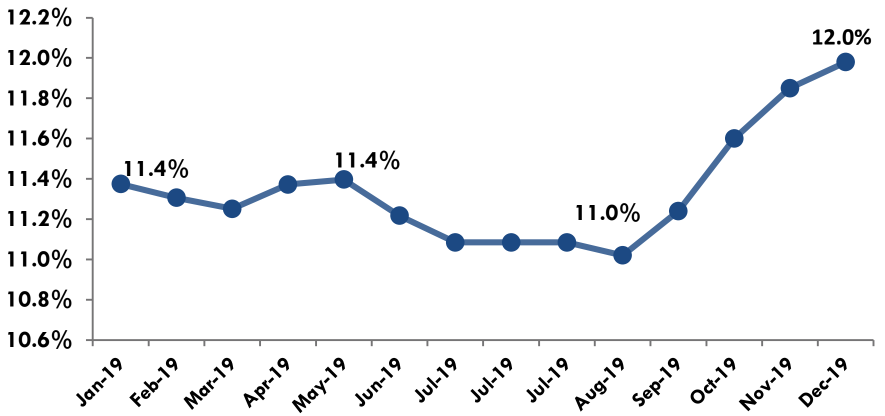
The Nigerian Economy: 2019 in Four Charts

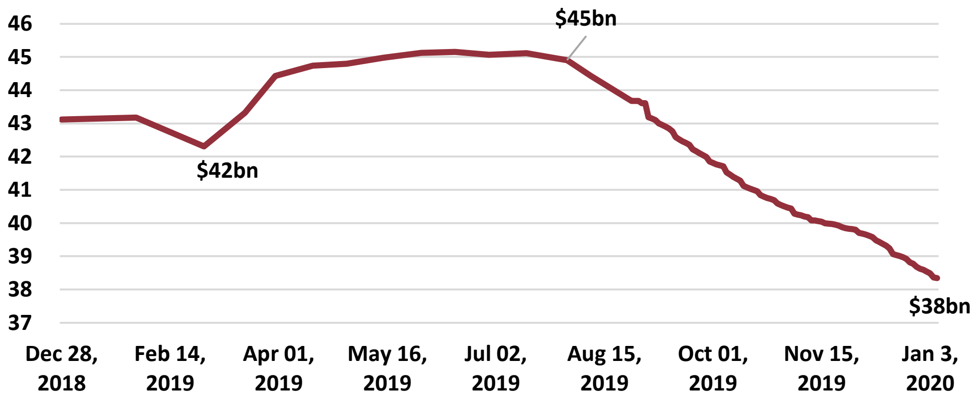
Nigeria's GDP Growth Rate - **The economy recorded slow but improved growth in 2019. Growth is expected to average 2.3%.**



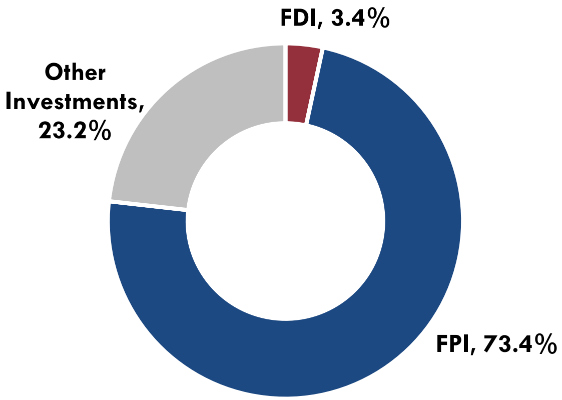
Nigeria's Inflation Rate - **Year-on-year Inflation rate averaged 11.4% in 2019 as inflation rose to 12% in December.**



Nigeria's External Reserves (US$ billion)- **External Reserves faced significant pressures in 2019 owing to rising FX obligations.**



Nigeria's Foreign Investment Inflows - **Total Investment Inflows hit US$19.7bn as at 2019Q3 of which 73% was FPIs.**



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

Factors that will influence the economy in 2020

2020

VAT increase to 7.5%

VAT increase came into effect on February 1st 2020. Prices are expected to increase for the affected goods and services.

FGN spending plan of N10.6 trillion

Early passage of the 2020 budget in December 2019 would translate to a higher capital budget implementation in 2020.

Continuation of LDR, OMO policies

Loan-to-deposit ratio and the open market operation policies of the CBN will result in increased lending to businesses and liquidity across markets in the year.

AfCFTA comes into effect

The trade deal is expected to come into effect in July 2020. It presents an opportunity for Nigeria to dominate the African market.

Increase in electricity tariffs

Electricity tariffs increase is expected to lead to higher cost of doing business in the year.

Movement in Oil Prices

The Nigerian economy is largely influenced by movement in oil prices. Annual average oil price is expected to remain above the budget benchmark of US$57pb.

SECTION 03

Outlook for key Macroeconomic Indicators

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Growth is expected to average 2.5% in 2020

- Real GDP growth is expected to average 2.5% in 2020.
- Growth will be driven by improved consumer spending as well as increase in government spending in the year.
- Increased lending to businesses as a result of CBN LDR policy is also expected to stimulate local output.
- Transport, ICT and crude oil will continue to drive economic growth in the year. Agricultural output is expected to increase while manufacturing is expected to increase marginally given the higher consumer and government spending, among other factors.

2.5%

Expected Average Real GDP Growth Rate in 2020

Some downside risks to growth include: Tough operating environment, policy uncertainty and imposition of several taxes.

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Inflation pressures exist in 2020…

Pressures on inflation are, in most cases, cost-push in nature. Efforts to improve the business environment are crucial in ensuring price stability

N10.6 Trn

FGN spending plan of N10.6 trn
With the early passage of the 2020 budget, spending on both capital and recurrent expenditure will increase and trigger a rise in overall aggregate demand.

Cost of Doing Business
Poor power supply, infrastructure deficit, harsh operating environment, charges from non-state actors continue to influence cost of doing business and the price level.

11.9%

Average Inflation rate expected in 2020

7.5% VAT

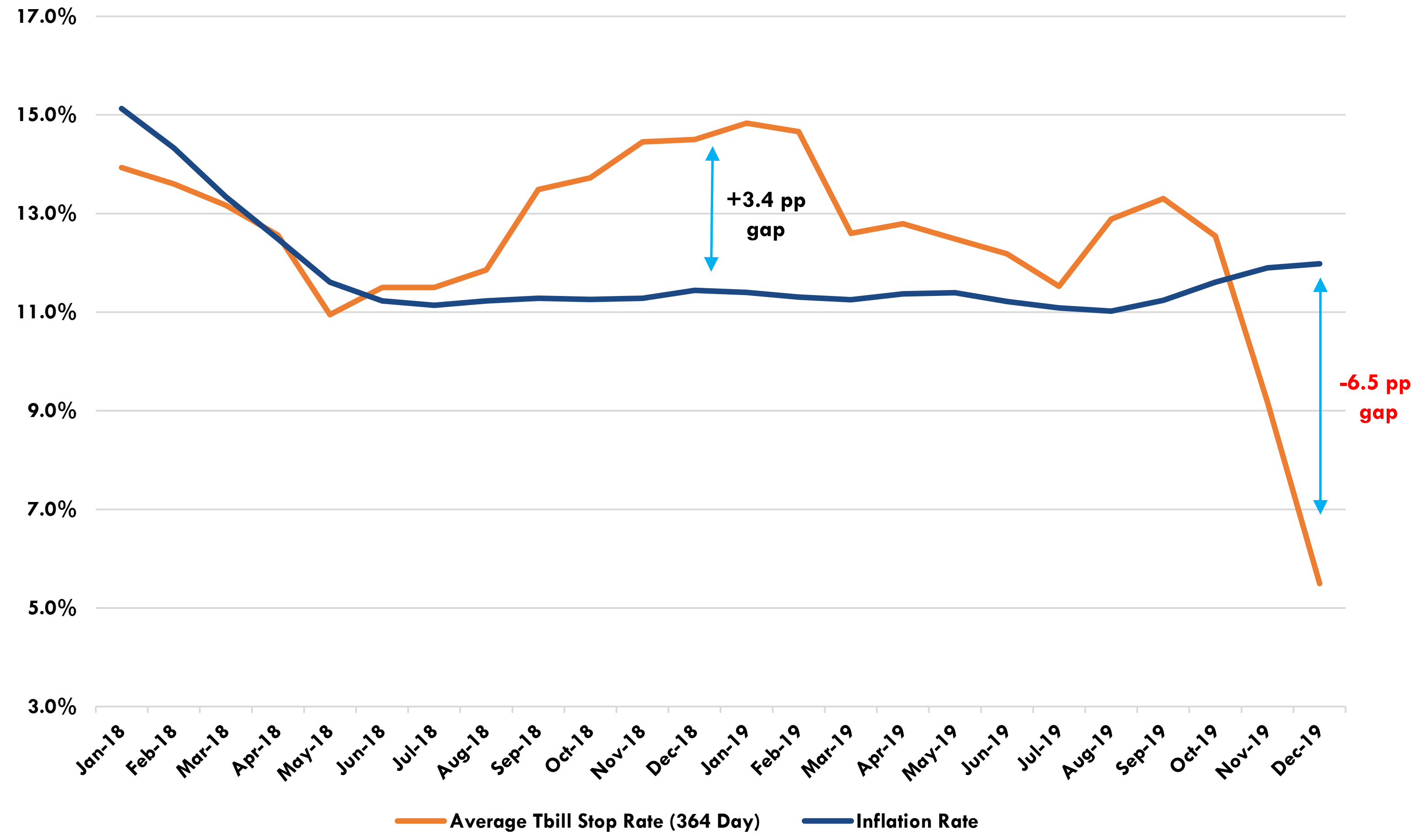
VAT comes into Effect
with the passage of the Finance Bill into law in January 2020, the VAT increase from 5% to 7.5% came into effect on February 1st, 2020.

The increase is expected to result in price increase of certain goods that are affected.

Closure of Land Border
Continued closure of land borders and uncertainty surrounding re-opening of the borders will continue to influence movements in food prices, though marginally.

…falling interest rate could slow growth in inflation in coming months

Real Interest Rate: 364-Day Treasury Bill Average Rate vs Inflation



*pp - percentage points

- The rise in Inflation rate in the later part of the year was also accompanied by significant fall in interest rates on government securities due to CBN OMO policy.
- Real interest rate was negative in November and declined further to -6.5% in December.
- The excess liquidity in the system has resulted in lower lending rates, which could reduce costs for businesses, boost investment spending and output.
- In addition, CBN policy on LDR is also expected to boost lending to the real sector and enhance output.
- These measures could slow down increase in prices of some goods in the year.

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

External Reserves & Exchange Rate

Exchange Rates would remain stable at the expense of declining reserves

- Although annual average oil price is expected to remain above US$57pb budget benchmark in 2020, slowdown in Chinese economy will result in lower prices relative to 2019.
- 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.

US$37 billion

External Reserves

N306/US$

Exchange Rate

- The CBN is expected to continue to intervene in the foreign exchange market to ensure exchange rate stability. The CBN will continue its FX restriction policies to limit the amount of FX outflows in the year.
- Since Reserves are expected to average US$37 billion in the year, this rules out the possibility of devaluation in 2020. Taking a cue from past experience, the last devaluation occurred when External Reserves fell to about US$25 billion in 2016.
- Exchange rate is expected to remain stable in the year at the expense of falling reserves.

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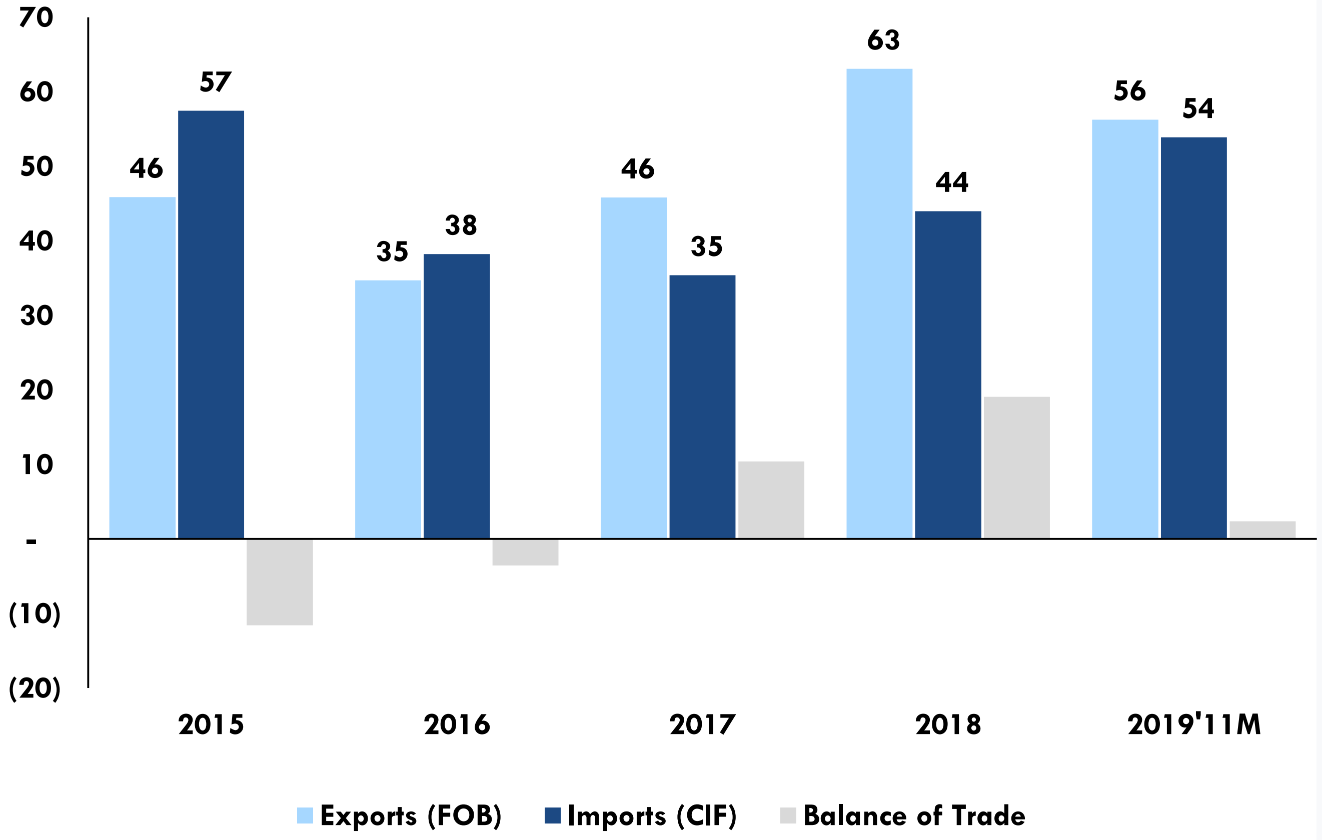
Nigeria's Trade Environment

Nigeria's Export, Import and Trade Balance ($'Bn)

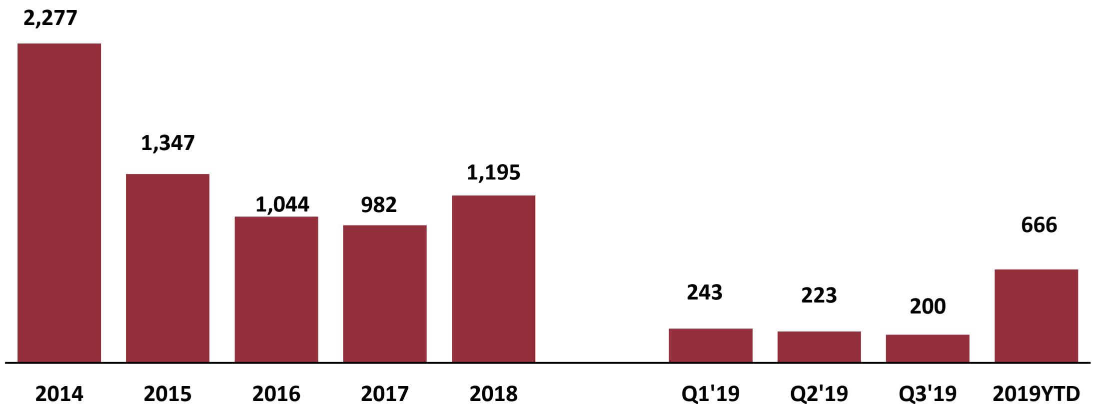


Data Source: National Bureau of Statistics

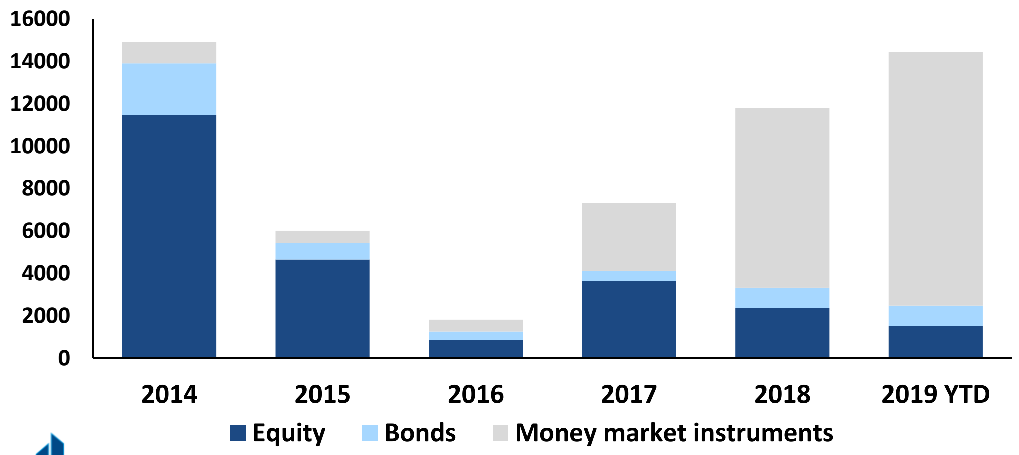
- **Nigeria's trade environment will be significantly influenced by the Africa Continental Free Trade Area (AfCFTA) agreement and government policies such as the closure of land borders and port reforms .**
- **Trade value in 2019 is already at $110 billion for the first 11 months. This is above $107 billion recorded in 2018. However, trade balance deteriorated as import grew faster than export.**
- **With the AfCFTA coming into effect in July, gradual removal of tariffs on goods produced within Africa will influence trade outcomes:**
  - Nigeria's non-oil exports to other African countries should expand significantly. Currently, exports to other African countries account for 20% of total exports.
  - Nigeria's imports from other African countries (which represents 8.5% of total imports) is also expected to increase.
- **Adequate measures such as infrastructure provision, improved power supply, border security, quality assurance, etc. are required to make Nigerian products competitive in the continent.**

Foreign Portfolio Investments to dominate Inflows in 2020

FDI Inflows (US$ million)



Breakdown of FPI Inflows (US$ million)



Data Source: National Bureau of Statistics

- **Total investment inflows as at 2019Q3 stood at US$19.7, higher than the US$16.8 billion achieved in full-year 2018.**
- **73% of total inflows were Foreign Portfolio Investments (FPIs). Foreign Direct Investment's share at 3.4% is still very low as investor sentiments tilt towards the capital market vis-à-vis the real sector.**
- **Portfolio investments are skewed towards money market instruments, which accounted for 80% of total FPIs.**
- **The significant drop in interest rates especially for short term securities could lead to some traction in the equity space. This factor will also limit FPI inflows relative to 2019.**
- **Nigeria's growth projection for 2020 stands at 2.5% which is relatively low. Several issues of ad-hoc and inconsistent policies, insecurity and poor infrastructure will limit the inflow of FDIs in 2020.**
- **We believe therefore that FPIs will continue to dominate total inflows in 2020.**

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SECTION 04

The Government's Monetary and Fiscal Policies Outlook

Fiscal policy targets expansion with higher budget spending

Capex spending

We expect 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. This will have positive implications on sectors such as Cement & Construction.

FAAC Disbursement

From January to September 2019, states and local governments received N3.2 trillion from FAAC allocations. With a stable oil price, FAAC disbursement is expected to increase marginally in 2020.

VAT increase to 7.5%

Revenue from VAT increase will significantly go to States governments. VAT will trigger rise in prices in 2020 and is a risk to economic expansion.

Finance Act- SMEs

One key provision is the exemption of Small businesses with turnover less than N25m from CIT. This will reduce burden on some SMEs and stimulate their growth.

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Funding the budget could be a challenge

Revenue of N8.4 trillion consists of N2.64 trillion of Oil Revenue (31%). Although annual average oil price is expected to remain above the US$57 pb budget benchmark, slowdown in China's growth will see a relatively lower price in the year. In addition, Crude oil production will likely remain below the budget target of 2.2mbpd creating pressure on oil revenue as experienced in 2019.

Non-oil revenue will include income from the proposed VAT increase as well as other non-oil taxes and tariffs. Although improvement is expected in collection rate, shortfalls are expected due to the higher budget target.

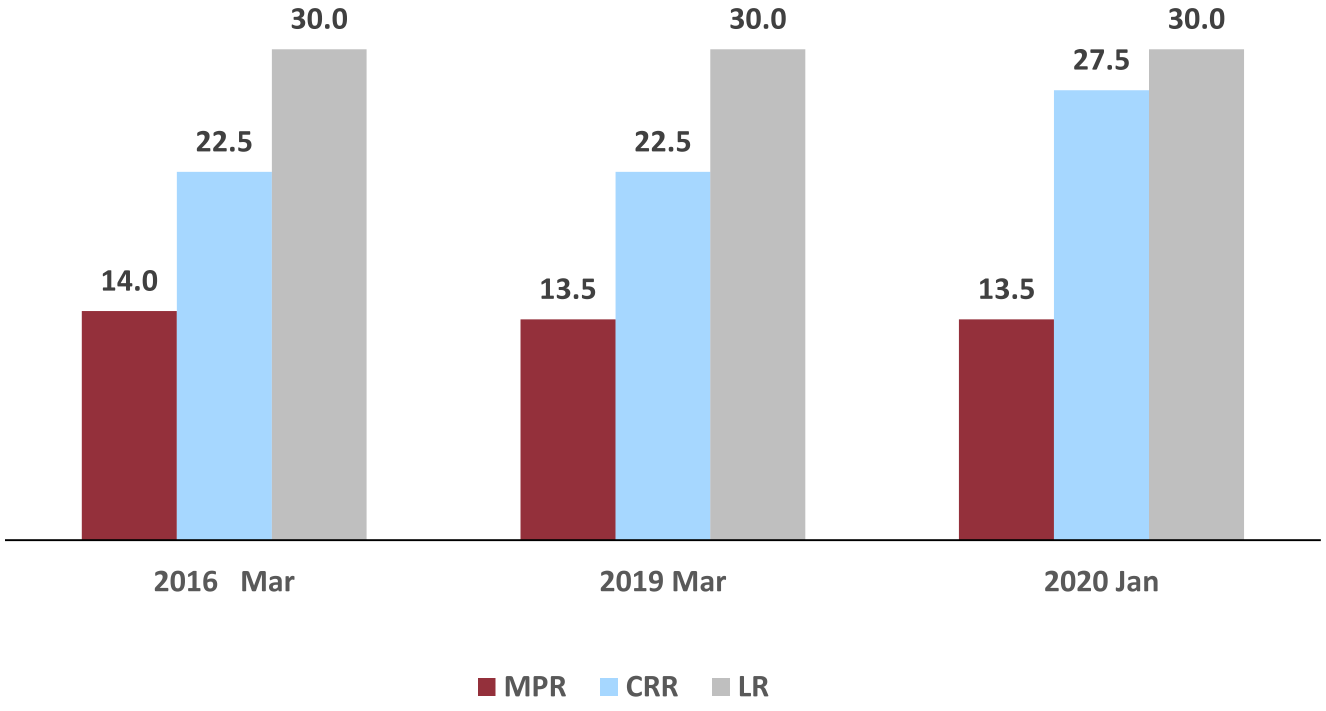
Customs revenue target was increased from N311 billion in 2019 to N617 billion in the 2020 budget. Following the border closure, the agency has reported improved revenue inflow as exporters increasingly utilized the seaports. This is expected to continue in the year. Revenue may however marginally fall short of target.

While VAT increase will lead to increased revenue, a significant portion of the revenue will go to state governments. Federal government is expected to receive N293 billion from VAT increase in 2020.

Data Source: Ministry of Finance, Budget and National Planning

Tight Monetary Policy expected in 2020

Key Monetary Indicators (%)



Data Source: Central Bank of Nigeria

- Over the last few years, Monetary Policy stance of the CBN has been driven by the need to ensure price and exchange stability as well as to support economic growth.
- Within the first half of 2019, the CBN reduced the MPR by 50bps in order to stimulate growth as inflation steadily declined.
- With rising inflation and imminent inflation pressures following the land border closure and VAT increase, we expect a tight monetary environment in 2020.
- Already, with the introduction of the policy that restricts access to OMO, market liquidity has heightened, exemplified by the sharp drop in rates of government securities.
- To mop-up this excess liquidity, we believe the CBN and the MPC will adopt several monetary policy tools in 2020. In the first MPC meeting in January, the CBN increased CRR to 27.5%. This is estimated to mop up an estimated N900 billion from the system.

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Monetary Policy Review and Outlook

On January 23 and 24, the CBN Monetary Policy Committee (MPC) held its first meeting of 2020. At the meeting, the Committee took the following decision:

- Retain the Monetary Policy Rate (MPR) at 13.5 per cent;
- Retain the asymmetric corridor of +200/-500 basis points around the MPR;
- Increase the CRR by 500bps to 27.5 per cent; and
- Retain the Liquidity Ratio at 30 per cent.

This was based on the following considerations:

- Rising inflation rate which stood at 12 per cent in December 2019
- Rising liquidity due to OMO policy changes
- Persistent decline in foreign exchange reserves - US$38 billion as at Jan. 30th 2020
- Uncertainty about oil price outlook
- Increasing credit to the private sector
- Attraction of more foreign portfolio investments
- Careful assessment of the recent CBN's heterodox policies aimed at driving the real sector.

Implication of the CRR increase:

- The increase is expected to squeeze liquidity in the markets and possibly raise interest rates, though marginally.

Expectation from next MPC in 2020

- The CBN is expected to continue in its effort to mop up the excess liquidity in the market to curtail inflation and attract FX inflows.
- Further, the CBN will intensify its heterodox policies outside the MPC; continuing to adopt tools such as LDR, OMO, FX restrictions and interventions to stimulate lending to the real sector and propel economic growth.

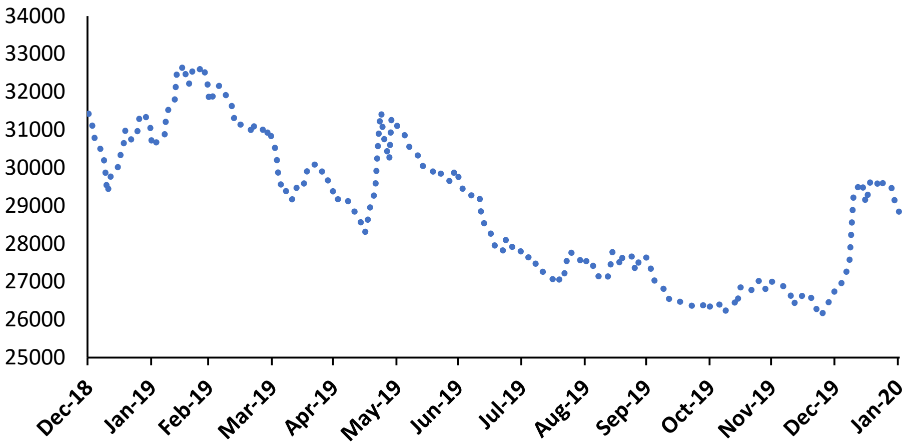
Key Considerations for 2020

- High inflation expectation and market liquidity
- Declining external reserves
- Slower than expected GDP growth
- Slowing Foreign investment flows
- Crude oil output and revenue
- Quality of banking assets in the face of LDR
- Fiscal policy and increasing public debt concern

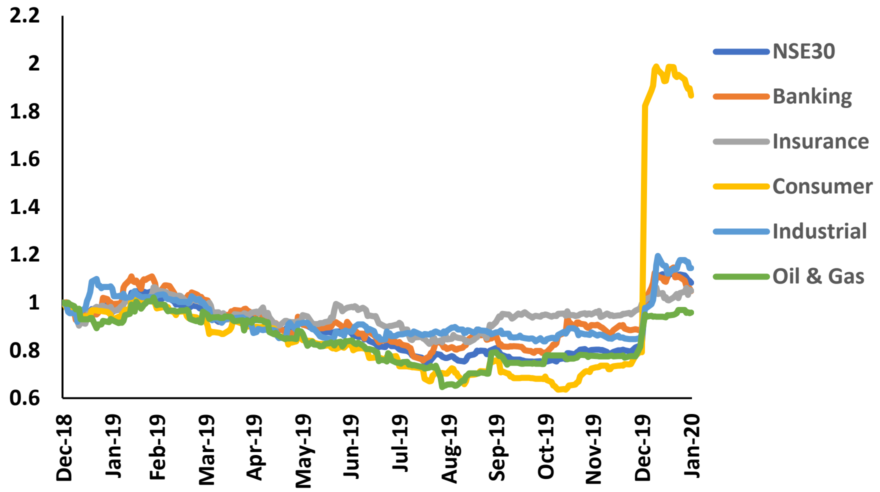
Capital & Money Market Performance & Outlook

Equities Market to rally on the back of market liquidity

NSE ASI



Sectoral Performance



- **The Nigerian equity market closed 2019 negative for the second year running at 26,842.1 index points as the year return stood at -14.60.**
- **Despite this, the Market Cap closed positive at N12.97tn, gaining 10.55%; this is sequel to the listing of large cap stocks such MTN and Airtel.**
- **The NSE30 which mirrors the stocks of large cap and best performing companies stocks listed on the NSE also lost 16.83%.**
- **Major sectors on the NSE closed the year in the red but picked up in January 2020.**
- **In January 2020, the stock market has been bullish recording 10.10% return riding on the restriction of non-bank corporates and individuals from OMO primary and secondary activities.**
- **Going forward, the equity market could reap from the excess liquidity in the fixed income markets. Stable oil price, improved economic growth figures could instill confidence in the market in 2020.**

NSE ASI (2019)		2020 YTD
Open	31,430.5	26842.07
Close	26,842.1	28843.53
% Change	-14.60	7.46

MARKET CAP 2019 (N'Bn)		2020 YTD
Open	11,731.27	12970.79
Close	12,968.59	14857.08
% Change	10.55	14.54

SECTOR	2019	2020 YTD
NSE30	-16.83%	8.25%
Banking	-10.55%	4.75%
Insurance	-0.52%	4.91%
Consumer Goods	-20.83%	86.65%
Industrial	-13.11%	14.39%
Oil and Gas	-13.13%	-4.19%

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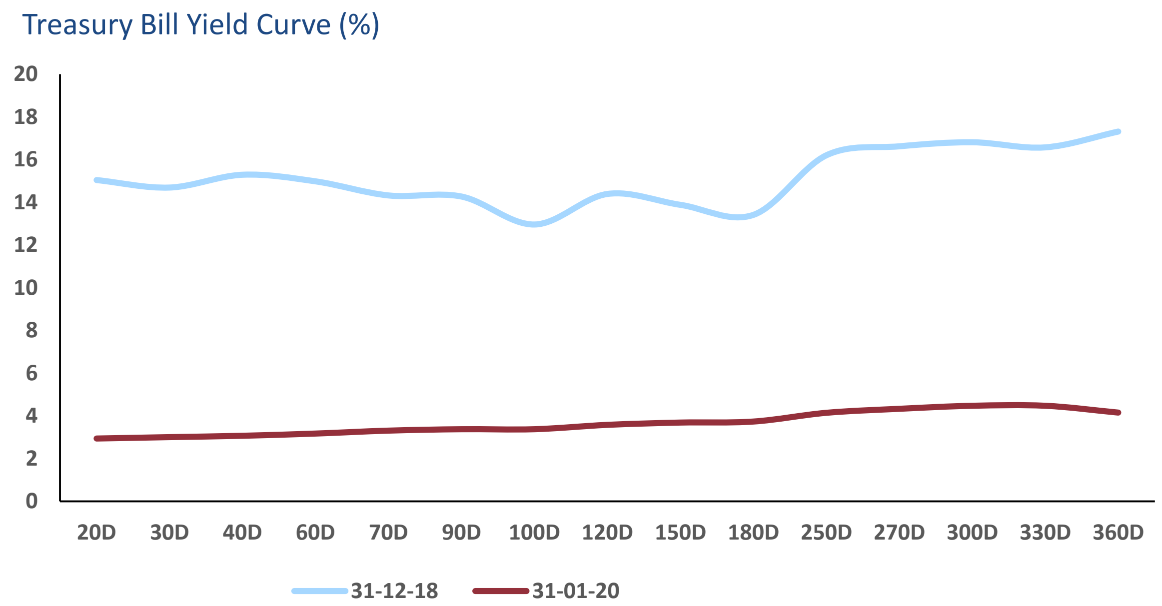
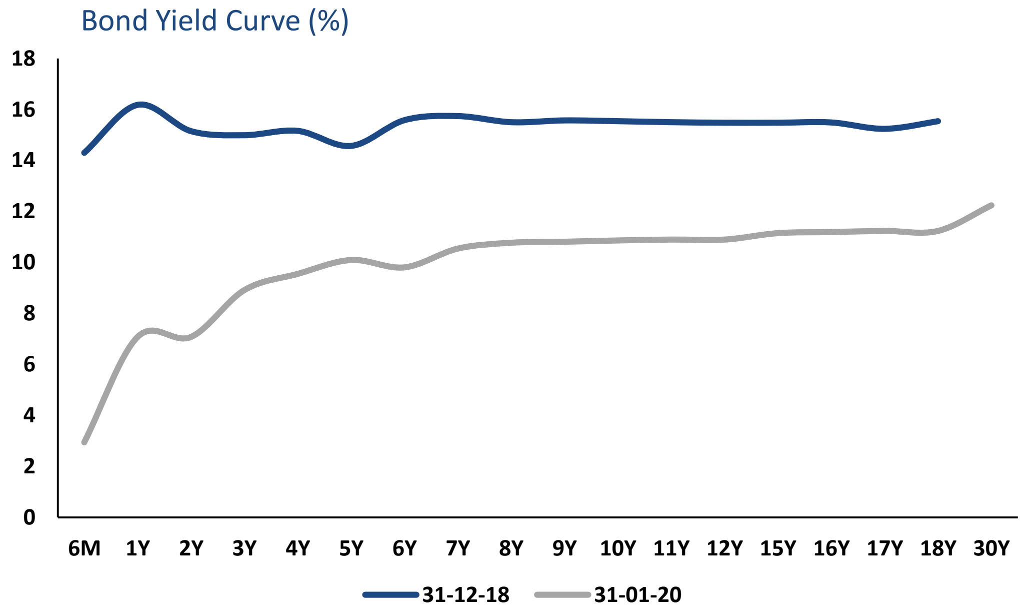
Data Source: Nigerian Stock Exchange

Yields dropped significantly across tenors and would remain low





- **The OMO policy introduced in the later part of 2019 led to significant surge in liquidity level and as such, yields especially in the Treasury Bills market have been on a downward trend. Part of the goals of this policy is to reduce government borrowing cost and improve forex inflows into the country.**
- **Yields across maturities have dipped significantly as average Treasury Bill yield closed 2019 at 4.85% from 15.37% the previous years while the average OMO rate closed at 13.18%.**
- **Lower rates are expected to persist in 2020.**

- **In similar vein, the FGN Bond space also witnessed moderated yields across maturities as average bond yield closed 2019 at 10.76% relative to 15.20% the previous year.**
- **Given the impending liquidity following maturities of some OMO securities that would not be reinvested in the market, we anticipate yield to press downwards in 2020.**
- **We anticipate more bond and commercial paper issuance in the year to take advantage of the low interest rate environment.**

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Data Source: FMDQ

Unconventional policies and implications for the financial markets

The late-2019 and January 2020 rally of the equity market is largely driven by the new OMO policy of the CBN with liquidity of OMO maturities going into stocks. There has also been stronger activity by pension funds as attention moved away from fixed-income (due to declining yields) to stocks. But it is not clear that this trend will continue for the long-term and there is also the issue of FG looking at borrowing from the pension funds for infrastructure which will limit flow to stocks.

Foreign investors have dominated net selling in the market and is there a likelihood that foreigners may have sold OMOs to locals? High flows are going into the money market and into bonds.

Overall, the underlying weak macroeconomic conditions will continue to cast a shadow on the performance of the financial markets and combined with policy uncertainty this is likely to feed into continued volatility.

While stocks are cheap , the short-term earnings outlook is poor, markets remain volatile in the near term and we advise investors to buy quality stocks with a long-term investment horizon.

Conclusion

Economic Growth	Economic growth is expected to be better in 2020 with GDP growth at 2.5%. Crude oil, ICT and Transport sectors will influence economic growth in the year.
Inflation	As output expands, prices are also expected to increase- Inflation is expected to average 11.9% in the year, following continued closure of land borders and implementation of tax increase.
Fiscal Policy	Fiscal policies of the federal government is expected to stimulate economic growth with the early budget passage which will ensure improved budget performance. 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.
Monetary Policy	On monetary policy, the higher liquidity levels have forced down interest rates of government securities. The CBN will resort to the use of multiple monetary policy tools to mop-up excess liquidity and attract investment inflows. This will be shape the monetary environment in the year.
Financial Markets and Investment	Government and private firms will take advantage of the low interest rate environment to issue debt instruments in the year. In terms of investment inflows, FPI will continue to dominate total inflows, especially given the high level of uncertainty, infrastructure deficit and insecurity challenges. These factors will continue to limit inflow of investments into the real sector of the economy.

Macroeconomic Projection

	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$)	490	363	358	358	370
Average External Reserves (US$ 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%