MACROECONOMIC REVIEW AND OUTLOOK FOR NIGERIA

Strengthening Economic Recovery: The Need for Speed and Urgency

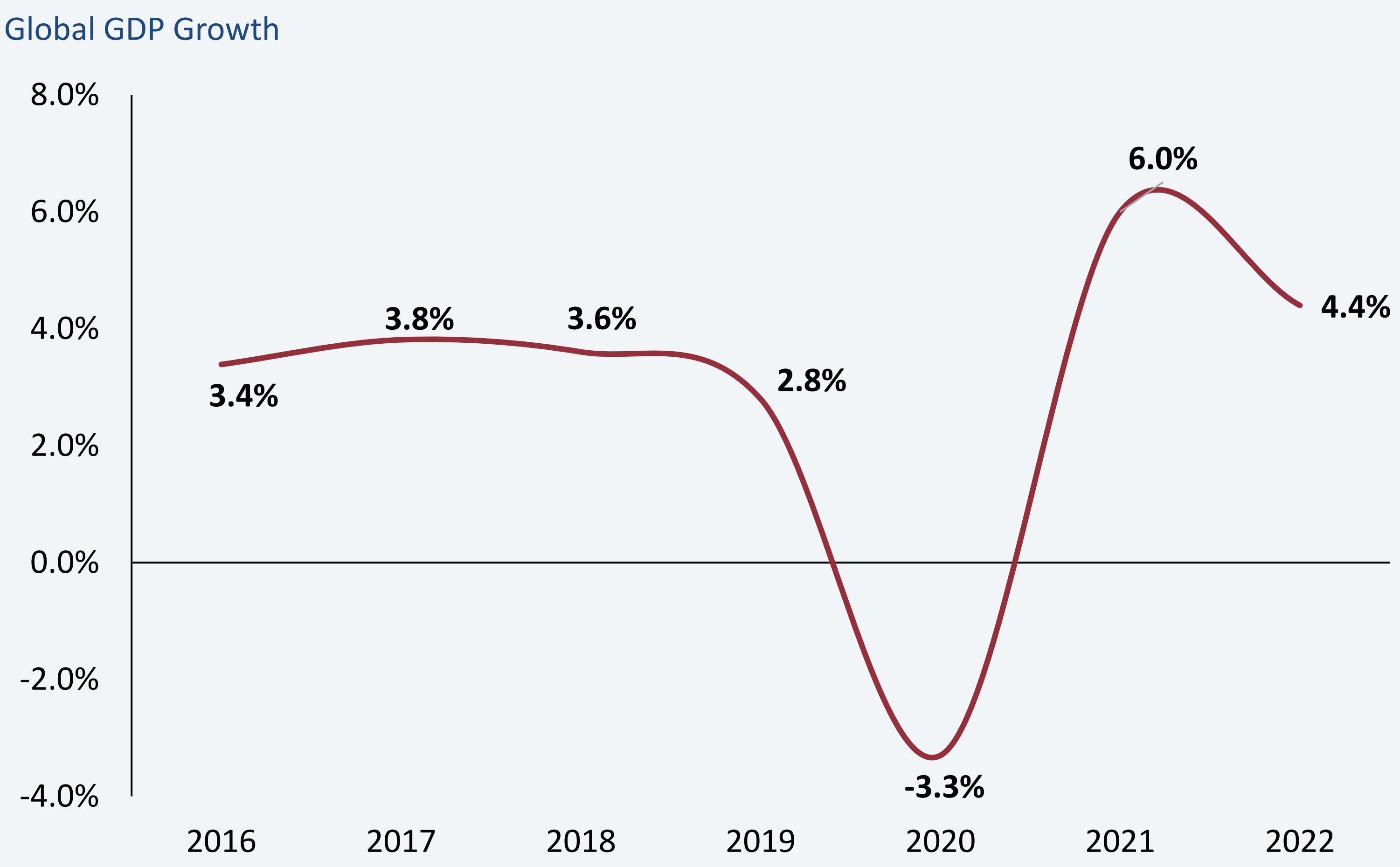
July 2021

CONTENTS

SECTION 01

Performance of the Global Economy

IMF updates global GDP growth projection for 2021 to 6%



- The International Monetary Fund (IMF) in April revised upwards its projection for 2021 for many economies. The Fund projected a global GDP (Gross Domestic Product) growth of 6.0% for 2021, an increase from 5.5% projected in January.
- In addition to the relaxation of lockdowns due to improved vaccine roll out, the continued fiscal and monetary support across economies will drive the higher growth projections.
- However, there are expectations of diverse performance across countries due to the differences in the pace of vaccination and government interventions.
- For 2022, the global economy will expand by 4.4%.

Data Source: International Monetary Fund (IMF)

Many economies will record high positive growth in 2021

GDP Growth forecast for 2021

USA

Vaccines distribution and Biden's $1.9 trillion rescue package will boost recovery.

6.4%

Euro Area

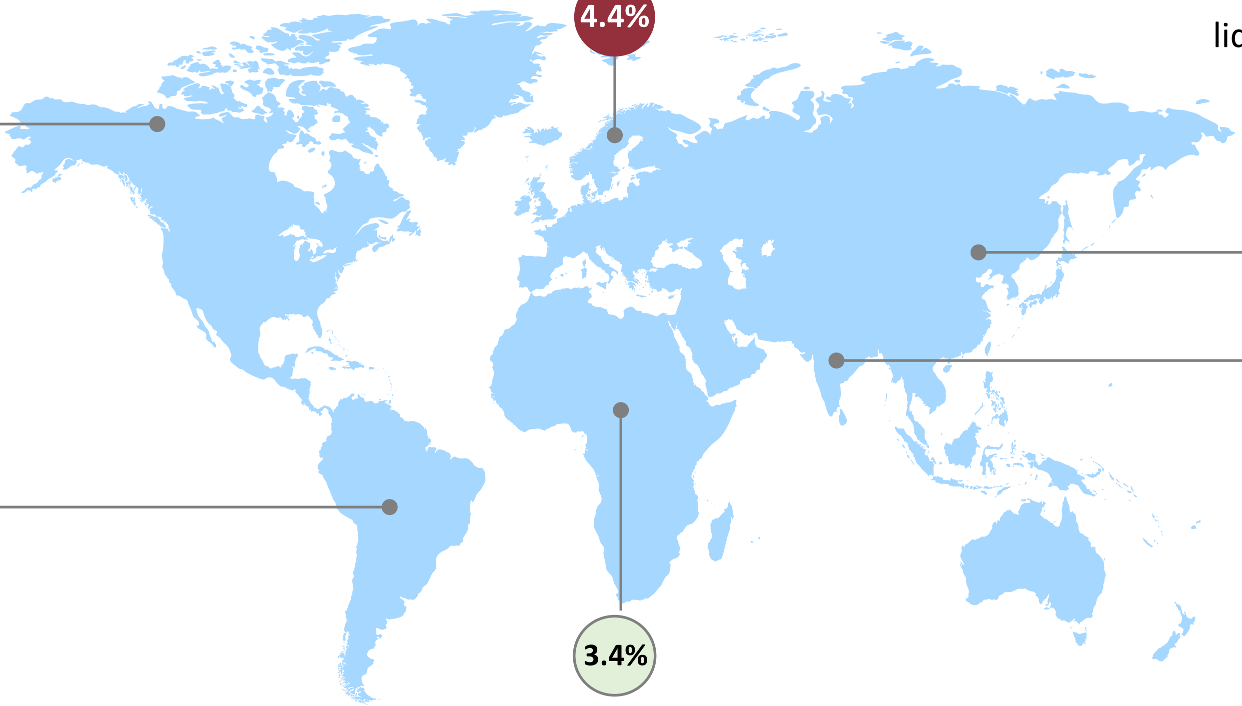
Vaccines distribution and relaxation of lockdowns will drive recovery.

4.4%

China

Public investment, Central bank liquidity and pick up in demand will spur growth.

8.4%



12.5%

India

High COVID-19 caseloads could slow down recovery.

3.7%

Brazil

Vaccines administration will be crucial in the recovery process.

3.4%

Sub-Saharan Africa

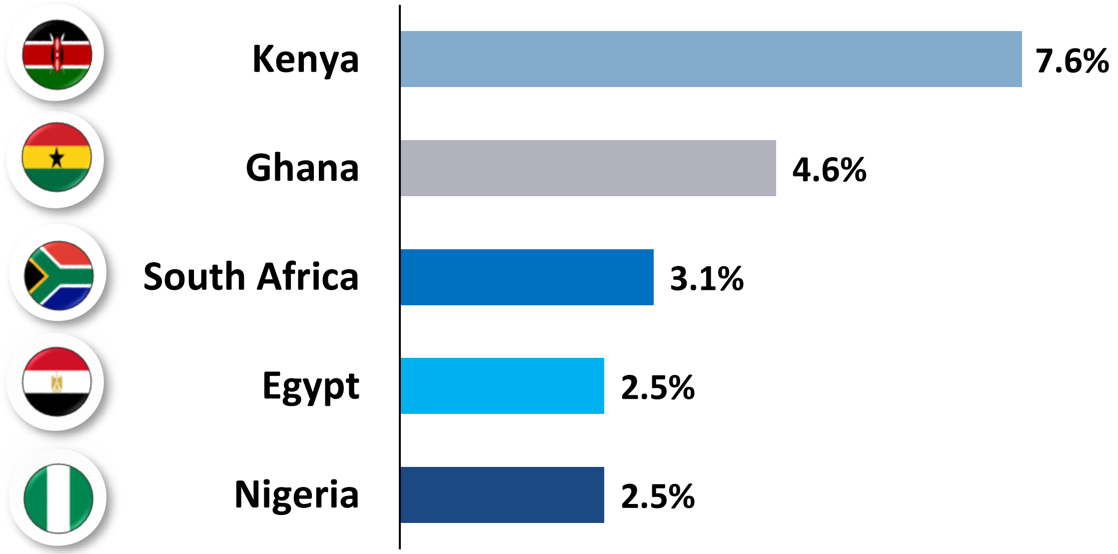
Rising commodity prices will play a key role in SSA's recovery

Data Source: International Monetary Fund (IMF)

Many African economies poised to recover in 2021

Sub-Saharan Africa is projected to grow by 3.4% in 2021. Growth will be mainly driven by rising commodity prices, improving consumer demand, higher government spending and vaccines administration in countries with high COVID-19 cases. The economies of Nigeria and South Africa will expand by 2.5% and 3.1%, respectively. Non-oil economies are expected to experience relatively higher growth in 2021 as Ghana and Kenya are projected to grow by 4.6% and 7.6% respectively. While Nigeria posted positive growth in 2021Q1, South Africa recorded its fourth consecutive quarterly contraction following the spread of COVID-19.

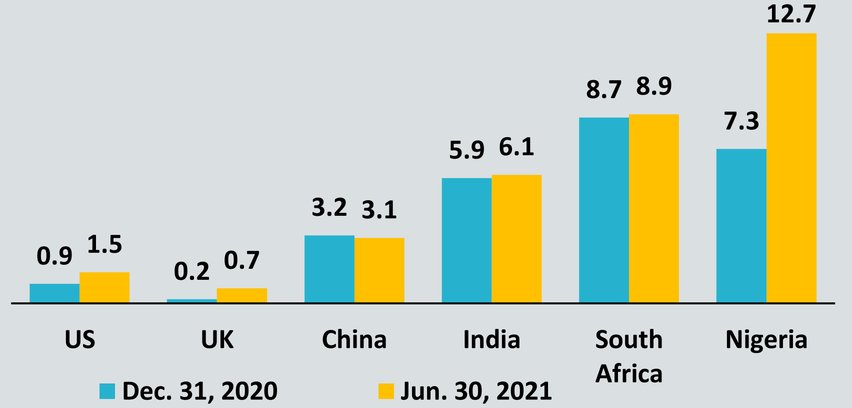
2021 GDP Growth for select African Countries



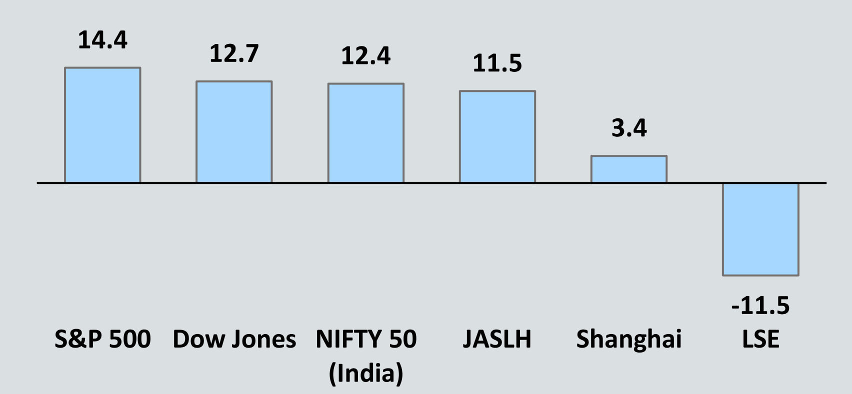
Data Source: International Monetary Fund (IMF)

Global Markets Charts

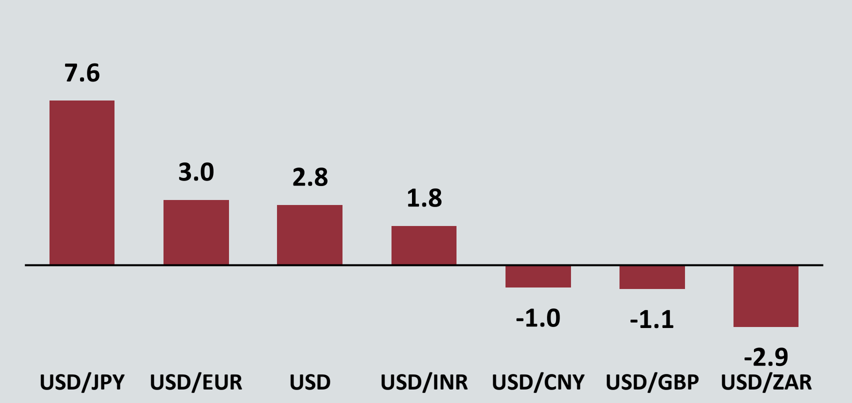
Ten Year Government Bond Yield Performance (%)



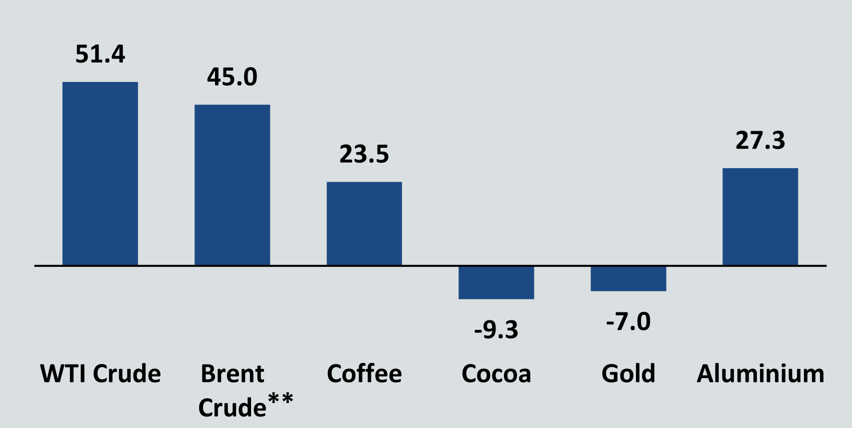
Stock Markets Performance (% YTD* Change)



Global Currency (% YTD* Change)



Commodity Markets Performance (% YTD* Change)

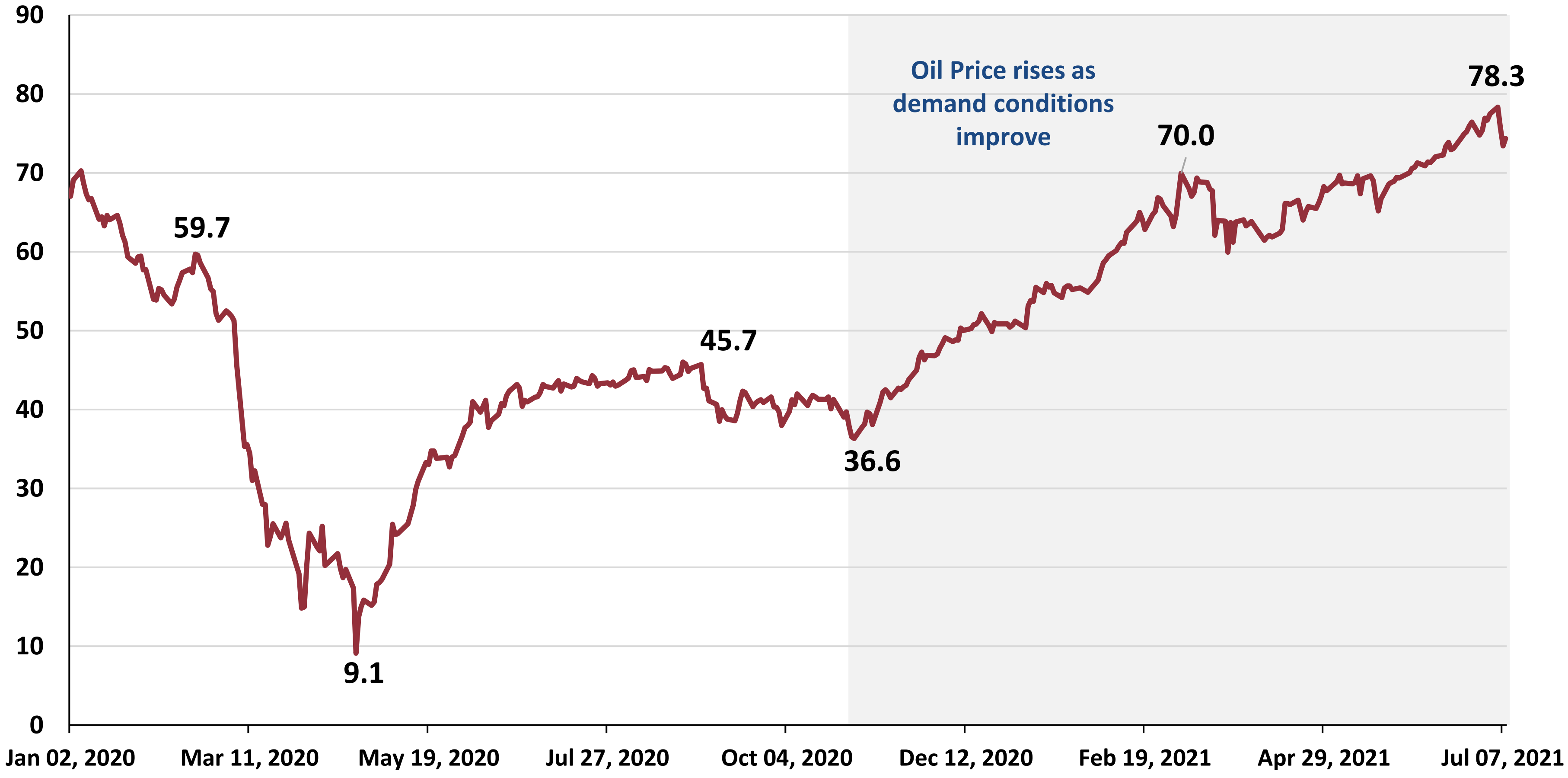


*YTD – Year To Date, January to June
**Brent Oil Futures

Data Source: investing.com

Crude oil price exceeded pre-COVID-19 level, crossed US$75 per barrel

Europe Brent Spot Price FOB (US Dollars Per Barrel)



- Improving crude oil demand and continued implementation of quotas have led to a significant surge in crude oil price.
- Brent crude oil spot price closed the second quarter at US$76.9 per barrel (pb), a year-to-date increase of 53%.
- On July 5, crude oil price reached US$78.3 pb, the highest since October 2018.
- To benefit from the higher oil prices, OPEC+ is considering a proposal to increase production by 400,000 barrels a day starting in August.
- This will place a cap on oil prices going forward.

Data Source: U.S. Energy Information Administration

Oil producers failed to reach an agreement on production cut

Voluntary Production Level in 1,000 barrels per day (May to July 2021)

	Reference Production	May 2021 Voluntary Adjustment	May 2021 Voluntary Production Level	June 2021 Voluntary Adjustment	June 2021 Voluntary Production Level	July 2021 Voluntary Adjustment	July 2021 Voluntary Production Level
Saudi Arabia	11,000	-1,768	9,232	-1,653	9,347	-1,505	9,495
UAE	3,168	-509	2,659	-476	2,692	-433	2,735
Kuwait	2,809	2,809	2,358	-422	2,387	-384	2,425
Nigeria	1,829	-294	1,535	-275	1554	-250	1,579
Angola	1,528	-245	1,283	-230	1,298	-209	1,319
Algeria	1,057	-170	887	-159	898	-145	912
Congo	325	-52	273	-49	276	-44	281
Gabon	187	-30	157	-28	159	-26	161
Eq. Guinea	127	-20	107	-19	108	-17	110
Iraq	4,653	-748	3,905	-699	3,954	-637	4,016
Total OPEC-10	**26,683**	**-4,287**	**22,396**	**-4,010**	**22,673**	**-3,650**	**23,033**
Non-OPEC	**17,170**	**-2,263**	**14,907**	**-2,190**	**14,980**	**-2,109**	**15,061**
Total OPEC+	**43,853**	**-6,550**	**37,303**	**-6,200**	**37,653**	**-5,759**	**38,094**

- OPEC+ failed to reach an agreement to extend a pact to cut oil production beyond April 2022. The UAE is demanding for a higher baseline production level.
- In the last few months, producers have agreed to relax production cuts as oil demand improved.
- Production cut was reduced from about 7.1 million b/d in the month of March to 5.76 million in July.
- Following these cuts, oil exporters including Nigeria might reap the gains of higher oil price in coming months.
- Nigeria's voluntary production level has increased, though marginally, from 1.535 million barrels per day in May to 1.579 in July.

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Data Source: Organization of Petroleum Exporting Countries (OPEC) and Energy Intel

Analyst Views on the Global Economy and Africa

Global Economy

- In our last Macroeconomic report, we shared the views of the IMF and World Bank that suggest the global economy will experience a sharp recovery in 2021 on the back of improved demand and supply conditions as economies relax lockdown and restriction rules.
- We maintain this position as the situation around COVID-19 continues to improve across many countries, although a few countries are still recording higher cases.
- The massive vaccination going on across countries alongside fiscal and monetary stimuli will continue to be the major driver of growth as we have been witnessing in some countries.
- However, we believe the pace of recovery as projected by the IMF and World Bank for the global economy alongside regions and countries appears to be too optimistic.
- Some countries like USA, China and Nigeria are already on the path to recovery for 2021 but the reality is tough for some countries as constraints to economic growth abound. Key risks include surge in COVID-19 cases and high oil price for importing countries.

African Economy

- In 2020, only 13 African countries recorded positive annual GDP growth.
- For 2021, the outlook is brighter as many African economies will recover from the pandemic.
- In terms of vaccination, African countries are disadvantaged as the continent relies on developed countries for vaccines.
- In essence, the pace of recovery will be more divergent for African countries and for commodity exporting countries, those that are able to reap the benefits of high commodity prices will recover faster.
- Crude oil exporting countries like Nigeria and Angola could be in for some positives.
- The AfCFTA agreement commenced in 2021. However, we do not expect it to contribute to the recovery process as most African countries are still working out programmes to enable them tap into the benefits of the deal.

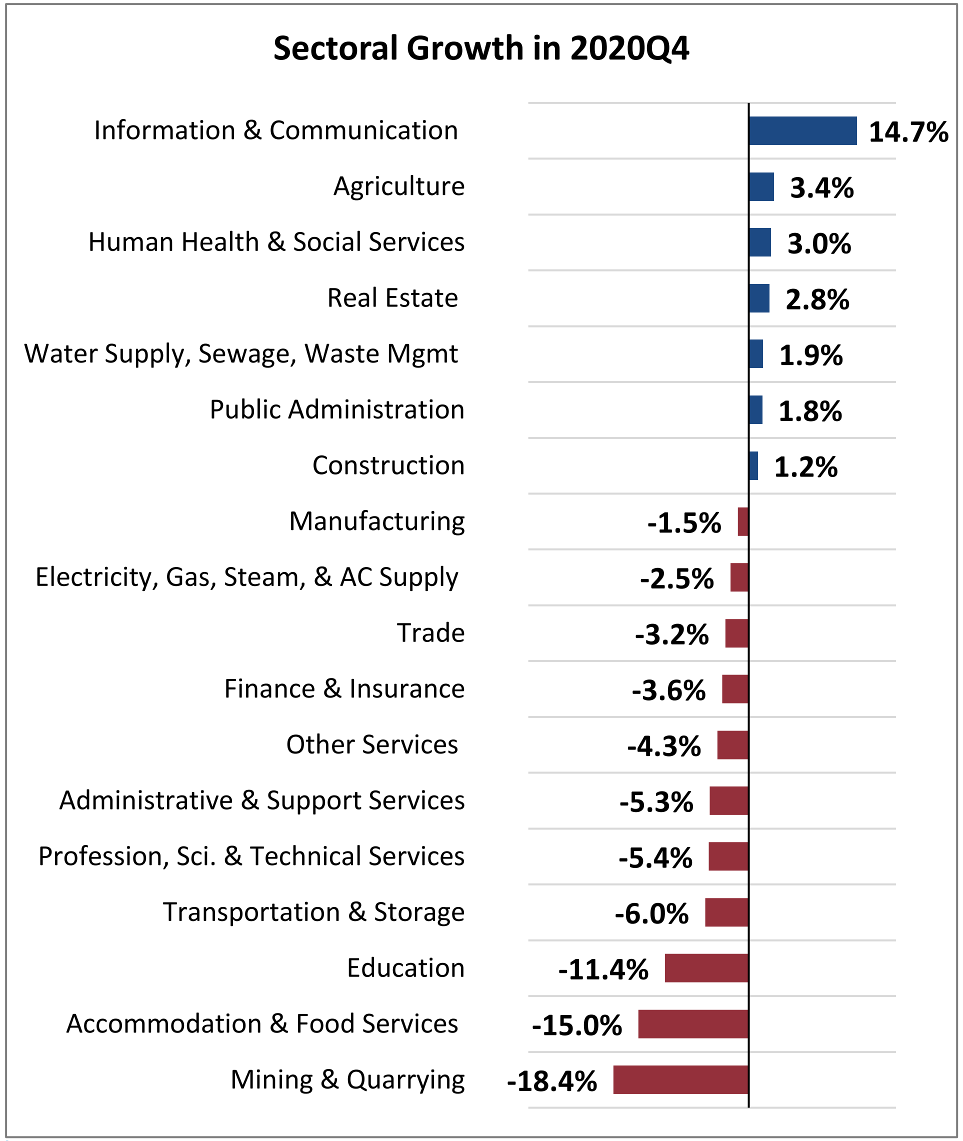
Nigeria’s Macroeconomic Update

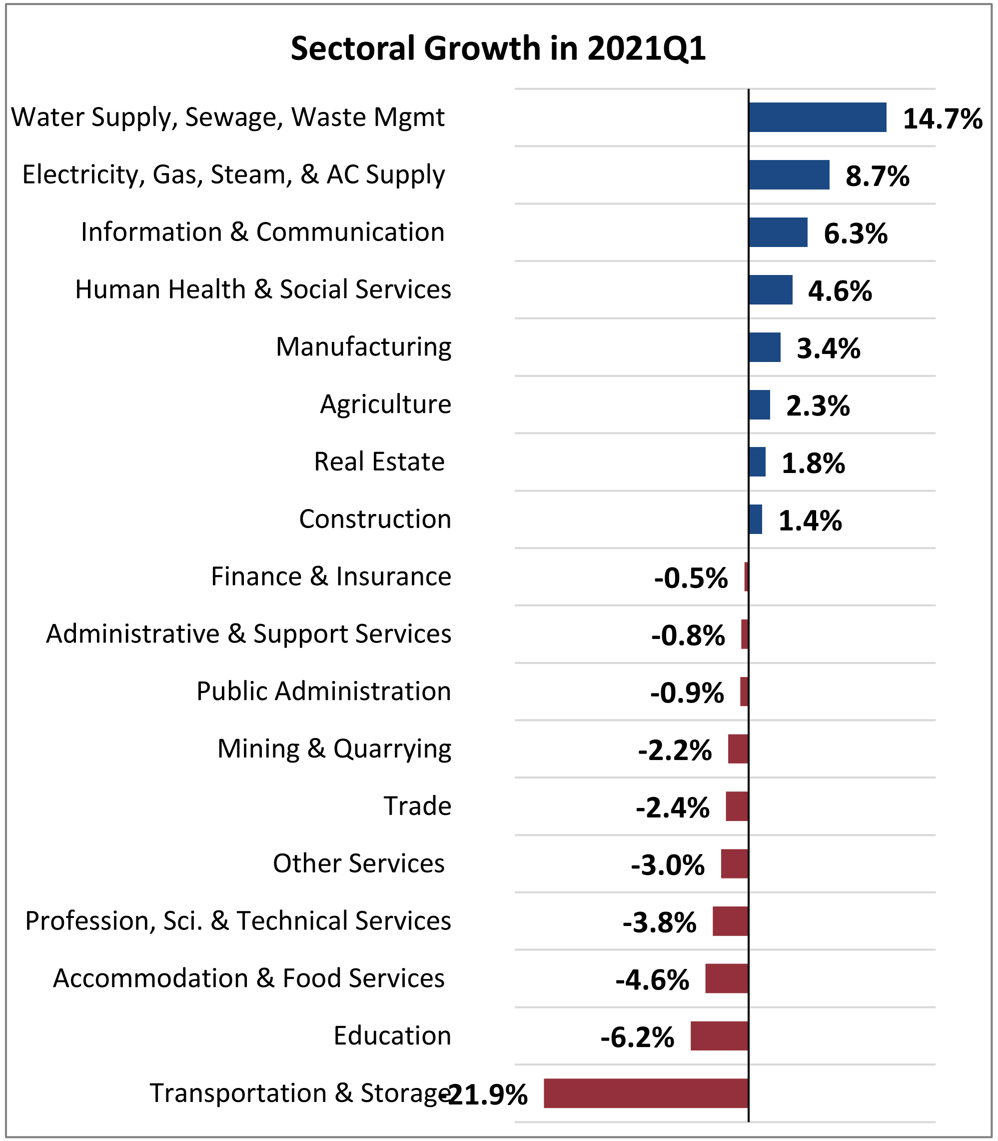
GDP: Nigeria maintained positive growth in 2021Q1, Q2 growth will be higher

- In the first quarter of 2021, the Nigerian economy grew by 0.5%. This represents a consecutive positive quarterly growth since the recession in 2020.
- The non-oil sector remained the driver of growth with an expansion of 0.8% while the oil sector contracted by 2.2%.
- Specifically for the second quarter of 2021, economies that recorded deeper GDP contractions in the second quarter of 2020 due to lockdowns will emerge with significant growth in the corresponding quarter of 2021.
- This is mainly due to the base effect.
- As a result, real GDP growth in Nigeria is expected to improve significantly in 2020Q2.
- We expect growth to at least fall in the range of 1%-3% in Q2.

Data Source: National Bureau of Statistics

Sectoral Growth: 8 sectors expanded in 2021Q1 as 10 sectors contracted



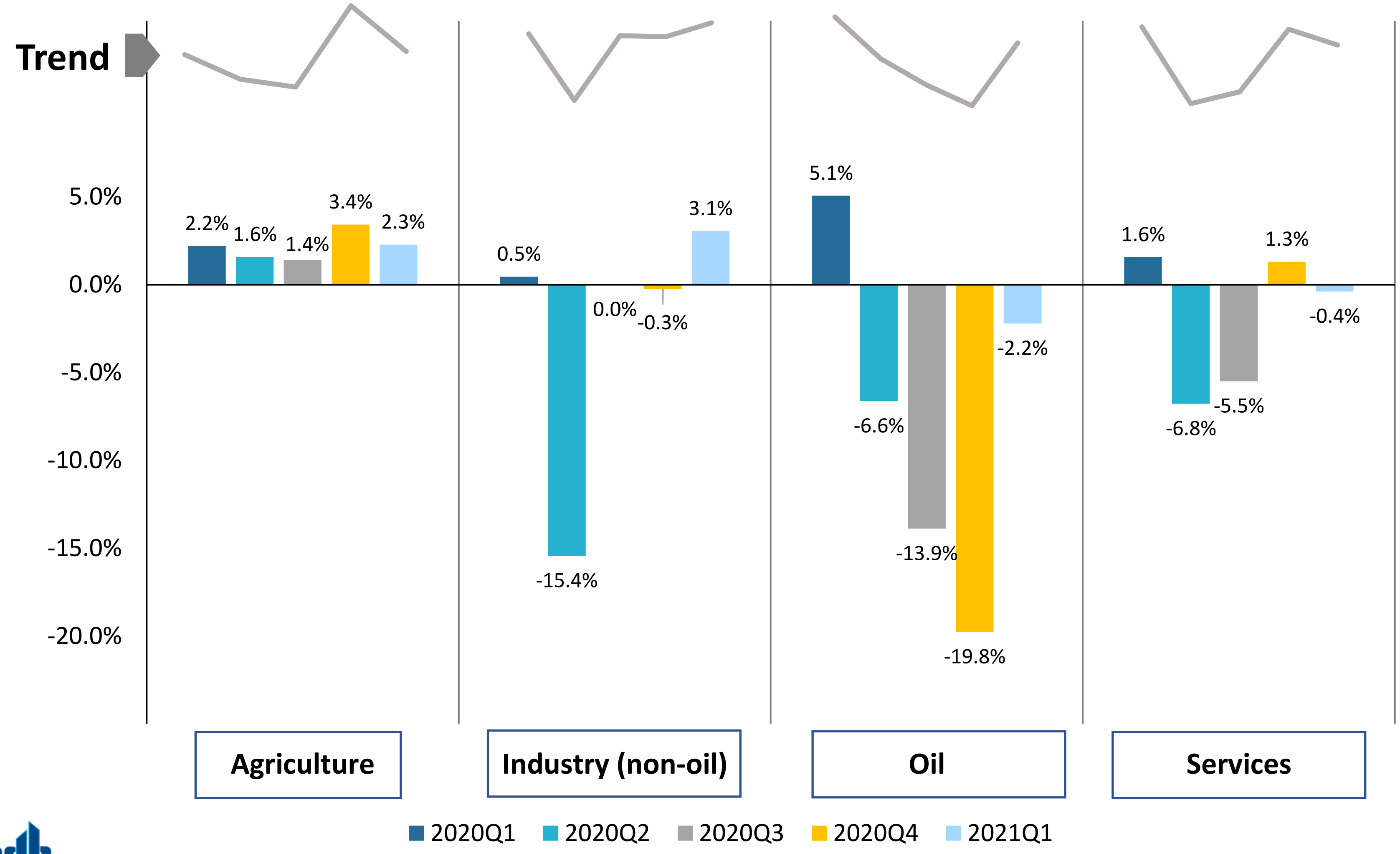


- 8 sectors recorded positive growth in 2021Q1 as against 7 sectors in 2020Q4.
- Two sectors moved from the contraction region to record positive growth – Manufacturing and Electricity.
- In 2021Q1, the magnitude of contraction reduced across major sectors except for Transportation & Storage.

Data Source: National Bureau of Statistics

Non-Oil Industrial Sector posted a strong recovery in 2021Q1

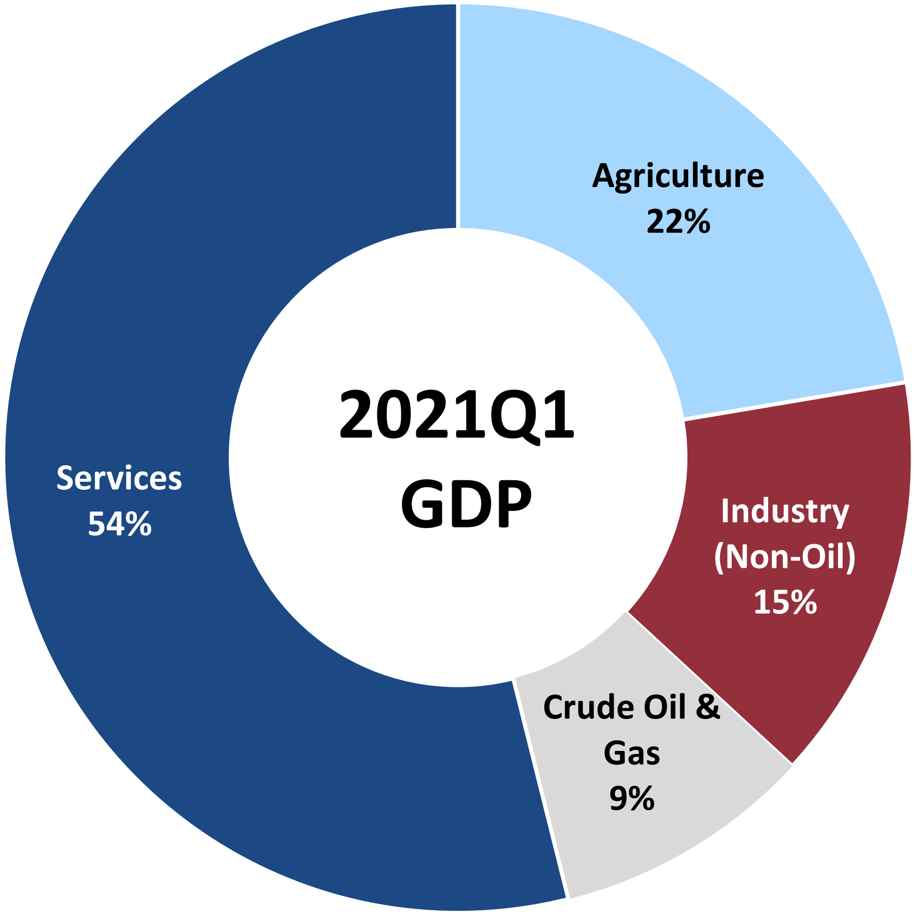
Real GDP growth of major sectors from 2020Q1 to 2021Q1



- The recovery of the manufacturing sector, which grew by 3.4%, was significant in driving the performance of the non-oil industrial sector in 2021Q1.
- Factors such as improving consumer demand and higher spending on construction activities led to a positive growth of the non-oil industrial sector.
- For agriculture, insecurity, seasonal factors and lower demand affected its output, which showed slower growth in 2021Q1.
- Crude oil sector posted its fourth consecutive negative growth rate (-2.2%) following low production volumes amidst OPEC cuts.
- In Q2, the factors that influenced performance across the sectors in Q1 will remain the same; however, growth will improve due to the base effect.

Data Source: National Bureau of Statistics

Share of GDP in 2021Q1: Services sector maintained dominance



Services sector continued to dominate GDP in the first quarter of 2021 with a share of 54%. The largest subsectors in Services include Trade (29% of Services GDP), Information and Communication (28%) and Real Estate (10%).

54%

Agriculture had a share of 22% of Q1GDP, the same share recorded in the first quarter of 2020. Of the four subsectors within agriculture, crop production had the highest share of 88% of agricultural output in 2021Q1.

22%

Non-Oil Industrial sector accounted for 15% of total GDP in the quarter. Manufacturing and Construction accounted for 68% and 28% of the sector, respectively.

15%

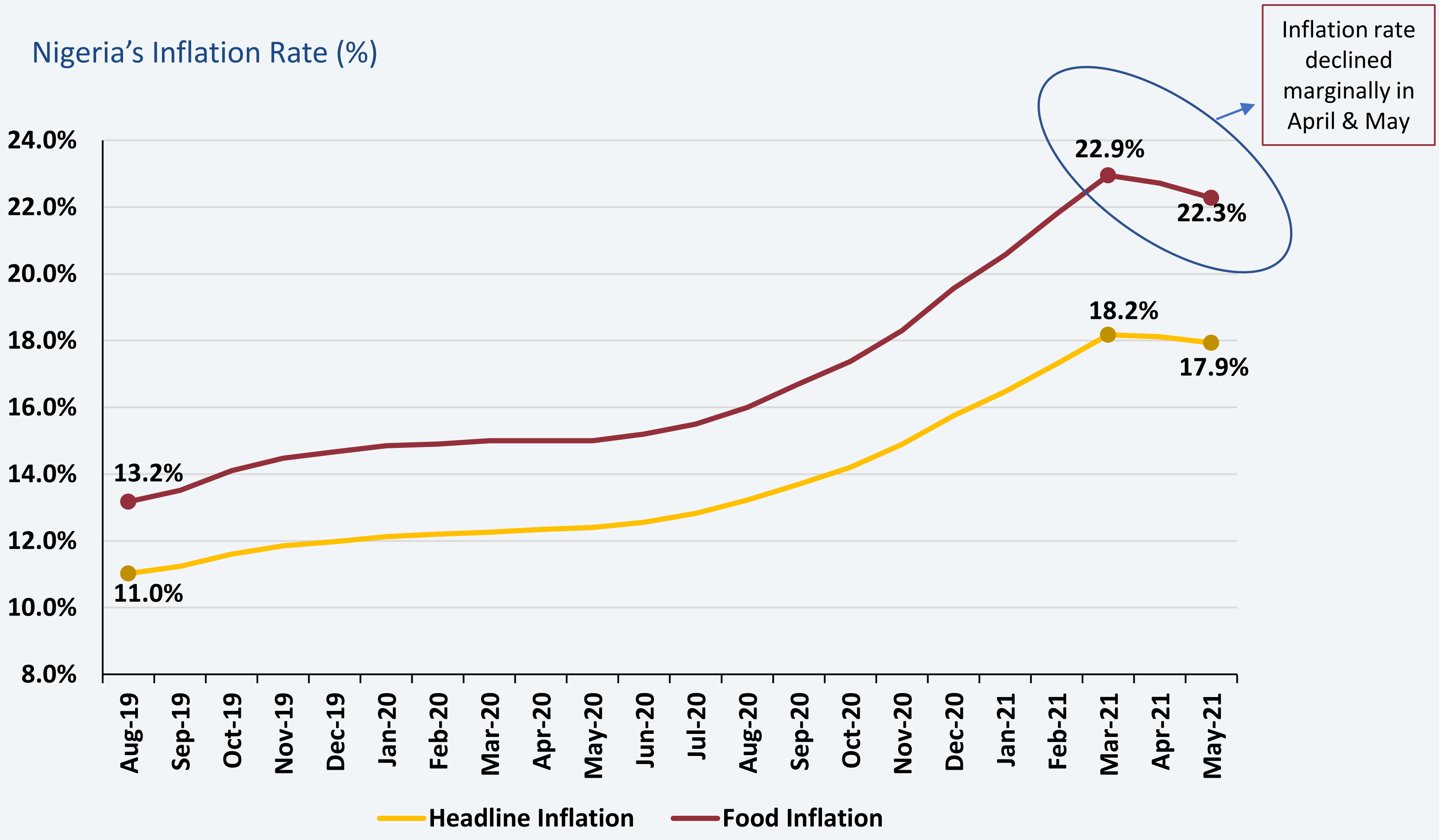
Crude Oil and Natural Gas sector accounted for 9% of GDP in the first quarter of 2021. The sector still remains in recession having posted a negative growth of 2.2% in 2021Q1.

9%

Data Source: National Bureau of Statistics

Inflation: Increase in price of goods and services slowed down in 2021Q2

Nigeria's Inflation Rate (%)



	Jan 2021	May 2021
Headline Inflation	**16.5%**	**17.9%**
Core Inflation	11.9%	13.1%
Food Inflation	20.6%	22.3%

- The upward trend in inflation rate was halted in the month of April.
- Inflation rate declined marginally by 10 basis points in April to 18.1% from 18.2% in March. In May, it declined further to 17.9%.
- The slowdown in price increase was driven by food inflation rate, which also fell from a peak of 22.9% in March to 22.3% in May.
- Month-on-month inflation rate also slowed to 0.97% and 1.01% in April and May, respectively from 1.56% in March 2021.

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Data Source: National Bureau of Statistics

Five areas with the highest increase in inflation rate (year on year)

Food & Non Alcoholic Beverage

Inflation Rate
May 2020: 15%
May 2021: 22.2%

Inflation rate for Food & Non Alcoholic Bev. has risen to 22.2% in May 2021, from 15% a year earlier. Insecurity, exchange rate devaluation and high cost of doing business are factors that are responsible for this increase.

Health

Inflation Rate
May 2020: 10.7%
May 2021: 15.8%

Higher demand for health services due to COVID-19 has led to an increase in health inflation rate, from 10.7% in May 2020 to 15.8% in May 2021.

Transport

Inflation Rate
May 2020: 10.1%
May 2021: 14.9%

Transport prices continue to rise, following the impact of insecurity, higher fuel price and logistics/infrastructure challenges. 4.9 percentage points were added to transport inflation rate in the last one year.

Recreation & Culture

Inflation Rate
May 2020: 8.9%
May 2021: 12.3%

Recreational activities were severely affected by the pandemic due to the lockdown and social distancing rules. This sector is yet to recover from the impact of COVID-19.

Miscellaneous Goods & Services

Inflation Rate
May 2020: 10%
May 2021: 13.3%

Miscellaneous goods & services which cover household appliances and tools have experienced upward trending inflation rate in the last one year mainly due to Naira devaluation and logistics costs.

In the last one year, inflation has been driven by insecurity, increase in fuel price, supply-chain disruption, exchange rate devaluation, higher demand (for healthcare), closed land borders and high cost of doing business.

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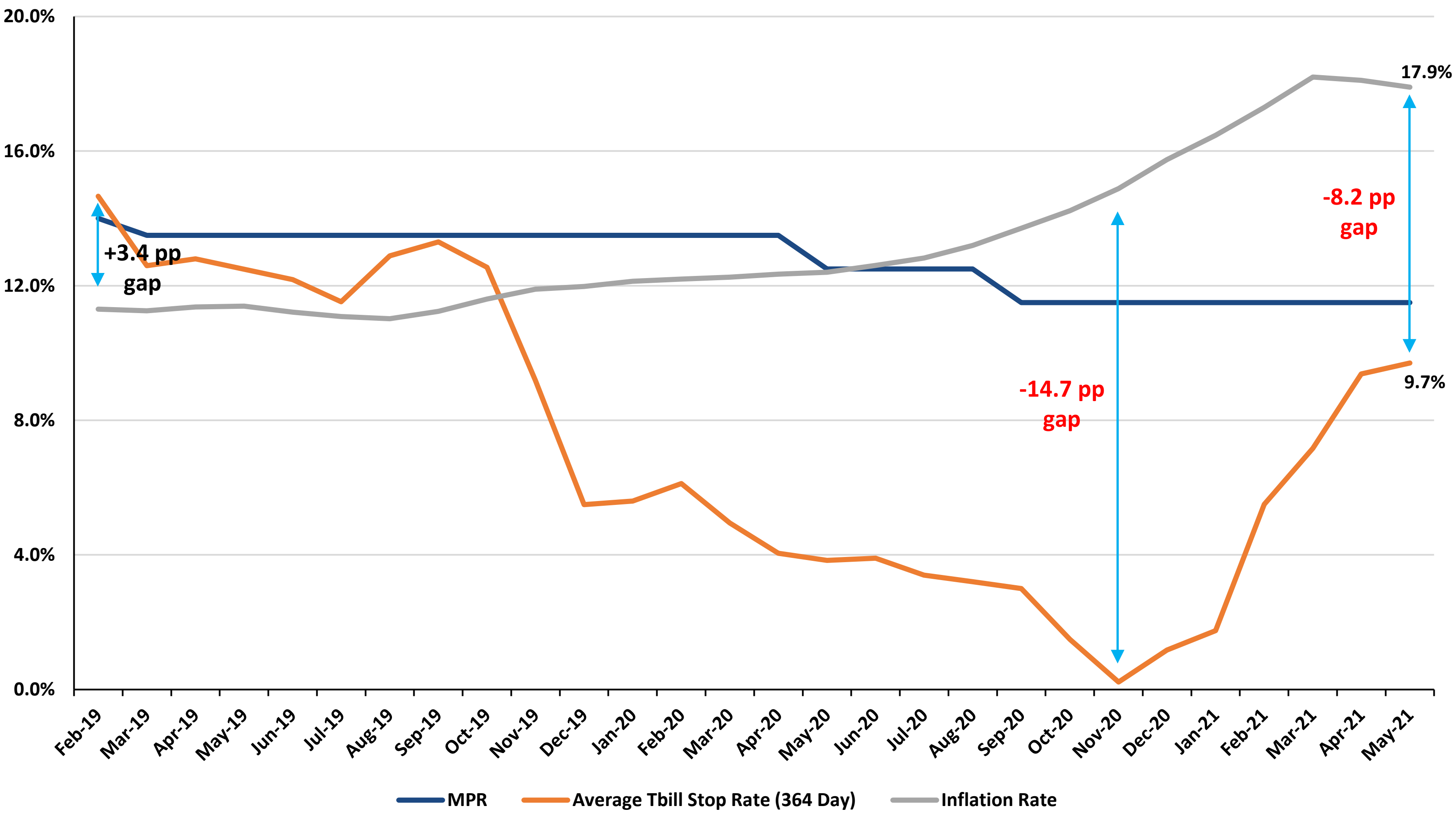
Data Source: National Bureau of Statistics

Real interest rate improves on the back of rising interest rate and falling inflation

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



*pp - percentage points

- As anticipated in our previous Macroeconomic outlook reports, the gap between interest rate and inflation narrowed further in 2021Q2.
- While average interest rate continued its upward trend to 9.7% in May 2021, inflation rate subsided in both April and May.
- Given these, real interest rate improved in April and May 2021.
- Although real interest rate remained negative in May 2021, we expect to see further improvements particularly a moderation of inflation in coming months. This is based on the expectation that the security situation will improve in subsequent quarters.

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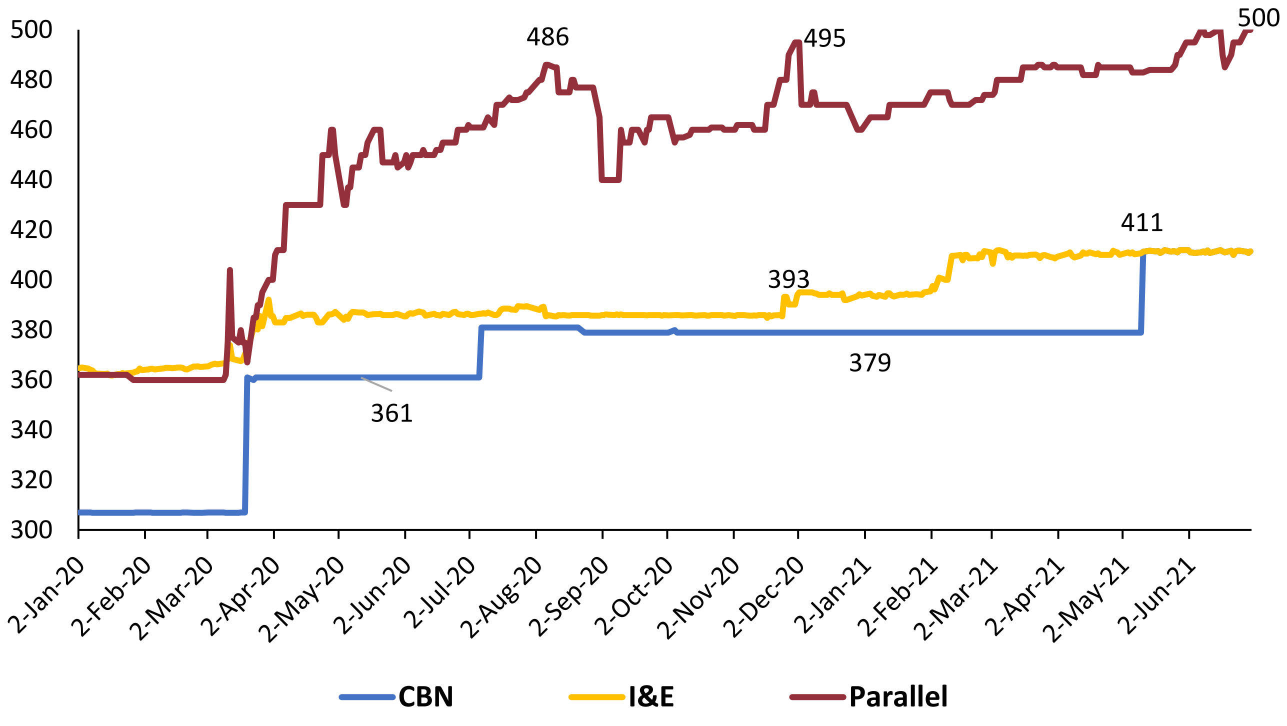
Data Source: National Bureau of Statistics & Central Bank of Nigeria

Exchange rate stabilizes in the I&E window but external reserves felt the pressure

Exchange rate Movement (N/US$)



Data Source: CBN, FMDQ

- In the second quarter of 2021, the Naira was fairly stable in the I&E window, relative to the previous quarter.
- The Naira closed the quarter at N411.5/US$, having opened the quarter at N409.3.
- This relative stability in the I&E window was reflected in the performance of external reserves which was severely pressured in the quarter. Reserves lost 4.4% of its value in the quarter.
- In the parallel market, the Naira depreciated, reaching N500/US$ due to forex scarcity and speculative activities, following the CBN's adoption of NAFEX rate in May.
- Consequently, the gap between the NAFEX rate and the parallel market expanded in the quarter.
- We expect forex pressure to continue into the third quarter owing to limited inflows from both crude and non-oil sources and rising imports.

Timeline of Recent Foreign Exchange Policies in Nigeria

January 2020
Inclusion of fertilizer in the list of items restricted from foreign exchange

February 2020
Restriction on Forex supply to authorized milk and diary product dealers

March 2020
CBN devalued the official exchange rate from N307/US$1 to N360/US$1

April 2020
Adjustment of exchange rate for import duty payment from N326/$ to N361/$

July 2020
Increase of forex bidding price for SMIS operators to N380/$1

July 2020
CBN added maize to the list of imported goods banned from official access to forex

August 2020
The CBN adjusted the official exchange rate to N380/US$1 from N360.1/US$1

August 2020
Resumption of forex sales to BDC after the halt due to COVID-19

November 2020
Amendment of the diaspora remittances rule to allow recipient to receive foreign currency in cash..

December 2020
Instruction to banks to transfer all diaspora remittances to beneficiaries

March 2021
Introduction of the 'Naira 4 Dollar Scheme' for diaspora remittances

May 2021
The CBN adopted the NAFEX (I&E Window) rate as the official rate

Unification of the official Exchange Rate by the CBN

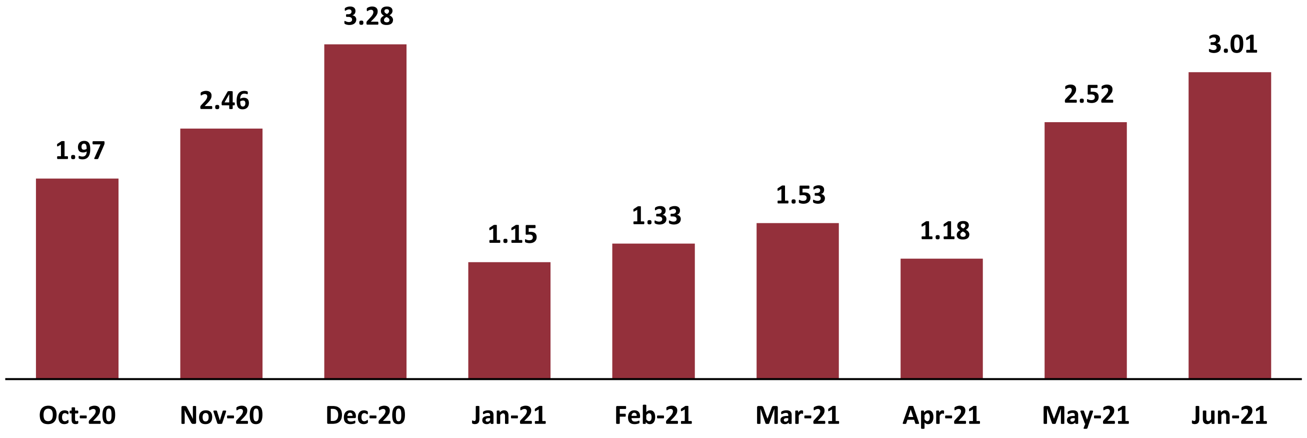
- On Monday, May 24, 2021, the CBN displayed the NAFEX exchange rate on its website.
- The Naira exchanged at N410.25/US$, an adjustment of 8.2% from N379/US$ in the early part of May 2021.
- Recall that the IMF in its Article IV recommended “establishing a market-clearing unified exchange rate with the near-term focus on allowing greater flexibility and removing the backlog of requests for foreign exchange”.
- Likewise, the Federal Government’s Economic Sustainability Plan (ESP) proposed to “unify exchange rates to maximise naira returns to FAAC from foreign exchange inflows”.
- The adoption of rates in the I&E window is long awaited and is among measures to regain market confidence and unlock funds from multilateral agencies including the World Bank and the IMF.

Potential Impact

- Previous exchange rate adjustments by the CBN were not aligned with prevailing market rates. They were below the rate in the I&E window.
- This time, however, the CBN adopted the rate in the I&E window as its official rate.
- We believe this is a first and major step towards gaining back investor’s confidence on the economy, which in turn could improve forex inflows into the economy.
- The federal government has also hinted the issuance of Eurobond which is expected to improve reserves position and ease pressure on the exchange rate when issued.

Despite the unification, CBN intervention in the I&E Window increased in 2021Q2

Investors' and Exporters' Window Turnover (US$'Billion)



Forex Inflow in the I&E Window (US$'Million)

Sources	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21
FDI	31.7	65.0	54.2	69.8	7.5	29	12.3	26.8	61.7
FPI	48.1	54.8	23.6	116.1	17.9	175.2	31.1	193.5	123.8
Other Corporate	43.4	22.9	24.0	17.3	9.3	9.7	25.3	29.8	17.6
CBN	**558.2**	**453.6**	**823.9**	**74.1**	**2.9**	**6.4**	**143.2**	**435.2**	**324.6**
Exporter	117.2	134.8	111.5	209.5	175.7	125.5	109.4	125.4	136.6
Individuals	26.3	29.8	12.3	20.9	2.5	14.4	16.5	2.5	2.2
Non-bank corporate	304.8	407.7	316.5	227.2	350.1	191.2	226.4	228.9	300.3
Total	**1,165.7**	**1,168.6**	**1,366.0**	**734.9**	**565.9**	**551.4**	**564.2**	**1,042.1**	**966.8**

Data Source: FMDQ

- The limited supply of forex is manifested in the contraction of inflows and turnover into the Investors' and Exporters' (I&E) Window, earlier in the year.
- But with the unification of the official exchange rate in May 2021, inflow and turnover increased.
- Consequently, the inflows and turnover in the market expanded to US$2.57 billion and US$6.71 billion in 2021Q2 from US$1.85 billion and US$4.01 billion in 2021Q1 respectively.
- This suggests a positive response of the market to the unification move as inflows improved across major sources of forex supply to the I&E Window.
- We note, however, the increase in inflows from the CBN to US$324.6 million in June, from US$6.4 million in March.
- This is a return to higher levels of intervention witnessed in 2020.

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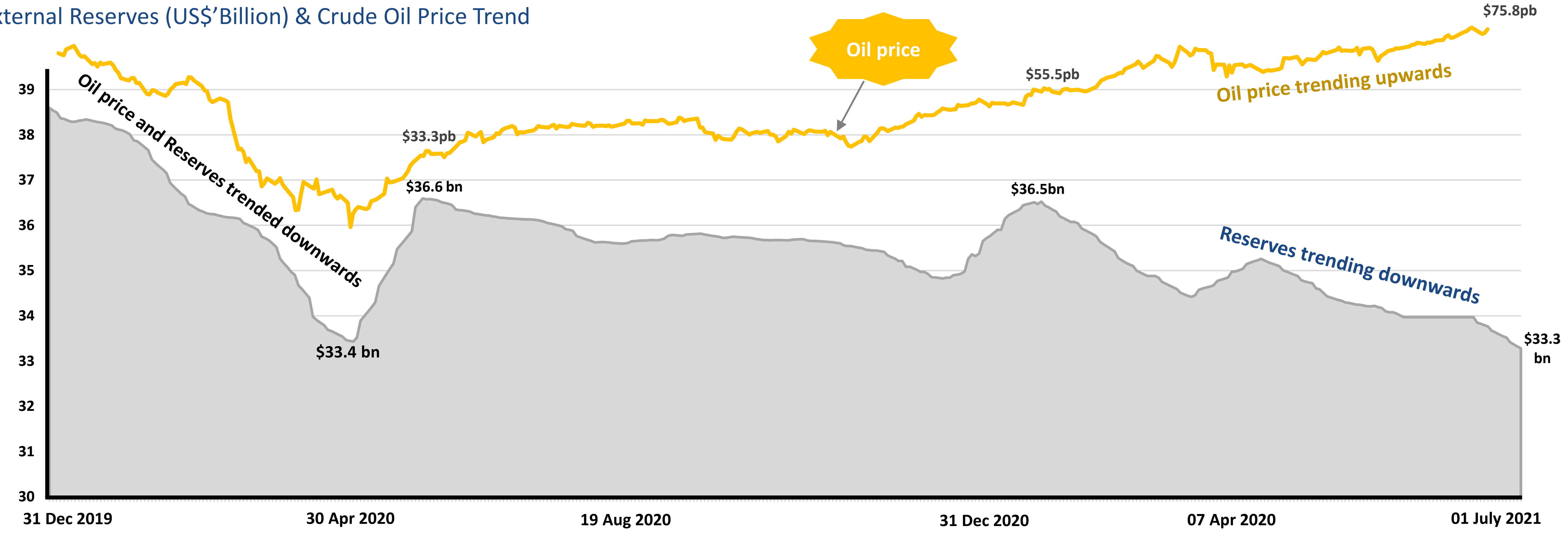
External Reserves fell below US$34 billion in June, closed Q2 at US$33.3 billion

External Reserves (US$'Billion) & Crude Oil Price Trend



Despite an increase in crude oil price since late 2020, Nigeria's external reserves continued to face significant pressure. Reserves closed the second quarter of 2021 at US$33.3 billion, the lowest since October 2017.

6.5%

As at June 30, 2021, reserves had lost 6.5% since the beginning of the year

Nigeria's compliance with OPEC cuts, weaker foreign investment inflows, high demand for foreign currency to finance imports and other needs are factors that continue to weaken external reserves. Year to date (June 30) reserve average stood at US$34.8 billion.

Data Source: Central Bank of Nigeria, U.S. Energy Information Administration

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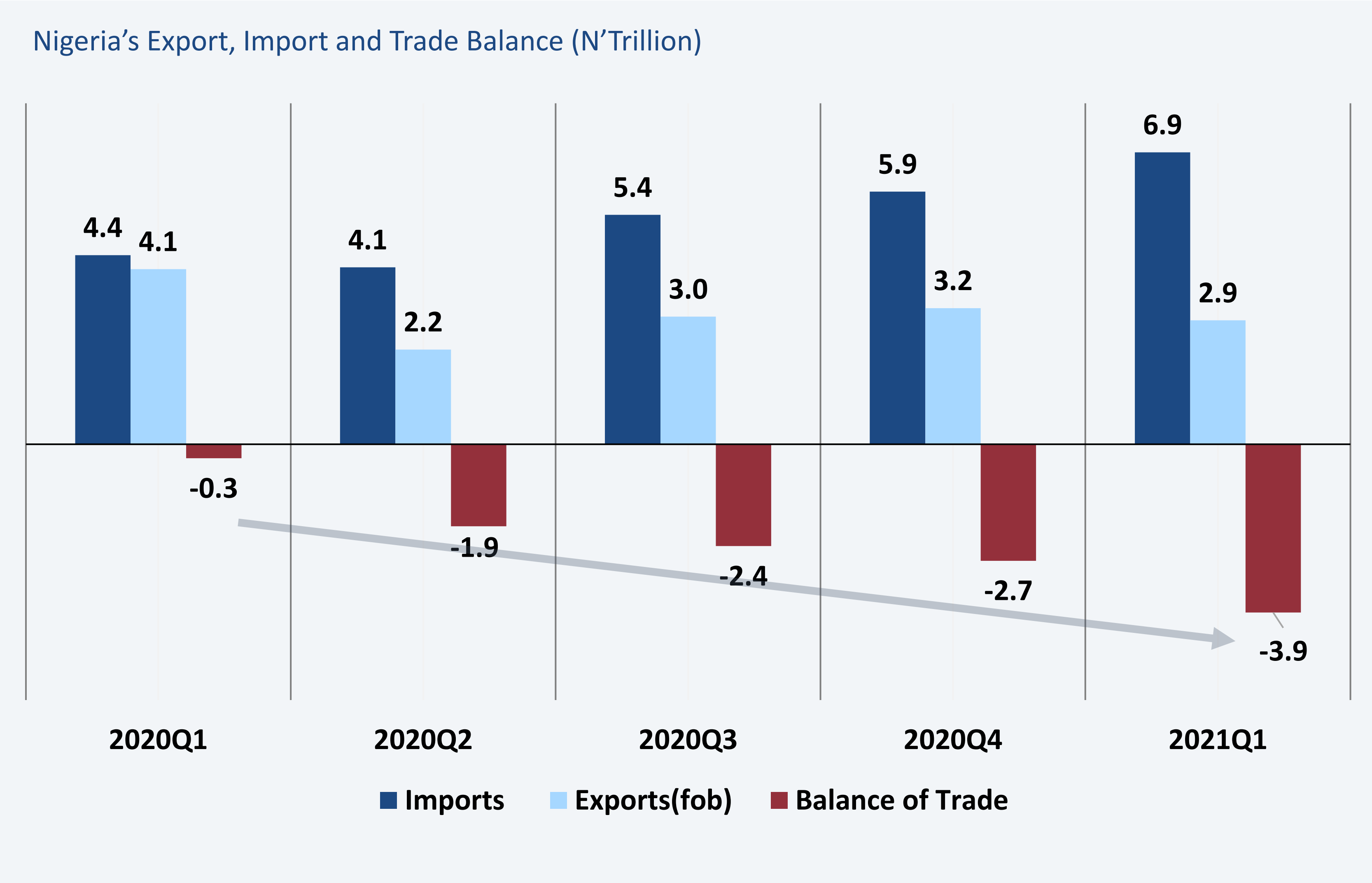
Trade: Imports continue to rise; Export stagnates, Deficit keeps expanding



- For four consecutive quarters, Nigeria's trade deficit expanded in 2021Q1 to N3.9 trillion, confirming the sluggish economic recovery.
- This was due to an increase in the value of imports in the quarter while exports value (particularly oil exports) declined.
- Challenges associated with local production as well as a huge and growing appetite for imported products are key factors that contributed to the rising trade deficit.
- In our previous Macroeconomic Outlook report, we noted that imports will continue to rise while Nigeria's ability to reverse its trade deficit in 2021 will depend largely on crude oil production volumes.

Data Source: National Bureau of Statistics

Value of imports in 2021Q1 was more than twice the size of exports

Top 4 Exports by Section in 2021Q1

01

Mineral products

Mineral products, dominated by crude oil accounted for 85.5% of total exports in 2021Q1.

02

Vehicles, aircraft and parts thereof; vessels etc.

This category of exports was valued at N180.5 billion and was 6.2% of total exports in 2021Q1.

03

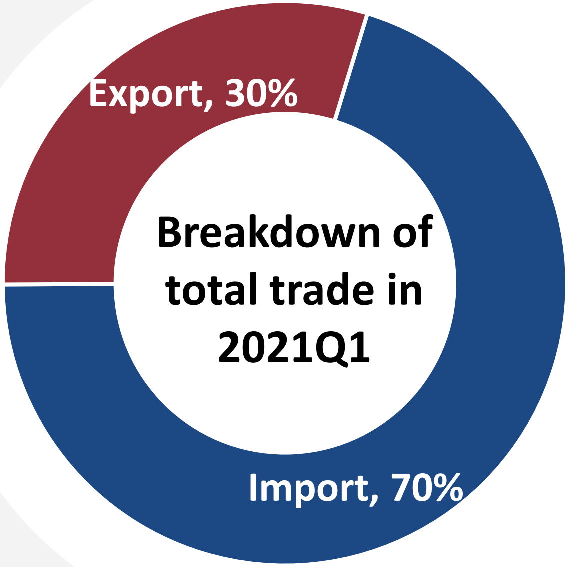
Vegetable products

Export value of vegetable products stood at N82.3 billion, representing 2.8% of total exports.

04

Prepared foodstuffs; beverages, spirits and vinegar; tobacco

Nigeria earned N63 billion from exporting items in this category.



01

Boilers, machinery and appliances; parts thereof

In 2021Q1, N1.85 trillion was spent importing items in this category. This represents 27% of total imports.

02

Mineral products

Fuel and other petroleum products were the second highest on the import list, accounting for 15% (N1.02 trillion) of total imports in the quarter.

03

Products of the chemical and allied industries

This category accounted for 14.2% of total imports with a value of N976 billion.

04

Vehicles, aircraft and parts thereof; vessels etc.

N635 billion was spent importing items in this category in the first quarter of 2021.

Top 4 Imports by Section in 2021Q1

Data Source: National Bureau of Statistics

Crude oil dominates exports as there is no change in the structure of Nigeria's Trade

Breakdown of Imports and Exports in 2021Q1

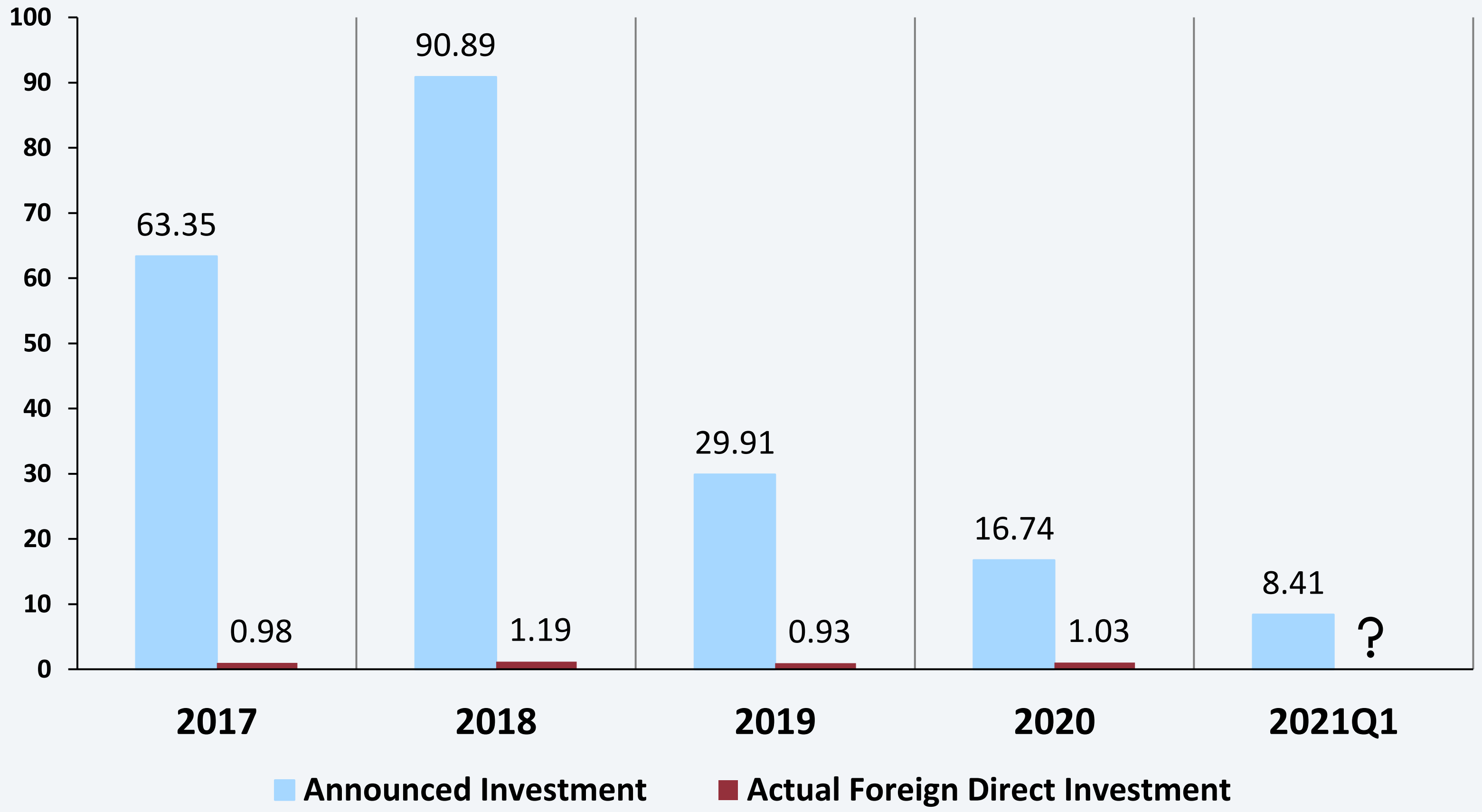
	Percentage of Imports	Percentage of Exports
Agricultural Goods	9.2%	4.4%
Raw Material Goods	9.8%	1.5%
Solid Mineral Goods	0.6%	0.3%
Energy Goods	0.0%	0.2%
Manufactured Goods	66.2%	8.6%
Crude and Other Oil Products	14.3%	85.0%

- Despite the intent by the Nigerian government to diversify its export profile, crude oil and other oil products continue to dominate, accounting for 85% of exports in 2021Q1.
- In the quarter, crude oil exports declined by 34.5% relative to 2020Q1 and by 23.5% when compared with data from 2020Q4.
- For imports, a significant share of forex is spent on importing manufactured goods and refined petroleum products.
- This trend will continue in 2021 especially given the absence of any major structural reforms.

Data Source: National Bureau of Statistics

Huge gap between announced and actual investment points to doing business hurdles

Nigeria's Announced Investment and FDI Inflows (US$ Billion)



- Nigeria's investment climate remains challenged despite the huge potentials of the economy.
- This is evident in the gap between announced investment and actual FDI inflows into key sectors.
- In the first quarter of 2021, announced investments in Nigeria was US$8.4 billion, 50% short of the figure in the previous quarter.
- The manufacturing sector accounted for the highest share (60%) of announced investment, followed by construction (34%).
- FDI is expected to remain under $300 million in the quarter , especially given the tough doing business environment.

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Data Source: Nigerian Investment Promotion Commission and National Bureau of Statistics

Analyst Views on GDP Growth, Inflation, Investment and Foreign Trade

GDP Growth

- Nigeria recorded a real GDP growth of 0.5% in 2021Q1. This represents the second positive growth since 2020Q3.
- We expect growth in 2021Q2 to be higher than the corresponding and previous quarters mainly due to the base effect.
- In 2020Q2, Nigeria implemented lockdown and restrictions which limited economic activities. Because GDP calculation compares one quarter with the previous corresponding quarter, this is expected to significantly influence Q2 results.
- Key sectors that will drive GDP growth in Q2 include Agriculture, Information and Communication and Healthcare.
- Factors that will influence growth will include consumer spending on food and transport as well as government spending on construction, defence and other areas.
- In terms of structure, we do not expect any significant change in the structure of the economy.

Trade and Investment

- Nigeria's investment climate remains tough, compounded by insecurity in different parts of the country. As a result, investment inflows into the real sector will remain subdued until there are improvements in the security situation.
- For trade, imports will continue to trend upwards mainly due to challenges associated with local production as well as a huge and growing appetite for imported products. This will have negative implication on foreign exchange and add pressures on the reserves.
- We expect marginal improvements in exports following improved demand conditions across the globe and reopening of land borders. We believe that trade deficit will begin to narrow in the third quarter as oil production and export improves.

Inflation

- We noted in our previous report that the rate of change in prices (inflation) will moderate as the government will intensify efforts to address insecurity concerns. This materialized in 2021Q2.
- However, we believe that inflation-stoking factors such as high fuel cost, logistics bottlenecks and infrastructure deficit will persist in the year.

Analyst views on Nigeria's Foreign Exchange Situation

- **The action by the Central Bank to unify the exchange rate is a positive move for the economy.** This was a recommendation in our Macroeconomic Review for 2021Q1. With this move, the CBN has taken a step towards ensuring clarity and improving market confidence. Nigeria can also unlock funding from several multilateral organisations such as the IMF and World Bank and ease the pressure on the exchange rate in the medium term. However, exchange rate unification is not a sufficient factor in attracting significant capital into the country. What should follow the CBN's recent actions, in our view, are a set of consistent forex policies that seek to improve market liquidity and prevent every form of forex arbitrage and unnecessary forex subsidies. The CBN will also need to clear forex backlogs to further instil confidence in the market. In February 2021, the IMF estimated backlogs at US$2 billion. We believe this will be done gradually.

- **As much as Nigeria needs effective management of forex and unification of exchange rate to breed confidence, the supply shortage of forex is still a major problem.** Increasing forex supply from non-CBN sources is vital in maintaining exchange rate stability in the I&E window and reducing speculative activities. In addition, the planned issuance of Eurobond by the government is expected to provide some relief in the market and boost external reserves in the short term.

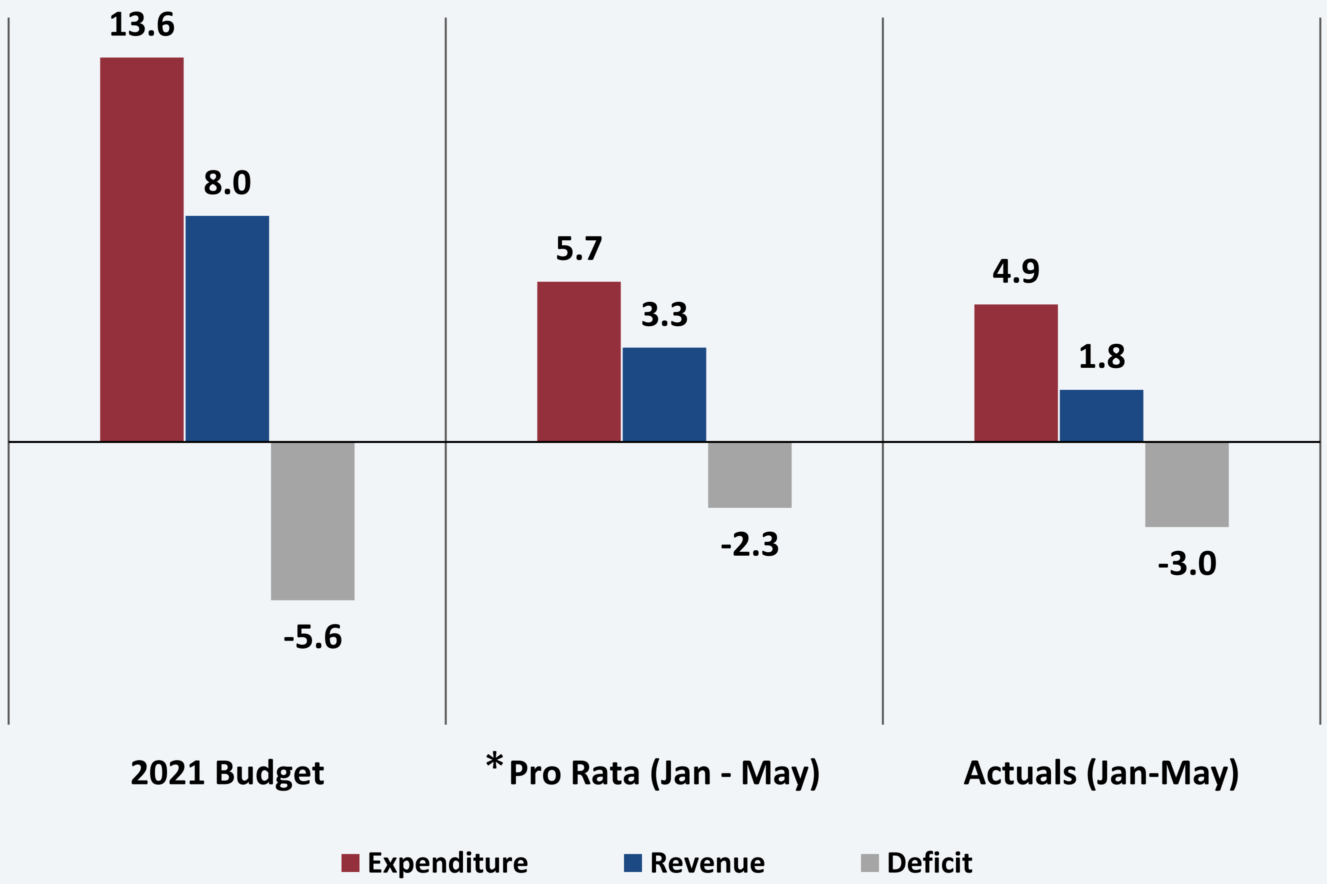
- **From the fiscal and trade perspective, Nigeria will need to leverage on the African Continental Free Trade Area (AfCFTA) Agreement to boost non-oil exports and increase forex inflows.** Providing direct incentives for businesses to produce for exports, implementing port reforms as well as developing a comprehensive industrial and trade strategies are important steps that the government must take.

- **We believe that the Naira will settle around N430/US$ in the later part of 2021.** Forex inflows are expected to also improve, especially when the Eurobond is issued, but increasing demand pressures from imports and other payments, will continue to exert pressure on the rate and on the reserves.

Fiscal & Monetary Review

Fiscal Policy: Actual FGN deficit in the first five months of 2021 exceeded target by 29.1%

Federal Government Deficit (Trillion Naira)



*Pro Rata figures: annual 2021 budget figures are proportionately distributed for five months.

- Actual federal government deficit totaled at N3 trillion in the first five months of 2021.
- This represents 53.8% of the total deficit planned for the full year 2020 (N5.6 trillion).
- Actual deficit is also higher than the Pro Rata figure of N2.3 trillion by 29.1%.
- In our previous outlook, we noted that "actual deficit will be higher due to the anticipated revenue shortfall when compared with its target". This scenario played out in the first five months of 2021.
- Actual revenue fell short of its target by 45% while expenditure was just 14% below target.
- As with previous budget, revenue was largely unmet while actual expenditure was close to its targets, except for capex.

Data Source: Budget Office of the Federation

Fiscal Policy: Non-oil revenue improved, debt service exceeded target

Revenue

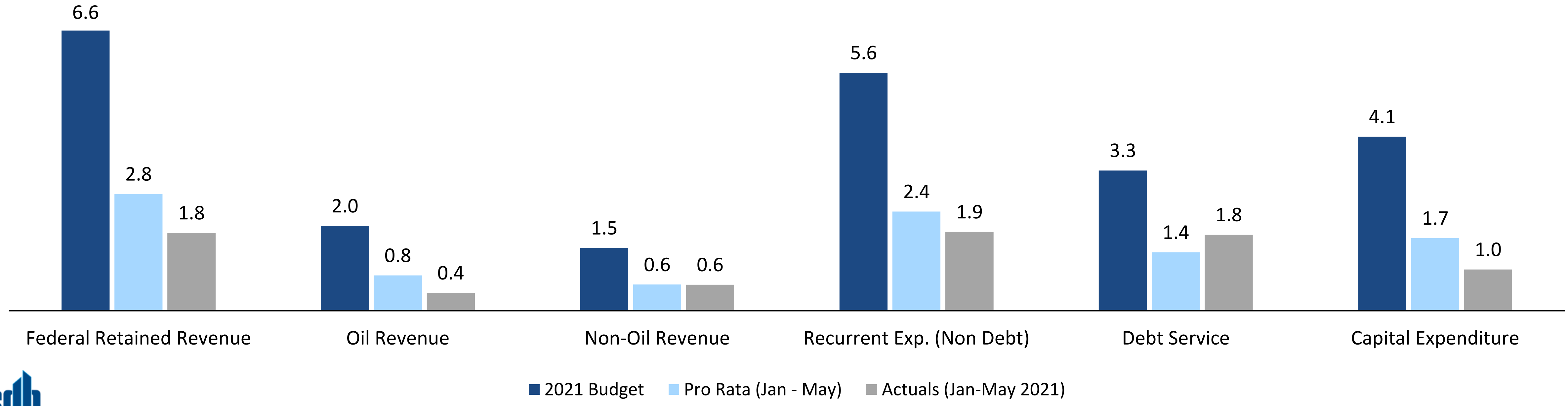
In the first five months of 2021, FG's revenue profile was challenged across several revenue components. Federal Retained Revenue was 35.5% short of its target while oil revenue was 49.5% below its target, mainly due to lower crude oil production volumes. However, the performance of non-oil revenue improved significantly (99.7% of its target was met), mainly due to higher inflows from Company Income Tax and Value Added Tax.

Expenditure

Although actual non-debt recurrent and capital expenditures were below their targets, debt servicing cost exceeded its pro rata figure by 28.6% from January to May 2021. Rising interest rates, FG payment obligations and the accumulation of more debts to finance expenditure are responsible factors. In the first five months of the year, 98% of total revenue was used to service debt.

Federal Government Budget Performance from Jan – May 2021, selected components

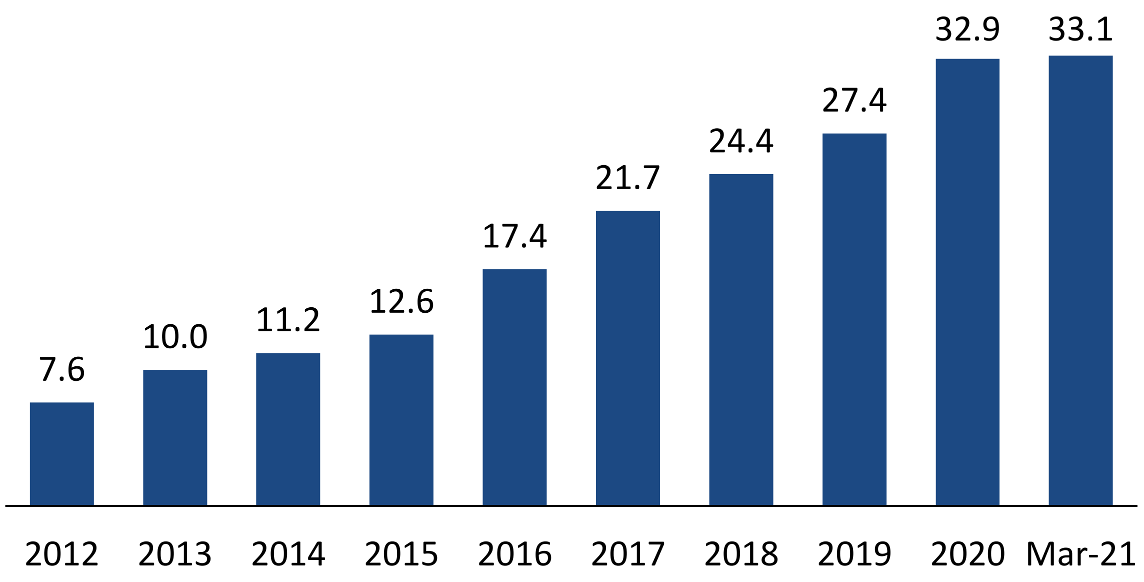
Figures in Trillion Naira



Data Source: Budget Office of the Federation

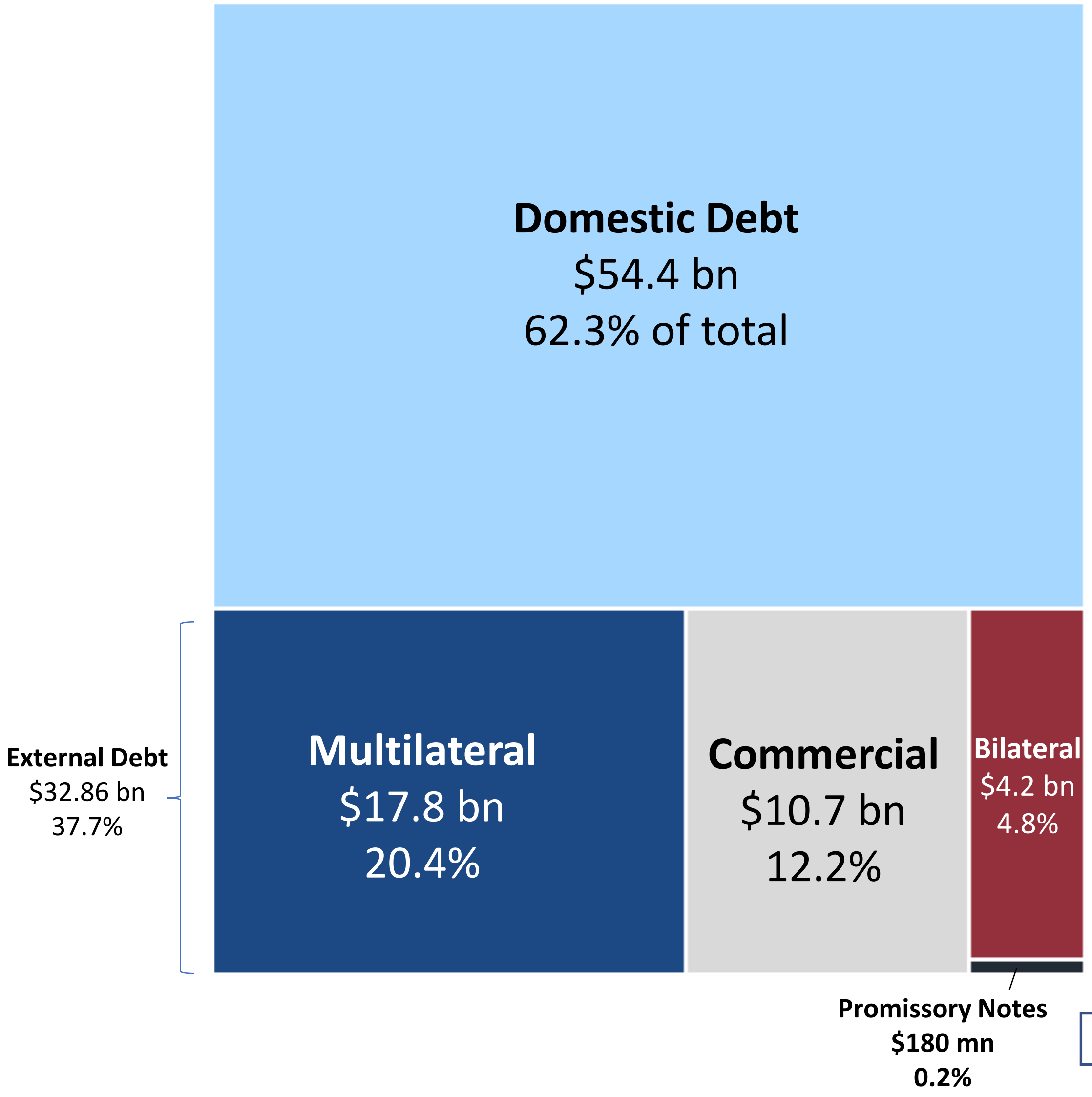
Total Public Debt rose marginally in 2021Q1 to N33.1 trillion.

Public Debt Stock (N'Trillion)



- Nigeria's public debt stock rose marginally to N33.1 trillion (US$87.2 billion) in the first quarter of 2021.
- The IMF estimated debt to GDP in 2020 at 34.4%, when CBN Ways and Means and AMCON bonds are included.
- Debt is expected to rise further in 2021 following the anticipated revenue shortfall (against projected revenue). The key challenge to debt sustainability is Nigeria's low revenue profile.

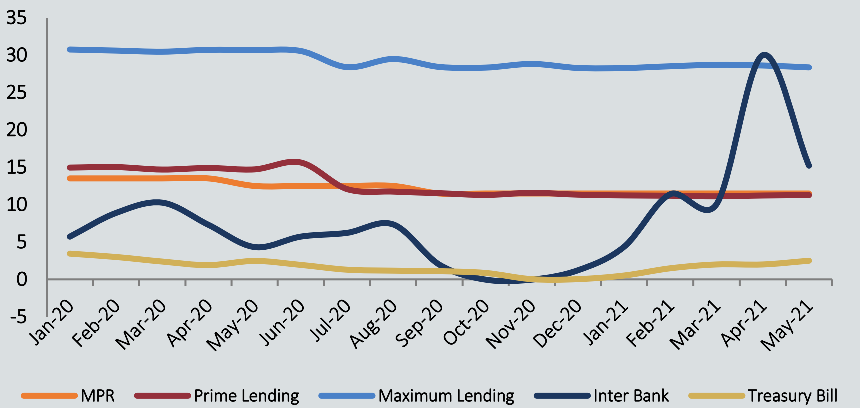
Breakdown of Nigeria's $87.2 bn Public Debt Stock & Share of Total



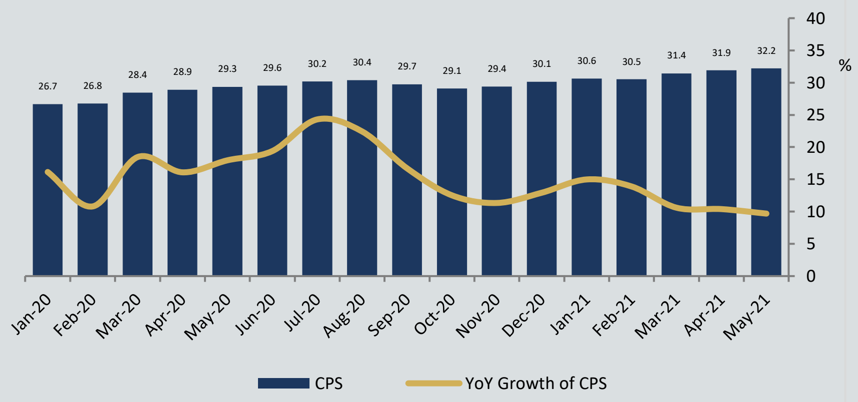
Data Source: Debt Management Office

Monetary Policy: Key Charts

Lending Rate (%)



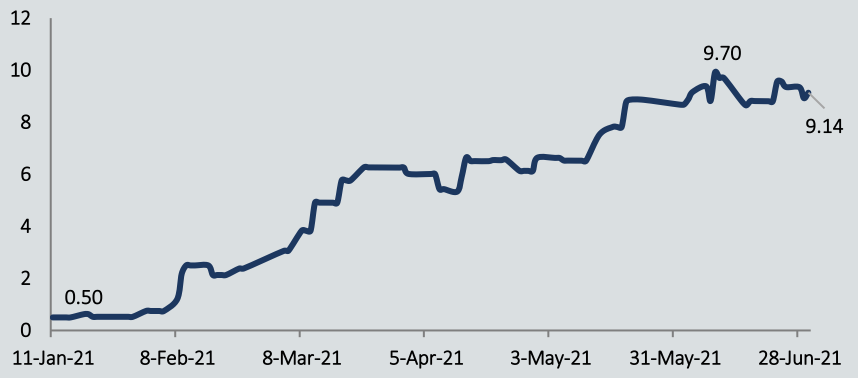
Credit to Private Sector (N'Trillion)



Financial Deepening Indicators (%)

	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21
Currency/M2	7.71	7.50	7.31	7.35	7.29	7.18
Currency/GDP	1.91	1.86	1.82	1.84	1.84	1.83
M2/GDP	24.75	24.78	24.97	25.09	25.20	25.50
CPS/GDP	19.79	20.12	20.03	20.64	20.89	21.14
Stock Market Capitalization/GDP	13.56	15.38	14.44	14.17	14.46	13.15

CBN Special Bill Yield (%)



Data Source: Central Bank of Nigeria

Monetary Policy: Outlook and Expectation

The CBN Monetary Policy Committee (MPC) held its third meeting of 2021 in May and the Committee maintained its previous policy stance for the fourth consecutive meetings. The MPC decided as follows:

- ***Retain the MPR at 11.5%;***
- ***Retain the Asymmetric Corridor at +100/-700 basis points around the MPR;***
- ***Retain Cash Reserve Ratio (CRR) at 27.5 percent; and***
- ***Retain the Liquidity Ratio at 30 percent.***

Key factors that influenced monetary policy decisions at the MPC meeting included:

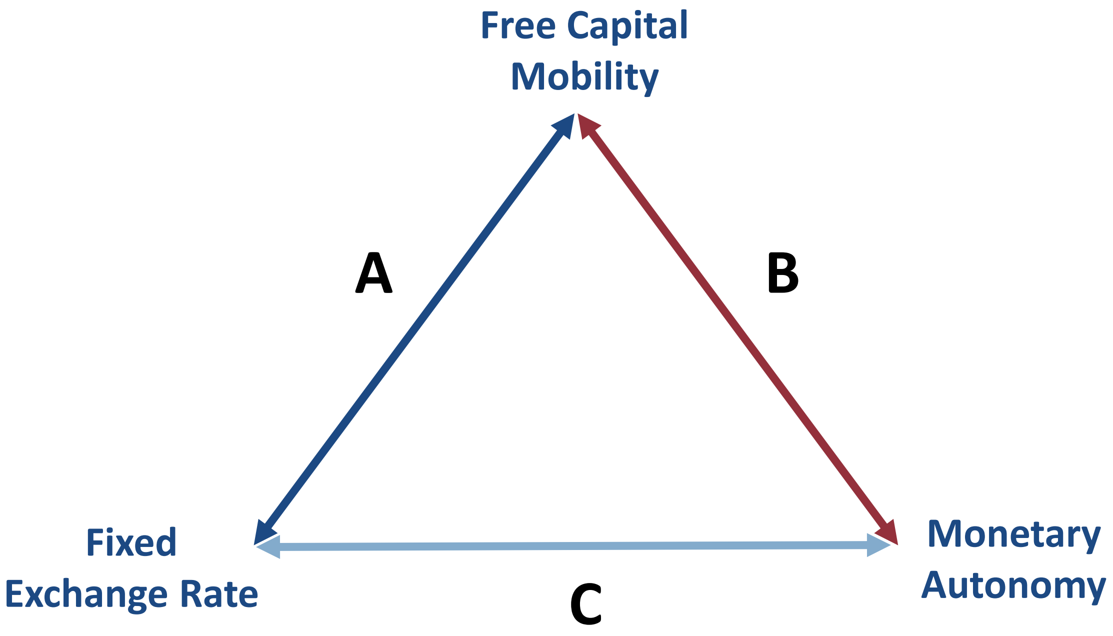
- **The need to support economic recovery**
- **Inflationary pressure**
- **The need to improve consumption and investment**
- **Credit to the private sector**
- **Persisting security challenges and infrastructural deficits**

Outlook and expectations

- **As economic activities resume across several activity sectors, we anticipate improved economic recovery in subsequent quarters.**
- **However, the inherent fragility due to structural factors such as infrastructural deficit, security challenges, foreign exchange instability, among others, will keep the growth rate tepid.**
- **Given that the recent driver of inflationary pressure remains structural rather than monetary, future MPC meetings will put this into consideration, raising the possibility of a rate reduction.**
- **However, the need to continue to attract capital inflows to boost foreign reserves, support the budget and ensure exchange rate stability would motivate the MPC to keep interest rates high.**
- **Consequently in the coming MPC meeting, we anticipate the committee will retain their policy position while observing the domestic and global developments.**

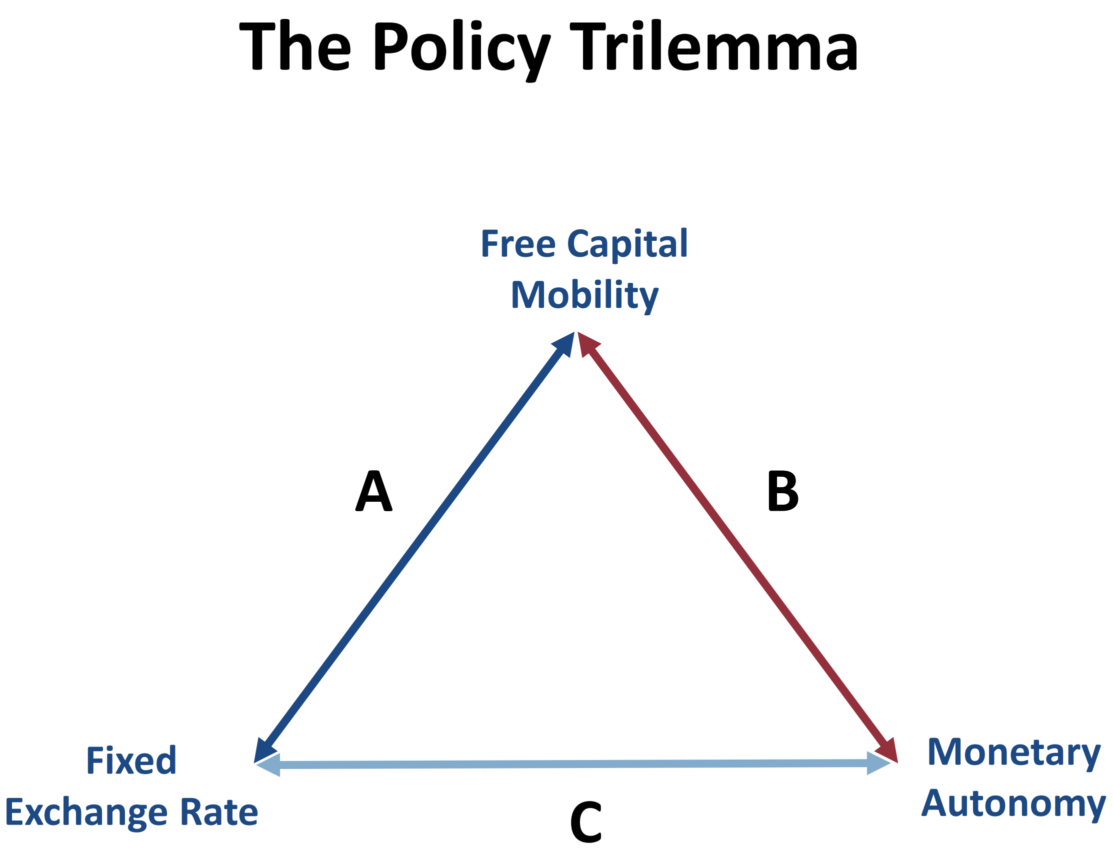
The Policy Trilemma: a useful guide for monetary policy decision

The Policy Trilemma



- The Policy Trilemma explains foreign exchange and monetary choices. The trilemma refers to the trade-offs a government faces when making crucial monetary policy decisions.
- In the framework, it is argued that all three objectives cannot be achieved at the same time. Only two of the three objectives can be achieved at a time.
- With COVID-19, Nigeria maintained the two objectives of having a fixed/managed official exchange rate and monetary autonomy (POINT C), at the expense of free movement of capital. This was evident in the capital controls and forex backlogs.
- The recent move by the CBN to adopt the I&E market rate as the official rate could move the country to POINT B: the CBN can control interest rate (monetary autonomy) while capital controls can be relaxed, but exchange rate will have to be flexible.
- Whether the Naira appreciates or depreciates will depend on the level of capital inflows and outflows, CBN’s involvement in the market and the external reserves position. This means the only way to maintain a stable exchange rate is to attract even more capital into the economy or intervene heavily in the forex market using the external reserves.

The Policy Trilemma: a useful guide for monetary policy decision



- At POINT B, exchange rate is expected to be flexible and market determined. This, to a large extent, reduces arbitrage and round-tripping and could move the Naira towards its fair value.

- The CBN's move is expected to instil confidence in the market as foreign investors are more likely to participate in a less fragmented market that can be fairly predictable.

- Given this framework, the options available for the CBN include:
  - *Raise interest rates to incentivise the inflow of capital into the economy. This could hurt economic recovery in subsequent quarters.*
  - *Relax capital control rules/restrictions and simultaneously increase market interventions to prevent significant depreciation of the Naira. This could result in reserves depletion. The CBN appears to favour this option following the recent pressure on the reserves.*
  - *"Allow" the Naira to move freely and grow the reserves.*

- As a way forward, we believe the Monetary Policy Committee will hold rates in the subsequent meeting to support economic recovery while the CBN adopts other measures to increase capital inflows. Forex restrictions will likely continue until reserves position improves.

Analyst Views on Fiscal and Monetary Policy

Fiscal Policy

- Nigeria's fiscal performance in the first five months of 2021 showed mixed outcomes of fiscal indicators, although the outcomes were largely negative.
- As with previous budget periods, revenue was short of its targets while expenditures (except capex) were either close to or exceeded their targets. This was the case for non-debt recurrent expenditure and debt service.
- On a positive note, there was improvement in non-oil revenues due to higher VAT and CIT. This is a welcomed development that must be sustained in the second half of the year.
- Actual oil revenue was 49.5% below its target in the period. This has grave consequences on the economy as reflected in declining reserves and exchange rate pressure.
- For full year 2021, we expect actual deficit to be higher than the budgeted deficit of N5.6 trillion mainly due to revenue shortfalls.
- This implies the total public debt will increase further, and this will raise concerns on debt servicing costs going forward.

Monetary Policy

- All through the year, Monetary Policy Committee will be caught in the battle of either raising rates to attract foreign exchange inflows into the economy or reducing rates to support economic growth.
- Since the last MPC meeting in May, Reserves have fallen below US$34 billion, while interest rates have risen to pre-COVID-19 levels as we envisaged in our previous outlook reports.
- The MPC's decision in the next meeting will be based on the need to strike a balance between growth and foreign exchange stability. This decision will also be influenced by 2021Q2 GDP growth figures and the performance of the Purchasing Managers Index.
- Following that inflation rate trended downwards in Q2 and given our expectation of improved Q2 GDP performance due to the base effect, we believe the Committee will keep rates stable to allow for further improvements of these two indicators.
- At the moment, Nigeria needs to attract foreign inflows and high interest rate will serve as an incentive. Rather than increasing the MPR, we believe the CBN will adopt other measures to tighten monetary policy.

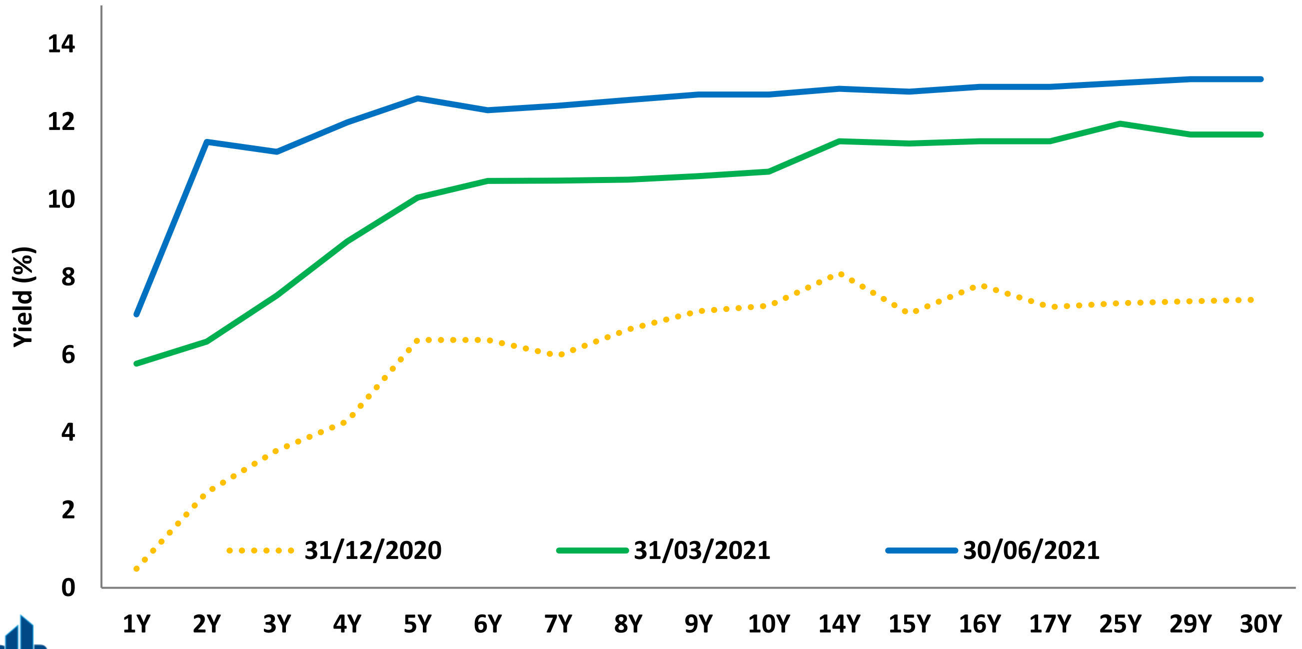
Market Performance

Yields across segments of the fixed income market recovers

FGN Bond Yields

6.12%	9.82%	11.82%
(31/12/2020)	(31/03/2021)	(30/06/2021)

FGN Bond Yield Curves



Data Source: FMDQ

- The fixed income market continues to recover as the impact of the CBN's OMO regulation fades out.
- Hence, yields are increasing across segments of the market.
- Average yield in the FGN Bond market advanced to 11.82% on June 30, 2021 from 6.12% at the beginning of the year.
- This is a further increase from 9.82% at the end of 2021Q1.
- Rising yields are driven by the numerous liquidity management strategies of the CBN to stabilize the market which include:
  - Introduction of the CBN Special Bill;
  - Week on week OMO Auctions;
  - Direct debit on banks' cash balance.
- Also, the expanded government's debt programme for the year influenced interest rates movement.
- Year to date, the government has borrowed a total of N1.42 trillion, a substantial part of which could have gone into repayment of past debts.

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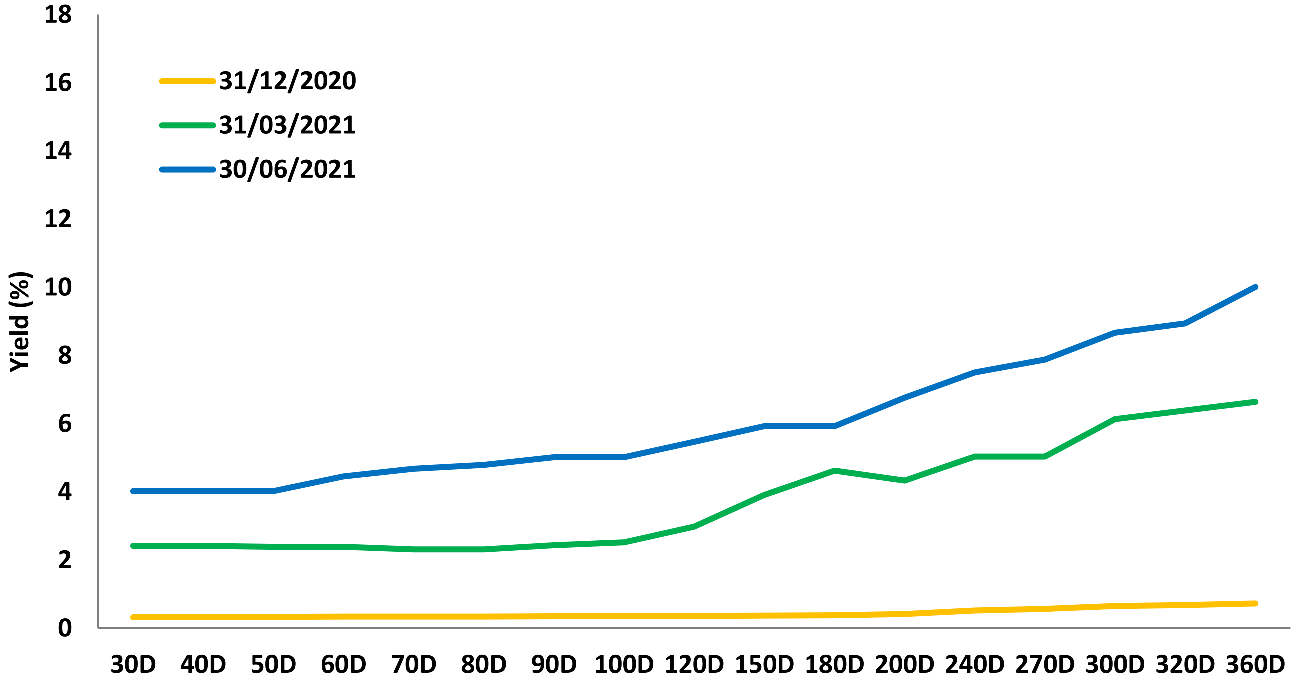
NT-Bill yields advanced in 2021H1 however, still far below inflation rate

NT Bill Yields

0.46%	4.13%	6.58%
(31/12/2020)	(31/03/2021)	(30/06/2021)

NT Bill Yield Curves



Data Source: FMDQ

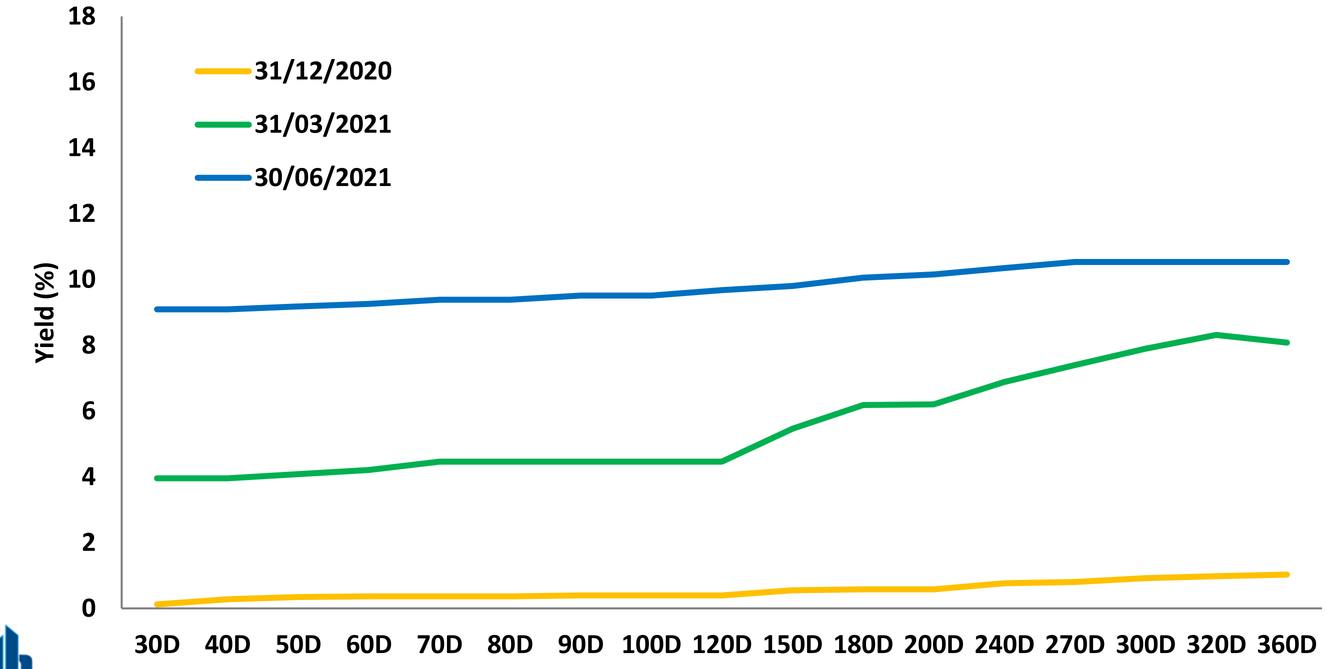
- Yields in the Treasury Bill space increased in 2021H1.
- Average yield in the NT-Bill market increased to 6.58% on June 30, 2021 from 0.46% at the beginning of the year.
- This is a further increase from 4.13% at the end of 2021Q1.
- This is also a direct fallout from the liquidity management strategies of the CBN in the form of OMO Auctions, introduction of CBN Special Bill, intermittent debit on banks’ cash balance and government debt programs.
- In the face of rising inflation and increasing appetite for debt, yields in the treasury bill market will continue to rise.
- Year to date, the government has borrowed a total of N1.83 trillion from the NT-Bill market.

Like similar markets, the OMO market is stabilising

OMO Yields

0.58%	6.45%	9.87%
(31/12/2020)	(31/03/2021)	(30/06/2021)

CBN OMO Yield Curves



Data Source: FMDQ

- As anticipated in our previous Macroeconomic report, yields in the OMO space are fast recovering.
- Average OMO yields increased to 9.87% on June 30, 2021 from 0.58% at the beginning of the year.
- This is also a further increase from 6.45% at the end of 2021Q1.
- Yields are expected to increase following the high inflation rate and government's need to attract foreign investment inflows into the country.

Equity market suffers as yields picked up in the fixed income market

Equity Market Indicators

NGX-ASI	2020	2021Q1	2021H1
Open (N'Bn)	26,842.07	**40,270.72**	**40,270.72**
Close (N'Bn)	40,270.72	**39,045.13**	**37,907.28**
% Change	50.03	**-3.04**	**-5.87**
MARKET CAP	**2020**	**2021Q1**	**2021H1**
Open (N'Bn)	12,958.38	**21,056.76**	**21,056.76**
Close (N'Bn)	21,056.76	**20,428.62**	**19,756.31**
% Change	62.50	**-2.98**	**-6.18**

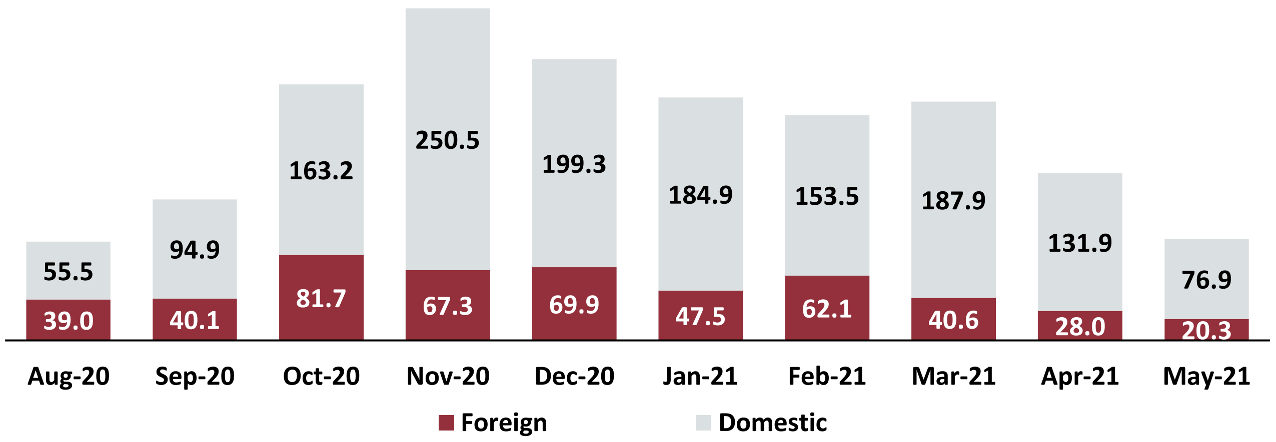
SECTOR PERFORMANCE	2020 (%)	2021Q1 (%)	2021H1 (%)
NSE ASI	50.03	**-3.04**	**-5.87**
NSE 30	39.25	**-5.13**	**-3.78**
Banking	10.14	**-5.94**	**-6.92**
Insurance	50.61	**7.94**	**5.15**
Industrial	90.81	**-7.92**	**-8.09**
Oil & Gas	-13.84	**17.54**	**39.07**
Cons. Goods	-3.29	**-5.30**	**-0.31**

Source: Nigerian Stock Exchange

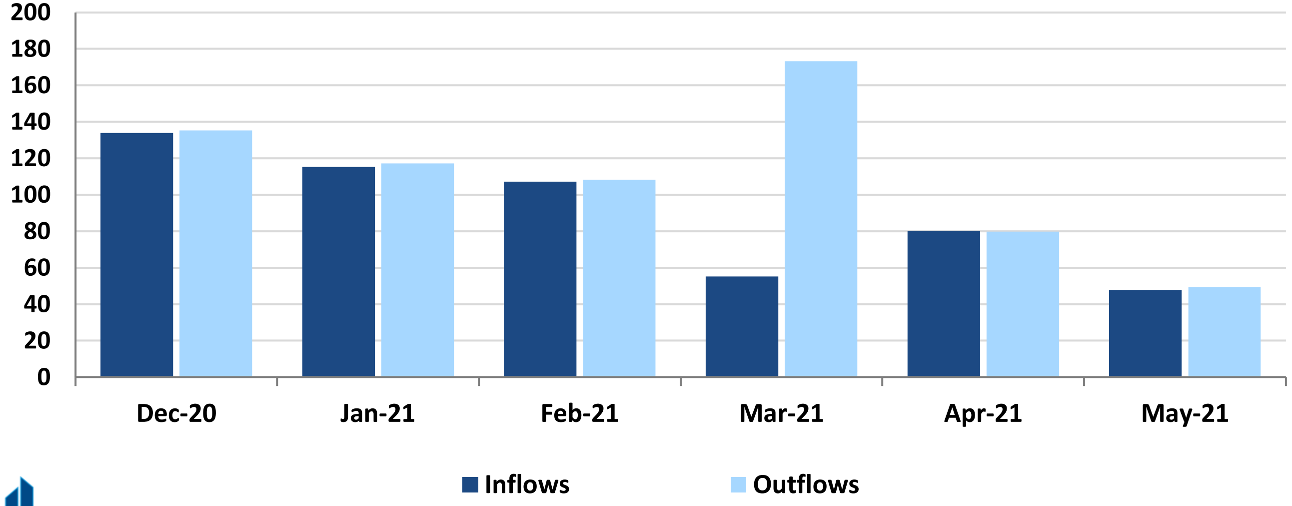
- The Nigerian Stock Exchange closed 2020 on an impressive note, despite fallout from COVID-19. This was partly as a result of lower yields in the fixed income market. The NGX-ASI closed the year with 50.03% gain while the NGX Market Cap expanded by 62.50%.
- However, following the recovery of yields in the fixed income market, the equity market is witnessing a profit-taking sentiment.
- Consequently, the equity market recorded a loss of 5.87% in 2021H1 while the Market Cap contracted by 6.18%. This amounts to a loss of N1.3 trillion in 2021H1.
- On a sector basis, the loss in the equity market has been driven by losses on the Industrial (8.09%) and Banking (6.92%) indices despite 39.07% gain in the Oil & Gas index.
- Beside the advancement of yields, the unimpressive financial statements across many listed companies, have contributed to the sell-off sentiment in the market.

Market participation suggests switch in investors sentiment from equity

NGX Domestic & Foreign Participation (N'Billion)



Breakdown of Participation by share of Inflows and Outflows (N'Billion)

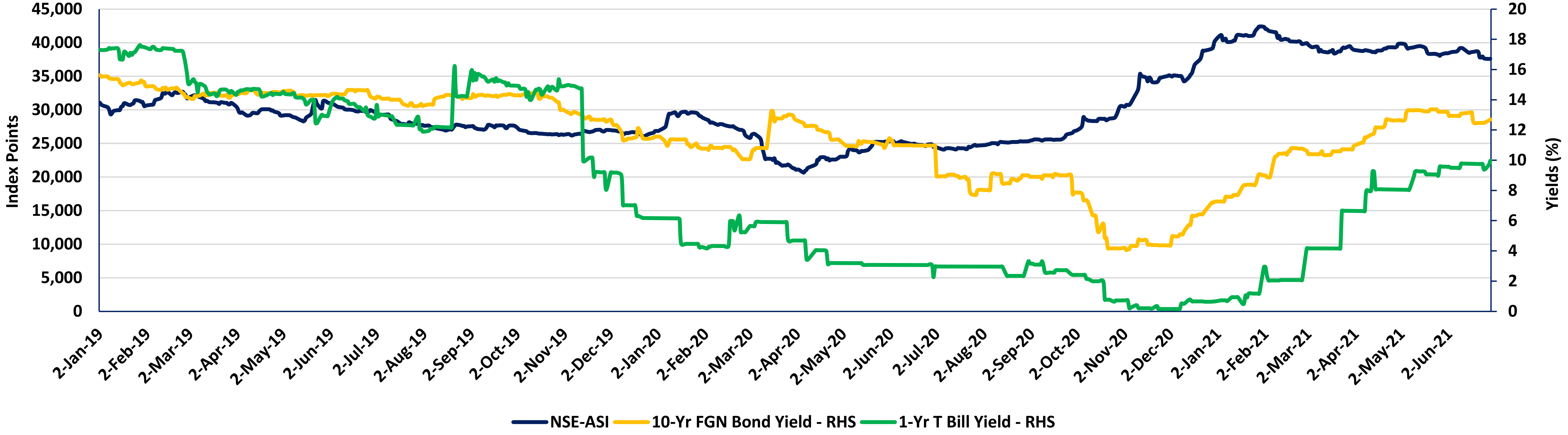


Data Source: Nigerian Stock Exchange

- Following the dousing momentum in the NGX, investors' participation in the equity market persistently contracted as market participation fell short of N100 billion in May 2021.
- Market participation over the first five months of 2021 stood at N933.65 billion, representing 6.74% rise when compared with corresponding period of 2020.
- Foreign participation continued to decline and was significantly lower when compared with domestic participation. Particularly, foreign participation over the first five months of 2021 was 41.66% lower than the corresponding period of 2020.
- The dominance of domestic investors in the market persisted, with participation in the market increasing by 37.56% when compared with corresponding period of 2020.
- Participation in the market was dominated by outflows from both foreign and domestic investors, but largely from domestic investors.
- Foreign investors continued to use the dual listed stocks as avenue for capital mobility as shortage of forex bites harder.

The equity and bond markets exhibit trade-offs

NGX-ASI Compared with 10-Year FGN Bond Yield (%) and 1-Year T-Bill Yield (%)



Following series of intervention from the CBN to manage the surge in liquidity, yields have been improving across segments of the fixed income market at the expense of the equity market. This is due to the following:

- The enduring fragility in the economy which has not made real sector investment attractive.
- Constrained investment climate with very few asset alternatives.
- Relatively high interest environment.

Source: Nigerian Stock Exchange

Capital Market: Analyst Views – Outlook and Expectations

Fixed Income Market

- The 2021 budget of the federal government was heavy on borrowing with a deficit of N5.6 trillion. The Federal Executive Council (FEC) has approved a draft supplementary budget of N895 billion, part of which will be funded by borrowing.
- In addition, the huge gap between actual and targeted revenue in the first five months of the year means that government debt will increase further in the year.
- Consequently, interest rates on the various segments of the fixed income market will experience further expansion.
- The existence of the CBN Special Bill will continue to support the OMO auctions in managing the liquidity in the system. As such, we do not expect any shock of liquidity surge despite an estimated N2 trillion in maturities of FGN Bond, NT-Bill and OMO to come in 2021Q3.
- Hence, we anticipate yields to settle at double digit towards the end of the year.
- Lastly, falling reserves raises the possibility of the issuance of dollar denominated bond in H2.

Equity Market

- In our previous reports, we anticipated a recovery in the market deep into the second and third quarters on the back of dividend payment. However, the outcomes from companies' financial reports have not been impressive enough to drive recovery in the market.
- The increasing interest rate appetite of the government following expanded government's debt programme and its impact on interest rates in the fixed income market have continued to trigger negative sentiments towards the equity market.
- Moreover, the enduring impact of COVID-19 on the economy and associated uncertainties continue to influence investors' participation in the market negatively. This impacts the general performance of listed stocks and continues to subdue market performance.

SECTION 05

The Nigerian Economy: Some Positives, Challenges and the Way Forward

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The Nigerian Economy: Positives and Challenges

Some Positives about the Nigerian economy

- **Nigeria's economic growth is expected to improve** in the second quarter of 2021 due to the base effect.
- **Inflation rate fell in April and May 2021.** This momentum needs to be sustained into the third quarter of the year.
- **The passage of the Petroleum Industry Bill** could unlock opportunities in the oil and gas industry in Nigeria.
- **CBN's adoption of NAFEX as the official exchange rate** is a good step towards improving investors' confidence.
- **The AfCFTA provides a window of opportunity for Nigeria** to improve exports to other African countries.
- **Numerous opportunities across sectors** such as leather, agro-processing, agriculture, ICT, construction, etc.

Key challenges and areas that require improvement

- **Rising state of insecurity** continues to affect agricultural output and safety of lives and properties
- **High cost of living** triggered by consistent increase in the prices of goods and services across the country.
- **Lower revenue from crude oil** due to OPEC production cuts could widen fiscal deficits and lead to more borrowing.
- **Foreign trade remains in deficit** and this could exacerbate exchange rate pressures in coming quarters.
- **Higher prices and a tough business climate** have led to lower investments, rising poverty and unemployment in Nigeria.
- **Absence of inclusive economic growth** as growth continues to be driven by few sectors with limited job creation potentials.
- **Continued pressure on exchange rate and external reserves** arising from weak inflows of foreign currency relative to outflows.

Core issues for Policymakers to swiftly and urgently address in 2021H2

Tackling insecurity

- Show political commitment in addressing insecurity challenges facing the country.
- Ensure recruitment of more security officials; ensure they are properly trained and well-equipped.
- Ensure transparency and accountability of security-related funds.

Foreign Exchange & Debt Management

- Clear foreign exchange demand backlogs and ensure clarity on foreign exchange policies to improve investors' confidence.
- Issue Eurobond which will see the inflow of Forex and boost external reserves in the short term.
- Link new borrowings with specific projects and ensure prudent spending, transparency and accountability of public funds.

Lack of economic diversification

- Embark on a massive campaign to improve non-oil export, leveraging on the African Continental Free Trade Area (AfCFTA) agreement.
- Pursue privatization/sale of redundant government assets.
- Ensure infrastructure development leveraging on private capital.
- Support local production of strategic products/mineral deposits across the country.

Governance & Regulatory reforms

- Institutionalize the policymaking process and ensure strict compliance by government officials to reduce policy inconsistency.
- Intensify ease of doing business reforms and ensure actual implementation. Ports reforms are also crucial.
- Ensure constant stakeholder engagements in the designing and implementation of policies that affect businesses.

Macroeconomic Projection for 2021

Macroeconomic Scenario for 2021

Scenario	Assumptions	Possible Outcome
Best Case (Economy opens up and government fully implements interventions to stimulate the economy)	• Oil price rises significantly above US$53 per barrel • Demand for Nigerian crude improves as economies recover-Nigeria produces 1.9 million barrels per day • Government capital spending at N1.7 trillion • Full implementation of sectoral support interventions	• GDP Growth at 2.3% • Inflation Rate at 14.5% • External Reserves at US$38bn • Exchange Rate at N380/US$
Moderate Case (the economy recovers moderately and embraces the new normal)	• Oil price averages US$45 per barrel • Gradual re-opening of cities, schools, airports, businesses, etc. • Crude oil production at 1.6 million barrels per day • Government capital spending at N1.4 trillion • Partial implementation of sectoral support interventions	• GDP Growth at 1.3% • Inflation Rate at 16.6% • External Reserves at US$34 billion • Average Exchange Rate at N430/US$
Worst Case (Death toll from COVID-19 increases rapidly, weak implementation of business support initiatives)	• Oil price below US$30 pb • Another wave of COVID-19 infections results in lock down of schools and restriction of gathering, etc. • Lower crude oil production- Nigeria produces 1.2 million barrels per day • Government capital spending at N700 billion • Weak implementation of sectoral support interventions • Civil unrests/protests disruptions productive activities	• GDP Growth at -2% • Inflation Rate at 19% • External Reserves at US$28 billion • Exchange Rate at N460/US$

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Macroeconomic Projection for 2021

	2017	2018	2019	2020	2021f*
Real GDP Growth	0.8%	1.9%	2.3%	-1.9%	1.3%
Inflation rate	16.5%	12.1%	11.4%	13.2%	16.6%
Average Exchange rate (N/US$)	365.58	361.97	361.93	382.07	430
Investment as a % of GDP (nominal)	14.7%	19.0%	24.6%	28.6%	23.0%
Monetary Policy Rate	14.0%	14.0%	13.5%	11.5%	11.0%
External Reserves (Average, US$ Billion)	31.3	44.6	43.0	35.9	34.0

**Please note that there is still a high degree of uncertainty around the forecast for 2021. Actual figures could exceed or fall below these forecasts. A lot depends on the path of COVID-19, vaccine effectiveness, oil price movement and possible disruptions in the local economy.*