

Nigeria: 2022 Economic Outlook

CONSOLIDATING

# RECOVERY

January 2022



# GLOBAL ECONOMY – COVID-19 induced cracks to persist in 2022

## COVID-19

- Vaccinations have proven broadly effective
- The possible emergence of new variants remain a key concern

## Growth Dynamics

- Global recovery to continue, supported by adaptation of economy to pandemic realities and policy support
- Lingering pandemic induced fault lines could slow down momentum

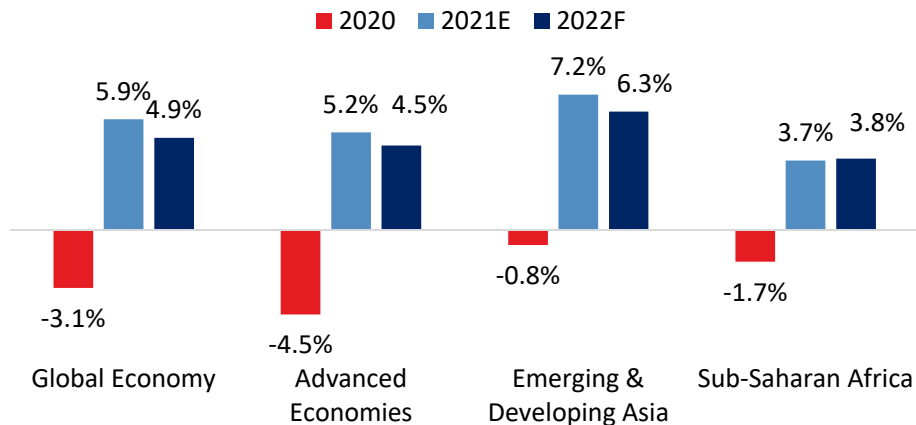
## Inflation

- Ongoing supply-chain disruptions have intensified inflation concerns
- Global central banks have assessed inflation trajectory to be 'transitory'

## Monetary Policy

- Inflationary pressures and worries about fragile global recovery highlight monetary policy uncertainty
- Global central banks are likely to hike policy rates

## IMF growth forecasts across regions



## Global economy

- Global recovery to continue, but resurging pandemic is slowing the momentum, growth estimated at 4.9%.
- Strongest growth expected in EMs and advanced economies
- Persistent spike in global consumer prices will likely spur policy reaction from central banks

## ANOTHER PRE-ELECTION YEAR – An all too familiar terrain

- This year is the eve of the presidential elections scheduled for Mid February 2023. Precedence suggests campaign activities will likely intensify in the second-half of the year.
- Similarly, security concerns around kidnapping, banditry and herder/ farmer conflict could be heightened given the geo-political divide.
- Market volatility is likely to intensify

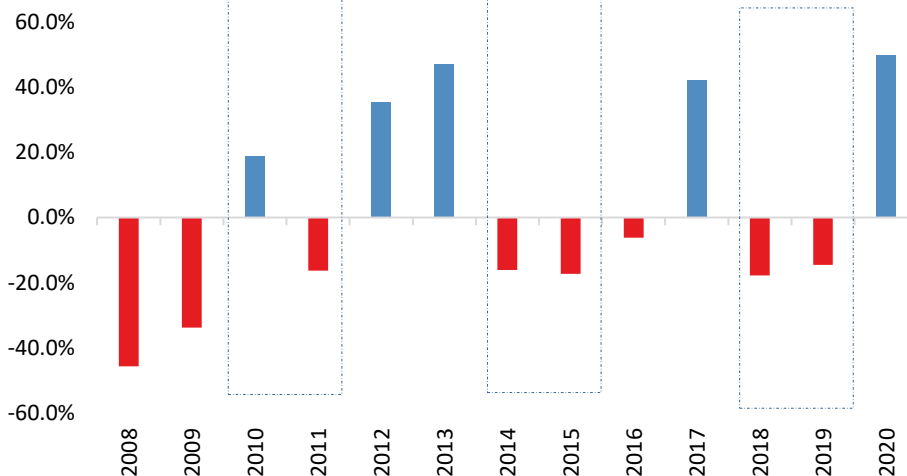
### Key Contenders

- Everyone wants to know who the key contenders are. Their orientations will likely define macroeconomic expectations
- The issue of power rotation

### Insecurity

- The voices of agitators are likely to be louder during the pre-election and elections years
- Other fringe players can take advantage of social unrest to cause a crisis

### Equities market has been mostly weaker in recent pre-election years



### Macro Uncertainty

- Likely to arise due to insecurity concerns
- There is also the likelihood that current administration could be distracted from governing by campaign related activities

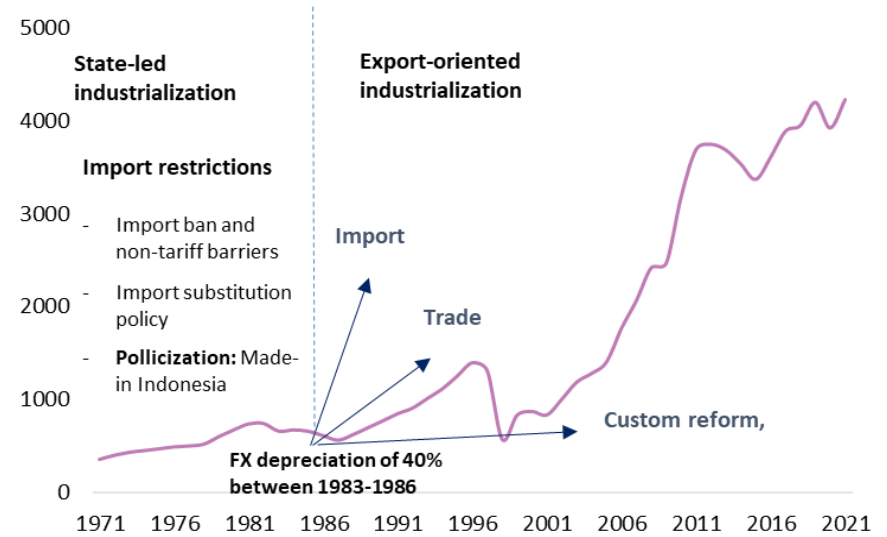
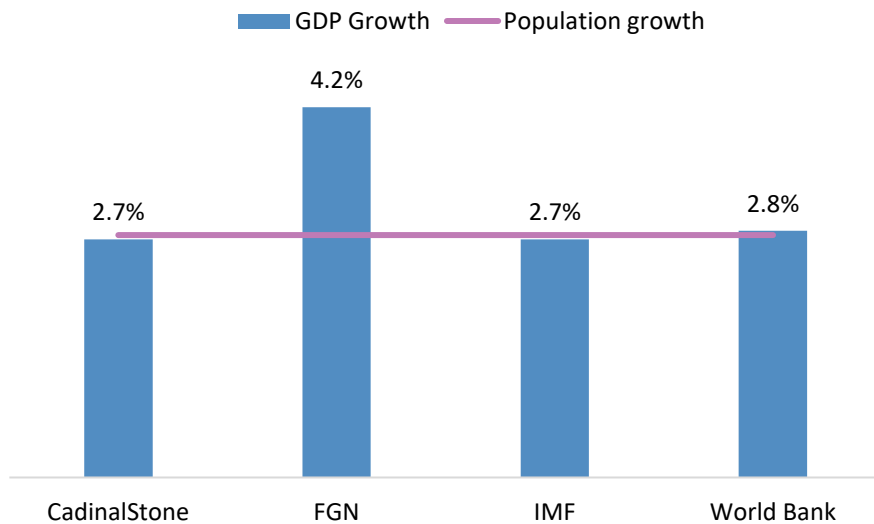
### Increased Spending

- Pre-electioneering could lead to materially higher spending
- Most investors are likely to hold significant cash positions
- Cash drag on investments likely

# DOMESTIC ECONOMY – Stagnant per capita despite continued economic recovery

Growth level is almost at par with the population growth rate, implying stagnant per capita in 2022

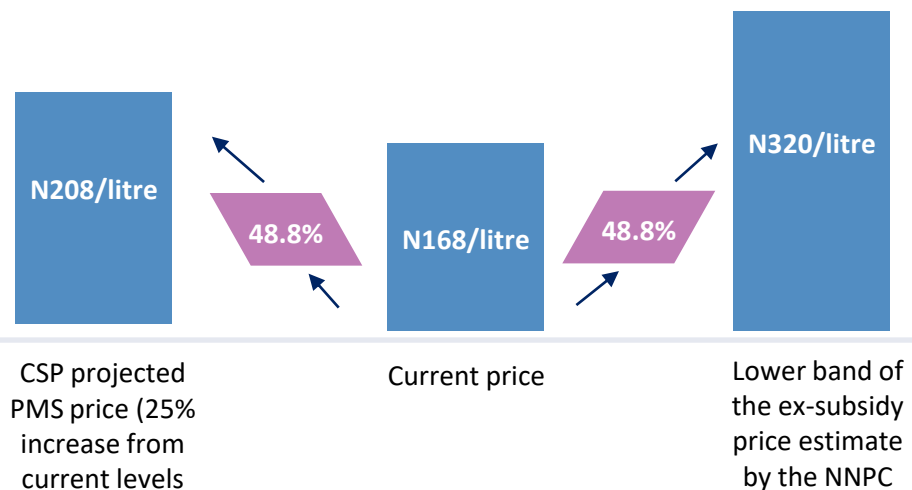
Indonesia's policy shift of 1985/86 could serve as a lesson for Nigeria . Note per capita income improvements below



- Non-oil sector to remain the primary output fulcrum, with growth projected at 2.5% YoY in 2022.
  - We expect manufacturing growth to settle at 3.2% YoY, supported by lagged impact of credit allocation and tailwinds from Dangote’s refinery.
  - The rise of mobile money, 5G technology, broadband penetration target of 70.0% by 2025 (vs 45% currently), and NCC's 5-year Strategic Vision Plan (SVP) to drive telecoms GDP to 10.8% YoY
  - Prevailing security challenges in the country will likely cap agric growth at 2.3% YoY (vs potential level of 4.0%)
- We project Nigeria's crude oil production 7.8% higher at 1.72 mb/d in 2022E, with the related oil GDP growth forecast at 7.24% YoY.
- Overall, we expect a 2.7% GDP growth in 2022 from 2.65% YoY in 2021.

## Inflation – A tale of two halves

PMS pricing may be critical to near term inflation



- We expect inflation to extend its moderation for most of H1'22 on the impact of high base effect
- Price pressure will likely surface in H2'22, due to likely PMS hike and currency adjustment.
- Most FMCGs facing higher production costs are likely to transfer the burden to consumers, leading to lower consumption and potential job losses

## Inflation expectations for 2022

<u>Scenarios</u>	Bull Case	Base Case	Bear Case
Currency Adjustment	6.5% devaluation	7.0% devaluation	9.4% devaluation
PMS Adjustment	No adjustment	No adjustment	25.0% adjustment
Core Inflation	12.9%	13.5%	14.9%
Food Inflation	14.7%	14.9%	15.9%
Headline Inflation	14.9%	15.1%	18.7%

## DOMESTIC ECONOMY – Bankrolling a N17.1 trillion budget

### Revenue

- Oil prices and taxes are supportive of revenue, but lower oil production and independent revenues remains downside
- Actual revenues may ultimately lag budgeted revenues

### Expenditure

- Expenditure has increased 16% on average in last 5 pre-election years
- May see higher recurrent spend, lower capex, increased used of Sukuk and project-tied loans

### Fiscal Deficit

- Budgeted deficit of N6.3 trillion translates to 3.4% of GDP
- Likely to overshoot projected deficit on weaker revenues, subsidy payments, vaccine procurement, worsening insecurity

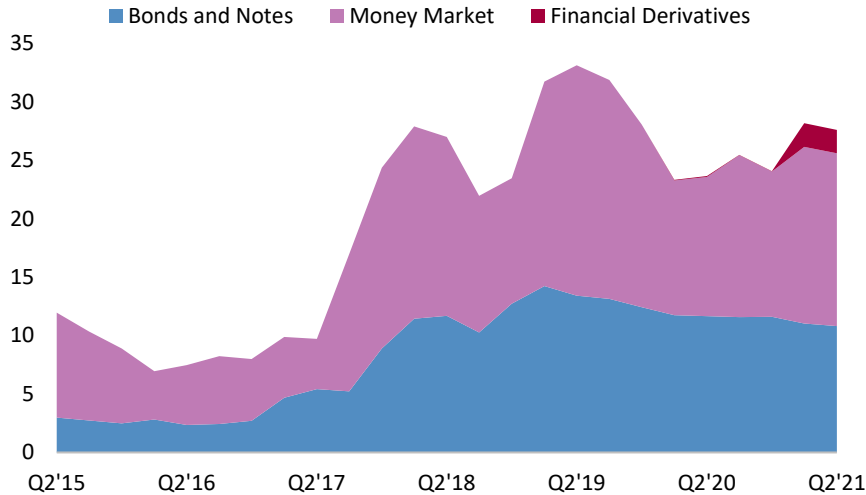
### Deficit Financing

- N2.5 trillion each from domestic and foreign sources; N1.2 trillion in project tied loans
- FG may continue its reliance on CBN's deficit financing, currently at N16.5 trillion (15% of GDP)

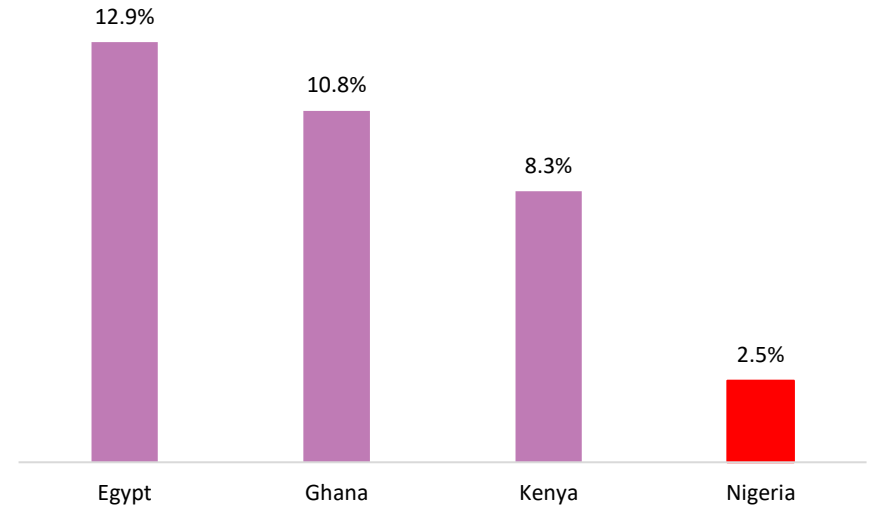
Fiscal balances in 2022 (N billion)	Budget	Bull case	Base case	Bear case
<b>Total Expenditure</b>	<b>-17.12</b>	<b>-14.72</b>	<b>-14.35</b>	<b>-14.03</b>
Recurrent non-debt	-6.83	-6.83	-6.83	-6.83
Debt service	-3.61	-3.74	-3.79	-3.87
Capital expenditure	-5.35	-2.82	-2.41	-1.99
Others	-1.33	-1.33	-1.33	-1.33
<b>Total Revenue</b>	<b>10.66</b>	<b>7.85</b>	<b>6.79</b>	<b>5.72</b>
Oil	3.40	3.19	2.85	2.52
Tax revenue	2.06	2.06	1.85	1.65
Others	5.20	2.60	2.08	1.56
<b>Fiscal deficit</b>	<b>-6.46</b>	<b>-6.88</b>	<b>-7.57</b>	<b>-8.30</b>
<b>Deficit (% of GDP)</b>	<b>-3.5%</b>	<b>-3.7%</b>	<b>-4.1%</b>	<b>-4.5%</b>

# CBN is unlikely to adopt market-driven FX price discovery

## Reserves per capita (\$) could benefit from SDR and foreign borrowings



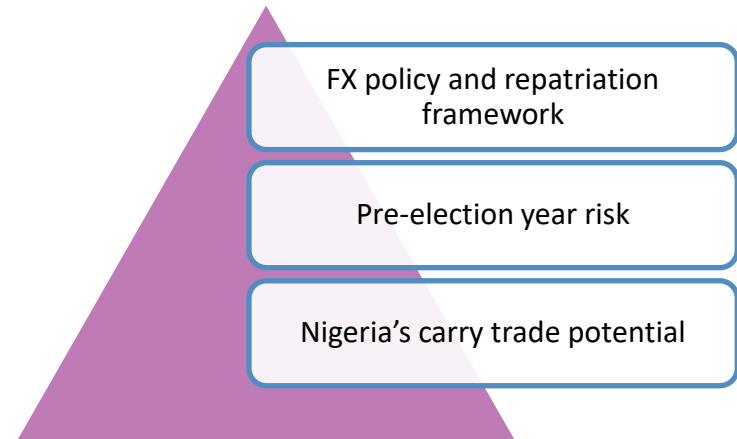
## Carry trade in Nigeria lags some African peers



## FX Market commentary

- The MPC may increase the MPR by 50bps to 100bps in 2022, due to projected sustenance in growth numbers and the normalisation of interest rates in advanced economies.
- Indicators of FX valuation suggest that the Naira remains overvalued and could weaken to N440.00/\$ in 2022.
- Parallel market premium to remain elevated unless for a material increase in FX supply via other channels.
- Electioneering activities are likely to increase pressure on the currency.
- Foreign investors may need better convincing in 2022.

## Factors to influence foreign investors sentiment in 2022

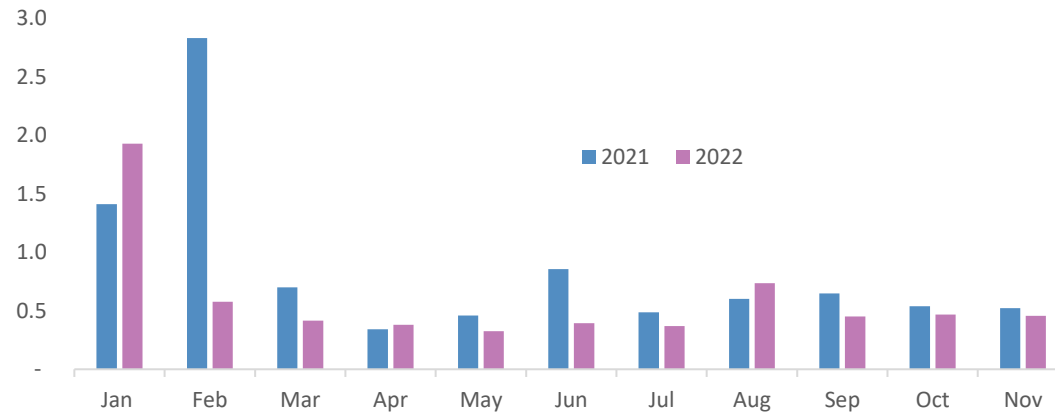


# FIXED INCOME – Yields likely to increase in 2022

## Key considerations

- We see scope for 100 to 200 bps yield increase in 2022, on the back of a likely hawkish rendition from the CBN, persistent fiscal spillage and tight system liquidity
- Local bonds may not be as volatile as Eurobonds. Foreigners account for less than 1.0% of domestic bonds outstanding
- Strategic view is that yields will increase, which suggests need for a short position.
- But look out for tactical opportunities that may require holding long duration instruments due to short term changes

Maturity profile for 2022



Fiscal spillage to persist in 2022

Output gap to further narrow

Monetary policy

Global financing conditions

Higher deficit amidst 40.8% less liquidity suggest yields could inch higher

Unless the FG increases its reliance on CBN's financing

With the output gap expected to narrow in 2022 and inflation is biased to the downside, we think that the apex bank will turn hawkish

FX concerns likely to remain a key driver of rates. CBN likely to focus on enhancing domestic carry trade attraction

Global hawkishness may intensify capital outflows from Ems and FMs. This may necessitate the CBN raising rates to retain market appeal



# EQUITIES – Macro and political climate to dictate equity direction in 2022

## Summary

- Variation in macroeconomic parameters continue to affect market sentiments
- Foreign investors may remain on the sidelines on macro and policy uncertainties

## How do you position?

- Cherry-pick stocks at deep discounts to peer/historical averages.
- Focus on companies with expansion strategies, strong ROE, robust cash position, history of high dividend payment etc.

## Critical drivers of sentiments

### 1 Macro/Political climate

- Sustained economic expansion is an upside risk for equities
- Tense political environment portends downside risk

### 2 Yields

- Direction of yields to largely dictate market performance

### 3 Company fundamentals

- Sector specific fundamentals and corporate actions could be key drivers of value

## Sectoral winners/ losers

Sector	Upside risks	Downside risks
Banking	Higher yields	Tense Socio-political Environs
Oil and Gas	Oil price; Deregulation	Cost pressures
Consumers	Improved demand	FX constraints; Rising costs
Telecoms	Data demand	Unfavourable govt policies
Cement	Government Capex	Above-average rainfall

# ALTERNATIVES – Commodities led the charge in 2021, what would 2022 look like?

## 1 Likely Supply Increase

- Higher prices may incentivize supply

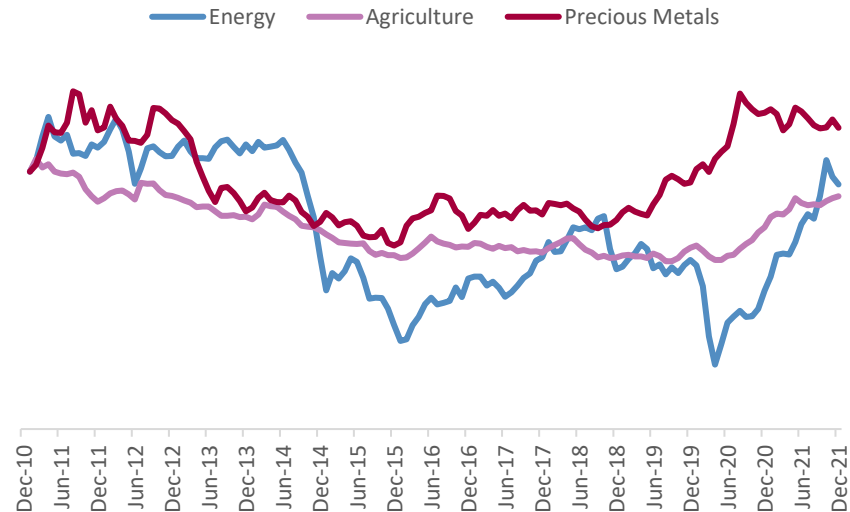
## 2 Higher Yields

- Strengthens dollar, make \$commodities expensive & discourage consumption

## 3 Expected Inflation Temperance

- Due to tighter monetary policy
- And lagged impact of supply increase

Commodity prices reached multi-year highs in 2021

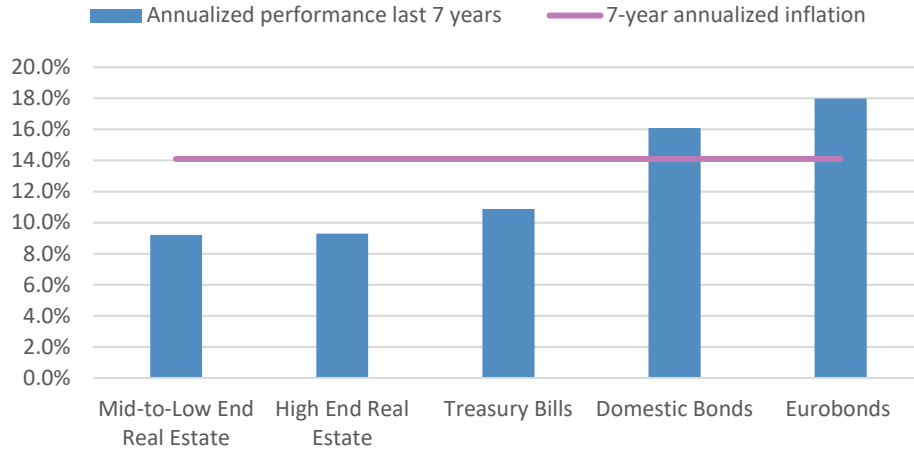


Fitch forecasts 19 out of the 27 key commodities to decline in 2022

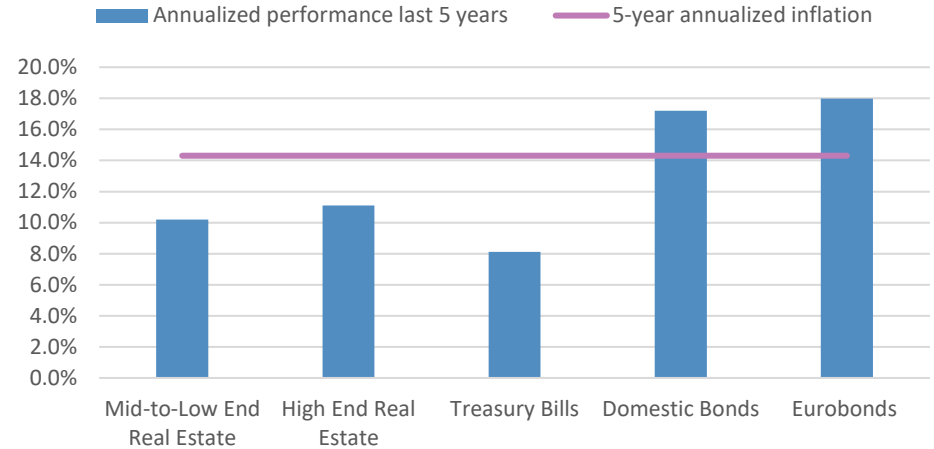
- Fitch Aggregate Commodity Index is forecast to contract 7.9% in 2022 (vs +43.8% in 2021)
- Energy: Strong supply from non-OPEC & further easing of output cut by OPEC+ to drive greater supply and cap prices
- Precious Metal: Safe haven investments like gold tend to fall when interest rate rises
- Soft Commodities: Supply disruptions may be supportive in H1, expect temperance in H2

# HISTORICAL ASSET REVIEW – What are the inflation beaters?

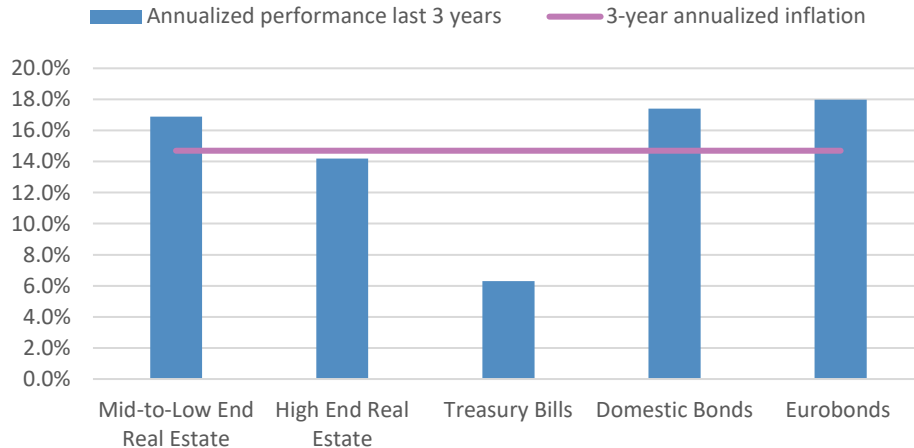
## Annualized 7-year return vs annualized inflation



## Annualized 5-year return vs annualized inflation



## Annualized 3-year return vs annualized inflation



## Lessons from historical numbers

- Domestic bonds and Eurobonds have consistently outperformed inflation over time
- Real estates (landed properties) became better inflation hedge over the last three years
- Diversification may be key to outperformance, given potential macro and sociopolitical drag on some traditional investments
- **NB:** Given planned rate hikes, one should attempt to buy the dip for US assets after the monetary adjustments

## ASSET ALLOCATION – Hypothetical asset allocation (two-asset scenarios)

		Conservative	Moderate	Aggressive	Description
INCOME	Fixed income	80.0%	60.0%	45.0%	These portfolios emphasize current income and minimal consideration for capital appreciation. Usually have less exposure to volatile growth assets but can still experience losses
	Equities	20.0%	40.0%	55.0%	
GROWTH & INCOME	Fixed income	55.0%	50.0%	40.0%	These portfolios emphasize a blend of current income and capital appreciation. Usually has some exposure to more volatile growth assets like equities
	Equities	45.0%	50.0%	60.0%	
GROWTH	Fixed income	50.0%	40.0%	20.0%	These portfolios focus on capital appreciation and minimal consideration for current income. Usually has exposure to more volatile growth assets
	Equities	50.0%	60.0%	80.0%	

## SUMMARY

Yield scenario for 2022	Bull case	Base case	Bear case
Expectation	-50bps to +100bps	+100bps to +200bps	>200bps
<b>Key assumptions</b>			
Liquidity management	Loose to Moderate	Moderate to Tight	Very Tight
Pre-election year risk	Low	Moderate	High
MPR	Flat	+50bps	≥100bps
Fiscal deficit	N6.9 trillion	N7.6 trillion	N8.3 trillion
Inflation (average)	14.9%	15.1%	18.7%
Currency	N410/\$ to N420/\$	N425/\$ to N445/\$	N450/\$ to N470/\$
Oil Price	\$80-\$90/bbl	\$70-\$80/bbl	\$60-\$70/bbl

### Some stocks with BUY recommendations across our domestic equity coverage

GTCO	ETI	TOTAL	TRANSCORP
ZENITH	FIDELITY	WAPCO	
UBA	SEPLAT	MTNN	
ACCESS	ARDOVA	PRESCO	

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**Thank you!**