FDC Economic Bulletin

January 22, 2021

Nigeria Economic Outlook 2021

The Year Ahead - Inflection, Reflation & Destitution

Financial Derivatives Company Ltd.
☎: 01-6320213 ▪ www.fdcng.com

Table of contents

1.0 Executive summary

In 2020, before the coronavirus plunged the Nigerian economy into a pandemic- induced coma, and before the disruptions of the #EndSARS protests that became riots, Nigeria was already grappling with limited buffers, double-digit inflation and significant vulnerabilities. The government's response to the crisis was rendered largely ineffective by plunging oil prices and its weak response.

The recovery will be tough, slow and uneven

Our expectations are that Nigeria will witness a tough, slow and uneven recovery across various activities in the economy. Nigeria has always relied on the unbalanced growth theory with the momentum and force of gravity of a dominant sector pulling the sectors along. The recovery will be back loaded (i.e. in Q3 and Q4) and ably supported by the policy-making front.

Our forecast is for the Nigerian economy to post positive growth of 1%-1.2% driven by a projected increase in oil output and price above $50pb. There is an expectation of an increase in the national savings ratio to GDP – as the federal government securitizes its debt. This is also likely to be accompanied by a shift to more orthodox monetary policy by Q2. We also expect an improvement in Nigeria's Terms of Trade as prices of key exports (oil and gas) are projected to rise faster than the prices of Nigeria's major imports. In addition, the loss in forex receipts from challenges in cocoa pricing as the cartel of Ghana and Ivory Coast lose bargaining power will be offset by a surge in the price of Liquefied Natural Gas (LNG).

The risks to growth include a surge in COVID-19 cases that the government is unable to handle. This could trigger another lockdown and prolong the recession – and possibly spark civil unrest as many businesses will be unable to operate. A sharp drop in oil prices below $40pb and the negative impact on government revenue and external imbalances is also a major risk to GDP growth and overall macro-stability.

Oil price recovery – Vaccines to the rescue

We expect the emergence and deployment of the COVID-19 vaccines to be crucial in sustaining the global economic recovery and boosting global oil demand. This is in addition to OPEC+'s apparent readiness to do whatever it takes to prop up oil prices. The strategy should keep Brent crude prices above $50 per barrel (pb) in 2021. Nigeria's oil output quota could also be raised from the current 1.41 million barrels per day (mbpd) as OPEC+ begins to gradually ease production cuts.

The oil price recovery will ease currency pressures but is unlikely to completely restore balance to the external sector. Another naira devaluation could become inevitable to allow the CBN to ease its forex rationing. As the CBN sustains its regular interventions in the forex market, the external reserves level will remain under pressure – in spite of higher oil prices.

Inflation, unchecked, will rise further

Underlying structural bottlenecks, particularly insecurity in the food belt and forex restrictions on finished food imports, will continue to drive inflation. This is in spite of the re-opening of the land borders. Higher fuel and electricity tariffs will further stoke inflationary pressures and push the headline index to an average of 16% in 2021.

CBN's primary mandate is price stability

We believe the CBN will reduce forex rationing and allow a crawling peg in its battle to bring inflation under control. A crawling peg will effectively allow the naira to fluctuate within a band – permitting a managed depreciation (probably monthly) of the currency rather than a large one-off devaluation. It is our view that the monetary policy committee (MPC) will prioritize price stability and hike interest rates as inflation is projected to rise further. This will ease currency pressures, restore stability in the external sector and attract foreign portfolio investments. However, higher interest rates will raise the government's financing costs and could stifle the economic recovery.

AfCFTA: It's about time

We believe that the launch of the African Continental Free Trade Agreement (AfCFTA) on January 1, 2021 is a game-changer for intra-African trade while the re-opening of Nigeria's land borders will ease shortages of food and other commodities. However, AfCFTA will open up Nigerian businesses to increased competition and the relatively higher production costs in Nigeria could put them at a disadvantage.

Another stock market rally unlikely

We expect a mixed performance from the equities market in 2021. The shift to higher interest rates will cause yields on fixed income instruments to start to rise and lower the demand of equities. Hence, the over 50% return seen in 2020 is unlikely to be replicated. Nevertheless, the deployment of the COVID-19 vaccines will boost investor confidence.

Do more with Ecobank FCY Cards

Take advantage of the higher spend limit on our FCY Cards

CARD TYPE	DAILY ATM WITHDRAWAL LIMIT	DAILY POS/WEB LIIMIT
Ecobank Mastercard Gold USD Credit Card	$2,000	$5,000
Ecobank Mastercard Platinum USD Credit Card	$2,000	$15,000
Mastercard FCY Debit Card (available in USD, GBP and Euro	$1,000	$2,000

To increase your spend limit, please contact your Relationship Manager or reach us via the channels below.

0700 500 0000, 01 270 1323, 0708 065 3700

@ecobank_nigeria
@EcobankNGR

ENGcontactcentre@ecobank.com

ecobank.com

Ecobank
The Pan African Bank

2.0 Economic Outlook

2.1 GDP Growth – 'W-shaped recovery expected in 2021

The Nigerian economy is not just a victim of COVID-19 but of structural weaknesses that amplify its vulnerability to external shocks. The country had pre-existing conditions before COVID: low productivity and output constraints, a fiscal gap, monetary imbalance, and external sector weaknesses. As the impact of COVID-19 gradually fades with the distribution of vaccines globally and locally, we expect a rebound in economic activities. This will be further supported by oil price stability at above $50pb, possible increase in national savings ratio to GDP as the FG securitizes its debt and a likely shift to more orthodox monetary policy in Q2. We expect forex receipts to be boosted by a surge in the price of LNG. However, with the rollout of vaccines expected by the end of Q1'21, the economy is unlikely to return to positive growth until the third quarter of 2021 in a base case scenario (Assuming oil price at $60pb and oil production at1.35mbpd).

Also, the growth trajectory is expected to be slow and tepid as structural challenges linger. Although the re-opening of the land borders is expected to ease supply constraints and boost trading activities, other structural factors, especially low total factor productivity, forex illiquidity and currency misalignment, will continue to impede output growth and slowdown the pace of economic recovery. More so, the second wave of the virus remains a potent risk which the projections do not fully take into considerations.

Scenario-based analysis

	Best Case	Base Case	Worst Case
Q1'21	-1.5	-1.9	-2.5
Q2'21	1.2	-0.2	-1.1
Q3'21	2.7	2.1	1.5
Q4'20	3.5	2.9	1.9
Full year 2021	1.5	0.7	-0.05

Best case scenario - Assumptions

- Oil price climbs back to $60pb
- Oil production: 1.35mbpd
- Chances of monetary tightening increases
    - Higher interest rates

- Risk of policy reversal is high as external balance improves
- Increased investment in the power sector
- Vaccinations commence in Q1'21
- AfCFTA yields desired outcomes

Base case scenario - Assumptions

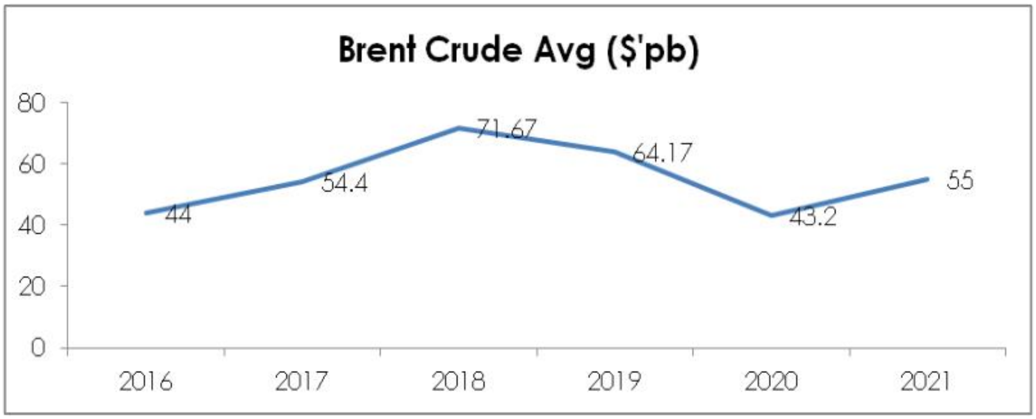
- Oil price steady at $50pb
- Oil production: 1.5mbpd
- Reforms with minimal controls
    - Status quo on monetary policy stance
    - Increased forex rationing with the use of CRR and OMO debits
- Dollar liquidity will improve
    - High oil proceeds
    - Diaspora remittances due to global recovery
- Vaccinations commence in Q2'21

Worst case scenario - Assumptions

- Oil price falls below $40pb
- Oil production: 1.4-1.5mbpd
- Expansionary fiscal & monetary policies
- Push back on reforms leading to social unrest
    - Investment sentiment dampened
    - Social unrest
- Limited distribution of vaccines due to superstitious beliefs

2.2 Oil prices

In 2021, the oil markets will be driven by COVID-19 vaccine sentiments and OPEC's determination to curb excess oil supply. Global oil prices will remain subject to high levels of uncertainty due to the spike in COVID-19 cases in top energy consuming regions like the US, Europe and Asia. Constrained global demand will continue to limit oil price growth. Goldman Sachs reduced its global oil demand forecast for 2021 to 92.5mbpd from 93.5mbpd and the IEA warns that renewed lockdowns would depress oil demand. Nonetheless, increased vaccination in these regions is expected to keep sentiments positive for the oil markets in 2021. Currently, over three million people have been vaccinated worldwide.



[1]

Brent crude would remain in contango above $50pb in the near term and may average $55-$60pb in 2021. This would be on the back of rising vaccine inoculations and oil producers committing to curb global supply. Saudi Arabia announced a 1mbpd drop in its oil output for February and March, which is 567% above the total output cut ease by OPEC+ for February and March (150,000b/d). Analysts have taken a more conservative approach to oil price forecast for 2021 ($45pb-$50pb).

Analyst	2021oil price forecast
EIA	$49pb
EIU	$45pb

Investors seem optimistic and are expecting oil prices to close the year around ($60pb-$65pb) on the COVID-19 vaccine optimism. Goldman Sachs maintained its Brent year-end forecast of $65pb.

Oil prices above $50pb would remain a huge support to Nigeria's export earnings and possibly external reserves. It also provides enough headroom compared to the 2021 budget oil price benchmark ($40pb).

[1]Bloomberg, EIU, FDC Think Tank

Get AIICO's travel insurance

Life Insurance | General Insurance | Investments

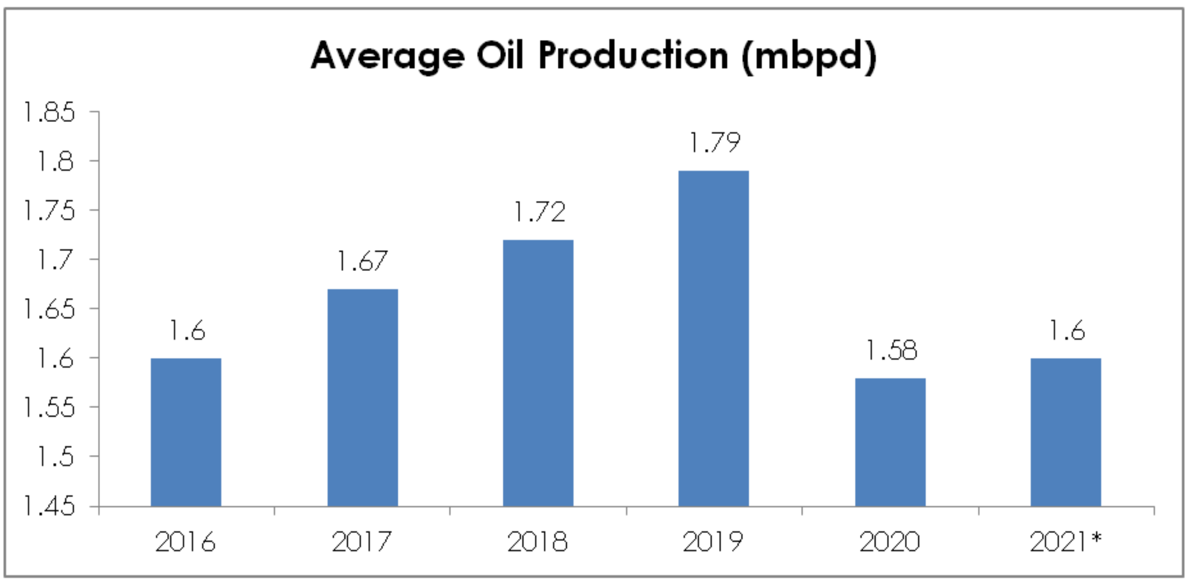
AIICO INSURANCE
AMERICAN INTERNATIONAL
...stability assured

AIICO Plaza, Plot PC 12 Churchgate Street, Victoria Island, P.O. Box 2677, Lagos, Nigeria
01279 2930, 0700AIIContact (0700 2442 6682 28) | aiicontact@aiicoplc.com | www.aiicoplc.com

2.3 Oil production

Global oil production will be highly responsive and sensitive to changing oil demand in 2021. OPEC and its allies, including Russia, will keep reviewing output cuts on monthly to avoid another unprecedented oil price crash. Saudi Arabia may *"lead by example in the OPEC cartel"* by continuously subduing its oil supply to keep prices at profitable levels, especially for oil dependent economies and price takers like Nigeria.

OPEC+ will stay cautious in its approach to production but there still lies the risk of increased output from Libya and Iran in 2021. In addition, the possibility of Saudi Arabia persistently cutting oil output could encourage more US shale production. Generally, we expect the oil supply to keep increasing gradually because like Nigeria, several oil producing economies are more sensitive to changes in oil production than prices. OPEC+ has already eased output cuts for January by 500,000b/d (7.2mbpd) and by 75,000b/d for February (7.125mbpd) and March (7.05mbpd). The Energy Information Administration (EIA) projects OPEC crude oil production to average 27.5mbpd in 2021, up 7.4% from an estimated 25.6mbpd in 2020.



[2]

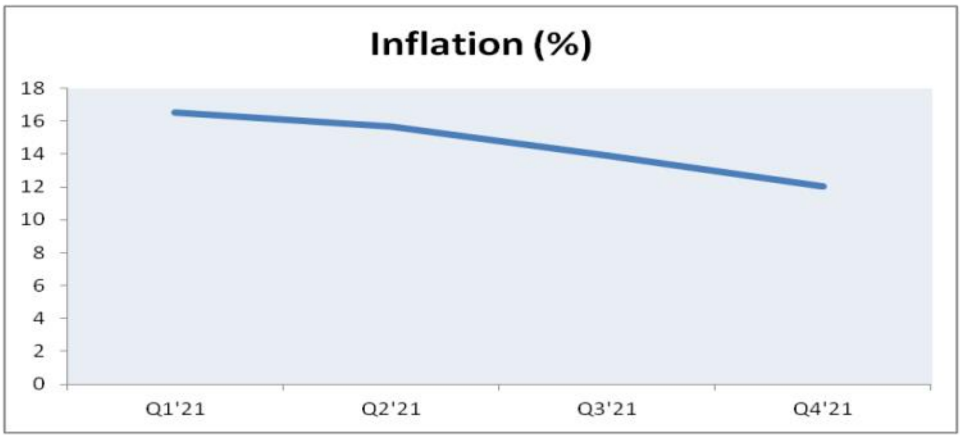
Nigeria's oil production is expected to remain around 1.45 -1.47mbpd in the near term as it continues to comply with its OPEC quota. However, average domestic production in 2021could gradually increase to end the year around 1.6mbpd as OPEC+ eases output cuts. An increase in oil production is positive for oil revenue but assuming a year end output at 1.6mbpd, it still implies a 14% decline compared to the 2021 oil production assumption (1.86mbpd) which is a huge constraint to meeting budget obligations.

[2]OPEC, FDC Think Tank

2.4 Inflation

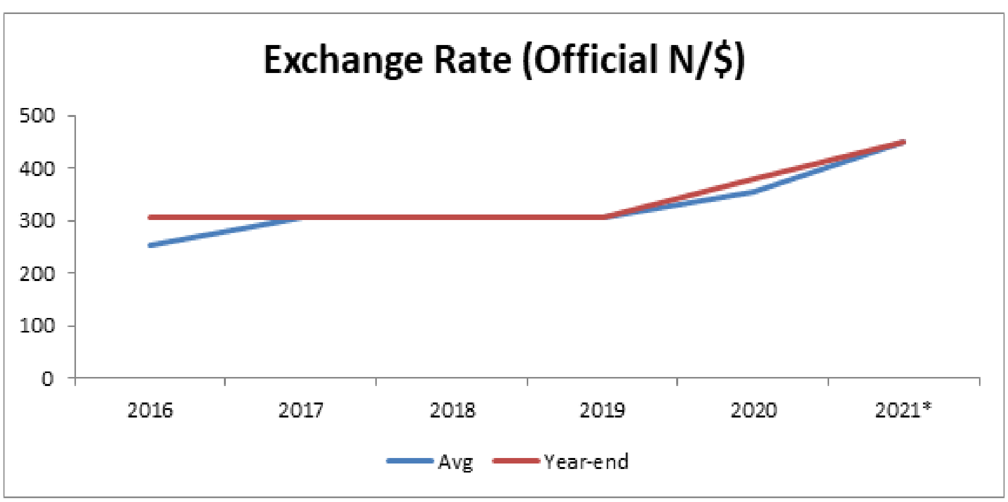
We expect a further build-up in inflationary pressures in 2021. Even though the border re-opening is expected to ease supply chain disruptions, its impact could be undermined by the underlying structural bottlenecks particularly insecurity in the food belt and forex restrictions on finished food imports. This combined with higher fuel and electricity tariffs will keep the general price level elevated. Hence, headline inflation is projected to average 14.92% in 2021.

We expect inflation to climb to 16.55% at the end of the first quarter in Q1'21. As we approach the harvest season, we expect a gradual ease in inflationary pressures to 15.69% (Q2'21 end), 13.9% (Q3'21 end) and 12.03% (Q4'21 end).

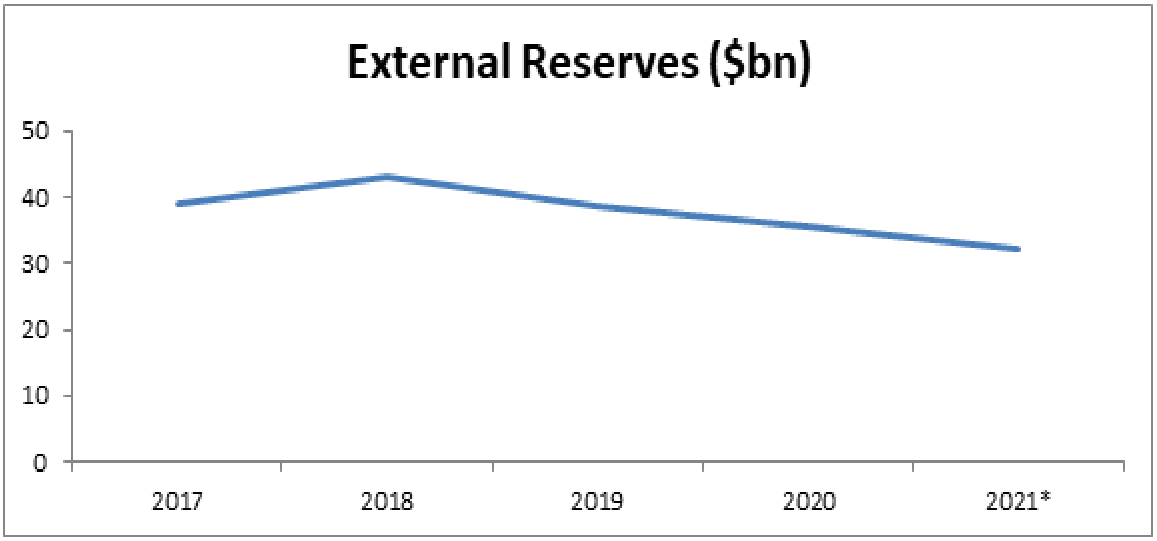


2.5 Forex market

The multiple exchange rate regimes will persist in 2021, however, further convergence is likely to occur as the CBN continues with its reform in the forex market. If oil prices fall below $40pb and capital outflow pressures continue due to the artificially low domestic interest rates, the CBN could be forced to devalue the currency again at the official market in 2021 after two devaluations in 2020. This could push the official rate to N390-400/$ from N379/$ at the end of 2020, bringing the official rate closer to the NAFEX rate.



The gross external reserves depletion will continue in 2021 but a possible reversal in capital flight as the CBN adopts a tighter monetary policy stance and an increase in diaspora remittances due to the new guidelines will support external buffers.



2.6 Interest rates

The CBN and debt management office (DMO) will do their best to maintain the low yield environment for as long as possible to keep fiscal financing costs low in the near term and encourage lending to the real sector. However, Nigeria is already in a liquidity trap as the weak transmission mechanism of the traditional monetary policy tools and the record low interest rates mean further cuts in the monetary policy rate. These are unlikely to provide additional support to the economy.

The pressure on external reserves will continue to mount amid negative real returns on investment and investors seeking to exit. This will leave the CBN with no choice but to raise interest rates as it prioritizes price and exchange rate stability over economic recovery. The introduction of special bills will also serve as an additional tool for liquidity management – signalling an increase in interest rates. Lending rates will rise as well as yields on treasury bills, bonds and the foreign investor dominated open market operations (OMO) bills.

In addition, the federal government's plan to securitize its debt to the CBN would lead to a huge injection of over N2.8trn into the fixed income market in 2021 which would trigger a rise in fixed income yields. This supports the forecast of a shift to a higher interest rate environment in 2021.

3.0 Policy Outlook

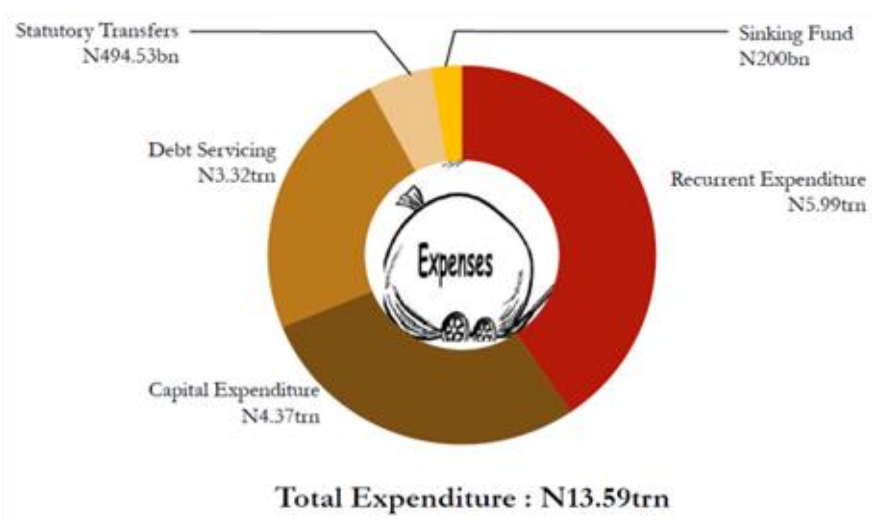
3.1 Fiscal policy

The 2021 budget, titled "Budget of Economic Recovery and Resilience", was signed into law by President Buhari on December 31. We expect the early approval of the budget, which restores Nigeria's budget calendar to January-December, to facilitate a timely implementation and support economic recovery.

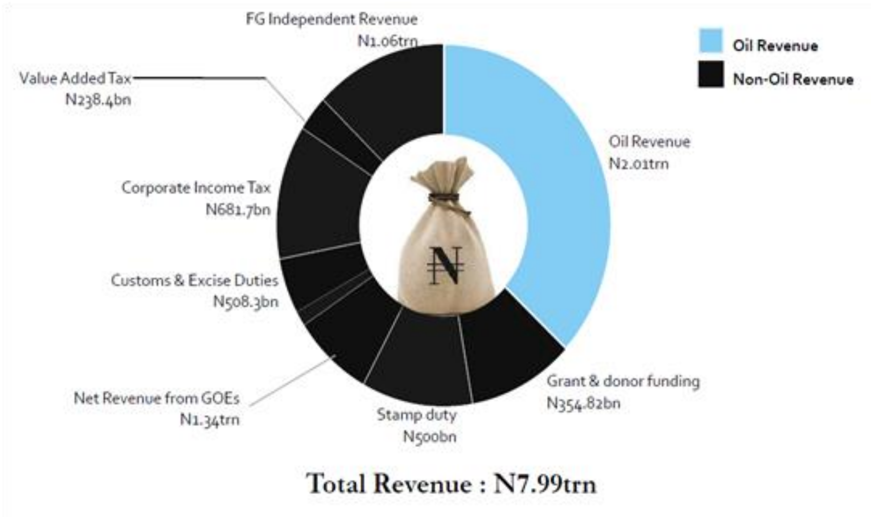
2021 Budget Assumptions

Scenarios	2021	Critique
GDP growth rate (%)	3.0	***Unrealistic:*** The EIU estimates a modest recovery of 1.8%
Inflation (%)	11.95	***Unrealistic:*** Average inflation in 2020 is 13.21%, projected to average 14.92% in 2021
Exchange rate (N/$)	379	***Optimistic:*** official exchange rate is already at $380/$ but could be devalued again in 2021
Oil price benchmark ($'pb)	40	***Modest:*** Building fiscal buffers to respond effectively to negative oil price shocks. Brent price is projected to trade at $45pb in 2021 (EIU)
Oil production (mpbd)	1.86	***Optimistic:*** Nigeria's oil production expected to remain within a range of 1.5-1.6mbpd even with the ease in OPEC production cuts

Nigeria is confronted with a wider fiscal deficit (N5.19trn) amid lower revenues and will attempt to spend its way out of the recession. Deficit financing will be via domestic and foreign borrowing (excluding the IMF) of N4.28trn. Other sources are multilateral/bilateral loan draw downs of 709.69bn and privatization proceeds of N205.15bn.



Oil revenue is projected at N2.01trn, non-oil revenue is estimated at N1.49trn, while N3.7trn is expected from other revenue sources. Significant additional domestic revenue mobilization is required to reduce fiscal risks. The options available to the government are limited at this time. They include broadening the excise base and increasing the VAT rate gradually to the ECOWAS average of 15% by 2025.



The government has already made clear its intentions not to seek assistance from the IMF or return to the Eurobond market. This is in spite of low interest rates globally as central banks in advanced economies pushing down benchmark interest rates to near-zero to stimulate their economies in the wake of the negative effects of the COVID-19 pandemic. The government's decision to not give in to floating the naira is limiting its ability to access significant funding from concessionary loans from the World Bank. Domestic debt issuances will increase as a result, crowding out private sector borrowing.

The switch to a higher interest rate environment by H2'21 means domestic bond issuances could rise in anticipation in H1'21. However, revenue challenges could trigger even more domestic debt issuances and higher yields earlier than expected.

The likely shift to a higher interest rate environment will increase debt servicing costs. This, in addition to pressing security needs and a large public wage bill, will elevate pressures on public expenditure even with the removal of subsidies on power and gasoline.

3.2 Monetary policy

The monetary policy committee (MPC) of the CBN will be faced with a dilemma: keep interest rates low to bolster the economic recovery and ease the pressure on government financing costs or shift to a tightened monetary stance to curb inflation and attract capital inflows, staving off currency pressures and restoring external sector stability.

In 2020, the CBN justified its two 100bp rate cuts amid rising inflation with the need to boost the supply side of the real economy to bring inflation back under control. However, structural rigidities such as inadequate public infrastructure, hard-currency shortages and rampant instability need to be addressed before the supply side can moderate the price level. Nonetheless, rather than the benchmark interest rate, it is the unorthodox policies of the CBN (minimum loan-to-deposit ratio of 65% and segregation of the OMO and T-bills market) that have driven down lending rates.

Headline inflation is now forecast to average 16% in 2021 and the CBN also admits that inflation above 12% is growth retarding. Our expectation is for high inflation to compel the CBN to raise interest rates as soon as Nigeria escapes the current economic crisis and GDP growth turns positive. The CBN is also likely to shift its focus back to price stability in 2021 as multiple objectives (price and exchange rate stability, domestic industrialization, credit growth) are currently undermining monetary policy effectiveness. Our base case is for an MPR hike of at least 200bps over the course of the year. The timing and pace of the hike will be a function of money supply growth, galloping inflation and exchange rate pressures.

The battle to bring inflation under control is likely to compel the CBN to ease off on its current forex rationing strategy and allow a crawling peg. This will effectively allow the naira to fluctuate within a band – permitting a gradual and managed depreciation (probably monthly) of the currency rather than a large one-off devaluation which could induce panic. The crawling peg could be based on (Nigeria-US) inflation differential – currently at 14.35%. In the medium term, the exchange rate is expected to be reflective of this inflation differential and depreciate by fairly the same magnitude. This will be transparent for investors and another step towards the eventual floating of the naira.

4.0 Nigerian stock market outlook

We expect a mixed performance in the Nigerian stock market in 2021. The availability of the COVID-19 vaccine in Nigeria by the end of Q1'2021 is good news, as this will boost investor's confidence in the economy and also in the stock market.

However, we also need to take note that a total of 20 million vaccines will be available, which will only cover about 10% of the Nigerian population. In addition, the second wave of the virus if not properly contained and the possibility of another lockdown will result in a slower economic recovery and further dampen foreign investors' confidence in the market.

We also expect a possible reversal as the current market situation does not reflect the true value of some stocks. Most stocks are trading above their fair value and a change in the fixed income space will trigger a reversal of the current share price of the stocks.

However there are sectors and peculiar stocks that have proven to be resilient over the years with strong growth fundamentals.

5.0 Sectors and stocks to watch in 2021

5.1 Telecommunications sector

We expect a continuous and steady growth in the telecommunications space as the pandemic prompted corporate organizations to adjust to digital work environments which will further increase demand for mobile data services. The Nigerian telecommunications industry outperformed the GDP growth in Q3'2020 with a 17.36% growth, compared to the 12.16% gain recorded in the corresponding quarter of 2019. This is due to the sector's growth resilience despite the pandemic, driven by increased demand for data usage and number of mobile subscribers.

5.1.1 MTN Nigeria

MTN Nigeria, a top player in the telecommunications space, is a stock with strong fundamentals which has continuously delivered excellent value to investors. MTN Nigeria contributes about 16% to the total equity market capital. It is the largest player in the telecom market in Africa and largest mobile operator in Nigeria with over 75 million subscribers and 30.7 million active data users.

The company seems well positioned for long term growth with its expansive wide network coverage and availability. In view of the rapid population growth in Nigeria, and with the company's focus on its 4G network expansion, and its exciting data, digital and fintech opportunities, it is expected that its subscriber base will grow to about 92 million in 2021.

In its 9M'2020 result, the company recorded a 13.9% growth in revenue to N976 billion, the 4.7% and 48.8% increase in voice and data revenue contributed to the revenue growth. Levered free cash flow grew by a whopping 335% to N260.5 billion. The 3.3% decline in PAT is due to the 32% increase in lease rental costs driven by aggressive rollout of 4G network. Also, exchange rate devaluation enhanced the increase in direct network operating cost.

5.2 Banking

The intense competition faced by Nigerian banks from telcos and other financial service providers has led some banks to rush to a holding company structure in order to stay afloat in the industry. Nigerian banks have started to restructure their operations to diversify their revenue base. There is also a need for the industry to move fast enough to meet customers demand as the global trend indicates that profitability protection and improved efficiency requires focus on customer strategies and adoption of digital banking and lending solutions, which includes big data analytics, block chain, cybersecurity and more. Players need to adopt different channel strategies to retain customers and provide flexible personalized channels that enable multiple devices. Collaboration with fintechs will speed up banks' digital transformation execution and enhance operational efficiency. We also expect to see possible merger and acquisitions in the banking space.

Banks' performances in 2020 were mixed due to the diversity of their balance sheet structure. GT and Zenith are top players in the industry with strong balance sheet footings and well-diversified sources of funding. We recommend that investors, with long term investment options, take positions in these stocks as their share prices offer significant upside potential.

5.2.1 GT Bank

The competitive landscape in the financial service space has initiated the need to diversify banks' earnings. GT Bank, a giant in the financial service space, has decided to jump on the holding company structure which it previously neglected. The shareholders' approval for the holding company structure of the bank will, however, enhance the bank's operations in the financial service space and also boost investors confidence in the stock as the entire existing shares of the bank will be transferred to the holdco.

The bank has proposed to diversify into payment service banking, asset management and pension fund administration in addition to its core banking business. The bank possesses strong growth fundamentals.

GT Bank recorded a marginal growth in its top line amidst the pandemic- induced economic downturn. The bank's gross earnings grew by 1.23% to N328bn in its 9M'2020 result, due to the 9.7% growth in interest income to N189.7bn, while profit after tax (PAT) declined by 3.2% to N142bn. The decline in PAT is attributable to the 10% increase in other operating expenses to N60bn.

5.2.2 Zenith Bank

Zenith Bank is well positioned for growth as prudential ratios remain above regulatory thresholds. Capital adequacy ratio declined by -2% to 21.5% while liquidity ratio also grew by 18% to 67.4%. We expect that the bank will continue to be resilient and deliver enormous return for investors.

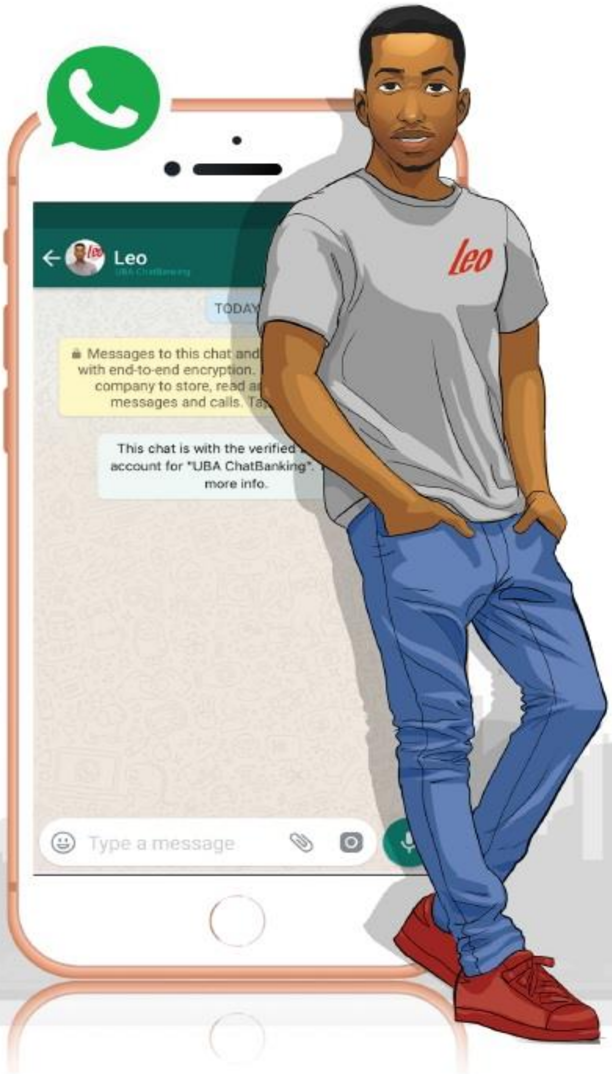
Zenith delivered an impressive performance in its 9M'2020 result as gross earnings grew by 4% and PAT grew by 6%. The net interest income and non-interest income also grew by 5% and 11% respectively. This performance shows the bank's resilience despite the challenging business environment posed by the pandemic.

Zenith Bank benefitted from an increasingly diversified business model as recorded in the non-interest income and also delivered optimal pricing despite a declining yield environment as measured by the 5% growth in net increase income on the back of the bank's robust liquidity management.

UBA
United Bank for Africa

Leo
on WhatsApp

Chat on +234-903-000-2455



Check Account Balance?

Top up your airtime?

Bank Transfers?

Bills Payment?

https://m.me/ubachatbanking ***Leo@ubagroup.com*** ***CFC (+234-1-2807400)***

5.3 Industrial sector-The cement Industry

The cumulative average growth rate for global cement consumption in the last three years is about 2.96%. Global cement consumption is expected to rise to about 4.4 billion tons in 2021. Increased government infrastructural projects and maintenance coupled with urbanization growth will likely drive the growth of the market. The sector is also expected to benefit from the commencement of AfCFTA. Cement manufacturers will be faced with the opportunity to produce more in order to compete with member nations and penetrate new markets.

5.3.1 Dangote Cement

Dangote Cement plans to serve the West African countries in order to make the region cement independent. The company's clinker strategy is expected to take advantage of the absence of limestone in most West African countries who import bulk cement and clinker, usually from Asia and Europe. The company has made a total of seven clinker shipments from Nigeria as of September 2020 and is ready to do more. This project will foster production and increase capacity utilization resulting in additional earnings for the company.

Dangote Cements' share buyback is expected to further boost its shareholders' fund and reported earnings per share resulting in a higher share price. The share price of the company has shown resilience compared to its peers and the share price also presents an attractive upside potential for long term investors.

Dangote Cement accounts for 20% of the total equity market capital on the Nigeria stock exchange, which makes it the stock with the highest market capital on the exchange.

The company recorded a stellar performance in its 9M'2020 result, despite the economic downturn posed by the pandemic. The declining yields in the fixed income market enhanced the increased demand for assets in the real estate sector and resulted in increased demand for construction. Revenue grew by 12% to N761 billion. The growth in revenue was supported by increased sales volumes to 11.9million tonnes. EBIDTA also grew by 17% to N355 billion with a corresponding 35.2% rise in PAT to N208.7 billion.