PAC Holdings
| A PROPRIETARY INVESTMENT COMPANY |
Ideas ■ Partnerships ■ Solutions

Nigeria Economic Outlook 2018

Fragile Recovery: Amidst Weak Economic Structure

TABLE OF CONTENTS

Economic Update

Nigeria | Economy | 2018 Economic Outlook | February 20, 2018 **PAC RESEARCH**

Executive Summary

Nigerian economy slipped into recession in the second quarter of 2016 after several quarters of decline in real GDP growth rate, precipitated by a large drop in the prices of crude oil that started in the second quarter of 2014 and production shock that was caused by hostility in the oil producing region. The recession was considered the worst in over two decades; however the country came out of it in the second quarter of 2017 after five consecutive quarters of contraction. Furthermore, the decline in the prices of crude oil which was one of the factors that led to the recession was one of the three largest declines since the end of the Second World War and the most persistent since the supply-driven collapse of 1986 with about 70% drop in price. The drop in the prices of oil was triggered by the following factors; surging U.S. shale oil production, geopolitical risk that involved some major producers, shift in policies by OPEC and weakening global growth prospects. However, the recovery in the oil sector (both prices and production) and notable improvement in agriculture resulted in the turnaround the economy witnessed and the economic recovery that followed, although the recovery is fragile.

Nigerian economy is broadly classified into oil sector and non-oil sector, while the oil sector has recovered the non-oil sector is still been weigh down by several challenges confronting the economy, therefore the fortune of the non-oil sector is being impacted negatively. Moreover, the two broad sectors are divided into three sub-sectors; agriculture, industries and services, while there have been notable positive activities in agriculture, the economic activities in services sector contracted while industries recorded impressive positive economic activities due to the recovery in the oil sector in the period. The economic recession led to foreign exchange liquidity crisis which resulted in about 70% devaluation in the value of the Naira with the parallel market exchange rate at a record high in February 2017, consequent to a gradual depletion in the nation's foreign reserves which got to a low of US$24 billion in October 2016. The recovery in the oil sector and several interventions by the Central Bank of Nigeria has ameliorated the situation with increased availability of foreign exchange, among which is the Investors and Exporters Window which has attracted huge foreign portfolio investments into the economy. Also, headline inflation moved up to a record high in the period, with food inflation at above 20% in November 2017; however it has recorded gradual deceleration in the recent period. Although, food inflation is still stubbornly high, other factors that were responsible for high food inflation are high transportation cost, adverse weather condition and tension in some part of the country.

Fiscal operations position of governments at all level was negatively affected by the decline in the prices of crude oil with several consequences such as accumulation of unpaid salaries of civil servants and increase in borrowings. However, this has improved with increase in revenue mostly from the oil sector with improvement in almost all the components of oil sector revenue, yet we are of the opinion that the oil sector is still vulnerable to production shock as the peaceful atmosphere in the oil producing region can only be sustained if policymakers keep up with the New Vision outlined for the region. Part of the response of policymakers to the weakness in the economy and the potential for further weakness was the release of the Economic Recovery and Growth Plan in March 2017, the Plan aims at economic recovery in the short-term and structural reforms aimed at diversifying the economy to set it on the part of sustained and inclusive growth over the medium to long term. Considering the turnaround in the trends of real GDP growth rate, although with fragile recovery, there is optimistic outlook for the economy in the short to medium term with an estimate of 1.0% growth rate in 2017 and a prediction of between 2.0% and 2.5% real GDP growth rate in 2018, to be driven by the sustained improvement in the oil sector and in the agricultural sector. However, the optimistic economic outlook is subject to some downside risk among which are; oil price and production shocks, disruption in availability of foreign exchange and political risk that pertains to election year.

Moses Ojo (Head, Investment Research & Business Dev.)
moses.ojo@panafricancapitalplc.com

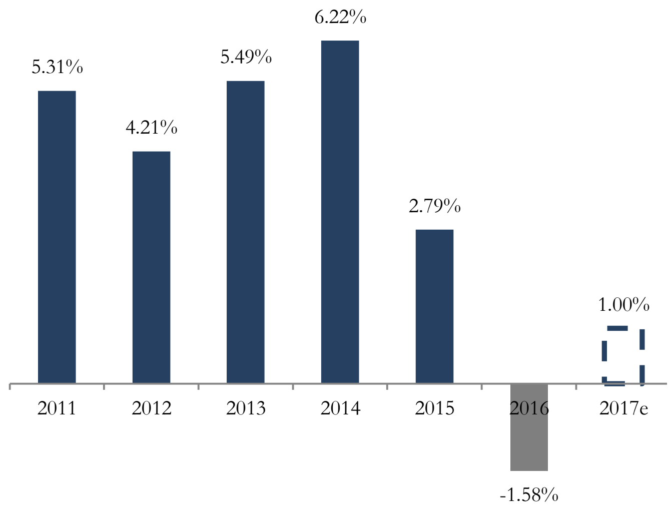
Nigeria's real gross domestic product (GDP) returns to positive trajectory in the second quarter of 2017. In the second quarter of 2017, Nigeria's economy recorded real GDP growth rate of 0.72% y/y – pulling the nation's economy out of the worst economic recession in two decades - after five consecutive quarters of contraction. The recovery was driven by improvement in oil prices in the global market, increase in production and modest growth in agriculture. The economy plunged into a recession in the second quarter of 2016 with real GDP growth rate of -1.49% y/y, after about two years of consistent weakness which was precipitated by a protracted decline in the prices of crude oil and reduction in production as a result of hostility in the oil producing region. Between the middle of 2014 and early 2016, the global economy faced one of the largest oil price shock in modern history. The 70% price drop over the period was one of the three largest declines since the end of the Second World War, and the most persistent since the supply-driven collapse of 1986. The decline was triggered by the following factors:

- Surging U.S. shale oil production
- Geopolitical risk that involved some major producers
- Shift in policies by OPEC
- Weakening global growth prospects

The oil sector sustained the improvement it recorded in the second quarter of 2017 with a fragile real GDP growth rate of 1.4% y/y in the third quarter, on the back of improvement in oil prices and crude oil production. Brent Crude Oil traded at an average price of US$55.27 per barrel in 2017, up by 7.8% compared with an average price of US$51.25 in the previous year.

On the other hand, the average crude oil production improved marginally in the first three quarters of the review year by 2.2% to 1.86 million barrel per day (mbpd) against 1.82 mbpd in the corresponding period of 2016 with average production of 2.03 mbpd in the third quarter of 2017 – the highest in six quarters. It is worthy of note to state that the contribution of the oil sector to the overall real GDP increased to 10.04% in the third quarter of 2017 relative to 8.90% in the second quarter of the year on the back of improvement in crude oil production. The understanding and rapprochement among the stakeholders in the oil producing region which resulted in peaceful atmosphere in the region led to the improvement in production.

Fig. 1: Yearly GDP real growth rates (%)



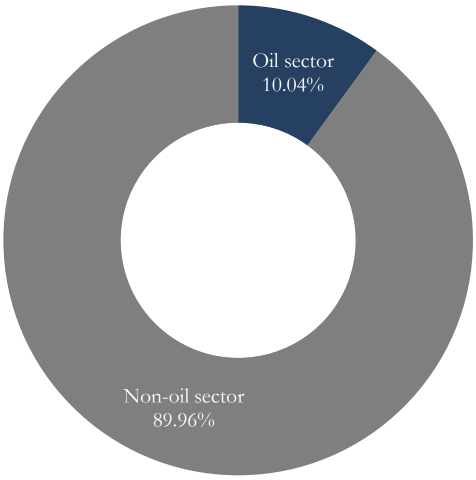
Source: NBS, PAC Research

Table 1: Oil sector and non-oil sector – quarterly real GDP growth rates

	3Q'16	4Q'16	1Q'17	2Q'17	3Q'17
Oil sector	-23.04%	-17.70%	-15.60%	+3.53%	+25.89%
Non-oil sector	+0.03%	-0.33%	+0.72%	+0.45%	-0.76%

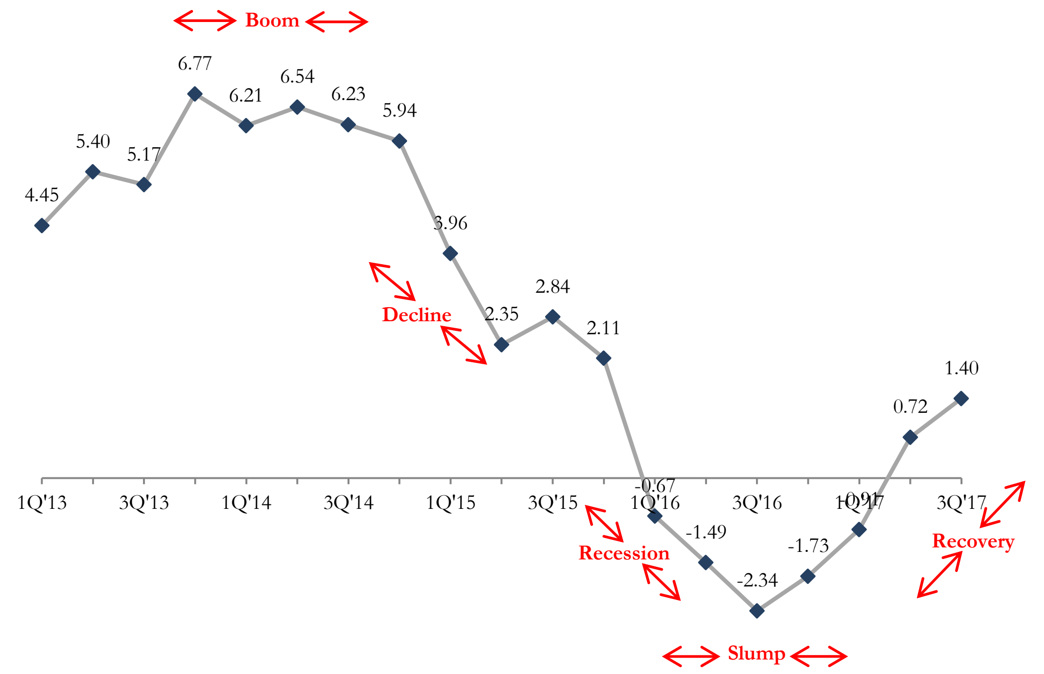
Source: NBS, PAC Research

Fig. 2: Contribution to GDP in 3Q'17 – oil sector and non-oil sector



Source: NBS, PAC Research

Fig. 3: Quarterly real GDP growth rates (%)

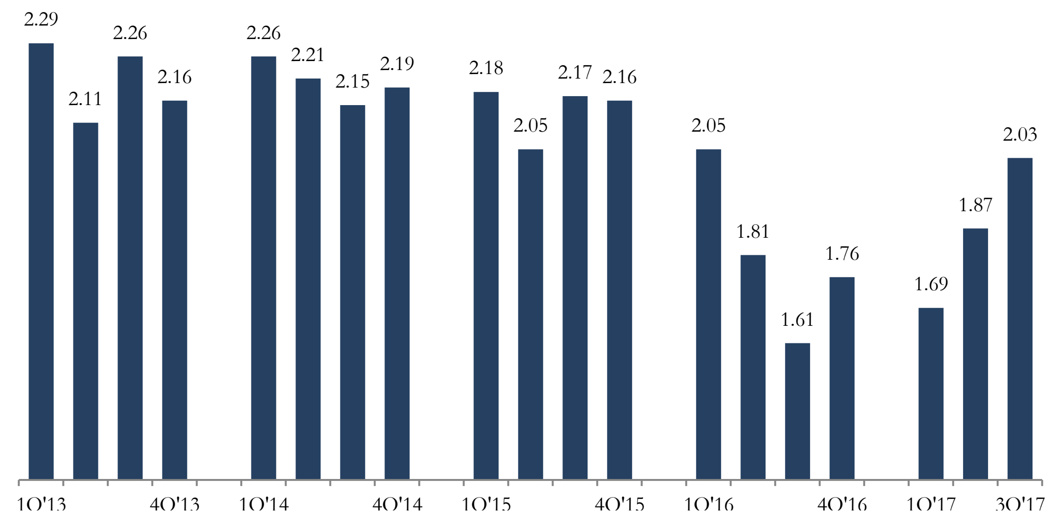


Source: NBS, PAC Research

Fig. 4: Prices of Brent crude oil (US$/barrel)

Source: Bloomberg, PAC Research

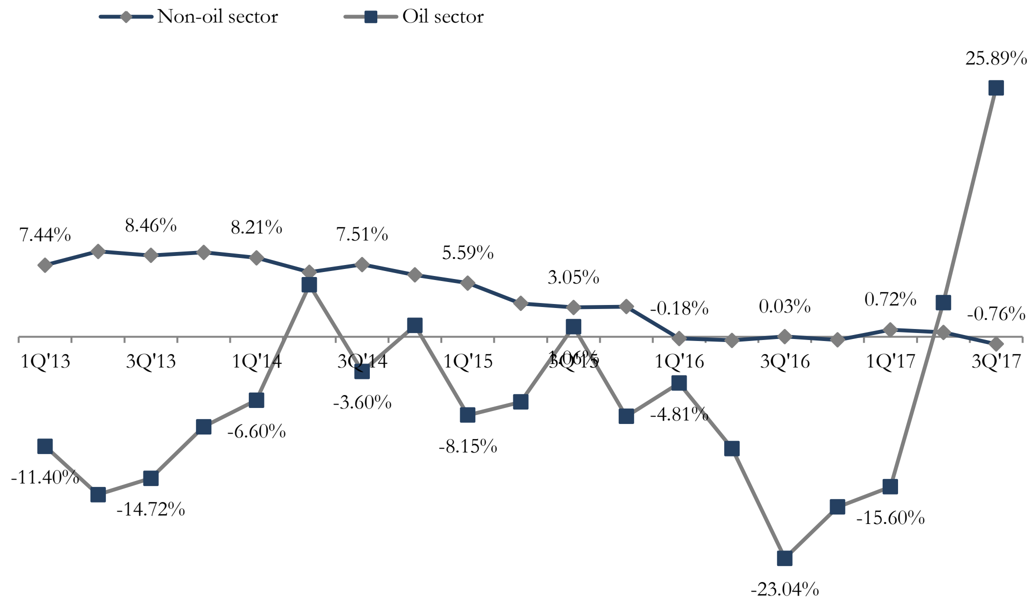
Fig. 5: Crude oil production (mbpd)



Source: NBS, PAC Research

Non-oil sector reverses with real growth rate of -0.76%. In the review period, the resilience displayed by the non-oil sector in the previous year could not be sustained as the sector slide back into negative trajectory with real GDP growth rate of -0.76% in the third quarter of 2017 compared with 0.03% in 3Q'16. The weak performance of the sector in the period was driven by the weakness in the activities of real estate sector and telecommunications sector in the period relative to their performance in the previous year. On the other hand, the weak performance of the non-oil sector was mitigated by the performance of crop production which recorded real GDP growth rate of 3.19%, although this was slightly lower than 3.21% recorded in the second quarter.

Fig. 6: Oil sector and non-oil sector – quarterly real GDP growth rates



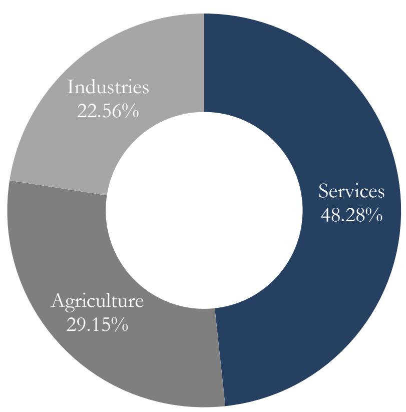
Source: NBS, PAC Research

Services sector is still in recession despite the resilient displays by the broad economy: Nigerian economy is broadly classified into three major sectors; agriculture, industries and services. While the agricultural sector has maintained positive growth even throughout the period of recession, its growth has continuously slowed in the past three quarters, although with a slight improvement in the third quarter of the review year. This may likely be due to the tension in some part of the country and sub-regional floods that have displaced farming communities and agricultural production over the years. The sector grew by 3.06%, 3.01% and 3.39% in the third quarter, second quarter and first quarter of the review period respectively. Agriculture expanded its contribution to real GDP to 29.15% in the third quarter compared with 22.97% in the second quarter; this was on the back of improvement in crop production.

Agriculture expanded its contribution to real GDP to 29.15% in the third quarter compared with 22.97% in the second quarter; this was on the back of improvement in crop production.

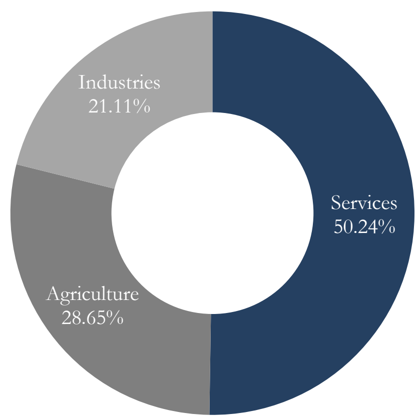
The contribution of industries sector improved to 22.56% in the third quarter relative to 21.1% in the corresponding quarter of the previous year, in addition the sector grew significantly by 8.83% in the third quarter compared with -12.66% in the third quarter of 2016 on the back of improvement in oil sector. Also, industries sector recorded real GDP growth rate of 1.45% and -5.83% in the second quarter and first quarter of the review year respectively. Furthermore, non-oil industries growth was buoyed by improvement in availability of foreign exchange. Foreign exchange from both the Central Bank of Nigeria (CBN) and autonomous sources was tight throughout 2016, but from February 2017 CBN was supplying foreign exchange to the market and in April, the flexible-rate Investors and Exporters Foreign Exchange (IFEX) window was established and it contributed to an increase in autonomous foreign exchange inflows. This unlocked major challenge to investments and output growth. The services sector continues to contract in the third quarter of the review year with real GDP growth rate of -2.66%, a worse performance compared with -1.17% in the third quarter of 2016 and -0.85% and 0.37% in the second quarter and first quarter of 2017 respectively. Also, the contribution of services sector shrunk to 48.28% in the third quarter from 53.73% in the second quarter, 55.45% in the first quarter and 50.24% in the third quarter of 2016.

Fig. 7: Sectoral contribution to real GDP in 3Q'17



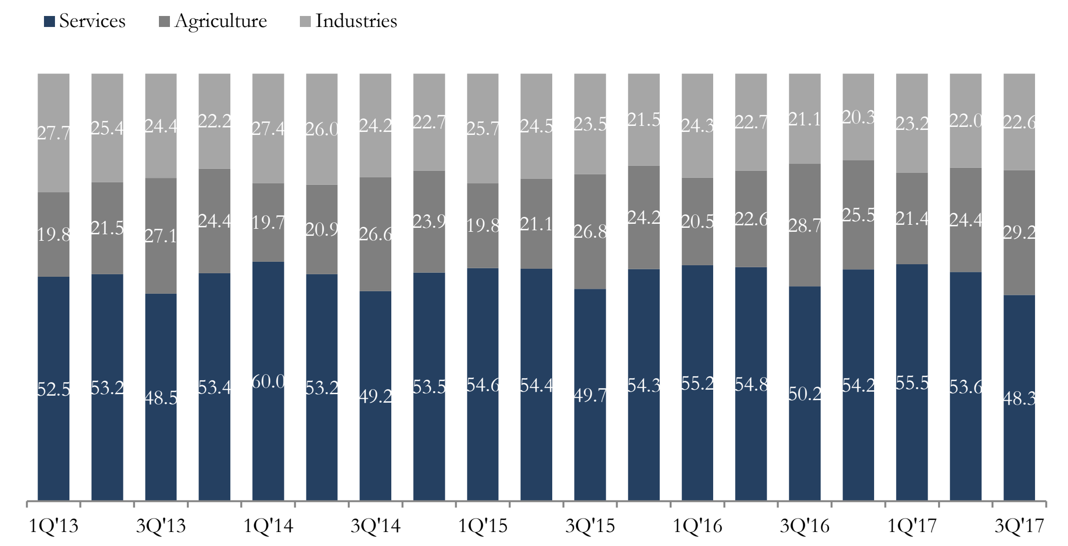
Source: NBS, PAC Research

Fig. 8: Sectoral contribution to real GDP in 3Q'16



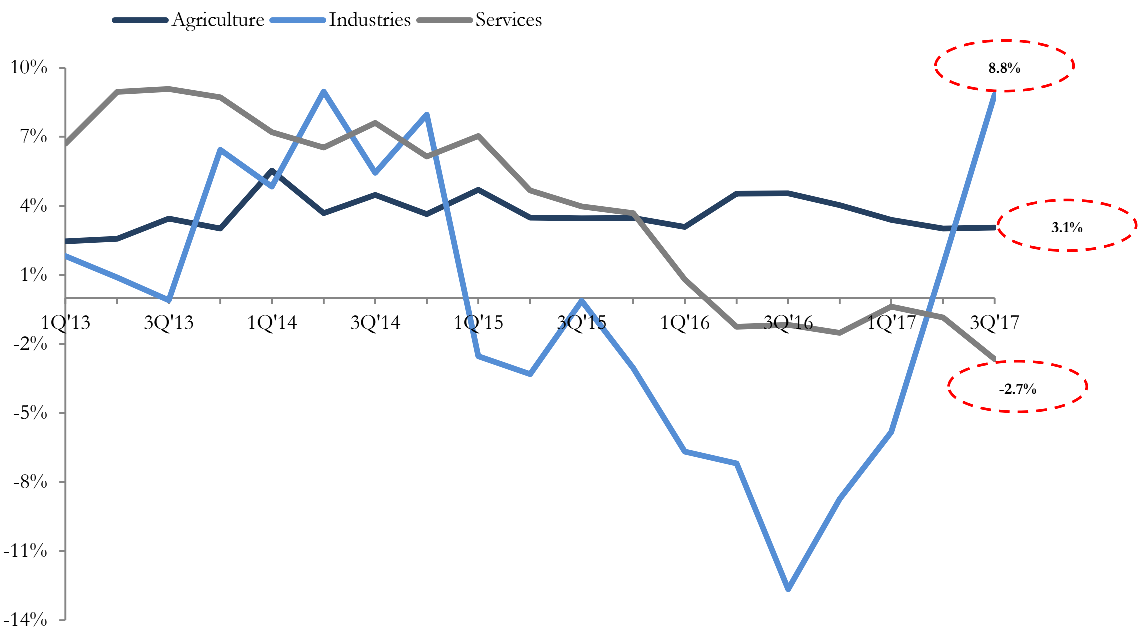
Source: NBS, PAC Research

Fig. 9: Sectoral analysis – quarterly contribution to real GDP (%)



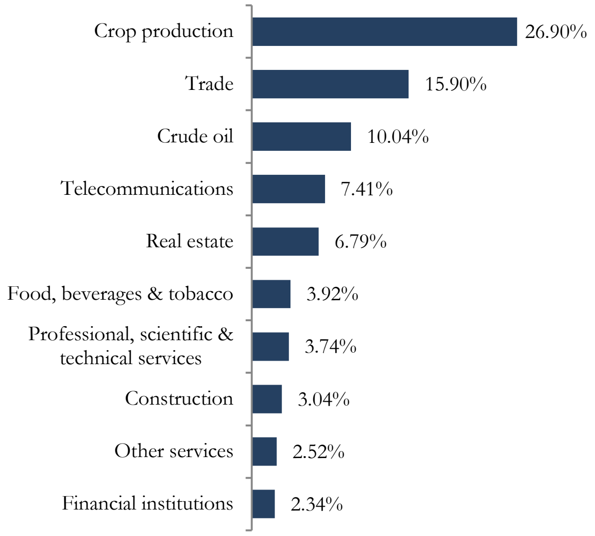
Source: NBS, PAC Research

Fig. 10: Quarterly sectoral real GDP growth rate



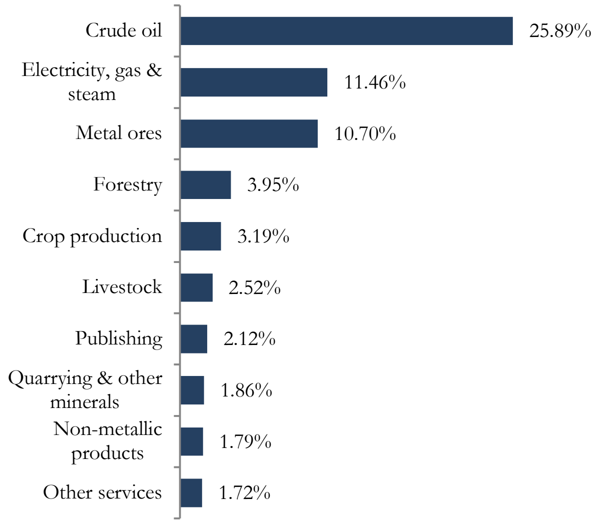
Source: NBS, PAC Research

Fig. 11: Economic activities: Top 10 contributors to real GDP - 3Q'17



Source: NBS, PAC Research

Fig. 12: Economic activities: Top 10 real GDP growth rate - 3Q'17



Source: NBS, PAC Research

Table 2: Real growth rate of selected sectors, y/y (%)

Economic Activities	Annual			Quarterly 2016				Quarterly 2017		
	2014	2015	2016	1Q	2Q	3Q	4Q	1Q	2Q	3Q
Real GDP	6.22	2.79	-1.58	-0.67	-2.34	-1.49	-1.73	-0.91	0.72	1.40
Agriculture	4.27	3.72	4.11	3.09	4.53	4.54	4.03	3.39	3.01	3.06
Industries	6.76	2.24	-8.85	-6.68	-7.19	-12.66	-8.73	-5.83	2.17	8.83
Oil & Gas	-1.32	-5.45	-14.45	-4.81	-11.63	-23.04	-17.70	-15.60	3.53	25.89
Manufacturing	14.70	-1.50	-4.32	-7.00	-3.36	-4.38	-2.4	1.36	0.64	-2.85
Construction	13.03	4.35	-5.95	-5.37	-6.28	-6.13	-6.03	0.15	0.13	-0.46
Services	6.85	4.78	-0.82	0.80	-1.25	-1.17	-1.52	-0.37	-0.85	-2.66
Trade	5.91	5.14	-0.24	2.02	-0.03	-1.38	-1.44	-3.08	-1.62	-1.74
ICT	7.12	6.27	1.95	4.07	1.35	1.11	1.38	2.73	-1.15	-4.48
Finance & Insurance	8.13	7.12	-4.54	-11.28	-10.82	2.64	2.68	0.67	10.45	-5.96
Real Estate	5.12	2.11	-6.86	-4.69	-5.27	-7.37	-9.27	-3.10	-3.53	-4.12
Oil GDP	-1.32	-5.45	-14.45	-4.81	-11.63	-23.04	-17.70	-15.60	3.53	25.89
Non-oil GDP	7.18	3.75	-0.22	-0.18	-0.38	0.03	-0.33	0.72	0.45	-0.76

Source: NBS, PAC Research

Foreign Exchange Policy and Foreign Reserves

Foreign exchange crisis was prevalent throughout 2016 and the first quarter of 2017 as foreign reserves got to a low of US$24 billion in October 2016, and the parallel market rate depreciated to a low of ₦520/US$ in February 2017, although official exchange rate remained in the range of ₦305 to ₦307/US$. The parallel market rate has recovered to around ₦360/US$ as foreign reserves improved to US$40 billion as at January 2018 due to improvement in the oil sector and inflow from foreign borrowings. The Central Bank of Nigeria (CBN) however abolished the requirement that banks allocate at least sixty percent of their foreign exchange sales to manufacturing sector. However, the list of forty-one items that were considered ineligible for official foreign exchange allocation which was instituted in June 2015 was retained. The CBN instituted several special windows for sale of foreign exchange to improve its availability. Consequently, the following foreign exchange windows exist in the Nigerian foreign exchange market:

The parallel market rate has recovered to around ₦360/US$ as foreign reserves improved to US$40 billion as at January 2018 due to improvement in the oil sector…

- The CBN official window for "visible" transactions where the CBN intervenes at a rate ranging from ₦305 – ₦307/US$. This is applicable mainly for the importation of petroleum products and other transactions consider worthy of intervention by policymakers.

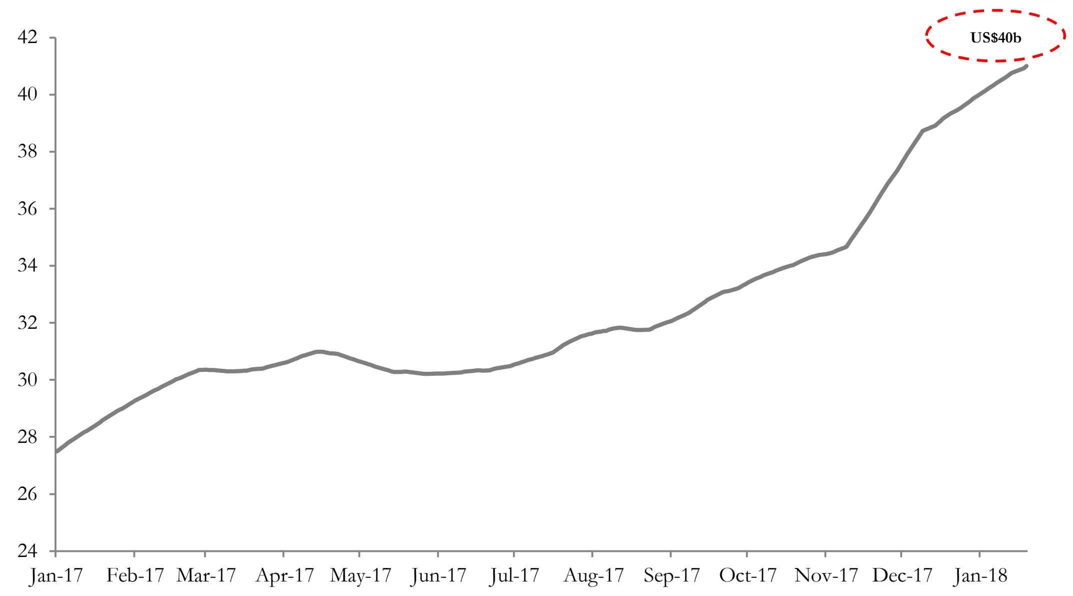
- The Inter-bank Secondary Market Intervention Sales window where the CBN intervenes through the sale of foreign exchange to authorised dealers or end-users in spot and forward sales. At this window, the CBN sometimes direct sales to specific sectors of the economy like agriculture, manufacturing, aviation etc.

- A special inter-bank foreign exchange window was established in February 2017 for retail "invisible" transactions like school fees, medical bills and business and personal travel allowance. The CBN indicated the rate which banks are expected to sell foreign exchange to the users in this respect.

- A special SME window was established in April 2017 to improve access of SMEs for foreign exchange with a maximum of US$20,000 per customer per quarter with highly simplified documentation requirements.

- Investors and Exporters (I&E) Window was established in April 2017 mainly for portfolio investors and exporters based on market-determined rates. The main objective of the CBN for establishing this window was to address the needs for capital repatriation, dividend remittances, loan repayments and software subscription payments among others. The turnover at this window at the end of December 2017 was over US$24 billion.

Fig. 13: Movement in foreign reserve (US$'b)

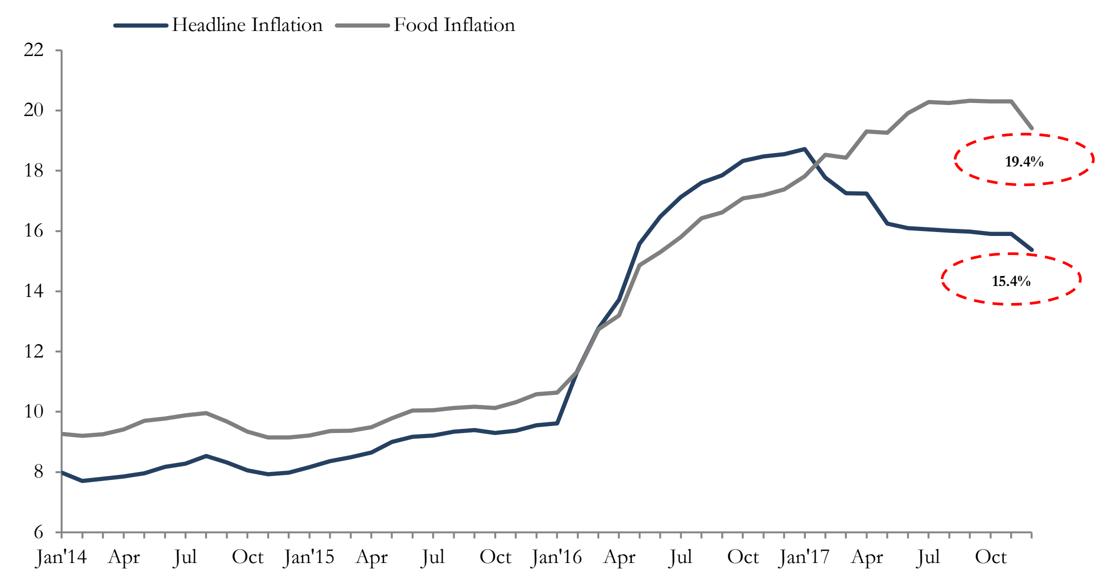


Source: CBN, PAC Research

Headline inflation slowed since February 2017 due to base year effect

Headline inflation peaked at 18.7% y/y in January 2017 but it slowed to 16.1% y/y in June 2017, also core inflation declined steadily from a high of 18.2% y/y in November 2016 to 12.5% y/y in June 2017. However, headline inflation slowed further to 15.4% y/y in December 2017 while core inflation stood at 12.1% y/y on the back of base effect and improved liquidity in the foreign exchange market. Furthermore, there was a divergence between the movement of headline inflation and food inflation in February 2017, as headline inflation was slowing down food inflation was moving higher; it got to a 7-year high of 20.3% y/y in November 2017 and ended the year at 19.4% y/y. The upward movement in food inflation was on the back of high transportation cost, adverse weather condition and protracted tension in the northern part of the country.

Fig. 14: Consumer price index, y/y (%)

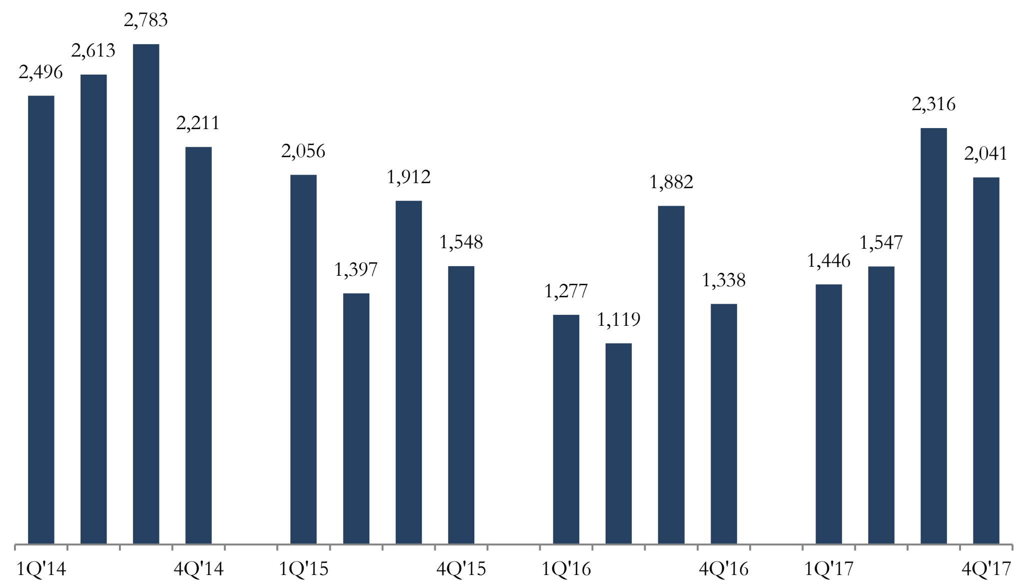


Source: CBN, PAC Research

Government's Fiscal Operations

In 2017, federally-collected revenue stands at ₦7,349 billion, lower than the budget estimate of ₦10,737 billion by 31.6% but higher than ₦5,616 billion in the previous year by 30.9%. The weakness in the revenue relative to the budget estimate in the period was due to the shortfall in receipts from both oil revenue source and non-oil revenue source. In the period, the oil sector revenue of ₦4,110 billion recorded was lower than the budget estimate of ₦5,395 billion by 23.8% which was a result of lower production compared with the budget estimate. On the contrary, the period's oil sector revenue was higher than ₦2,694 billion recorded in 2016 by 52.6%. Furthermore, the oil sector revenue contributed 55.9% to the total federally-collected revenue in the period compared with 48.0% in 2016. Further analysis revealed that crude oil/gas sales accounted for 29.7% of the oil sector revenue, while Petroleum Profit Tax (PPT) and "Others" contributed 43.8% and 26.5% respectively. Crude oil/gas sales recorded revenue of ₦1,221 billion in the period, up by 213.9% y/y compared with ₦389 billion in 2016. Also, PPT/ Royalties' revenue of ₦1,801 billion improved by 51.1% compared with ₦1,192 billion in the previous year. On the other hand, revenue line items termed "Others" declined marginally by 2.2% to ₦1,087 billion against ₦1,112 billion in 2016.

Fig. 15: Gross federally-collected revenue (₦'billion)



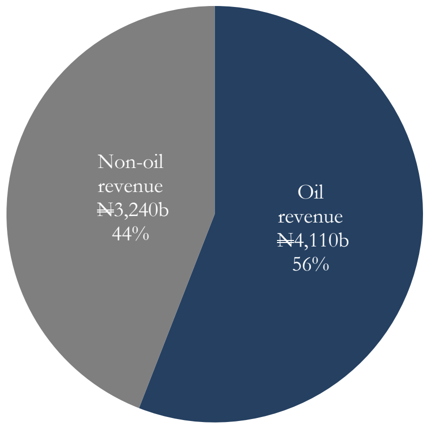
Source: CBN, PAC Research

Table 3: Components of federally-collected revenue (₦'billion)

	1Q'15	2Q'15	3Q'15	4Q'15	1Q'16	2Q'16	3Q'16	4Q'16	1Q'17	2Q'17	3Q'17	4Q'17
Federally-collected revenue	2,056	1,397	1,906	1,548	1,276	1,119	1,882	1,338	1,446	1,547	2,316	2,041
Oil revenue	1,211	839	949	831	666	537	817	673	817	796	1,271	1,226
Non-oil revenue	845	558	956	717	610	581	1,065	665	629	751	1,045	815

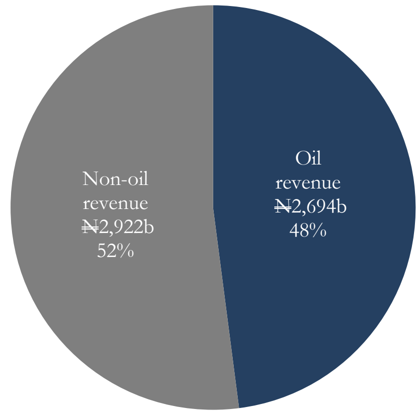
Source: CBN, PAC Research

Fig. 16: Components of federally-collected revenue - 2017



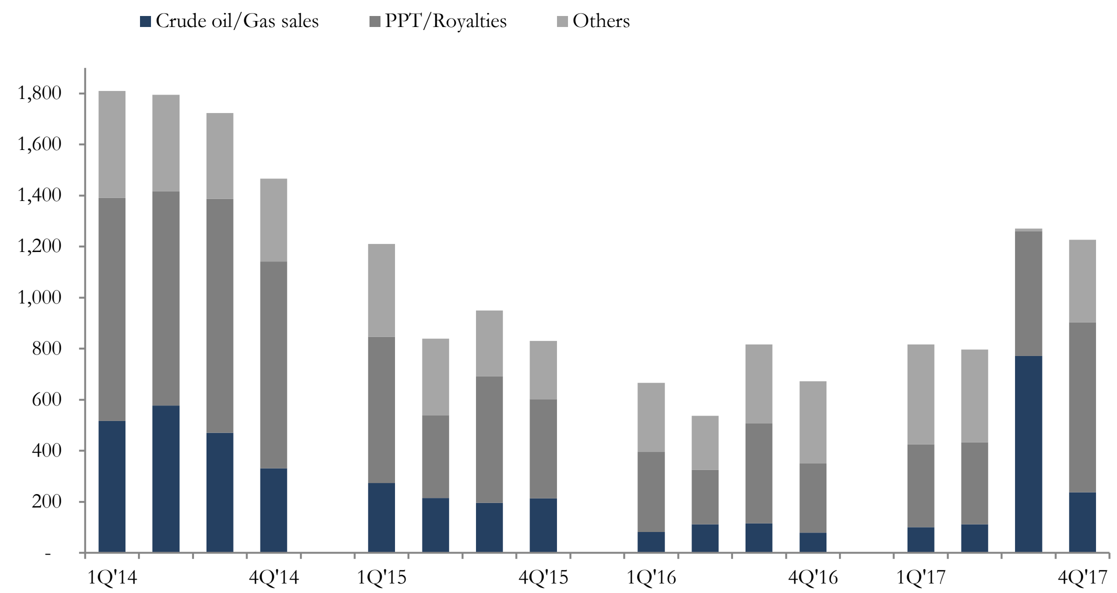
Source: CBN, PAC Research

Fig. 17: Components of federally-collected revenue - 2016



Source: CBN, PAC Research

Fig. 18: Components of gross oil revenue (₦'billion)



Source: CBN, PAC Research

Table 4: Components of gross oil revenue (₦'billion)

	1Q'15	2Q'15	3Q'15	4Q'15	1Q'16	2Q'16	3Q'16	4Q'16	1Q'17	2Q'17	3Q'17	4Q'17
Oil revenue	1,211	839	949	831	666	537	817	673	817	796	1,271	1,226
Crude oil/gas sales	274	215	196	213	82	113	116	79	101	112	771	237
PPT/Royalties	573	325	495	389	314	213	392	273	325	320	489	666
Others	363	299	258	229	270	212	309	321	391	363	10	323

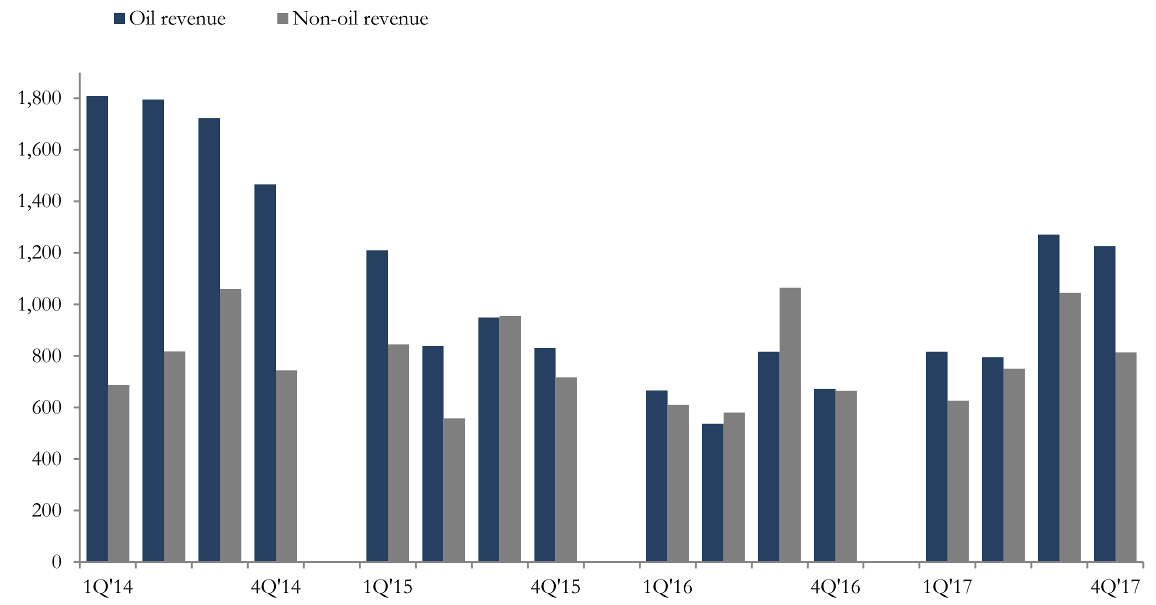
Source: CBN, PAC Research

Non-oil sector contributes 44.1% to gross federally-collected revenue in 2017

For the review period, non-oil revenue source recorded ₦3,240 billion, down by 39.4% compared with the budget estimate of ₦5,342 billion but it increased by 10.9% against ₦2,924 in 2016. The wide gap between the budgeted revenue and the actual revenue in the period was due to weaknesses in the receipts from all the components of non-oil revenue source. Furthermore, Value Added Tax (VAT) contributed 29.9% to the total non-oil revenue in the period; it recorded ₦967 billion, up by 19.2% against ₦811 billion in the previous year. In addition, Company Income Tax increased by 21.9% to ₦1,206 billion compared with ₦989 billion in 2016, the revenue component accounted for 37.2% of the total non-oil revenue. Customs and Excise Duties recorded revenue of ₦628 billion in the period, up by 14.4% y/y compared with ₦549 billion in 2016. It is worthy of note to state that Customs and Excise Duties contributed 19.4% to the non-oil revenue source, also the non-oil revenue line item termed "Others" declined by 24.0% to ₦437 billion against ₦575 billion the previous year. The weak performance of the non-oil sector in the period relative to the budget estimate reflected the harsh business operating environment, which was consequent to the persistent scarcity of foreign exchange for importers in the early part of the review year and infrastructural deficiency among other factors. In our view, if the efforts of policymakers in improving the availability of foreign exchange and the various policies that are being put in place to reduce the level of tax evasion can be sustained, there will be significant improvement in the receipts from the revenue source in the years ahead. This will reduce the level of vulnerability of the nation's fiscal dependence on oil revenue.

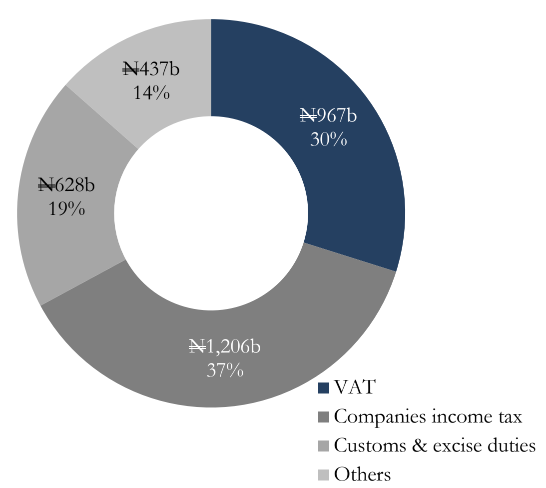
The wide gap between the budgeted revenue and the actual revenue in the period was due to weaknesses in the receipts from all the components of non-oil revenue source.

Fig. 19: Oil revenue and non-oil revenue (₦'billion)



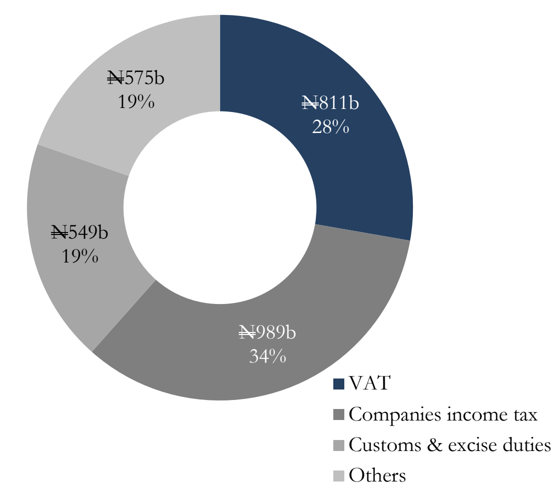
Source: CBN, PAC Research

Fig. 20: Components of non-oil revenue - 2017



Source: CBN, PAC Research

Fig. 21: Components of non-oil revenue - 2016



Source: CBN, PAC Research

Table 5: Components of gross non-oil revenue (₦'billion)

	1Q'15	2Q'15	3Q'15	4Q'15	1Q'16	2Q'16	3Q'16	4Q'16	1Q'17	2Q'17	3Q'17	4Q'17
Non-oil revenue	845	558	964	717	611	581	1,065	665	629	751	1045	814
VAT	196	203	202	178	197	195	210	209	222	243	248	253
Companies income tax	175	159	416	279	176	172	454	187	159	206	543	298
Customs & excise duties	138	128	139	142	136	107	150	157	144	151	164	169
Others	336	68	207	119	103	109	251	112	159	151	89	94

Source: CBN, PAC Research

Federal Government retained revenue significantly lower than budget estimate

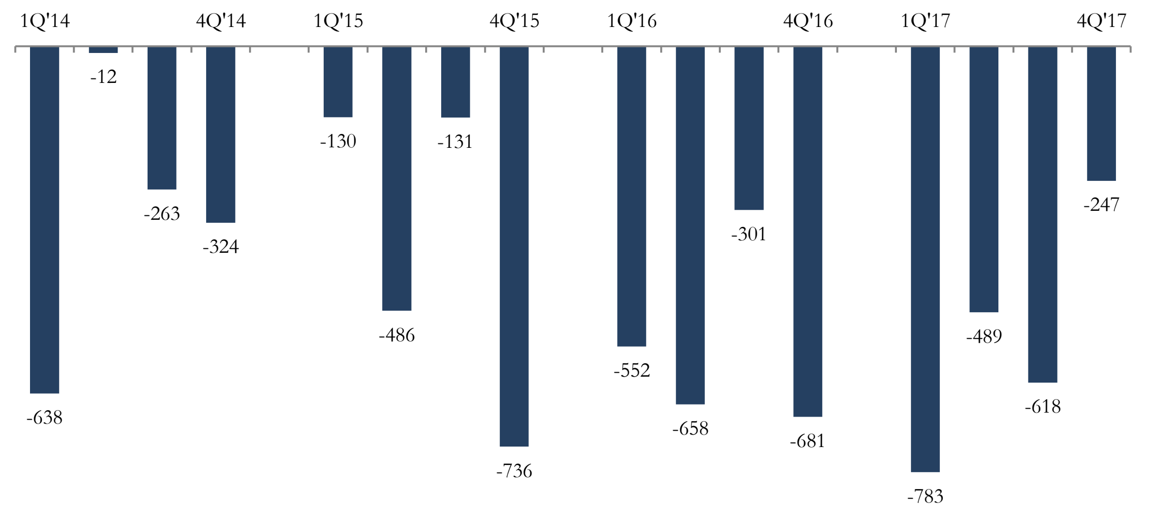
The Federal Government recorded retained revenue of ₦2,765 billion in 2016, lower than ₦3,189 billion in the previous year. Moreover, the review year retained revenue was significantly lower than budget estimate of ₦6,390 billion by 56.7%. The composition of the retained revenue are; Federation Account, Value Added Tax, Federal Government Independent Revenue and Exchange Gain. On the other hand, the estimated Federal Government's expenditure for the review year was ₦4,902 billion, lower than the previous year estimate of ₦5,381 billion by 8.9%, also it was lower than budget estimate of ₦7,752 billion by 36.8%. Therefore, the fiscal operations of the Federal Government resulted in an estimated deficit of ₦2,137 billion, lower by 9.3% compared with budget estimate of ₦2,357 billion and marginally lower than ₦2,192 billion in the previous year by 2.5%.

Table 6: Federal Government Fiscal Operations (₦'billion)

	1Q'15	2Q'15	3Q'15	4Q'15	1Q'16	2Q'16	3Q'16	4Q'16	1Q'17	2Q'17	3Q'17	4Q'17
Retained revenue	1,027	539	1,045	1,005	588	722	955	881	608	689	789	732
Expenditure	1,157	1,025	1,176	1,544	1,119	1,380	1,352	1,562	1,676	1,178	1,407	979
Deficit	-130	-586	-131	-544	-531	-657	-397	-681	-1,068	-489	-618	-247

Source: CBN, PAC Research

Fig. 22: Federal Government's fiscal deficit (₦'billion)

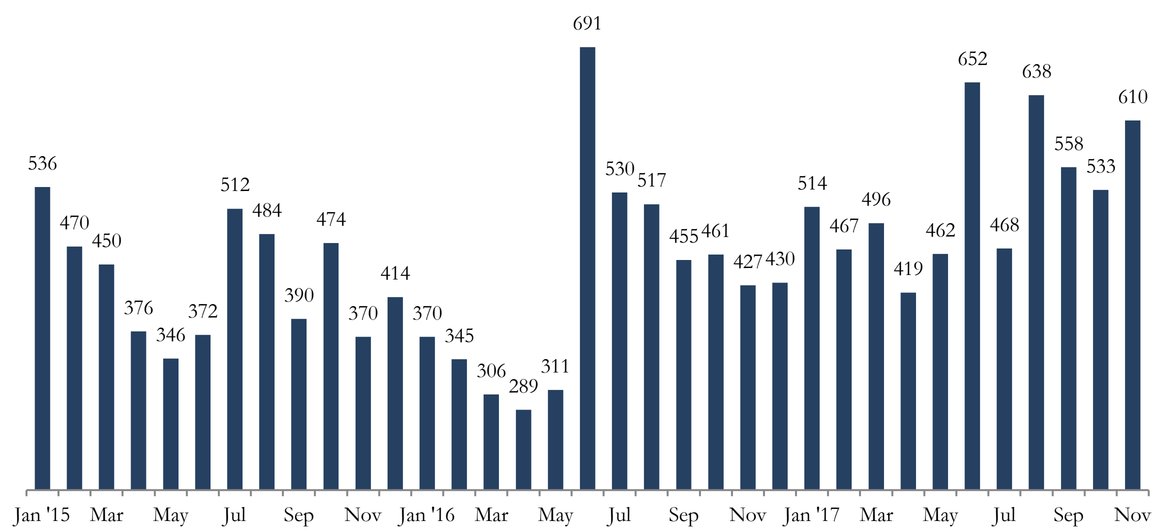


Source: CBN, PAC Research

Fiscal Performance of State Governments

The sub-national fiscal framework in Nigeria consists of expenditure responsibilities and tax assignments, inter-government fiscal transfers and a fiscal policy framework that seeks to ensure overall macroeconomic stability. State and Local Governments are responsible for an average of 43.0% of total public expenditure and a high proportion of health and education spending. Statutory transfer to State Governments were severely affected by the revenue shortfall, as at the end of the second quarter of 2017 transfer from the federation account fell short by 57.0%, also transfer from value added tax pool account fell short by 48.0%. In a bid to cushion the effects of the revenue shortfall on the fiscal operations of State Governments, Federal Government packaged various bail-out plans for State Governments among which was the refund of Paris Club debt over-deduction. The first tranche of ₦523 billion was released in December 2016, while the second tranche of ₦244 billion was released in July 2017 and the final tranche of the refund was paid in December of the review year.

Fig. 23: Monthly FAAC Allocation (₦'billion)



Source: CBN, PAC Research

Government's Policy Response – The Economic Recovery & Growth Plan

In recognition of the deep weakness in the economy and the potential for further weakness, the Federal Government developed Economic Recovery and Growth Plan (ERGP) for the period 2017 – 2020. The plan was released in March 2017 and it lays out the strategy for achieving the Government's vision of sustained and inclusive economic growth. The Plan aims at economic recovery in the short-term and structural reforms aimed at diversifying the economy to set it on a path towards sustained and inclusive growth over the medium to long-term. The Plan serves as an umbrella framework that incorporates sixty strategies out of which twelve have been identified as priorities including infrastructure, industrial and power sector development. The three broad strategic objectives of the ERGP are:

a.) Stabilising the macroeconomic environment

1.) Align monetary, trade and fiscal policies
2.) Accelerate non-oil revenue generation
3.) Drastically cut costs
4.) Privatise selected public enterprises

b.) Achieving agriculture and food security

5.) Delivering on agricultural transformation

c.) Ensuring energy sufficiency (power and petroleum products)

6.) Urgently increase oil production
7.) Expand power sector infrastructure
8.) Boost local refining for self-sufficiency

d.) Improving transportation infrastructure

9.) Deliver targeted high priority transportation projects
10.) Enable private sector financing of infrastructure

e.) Driving industrialisation with focus on SMEs

11.) Improve the ease of doing business
12.) Accelerate implementation of the National Industrial Revolution Plan

The ERGP sets a high target of 7.0 percent real GDP growth by 2020, initially to be driven by the oil sector and then increasingly by strong non-oil sector growth – agriculture, manufacturing and services. The Plan expects strong recovery and expansion of crude oil and natural gas production in the years ahead as challenges in the oil-producing region are overcome. The Plan has a strong focus on agriculture which is expected to continue to play an important role in Nigeria's growth story, also ERGP anticipate strong growth in the manufacturing sector, particularly in agro-processing and food and beverage manufacturing. Ongoing strategies to improve the ease of doing business have been yielding results; this is expected to boost other economic activities in the manufacturing sector including light manufacturing. Overall, the ERGP estimates an average annual growth rate of 8.5% in manufacturing between 2018 and 2020 and services sector is expected to grow at a rate of 2.5% during the period of the Plan.

Table 7: Nigeria Economic Recovery and Growth Plan Projections

Growth scenario	2017	2018	2019	2020
Real GDP growth (%)	2.2	4.8	4.5	7.0
Oil production (mbpd)	2.2	2.3	2.4	2.5
Oil price benchmark (US$)	42.5	45.0	50.0	52.0
Headline inflation (%)	15.7	12.4	13.4	9.9
Per capita real GDP (US$)	2,542	2,640	2,731	2,854
Unemployment (%)	16.3	14.5	12.9	11.2
Net job creation (million)	1.5	3.8	4.3	5.1
Poverty level	Poverty rate to decline to between 50% and 55% by 2020			

Source: ERGP, PAC Research

Downside risk to the achievement of the objectives of ERPG

Considering the severe challenges that the country faces, the Plan is an important step forward, it is a reform strategy that seeks to be comprehensive in addressing the country's challenges. However, certain aspects of the Plan appear more challenging especially growth targets, financing of the Plan and the extent of support and contribution from sub-national governments. The following downside risks were noted:

- The ERGP growth targets are optimistic given the weaknesses on the macroeconomic policy frameworks and the implementation risks associated with the structural reforms in the Plan.

- The Plan contains little discussion on the estimated costs and financing sources (public finance through the annual budget, development financing programs and private sector financing) need to be assessed, including the potential amounts derivable form each source.

- The strategy for engaging and incentivising sub-national governments in delivering the outcomes of the Plan implementation is not fully articulated. Quite a number of ERGP strategies rely on States and Local Governments to implement in the reform program especially fiscal transparency and sustainability, improving the business environment, governance and local service delivery.

- The credibility of the Plan depends on its implementation, i.e. whether it can restore confidence in the economy has to do more with rapid identification and implementation of some of its objectives in order to achieve expected goals. The approval of the Power Sector Recovery Plan in March 2017 is a major milestone towards the achievement of the priorities of the Plan.

Government's Policy Response - The Nigeria Power Sector Recovery Program

In view of the urgent need to address the challenges within the power sector, the Power Sector Recovery Program (PSRP) was developed and it was approved in March 2017. Several years after the privatisation of the distribution and generating assets in the sector, the power sector reform program has not yet delivered substantial improvement in electricity services. The key objectives of the program are as follows:

- To restore the sector's financial viability
- To improve power supply reliability to meet growing demand
- To strengthen the sector's institutional framework and increase transparency
- To implement clear policies that will promote and encourage investor in the sector
- To establish a contract-based electricity market

Components of the Recovery Program

The specific strategies highlighted by the Plan for the achievement the objectives are as follows:

- Elimination of cash deficits that have accumulated in the past up till December 2016 and through disbursement of the CBN's Nigeria Electricity Market Stabilisation Facility (NEMSF)

- Implement an end-user tariff trajectory that ensures cost reflective tariffs in the next five years from the day of launching of the program

- Ensure DISCO's performance and accountability including through the enforcement of commitments made in the performance agreement signed with the Bureau of Public Enterprises (BPE) and reflected in the tariffs at privatisation

- Ensure grid stability by attaining effective and dependable generation and distribution of at least 4,000 MW in order to build confidence with consumers

- Ensure that accumulated MDA electricity debts are paid and implement payment mechanism for future bills, including through the introduction of a system where bills are paid centrally on behalf of MDAs and deducted from their budgetary allocations

- Improve the governance of regulatory agencies in the sector by making relevant appointment into the vacant board seats

- Increase access to electricity by implementing off-grid renewable solution

- Develop and implement foreign exchange policy for the power sector

Policies and Events that Shaped 2017

The release of ERGP	Ogoni clean-up: The Niger/Delta new vision
Late passage of the 2017 budget	Passage of PIGB
OPEC concession	Power Sector Recovery Program
CBN I&E foreign exchange window	Tension between the executive and the legislative arm of government
VAIDS	Paris Club Refund to State Govt.
Improvement in World Bank Ease of Doing Business Index	Social security program - CCT
FG's whistle blower policy	

Economic Outlook

Real GDP growth rate

Economic recovery is expected to be strengthened in 2018, with an estimate of 1.0% for 2017 and projection of between 2.0% and 2.5% in 2018. Although, Federal Government made projection of 3.5% in the 2018 Appropriation Bill and 4.8% in the Economic Recovery and Growth Plan for 2018 which are too optimistic in our view considering the current weaknesses in the structure of the economy. Growth is expected to be driven by sustained recovery in the oil sector, continuous growth in agriculture and the positive impact on investment and other private sector activities from improved availability of foreign exchange to support imports. Moreover, as government continue to implement the structural reforms in the ERGP, growth can be expected to strengthen in the medium term.

Crude oil production and prices

Global demand for crude oil is expected to remain robust in the short to medium term as the prospect of global economic growth strengthened. With average daily production of 2.03 mbpd in the third quarter of 2017, the production target of 2.30 mbpd can be achieved on the back of sustained peaceful atmosphere in the oil producing region and extension of waiver granted to Nigeria on production quantity by OPEC. Brent Crude Oil traded at an average price of US$55.27 per barrel in 2017 on the back of agreement among both OPEC members and non-OPEC producers to extend production cut till March 2018 and on the strength of optimistic global economic prospects in the medium term. However, the production cut has been extended till December 2018. Average price of US$59.00 per barrel was projected by the Economic Intelligent Unit for Brent Crude Oil in 2018 which is higher by 6.7% compared with the average price of US$55.27 per barrel in the previous year. Also, the passage of the Petroleum Industry Governance Bill (PIGB) and other sub-component of the Bill will go a long way to attract investment into the sector in the medium to long term and to achieve the production target set by the Federal Government. The PIGB has been passed by both the Senate and the House of Representatives, it is therefore awaiting assent of the President as at the time of preparation of this report.

Global demand for crude oil is expected to remain robust in the short to medium term as the prospect of global economic growth strengthened.

Consumer Price Index and Foreign Exchange Policy

Headline inflation is projected to remain high, declining slowly in the short-to-medium term; inflationary impact is expected to put pressure on general price index as the prices of imported goods remain sticky even after mild appreciation of Naira in the parallel market. Food inflation is expected to remain high in the short to medium term, due to slower growth in agricultural production, the restrictions on some imported food items and disruption in some regions in the country. The availability of foreign exchange is expected to improve during the year as the level of accretion to foreign reserves is growing on the back of recovery in the prices of crude oil and production and increasing inflow from foreign borrowings by the Federal Government. Therefore, the official and the parallel market exchange rate are expected to converge mildly in the course of the year, Naira is projected to strengthen to between ₦330 and ₦340/US$ in the parallel market while the official exchange rate remains at between ₦306 to ₦307/US$. Furthermore, flexible exchange rates in favour of some selected sectors of the economy and for various reasons are expected to persist, and administrative measures introduced by the CBN to ensure liquidity of foreign exchange are expected to continue in 2018.

Fiscal and Monetary Policy

Fiscal policy remained expansionary in 2017 and this is expected to continue, although total spending as a proportion of GDP declined to 10.3% in 2017 from 13.0% in 2014. Budget deficit that was estimated to be 4.8% in 2017 is projected to improve to 4.3% in 2018 as the performance of revenue improves. Furthermore, fiscal operations of government at all levels are expected to improve in the year on the back of projected improvement in FAAC allocations, however non-oil revenue is still expected to remain low especially at the sub-national level due to their low revenue generation potential. Although, we projected slight improvement in the level of non-oil revenue generation at the federal level due to some initiatives currently embarked upon to expand the revenue source. On the other hand, monetary policy is expected to continue to be contractionary in 2018; the policy rate has been kept at 14.0% since July 2016 to support the Naira and control inflation. It is expected to be adjusted downward during the year as headline inflation eases gradually, however there is uncertainty as to the ability of the monetary policy committee to meet up with the number of times they are expected to hold meeting constitutionally in a year. This was on the backdrop of the fact that the committee members as presently constituted do not form quorum because the term of office of some of the members have expired while others retired during the previous year and the legislative arm of government seems not to be positively disposed to screening new nominees for confirmation who are expected to fill the vacancies. We are of the opinion that the stalemate between the two arms of government in this respect will be resolved during the year in the overall interest of the economy.

Although, we projected slight improvement in the level of non-oil revenue generation at the federal level due to some initiatives currently embarked upon to expand the revenue source.

Downside Risk to the Outlook

- The prospect of sustained positive economic growth remains contingent on a sustained recovery in oil sector and the absence of shocks in agriculture, although the hostilities in the oil producing region has been stemmed down significantly, yet sustained economic recovery is still vulnerable to oil production and price shocks

- Given the unorthodox exchange rate policies, the exchange rate stability depends on recovering oil exports and external financing inflows. External shocks to foreign exchange earnings may lead to a recurrence of disruptive foreign exchange shortages

- Lack of political will to embark on the much-needed reforms to reduce inefficiencies and to boost non-oil revenue generation e.g. full deregulation of the downstream sub-sector of the petroleum industry

- Fiscal imbalance among sub-national governments that leads to persistent delay in payment of salaries of civil servants
- Disruption in fuel supply, power shortages, high unemployment and high level of poverty
- Insecurity and tension in some parts of the country might lead to food shortage in the short-term
- Recurring ravaging flooding in some parts of the country may impact agricultural production negatively
- Banking sector fragilities – worsening non-performing loans
- Political risk – election year

Policies and Events that are Expected to Shape 2018
Global oil market outlook
Monetary policy developments in advanced countries
Delay in passage of the 2018 Appropriation Bill – it might affect implementation of capital projects
Debt re-balancing strategy – it will result in lower borrowing cost for government among others
Implementation of business reforms will lead to improvement in the World Bank Ease of Doing Business Index
2019 General Election – increased government spending relating to the election

IMPORTANT DISCLOSURES

This research report has been prepared by the analyst(s), whose name(s) appear on the front page of this document, to provide background information about the issues which are the subject matter of this report. It is given for information purposes only.

Each analyst hereby certifies that with respect to the issues discussed herein, all the views expressed in this document are his or her own and reflect his or her personal views about any and all of such matters. These views are not necessarily held or shared by PanAfrican Capital or any of its affiliate companies. The analyst(s) views herein are expressed in good faith and every effort has been made to base our opinion on reliable comprehensive information but no representation is made as to its accuracy or completeness. The opinions and information contained in this report are subject to change and neither the analysts nor PanAfrican Capital is under any obligation to notify you or make public any announcement with respect to such change.

This report is produced independently of PanAfrican Capital and the recommendations (if any), forecasts, opinions, estimates, expectations and views contained herein are entirely those of the analysts. While all reasonable care has been taken to ensure that the facts stated herein are accurate and that the recommendations, forecasts, opinions, estimates, expectations and views contained herein are fair and reasonable, none of the analysts, PanAfrican Capital nor any of its directors, officers or employees has verified the contents hereof and accordingly, none of the analysts, PanAfrican Capital nor any of its respective directors, officers or employees, shall be in any way responsible for the contents hereof.

With the exception of information regarding PanAfrican Capital, reports prepared by PanAfrican Capital analysts are based on public information. Facts and views presented in this report have not been reviewed and may not reflect information known to professionals on other PanAfrican Capital business areas including investment banking. This report does not provide individually tailored investment advice. Reports are prepared without regard to individual financial circumstances and objectives of persons who receive it. The securities discussed in this report may not be suitable for all investors. It is recommended that investors independently evaluate particular investments and strategies. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances or objectives. Neither the analyst(s), PanAfrican Capital, any of its respective directors, officers nor employees accepts any liability whatsoever for any loss so ever arising from any use of this report or its contents or otherwise arising in connection therewith. Each analyst and/or any person connected with any analyst may have acted upon or used the information herein contained, or the research or analysis on which it is based prior to its publication date. This document may not be relied upon by any of its recipients or any other person in making investment decisions.

Each research analyst certifies that no part of his or her compensation was, or will be directly or indirectly related to the specific recommendations (if any), opinions, forecasts, estimates or views in this report. Analysts" compensation is based upon activities and services intended to benefit clients of PanAfrican Capital. As with other employees of PanAfrican Capital, analysts' compensation is impacted by the overall profitability of PanAfrican Capital, which includes revenues from all business areas of PanAfrican Capital.

PanAfrican Capital Plc
8A, Elsie Femi Pearse Street
Victoria Island
Lagos, Nigeria
Tel: +234 (1) 2716899, 2718630
www.panafricancapitalplc.com