

24 November 2016

Weaker Q3-2016 GDP Growth. Nigeria's Economy Extends Recessionary Trend

Earlier this week, the National Bureau of Statistics (NBS) released Nigeria's Gross Domestic Product (GDP) report for the third quarter ended September. According to the report, real output growth during the three months period slumped by 2.24% y/y (the biggest since -7.59% recorded in Q1-2004), representing 18bps and 508bps declines from growth rates of -2.06% and 2.84% recorded in the previous quarter and Q3-2015 respectively. Although the insipid growth was widely expected, the contraction was bigger, overshooting Bloomberg-compiled median estimate of -2.05%, and consequently heralding the first three successive negative growths since 1987 (prior to rebasing). Suffice to say that the sombre performance of the economy in the review period broadly accentuates the fact that legacy negative growth drivers have not been proactively responded to; in fact, structural and systemic challenges remain elevated.

As was the case in the first half, the economy grappled with (1) record low crude oil and gas production owing to continued pipeline vandalism and theft; (2) weak government spending, which is a fallout of the tardy passage of the 2016 appropriation bill, fiscal tightening measures and depressed government revenue; (3) soft aggregate demand, driven by falling disposable personal income amid accumulated salary arrears of civil servants particularly at the sub-national levels of government, private sector lay-offs, pay cuts, and record high inflation rates; (4) slowing growth of credit to private sector – compared to credit to government – over rising NPLs, which has undermined employment and productivity (5) forex scarcity owing to weak oil revenues (due to low crude oil prices) and capital controls; (6) constraint in electricity supply and distribution following frequent gas pipeline attacks; and (7) insecurity apprehensions, particularly incited by Boko Haram attacks and herdsman-farmers clashes (although at reduced levels), in some parts of the country.

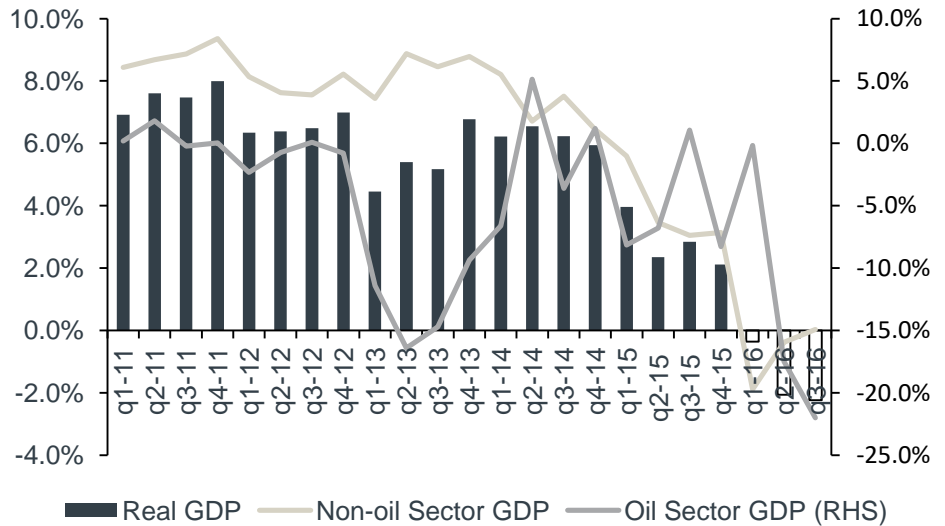
The fallout of the foregoing is a renewed call on the fiscal authority to consider more decisive measures at jumpstarting growth, given particularly the rhetoric of the monetary authority constantly laying claim on how burdened monetary policy tools have become and how its instruments could not have directly ameliorated the challenges highlighted above.

Looking at the breakdown of the growth figures, it is apparent that save for the positive growth recorded by the non-oil sector (after a negative growth in the previous quarter), the overall output contraction would have been worse. Specifically, the oil sector recorded a negative growth of 22.01% (from -17.48% in Q2-2016 and 1.13% in Q3-2015) while the non-oil sector grew by a marginal 0.03% (from -0.38% in Q2-2016 and a growth of 3.05% in Q3-2015) to exit recession. For information, the significant contraction in the

24 November 2016

oil sector GDP is the most disappointing within available CBN data and equally marks the fourth successive negative growth which started in Q4-2015.

Figure 1: Real GDP Growth (y/y)

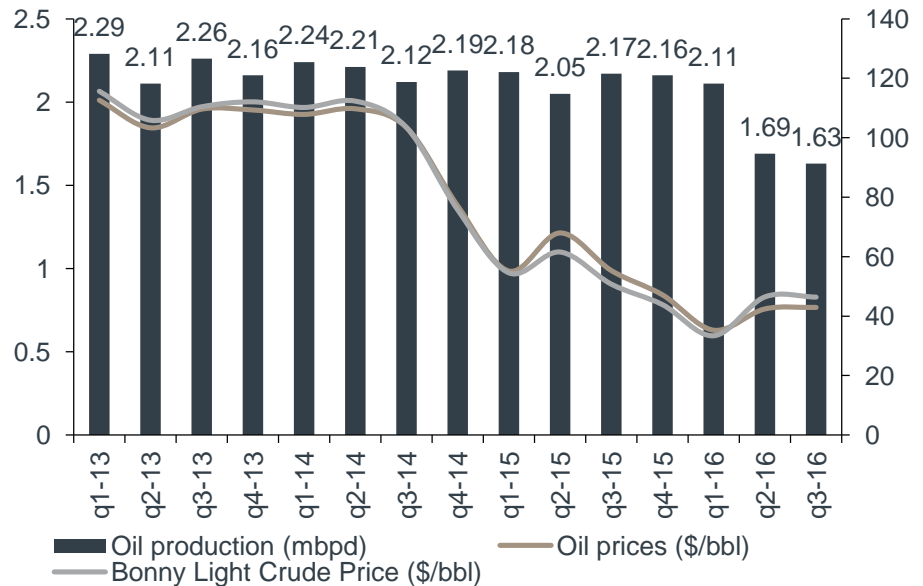


Source: : NBS, Cordros Research

Oil Sector GDP in Recession Plus

The oil sector continued to struggle with lower average crude oil prices, and most especially, domestic production headwinds. Specifically, the NBS report shows that crude oil production was lower both on q/q and y/y bases -- the Bureau estimated crude oil production at 1.63mbpd (a record low) during the reference period, 0.06mbpd lower than Q2-2016's output of 1.69mbpd. Compared with output level of 2.17mbpd in the corresponding quarter of 2015, production was down by 0.54mbpd. Worthy of mention, however, is the fact that the NBS' reported output -- usually from the Nigerian National Petroleum Corporation (NNPC) -- is 0.16mbpd higher than the 1.47mbpd estimate reported by the Organization of the Petroleum Exporting Countries (OPEC) during the same period. Oil production during the period was scuttled by major blows from (1) vandalism and theft which left most fuel pipelines and depots idle; (2) failed government attempt at dialoguing with the Niger Delta Avengers; (3) deceleration in capital investment in the sector; and (4) lack of executive-legislative commitment over pushing reforms -- most especially the Petroleum Industry Bill (PIB) -- through in this segment (The Nigeria Extractive Industries Transparency Initiative has said the country is losing about \$200bn as a result of its failure to pass the PIB as an enabling law for the oil and gas industry).

Figure 2: Oil Production and Prices



Source: CBN, OPEC, Cordros Research

On militants attacks – which have reduced Nigeria's oil production in the onshore and shallow water by 70% -- we refer to (1) series of reported simultaneous attacks on oil and gas facilities (e.g. NNPC, NPDC, Agip, Qua Iboe, Shell, Chevron and Eni) within the period; resulting in (2) sustained force majeure on some of the nation's export streams; and (3) production disruptions (leakages) also experienced by local firms. The challenges faced by the oil sector during the period was exacerbated by external factors, such as (1) strong competition in the oil market and (2) reduced demand given turnaround maintenance activities across some Asian refineries. On competition, we note report in August that Saudi Arabia cut all official selling prices for its crude sales to Asian buyers and the United States.

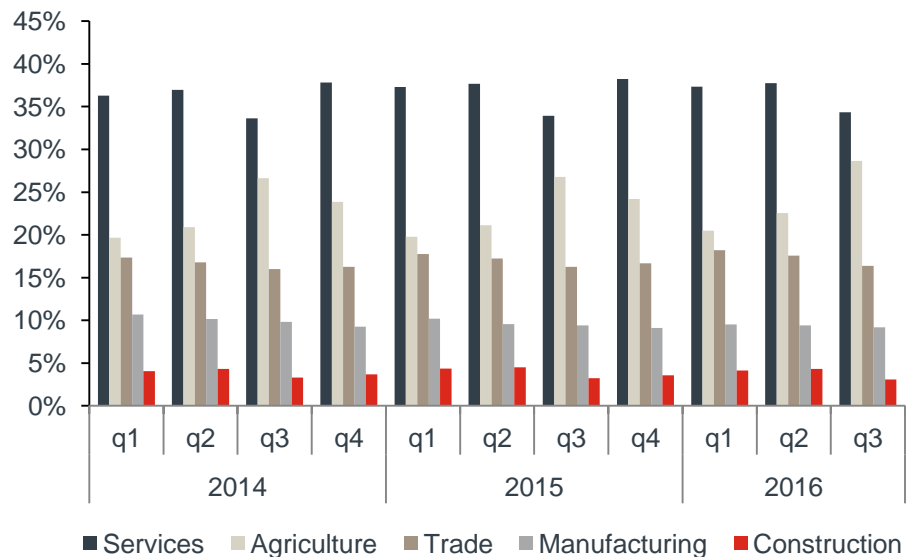
Still on the downside, oil prices remained low y/y during Q3-2016. Specifically, Bonny Light Crude stood at \$46.37/bbl average (vs. \$46.44/bbl and \$50.73/bbl in the previous quarter and Q3-2015 respectively); while the OPEC basket price was estimated at \$42.89/bbl average, compared to \$42.38/bbl last quarter and \$48.16 in the corresponding quarter of 2015.

Non-Oil Sector Exits Recession with a Marginal Growth

The non-oil sector grew by a marginal 0.03% y/y (vs. -0.38% and 3.05% last quarter and Q3-2015 respectively) to exit recession, largely driven by agriculture (crop production), which remained resilient. The q/q growth experienced across some key non-oil subsectors also contributed to the overall marginal growth. It is logical to attribute the rebound in this sector to the improved budgetary disbursements recorded during the period,

wherein monthly FAAC allocations were positively impacted by (1) tax collection efforts and (2) the naira devaluation. That said, the fact that manufacturing, services and trade contracted year-on-year during the review period overshadowed their improved q/q performances. Systemic issues, notably (1) foreign exchange crisis; (2) sizable drop in electricity power supply and distribution; and (3) the lag effect of delayed fiscal actions remained the bane of these large components of the non-oil sector. In real terms, the non-oil sector maintained its dominance in terms of contribution to overall GDP, accounting for 91.81% -- up from its shares in the previous quarter (91.74%) and the corresponding quarter of 2015 – of total output for the period.

Figure 3: Components of Non-Oil GDP



Source: : NBS, Cordros Research

Manufacturing Sector Deepens Recession

The manufacturing sector remained pressured, deepening its recessionary trend with a negative growth of 4.38% y/y from -1.75% recorded in Q3-2015. Compared to the preceding quarter, growth was 102bps lower. The unimpressive growth recorded in this sector speaks to the largely subdued environment, wherein the challenges facing manufacturers remained unresolved. Here, we reiterate the (1) difficulties in accessing forex for basic operations; (2) severe shortage of fuel to power owned plants, amid significant drop in power generation and supply from the national grid; and (3) sluggish recovery of aggregate demand which discouraged expansive production.

Underlining the magnitude of downside impact of forex shortage on manufacturing output are claims by the Manufacturers Association of Nigeria (MAN) that (a) more than 70% of the manufacturing sector was severely affected by the acute shortage of the greenback; (b) some manufacturers who

24 November 2016

had outstanding dollar requests and Letters of Credit (applied for at N197/USD) before the flexible FX policy recorded huge losses; and (c) manufacturers sometimes have to wait for three months after bidding for forex before getting a response from the CBN.

Also quite significant is the adverse impact of gas supply shortage on manufacturers, ranging from lost production days, to margins shrinkages owing to increased substitution of expensive (and yet insufficiently available) fuel (LPFO). Furthermore, aggregate demand remained weak, as the impact of both retrenchment in the private sector and arrears of civil servants salaries lingers. Corroborating this is the dismal Q3'2016 corporate earnings released by most manufacturing names quoted on the Nigerian Stock Exchange.

Services Records Another Negative Growth

The services sector (-1.9% y/y) also extended its recessionary period, as it remained ruffled by uncertainty in the foreign exchange environment, particularly chronic dollar shortage. Growth in this sector was specifically slowed by declines in Real Estate (-7.37% y/y) and Accommodation (-4.88% y/y) which offset year-on-year improvements in Finance & Insurance (+2.64%), Information and Communication (+1.11%) and Transportation & Storage (+0.72%).

Depressed Business Conditions Pressure Trade

Further strained by depressed consumer demand, inadequate government spending, dollar illiquidity, higher tariffs and rising inflation, real GDP in the trade sub-sector stood at -1.38% y/y (i.e. 135bps and 579bps lower than rates recorded in the preceding quarter and one year previous). Quarter-on-quarter, trade grew by 1.62% in the review period, after recording negative growth in the first and second quarters.

Agriculture Remains Resilient; Crop Production in the Spotlight

The agriculture sector remained resilient, posting a real GDP growth of 4.54% (almost unchanged from +4.53% in Q2-2016), 105bps higher than the growth recorded in the corresponding quarter of 2015. When compared to Q2-2016, growth was in line with historic c.39%. Growth in this sector was mainly driven by in crop production (accounting for 95% of overall nominal growth of the sector), which we sense continues to benefit from the relative dissipation of Boko Haram attacks, reduced herdsmen-farmers clashes across the country, and renewed government focus on the sector – as part of its diversification drive.

24 November 2016

Dim Prospects on Weak Near Term Fundamentals

The key undercurrents – both systemic and structural headwinds – that have contributed to the lull in productive activities thus far this year are largely unresolved. The weak October PMI (of less than 46) is synonymous with those of earlier months, and November is not expected to be any different. Hence, a more modest expectation for Q4-2016 GDP.

The latest growth figure, combined with the negative growth in the first half of the year, suggests that output would have to grow by at least 4.23% in the final quarter for the domestic economy to escape its first yearly negative growth in over two decades. We had forecast a negative 1.5% growth for 2016, on our estimate of -1.8% growth for the second half (including estimate of -3.16% for Q3-2016). We have revised our growth estimate for the second half to -0.46% (including 1.27% growth for Q4), equating to full year weighted average growth of -0.82%.

Oil Sector GDP to Potentially Benefit from Higher Prices

The oil sector is poised to benefit from potentially higher crude oil prices, given the increasing likelihood that OPEC members will commit to the proposed output freeze agreement in coming days. Higher prices should serve as good hedge for the production challenges currently faced locally, but are unlikely to have major impact on oil sector GDP until first quarter 2017. Key risks, however, are that (1) the activities of militants in the Niger Delta may take a drastic turn in the event that the FG fails in the ongoing epileptic dialogue, and (2) the success of Donald Trump's plan for US oil (to open more federal lands and waters to oil and gas drilling) will eventually become bearish for global prices.

Non-Oil Sector Growth to Remain Threatened on Bleak Outlook in Major Sub-Sectors

Growth in agriculture will remain positive in the fourth quarter. This is supported by (1) the pronounced commitment by the FGN on diversifying the economy via laudable Agriculture Promotion Policy (e.g. The Green Alternative); (2) the Bank of Agriculture's proposed single digit interest rate for farmers in the country; and (3) increased output from the harvest season. All these said, we note that risks such as (1) higher-than-average flooding in most parts of the country, (2) the late onset of the rainy season and early cessation of rain in some parts of the country, and (3) dry spells in the North, amid insecurity apprehensions (particularly in the eastern region), were experienced during the planting season and could result to lower than expected gross output. Also, the current episode of dollar scarcity (which the CBN's flexible FX policy has hitherto failed to address) may further constrain access to basic farming inputs, such as seedlings, fertilizers, pesticides and other equipments.

24 November 2016

The prospect of recovery in manufacturing in the near term remains weak, given the lingering challenges faced by manufacturers – (1) difficulty in accessing forex for basic operations, (2) poor electricity power generation and supply, and (3) the sluggish recovery of aggregate demand. The imminent devaluation of the naira adds to uncertainty facing this segment.

There are no enough reasons to expect a material rebound in trade and services over the remaining three months of the year, as the risks -- limited availability of forex, weak consumer confidence and high interest rate – associated with these sub-sectors linger.

24 November 2016

Analyst:

Peter Moses (*peter.moses@cordros.com*)

Important Disclaimers

This document has been issued and approved by Cordros Capital (Cordros) and is based on information from various sources that we believe are reliable. However, no representation is made that it is accurate or complete. While reasonable care has been taken in preparing this document, no responsibility or liability is accepted for errors or fact or for any opinion expressed herein. This document is for information purposes only. It does not constitute any offer or solicitation to any person to enter into any trading transaction.

Investments discussed in this report may not be suitable for all investors. This report is provided solely for the information of Cordros clients who are then expected to make their own investment decisions. Cordros conducts designated investment business with market counter parties and customers and this document is directed only to such persons. Cordros accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report is for private circulation only and may not be reproduced, distributed or published by any recipient for any purpose without prior express consent of Cordros. Users of this report should bear in mind that investments can fluctuate in price and value. Past performance is not necessarily a guide to future performance.

Cordros and/or a connected company may or may not have a relationship with any of the entities mentioned in this document for which it has received or may receive in the future fees or other compensation. Cordros is regulated by the Securities and Exchange Commission to conduct investment business in Nigeria.