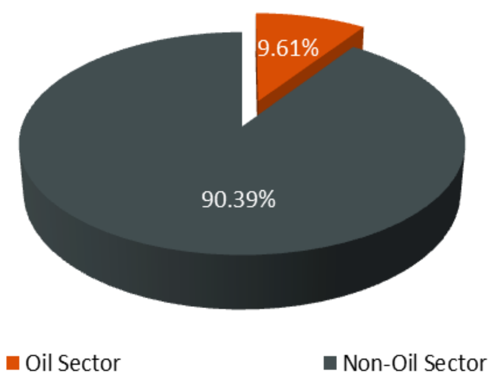
INVESTMENT ONE

Nothing But Oil

Nigeria's growth prospects, investor and business sentiment continued to be swayed by the performance of the nation's oil sector despite the administration's intentions to diversify revenues away from the commodity.

Figure I: Oil and Non-Oil Contribution to GDP



Source: NBS, Investment One Financial Services Research.

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Table I: Top and Worst Performing Sectors Q1 2018		
Sector	Performance	Contribution
Mining & Quarrying	14.85%	9.67%
Transportation and Storage	14.45%	1.50%
Financial and Insurance	13.30%	3.55%
Water Supply, Sewerage, Waste Management and Remediation	11.61%	0.18%
Electricity, Gas, Steam and Air Conditioning Supply	4.93%	0.20%
Real Estate	-9.40%	5.63%
Trade	-2.57%	17.06%
Professional, Scientific and Technical Services	-2.35%	3.51%
Public Administration	-1.72%	2.23%
Construction	-1.54%	4.04%

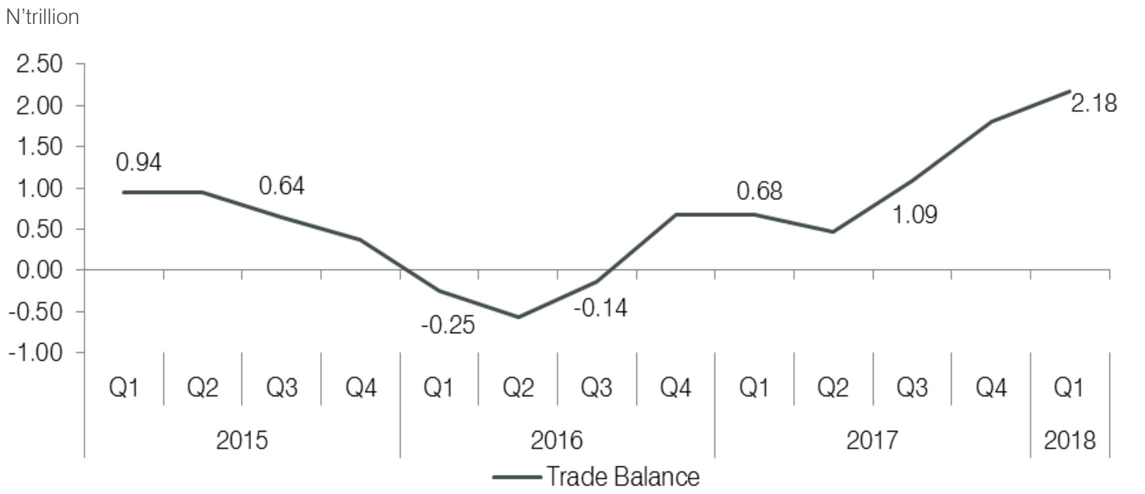
Source: NBS, Investment One Financial Services Research.

Nonetheless, sentiments were boosted by the surprising surge in Brent oil prices, which hit a four year high of US$80/barrel, averaging US$71/barrel in H1 2018 (18% above our average forecast). High oil prices and the rise in oil production (14% year-on-year in Q1 2018) although volatile, were key drivers of 1.95% year-on-year (y/y) increase in Nigeria's GDP in Q1 2018.

Higher oil prices and production levels were also supportive of the increase in the nation's trade balance, which jumped 221% y/y to N2.17trillion in Q1 2018, the highest in fourteen consecutive quarters. This occurred despite the jump in total imports (+8.04% y/y in Q1 2018) possibly due to high cost of petroleum products. We suspect there was also an increase in volume to meet local demand on the back of the scarcity experienced towards the end of Q4 2017.

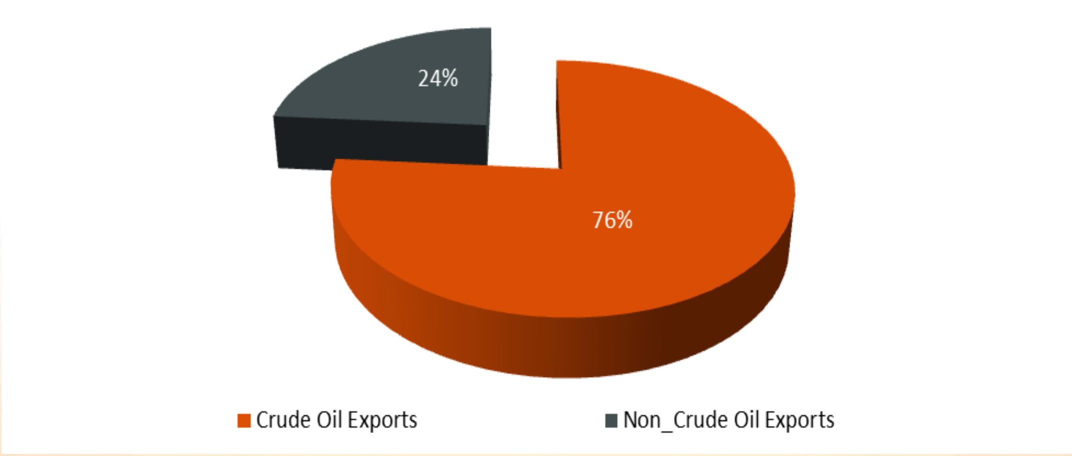
While oil was the main driver of the improvement in trade balance, there was a 237% y/y surge in non-oil exports to N578billion in Q1 2018, on the back of the increase in exportation of vehicle, aircraft and vessel parts. However, crude oil and other oil products accounted for 87% of total exports in Q1 2018.

Figure II: Trade Balance



Source: NBS, Investment One Financial Services Research.

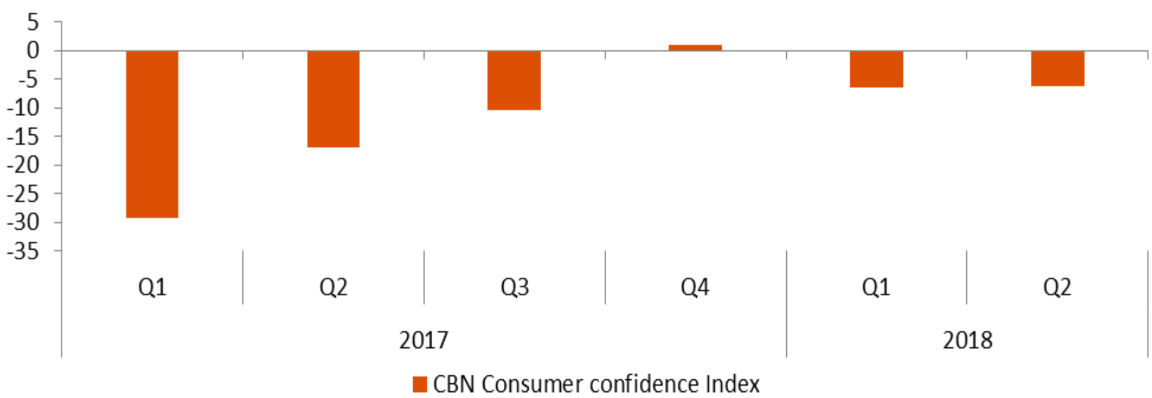
Figure III: Crude Oil vs Non-Oil Exports



Source: NBS, Investment One Financial Services Research.

The growth in economic activities currently lags behind our projection of 2.5% in FY 2018 partly due to uninspiring growth in the non-oil sector (0.76% y/y in Q1 2018). Despite Nigeria being an oil economy, higher oil prices have not trickled into increased consumer demand due to double digit inflation as well as the backlog of salary and pension arrears owed by numerous states and debt estimated at N2.7trillion owed to contractors by the government. As indicated by the Central Bank of Nigeria's Consumer Confidence Index, consumer sentiment still remains weak although better than 2017.

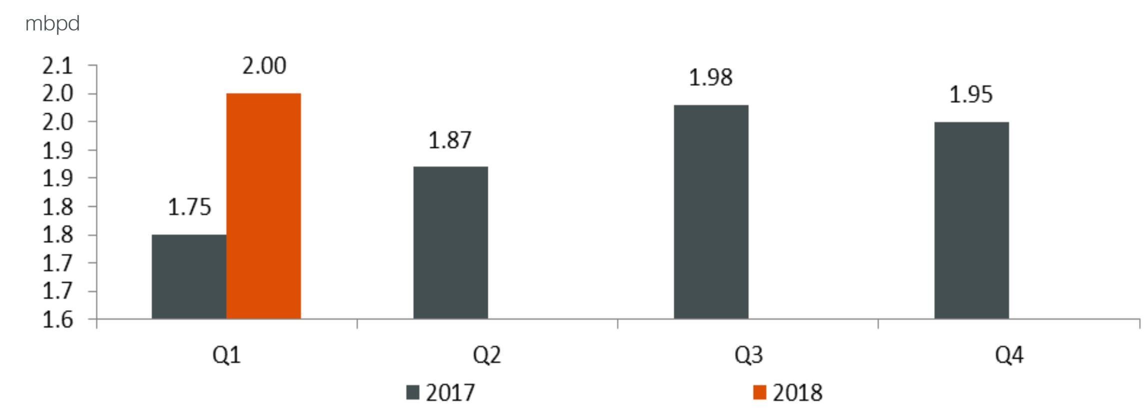
Figure IV: CBN Consumer Confidence Index



Sources: CBN, Investment One Financial Services Research.

More concerning is the likelihood that oil production levels may not rise significantly above 2million barrels per day in H2 2018, meaning we are likely to see real growth in the oil sector slow. This could drive down the nation's GDP growth in the absence of a noteworthy rebound in the non-oil sector (90% of GDP as at Q1 2018).

Figure V: Oil Production 2017 vs 2018

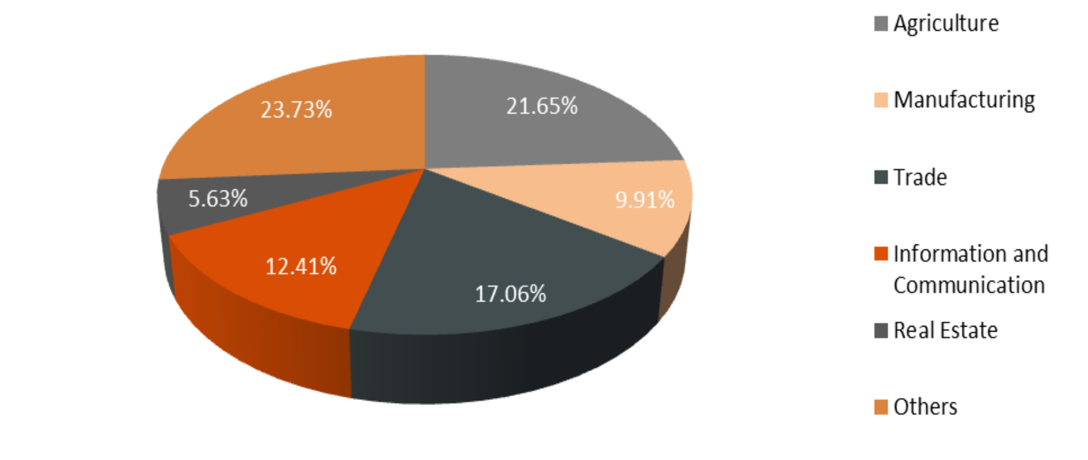


Sources: NBS, Investment One Financial Services Research.

H2 2018 Growth Prospects Hinges on Non-Oil Sector

Although non-oil sector growth remained positive in Q1 2018, it slowed from 1.45% in Q4 2017 to 0.76% in Q1 2018 on the back of weaker agriculture, trade, construction and real estate output while manufacturing activities accelerated. We believe the likelihood of GDP growth matching or exceeding our outlook could depend on activities in the Agriculture and Trade sectors, which collectively accounted for 39% of the non-oil sector in Q1 2018.

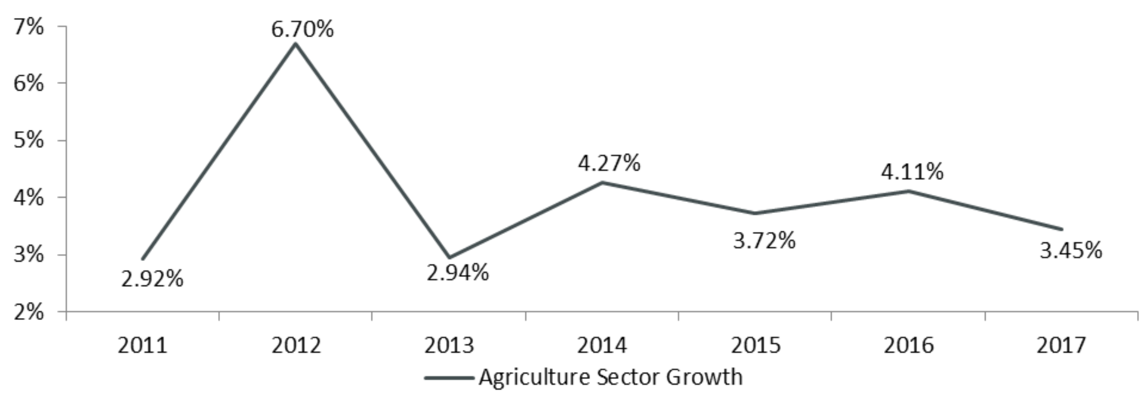
Figure VI: Contribution of Sectors to the Non-Oil Sector Q1 2018



Sources: NBS, Investment One Financial Services Research.

While the administration's focus on self-sufficiency on key food items and intervention funds (e.g. the Central Bank of Nigeria's Anchor Borrower program) should have been a positive for the agriculture sector, we have seen growth slow to 3% levels in 2017 and Q1 2018, from 4% levels in 2016. This may not be unconnected with the worrying conflicts between farmers and herdsmen in the Northern region of the country. With conflicts escalating in recent months, the possibility of further clashes as electioneering nears could see output in the sector slow even further.

Figure VII: Agriculture Sector Growth from 2011 - 2017

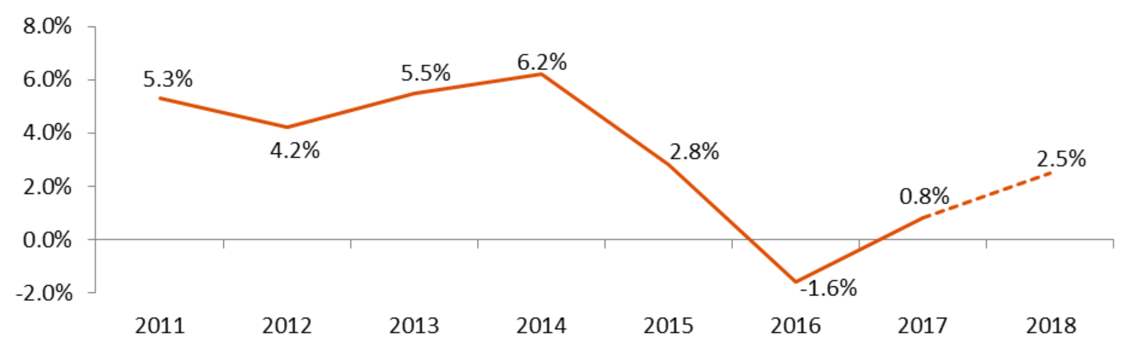


Sources: NBS, Investment One Financial Services Research.

With this said, we believe output in the trade and real estate sectors could improve in H2 2018 on the back of stronger consumer demand. Our view is premised on the potential acceleration of the recently passed N9.12trillion 2018 budget, election spending, the potential for Federation Account Allocation Committee's (FAAC) disbursements to rise in the near term and the much discussed but yet to be concluded increase in the national minimum wage.

The implementation of the budget, 31.5% of which is targeted at capital expenditure, should also be a positive for the construction sector; however the backlog of payment to contractors could hinder activities in this space.

Figure VIII: GDP Growth and 2018 Forecast

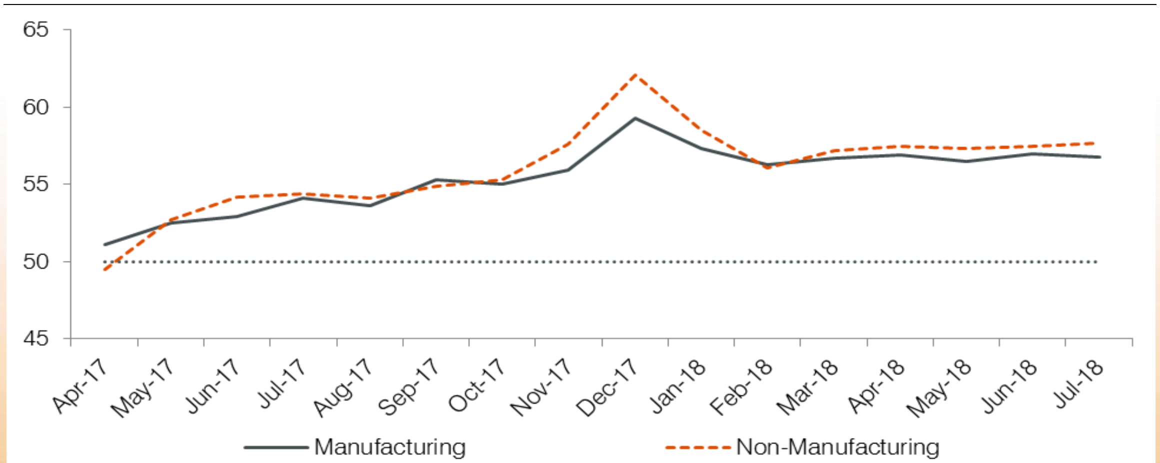


Sources: NBS, Investment One Financial Services Research.

Businesses Await Consumer Rebound

On a positive note, general business sentiment remained strong in H1 2018 with Central Bank of Nigeria's Purchasing Manager Index (PMI) indicating an expansion in manufacturing and non-manufacturing activities. We point out that PMI readings have been above 50points (a signal of expansion) for both the manufacturing and non-manufacturing sectors over the last sixteen and fifteen months respectively.

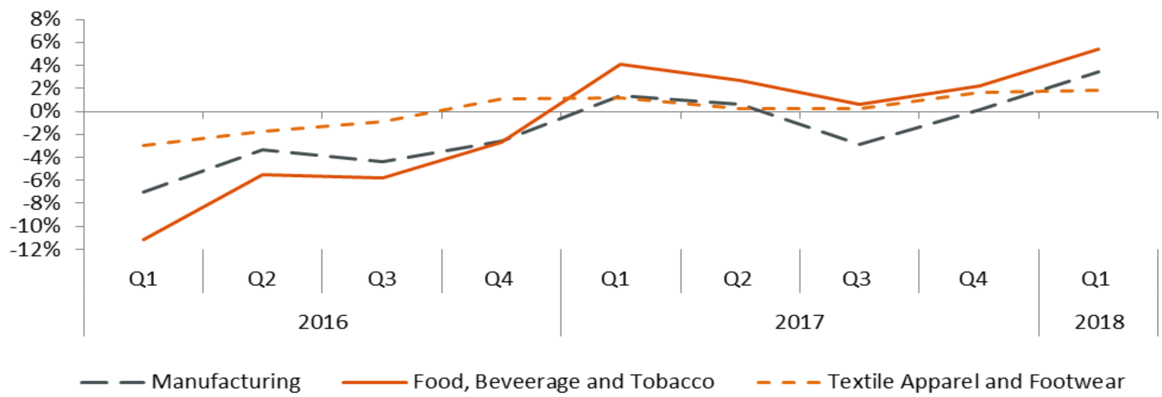
Figure IX: PMI Numbers



Sources: NBS, Investment One Financial Services Research.

This directly coincides with the establishment of the Investors' & Exporters' foreign exchange window (IEFX) in April 2017, which further increased the availability of foreign currency in the economy, specifically for manufacturers to import key inputs for production. Consequently, we saw activities in the Food, Beverage & Tobacco and Textile, Apparel & Footwear subsectors of the manufacturing sector continue to expand in Q1 2018.

Figure X: Manufacturing, Food, Beverage,& Tobacco, Textile Apparel & Footwear GDP



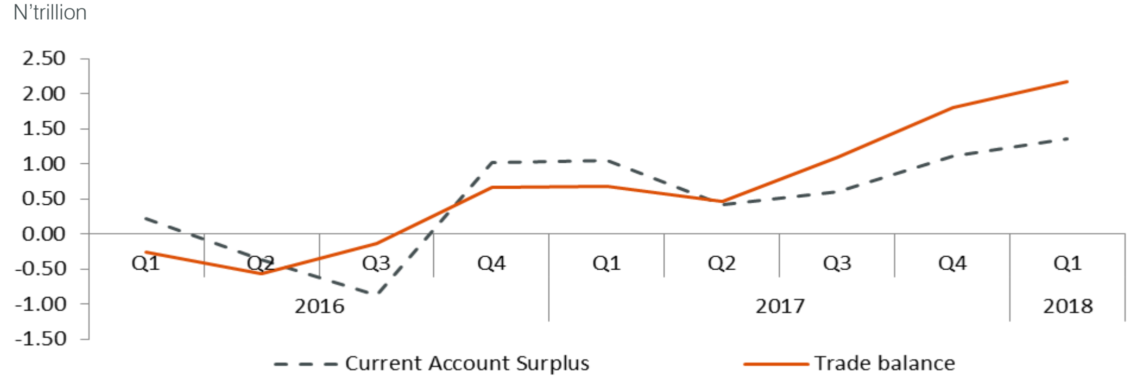
Sources: NBS, Investment One Financial Services Research.

While it appears as though businesses are increasing output ahead of an expected increase in consumer demand in H2 2018, we point out that improvements in business sentiment and consequently non-oil sector may lie in sustainable increase in consumer spending.

The Peak

The growth in the nation's current account surplus, which surged up 30.8% y/y to N1.36trillion (about 4.75% of GDP in Q1 2018 against 3.98% of GDP in Q1 2017), was largely due to the jump in the nation's trade balance as well.

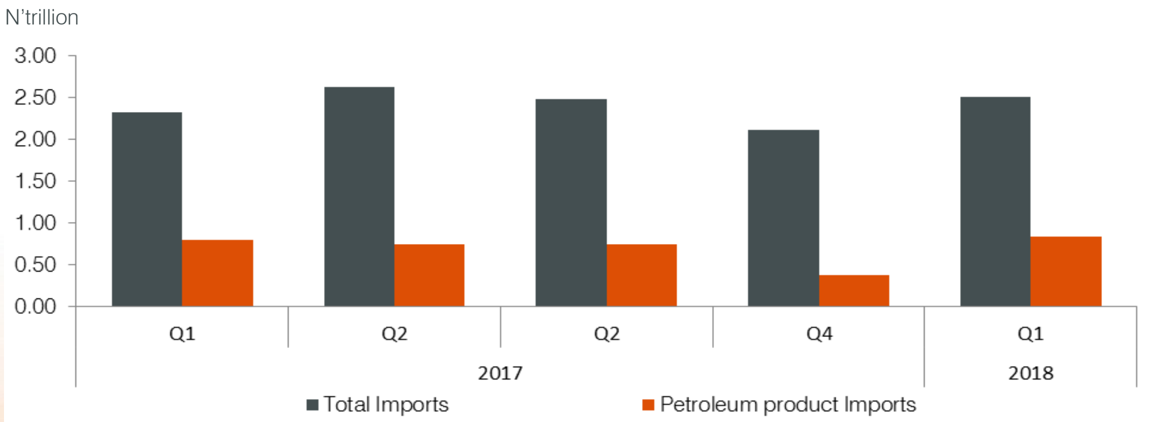
Figure XI: Current Account Surplus vs Trade Balance



Sources: CBN, NBS, Investment One Financial Services Research.

However, with oil sector growth to slow as mentioned earlier, we may have seen the peak of the growth of the nation's current account surplus, in the near term. In the same vein, importation could rise on the back of higher non-oil sector activities, given the dependency of the nation's economy on imported raw material, which may further pressure the improvements in the country's current account surplus in H2 2018.

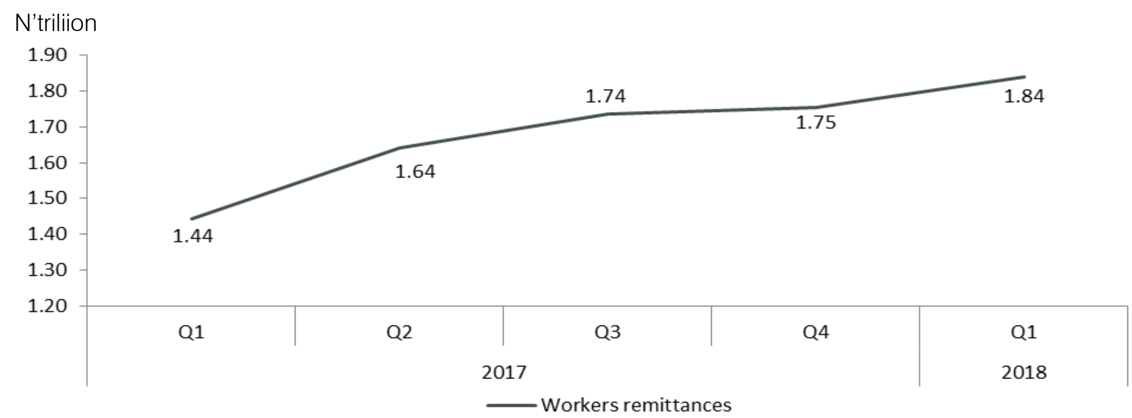
Figure XII: Total Imports vs Petroleum Product Imports



Sources: NBS, Investment One Financial Services Research.

Also, looking at the nation's balance of trade, it is worthy to note the significant increase in net foreign portfolio investments (up N1.44trillion y/y to N1.57trillion in Q1 2018 (US$5.14billion)). This, and noticeable improvement in worker's remittance (up 27.5% y/y to N1.84trillion, equivalent to US$6.02billion), was mostly likely due to the establishment of the IEFX window, which encouraged foreign investment inflows. It may also have encouraged remittance through official channels as the spread between the parallel and official market narrowed.

Figure XIII: Workers Remittances



Sources: CBN, Investment One Financial Services Research.

Nonetheless, the growth in foreign portfolio investment is likely to moderate in the near term as a result of 'risk off' sentiment by foreign investors towards emerging and frontier markets, lower yields in the domestic fixed income markets and concerns on political risk as electioneering kicks off in H2 2018.

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