



NIGERIA

MACROECONOMIC AND BANKING SECTOR THEMES FOR 2014



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This article presents our forecasts and opinions of the broad Nigerian macroeconomic and banking sector trends that we expect will shape the economic landscape in 2014.

KEY THEMES/TRENDS FOR 2014 INCLUDE:

1. Pre-election year dynamics and other macro trends
2. Development of newly reformed sectors
3. Change in Central Bank governor and other banking sector themes
4. 2014 FG Budget and its implications

This report merely represents our views of the banking and macroeconomic landscape for 2014 and should not be relied upon for making investment decisions. Please consult a qualified professional before making investment decisions.



1

Pre-election year dynamics and other macro trends

- Pre-election year fiscal policy
- Increased output from non-oil sector
- Inflationary and foreign exchange rate pressures
- 6.5% GDP growth forecasted for 2014

2013 Overview:

2013 was a relatively good year for macro stability, inflation, fx price stability, and the implementation of reforms.

Over the course of 2013,

- Inflation declined from 9.0% to 7.9% (January to November 2013),
- Foreign exchange traded within $\pm 3\%$ of N155 for most of 2013,
- Monetary Policy Rate remained unchanged at 12%,
- Fx reserves grew from \$44.18bn to a peak of \$48.86bn before declining to \$44.58bn,
- FGN issued \$1bn in bonds
- Agriculture, Transportation and Power sector reforms were implemented

GDP growth figures for the first three quarters of 2013 were below 7.00% (Q3 2013: 6.81%), largely due to the negative growth from the oil sector. The crude oil sector, which currently accounts for 12.5% of GDP, came under pressure as a result of unabated oil theft, culminating in sustained reduction in production levels (Q3 2013 average production: 2.26mbpd vs. Q3 2012: 2.52mbpd). Non-oil output however, grew by 7.95% as at Q3 2013 (7.55% in Q3 2012) as a result of stronger output in the agriculture sector which has since recovered from the floods of 2012 (Agriculture sector 2012 output: \$3.0bn vs. 2013 Annualized estimate: \$3.54bn based on actual \$2.64bn output as at September 2013).

2014 Outlook:

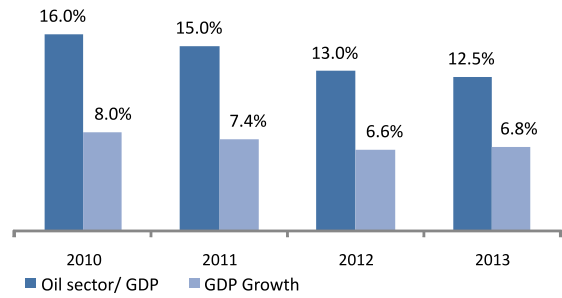
Events of macroeconomic consequence for 2014:

- Growth and development of non-oil sector (Agriculture)
- Development of newly reformed sectors (Power)
- Import substitution programs (restrictions on importation)
- CBN's retail sector development initiatives (Financial inclusion)
- Further divestment by IOCs of onshore assets

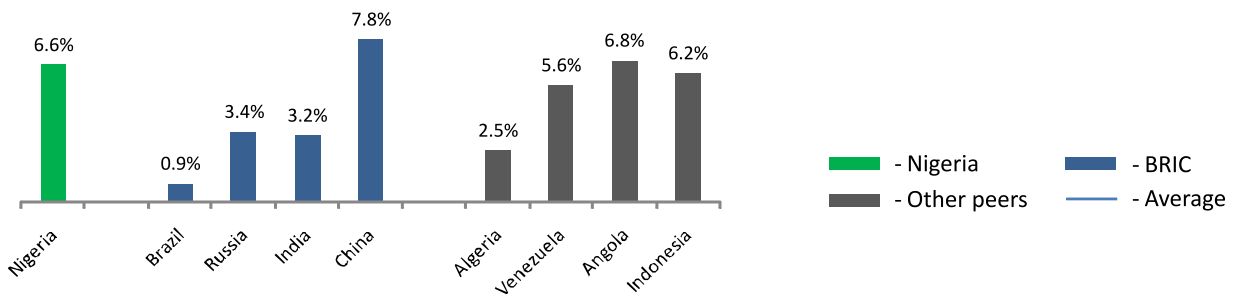


In line with previous pre-election years, we expect 2014 fiscal policy to be largely influenced by preparations for 2015 elections. Ahead of the elections, fiscal expenditures are expected to be relatively higher, due in-part to the incumbent's need to build on current achievements, and consolidate the currently splintered ruling party. We therefore anticipate increased system liquidity and inflationary pressures as a result of higher fiscal spend.

In agreement with global forecasts of a decline in oil prices in 2014, further compounded by insufficient plans to curb oil theft, we forecast a decline in oil related revenues in 2014.



We however remain bullish about 2014 forecasting GDP growth of 6.5% based on strong growth in the non-oil sector driven primarily by increased output from agricultural sector reforms, power sector development and import substitution programs. At 6.5%, Nigeria will continue to be one of the fastest growing economies among its peers. The growth rate may vary a little following the rebasing exercise which is to be concluded early in 2014. The post-rebasing, estimated GDP growth rate will likely be less than the current growth estimate.



2

Development of newly reformed sectors

- Development of privatized power generation and distribution
- Import substitution programs
- Agriculture and transportation sector reforms
- Passage of PIB unlikely to occur prior to elections

2013 Summary:

Physical handover of PHCN successor companies by the government to their private sector owners was successfully completed in November 2013.

Through the Growth Enhancement Scheme and other proactive measures by the Ministry of Agriculture, the Agriculture sector achieved significant recovery from the devastation caused by the floods of 2012.

2014 Outlook:

Power Sector

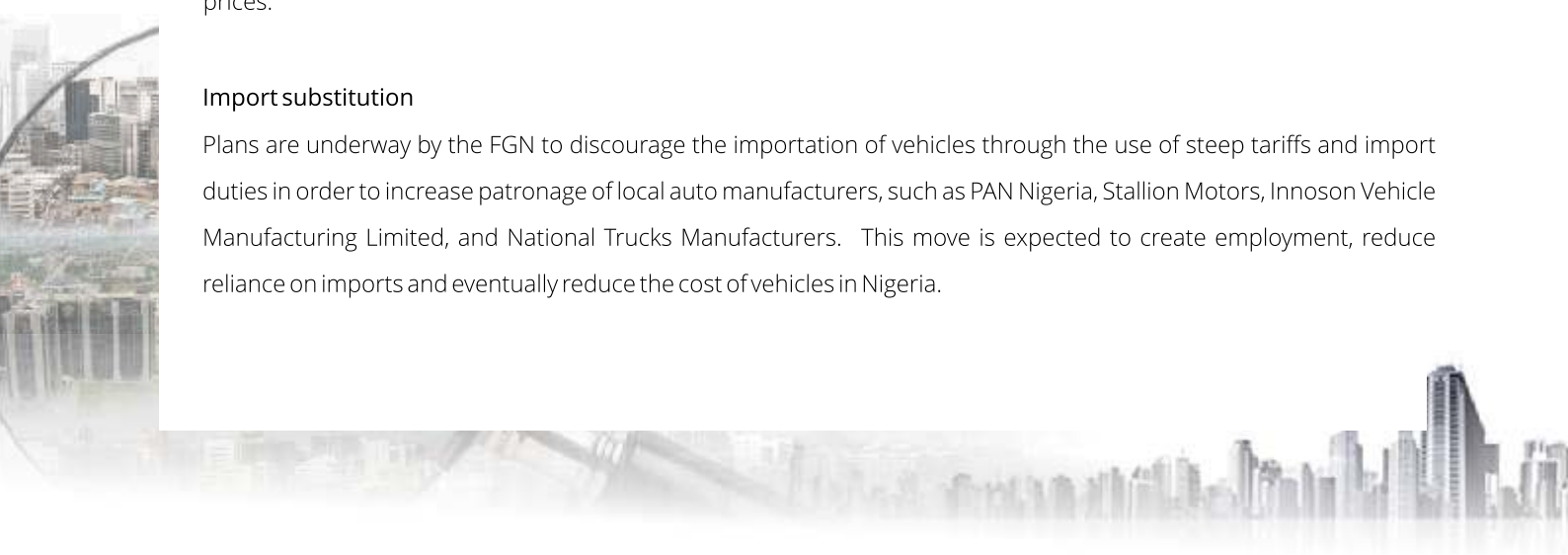
Following the successful privatization of the Power sector, we expect additional investments via Capex financing to refurbish and upgrade existing generating equipment and distribution systems. It is estimated that additional investments of up to \$4.5bn are needed over the medium term, to bridge the current demand-supply gap of 4,284.0MW. While the reform is expected to lower the cost of living and doing business, we don't expect to begin to see these improvements in any material way till late in 2014.

Agriculture Sector

To further boost the contribution of the Agriculture sector to GDP, we expect the government to continue the implementation of its gradual ban on importation of select food items. A ban on the importation of fish is currently underway with discussions of further bans on rice and wheat to be implemented in 2014. This is expected to encourage investments in agricultural production in line with the government's aim for food sufficiency by 2015, further boosting the contribution of the non-oil sector to GDP, while reducing the impact of external shocks arising from a decline in oil prices.

Import substitution

Plans are underway by the FGN to discourage the importation of vehicles through the use of steep tariffs and import duties in order to increase patronage of local auto manufacturers, such as PAN Nigeria, Stallion Motors, Innoson Vehicle Manufacturing Limited, and National Trucks Manufacturers. This move is expected to create employment, reduce reliance on imports and eventually reduce the cost of vehicles in Nigeria.



3

Change in Central Bank governor and other banking sector themes

- Mallam Sanusi Lamido Sanusi to retire in June 2014
- QE tapering and imminent reversal of capital flows
- Ensuring adequate capitalization of banks
- Increased focus on credit growth by banks
- Further tightening through bank regulation

2013 Summary:

The CBN maintained a tight monetary policy in 2013, through a combination of monetary policy and regulatory pronouncements which effectively reduced system liquidity. The results were a stable MPR, fx price stability even in the face of QE tapering (Naira fared much better than most emerging markets peers) and lower inflation.

In its drive to improve on retail banking and financial inclusion, the CBN implemented the New Banker's tariff which included measures such as reduced transaction fees and minimum interest rates on savings. The side effect of the new Banker's Tariff, coupled with an increase in CRR on Public Sector deposits was a tougher earnings year for banks. The banks have however shown resilience in light of these measures and have implemented various strategies to mitigate ensuing loss of income with varying degrees of success.

2014 Outlook:

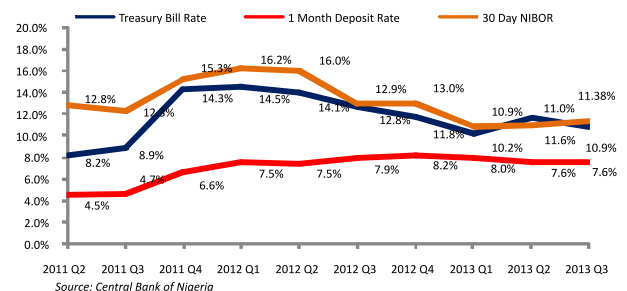
CBN

The tenure of the current CBN governor Mallam Sanusi Lamido Sanusi expires in June 2014. While it is still unclear who the candidates are, we expect that the new Governor will keep the MPR at 12% throughout 2014 and that the CBN will rely less on monetary policy and increasingly utilize other regulatory measures to moderate system liquidity and neutralize fx pressures.

Inflation

Going into 2014, we expect the CBN to continue to implement policies to drive down inflation in line with the ECOWAS single currency initiative which requires all West African countries to achieve an inflation rate of $\leq 5\%$, however the pre-election peculiarities of 2014 will make this an increasingly difficult task in the short

term. Due to the lag effect of inflation, we expect that the policies implemented thus far and going



into 2014 will keep inflation between 6% and 8% through to Q3 of 2014. However, increases in fiscal spending pressures are likely to cause a rise in inflation towards the end of 2014.

Interest rates

Lending rates came under pressure in 2013 as banks reacted to a review of the extant Bankers' Tariff and the introduction of additional cash reserve requirements on public sector deposits.

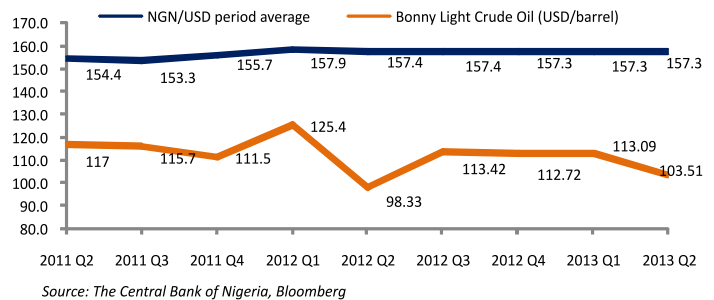
The 38% increase in Cash Reserve Requirements for public sector funds and the introduction of a minimum rate of 30% of MPR on savings accounts resulted in a rise in cost of funding for banks. In reaction, lending rates rose an average of 150bps across the market. Fixed income yields on the other hand declined between 75bps – 190bps due to rising system liquidity and lower dependence on traditional liquidity mop up strategies by the CBN.

Going into 2014, we expect the monetary policy environment to remain restrictive in view of huge flows expected from maturing securities. We however anticipate that the CBN will depend more on alternative policy actions around increase in CRR and/or implementation of the Treasury Single Account initiative to curtail excessive market liquidity and the inflationary pressures of an especially loose pre-election fiscal environment.

We expect events around the tapering of QE activities in America to spur a rise in fixed income yields as investors wind down assets in the local market. We therefore anticipate a marginal rise in lending rates in the wake of a rise in fixed income yields.

Foreign Exchange

We expect FX stability to continue into early 2014 with pressure mounting from Q2 due to continued QE tapering, projected decline in oil prices, troubled production levels and the uncertainty around who the new Central Bank Governor will be and what that Governor's policy on the currency will be. As seen by the policy and



regulatory measures implemented in 2013, it is becoming increasingly expensive and requiring greater creativity to support the Naira. This indicates that there is a strong likelihood that regardless of the policy stance of the new Central Bank Governor, some depreciation in the Naira will occur in 2014.

The Naira depreciated by 8.2% on the parallel market from its open of \$/N159 on 02-Jan-13 to its close of \$/N172 on December 13th and this is considered by some as an accurate barometer (on average) of how the Naira is expected to trend. We expect the interbank rate to rise from an average of N159.27/USDollar in 2013 to an average of N168/USDollar in 2014.

AMCON

AMCON has concluded all activities related to the acquisition of toxic assets. However, the Central Bank is desirous of keeping industry NPLs below 5% through the implementation of an open market bidding system for the purchase of troubled assets by private asset management companies going forward. This bidding system is scheduled to commence in the first half of 2014 following a likely special audit of banks prior to the retirement of the current Central Bank Governor.

Financial inclusion/Retail banking

The Central Bank plans to continue its drive for increased financial inclusion and retail sector banking through the following initiatives:

- Single ID system across financial institutions, scheduled to launch in February 2014
- Lower KYC requirements
- Cashless banking
- Agency banking initiative

We do not anticipate further pronouncements reducing transaction related fees.

Banking sector opportunities

We expect a strong 2014 for Banks due to sector reforms implemented in 2013, retail and middle market opportunities and expected growth in key sectors.

- Following the successful Power Sector reform, we expect that 2014 will see high levels of Capex financing requirements from the new GenCos and DisCos.
- We anticipate that recent Agriculture sector reforms and ban on importation of food items will result in increased agriculture sector expansion and financing requirements.
- Building on initiatives by the Central Bank to improve customer identification, lower the cost of banking and develop cashless banking, we expect increased generation of Assets and Liabilities in the under-penetrated middle and retail sectors.
- Sector specific developments such as the licensing of additional wireless bands, ongoing divestment by IOCs, and import substitution measures are expected to drive growth in the Oil & Gas, Telecoms, Manufacturing and other related sectors.



4

2014 FG Budget and its implications

- 2014 Budget set at N4.64trn (down 5.7% from N4.92trn budgeted for 2013)
- Recurrent expenditure at 72%
- budget tagged "Budget for Jobs and Inclusive Growth"
- budget based on an oil price of \$77.5/barrel at 2.39mbpd with an average price of N160 per USDollar

2014 Outlook:

The Federal Government presented its 2014 budget of N4.64trn in mid-December 2013. The budget for 2014 came in 5.7% lower than the 2013 budget as a result of unabated oil theft and an anticipated decline in customs duties as a result of impending import substitution programs.

We note an increase in the budget allocation for recurrent expenditure from 68.7% to 72% (in contrast with 2012 and 2013 budget allocation trends) and increased allocation to INEC (rose to N45bn from N32bn in 2013), which are all unsurprising in light of the 2015 elections.

The Government's theme for the 2014 budget is to promote job creation and inclusive growth through the continuation of the President's transformation agenda. Job creation is expected to be created through increased manufacturing, and increased growth in the agriculture sector.

** As at the writing of this report, the full draft of the 2014 budget had not been released to the public.*

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