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NIGERIA IN 2022

Economic outlook for 2022

Our story line

Full presentation on 20 January 2022

THE WORLD

COVID-19

- Mass vaccinations, Omicron and newer variants that may cause milder illness but with higher infection rates leading to herd immunity.
- Supply chain problems should ease, and, according to the IMF, the real output of the World will grow by about 5% in 2022 leading to an increase in the demand for crude oil.

The World Crude Oil Market

- World demand for crude oil will increase from about 96mbpd in 2021 to about 100mpbd in 2022.
- Compliance with OPEC+ quota will still be important and if this is in place, the average price of Brent and Bonny Light will be around US$75 per barrel compared to US$70 per barrel in 2021.

THE NIGERIAN ECONOMY

The External Sector

- At a production rate of 1.8mbpd and an average price of US$75 per barrel, oil & gas export revenues will be around US$50 billion in 2022 compared to US$43 billion in 2021.
- It is unlikely that the CBN will change its exchange rate management strategy in 2022, therefore a parallel market premium of around 40% on the official exchange rate will continue to exist. This means that foreign investors will be wary of bringing in new money at the official rate therefore net foreign investment will be not be a sizeable source of USD inflow into Nigeria in 2022.
- Exchange rates
    - It is unlikely that the CBN will allow a significant currency depreciation in an election year and one in which oil & gas export revenue is likely to rise by about 15%. Therefore, we believe that the official NGN/USD exchange rate will be about ₦430/$1 at the end of 2022.
    - A close to 10% point difference between the NGN inflation and the USD inflation will continue to put pressure on the parallel market exchange rate. However, the CBN may dampen the impact of this by injecting some USD into the parallel market. We expect NGN/USD to be about ₦610/$1 at the end of 2022 in the parallel market.

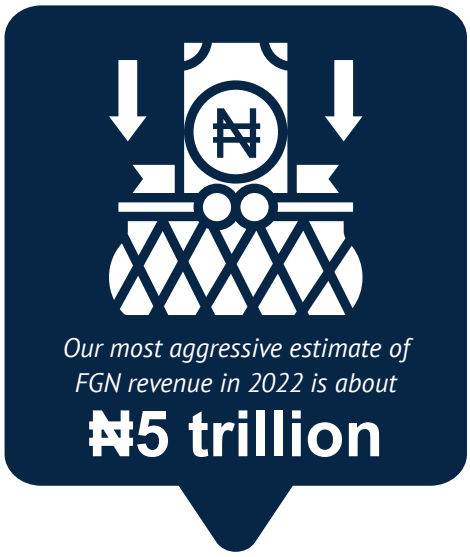
The Finances of the FGN

- The FGN gets cash from the following sources to fund her budget:
    - her share of the federation account,
    - her independent revenue,
    - Naira borrowings from the markets,
    - Naira borrowings from the CBN, and
    - FCY borrowings.

In 2022, we estimate that the cash from all these sources will add up to about

₦13 trillion

- We estimate that the cash from all these sources will add up to about NGN13 trillion in 2022 compared to FGN's planned spending of NGN17 trillion.
- FGN spending, as in prior years, will be constrained by the total amount of cash it can muster from these sources. Therefore, the FGN will meet most of her obligatory spending (interest on her loans, statutory transfers and payroll & pensions) amounting to about NGN10 trillion leaving a balance of about NGN3 trillion.
- The bulk or about NGN2.1 trillion of the remaining cash will be allocated to capital expenditure. However, this sum plus another NGN1.0 trillion that the States will spend would be about 1.6% of nominal GDP which, in our opinion, is unlikely to stimulate significant economic growth.
- Our most aggressive estimate of FGN revenue in 2022 is about NGN5 trillion. This means the FGN will need to borrow about NGN8 trillion in order to finance aggregate spending of NGN13 trillion. We estimate that the FGN will borrow about US$5 billion in foreign currency (FCY) in 2022 (NGN2.1 trillion) and the rest will be local currency (LCY) borrowings. This will increase FCY borrowings to about US$44 billion and LCY borrowings to about ₦43 trillion. LCY borrowings will therefore be about 860% of FGN revenue compared to a median of about 200% for the central governments of key economies in sub-Saharan Africa. Interest payments will be about ₦4.7 trillion almost 100% of FGN revenues using our most aggressive revenue estimates.



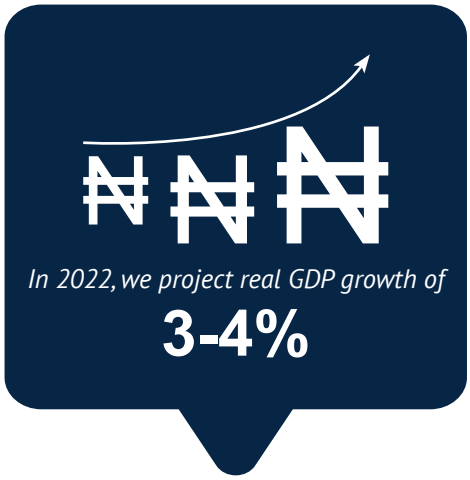
Money and banking

- Average inflation for 2022 will be higher than the long-term (ten-year) average of 12% but will be lower than the average of 17% in 2021. The gap between demand and supply of goods and services will continue to put an upward pressure on inflation while improved supply of USD will moderate currency depreciation and thus imported inflation.
- The CBN will continue to manage Naira interest rates. We therefore believe that the yield on one-year FGN treasury bills will remain below inflation in 2022. This negative real return will increase speculative demand for foreign exchange (FX). In 2021, savers earned, on average, a 7% return on one-year FGN securities but those who went into USD earned a 20% return as exchange rates moved from ₦470/$1 to ₦563/$1 in the parallel market.

- USD interest rates measured by the yield on FGN's 10-year USD bonds averaged 7.1% in 2021 compared to 1.4% on those issued by the US government. This translates to a country risk premium of 5.7% on the FGN bonds. The premium that the FGN pays in this tenor bucket relative to the US government is usually 400-600 basis points. We expect this premium to be around 500 basis points in 2022. Uncertainties about the 2023 elections will put an upward pressure on this premium but this should be moderated by improved oil and gas export revenues. In fact, aggregate FX inflows into Nigeria in 2022 will be around US$90 billion compared to projected FCY debt of US$44 billion at the end of 2022. This means that Nigeria needs only 6 months of USD inflows to liquidate her FCY debts. Kenya needs three years' FX inflows to liquidate her FCY debts. We therefore believe that Nigeria will continue to meet her USD obligations comfortably – at least in the near term.
- At the end of 2021, mandatory Cash Reserve Requirement (CRR) of banks stood at about 35% of LCY deposits. Historically, cash reserves were between 5% and 10% of LCY deposits. In Ghana and Kenya, they are currently 8% and 4.25% of LCY deposits respectively.
- In addition to these mandatory CRR, Nigerian banks hold "special bills", issued by the CBN, that bear interest at 0.5% per annum. These "special bills" are not easily convertible into cash and are, in substance, interest bearing cash reserves. We estimate that cash reserves (including interest bearing cash reserves) were about 50% of LCY deposits at the end of 2021. We do not believe that the CBN will reduce this ratio significantly in 2022 as it continues to see this as a major instrument for maintaining "stable" exchange rates.

The real sector

- **Businesses**
  - We project real GDP growth of 3-4% in 2022 driven largely by the services, manufacturing and oil & gas sectors. The financial services sector will continue to hurt largely due to negative regulations – above normal CRR and negative real interest rates.
  - In 2022, businesses will need to grow their nominal sales by about 15% to keep pace with inflation. This will be difficult for most as the real wages of consumers are unlikely to keep pace with inflation.
  - After-tax return on equity (ROE) across most industries will remain weak and below the cost of equity which we estimate at around 27% for 2022. However, key businesses in the real sector should deliver ROE that is above average inflation of about 15% in 2022. Financial services businesses will struggle to meet this hurdle rate largely due to negative regulations and a higher effective tax rate.
  - Weak performance by quoted companies and the apathy of foreign investors towards the Nigerian stock market mean another lackluster year on the NGX.



- **Households**
  - Population growth of 2.5% will eat the bulk of the real GDP growth of 3%-4% we have projected. This means that real GDP per person will still be below the ₦383,000 for 2015.
  - Real wages of employees who work for the key businesses in the real sector will continue to fall.
  - Unemployment will continue to rise as school leavers join an economy that is weak at creating jobs.

- **Security**
  - Insecurity in Nigeria stems from five main sources:
    - Jihadism including Boko Haram and their successors
    - Banditry, including kidnapping
    - Conflict between herders and farmers
    - Niger-Delta
    - Separatists including IPOB
  - We believe that the security situation in Nigeria will improve in 2022 as the government moves to stabilize the environment so that elections can take place uninterrupted. Jihadist and bandits are feeling the impact of the FGN's air power and the government is engaging the leaders of the Niger-Delta and IPOB. What happens after the election?

CONCLUSIONS

In 2022, businesses and households in Nigeria will fare slightly better than they did in 2021 as the World recovers from the Covid-19 pandemic. However,

- Returns delivered by key businesses will still be below the expected return (cost of equity)which we estimate at about 27% for Nigeria. This, in addition to foreign exchange policies that are unattractive to investors, will impact the valuation of these businesses adversely.
- Real GDP per person will still be below what was recorded in 2015. Real wages will continue to drop and unemployment will keep rising.
- Security situation in Nigeria should improve in 2022 but can this be sustained?