GTBank

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NIGERIA

MACROECONOMIC AND BANKING SECTOR THEMES FOR 2015

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This article presents our forecasts and opinion of the broad Nigerian macroeconomic and banking sector trends that we expect will shape the economic landscape in 2015

KEY THEMES/TRENDS FOR 2015 INCLUDE:

This report merely represents our views of the banking and macroeconomic landscape for 2015 and should not be relied upon for making investment decisions. Please consult a qualified professional before making investment decisions.

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Introduction

In the first two quarters of the year, Nigeria recorded year-on-year GDP growth rates above 6% in the midst of declining worldwide growth trends. This trend continued in the third quarter as Nigeria recorded a Q3 year-on-year GDP growth of 6.23% driven by the Non-Oil sector which grew by 7.5%.

2014 at a glance

Godwin Emefiele became the new Governor of the Central Bank of Nigeria

Nigeria became the largest economy in Africa following the rebasing of its GDP

Inflation remained stable, moving from 8.0% at the start of the year to 7.9% as at November 2014

January

- MPC increases CRR on public sector deposits from 50% to 75% to strengthen the weakening Naira.
- Reduced Capital inflows due to the US Feds tapering of QE.

February

- CBN Governor Mallam Lamido Sanusi is placed on suspension
- Sarah Alade appointed as interim acting Governor
- Godwin Emefiele appointed to take over in June

March

- MPC raises CRR on private sector deposits from 12% to 15%

April

- Nigeria's rebased GDP makes it the largest economy in Africa and the 26th largest in the world at $510 bn.

May

- MPC convenes and maintains status quo

June

- Godwin Emefiele resumes office and releases vision paper promoting rate stability, increased reserves and stronger risk based supervision for Banks
- DMBs commence Bank Verification Number project

July

- MPC convenes and maintains status quo

September

- MPC convenes and maintains status quo amidst pressures on exchange rate, inflation rate and liquidity in the inter-bank market

October

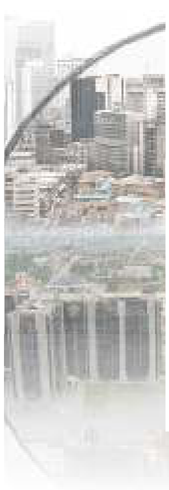
- Banks to commence reporting in compliance with Basel Accord 2

November

- CBN limits importers of select products from accessing FX from the CBN official auction window
- CBN limits the remunerable funds that Banks can place at the SDF to NGN7.5bn
- MPC meets and implements the following:
  - Increased Benchmark MPR by 100bps to 13%
  - Increased CRR on private sector funds by 5 percentage points to 20%
  - Moved the midpoint of the exchange rate at the official window to N168/USD from N155/USD

December

- Banks NET OPEN position reduced from 1% to 0%



The Naira depreciated by 8.39% against the dollar at the official window

FX Reserves declined by 17.8% from January to a 6 month low of $36.7 billion

Oil Prices shed off 47% from a high of $111.59/barrel in June 2014

Offsetting what would have otherwise been a stable pre-election year, declining oil prices set the tone for tighter monetary policies, market turbulence and the inevitable devaluation of the Naira in the 4th quarter. The combined effect of declining oil prices, gradual capital flight, a reduction in FX supply, and the import dependent nature of the Nigerian economy resulted in sustained pressure on the Naira. The CBN continued to defend the Naira by employing tightening measures which included upward adjustments in the CRR, increased controls on BDC sales and imposing restrictions on FX sales to certain industries.

In spite of the measures executed by the CBN, the country's reserves dropped to a 6-month low of US$34.55 billion (as at 25th of November, 2014), and this compelled the CBN to devalue the Naira (the exchange rate moved from N155/USD to N168/USD) and adjust the width of the band around the midpoint (from ±3 to ±5) in an attempt to stabilize the currency. The struggle for price stability largely dictated monetary policy for 2014 and we expect that concerns around price discovery/stability will greatly influence 2015 monetary policy.

2

Outlook for 2015: The Election Year

The General Elections which are scheduled to be held on February 14th, 2015 are expected to be free and fair. In addition to the elections, other prospects of macroeconomic importance for 2015 include:

- Weak Oil prices in H1 2015
- Further Pressures on the Exchange Rate
- Slower GDP growth
- Growth of Import Substitution programs
- Capital flows

Weak Oil Prices in H1 2015

Given the international variables contributing to the weakened state of Oil prices and OPEC's intent to maintain current levels of supply, even if prices go to as low as $20 per barrel, we do not expect a reversal in the direction of oil prices in the first half of 2015. However, we expect that this may change later in the year as declines in supply are expected in the second half of 2015.

Further Pressure on the Exchange Rate

Oil revenues currently account for more than 75% of government revenue and close to 90% of foreign exchange income. Given that weak oil prices are expected to prevail till mid-2015, we expect FX supply to suffer a significant decline. In spite of Government's efforts to diversify the economy and to reduce demand for FX, we do not see this taking effect in the short-term. We are, however, confident in the Central Bank's ability to hold the current official exchange rate steady, for oil prices above $55 per barrel.

Slower GDP Growth

We expect a slowdown of 100 – 150bps in GDP growth for 2015 from the current growth levels of 6.23%. This forecast is supported by the recent tightening of monetary policy, the devaluation of the Naira and the continued slump in the oil market. The rate of growth will be further challenged by the fact that growth calculations would now be based on a larger base vis-à-vis the rebased GDP.

Growth of Import Substitution

In addition to previous import substitution initiatives restricting the importation of fertilizers, sugar, cement, fish and other items, the FGN in 2014 placed restrictions on the importation of certain classes of vehicles and automobile spare parts through increased tariffs and levies. The FG expects that the policy would create jobs, reduce the dependence on imported vehicles, thereby reducing the demand for FX for the purposes of vehicle ownership. Faced with dwindling oil revenue, we expect the FG to ramp up efforts in this regard.

The FG along with other institutions are taking a closer look at implementing more import substitution programs in 2015 with an aim to diversify away from and dampen the effects of oil prices on the economy. The Ministry of Industry, Trade and Investment, the CBN and the Ministry of Petroleum Resources are working together to discover ways to cut down on the importation of finished petroleum products. We expect to see further restrictions on importation coming into effect particularly in the Agriculture sector, on items such as oil palm, nuts, and rubber goods.

Capital flows

In line with analyst expectations, oil prices are expected to rebound in late 2015. This development is expected to promote price stability, while allaying the fears of foreign investors who exited the market as a result of uncertainties driven by market turbulence and lack of confidence in the Naira. The return of these portfolio inflows are expected to strengthen the Naira and capital markets.

3

2015: For Companies and Households

Tax, Real Income and Disposable Income

So far the Federal Government of Nigeria ("FGN") has revised its 2015 Budget Oil price benchmark downwards twice, from \$78 to \$73 and to \$65 (a 13% drop from 2014 benchmark of \$75) despite the fact that oil prices today are under \$60 and analysts have recommended a conservative Benchmark of \$50 (vis-à-vis \$45 benchmark for 2009 Budget). The FG will need additional sources of revenue to offset income lost as a result of a drop in oil prices as oil revenue accounts for over 75% of government revenue.

In the drive to ramp up its revenue, the FG will focus on luxury taxes and value added taxes which will affect most individuals and households. For luxury taxes, new private jet import surcharges are expected to generate N3.70 billion, luxury yacht surcharges N1.6 billion, luxury car import surcharges N2.60 billion, luxury surcharge on champagnes, wines and spirits N2.30 billion[i]. For Value Added Tax, the FG has stated its intent to review the tax policy which could see the Value Added Tax (currently at 5 percent) raised to 10 percent. This drive is premised on the fact that Nigerians currently pay the lowest VAT in the world.

Companies are also expected to bear their own share of the burden as the FG is set to plug leakages and loopholes that have arisen as a result of tax waivers and exemptions. The Government has already commenced a review of pioneer status exemptions to some oil companies which could unlock up to N36billion of additional tax revenues in 2015[ii].

The FG/FIRS has also employed McKinsey, a consulting firm, to boost its Income Tax revenues as it aims to collect an additional N160 billion in tax receipts and an aggregate of about N460 billion over 2014 levels in the 2015-2017 period.

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i http://www.thisdaylive.com/articles/fg-to-generate-n84-06bn-from-luxury-tax-surcharge-expenditure-measures-in-2015/197533/

ii http://businessdayonline.com/2014/12/luxury-tax-to-fetch-n10-56bn-as-fg-unfolds-2015-budget/#.VJrTGsBtQ

In the event that the FG is unable to offset oil-price induced losses, the first casualty will be CAPEX spending given the sensitive nature of recurrent expenditure. This will lead to a massive reduction in capital expenditure, thus adversely affecting the construction sector, government contractors, the agricultural sector and all other traditional direct and indirect beneficiaries of Capital expenditure. These in addition to the rise in inflation rates, expected as a result of import dependence and currency devaluation would ultimately lead to a contraction of the real sector.

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2015: The Banking Industry

Liquidity, capitalization and other banking sector themes

2014 at a Glance

For the majority of 2014, the CBN maintained its focus on price stability despite the change of guard at the helm from Sanusi Lamido to Godwin Emefiele in June 2014. The CBN was largely successful at stabilizing the Naira through the use of monetary policies to reduce liquidity and currency speculation; however as oil prices continued to drop, the CBN was left with little choice but to devalue the naira.

Over the first three quarters of the year, the CBN released very few circulars which focused on increasing CRR on both public and private sector deposits, and instructing Banks to commence reporting in accordance with Basel II. However in the last quarter the Central Bank released several directives such as the exclusion of certain importers from the RDAS window, a further increase in CRR on private sector deposits, and other measures, in response to the pressure on the Naira which was attributable to falling oil prices, Capital outflows and the front loading of orders by businesses concerned about a possible devaluation. It was eventually too expensive to continue supporting the Naira and the CBN had to devalue the local currency. Overall, the CBN's policy initiatives of the fourth quarter have been reactionary, which is understandable as most analysts did not anticipate that oil prices would drop to current levels.

2015 Outlook

Policy Formulation

We expect a more proactive stance from the CBN in 2015. We expect more policies fostering currency stability, economic improvement and the continued development of growth sectors, stemming from the realization that there is a limit to what can be achieved solely through monetary policy.

Despite the release of Godwin Emefiele's Vision Paper, the general public is yet to appreciate or understand the new Governor's legacy due to the mini economic crisis that he has had to tackle very early in his tenure. In 2015, we expect to better understand the new Governor's priorities and personality as the macro environment stabilizes towards mid-2015.

Liquidity

Market liquidity has been adversely impacted over the last 2 years largely from increases in CRR which require banks to sterilize increasing amounts of funding. Going into 2015, we see greater liquidity constraints as a result of tight monetary policies, capital outflows, reduced government revenue, and a slowdown in capital market activity. While this may be great for supporting the Naira, it will ultimately lead to an economic downturn. A further increase in CRR of Banks is unlikely due to the attendant impact on credit growth.

Credit Quality

We anticipate a slight increase in NPLs across the market as a result of secondary effects of the depreciation of the Naira. The absence of a Capital Market bubble going into this devaluation, will result in much lower credit quality issues compared with 2008/2009. The lessons learned from the 2008 oil price crash/devaluation have resulted in the implementation of sector limits, increased regulatory risk parameters, improved corporate governance and reduction in currency mismatches, which greatly reduce the likelihood of high levels of NPLs compared with 2009.

Capitalization

The CBN mandated that all Banks commence reporting in accordance with Basel II reporting standards from October 2014. This will largely result in a few banks falling short of minimum requirements, which will leave the affected banks with the option of either trying to raise equity in a weak capital market or reducing their asset size. The option of reducing asset size might be particularly attractive to some banks as it will solve immediate liquidity concerns pending when additional capital can be raised.

Inflation

As a result of the recent devaluation of the currency in our import dependent economy; increases in import duties, Corporate, Value Added and Luxury taxes, we expect a gradual pickup in inflation to low double digits by mid-year of 2015.

Interest Rates

We expect a further 50 -100bps increase in MPR and on fixed income in 2015. A combination of reduced liquidity in banks, rising costs of funding, continued pressure on the Naira and rising yields in fixed income investments will compel banks to increase lending rates in 2015. A resultant rise of 100 – 200bps in lending rates is likely.

Foreign Exchange

We expect continued pressure on the Naira through the first half of 2015 due to further declines in Oil prices and the upcoming February 14 General Elections. We expect increased volatility around the election period after which we expect pressure to reduce. As pressure continues to increase in the first half we expect that the CBN may consider another devaluation within a range of N180-N185 per USD, as reserves and oil prices continue to fall.