



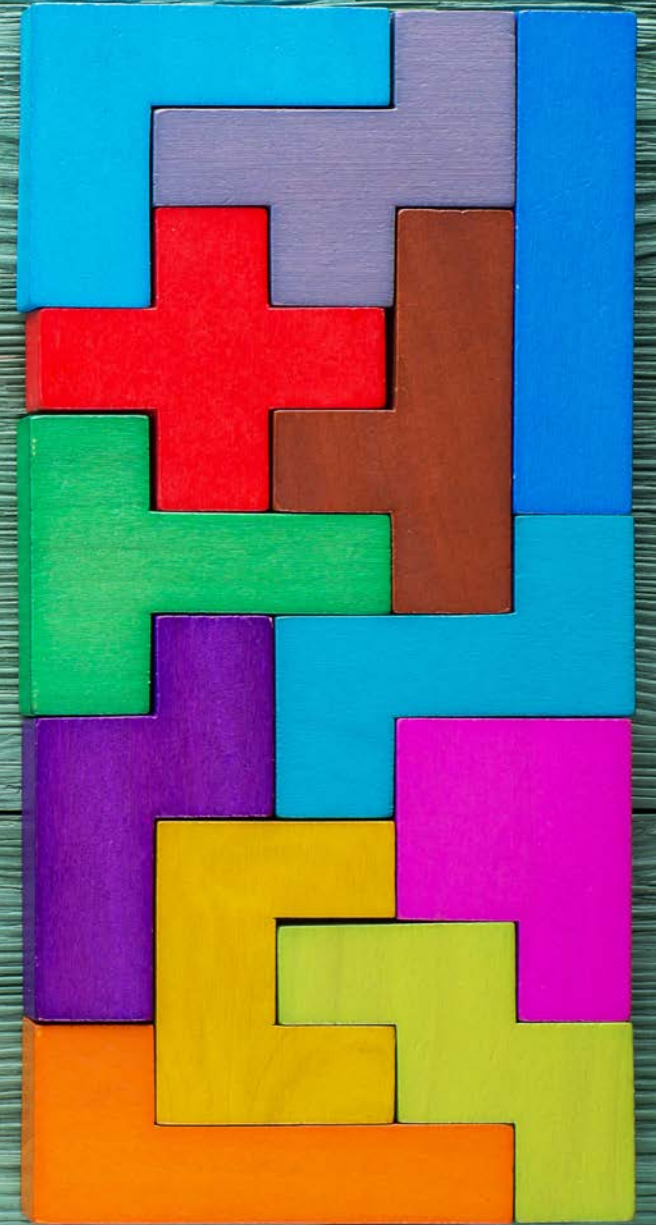
10 Macro Trends that will Shape 2020 & Implications for Nigeria

Presentation to:
American Business Council

By:

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Associate Director, KPMG

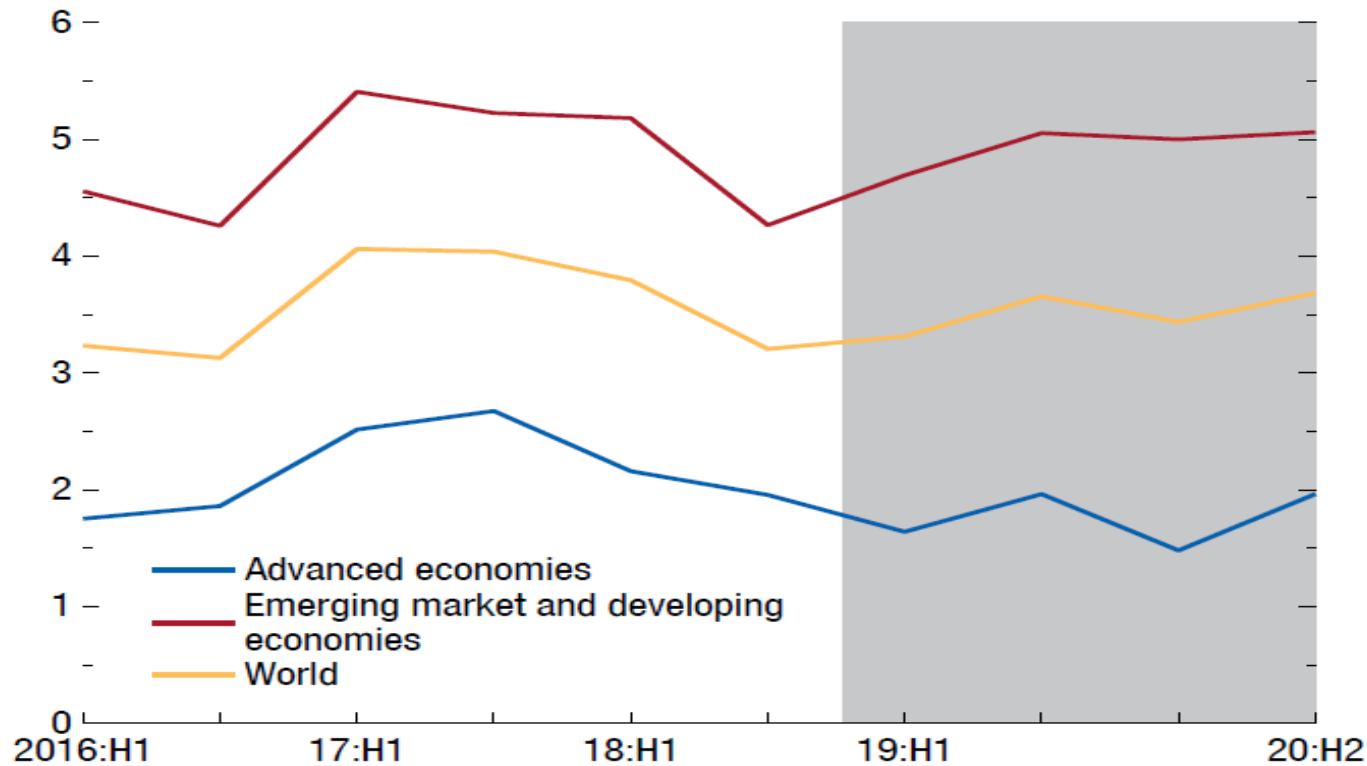
27 November 2019



Snapshots of the macro trends...



Annual GDP Growth % (2016:H1 to 2020H2)



Comments

- **2019 global GDP growth estimate revised down to by 0.3% to 3%, lowest level since the Global Financial Crisis**

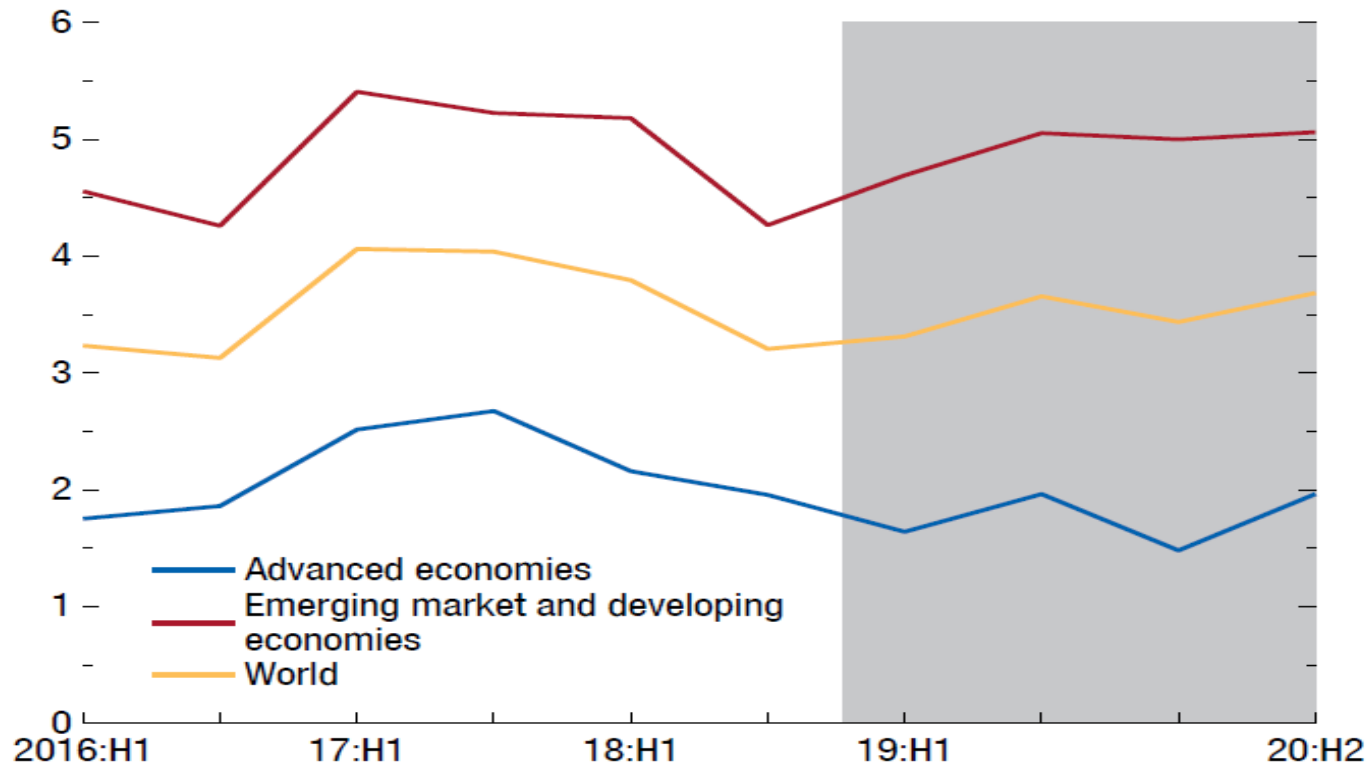
Key drivers of 2019 economic performance

- **China's tapering economic growth due to reduced aggregate demand**
 - Regulatory tightening of shadow banking
 - Trade war with US
- **Slow down in industrial output as a result of weak external demand**
- **Widening global repercussion of trade tensions**
- **Global car production decline with huge impact on Germany**
- **Impact of increased uncertainty in business confidence and investment**

Source: IMF



Annual GDP Growth % (2016:H1 to 2020H2)



Comments

- **2020 global GDP growth revised by down by 0.2% to 3.4%**
- **Growth in the Euro area and US is expected to be weaker**
- **Overall weakening of consumer and business sentiments**
- **Growing concerns of no-deal Brexit**
- **Geopolitical tensions**
 - Disruption of global supply chain
- **Potential tighter financial conditions with adverse impact on vulnerable economies**

Oil prices to average \$57.9 in 2020 from an average of \$61.8 per barrel in 2019.

- oil futures contracts indicate that Brent prices will gradually decline to \$55 over the next five years

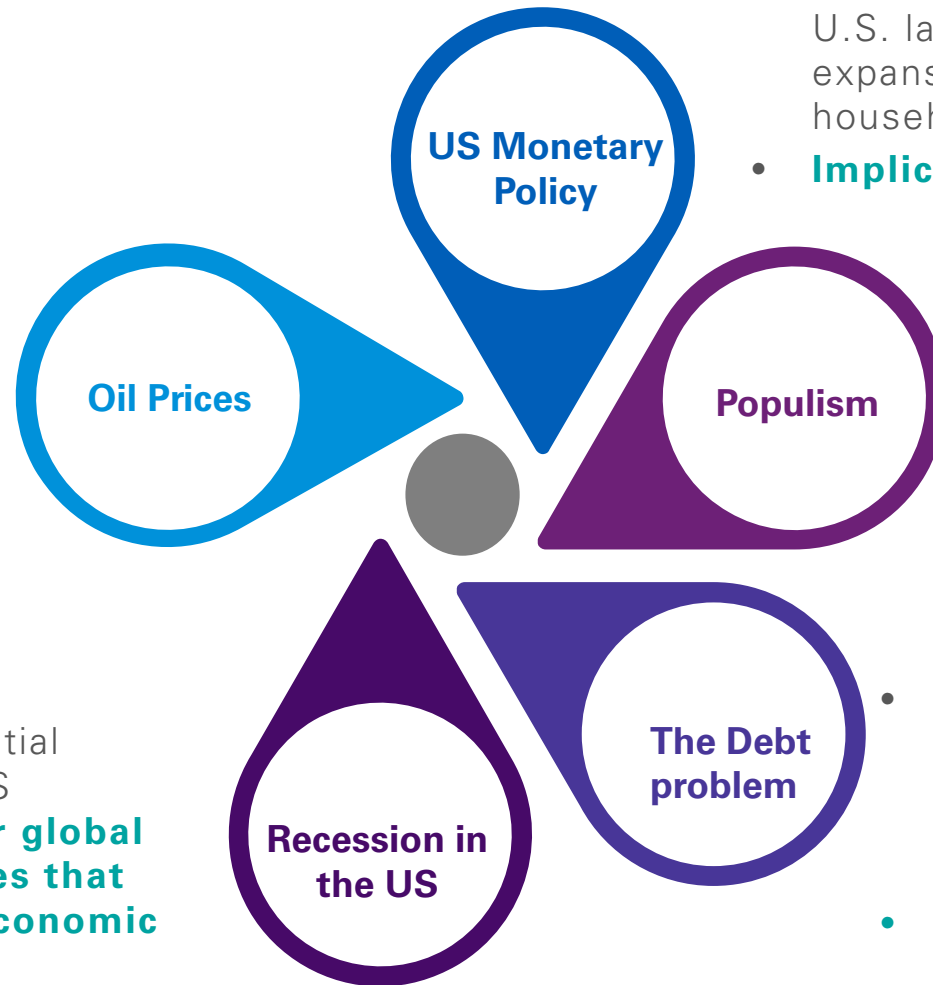
Source: IMF



The world's economy currently hangs on some key levers...

- IEA cuts global oil demand growth estimate for 2020 to 1.2mpd
- OPEC is considering deeper cut in oil supplies
- **Implication: Potential weaker fiscal revenues for the FGN**

- Key forecasts and discourse on potential recession in the US
- **Implication: lower global economic activities that may impact the economic output of Nigeria**



- The Fed's decision to cut policy rates for the third time in a year - despite the tight U.S. labor market and robust economic expansion (driven not least by strong household consumption)
- **Implication: potential increase FDI**

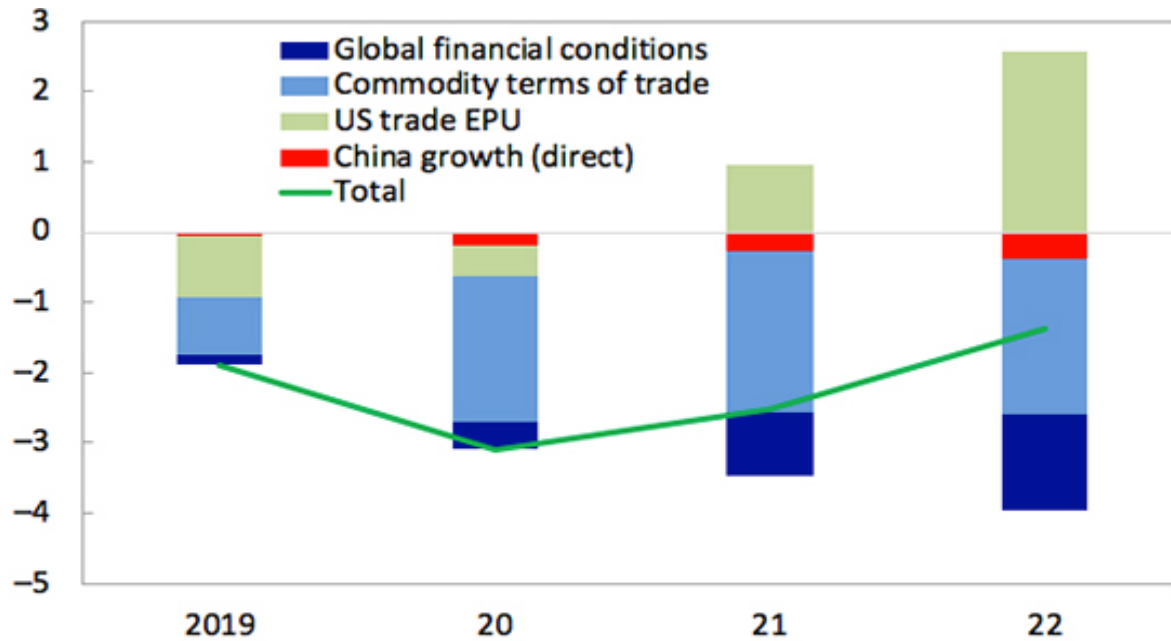
- Rising populism - whether due to economic or socio-cultural factors - is the primary driver of global policy uncertainty

- Growing debt vulnerabilities in frontier markets (FM): a new record high of \$3.2 trillion, total FM debt is up by over \$630 billion since mid-2016
- **Implication: higher costs of borrowing**

Negative external developments could impact SSA's GDP by 2 per cent in 2020.

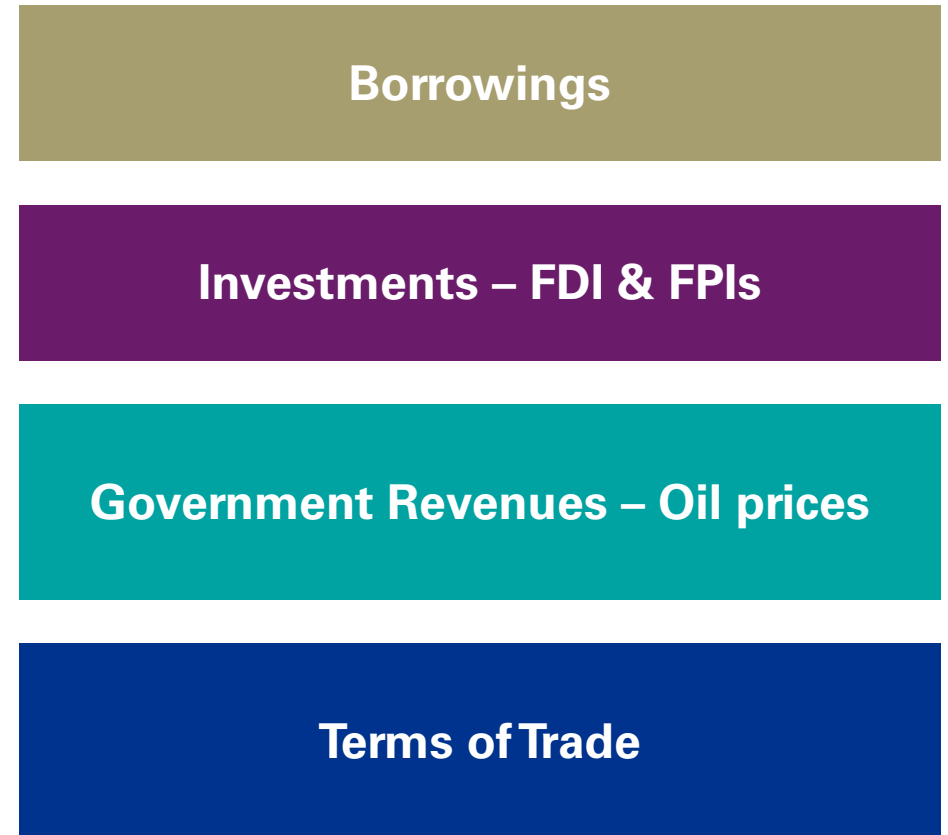
Global developments in 2020 **portends significant risks** for SSA...

Impact on GDP in percentage points



Source: IMF staff calculations.
Note: EPU = economic policy uncertainty.

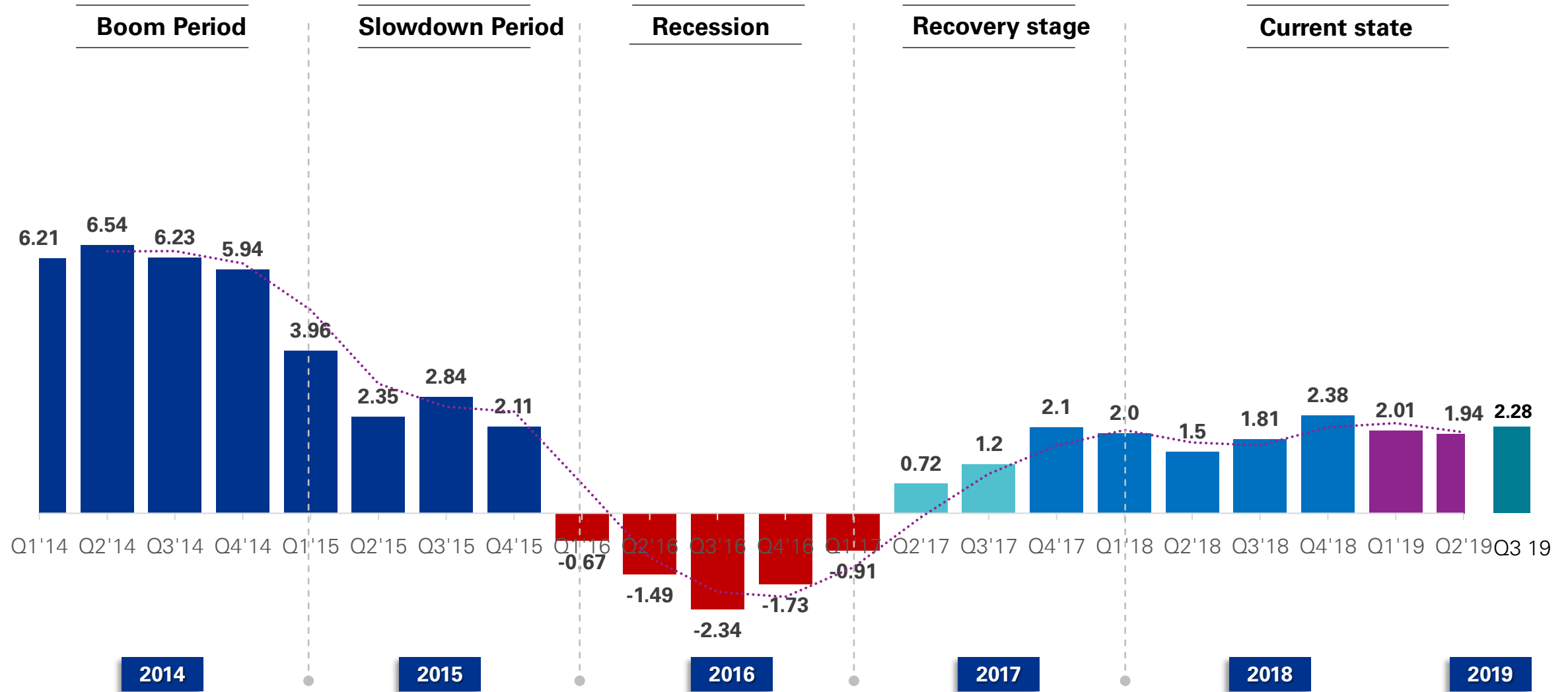
...with broad implications on **key fiscal and monetary indicators**



Source: IMF, KPMG Analysis



Nigeria is currently on a slippery slope of recovery

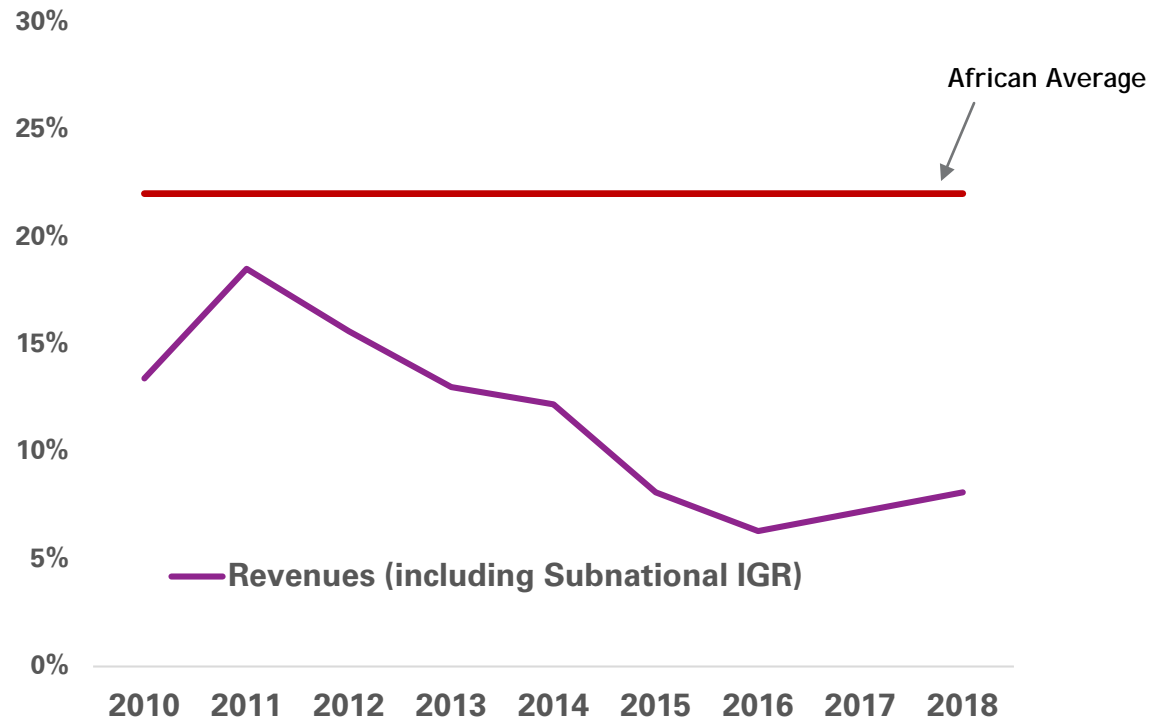


Source: NBS, IMF, World Bank

Weak revenues driving increase in debt service ratio

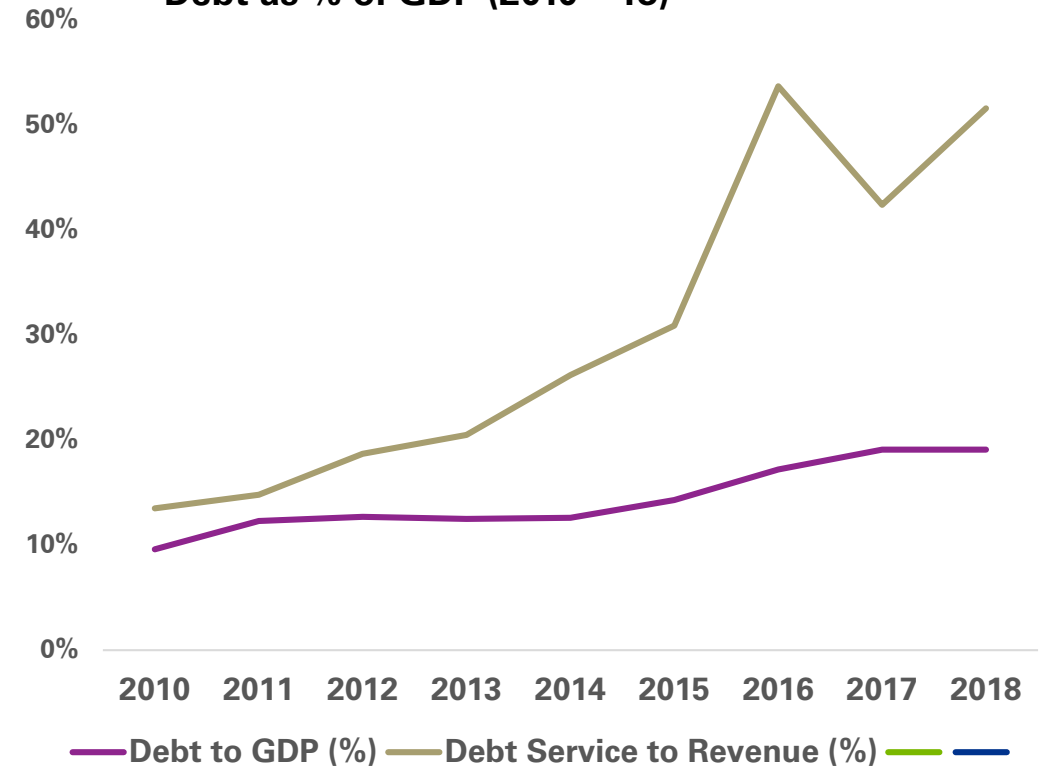
Revenues relative **to GDP has been declining...**

Revenues as % of GDP (2010 – 18)



Debt service ratio has **accelerated since 2016**

Debt as % of GDP (2010 – 18)

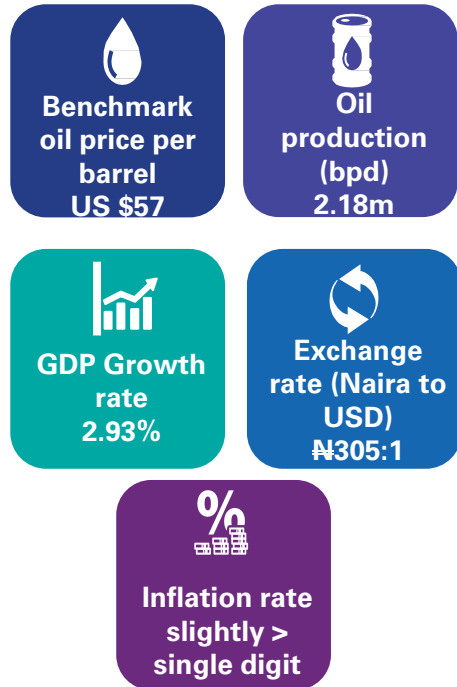


Source: Kainosedge

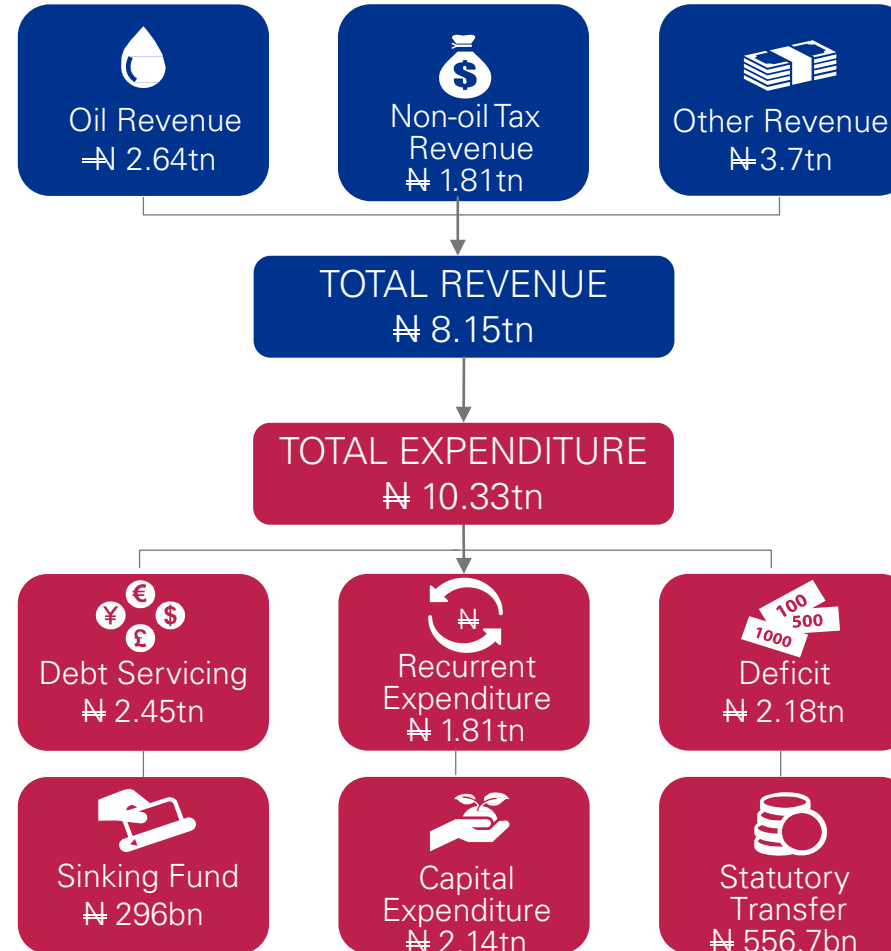


2020 Budget revenue targets are ambitious

Key Budget Assumptions



Breakdown of 2020 FGN's Budget



Source: Budget Office of the Federation



Strong push for revenues across all fronts anchored on the Finance Bill, 2019

Sector	Tax/Levy
Oil & Gas	<ul style="list-style-type: none">• NDDC levy• NCDF
Telecommunications	<ul style="list-style-type: none">• Communication tax• USSD
Banks	<ul style="list-style-type: none">• Penalties for non-compliance to regulations
FMCG	<ul style="list-style-type: none">• VAT increase• Excise duty• Sugar tax
Others	<ul style="list-style-type: none">• Land use charge• Tax on plastics (N50 per bag)• New toll gates

Source: Financial Derivative Think Thank



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Potential impact of increase in taxes on the real sector - Example from recent excise duty increase in the Beer Sector

Consumers are **highly sensitive to price changes...**



For every **10% increase** in the average price of beer, aggregate volumes **decrease by 19.4%**

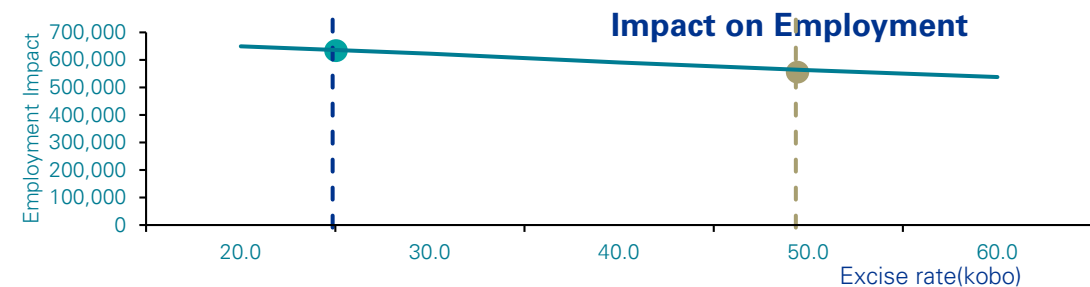
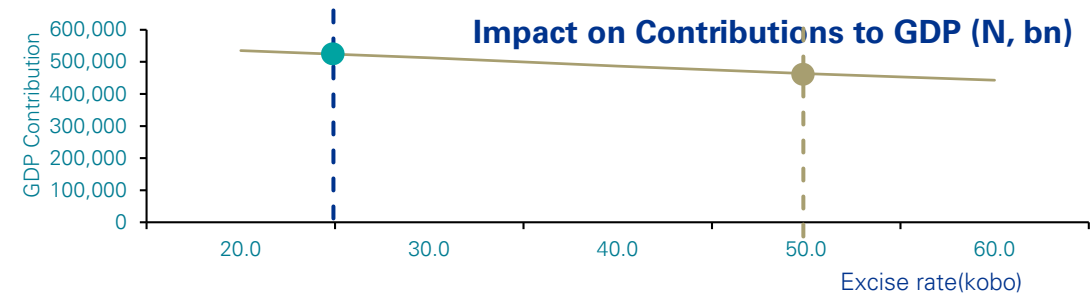
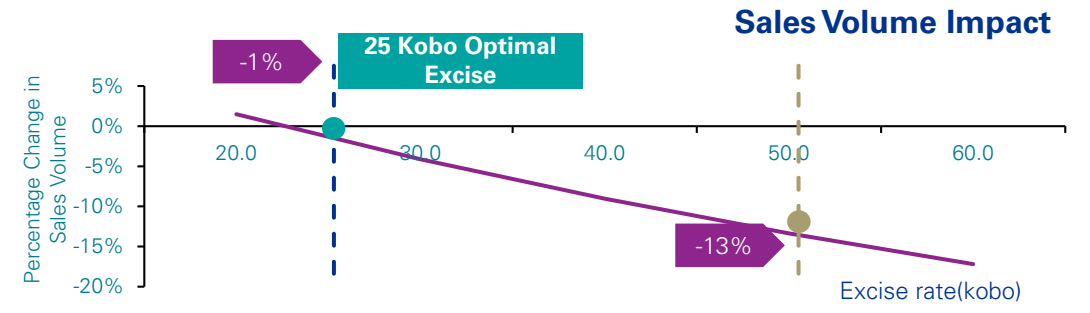
Income elasticity of beer



For every **10% increase** in consumer's income, aggregate volumes **increase by 3.1%**

Price and income elasticity of beer were computed using Auto-regressive Distributed Lag (ARDL) model

Increase in taxes have negative impact on sales volume and firms contribution to GDP...

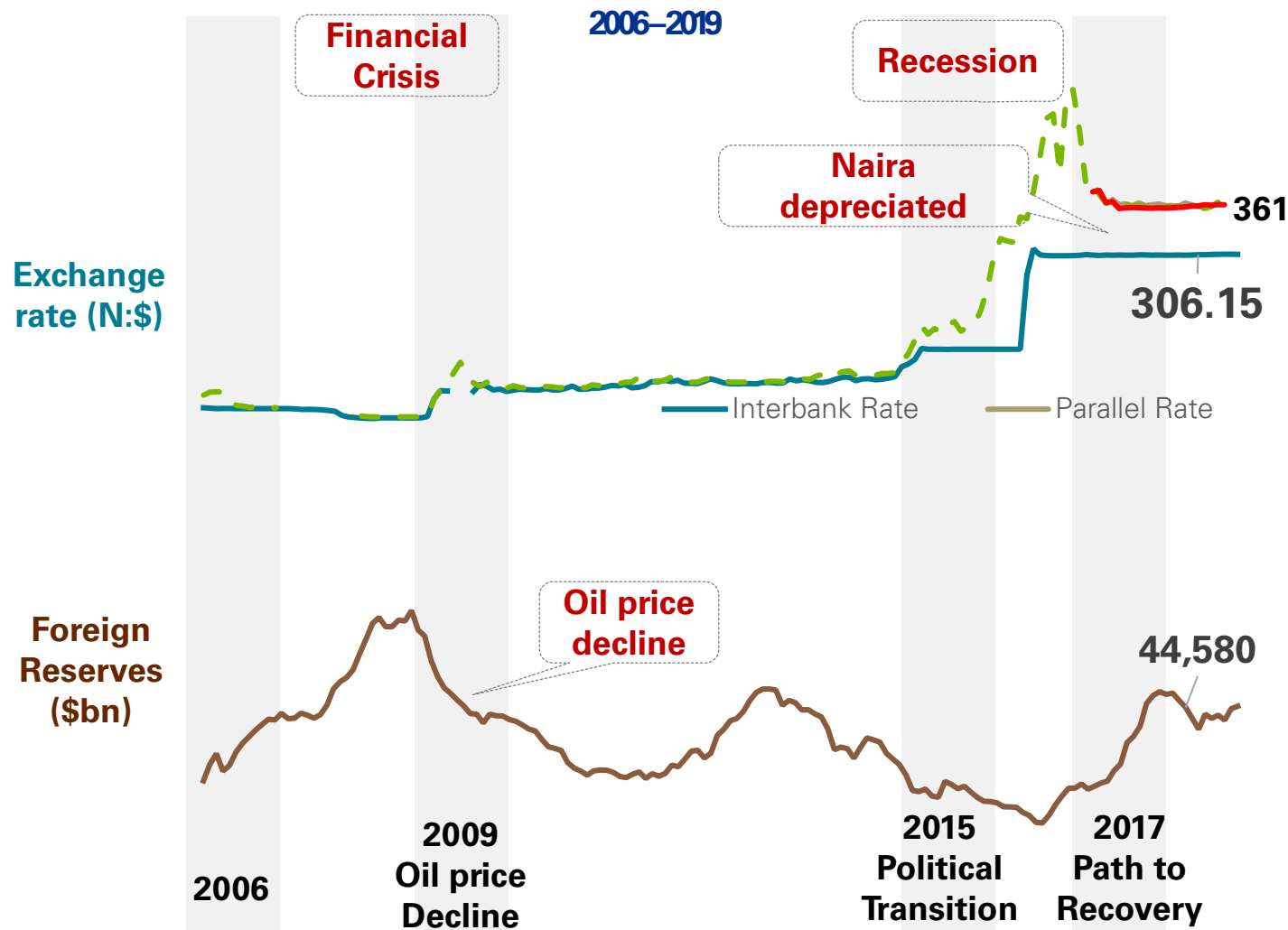


Source: KPMG Analysis



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The FX environment has been largely stable...



Source: NBS, CBN, OPEC, Kainosedge



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Comments

- There has **been no depreciation** of the naira to dollar as **N306/\$1 has remained consistent since August 2018**.
- CBN continues its forex intervention strategy with a total of **\$39 billion injected** into the forex market **in 2018**.
- Higher oil prices and increasing oil exports is **driving foreign reserves** even as the **trade position improves**
- CBN's forex intervention strategy equally has an impact on the state of Foreign reserves

CBN has made some progress...

- 1 **Stability in the foreign exchange market**
- 2 **Improved liquidity in the market**
- 3 **Increase in foreign portfolio investments**

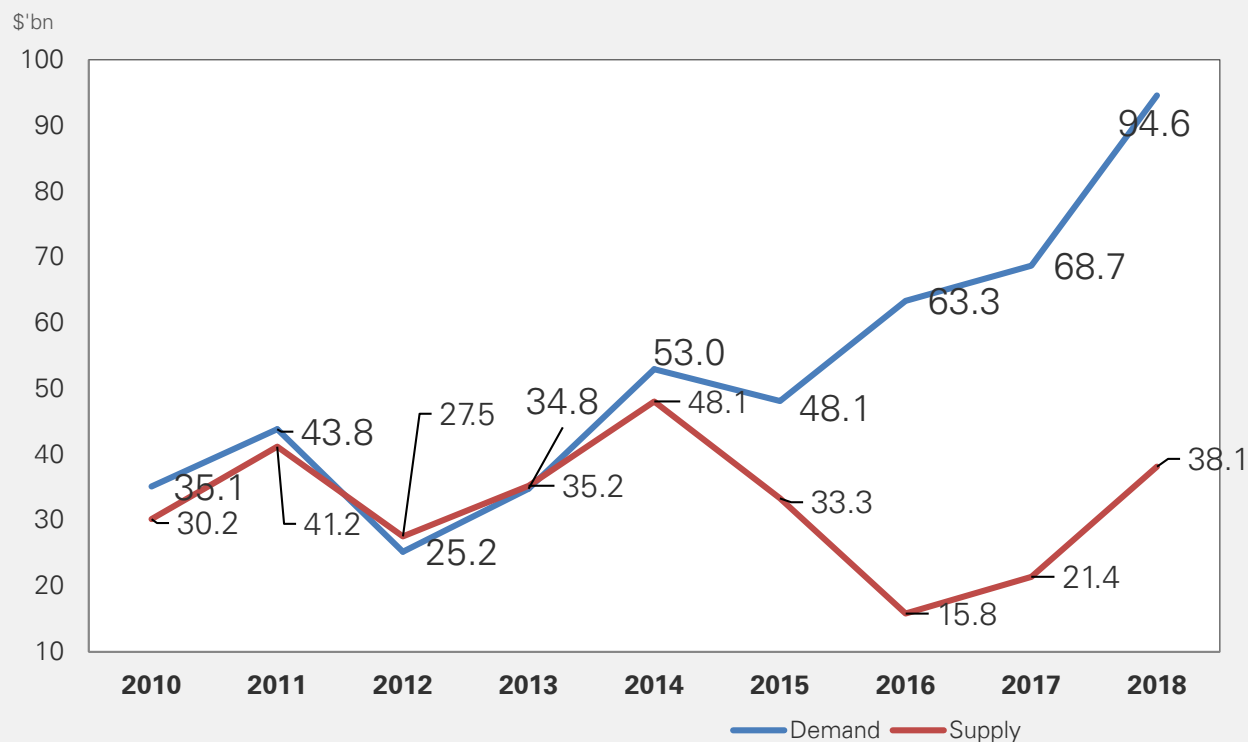
...however, key underlying issues exist

- 1 **Supply gaps exist**
- 2 **Depletion of the foreign reserves so as to defend the Naira**
- 3 **Expensive OMO instruments in a bid to attract FPIs**
- 4 **REER index of the Naira has started to increase – 109 (2018) vs 100 (2010)**

...but key vulnerabilities points persist

Foreign exchange demand exceeds foreign exchange supply year on year

Foreign exchange Demand and Supply (2010-2018)



Source: Central Bank of Nigeria, National Bureau of Statistics, KPMG Analysis

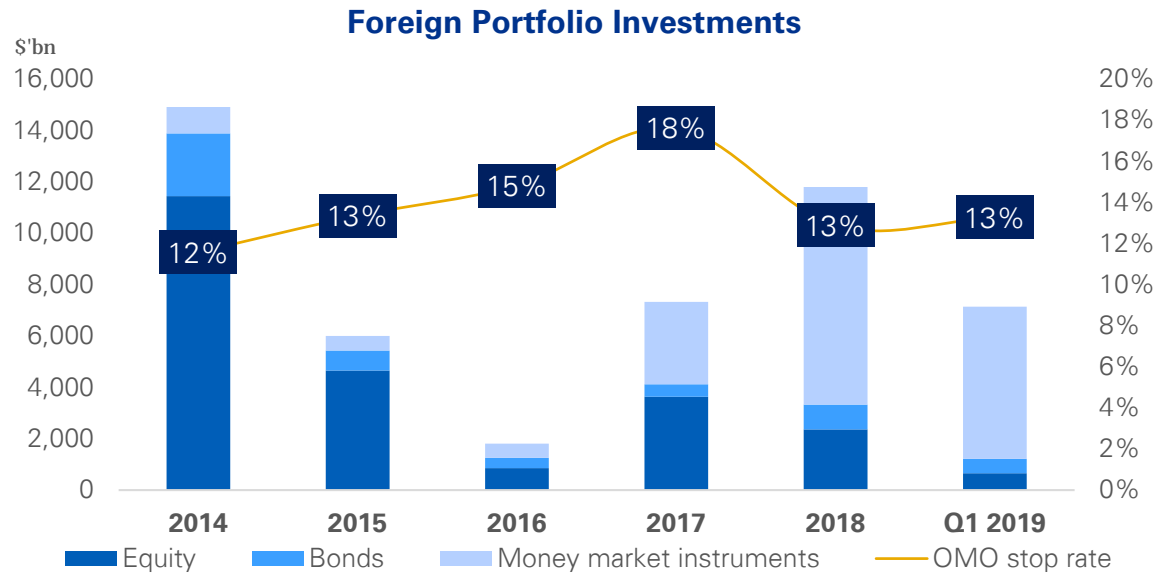
Note: Foreign exchange supply for 2015 to 2018 was derived by applying the annual growth rate of the value of imports to the foreign exchange supply in the previous year.

Comments

- The **huge gap between the foreign exchange supply and demand leads to price distortions and increased demand in the parallel market** which contributed to a wide gap between the official and parallel rates
 - The parallel market rate hit a record low of about N500/\$1 in February 2017
- **Introduction of multiple windows in 2017 led to an increase in foreign exchange supply** from \$21.4 billion in 2017 to \$38.1 billion in 2018.
- **However, there is still a wide gap between foreign exchange demand and supply.**

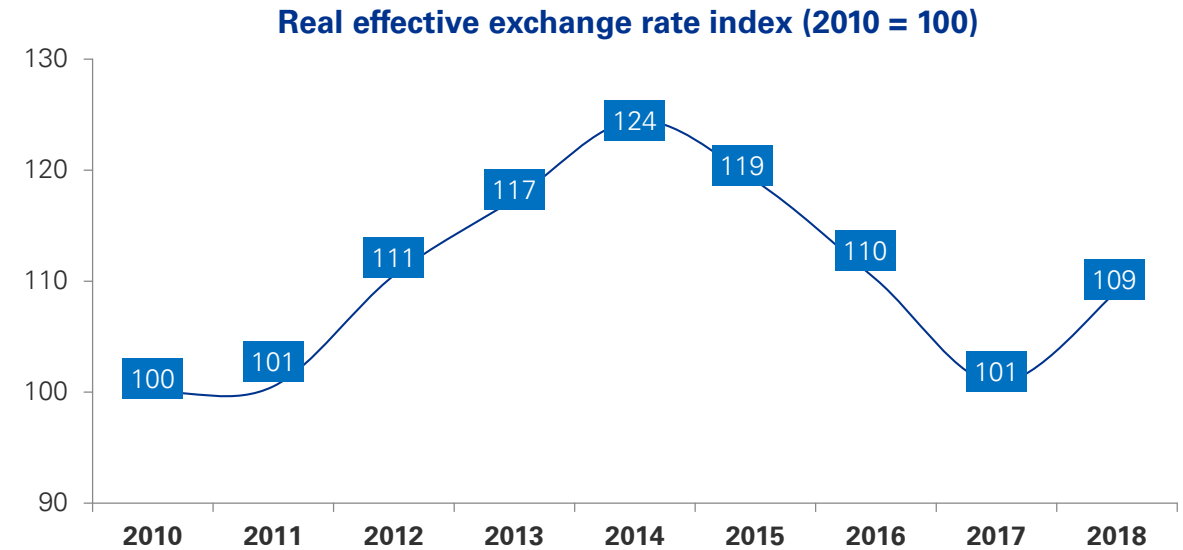
...but key vulnerabilities points persist

CBN auctions expensive OMO instruments in a bid to attract FPIs



- ✓ The CBN continues to sustain its reliance on open market operations (OMO) as the main tool in managing the banking system liquidity through its frequent OMO auctions
- ✓ Drastic increase in purchase of money market instruments by foreign portfolio investors as a result of high rates leading to foreign reserves accretion

REER index of the Naira has started to increase



- ✓ Recent uptick in the REER valuation of the Naira indicate that exports are becoming more expensive and less competitive, all things being equal
- ✓ The IMF estimated that for 2016, the Naira's overvaluation was at 18% and that the "foreign exchange restrictions would contribute to a continued large premium in the parallel market and hinder the restoration of normal functioning of the FX market"

Sources: Central Bank of Nigeria, National Bureau of Statistics, KPMG Analysis

There have been arguments on whether Nigeria adopts multiple exchange rate practices or not...

However, a review of the criteria for establishing multiple exchange rate practices by the IMF¹, reveals that our current exchange rate system has at least three characteristics that meet the definition of multiple exchange rate practices.

Multiple exchange rate practices

Dual or multiple foreign exchange markets	✓
Different rates for different transactions	✓
Exchange taxes	✗
Bilateral Payment Agreements (BPAs)	✗
Exchange guarantee schemes	✗
Foreign exchange auctions	✓
Import deposit requirements	✗



- Nigeria currently operates **several foreign exchange windows** such that economic players can access foreign exchange for their respective needs.
 - Such windows include the official window; the interbank wholesale and retail windows; the Investors & Exporters window etc.
- The CBN also rations foreign exchange for subsidization purposes through the Dutch auction system. This plays out as the CBN **sets up various windows and rates that are less than the more market-determined I&E rate**.
 - The CBN official rate of N305/\$1 is specifically for petrol importers and government transactions.
 - Custom duty rate is N325/\$1

1. IMF, Review of Fund's Policy on Multiple Currency Practices: Initial Considerations, 2019

Multiple exchange rates have negative economic impacts on the medium to long term...

Impact of multiple exchange regimes are multifaceted...

1 create an opportunity for arbitrage activities

2 reduce investor confidence and clarity

3 Prolonged use of multiple exchange rates may lead to distortionary economic effects

...with negative impacts on the GDP

#1





Multiple exchange rates practice inhibits economic growth

and the continued application of the multiple exchange rates practice may have unintended consequences in the long run. Notably, **our findings indicate a negative and significant effect of the multiple exchange rates practice on GDP growth rate** and the negative effect is more pronounced in the long run relative to the short run.

#2

Following IMF's allowable spread of up to 2% between rates, **we proffer that the harmful effect is greater when the deviation of the Bureau De Change rate from the Interbank rate exceeds 2%**. The available data shows that, with an increase in the deviation from 13.95% in 2015 to 47.09% in 2016, economic growth respectively dropped from 2.65% to -1.62%.

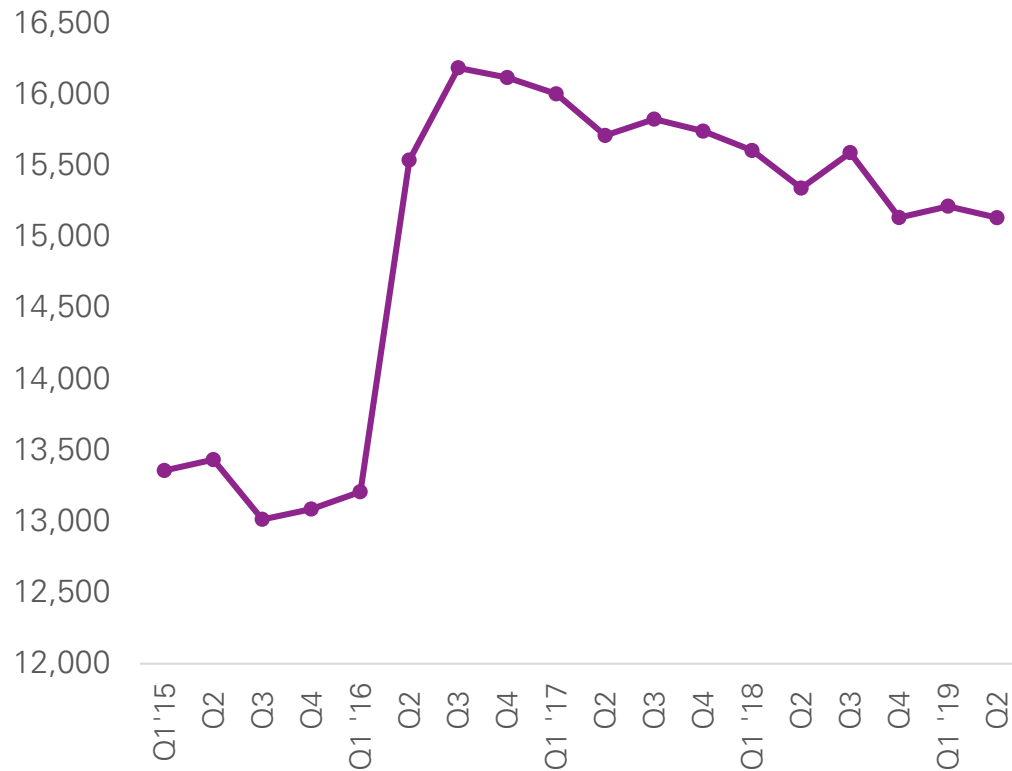
Results from a survey administered by KPMG provide some insight into the impact of Nigeria's exchange rate arrangement on business performance and investments

-  Top three (3) **foreign exchange related challenges** faced by respondents are **sourcing foreign exchange; restriction of access in certain windows and multiple foreign exchange windows.**
-  More than 60% of respondents highlighted that the current multiple exchange rates system **has negatively impacted their business operations in the areas of competitiveness in their markets, costs of financing and cost of sales**
-  **20% and 15% of respondents have delayed or deferred their capital investments and investments in new businesses, respectively.**
-  Majority of **respondents are seeking key policy changes such as convergence of rates and greater flexibility in the foreign exchange market**, in order to ensure a conducive business environment.
-  **A favourable foreign exchange policy will stimulate increased investments in capital investments and new businesses** – 63% of respondents are willing to bullishly invest in new businesses given that there is a change in the foreign exchange policy.

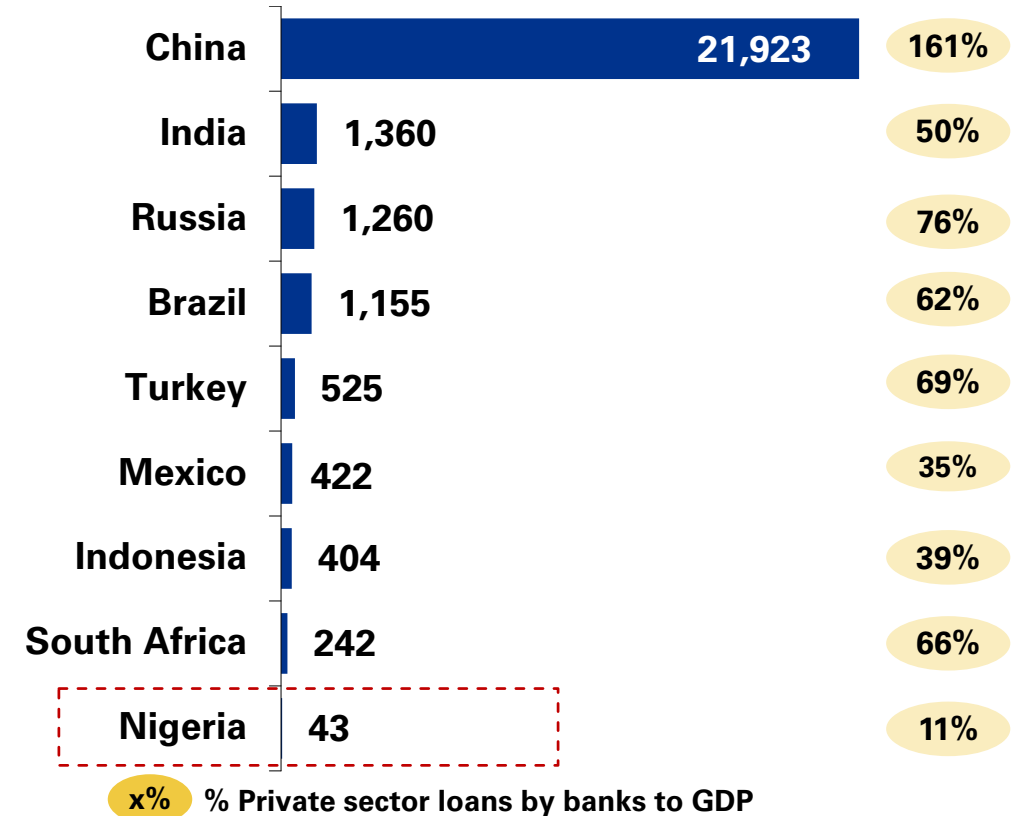
The key takeaway from the survey findings is that the private sectors remains cautious and may not be willing to make significant investments required to drive accelerated economic growth unless the foreign exchange policy environment becomes more supportive.

Nigeria has been credit starved with declining supply to the private sector...

Credit to private sector (Q1 2015-Q2 2019)



Private sector loans by Banks, USD billion (2018)



- **New minimum LDR likely to improve credit to private sector**
- **Credit to the private sector has only grown at less than 16% since 2016**

Source: NBS, World Bank Global Findex, World Bank Statistics Database

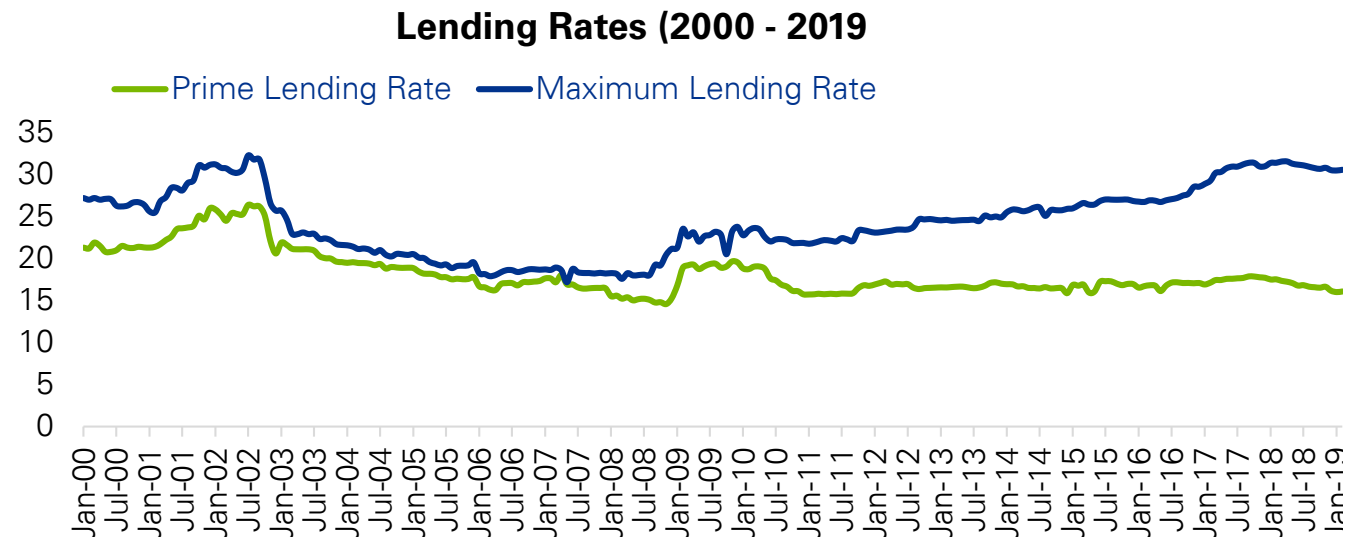
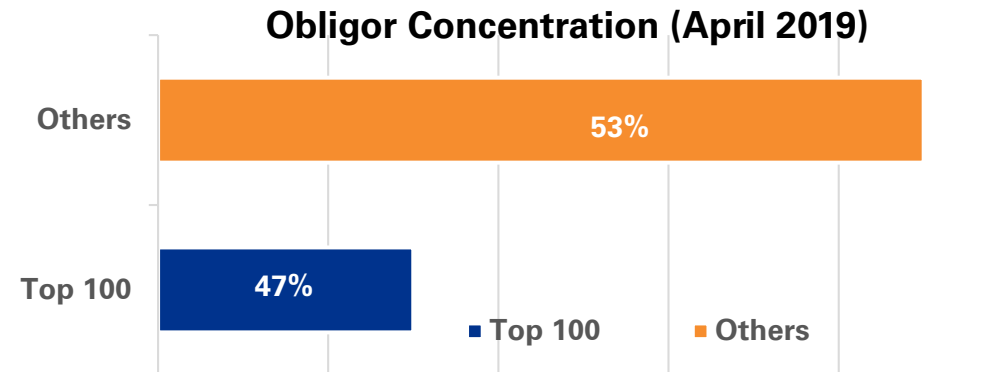


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CBN home-grown heterodox policies are stimulating credit growth

- CBN has introduced some key initiatives
 - Global Standing Instruction (GSI) to address the predatory impact of serial borrowers in the banking system
 - LDR stipulated at 60%, now increased to 65%
 - OMO restrictions increasing overall liquidity in the banking sector
- With some short term positive outcomes
 - An increase in absolute gross credit, amounting to N1,169.70 billion, was recorded between end-May and end-October 2019
 - Decreasing interest rate - Borrowing rates dropped 400 basis points between June and October 2019

... prime customers will benefit more from the enhanced credit penetration and decreasing borrowing rates



Source: CBN

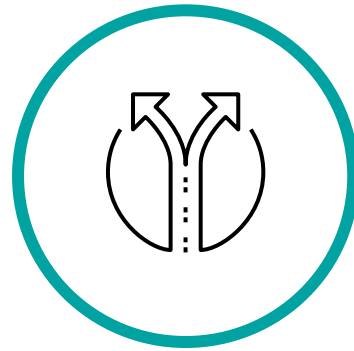


The Policy Environment is creating a VUCA scenario in Nigeria...



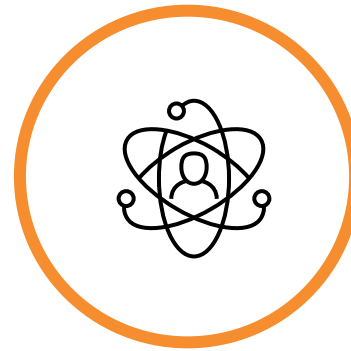
Volatile

The speed of change which drives fluctuations in demand, market turbulence etc. Volatility accelerates change.



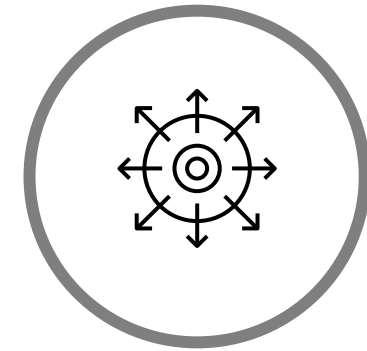
Uncertain

The extent to which the future can be confidently predicted. Uncertainty limits decision making capabilities.
e.g. Trade restrictions and border closure



Complex

Intricately interwoven forces that defy the traditional cause and effect analysis.
e.g. Multiple taxation



Ambiguous

Lack of clarity resulting in multiple and conflicting interpretations.
e.g. Multiple FX window practice.

With negative impact on economic growth...

"Adapt"

- **Game the policies – frustrate achievement of policy objectives**
- **e.g. Banks are working around the LDR targets. Credit concentration on few top corporates will increase**

Retreat – maintain status quo

- **"Wait & See" posture with limited capital investment or cut back**
- **Potential impact on FDI decision to be made by Total at the end of the year**

Exit – Scale down divest

- **More players in capital intensive sectors will scale down or exit to reduce their exposure**
- **e.g. More divestment of IOCs - particularly Chevron/ Exxon**



Declining business confidence

Reduced private sector investment

Declining economic activities and output

Capital flight/ FDI reversal

The 2020 fiscal Policy thrust is expected to be driven by several themes...



Protectionism

Increasing attention towards curbing trade losses in cross border trade is a key driver expected to shape policy formulation in 2020



Anti-Corruption

Strong drive to stifle corruption at Federal and State levels is expected to shape policy actions



Poverty

The presidency is expected to sustain initiatives towards lifting the bottom of the pyramid out of poverty



Pressure for Revenues

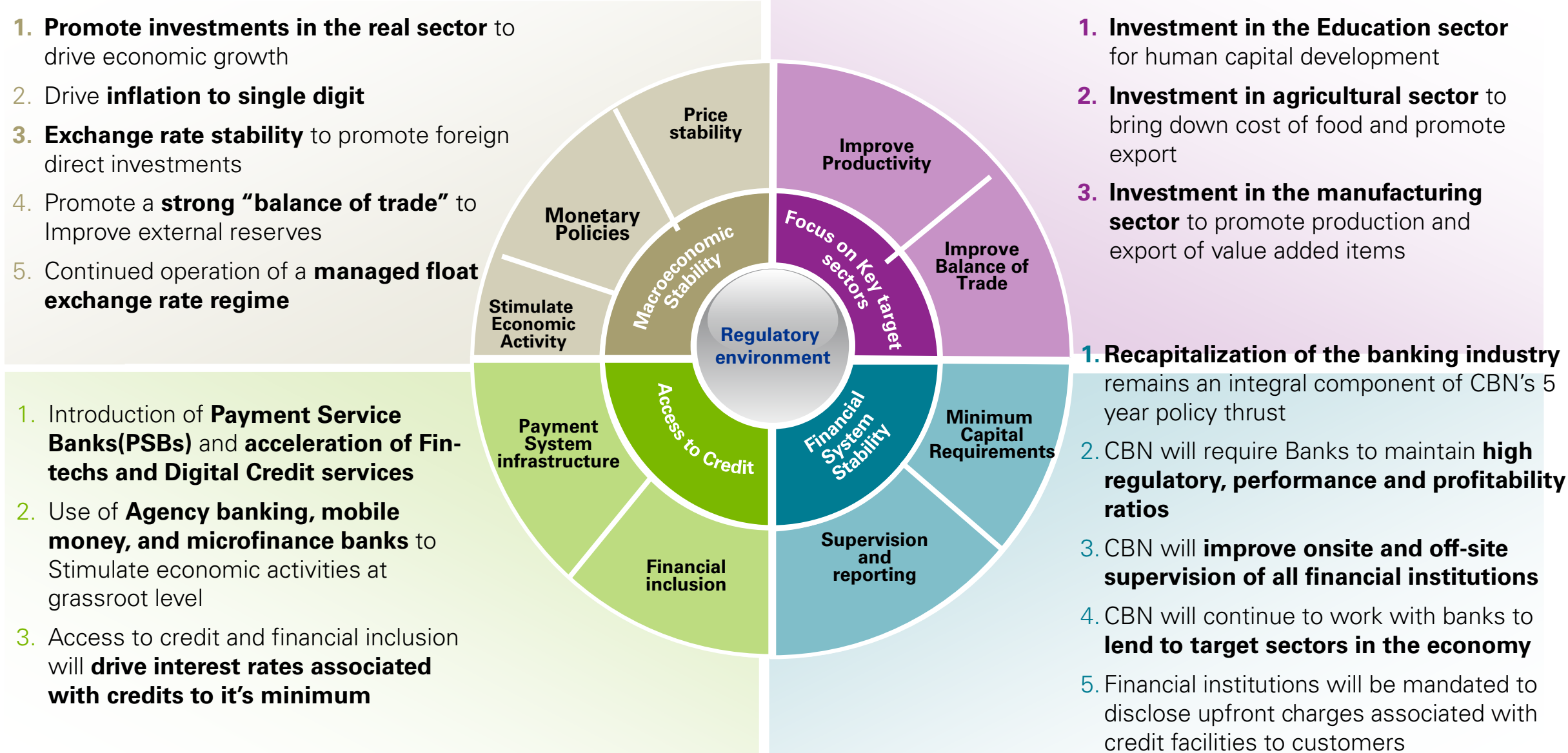
The need to close budget deficits through intervention mechanisms that drive revenue is expected to continue



Subsidies – an open question

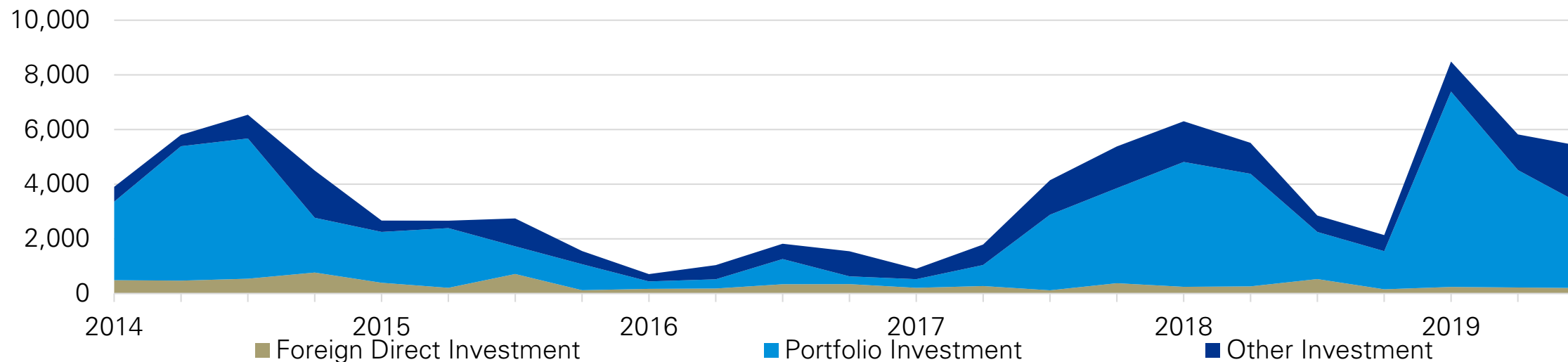
The need to address the key subsidy challenges including:

- Petroleum subsidies on PMS in excess of N1trn
- Gas and power subsidies and electricity tariffs that are priced well below Marginal Cost
- Multiple exchange rates and a misaligned currency market structure



FDI still to garner strong momentum

Capital Importation, Q1 2014 – Q3 2019 (\$Mn)



FDI

- Accounted for \$200.08 million or 3.73%
- Quarterly and year-on-year decline of 10.23% and 62.29% respectively

Other Investments

- Accounted for \$2,167.98 million or 40.39%
- Loans dominated other investment and accounted for 81.87%

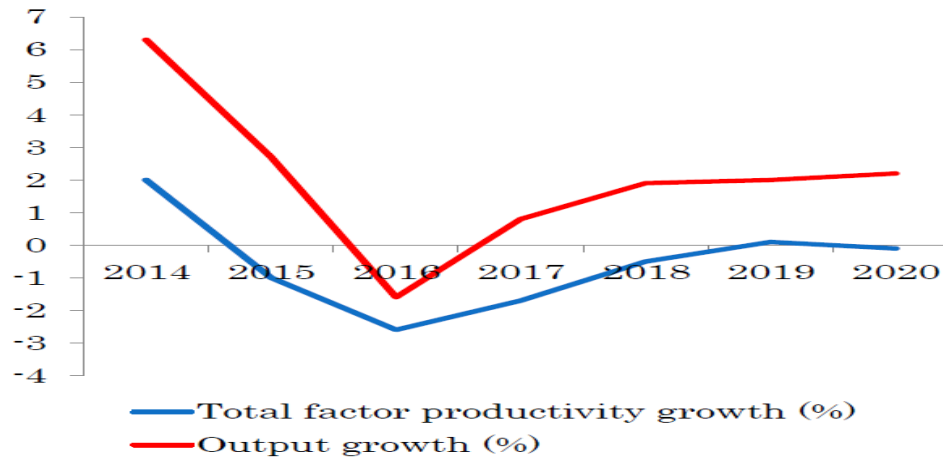
Portfolio Investment

- Largest component of capital importation and accounted for \$2,999.50 million or 55.88%
- Money market was the largest component and accounted for 85%

Source: National Bureau of statistics, Nigerian Capital Importation, Q3 2019

Productivity remains a persistent problem...

Total Factor Productivity Growth Vs GDP Growth (2014 – 2020 (f))



Labour Productivity Growth (Jan 16 - Jul 18)



Source: Financial Derivatives, McKinsey

SOURCE: WWW.CEICDATA.COM | CEIC Data

Comments

- Improved ranking in ease of doing business
- Huge infrastructure deficit (\$300bn)
- Power sector yet to be unlocked
- Regulation may stifle performance

Digital technology is disrupting businesses...

Payments

InsurTech

Personal Finance

Digital Bank

Investment Banking & Capital Markets

Blockchain/ Cryptocurrency

Alternative Financing

Increased Investment



Increased investment resulting in capital to drive growth

- Total funding in Nigerian startups in 2018 up to \$178 Million
- 15 startups raised more than \$1million

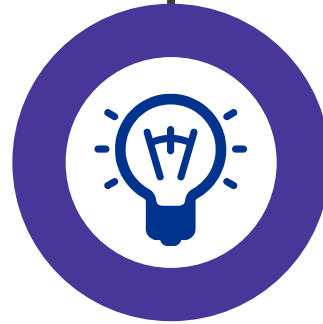
Agile Business Model



Agile Business Model resulting in:

- Faster speed to market
- Ability to drive experimentation
- Emergence of platform model

Innovative Propositions



Innovative products that are:

- Easy to use
- Accessible to the market
- Relevant

Global Capabilities



With the entry of Global Players:

- Strategic partnerships with global Fin-techs
- Market entry of global Fin-techs.

Skillsets



Increasing available talents:

- Increased training of people to build the necessary skillsets

The social wheel of pressure is spinning ...

- 1. Education Exclusion**
- 13.5m children out of school
-

- 2. Corruption**
- Corruption Rank 144 / 180
 - Transparency score 27/100
-

- 3. Health**
- 4th worst country in healthcare delivery
 - 70% exclusion to health insurance cover
-

- 4. Income Level**
- 90m people living below the poverty line
-

- 5. Insurgence & Insecurity**
- 2 million Nigerian refugees and internally displaced persons
-

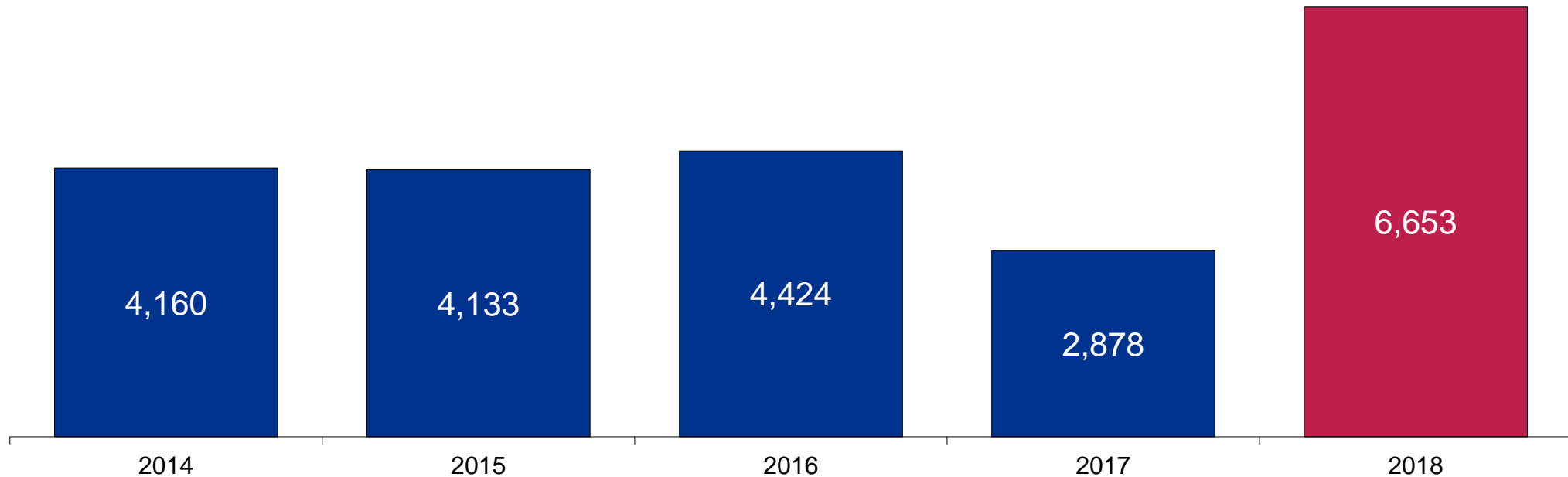
- 6. Migration**
- Africa, Europe and North America account for ~80% of emigration out of Nigeria
-

- 7. Mortality Rate**
- Mortality rate per 1,000 men was 371 in 2016
-

- 8. Millennials**
- Majority of the country's population are millennials
-

A fallout of this is the growing flux of skilled talent to other climes...

Nigerian Permanent Residence Admissions to Canada (2014 – 18)



- **Other destinations include: United Kingdom, Australia and United States**
- **The global war for talent and cross-border mobility is set to take a greater toll on Nigeria's talent pool in 2020.**

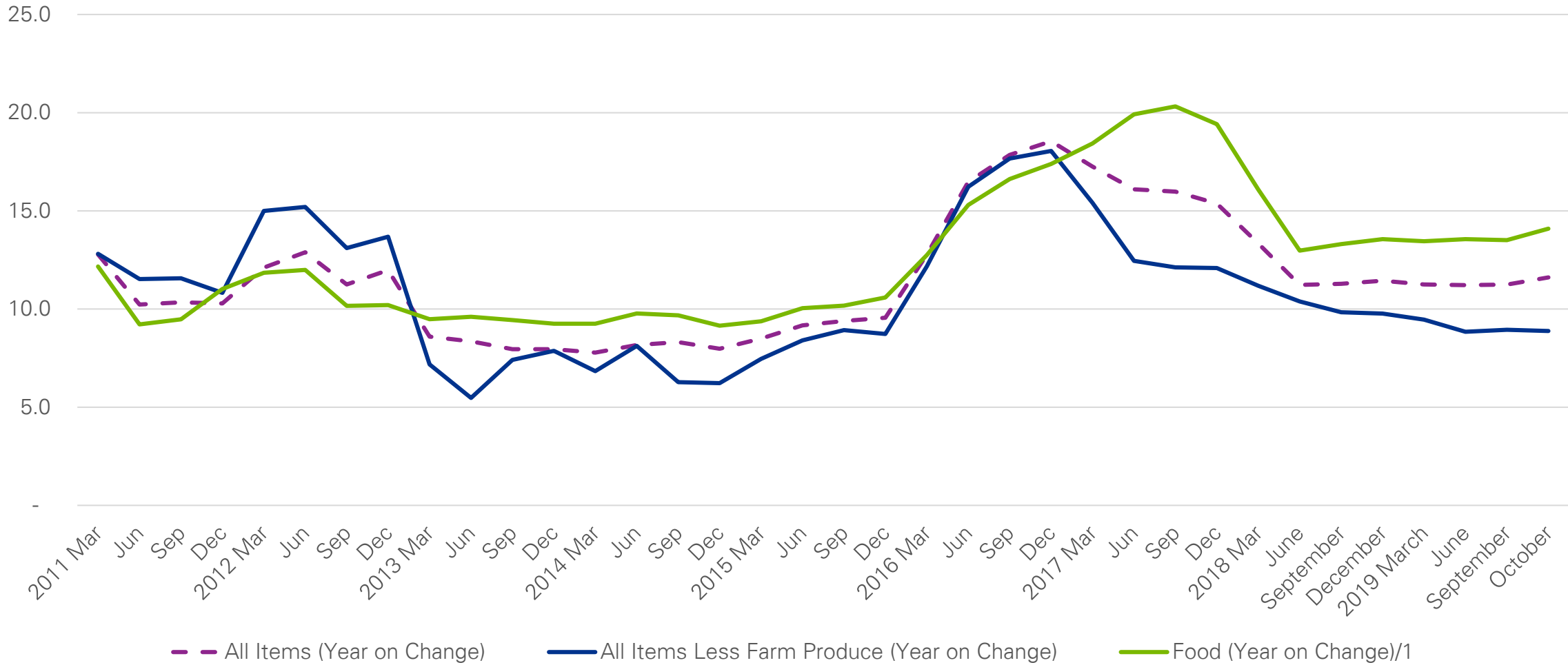
Source: Canadian Immigration Statistics - <http://www.cic.gc.ca/>



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Inflation recently rose to 11.61% from 11.2% driven by border control

Inflation rate (Jan 2011 – September 2019)

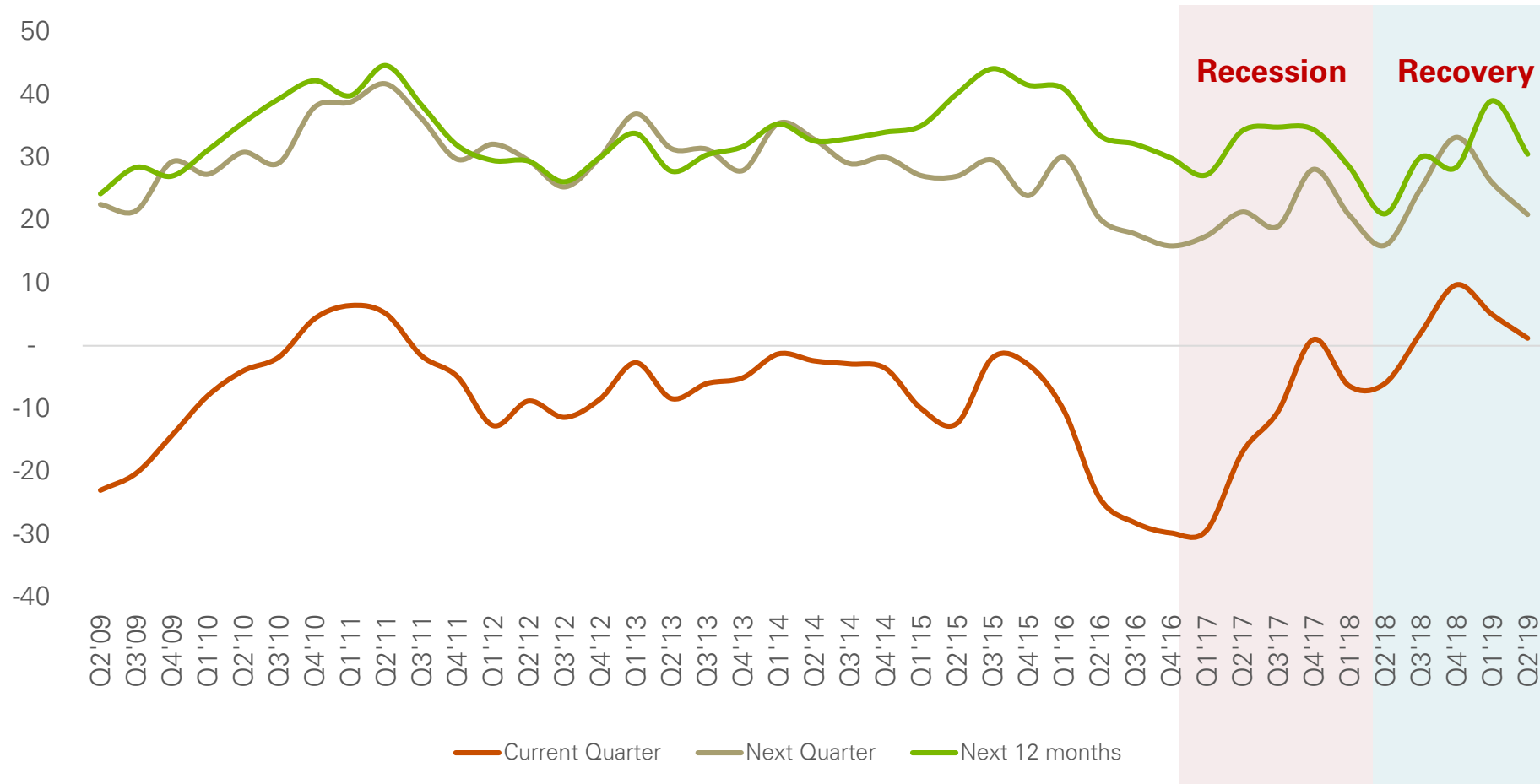


Source: CBN



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Consumers' overall confidence outlook remained positive, but dropped in Q2 2019



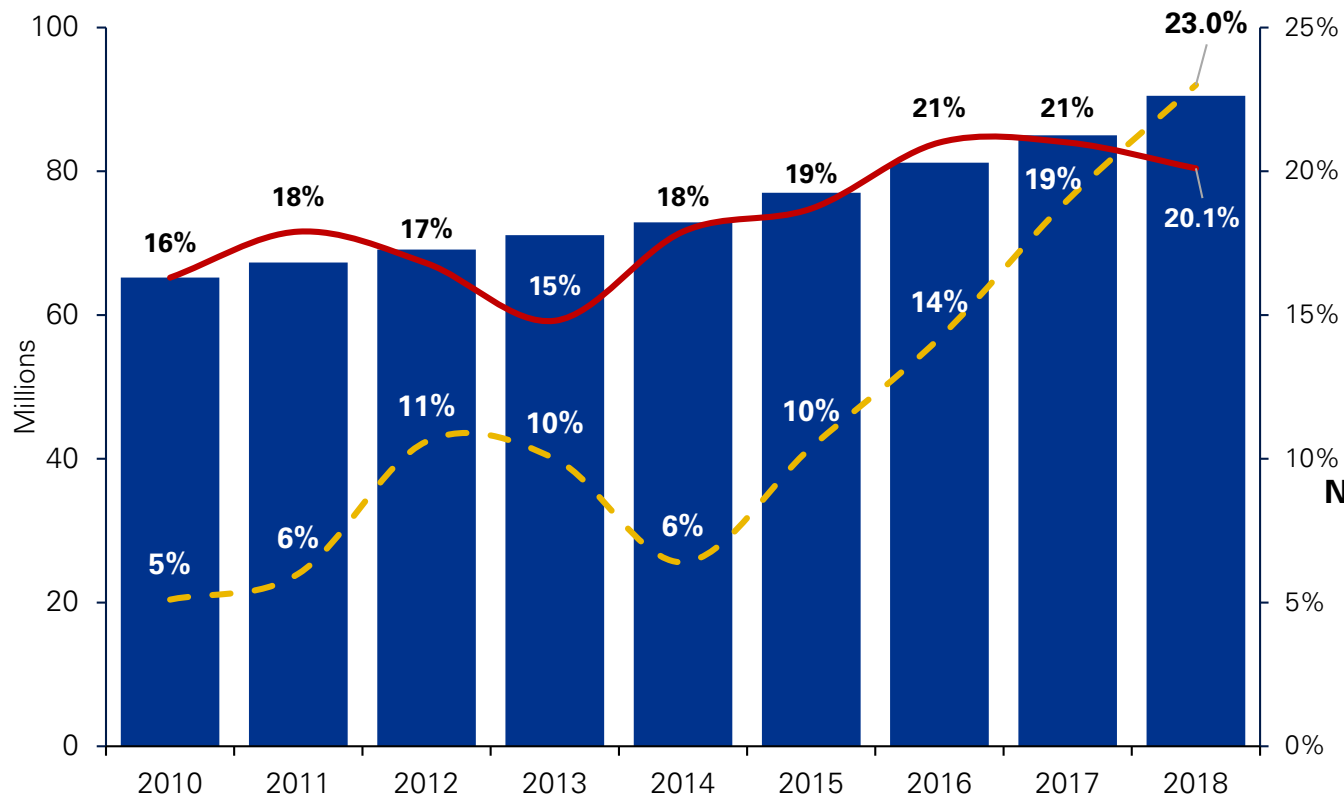
- The consumer outlooks for the next quarter and next 12 months were positive at 20.9 and 30.5 points, respectively
- This outlook could be attributed to the expected increase in net household income, an anticipated improvement in Nigeria's economic conditions and expectations to save a bit and/or have plenty savings in the next 12 months

Source: CBN



Employment remains a major challenge across the country...

Labour force, Unemployment and Underemployment

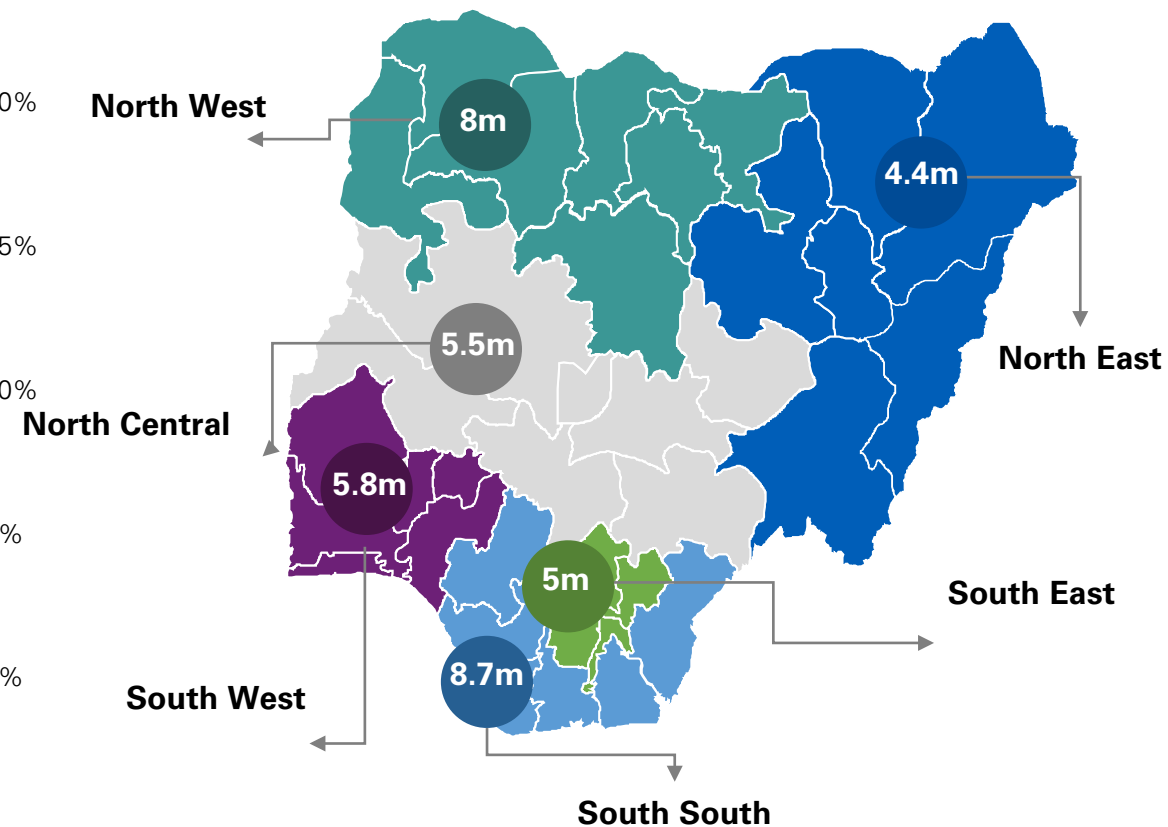


■ Labour Force Population (mn) - - - Unemployment Rate (%) — Underemployment Rate(%)

...impacting demand for economic goods and services...

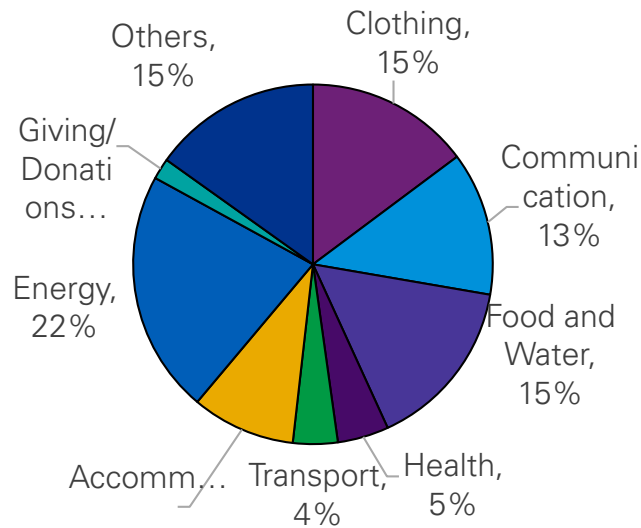
Source: CBN, NBS Labour Force statistics

Distribution of Unemployment in Nigeria

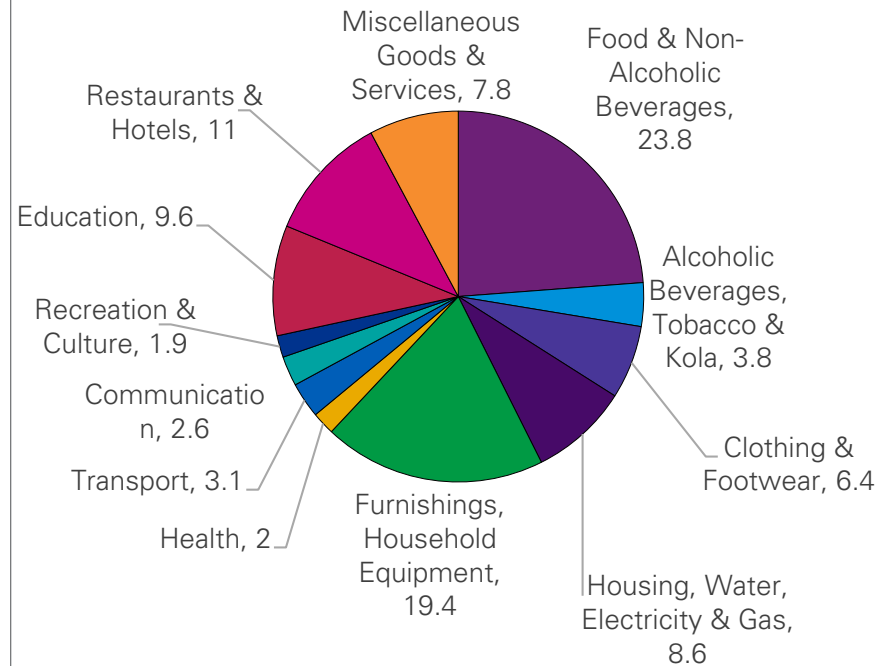


With inflationary pressure likely to have impact non-discretionary expenditure

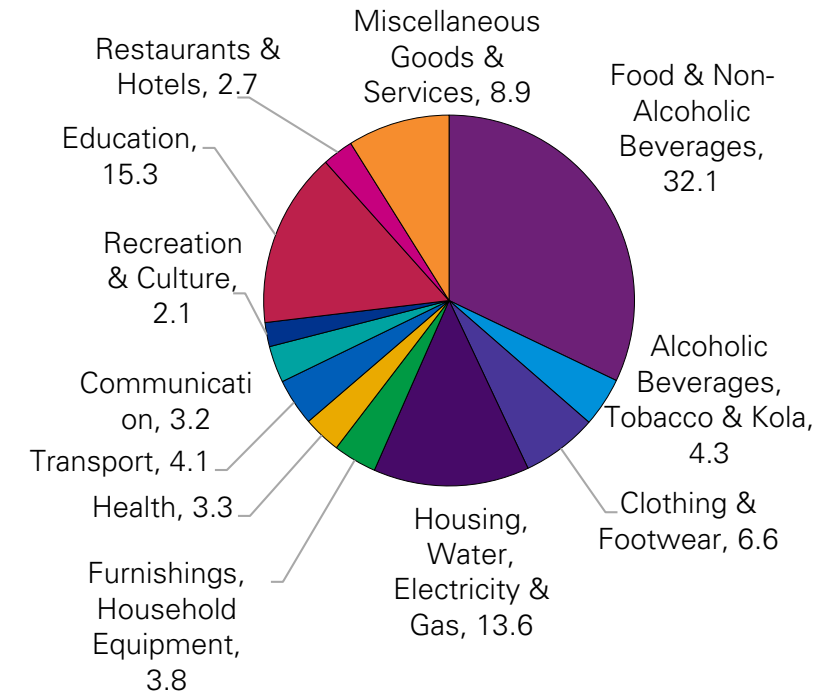
Consumption Profile of an Average Nigerian (2015/2016)



Proportion of Spending in Lagos (2018)



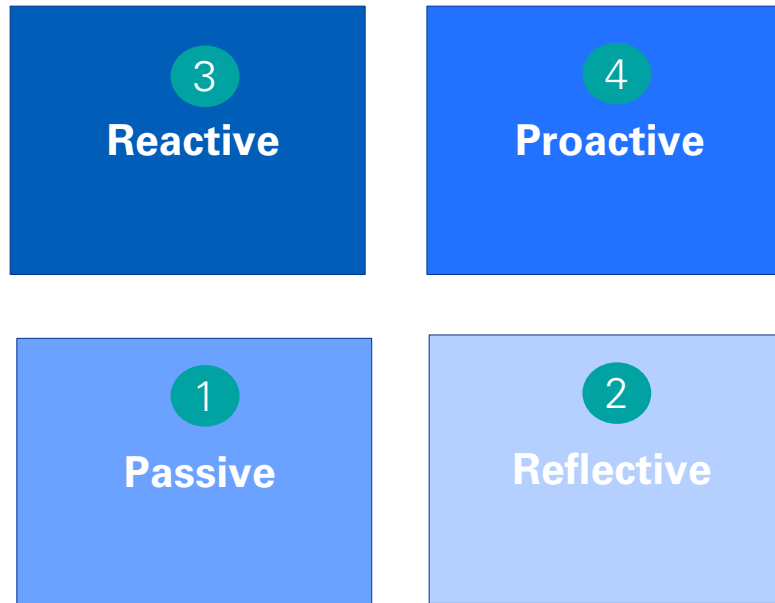
Proportion of Spending in Rivers (2018)



Source: The Macroeconomic Review: The Nigerian Business Environment in 2020, Kainosedge

To successfully navigate the downturn and thrive in the subsequent upturn, organisations need to adopt a Proactive Strategic Posture

Organisation that take a proactive strategic posture have greater chances of surviving the turbulent time and take opportunity of the upside of recovery while minimising the risks in the downturn



- 1** **Passive** – management is overwhelmed by the externalities of the turbulent times and take little or no mitigating decision. They resign to the Invisible Hand. Sometimes, it is as result of denial of the gravity of the crisis
- 2** **Reflective** – Management spend extensive time on reviewing, analysis, discussion and strategizing with no action or decision-making are delayed due to bureaucracy. Agility is missing and organization cannot translate its corporate knowledge to pragmatic mitigating actions
- 3** **Reactive** – Management is focused on tactical actions driven by survival instinct. Long-term perspective is missing in the decision-making process e.g. Immediate retrenchment of staff, reversing capital investment decision. Limited or no consideration is giving to positioning for the opportunities at the upturns
- 4** **Proactive** – Management adopt analysis-based decision making given consideration for the medium to long term while balancing prompt tactical survival action steps.

Five levers proactive organisations leverage to manage turbulent times



Managing your Markets



Managing Lean



Manage with Innovation Mindset



Manage People and Talent



Managing for the Long Term

Thank You



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