VETIVA
CAPITAL MANAGEMENT LIMITED

Vetiva Research

A shot at dawn

2022 Macroeconomic Outlook

December 2021

Executive Summary

A shot at dawn

02 December 2021

Although the great lockdowns of 2020 are behind us, yet its offshoots are lingering, from the mutation of the virus to supply chain disruptions, the build-up in commodity prices, and higher inflationary pressures. As a result, central banks are becoming increasingly hawkish as inflation rears its head above its upper targets. While advanced economies are tapering their asset purchases, emerging economies are already hiking interest rates, setting the pace for tighter global financing conditions.

Going into 2022, a possible fourth wave of the virus could erupt if further mutations of the virus occur. Following the discovery of the Omicron variant, the likelihood of a fourth wave is becoming glaring. Although, economies are beginning to wind down their policy supports, lockdowns and restrictions could still surface from time to time to stem the pace of infections. Meanwhile, sustained commitment towards renewable energy could keep commodity prices elevated due to underinvestment in fossil fuels and increased demand for other commodities. We expect digital currencies to thrive in the coming year, as more economies take advantage of the blockchain technology.

In Sub-Saharan Africa, vaccination rates remain low amid nascent pressures from climate change and political instability. Two of our coverage countries are going to the polls in 2022 (Kenya and Angola) while Nigeria is approaching its pre-election year. Inflation is set to moderate across our coverage countries, while monetary policy stance remains hawkish.

In Nigeria, we see economic activities normalizing in 2022. As a result, we expect growth to range between 1.3% and 3.7%. Key economic activities to watch out for in 2022 include the electioneering, removal of subsidies, and floatation of the Naira. While we see inflation moderating in 2022, we expect the CBN to remain accommodative. However, external pressures could result in rate hikes. Fiscal metrics could improve in 2022 on the back of recovery in oil revenue. However, we hold a differing view on subsidies considering the electoral season. On the external scene, we see room for deprecation in both the official and parallel market. However, recoveries in the oil sector and maximization of the e-Naira could help keep the parallel market in check.

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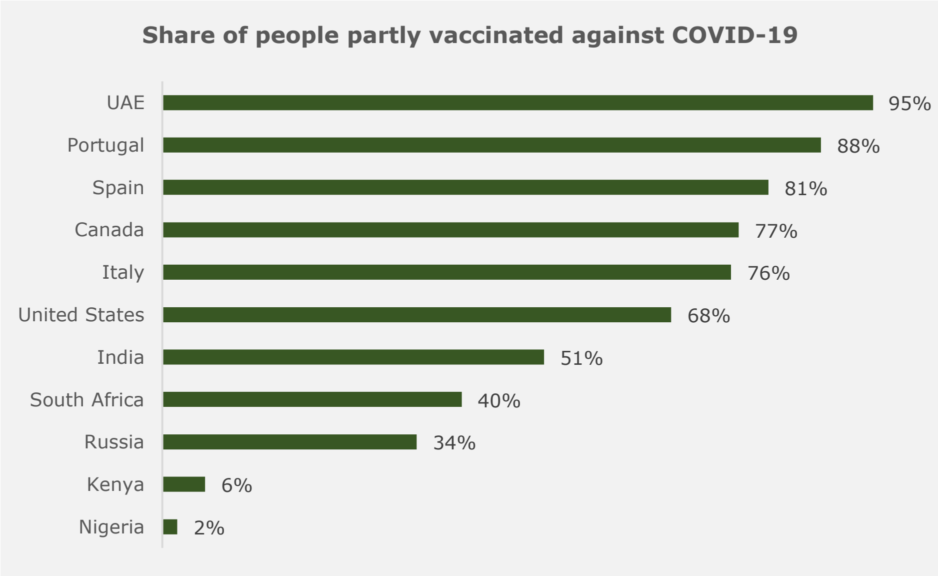
Global Economy

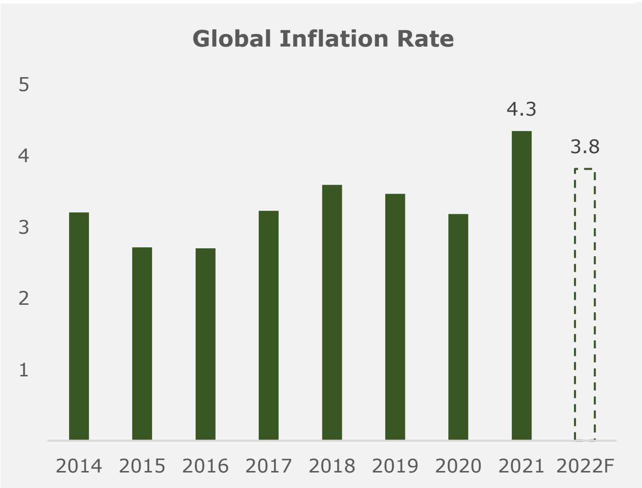
Inflation: An aftermath of the pandemic

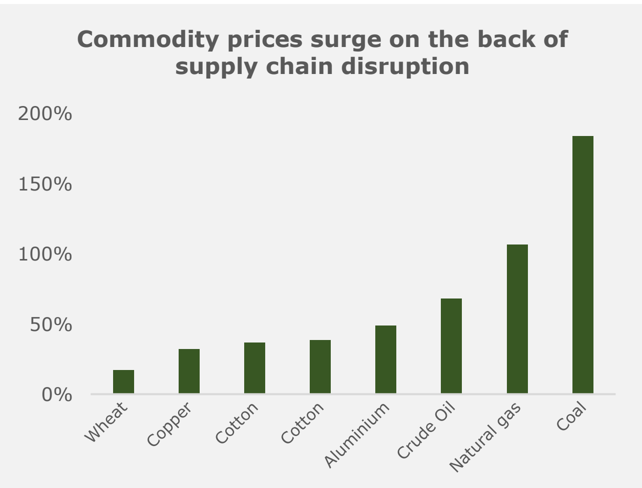
The pandemic remains a recurring theme in our world today. As of when this report was written, half of the global population had received at least a dose of the COVID-19 vaccine. Vaccine inequity and nationalism have resulted in diverging economic outcomes, especially as booster shots are championed in advanced economies while barely 3% of low-income countries have received at least one dose.



Source: Our World in Data, Vetiva Research

More recently, the narrative has evolved from the pandemic itself to its offshoots; supply chain disruptions, rising commodity prices, and surging inflation rates. Replete in the news are reports of chip shortages, resulting from the inability of supply to keep up with the increased demand for consumer electronics post-lockdown. In advanced economies, inflation has shot up considerably above their desired limits. The question now is, are current inflationary pressures transitory or persistent? Following a recession, countercyclical policies should be enacted to restore the economy on the path of long-term growth. In this case, however, the economy is yet to fully adjust to pre-pandemic paths as supply tries to keep up with demand.

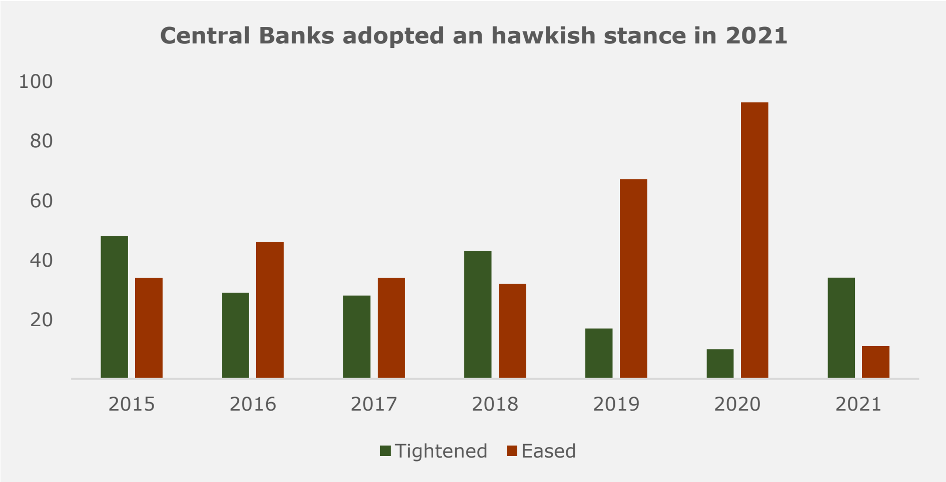




Source: World Bank, IMF, Vetiva Research

Commodity prices have been on a tear this year, owing to rising demand and supply challenges. Supply challenges emanate from China's attempts to reduce carbon emission and the subsequent negative effect on the supply chain. Furthermore, rising shipping costs add another layer of supply constraint. Meanwhile, demand for commodities remains strong, bolstered by expansionary fiscal policy. Oil prices, for instance, broke through several resistance levels in 2021 alone, outwitting expectations.

Amid the upsurge in inflation, many economies resumed the hiking cycle. As at the writing of this report, 140 rate hikes have been delivered while policy rates have been eased 41 times. The swift change in monetary policy stance is unsurprising, given the sustained ascension in global food prices and surge in commodity prices. Top central banks are reluctant to taper due to the transitory perception of current inflationary pressures and the contagion effect. While England and Australia have indicated intentions to taper, the Federal Reserve has announced its decision to slow down its $15 billion monthly bond purchases, hereby ending its quantitative easing (QE) program at the end of H1'22.



Source: Bloomberg, Vetiva Research

Advanced Economies: In the quest for recovery

Advanced economies are leading the race to recovery in every aspect – COVID-19 containment, vaccination rates, stimulus packages, and job support. As a result of ample stimulus measures, most of these economies are poised to reach pre-pandemic heights by the end of 2021. However, due to the strong growth outcomes, high and rising inflation, and evolving global dynamics, governments have begun to phase out stimulus measures.

The United Kingdom, which was the first country to administer COVID-vaccines, recorded a 5.5% q/q expansion in the second quarter of 2021. The bump in economic output is linked to the easing of COVID-19 restrictions, which supported the pick-up in trade, accommodation, and food services. In July, the UK government lifted legal restrictions including social distancing and the indoor use of facemasks. With clubs and restaurants opening, reduced public regard for COVID-19 measures elevated fears of a spike in COVID-19 cases. While that did not play out outrightly, COVID-19 cases rose sharply in Q3'21. In hindsight, it appears the decision to return to pre-pandemic levels is hasty. This has been attributed to waning immunity levels and the need for booster shots. While the country's early start to vaccination could have supported the need for quick return to normalcy, the government's furlough scheme – which staved COVID-19 induced layoffs – eventually came to an end in September, after five postponements. Meanwhile, the United Kingdom has been severed with some post-pandemic challenges recently including labour shortages, rising gas prices and supply chain constraints, which were offshoots of both Brexit and the COVID-19 pandemic. Due to its post-Brexit status and ongoing disputes with the European Union over the Northern Ireland protocol, the UK has resorted to providing temporary visas to foreigners to fill the void in its labour markets.

Unlike the United Kingdom, the European Union could cash in on its single market to douse tensions. However, like the UK, the EU faces similar difficult policy choices regarding COVID-19 restrictions and the timing of policy support withdrawals. In 2022, the European Commission would provide guidance for their medium-term fiscal policy plans and long-term reform proposals. These measures would prevent fiscal consolidation measures from stifling growth.

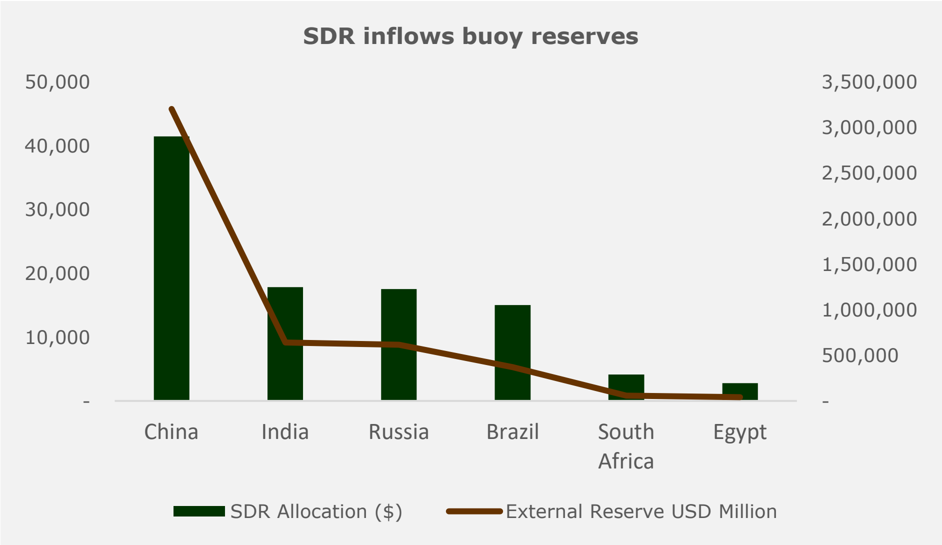
In the United States, about $5.7 trillion has been expended on COVID-19 reliefs in over 9 stimulus plans since the pandemic struck. As a result of the stimulus measures, consumer spending rose at a record pace, fuelling a revised 6.7% y/y growth in the second quarter of the year. As a result of expansionary fiscal policy, sovereign debt limits have almost been exhausted. While temporary legislations have been enacted to push the deadline for debt default, there may be need for fiscal consolidation plans in future, even as governments wind down their stimulus measures. Meanwhile, the US is caught in the web of high inflation and labour market shortages. Inflation has risen by 4.8ppts YTD to 6.2% y/y in Oct'21, propelled by higher oil prices, stimulus packages, supply chain disruptions and recovery in economic activities. On the flipside, unemployment fell from a peak of 14.8% after the lockdowns to 4.6% in Oct'21. In October, the US recorded 531,000 more jobs, with most gains recorded in the sectors most hit by the pandemic - leisure and hospitality, professional and business services, manufacturing, and transportation & warehousing.

Emerging and Developing Economies: SDRs provide a breather

Emerging and developing economies are lagging in the race to recovery due to uneven access to vaccines, constrained fiscal space, high debt levels, and financial market volatility. To begin with, vaccination rate remains low in emerging economies, when compared to their advanced counterparts, creating room for wider spread and mutation of the virus. We note that three of the four variants of the virus were initially discovered in an emerging economy. Calls for booster shots in advanced economies have widened vaccine inequity, as 36% of emerging economies and 5% of low-income developing countries barely have access to vaccines. Meanwhile, policy support is being rolled back as growth reaches peak levels in some foremost emerging economies. Other surfacing worries include the spill over effects of China's property development crisis, surging energy prices, and adverse weather conditions. Meanwhile, growth expectations in low developing economies have plummeted due to slow vaccine rollouts.

Growth in China - the only major economy to return to pre pre-pandemic levels in 2020- appears to have peaked in 2021. With low base effects spurring an 18.3% y/y expansion in Q1'21, the Asian giant recorded slower growth outcomes in Q2'21 (7.9% y/y) and Q3'21 (4.9% y/y) respectively. While base effects could be the obvious reason for the reduced growth momentums, high input costs, supply disruptions, and environmental controls have contributed their quota to the downbeat performance. The People's Bank of China, in a bid to support the economy, reduced the cash reserve requirements of banks, releasing c.$154 billion in liquidity to grease recovery. Chinese exports blossomed on pandemic-induced exports. This could slow down as reopening of the economy result to normalization in economic activity. However, some risks have come to the fore in recent times including Evergrande's debt crises and power outages amid aggressive implementation of green initiatives. The Evergrande group is a prominent property developer with over 1,300 projects in more than 280 cities across China. The company's downturn is linked to its aggressive growth strategy which has placed the company at the edge of defaults, as its ambitions were not matched with adequate demand. Fears of a contagion rattled the markets.

Across other emerging economies, the constrained fiscal space -incident upon pre-pandemic challenges- left a void in the fight against the pandemic. Thus, the allocation of $650 billion in Special Drawing Rights (SDRs) alleviated this pressure and boosted external reserve levels without mounting any additional debt burden on the sovereigns. Countries exchanged their SDR assets for hard currencies to address their liquidity challenges, fund budgets, boost import of vaccines and commodities, support social investments, and stabilize their currencies. While Mexico has indicated that SDRs would be used to settle debt obligations, Ecuador intends to invest SDR flows in social services. Meanwhile, Nigeria, Pakistan and Zimbabwe could use the SDR flows to support their respective currencies.



Source: IMF, Trading Economics, Vetiva Research

In its recent World Economic Outlook, the International Monetary Fund (IMF) revised global projections for 2022. The Fund expects a reduction in global growth to 4.9% y/y in 2022 from 5.9% y/y in 2021, hinged on supply disruptions which could hold back advanced economies and worsening pandemic dynamics in low-income developing countries. However, the Fund expects the strong momentum in the commodity market to support commodity-exporting emerging market and developing economies. While policy support could continually buoy output levels in advanced economies, slower vaccine rollouts could yield persistent output losses in emerging economies.

IMF Oct'21 Forecasts	GDP (%)	Inflation (%)
World	**5.9**	**3.8**
Advanced Economies	5.2	2.3
US	6.0	5.2
Euro Area	5.0	1.7
UK	6.8	2.6
Japan	2.4	0.5
EMDEs	6.4	4.9
China	8.0	1.8
India	9.5	4.9
ASEAN-5	2.9	2.4
Saudi Arabia	2.8	2.2
Russia	4.7	4.5
SSA	3.7	9.8

Source: IMF, Vetiva Research

Macroeconomic and policy themes in 2022

Fourth wave of COVID-19

The world has undergone three major waves of the virus. While there have been initiatives to provide vaccines to less developed countries, vaccine inequity could give rise to fiercer strains of the virus, bringing the world back to square one. While some advanced economies demand booster shots to boost immunity against the virus, developing economies could grapple with the mutation of the virus, which could slow down the fight against the virus. Three of the four variants identified were discovered in emerging economies. Already, a fifth mutated strain of the virus has been uncovered in South Africa. While the variant has also been detected in 15 other countries, the source of the virus remains largely unknown. Tagged the Omicron variant, early evidence suggests the virus has a higher reinfection risk. Thus, temporary travel bans on Southern African nations may not be sufficient to nip a possible contagion in the bud. Thus, concerted efforts are required to stem further disparity in vaccine coverage, including donations of excess supplies to richer countries, and increased awareness to address vaccine hesitancy. Recently, the United States donated 200 million doses to over 100 countries. Similar efforts are necessary to nip a fourth wave of the virus in the bud.

Shift in monetary policy stance

Inflation could be a recurring theme till supply chains recover from the disruptions. With global inflation on the rise, we expect central banks in advanced economies to resume monetary policy normalization. A bulk of the rate hikes we witnessed in 2021 were from emerging economies. Barring any significant spike in COVID-19 related fatalities, the US Fed could tighten rates following the completion of its bond purchase slowdown in H1'22. This could influence further reactions from other central banks in emerging and developing economies. 2022 is most likely going to be a hawkish year, as central banks seek to avoid the ensuing volatilities associated with normalization in advanced economies.

Withdrawal of policy support

Economies literally survived on ample fiscal policy support in 2020. With growth slowing and inflation rising, new challenges are surfacing due to the largesse of several governments. To begin with, labour shortages have emerged as stimulus checks and furlough schemes support household consumption. As these economies return to pre-pandemic output levels, we could see such policy supports withdrawn. This could have some implications for unemployment numbers in those economies and remittances to developing economies.

Global minimum tax

In a bid to address evasion of taxes by multinationals, the global minimum tax initiative was conceived. Initially popularized by the US Treasury Secretary, Janet Yellen, a global minimum tax deal has been put forward to discourage multinationals from shifting profits to tax havens regardless of where their sales are made. This deal would also end the age-long competition among countries for foreign investments. With 136 countries agreeing to the deal, the deal is as good as ready despite a few developing economies on the side lines. As the current signatories make up 90% of the global economy, the deal is as good as done. However, the likes of Kenya, Nigeria, and Pakistan are yet to join the agreement. This is expected in economies which are yet to successfully tax the digital sector. Overall, the Organisation of Economic Cooperation and Development has estimated that minimum tax will generate $150 billion in additional global tax, which would be of greater benefit to advanced economies, where top multinational enterprises have their headquarters situated.

Widespread adoption of CBDCs

Following the COVID-19 pandemic, the concept of digital currencies has grained traction globally. While the issues around volatility had made risk-averse investors to step back, the fast uptake of digital currencies has been entrenched by a surge in both demographic and institutional interest. Bitcoin, a popular privately-owned digital currency, has rallied to new all-time highs in recent times, breaking through previous resistance levels, despite the shocks from China's regulatory crackdown and anti-crypto comments from top world officials. The surge in adoption of cryptocurrencies has aided the development of Central Bank Digital Currencies (CBDC). According to the IMF, about 110 countries were at several stages of developing their CBDCs, due to the low transaction costs, increased surveillance, and suitability for welfare schemes. In addition, we believe the CBDC initiative could help foster the flow of remittances.

Green initiatives

There is an increasing attention towards climate change in the world today, as countries and companies channel their resources towards renewable energy. According to news sources, China emits 27% of the world's greenhouse gases, emitting more greenhouse gas than the entire developed world. In a bid to reduce these emissions and meet their targets for emission reduction, local governments in China pushed for power cuts, leading to production cuts from industrial power houses. On the corporate angle, investments in renewables continue to rise as companies position for the transition in the energy sector. However, underinvestment in fossil fuels could send oil prices higher over the medium term, unless appropriate balance is reached.

Sub-Saharan Africa

Africa lags in vaccination

On the race to recovery, Africa has been on the backbench. Low access to vaccines remains the culprit amid the eruption of Beta, Delta, and Omicron variants. Unlike 2020, where the first wave of the virus hampered economic activity significantly, the continent has witnessed two waves of the virus in 2021. With limited fiscal space, outright lockdowns were ruled out of place. Although some economies imposed some restrictions in affected areas, the resultant effect on economic activities prevented the reinstatement of hard lockdowns. Vaccination rate remains abysmally low in SSA economies as barely 3% of the population has been fully vaccinated, compared to 60% in advanced economies and 35% in other emerging and developing economies.

Source: Our World in Data, Vetiva Research

The IMF expects Sub-Saharan Africa to grow by 3.7% y/y in 2021 on the back of rise in commodity prices, steady improvement in economic activities, and the recovery in travel and tourism. However, some risks have surfaced in the region - social unrest, political upheavals, adverse weather conditions, and subdued recovery in tourism. High levels of unemployment elevated socio-political risks in the region citing the pro-Zuma protests in South Africa, ENDSARS protests in Nigeria, FixTheCountry protests in Ghana and a few others. We have seen four successful coups (two in Mali, one in Guinea and one in Sudan), an unsuccessful coup attempt in Niger, and a military takeover in Chad following the President's assassination. This reflects elevated political instability and social inequality. On the brighter side, however, the smooth transfer of power to Hichilema Hakainde was a high point for Zambia, as the five-time contender defeated the incumbent President in the 2021 Presidential elections. Come 2022, Kenya and Angola will be heading to the polls.

Adverse weather conditions in Angola, Kenya and Madagascar contributed to pressure on the agricultural sector, as resulting droughts have negative implications for inflation. Meanwhile, the surge in commodity prices, which has contributed to inflation in advanced economics, is a blessing in disguise for commodity exporters. As we noted in the global section, several commodities have surged this year to record highs. On the contrary however, oil production in the region have been underwhelming.

In its recent review, the Fund downgraded its growth expectations for the region in 2022 from 4.0% to 3.8% y/y, due to worse-than-expected prospects for non-resource intensive countries. Oil exporters are expected to benefit from high oil prices and recovery in oil production. Tourism-dependent economies are expected to face a challenging recovery trajectory despite the return to pre-pandemic paths due to the permanent income losses from the global shocks to travel and tourism. However, large scale vaccination programs and philanthropic efforts of richer countries and COVAX facilities could resuscitate these economies.

IMF Oct'21 SSA Growth Forecasts

Resource Dependence	Country	RGDP	Inflation
Crude Oil	Angola	2.4	14.9
	Cameroon	4.6	2.1
	Chad	2.4	2.8
	Republic of Congo	2.3	2.8
	Equatorial Guinea	-5.6	3.1
	Gabon	3.9	2.0
	Nigeria	2.7	13.3
	South Sudan	6.5	24.0
Non-Resource-Intensive	Benin	6.5	2.0
	Burundi	4.2	4.6
	Côte d'Ivoire	6.5	2.5
	Eritrea	4.8	4.2
	Eswatini	1.7	4.7
	Guinea-Bissau	4.0	2.0
	Kenya	6.0	5.0
	Lesotho	1.6	5.3
	Madagascar	4.8	6.4
	Malawi	3.0	9.0
	Mozambique	5.3	6.4
	Rwanda	7.0	4.9
	Senegal	5.5	2.0
	Togo	5.9	2.5
	Uganda	5.1	5.0
Tourism	Cabo Verde	6.5	1.6
	Comoros	3.8	1.2
	The Gambia	6.0	6.3
	Mauritius	6.7	6.6
	São Tomé and Príncipe	2.9	7.8
	Seychelles	7.7	3.7
Other Resource-Intensive	Botswana	4.7	5.0
	Burkina Faso	5.6	2.6
	Central African Republic	4.0	2.5
	DR Congo	5.6	6.4
	Ghana	6.2	8.8
	Mali	5.3	2.0
	Namibia	3.6	4.5
	Niger	6.6	2.5
	Sierra Leone	5.9	13.3
	South Africa	2.2	4.5

Tanzania	5.1	3.4
Zambia	1.1	19.2
Zimbabwe	3.1	30.7
Sub-Saharan Africa	**3.8**	**8.6**

Source: IMF, Vetiva Research

Monetary Policy Overview

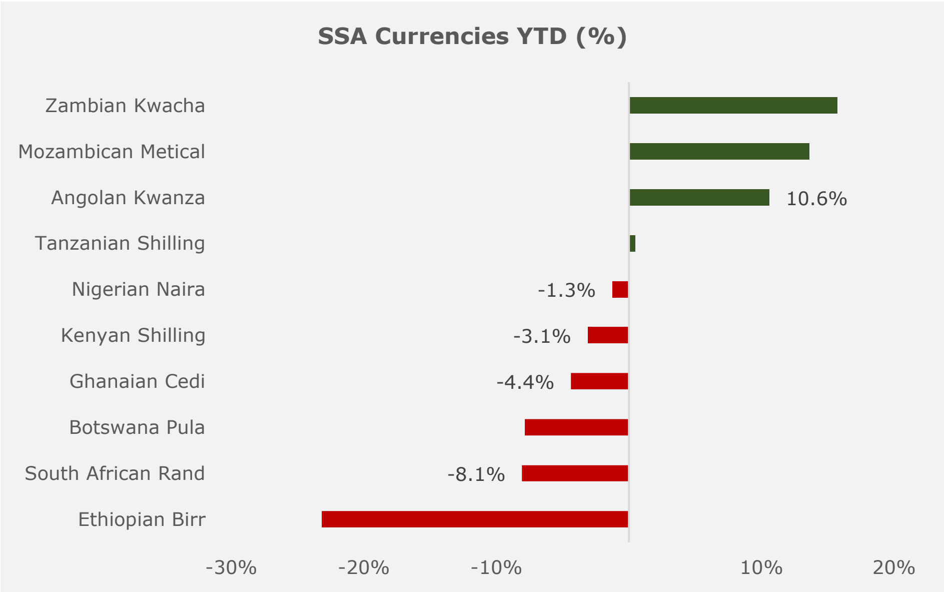
Mimicking the trend in global inflation, inflation has risen to new highs in the region propelled by higher food prices. High food inflation has been linked to adverse weather conditions, insecurity, and most recently export restrictions. Thus, the region's headline inflation has risen from 2% pre-pandemic to 11% in 2021. As a result of surging inflation, some economies (Mozambique, Zambia, and Angola) have begun tightening while countries with stable inflation outcomes have eased further (Ghana, Uganda). Most economies have left interest rates unchanged, due to the global easy monetary policy stance. Rising inflationary risks made Ghana reverse its rate hike in November.

Source: Bloomberg, Vetiva Research

SSA Currencies

In 2020, most currencies went under the weather as a result of COVID-19 induced plunge in commodity prices, the dent on external investment flows, and fall in tourist arrivals. 2021 has fared differently, with a host of currencies riding on the recovery in commodity prices, political stability, and accommodative monetary policy stance in advanced economies. The Zambian Kwacha was literally the world's best performing currency following the smooth transition of power after its presidential elections. Riding on the back of political stability and recovering copper prices, the Kwacha unseated the Mozambican Metical, which had been propped up by higher metal prices. The surge in oil prices made the Angolan Kwanza strengthen after years of depreciation. The South African Rand continues to ride on current account surpluses despite some volatile moments from pro-Zuma protests and rising US treasury yields. Meanwhile, rising import demand has resulted to a weaker Kenyan Shilling and a falling Naira. The Naira was unable to maximize the oil rally in 2021 due to deteriorating oil infrastructure amid teeming import demand and lacklustre investors' interest.

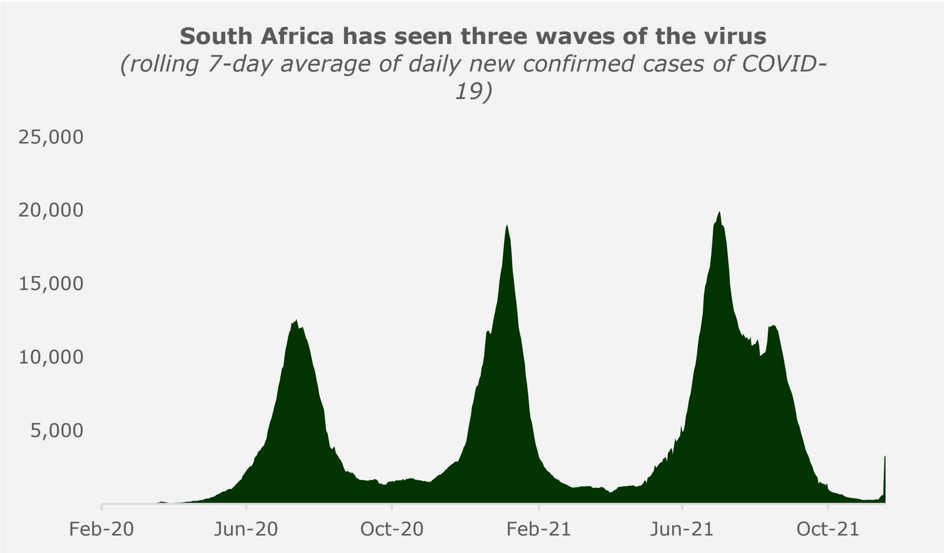
The new allocations of Special Drawing Rights (SDR) has given the region the opportunity to accumulate external reserves and address critical needs. Thus, we expect this buffer to support the activities of central banks in the region. In 2022, we expect further recoveries on the back of high commodity prices. However, monetary policy normalization could accentuate pressures on SSA currencies. Easy monetary policy afforded SSA economies the opportunity to tap into the liquid international debt market. This trend could persist into 2022 until monetary policy normalization sets in.



Source: Bloomberg, Vetiva Research

South Africa: Acing pandemic scorches

Following a revised 6.4% y/y contraction in 2020, the South African economy was expected to rebound strongly in 2021. However, the economy was laced with new challenges. First, the discovery of the Beta variant and the spread of the Delta variant, which led to the reimposition of containment measures, informed a 2.5% y/y contraction in Q1'21. Next was the civil unrest which erupted following Jacob Zuma's court charges. Meanwhile, the economy rebounded by 19.4% y/y in Q2'21 on the back of favourable base effects. We note that due to the rebasing of the GDP, the South African economy is currently 11% larger. Thus, we have revised our expectations for GDP growth, as we now expect a 5.6% y/y recovery in 2021 vis-à-vis a 6.4% y/y downturn recorded in 2020.



Source: Our World in data, Vetiva Research

On a broader note, the country was able to survive a brief turmoil in July following the conviction of Jacob Zuma as looting and breakdown of law and order constrained economic activity. The labour market took a hit from the ensuing civil unrest apart from earlier containment measures as unemployment rose to an all-time high of 34.4%. Adjusting the figure for those that were discouraged from seeking work, the statistic jumps to 44.4%. The sustained rise in unemployment could be a challenge as wallets are further constrained by rising inflation. Although inflation has since remained within the apex bank's ban of 3-6%, consumer prices have come under pressure since the end of Q1'21. Flayed by rising food and energy prices, inflation rose to a post-pandemic high of 5.2% y/y in May'21. After retreating for three months, headline inflation has touched 5.0% y/y levels, which is barely 100 basis points away from the Reserve Bank's upper target of 6.0% y/y.

Monetary policy had remained largely accommodative in H1'21 before inflationary risks spurred a 25bps rate hike to 3.75% in November. In the short term, rising crude prices and higher power tariffs could incite inflationary pressures. Over a longer term, currency weakness, higher domestic import tariffs alongside wage-related demands could be the triggers. We expect growth-inflation dynamics in the domestic economy and monetary policy normalization on the global scene to influence rate decisions in 2022. That said, we pen down a 75bps rate hike in 2022.

With respect to fiscal policy, the government recorded a 60% y/y rise in revenues in Q2, signalling a recovery in economic activities vis-à-vis the stringent lockdowns of the prior year. Improved revenue collections reflected across all revenue categories with Company Income Tax recording the most significant pick-up due to larger profits from mining, manufacturing, and finance sectors. Meanwhile, taxes on income, profits, and capital gains, which was the main source of revenues surged by 46% y/y. Expenditure also grew (11% y/y) but at a slower pace than revenue. The increase in expenditure was driven by an increase in voted expenditure by national government departments.

On the external sector, the South African economy has enjoyed positive current account balance in 2021, benefitting from the surge in metal prices. In Q2'21, South Africa recorded a trade surplus equivalent to 10% of GDP. Current account balance, on the other hand soared to 5.6% of GDP on account of a trade surplus which masked the shortfall on other segments of the current account. External reserves also built up on the strength of external borrowings, foreign exchange swaps, and SDR inflows from the IMF.

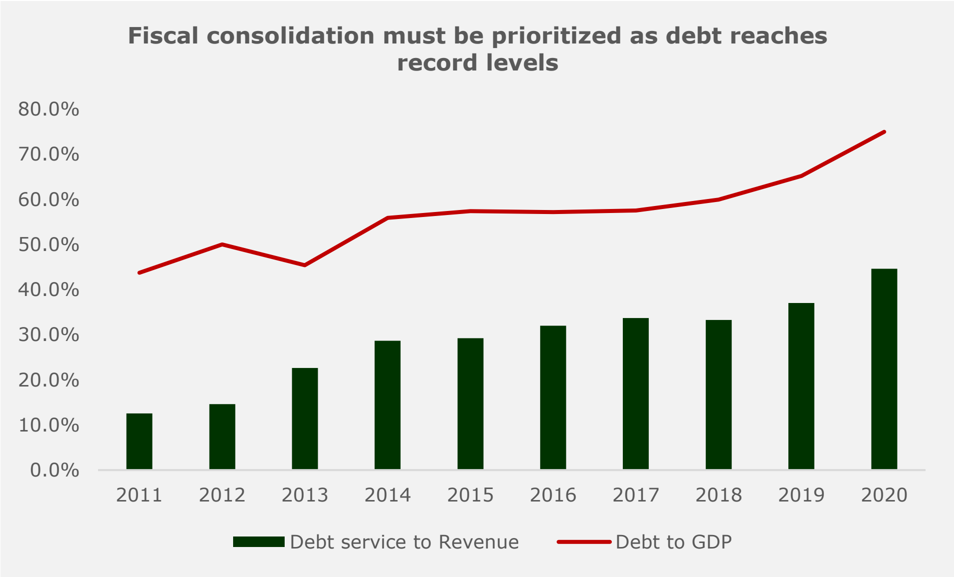
In the forthcoming year, we expect economic activities to recover on the back of supportive base effects, recovery in household consumption, and sustained surge in export demand. Thus, we anticipate a 3.5% y/y expansion in 2022. High base effects could influence deceleration in inflation, albeit high oil prices could spark inflationary torches. Thus, we expect inflation to average 4.63% y/y in 2022.

Ghana: Rising debt raises eyebrows

Following a 3.1% y/y growth recorded in the first quarter of 2021, the Ghanaian economy expanded by 3.9% y/y in the second quarter vis-à-vis a 5.7% y/y contraction in Q2'20. The expansion was driven majorly by the non-oil sector, which advanced by 5.2% y/y (Q2'20: -5.8% y/y) buoyed by agriculture, hospitality, real estate, and trade sectors. The mining sector, however, contracted by 10.8%, resulting to a downturn in the mining and quarrying sectors. Overall, high frequency indicators point to recovery in 2021, as growth in the Composite Index of Economic Activity (CIEA) remains in double digits. Consequently, we raise our growth expectations for 2021 from 4.2% y/y previously to 4.4% y/y.

Since the pandemic struck, the Ghanaian authorities introduced a couple of measures to address its offshoots. However, the introduction of new taxes coupled with rising burden from the surge in gasoline prices fuelled social uprisings. Despite the introduction of new taxes, revenue-to-GDP remained somewhat flat as of Jul'21, while expenditure is twice as much. Debt-to-GDP level has risen above 76%, amid the issuance of a $3 billion Eurobond in the international debt market. Fitch has flagged Ghana's effective loss of access to the international market as a key risk in meeting its medium-term financing needs. While the rating agency affirms a B rating, it posits that elevated risk aversion on account of rising US yields could make it expensive for the sovereign to visit the international debt market in 2022. According to the agency, tight financing conditions could make the government falter on its path of fiscal consolidation, resulting to a possible downgrade. Nonetheless, Ghana has to deal with its weak revenue mobilization to accommodate its high costs of servicing. Despite the social calls for fiscal leniency, Ghana may need to look inwards to identify low-hanging fruit in its fiscal system to optimize revenue collection and accelerate the pace of fiscal consolidation. However, its cost profile may rise further in January 2022 once a higher minimum wage comes into force, barely six months after an earlier review.

The Finance Minister presented the 2022 Budget in November. The government planned to narrow the fiscal deficit from an expected FY'21 turnout of 12.1% of GDP to 7.4 % of GDP. While the government abolished tolls on public roads, the introduction of a 1.75% charge on electronic transactions has stirred sour reactions, given the impact on small scale businesses. The government, however, has a budget outlay of GH₵ 137.5 billion ($ 22.4 billion) with a revenue expectation of GH₵ 100.5 billion ($ 16.37 billion). With the economy leaning towards fiscal consolidation, the government may continue to tackle the side-effects of its reforms. Meanwhile, the markets believe its fiscal consolidation efforts are not deep enough as Ghanaian bonds were dumped following the budget release.



Source: MOFEP, Vetiva Research

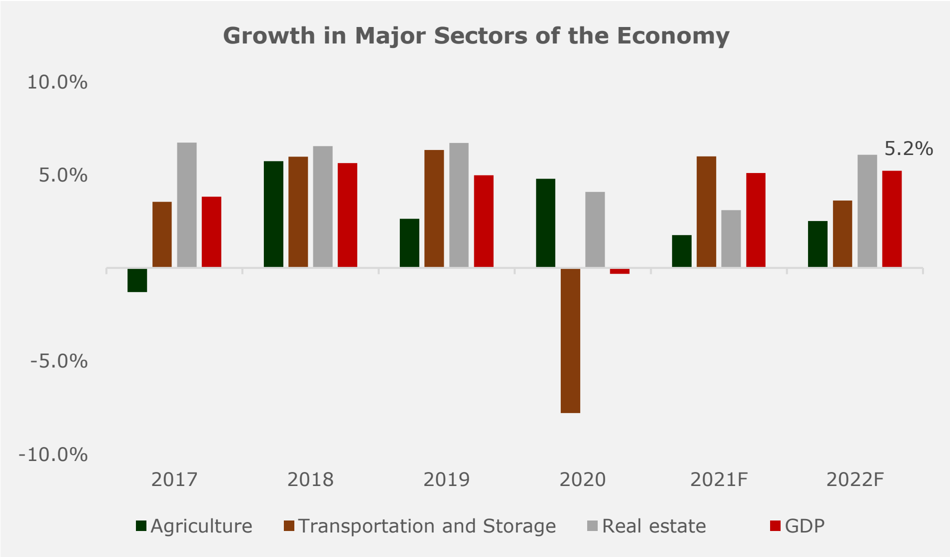
Inflation, which portrayed mixed outcomes in H1'21, has risen consistently in Ghana over H2'21 on the back of rising food prices. As of Oct'21, headline inflation rose to 11.0% y/y, crossing the apex bank's upper target. Meanwhile, gasoline prices have risen by close to 30% year-to-date in Ghana, in line with the surge in global oil prices. The surge in inflation could continue to mount pressure on the apex bank to tighten. In May, the Bank of Ghana (BoG) cut interest rates by 100 basis points to 13.5% to support recovery in the economy. While the apex bank believes the harvest season could abate inflationary pressures, it neutralized its rate cut with a 100bps rate hike to 14.5% in November, citing external pressures and heightened inflationary concerns as reasons for its hawkish stance.

On the external front, Ghana experienced a lower trade surplus in the first 8 months of the year, compared with 2020. This was driven by a sharp decline in the value of gold and crude oil exports, amid a 59% y/y surge in the value of refined petroleum products imports. While there was a surge in cocoa exports, this was subsumed by high cocoa supply from major producers which dragged prices. On the other hand, a stronger dollar contributed to the decline in gold prices. Nonetheless, the country's external reserves strengthened on the back of SDR flows, helping to fund the FX needs of several sectors during the resumption of economic activity in Q3'21. The Ghanaian Cedi has depreciated fairly well against the US Dollar thus far in the year, on the back of ample reserve buffers and inflow from foreign investors.

Going into 2022, we expect recovery to further strengthen on the back of continued normalization in economic activities, better vaccination measures, and favourable investment climate. We expect the economy to grow by 5.5% y/y (IMF: 6.2% y/y). Although the apex bank could worry that high interest rates could continue to crowd out the private sector, we see room for a 50bps rate hike in 2022 should inflationary pressures persist. Meanwhile, inflation is expected to ease further in 2022 on the back of normalization in economic activities. Thus, we expect inflation to average 9.0% in 2022 (IMF: 8.8% y/y). On the external side, some pressures could come from the tapering of asset purchases and a global shift in monetary policy stance, as pandemic measures are gradually phased out in advanced economies.

Kenya: Growth to stabilize amid electioneering

Kenya just concluded its rebasing exercise. Changing its base year from 2009 to 2016, the Kenyan economy is now 4% larger, with a nominal GDP of $97 billion. The rebased data reveals that real output slid by barely 0.3% y/y in 2020, thanks to the resilience of the agriculture and real estate sectors. In 2021, we saw renewed restrictions as the country has undergone four COVID-19 waves. In Q1, the economy grew barely by 0.7% y/y owing to a slump in the agricultural sector. Nonetheless, the economy recorded a 10.1% y/y rebound in Q2'21 (Q2'20: -4.7% y/y). However, we expect the Kenyan economy to revert gradually to pre-pandemic paths, as we have a revised 5.1% y/y growth expectation for the largest East-African economy in 2021.



Source: KNBS, Vetiva Research

As the Kenyan Finance Minister has a bright growth outlook (GDP: +6%), he expects fiscal deficits to narrow in 2022 on the back of the country's fiscal consolidation efforts. We recall that the authorities had to roll back COVID-19 reliefs at the beginning of the year. Bills are in motion to alleviate the impact of pricing pressures on the populace, especially a reduction of Value Added Tax on fuel prices. This comes at a time when revenue collections have improved. According to the Kenyan Revenue Authority, between July and October, revenues outperformed by Ksh 27 billion ($240 million). With a revenue-to-GDP ratio of c.14%, there is still room for increasing the tax base, improve tax incentives and support revenue generation and fiscal consolidation efforts. On the back of these surpluses, the President announced a KSh 25 billion ($222 million) stimulus program. Meanwhile, the country could continue to ramp up external borrowing, due to the high cost of domestic borrowings. In 2021, the country took advantage of global liquidity conditions to raise $1 billion in the international debt market. More concessionary loans and Eurobonds may be raised to fund fiscal activities in the near term.

Inflation has largely been on the uptrend in Kenya, buoyed by higher food and fuel prices. Fuel inflation remained elevated as higher oil prices on the global scene give way to higher fuel prices. Food inflation, on the other hand, was triggered by dry weather conditions and supply constraints. In the near term, new taxes could add another round of pricing pressures, amid higher food and fuel prices.

Weighing inflation outcomes and market survey outcomes, the Central Bank of Kenya (CBK) remained largely accommodative in 2021. Market surveys reflected optimism over the continued recovery in business activities, propelled by easing of COVID-19 containment measures and increased vaccinations. However, key concerns remained pandemic uncertainties, the impact of increased taxes on business activities, and increased electioneering activities ahead of the 2022 general elections. We recall the failure of the Building Bridge Initiative (BBI) to fall through at the courts. Initiated through a handshake between the major political contenders, the BBI was introduced in 2017 to address several issues. The outcome of the consultations was enshrined in a report which had several recommendations including granting the runner-up to the Presidential election, an automatic seat in the Parliament. The courts declared the project unconstitutional, citing the President's lack of jurisdiction in initiating constitutional changes. This flags a key political risk that could derail recovery as the country holds its general elections in 2022. Elevated political risk in the domestic economy may limit scope for dovish monetary policy, especially due to policy support withdrawal in advanced economies and possible risk aversion towards emerging economies. With pricing risks in the domestic economy skewed to the upside, we pen a 100bps rate hike in the benchmark rate.

On the external side, exports have strengthened on the back of increased horticulture and manufacturing exports, despite a decline in tea exports due to frontloading in 2020. Imports have also grown in line with the pick-up in economic activities, and surge in commodity prices. Easing of travel restrictions has supported an uptick in tourist arrivals. Remittances continue to firm up on the back of stimulus measures in advanced economies. External reserves have risen on the back of external debt issuance and multilateral inflows. However, the Kenyan Shilling continues to weaken due to the strengthening of the dollar amid pent-up import demands.

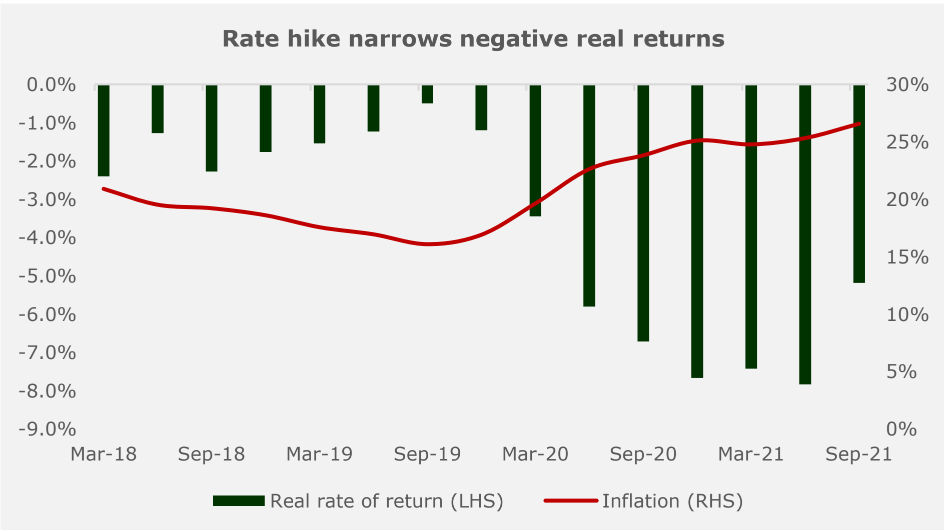
Going forward, political uncertainties, fiscal consolidation measures, and adverse weather conditions are key risks which could stall broad-based growth in 2022. Thus, we expect the economy to grow by 5.2% y/y (IMF: 6.0% y/y) in 2022. With oil prices likely to stabilize in 2022, inflation is expected to remain within the apex bank's band. Thus, we expect inflation to average 5.5% in 2022 (IMF: 5.0%).

Angola: Awaiting Dawn

The Angolan economy may see the light soon following five consecutive years of economic slowdown, sharp depreciations, and high inflation. Following seven quarters of contraction, the Angolan economy expanded by 1.2% y/y in Q2'21 on the back of low base effects. The major drivers of growth include the agriculture, fisheries, transport & storage, trade, and manufacturing sectors. Like Nigeria, its mining sector continues to shrink, as activities in both oil and diamond extraction fell on a y/y basis. Meanwhile, the finance and real estate sectors grew slightly. This outcome is unsurprising as more sectors declined in 2020 than in previous years. Nigeria and Angola were recently unseated by Libya as the leading oil producing economy in Africa. The resource curse continues to stay its course in Angola as oil constitutes one-third of the economy, while more than half of its jobs are in the primary sector.

Amid high debt-to-GDP levels, Angola maintains a balanced budget with a conservative oil price benchmark of $59/barrel and an oil production estimate of 1.14 million barrels per day. With revenues and expenditure pegged at 18.8 billion kwanzas ($32 million), the budget represents a 27% y/y improvement from the 2021 budget. During the course of the year, the government thought it necessary to reduce Value Added Tax (VAT) from 14% to 7% on essential food products to calm food inflation.

While time is needed to observe the impact on consumer prices, inflation remains elevated rising to 26.87% y/y in October, a four-year high. Other factors such as the depreciation of the Kwanza remain sticky points for Angolan inflation. Meanwhile, the apex bank bowed to inflationary pressure, dishing a 550-basis points rate hike to 20.0%. The hawkish rendition came on the back of widening negative real returns and the upside risks to inflation. Thus, the rate hike was delivered to stabilize exchange rates which could passthrough to inflation.



Source: Banco Nacional De Angola, Vetiva Research

On the external scene, however, recovery in oil prices boosted oil exports by 146% y/y in Q2'21 amid healthy demand from its major trade partner, China (responsible for 64% of exports). Thus, the Angolan Kwanza has appreciated by 9% YTD.

In 2022, the IMF expects the Angolan economy to expand by 2.4% y/y, barring any return to lockdowns. Inflation is expected to average 14.9% y/y, as base effects stir moderation in inflation. Interest rates could be eased by 200bps as inflationary pressures subside. More external support could be gotten from external sources as recovery begins in the economy.

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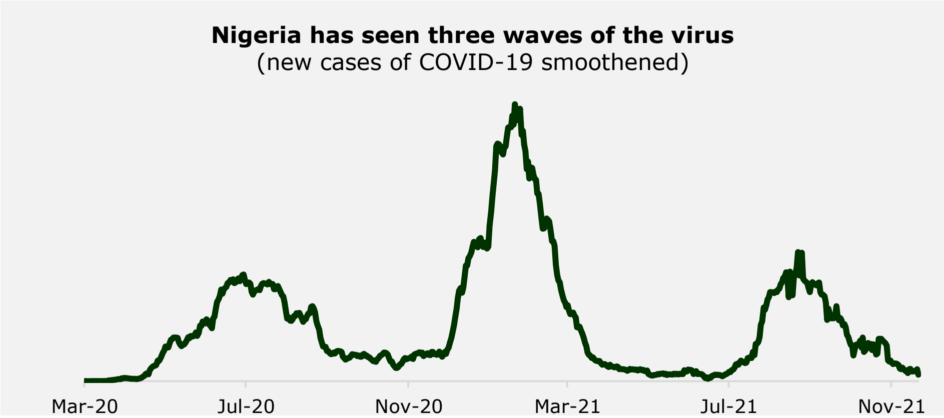
Domestic Economy

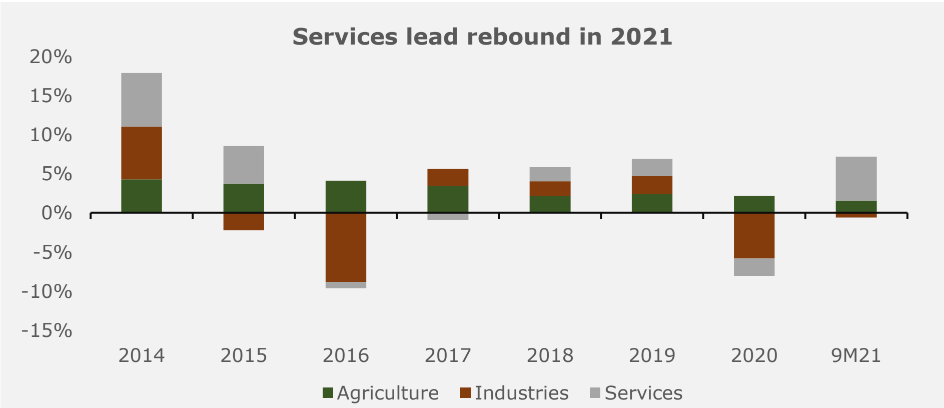
Base effects to wane in 2022

Since the great lockdowns of Q2'20, Nigeria has ruled out lockdown as a response measure to the pandemic. Data reveals that the country has witnessed three waves of the virus. The first wave peaked in Jul'20 following the reopening of the economy, a fiercer wave which spanned Dec'20 through Feb'21 and a milder wave, which peaked in Aug'21. Barely 3% of the population has been partly vaccinated against the virus, compared to 7% in Kenya and 27% in South Africa. The underwhelming vaccination rates can be attributed to supply chain disruptions associated with the outbreak of the Delta variant in India and vaccine hesitancy.



Source: Our World in Data, Vetiva Research

Nigeria is still nursing bruises from its worst recession in thirty years. Recovery, which began in the final quarter of 2020, is still underway. Following two quarters of sub-1% growth rates, the economy recorded a 5.01% y/y recovery in Q2'21. While this represents the strongest growth outcome in 7 years, the bright turnout was largely due to a low base effect. Comparing a 5.0% y/y recovery with a 6.1% y/y contraction, approximately 23% of real output loss is yet to be restored. In Q3'21, the economy aced slightly passed pre-pandemic levels by 0.4% following a 4.03% y/y growth outturn (Q3'20: -3.62% y/y). Compared with 2016 when the oil sector led the rebound, the services sector was responsible for the recovery in 2021 as the agricultural sector was flat amid sustained decline in the industrial sector.



Source: NBS, CBN, Vetiva Research

In 2021, the oil sector was majorly held back by deteriorating oil infrastructure, pipeline leakages, and difficulties in restoring previously closed reservoirs. Thus, the oil sector was unable to extract the fiscal and external gains from the surge in oil prices. Although the Petroleum Industry Act was finally passed, the timing of passage limits the potential output gains. Nonetheless, we retain a conservative outlook on the oil sector. Following an 8.9% y/y contraction in 2020, we envisage a 5.6% y/y contraction in 2021 as infrastructural defects prevent the country from meeting its quota. While the upward revision for Nigeria's production quota provides a tailwind for recovery in 2022, long-standing issues, Niger-Delta agitations, and production downturns could undermine recovery.

In 2022, we expect base effects to wane as economic activities normalize in the non-oil sector. This means the economy will grow at a slower pace in 2022. Nonetheless, the non-oil sector may have to grapple with foreign exchange volatility and higher energy prices, upon the possible floating of the Naira and removal of fuel subsidies. We would be assessing the components of GDP via three broad classifications.

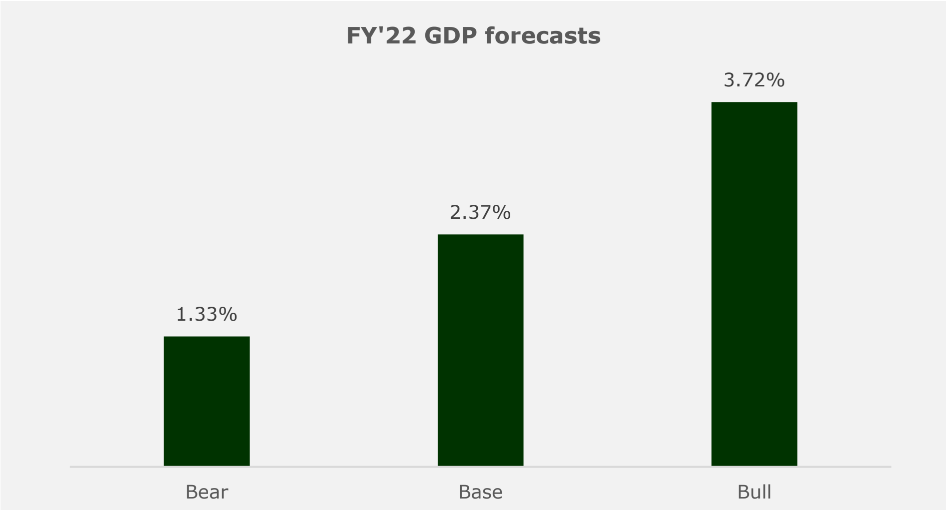
Beginning with the Agric sector, this sector has consistently recorded positive growth rates over the past decade despite numerous challenges from banditry, terrorism and supply chain disruptions. This is largely due to the intervention efforts of the CBN. The Agricultural sector could maintain its resilience into 2022 on the back of CBN's intervention efforts. News reports estimate that over 3 million farmers have benefitted from agricultural interventions. However, insecurity could remain a major risk to output growth apart from adverse weather conditions. Thus, we expect the Agricultural sector to expand by 2.1% y/y in 2022.

Away from agriculture, the industrial sector is expected to contract by 0.7% y/y in 2021 on the back of shrinking oil output amidst the rebound in manufacturing, construction, power, and utilities sectors. Crude production fell to record lows in 2021 due to pipeline leakages, deteriorating production infrastructure, and poor pipeline maintenance. Although OPEC+ production quotas were still in place, Nigeria was unable to ramp up output levels following the easing of production cuts, let alone meet its production targets. We expect this underperformance to persist into 2022. However, the sector could recover by mid-2022. On the manufacturing sector, we expect favourable demographics, interventions in the textile sector, and the inelasticity of the food, beverage & tobacco sector to buoy output levels. However, tacit devaluation and subsidy removal could raise input costs, drag consumer spending, and limit the pace of growth in the coming year. Construction could continue its steady pace of growth in 2022. However, increased politicking ahead of the 2023 general elections, could stall public capex growth in the course of the year, despite the early presentation of the budget.

In the services sector, we expect recovery to peak at 4.7% y/y in 2021. In 2022, we expect growth to slow to 2.2% due to uncertainties in the trade sector. Trade, which recorded a surprise recovery from a 5-year long recession could slip back into the negative territory as a result of retaliatory tariffs by neighbouring countries. This could wipe out the gains from border closure and feed into inflation numbers. Meanwhile, smuggling continues to understate trade output.

As a result of underwhelming performance in the trade sector over the years, the ICT sector could emerge the largest contributor to services GDP in a couple of years. Growth in the ICT Sector moderated in 2021 as a result of the restriction on SIM registrations due to the NIN-SIM linkage exercise. Following the lifting of these restrictions, we could see double-digit growths in the ICT sector. Next to the ICT sector is the real estate sector, which is responsible for c.11% of services GDP. We remain pessimistic about growth in the real estate sector due to foreign exchange concerns, high cost of construction, and largely limited fiscal space. Thus, we envisage a slight decline in real estate sector in FY’22.

Overall, we envisage a 2.37% y/y recovery in FY’22. However, we see three major risks that could thwart our expectations – FX volatilities, fuel subsidy removal, sustained downturn in the oil sector, and the eruption of a deadlier wave of COVID-19. Should any of these risks crystallize, growth could shrink to 1.33% y/y. Our bull case scenario (3.72% y/y) incorporates significant recovery in oil production, ramp-up of local refining, sustained expansion in the trade sector, and above average growth in the agricultural sector.



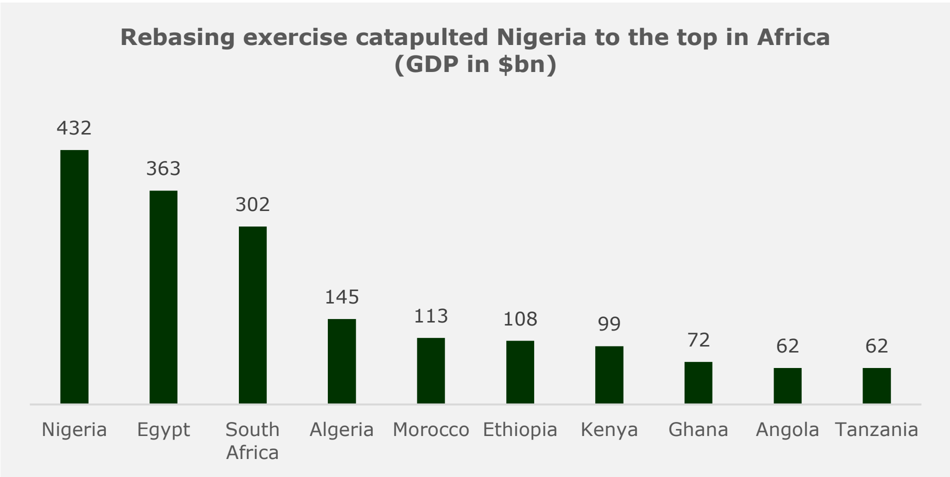
Source: Vetiva Research

Rebasing Exercise: New series could surface in 2022/23

The National Bureau of Statistics completed its last rebasing efforts in 2014, shifting the reference year from 1990 to 2010. The 2014 rebasing exercise resulted in the addition of information and communications services, arts, and entertainment to economic output. Following the exercise, Nigeria surpassed South Africa to become Africa's largest economy. Kenya, Tanzania, Uganda, and Zambia also completed rebasing exercises in 2014, which resulted in Kenya being reclassified from low income to lower-middle income according to the World Bank's criterion. The rebasing exercise is advantageous in that it allows stakeholders acquire a more accurate view of economic realities while making decisions. Although rebasing will not eliminate a country's macroeconomic bottlenecks, it will better prepare them to identify and implement policies that may address them. In accordance with best practices, the United Nations Statistical Commission (UNSC) recommends a 5-year interval for the exercise. In 2021, Kenya and South Africa also rebased their economies leading to an uptick in nominal output by 4% and 11%, respectively.

In Nigeria, 2018/2019 was chosen as the new base year, given the relative change in economic fundamentals. We believe the selected 2018/2019 year would be most appropriate considering the oil price crash of 2014, initial recession in 2016 and eventual recovery in 2017. Additionally, the pandemic created a highly unstable environment in 2020, making 2018/2019 the most plausible year for this exercise. Among the goals of this exercise is the provision of disaggregated data at the state level to identify sectors that contribute considerably to output and those that require government intervention.

In Nigeria, we envisage that after the exercise, access to current data in both quality and quantity could improve government strategies and investor confidence with the due date for the new series slated for either Q4’22 or Q1' 23.



Source: Trading Economics, Vetiva Research

Fiscal policy: Spending plans remain expansionary despite sticky revenues

Bucking historical trend, the current administration has kept to its schedule of timely presentation and passage of budgets, which has aided the implementation of fiscal policy. Our analysis reveals that spending plans rose the fastest during post-recession years - 2021, 2017, and 2018. This is in line with the expansionary fiscal stance embarked upon to close the negative output gap created by the recession. However, due to the heavy leanings towards recurrent expenditure, the multiplier effect of the increased spending has been minimal. Over the past six years, average growth in spending plans amounts to 18.4% y/y. The 2022 Budget proposal (₦16.4 trillion) is 12.5% larger than the 2021 initial and supplementary spending plans.

Tagged the Budget of Economic Growth and Sustainability, the budget proposal is hinged on the following assumptions: an oil price benchmark of $57/barrel, a daily production estimate of 1.88 million barrels per day, a GDP growth of 4.20%, and an inflation rate of 13.0%. With the exception of the GDP growth expectation, we believe the underlying assumptions are achievable. Nigeria's oil production has stalled for a better part of 2021 despite the easing of OPEC+ cuts. Further downturn in oil production could drag revenue downwards as oil revenue makes up 35% of projected revenue.

Recurrent expenditure remains the lead item on the spending list amid growing personnel costs. Out of the non-debt recurrent expenditure of ₦5.7 trillion, personnel costs gulp 60%. Meanwhile, the government's cost of funds is on the rise, as ₦3.6 trillion is set aside for debt servicing. Although planned debt service amounts to 39% of revenues, revenue underperformance has made the actual ratio exceed 50% in the past four years.

Due to the shift in the political climate towards the 2023 elections and sustained resistance from labour unions, the resurgence in subsidies could cause our negative fiscal balance to continually breach the legal limits of 3.0% to GDP. Revenue could be held bound by operational challenges in the oil sector. Expenditure, on the other hand, could rise significantly with the inability of the authorities to remove fuel subsidy by H2'22. The planned introduction of ₦5,000 subsidy relief for the poor upon removal of subsidy could buoy expenditure levels by ₦2.4 trillion. Either way, the government is poised to spend more and the cost could increase should social unrest arise following the enactment of the reform. Following the signing of the Petroleum Industry Act, subsidies ought to be expunged from the budget. However, we expect social resistance and election concerns to halt plans to remove subsidy. At best, we may see slight pump price increases as full removal may not be implemented until 2023. However, fading administrative will towards capital expenditure could surface in H2'22, as electioneering dominates the political scene. Should oil production be restored adequately, we could see fiscal deficit-to-GDP slightly above 3.0%. However, underwhelming oil production and a surge in pre-election spending could see our fiscal deficit-to-GDP rise to 5.0%.

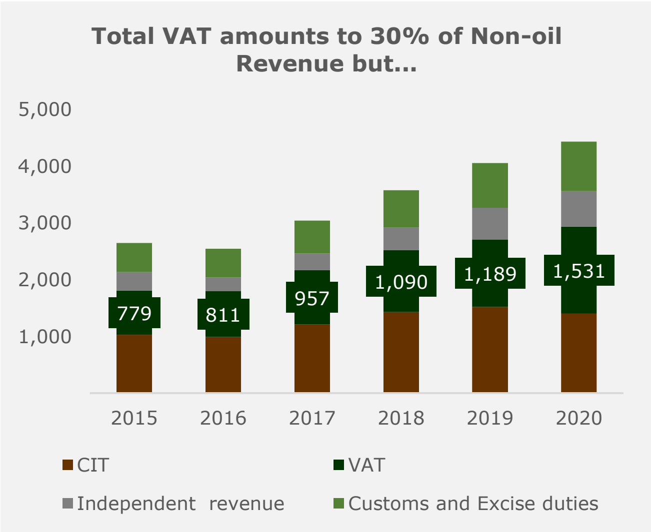
Budget Aggregates	Approved 2021 Budget	Proposed 2022 Budget	Variance (%)
Assumptions			
Oil price ($/bbl)	40	57	42.5%
Oil production (mbpd)	1.86	1.88	1.1%
Exchange Rate (₦/$)	379.00	410.15	-8.2%
Real GDP Growth rate (%)	3.00	4.20	40.0%
Inflation (%)	11.95	13.00	8.8%
Aggregate Revenue (₦'bn)	**7,886.0**	**10,123.5**	**28.4%**
Oil revenue (₦'bn)	2,011.0	3,531.0	75.6%
Non-oil revenue (₦'bn)	1,488.9	1,816.0	22.0%
Aggregate Expenditure (₦'bn)	**13,080.4**	**16,391.0**	**25.3%**
Recurrent (₦'bn)	8,994.3	10,731.0	19.3%
Capex (₦'bn)	3,603.7	4,891.8	35.7%
Statutory Transfers (₦'bn)	484.5	768.3	58.6%
Debt servicing (₦'bn)	3,123.4	3,902.0	24.9%
Deficit Financing			
Fiscal Deficit (₦'bn)	-5,194.4	-6,267.6	20.7%
Nominal GDP (₦'bn)	147,249.3	184,382.0	25.2%
Deficit-GDP (%)	-3.5	-3.4	-3.6%
Expenditure Ratios			
Recurrent -Total Expenditure (%)	68.8%	65.5%	-4.8%
CAPEX-Total Expenditure (%)	27.6%	29.8%	8.3%
Revenue Ratios			
Recurrent Expenditure-Revenue (%)	114.1%	106.0%	-7.1%
CAPEX-Revenue (%)	45.7%	48.3%	5.7%
Debt servicing - Revenue (%)	39.6%	38.5%	-2.7%

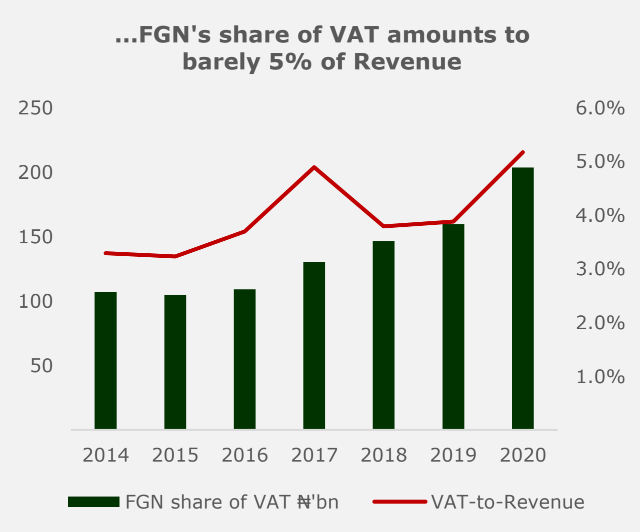
Source: Budget Office, Vetiva Research

FG-States VAT Row: Much worry for states, less for the Federal Government

Value Added Tax (VAT) is a consumption tax levied at several stages of production. VAT is the fastest growing non-oil revenue component. In 2021, a row over the collection of consumption tax erupted following a court order affirming that Rivers State government should collect Value Added Taxes (VAT) in its state, thus restraining the Federal Inland Revenue Service from collecting taxes in its state. The court ruling led to speedy passage of bills in both Rivers and Lagos State Governments.

Existing laws posit that state governments (50%) and local governments (35%) get 85% of net VAT collections, while the remaining 15% sits with the Federal Government. In 2020, a total of ₦1.5 trillion was collected from several sectors and states across the country. The Federal Government's share of VAT amounted to ₦203 billion, which is 13% of the total VAT collections and 5% of its Revenues. Thus, the row over VAT collection may have a more severe impact on states with low Independently Generated Revenues (IGR) should the Supreme Court rule in favour of the state governments. While Lagos State received 14% of total net VAT allocation in Feb'21, 4% was given to 3 other states including Rivers State. The rest received between 2% - 3% of total net VAT allocations. Thus, should VAT revenues be ceded to the state governments, less-privileged states could be worse-off while FG stomachs a revenue loss of 6%. Less-privileged states may require time to build structure required for VAT collection as collection inefficiency would persist. Multiple taxation could also arise from the disaggregated structure of businesses across the country. In all, we believe the current structure is necessary for fiscal federalism. However, a middle ground could be reached to address all parties.





Source: Budget Office, Vetiva Research

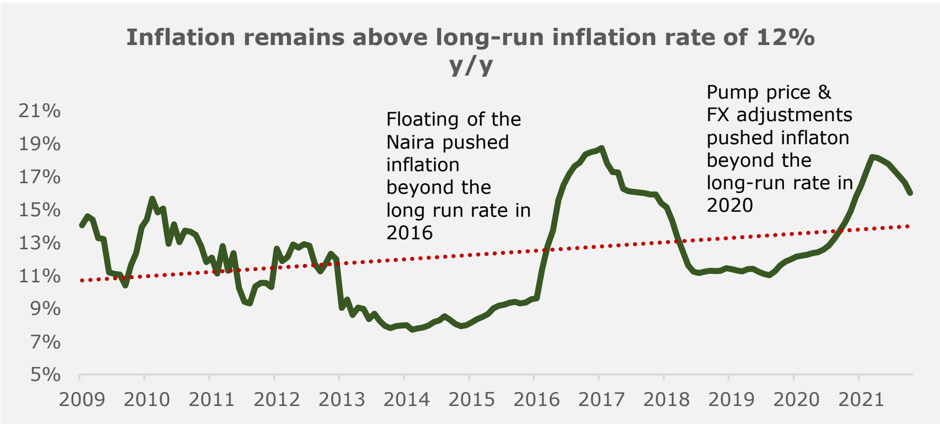
Debt outlook: Growing debt burden raises sustainability concerns

Nigeria's national debt stock has grown immensely over the years. The Debt Management Office (DMO) places the debt stock at $86 billion. While this precludes Ways and Means Advances, we see leg room for further borrowing over the medium term as a result of weak revenue mobilization and infrastructural deficit. The DMO had raised the debt-to-GDP limit from 25% to 40% in its medium-term debt strategy for 2020–2024. Already, the Debt Management Office has released guidance on the issuance of a Sukuk bond to the tune of ₦200 - ₦250 billion to finance critical infrastructural projects in the country. Meanwhile, debt financing and loans would finance the budget deficit and add c.$15 billion to the total debt stock. While monetary deficit financing may cloud the pace of debt accumulation, official debt-to-GDP figures could rise from 21% currently to 25% in 2022.

Debt servicing has been rising over the years. Amid weak revenue mobilization, debt servicing gulped an average of 61% of revenues pre-pandemic. The metric skyrocketed to 83% in 2020, as the government prioritized debt repayments despite the COVID-19 pandemic. Due to the minimal gains from the Debt Service Suspension Initiative, the Federal Government preferred to settle its creditors. Going into 2022, we expect debt-servicing-to-revenue ratio to improve slightly as higher oil prices and a pick-up in oil production supports revenues. Thus, debt servicing-to-revenue could moderate to 60%-70%.

Inflation: Subsidy removal would be a deciding factor in 2022

An average Nigerian finds it hard to believe that inflation is falling. This can be attributed to three reasons. One, inflation rate remained largely above the long-run rate of 12% y/y. Two, the NBS needs to review the components of its CPI baskets, to align survey outcomes with market realities. Three, the rapid build-up in commodity prices shows commodity prices were not immune from supply-chain disruptions, global food inflation, and the depreciation of the Naira. While we cannot but acknowledge these pressures, a glance through data shows that the removal of fuel subsidies had a greater impact on consumer prices than any other factor on a month-on-month basis. In January 2012, the country witnessed its highest month-on-month inflation outturn of 3.35% m/m, which coincides with the removal of subsidies and the Occupy Nigeria protests. We may see this replaying in 2022 should subsidies be removed fully as planned.



Source: NBS, Vetiva Research

We recall that in H2’20, the pump price of Premium Motor Spirit (PMS) was adjusted upwards at least three times. In addition, a double adjustment of the exchange rate was enacted. These twin forces reinforced a high base, and as a result, inflation began to trend downwards from April 2021, shortly after the Petroleum Products Pricing Regulatory Agency (PPPRA) rescinded its decision to hike PMS prices.

Consequently, retail inflation fell at a seemingly faster pace as base effects from earlier reforms failed to loosen grip over inflation. Despite seven months of disinflation, inflation still remains 24bps above 2020’s close (15.75% y/y). The deceleration in headline inflation was driven primarily by food inflation, which concurrently descended from its peak in March. Unlike headline inflation, food inflation has fallen 122bps from the previous year’s close on the back of rapid intervention in a food blockade, sustained intervention of the Central Bank, and flat PMS prices. However, with food inflation in its high teens, consumer welfare continues to diminish. On the other hand, core inflation remains pressured by weaker exchange rates. As of Oct’21, core inflation sits

186bps above 2020's close. Going into 2022, we expect further moderation in headline inflation. However, we provide alternative scenarios to guide our expectations.

Base case (12.5% y/y): Our base expectation is hinged on the retention of fuel subsidies, modest improvement in agricultural production, and stability in the foreign exchange environment. Despite the passage of the Petroleum Industry Act, we do not expect subsidy reforms in 2022 due to labour union pressures and election concerns.

Bull case (11.0% y/y): Our best-case scenario incorporates retention of fuel subsidies, an appreciation in the exchange rate, significant improvement in local food supply, and removal of restrictions on food imports. Here, we see a replay of the 2017 FX scenario, where there is a massive appreciation in the parallel market and a narrower official-parallel market gap.

Bear case (16.0% y/y): Removal of fuel subsidies in the second half of 2022, sustained depreciation in the exchange rate, and elevated insecurity challenges could ignite inflationary torches in 2022.

Monetary Policy: Neutral outlook with hawkish tendencies

In 2021, the Central Bank of Nigeria was largely accommodative, keeping all policy rates constant. True to its prognosis, inflation began its downtrend in Q1'21 substantiating its wait-and-see approach, while influencing its policy variables through alternative measures. As a result of its pro-lending policies, credit growth has averaged 20% in the past three years. In 2021, credit to the private sector has grown by 12% YTD (2020: 13% y/y) while credit growth to the government has slowed down to 5% YTD (2020: 31% y/y).

Despite flat benchmark rates, lending rates remain in double digits. Over the years, the spread between maximum and prime lending rates has expanded. From 5% in 2010, the spread has risen to 15.4% in 2021, mirroring the mounting challenges in the business environment. Although the maximum lending rate has reduced marginally between Q4'20 and Q3'21, they remain in the high twenties. As a result, this weakens the transmission policy of earlier rate cuts. While the apex bank maintains its loan-to-deposit ratio (LDR) policy, the bank has rolled out new initiatives to drive credit to the private sector.

The '100 for 100' policy is one of the most recent initiatives of the apex bank to drive credit growth to the private sector. According to the CBN, the initiative would select 100 private sector companies with projects that have potential to significantly increase domestic production and productivity, reduce imports, increase non-oil exports, and overall improvements in the foreign exchange generating capacity of the Nigerian economy. On a quarterly basis, a new set of 100 companies would be selected. While the broad objective of the initiative is to reverse Nigeria's overreliance on imports, emphasis would be placed on companies in the manufacturing, agriculture, extractive industries, petrochemicals and renewable energy, healthcare and pharmaceuticals, logistics and other activities prescribed by the CBN. Loans under this intervention would be in single-digits (5% up to Feb'2022 and 9% thereafter).

Going into 2022, higher premiums could be required from investors due to broad-based monetary policy normalization that may arise in 2022 and political risks associated with the 2023 general elections. Thus, we pen down two scenarios: a HOLD decision throughout 2022 and a 100bps rate hike to 12.5%. The current stance suggests the CBN could remain accommodative. However, in extreme cases, external pressures could cause the bank to hike rates to attract portfolio investment.

E-Naira: A monetary tool for economic harmony

Since 2012, the CBN has been implementing a cashless policy system, which brought about the use of ATMs, Point of Sales machines, and other innovations in the financial ecosystem. While currency in circulation doubled over 10 years, the value of digital transactions has achieved the same feat within four years. This underscores the numerous benefits associated with the ease of transacting via digital means. The most recent innovation that is currently been adopted across the world is the Central Bank Digital Currency (CBDC). Amid widespread adoption of privately-owned digital currencies, central banks have taken advantage of the underlying blockchain technology to build their CBDCs. In addition, widespread adoption of cryptocurrencies could weaken the apex bank's oversight over the financial system.

After four years of research, the Central Bank of Nigeria (CBN) has finally rolled out its CBDC, the e-Naira. The e-Naira is a legal tender and the digital equivalent of the physical Naira. Thus, the e-Naira is non-interest bearing and cannot be accessed by banks to issue loans. It is pertinent to note that widespread adoption could impact banking system liquidity negatively. This is the reason we believe limits were introduced based on Know-Your-Customer (KYC) requirements. With respect to manner of operations, speed wallets will be operated by consumers while merchants have their own wallets. Unlike individuals which have wallet limits, merchants could activate auto-triggers that can be generated to transfer funds that exceed a threshold to their bank accounts. We believe these limits were introduced for risk management purposes and to prevent liquidity challenges in the banking system.

Wallet	Tier	Category	Requirement	Daily Transaction Limits	Daily Cumulative Balance
Individual	0	Non-Bank Account Holders	Telephone number (Awaiting NIN verification)	20,000	120,000
	1	Non-Bank Account Holders	Telephone number (NIN verified)	50,000	300,000
	2	Bank Account Holders	BVN	200,000	500,000
	3	Bank Account Holders	BVN	500,000	5,000,000
Merchant		Bank Account Holders	BVN, TIN, and Bank Confirmation	None	None (with auto-sweep trigger)

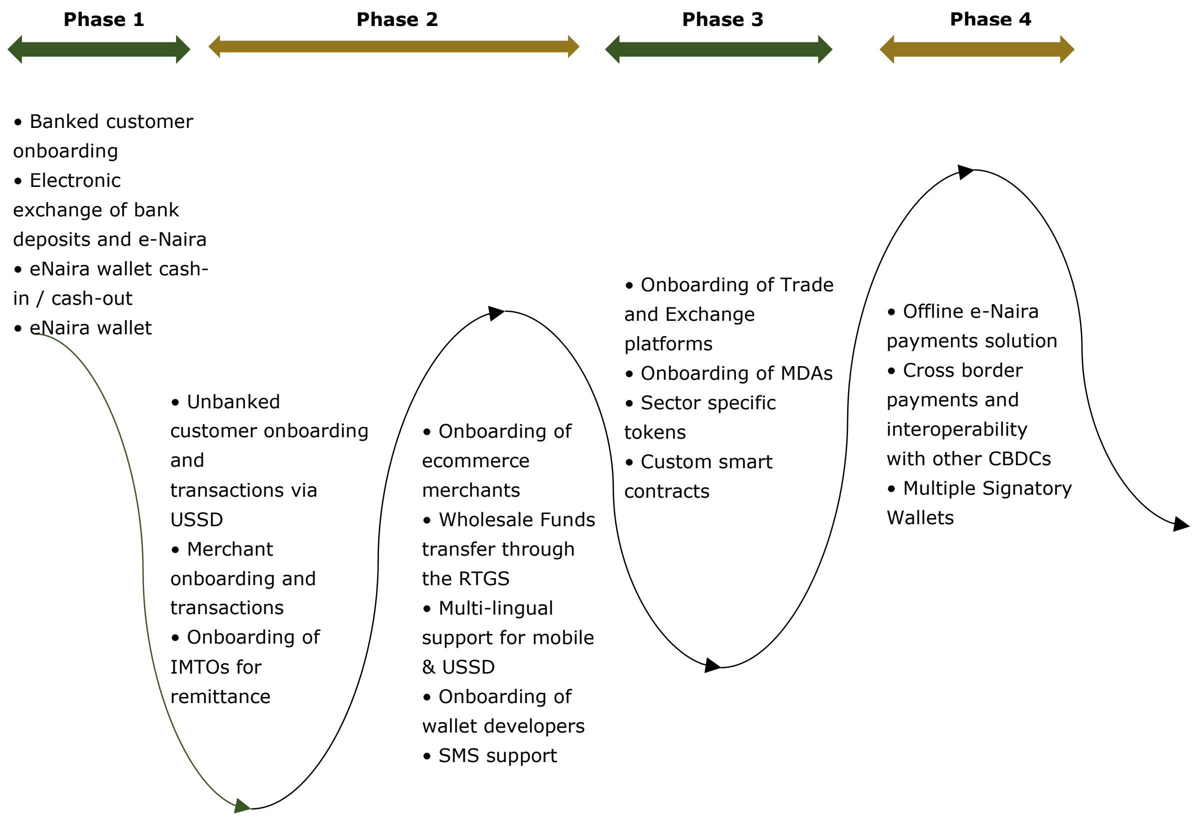
Source: CBN, eNaira.com, Vetiva Research

At the outset, the rollout of the e-Naira stalled due to uncertainty about the new offerings of the CBDC. As seen in the implementation roadmap of the e-Naira, the unique features of the e-Naira would be unveiled as the phases are exhausted. With respect to existing structures, the presence of internet banking, mobile apps, and Unstructured Supplementary Service Data (USSD) have aided the flow of financial resources between two or more parties. In this regard, the eNaira could be a viable option if the cost of transacting is significantly less than the substitutes in the ecosystem. We believe this influenced the decision to eliminate transaction charges for the first 90 days of use. According to the apex bank, transactions performed on the eNaira platform will be free for the first 90 days, after which respective charges as indicated in the Guide to Charges by Banks, Other Financial, and Non-banks would apply. We foresee that while this may increase acceptance in the short term, the subsequent introduction of charges may lessen the eNaira's substitutionary impact on existing online banking and fintech platforms unless transaction costs are lesser.

The integration of Unstructured Supplementary Service Data (USSD) services for the unbanked could help foster financial inclusion. Given the integration of USSD services into the framework, transactions could take place on non-internet-enabled phones. Thus, areas that are fairly banked can be reached. However, increased sensitization by the Nigerian Orientation Agency (NOA) and the Central Bank of Nigeria (CBN) is required to boost the financial literacy of citizens in remote areas. Even as the CEO of Bitt Inc., the CBN’s technical partner mulls over developing an app for non-bank owners, enablement of multi-lingual support could achieve the CBN’s goal of financial inclusion.

The onboarding of International Money Transfer Operators (IMTOs) could help attract remittances. However, we note that the success of this feature would be tied majorly to the use of a market-reflective exchange rate and lower transaction costs. Should these conditions be met, we could see the parallel market rate appreciate as patronage of unofficial channels reduces provided foreign exchange supply remains adequate. In addition, the onboarding of Ministries, Departments, and Agencies could help engender fiscal transparency and tackle corruption.

In the final phase, the possibility of exchanging the e-Naira for other CBDCs could help foster cross-border payments. With China, a major trade partner, advancing its e-Yuan to advanced stages, this feature should theoretically reduce the dollarization of the Nigerian economy.



Source: CBN, eNaira.com, Vetiva Research

Theoretically, the e-Naira should improve credit flow in the economy and strengthen the transmission mechanism of monetary policy. The ability to transact using non-internet enabled phones with multi-lingual support also provides a strong foothold for financial inclusion. The sign-ups of MDAs could also foster transparency and accountability in the fiscal space.

Nigeria's young population is also a strength, as they could easily adopt the innovation unlike the elderly population, who prefer facetime with financial institutions and have limited scope for innovation. The eNaira could also increase the bank's oversight over the financial system, ensuring IMTOs are not circumventing the process, and this also reduces the likelihood of fraud across the ecosystem.

The reluctance of merchants and individuals to take up the e-Naira could be a key weakness. Coupled with the fact that transaction costs would be introduced after the 90-day window, this could discourage the take-up of the e-Naira. Considering remittances, while it is not clear whether the transaction costs would be lesser, there is a likelihood that the exchange rate could be artificially low. Thus, this may not have a material impact on unofficial channels.

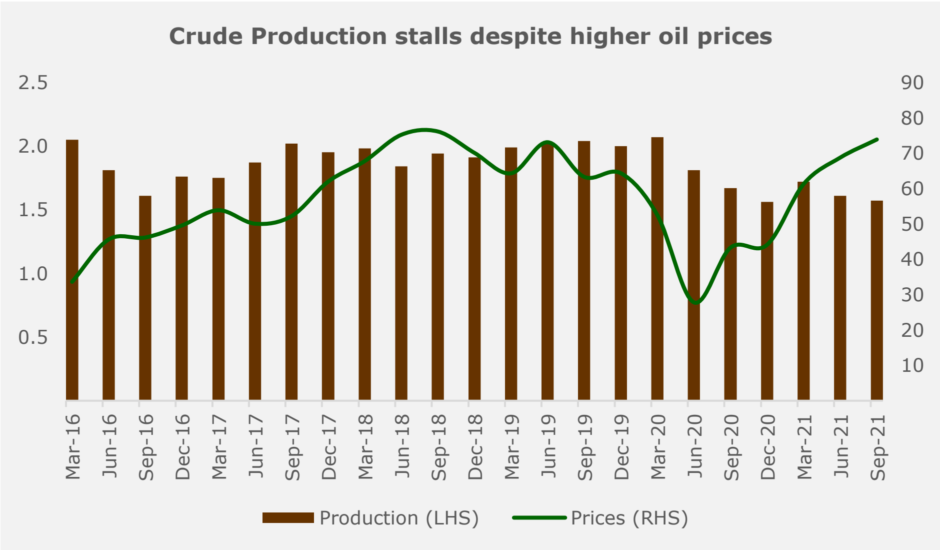
In the medium term however, there are opportunities from the introduction of the eNaira. Enablement of cross border transfers and ability of individuals to exchange CBDCs for another could also be high points to watch out for. This could help to de-dollarize economies and facilitate transaction flows globally. However, this could require cross-country cooperation and could require tight cybersecurity measures to avoid hacking and other cyber-vices. In addition, the federal government could extend social transfers to beneficiaries electronically. This could be useful at advanced stages of development and could also be deployed via conditional cash transfers to encourage sign-ups in rural areas.

The threats from the CBDC issuance includes obvious cybersecurity threats following reports of hackers getting into some exchanges. However, with pent-up investment in cybersecurity, this risk could be mitigated. We also note the risk from massive sign-ups by individuals. This could reduce the deposits that are required for banking system liquidity and result to reduction in the availability of funds for lending or investing. However, we believe existing limit on daily transactions and overall balance could help mitigate this threat.

External Outlook: A leap into the future

Current Account Analysis

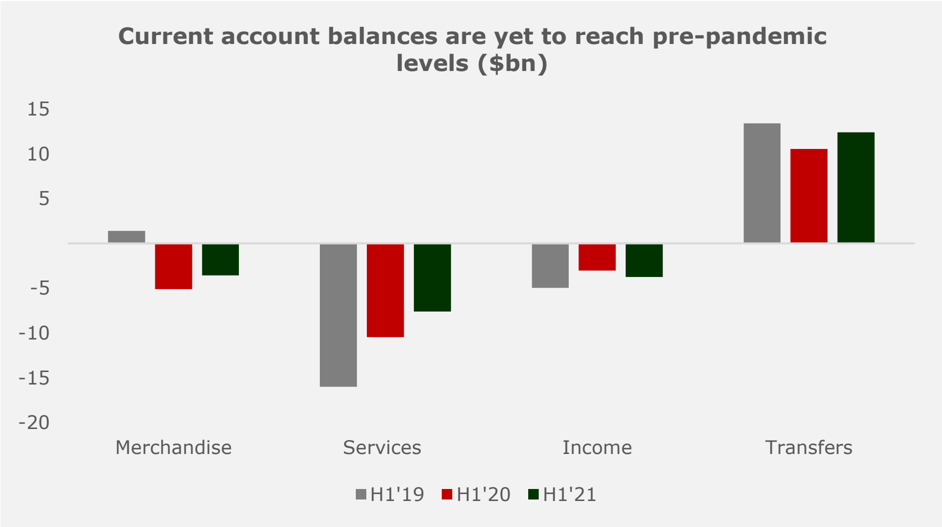
In 2021, oil prices recovered fourfold from lows of $19/barrel in 2020 to multi-year highs of $83/barrel. Nigeria was unable to maximize the surge in oil prices as oil production continued to fall. While OPEC+ agreement raised production quota to 1.67 mb/d, oil production averaged 1.6 mb/d. The fall in oil output has been linked to deteriorating infrastructure, pipeline leakages, and poor maintenance. Within the first six months of the year, trade balance remained in a deficit position despite the marginal trade surpluses in April and May.



Source: CBN, NBS, Vetiva Research

Meanwhile, deficit in the services segment moderated in H1'21 due to the high base from Q1'20. On the other hand, deficit in the income segment expanded by 23% y/y in H1'21 due to higher investment income generated by non-residents of the Nigerian economy. The transfer segment remained in the positive territory due to remittance inflows. In H1'21, the CBN introduced the Naira for Dollar policy to incentivise remittance inflows. This improved remittances by 15% q/q in Q2'21, compared to 5% in the preceding quarters. However, remittances are yet to return to pre-pandemic levels due to proliferation of alternative channels. A successful rollout of the e-Naira could help propel remittances to pre-pandemic levels, provided transaction costs are reduced and exchange rate is competitive. Consequently, Nigeria's current account deficit has narrowed to 0.44% of GDP.

In 2022, we expect a pick-up in the oil sector to narrow the deficit in the goods segment. However, a surge in imports could cause the deficit to persist. In the services segment, the exodus of Nigerians to greener pastures could expand the deficit in the services segment to pre-pandemic heights, while relatively higher yield environment supports the income segment. The integration of International Money Transfer Operators (IMTOs) in the e-Naira app could support the build-up in remittances and preserve the surplus in transfer segment. A successful rollout could see remittances build up significantly and bolster reserve levels in 2022.



Source: CBN, Vetiva Research

Given the ultra-low yield environment on the global scene, portfolio investors have favoured the Nigerian fixed income market over the domestic equity market, placing their funds in money-market investments. Foreign direct investors, on the other hand, reinvest their earnings to support their investments in the country. We expect investors to request higher premiums on their investment in 2022 on the back of monetary policy normalization on the global scene and elevated political risks ahead of the 2023 general elections.

FX Outlook: Can the Naira be floated in 2022?

The Naira was unable to benefit from the oil rally in 2021 as external reserves declined steadily in H1'21 amid mounting import demands, external debt redemption, and increased travel demands. With unattractive yields keeping foreign portfolio investment at bay, the sustained weakness of the Naira eroded the returns of existing investors. Thus, higher yields ensued on fixed income instruments, in a bid to attract/retain investments. In 2022, portfolio investors could shy away from Naira assets unless compensated by higher yield environment and a market-reflective exchange rate. Constraint on investment flows during times of crisis has been a sticking point for portfolio inflows.

Away from portfolio investments, diaspora remittances are another point of call. According to data released by the CBN thus far, remittances are yet to return to pre-pandemic levels despite the 'Naira for Dollar' policy of the CBN. In Mar'21, the CBN decided to give ₦5 for every $1 received through the official channels. While the policy had a short-term impact on the Naira, the fundamental FX supply constraints remained and as a result, the Naira fell free in the parallel market. As noted in an earlier segment, the integration of IMTOs with the e-Naira could support remittances in the coming year, provided transaction costs are lower and the exchange rate is market-reflective. We believe the existence of unofficial peer-to-peer channels contributed to the proscription of cryptocurrency dealing by the apex bank, besides insulating the financial system from system risks. Amid the decline in FX liquidity, the apex bank embarked on some bold currency reforms including the adoption of the Nigerian Autonomous Foreign Exchange (NAFEX) rate as the official exchange rate. While this narrowed the official-parallel market gap briefly, the ban on FX sales to Bureau de Change (BDC) operators contributed to the widening of the gap as the Naira slipped to new highs of ₦575/$. Although there has been some appreciation to ₦545 levels in Q4'21, we attribute this modest appreciation to the peak period which climaxed in September as opposed to the absence of parallel market data aggregators following the apex bank's proscription of Abokifx.

In the coming year, the CBN Governor has hinted at a possible floatation of the Naira. This decision is hinged on the take-off of the Dangote Refinery, which could lead to FX savings for the economy. In our opinion, we still see the CBN adopting the managed exchange rate regime, as the same timeline has been selected for the removal of subsidies. However, we expect the CBN to monitor the accretion in external reserves, as a result of the FX savings from the project. Nonetheless, a possible postponement of the completion date could be carried out as done in the past. Thus, we remain cautiously optimistic about a possible floatation of the currency in 2022.

Furthermore, we note that substantial recovery in oil production would be essential for an organic build-up in external reserves. With the absence of any substantial Eurobond maturities in 2022, domestic import demand may continue to take its toll on external reserves. In event of constrained receipts, the CBN could add more products to the FX restriction list. Meanwhile, external borrowings could support reserve levels in 2022. A modest recovery in oil production and remittances could keep external reserves above $35 billion. A stronger-than-expected recovery could keep reserve levels above $40 billion. External fund raise could also support reserve levels in 2022.

We expect the NAFEX rate to depreciate to ₦430/$ levels. Our bull expectation is that the Naira could stabilize at ₦410 levels on the back of oil receipts and renewed remittance inflows. In the parallel market, pre-election spending could result to increased demand for the greenback. Alternatively, an increase in FX supply could see a massive appreciation in the parallel market to ₦480/$. On the flip side, a mix of sustained downturn in oil production, declining remittances, deeper risk-off sentiments, and heighted political uncertainty could see the parallel market rate fall towards ₦600/$.

Vetiva Exchange Rate Forecast				
Period	Indicator	Forecasts Worst	Base	Best
	Reserves ($'mn)	35,396	40,883	41,477
Jan-22	I&E (₦/$)	440	418	400
	Parallel (₦/$)	594	574	520
	Reserves ($'mn)	35,061	38,808	41,989
Mar-22	I&E (₦/$)	445	420	402
	Parallel (₦/$)	605	595	515
	Reserves ($'mn)	34,301	37,928	41,323
Jun-22	I&E (₦/$)	450	423	405
	Parallel (₦/$)	615	593	510
	Reserves ($'mn)	33,520	36,712	41,659
Sep-22	I&E (₦/$)	455	426	408
	Parallel (₦/$)	620	590	490
	Reserves ($'mn)	32,737	37,591	41,007
Dec-22	I&E (₦/$)	460	430	410
	Parallel (₦/$)	650	588	486

Forecast Assumptions			
	Worst	Base	Best
Jan-22	Brent (avg.): $53/bbl	Brent (avg.): $77/bbl	Brent (avg.): $95/bbl
	Imports restriction: Yes	Imports restriction: Yes	Imports restriction: Yes
	Risk-off sentiment	Risk-on sentiment	Risk-on sentiment
	Crude oil sales: low	Crude oil sales: moderate recovery	Crude oil sales: strong recovery
	Spending limits relaxed: Yes	Spending limits relaxed: No	Spending limits relaxed: No
	Remittances: low	Remittances: modest	Remittances: strong
	Retention of ban on BDCs	Retention of ban on BDCs	Relaxation of ban on BDCs
			External fundraise
Mar-22	Brent (avg.): $53/bbl	Brent (avg.): $77/bbl	Brent (avg.): $95/bbl
	Imports restriction: Yes	Imports restriction: Yes	Imports restriction: Yes
	Risk-off sentiment	Risk-on sentiment	Risk-on sentiment
	Crude oil sales: low	Crude oil sales: moderate recovery	Crude oil sales: strong recovery
	Spending limits relaxed: Yes	Spending limits relaxed: No	Spending limits relaxed: No
	Remittances: low	Remittances: modest	Remittances: strong
	Retention of ban on BDCs	Retention of ban on BDCs	Relaxation of ban on BDCs
			Eurobond raise
Jun-22	Brent (avg.): $53/bbl	Brent (avg.): $73/bbl	Brent (avg.): $95/bbl
	Imports restriction: Yes	Imports restriction: Yes	Imports restriction: Yes
	Risk-off sentiment	Risk-on sentiment	Risk-on sentiment
	Crude oil sales: low	Crude oil sales: moderate recovery	Crude oil sales: strong recovery
	Spending limits relaxed: Yes	Spending limits relaxed: No	Spending limits relaxed: No
	Remittances: low	Remittances: modest	Remittances: strong
	Retention of ban on BDCs	Retention of ban on BDCs	Relaxation of ban on BDCs
			Completion of Refinery
Sep-22	Brent (avg.): $50/bbl	Brent (avg.): $70/bbl	Brent (avg.): $93/bbl
	Imports restriction: Yes	Imports restriction: Yes	Imports restriction: Yes
	Risk-off sentiment	Risk-on sentiment	Risk-on sentiment
	Crude oil sales: low	Crude oil sales: moderate recovery	Crude oil sales: strong recovery
	Spending limits relaxed: Yes	Spending limits relaxed: No	Spending limits relaxed: No
	Remittances: low	Remittances: modest	Remittances: strong

	Retention of ban on BDCs	Retention of ban on BDCs	Relaxation of ban on BDCs Completion of Refinery
Dec-22	Brent (avg.): $50/bbl	Brent (avg.): $70/bbl	Brent (avg.): $93/bbl
	Imports restriction: Yes	Imports restriction: Yes	Imports restriction: Yes
	Risk-off sentiment	Risk-on sentiment	Risk-on sentiment
	Crude oil sales: low	Crude oil sales: moderate recovery	Crude oil sales: strong recovery
	Spending limits relaxed: Yes	Spending limits relaxed: No	Spending limits relaxed: No
	Remittances: low	Remittances: modest	Remittances: strong
	Retention of ban on BDCs	Retention of ban on BDCs	Relaxation of ban on BDCs Completion of Refinery

Source: Vetiva Research

Risks to the outlook

Given the events that surfaced in 2021, we acknowledge the following events as risks to the outlook. With COVID-19 caseloads rising and the discovery of the Omicron variant, health risks remain pronounced due to the disparity in vaccine coverage. From a property market crash in China to tighter financing conditions on the global scene, the financial and property markets could be risks to watch out for. On the continental scene, we see droughts as a key risk to economies, given the agrarian nature of African economies. Finally, heightened insecurity, unsystematic removal of fuel subsidy, and ensuing widespread protests/social unrest could be a key risk to the Nigerian Economy.

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