NIGERIA

MACRO ECONOMIC & BANKING SECTOR OUTLOOK

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Macroeconomic and Banking Sector Themes for 2013

This article presents our forecasts and opinions of the broad Nigerian macroeconomic and banking sector trends that we expect will shape the economic landscape in 2013.

Key themes/trends for 2013 include:

1. Stronger economic growth
2. FG Budget and its implications
3. Reforms: Prospects and markets
4. Some easing expected to aid growth
5. Banking sector themes
6. Emergence of the formal retail consumer

1 Stronger economic growth

- stronger GDP growth (7.5%) expected in 2013;
- inflation expected to stay within 11.5% - 12.0% band;
- political focus and drive (no pre-election year distractions);
- increasing foreign reserves and favorable debt profile; and
- improving macroeconomic profile (JPM Emerging Markets Bond Index and S&P ratings upgrade)

Outlook: 2012 GDP growth estimates currently stands at 6.77%, which is 13% lower than 2011's 7.67% growth. Despite this relatively weaker estimate, we believe that this is a strong finish for 2012 due to several challenges which occurred during 2012. Beyond the floods, other factors that in our opinion dampened growth in 2012 include the effects of the tight monetary policy, lack of significant progress on anticipated reforms and two weeks of lost productivity as a result of the fuel-price increase related civil unrest in January 2012. For 2013, we expect stronger GDP growth of 7.5% driven primarily by:

- non-oil sector growth (agriculture, telecoms, manufacturing, construction, retail etc);
- the conclusion of current government reforms and privatization efforts (Petroleum Industry Bill ("PIB"), power sector privatization etc); and
- easing of current monetary policy stance by the Central Bank of Nigeria ("CBN") (credit growth).

In our opinion, the current spikes in food and core inflation will be short lived as we expect the full dissipation of some of the contributory elements (2012 fuel & tariff increases and floods) by Q1 2013. The likely increase in fuel prices in 2013 is expected to have a similar short lived effect on inflation as in 2012 and even less so as we expect most organizations have built this possibility into their 2013 budget. Overall, Nigeria still remains among the fastest growing countries in its peer group and we see that momentum continuing into 2013 with expected GDP growth rate of 7.5% vis-à-vis the current world average of 3.7%.

- Nigeria - BRIC peers
- Other peers - Average
Source - World Bank

Chart Keys

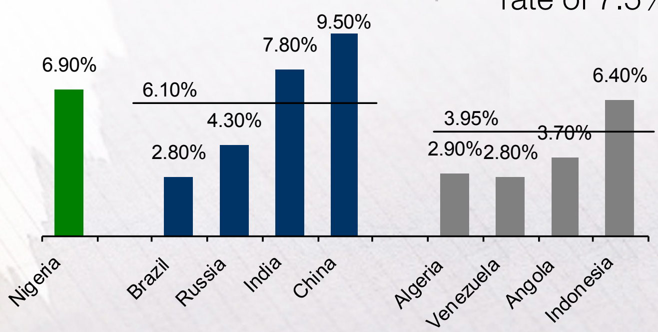

Exhibit 1: 2011 real GDP growth

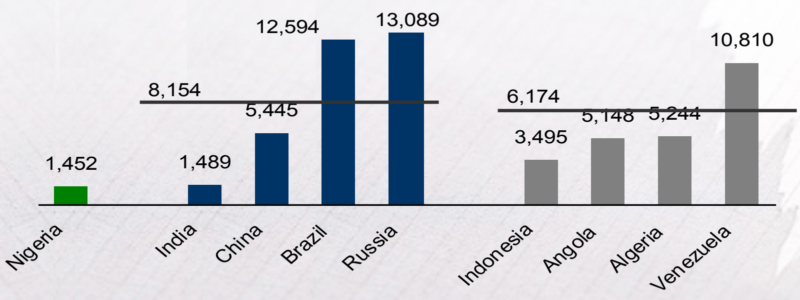

Exhibit 2: Growth potential (GDP per capita in US$)

2 FG Budget & implications

- 2013 budget set at N4.92trn (up 4% from 2012);
- reforms and privatization expected to drive growth;
- increased focus on security; and
- Inadequate provision for fuel subsidy signals price increase

Outlook: The Federal Government presented its 2013 budget of N4.92trn in November 2012. A few budgetary allocations of interest include fuel subsidy, power, agriculture and security.

It can be inferred that based on the under-allocation for fuel subsidies in the 2013 budget that the FG intends to either reduce or completely eliminate fuel subsidies in 2013. As can be seen from 2012, fuel price increases did not have a sustained impact on productivity or inflation. Consumers initially reacted by altering consumption patterns and by becoming more efficient, which led to the elimination or reduction of initial pricing spikes as retailers and service providers reverted pricing to counter dropping demand. The 2012 fuel price increase did however have a minor impact on 2012 GDP, through the two week strike in January 2012 which cost an estimated N100 billion per day in lost productivity. We expect that the FG will be better equipped to prevent loss of productivity in the event of a fuel price increase in 2013.

Allocation to power and agriculture were reduced by over 50% in the 2013 budget. We interpret the 54% drop in power sector allocation as an indication that the FG remains committed to the ongoing privatization program. We also estimate from the 71.2% drop in agriculture spend, that the FG is more focused on encouraging private sector involvement in the growth of the sector.

Allocation to security was 21% of the 2013 budget, up from 14% in 2012, which shows a resolve to tackle the emerging social problems before they evolve to major economic problems.

3 Reforms expected to be concluded in 2013

- Power sector privatization;
- Petroleum Industry Bill ("PIB"); and
- reforms in agriculture and transportation sectors.

Outlook: We hope that given the progress thus far, the power sector privatization process will be concluded by mid 2013. The unbundling of the power sector all at once may overwhelm the market, however we foresee significant market activity as both international and local players work together to absorb all generating and distribution assets being offered for sale. While the industry currently celebrates an all time peak generation of 4,349.7MW, this represents about a tenth of that produced by South Africa which has less than a third of Nigeria's population. The shortfall highlights the potential opportunity which many have estimated will surpass the boom created by the privatization of the telecoms industry over a decade ago.

We expect the long awaited PIB to be concluded in 2013 having undergone significant review.

The agriculture sector continues to receive developmental support from the FG and CBN as the government aims to diversify and boost the non-oil sector's contribution to GDP. The FG's aim has been to encourage greater participation from the private sector in driving the growth of this sector. Increasingly, the government is banning the importation of several food items with sugar being the latest proposed ban and rice being likely in 2013 given the government's goal for self sustenance by 2015. We foresee significant growth and demand in 2013 from the agriculture sector with the recent entry of foreign players and increasing consolidation, sophistication and competition among food and beverage manufacturers looking for efficiency through backward integration and sourcing an increasing amount of raw materials locally.

4 Some easing expected in 2013

- CBN expected to relax its tight monetary policy
- MPR expected to hold steady at 12%
- Exchange rate expected to slide marginally to NGN165/US$
- Increased system liquidity expected, lower CRR, lower yields on TBills

Outlook: The Naira witnessed some appreciation during the year, with interbank and parallel market rates converging on the official rate, which has been relatively stable around a notional rate of $1/N155.76, contrary to 2012 forecasts of $1/N165 - N170. Part of the Naira's appreciation is attributable to CBN's tight monetary policy aimed at reducing excess system liquidity, curtailing currency speculation and attaining price stability.

Going into 2013, we expect that in line with the FG's agenda for economic growth and development, the CBN will relax some of its monetary measures. Of the options available to the regulator, we anticipate the easing will come via a reduction in government securities offered for sale and/or a reduction in CRR requirements for banks. In our opinion, the monetary policy rate and Net Open Position restrictions will remain unchanged at 12% and 1% respectively. We expect these measures to be gradual and that the CBN will continue to intervene in the market to ensure that excess liquidity and currency speculation are kept to a minimum.

We anticipate a rise in demand for foreign exchange in 2013 from a combined impact of an improvement in commercial activities due to growth in real sector credits and a resolution of outstanding petroleum subsidy payments which will herald the resumption of importation of products by marketers.

With demand for and supply of fixed income securities expected to moderate somewhat in 2013 as some foreign portfolio investors exit the market, foreign exchange rates are expected to come under pressure, with a widening of the spread between the official and interbank markets. We anticipate that interbank rates would revert to their early 2012 levels but peak at $1/N165 while the official rates will remain within the 3% of the $1/N155 base rate.

Exhibit 3: Official and interbank markets

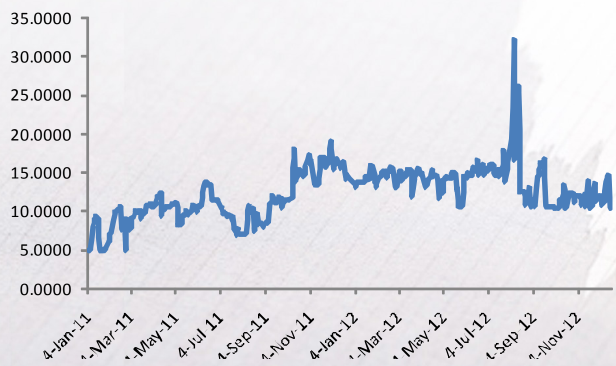

Exhibit 4: Money Market rates

5 Banking sector themes

- Increased confidence in banking sector (post successful intervention)
- Ratings upgrades for stronger banks (S&P and Fitch)
- AMCON expected to refinance bond in 2013
- Increasing focus on retail and middle market
- Entrance of foreign banks

Outlook: We estimate a 15% - 20% average credit growth in 2013. This is further supported by the weak growth of real sector credit in 2012. As at Q3 2012, credit growth from banks was less than 10%. With declining yields on government securities, banks are now being compelled to grow their loan books more aggressively with the middle market and retail customer base being the most likely beneficiaries. With decline in AMCON activity and the expected return of all banks to profitability by FY 2012, we project a continued rise in cost of funding (2% - 3%) as banks continue to compete for funding and customers become increasingly confident in the entire banking industry.

The AMCON Levy on banks was recently revised from 0.3% to 0.5% effective from January 2013. We estimate that this will have a 2-4% impact on the cost to income ratio for most banks but otherwise would not affect commercial activity. We also expect AMCON to refinance its existing bonds maturing in 2013, however, there is some uncertainty around if these bonds will be refinanced in part or in total.

We expect AMCON to sell at least 2 of its 3 banks in 2013. The likely candidates for acquisition of these banks would be international banks looking for an entry into the Nigerian market.

6 Emergence of the formal retail consumer

- Enabling environment – urbanization, financial inclusion, electronic banking (e-business, e-payments, internet banking), cashless Nigeria;
- Growth in middle class (size and income); and
- Entrance of international retailers of luxury and staple items

Outlook: With giant strides in financial inclusion, e-business and debit card penetration over the past 5 years, we have seen a gradual progression of informal retail sector consumers into increasingly sophisticated formal retail consumers. Developments in electronic banking, fostered both by the CBN and Nigerian banks, have created an environment in which retailers can increasingly capture a wider retail audience though e-payments. Approximately 65% of Nigeria's population is under the age of 24 years and we estimate that this demographic will naturally adopt our developing electronic transaction culture. The adoption of e-banking by youth and our growing middle class will lead to increasing opportunities for more efficient retailers and distribution systems.

We expect that following the entry of successful international retail franchises such as Shoprite, 2013 will see the entry of an increasing number of international retailers of both luxury and essential items. We also expect that existing retailers who have had a successful launch in Lagos will increasingly look upcountry for growth and expansion.

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