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Q3’20 GDP: How long until exit from recessionary waters?

Q3’2020 GDP: -3.6% YoY

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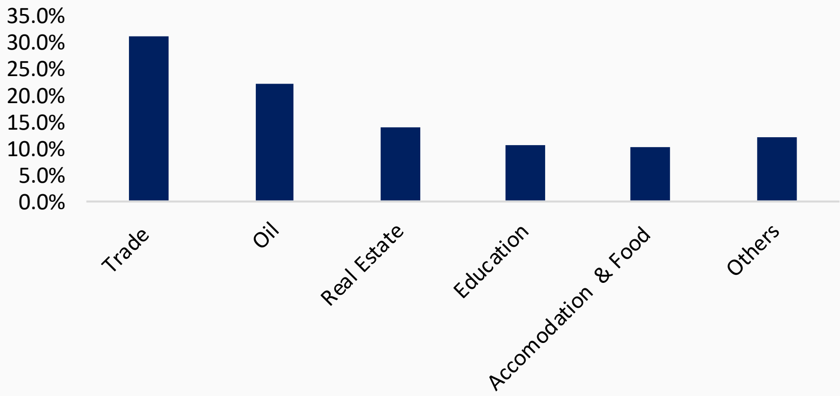
How long until exit from recessionary waters?

Data from the National Bureau of Statistics (NBS) revealed that the Nigerian economy has officially slipped into recession for the second time in 5 years, as the economy contracted by 3.62% YoY in Q3’20. Nigeria has joined a list of over 30 countries (including the US, Israel, Japan, Germany) to have experienced a recession in 2020, as COVID-19 outbreak weighed heavily on global economic activity. In line with our forecast of -3.76%, the third quarter economic contraction of 3.62% reflected contractions in both oil (-13.9% YoY) and non-oil (-2.51% YoY) GDP segments. While the non-oil sector contraction mirrored trade frictions, weaker consumption, and a fall in investments, oil weakness reflected impacts of OPEC+ cut agreements and a COVID-19 induced slowdown in global travel. For context, oil production collapsed by 18.13% YoY to 1.67 mbpd, representing its lowest level since the vandalism-driven pressures of the third quarter of 2016. Cumulatively the economy has contracted by 2.48% YoY in 2020, the worst contraction in 30 years.

Trade weakness was responsible for almost a third of the GDP contraction

The trade sector, which mostly reflects reselling activities, has remained weak since the commodity shock of 2014-2016 that decimated consumer purchasing power. A combination of c.94.1% naira depreciation (since the start of 2016), 89.8% rise in general price levels and stagnant wage growth were the main drivers of weaker consumer purchasing power and trade declines before 2019. COVID-19 induced lockdowns, supply chain disruptions, FX accessibility issues and sustained border closures have only exacerbated the decline in the last two quarters (Q3’20: -12.1% YoY, Q2’20: -16.6% YoY), consequently setting trade activities back to 2012 levels. Notably, the recent contractions have shrunk the sector’s contribution to GDP to 13.9% (2015: 16.9%; 2019: 16.0%). But for the contraction in the sector, GDP would have declined by only 1.8% in the third quarter.

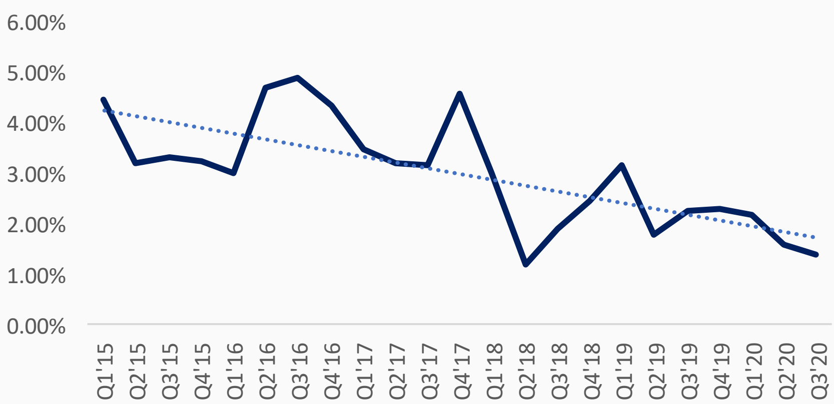
Figure 1: Trade contribution to total GDP contraction



Sources: NBS, CardinalStone Research

Declines in other manufacturing and some services sub-sectors compounded the adverse impacts of trade weakness on the economy, even though telecoms and construction sectors provided some support to aggregate output. Telecoms sustained its impressive growth momentum (+17.4% YoY) as movement restrictions accelerated the adoption of virtual communication, while construction (+2.84% YoY) appeared to have benefited from limited rainfall and greater government focus on the sector. The agricultural and financial sectors also recorded growths in the quarter, albeit considerably slower than those of previous quarters. Growth in agriculture (+1.4% YoY) has materially slowed (average of 2.2% in the last eight quarters vs prior 5-year mean of 3.5%) despite prolonged monetary and fiscal support. We link the growth moderation to insecurity concerns, structural impediments to productivity. The drags on the sector may have been heightened by the adverse impacts of flooding in several foods producing regions in Q3’20. Similarly, a slowdown in loan creation amid asset quality concerns and weak macro conditions appeared to have forced normalisation of growth in the financial sector (+3.2% YoY), which had hitherto enjoyed double-digit growth on the back of CBN’s LDR policy.

Figure 2: Trade contribution to total GDP contraction



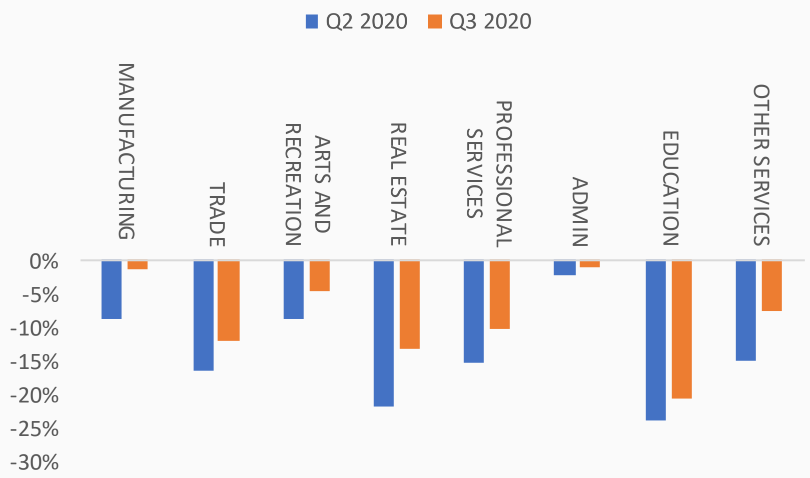
Sources: NBS, CardinalStone Research

Gentle recovery beginning to take root

In line with earlier expectations, Nigeria experienced a milder contraction in Q3'20 than in the previous quarter as economic activity gradually reverted to pre-COVID levels. Indeed, COVID-19 appears to have worsened structural concerns across a few sectors, but the sustained pickup in economic activities in other sectors suggests that some non-oil contraction may be mostly transient. Notably, the contraction in manufacturing eased from 8.8% YoY in the second quarter to 1.5% YoY in the third quarter, with CBN data showing improvements in new orders as well as production and inventory levels in the review period. The manufacturing PMI data also revealed that the sector recovered in November since its contraction in May 2020, leaving legroom for continued recovery compared to the average levels of the last two quarters. The considerable improvements observed in real estate, education, entertainment, and trade sub-sectors also support a possible non-oil sector-led recovery in coming quarters.

Elsewhere, the oil sector is unlikely to record a considerable rebound until Q2'21 on likely extension of OPEC+ cuts and expected lag in mass COVID vaccinations. All in, we expect a further 2.7% contraction in GDP in Q4'20.

Figure 3: Manufacturing and services show signs of green shoots



Sources: NBS, CardinalStone Research

MPC may choose to stay put on GDP beat

Markets are awaiting the decision from the two-day Monetary Policy Committee meeting scheduled to finish tomorrow. The Committee has already cut rates twice this year, signaling its strong focus on economic recovery. We opine that the decision to reduce MPR at the last meeting may have reflected the surprising magnitude of GDP contraction (-6.1% YoY) relative to CBN's estimate of -1.0%. The apex bank has since adjusted its estimate in line with new realities which were factored in its last monetary committee decision. Considering that Q3'20 GDP numbers slightly outperformed its estimate of -3.9%, the apex bank committee may decide against further easing amid Nigeria's climbing inflation and substantially low yield environment.

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