ELAN

# 2020 OUTLOOK

# 2020: WEAK MOMENTUM, MORE CHALLENGES AS LEASING REMAINS RESILIENT

EQUIPMENT LEASING ASSOCIATION OF NIGERIA LTD/GTE
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**The Global Economy**

According to the World Bank, Global Gross Domestic Product (GDP) growth fell to 2.6% in 2019 – 0.3 percentage point below previous projections - its lowest rate since the financial crisis, reflecting the broad-based weakness observed during the first half of the year, including a further deceleration in investment amid rising trade tension. As recent softness abates, global growth is projected to edge up to 2.7 (some experts projecting 3.4 percent) in 2020.

Further analysis indicates that activities in advanced economies, are slowing. Growth in the Euro area and US is expected to be weaker, in part due to weakening exports and investment, overall weakening of consumer and business sentiments, growing concerns of no-deal Brexit geopolitical tensions and disruption of global supply chain. Growth is expected to further decline from 2.2% in 2018 to 1.9% in 2019 and 1.7% in 2020.

In Emerging Markets and Developing Economies (EMDEs), growth is projected to pick up from a four-year low of 4 percent in 2019 - 0.3 percentage point below previous projections, to 4.6 percent in 2020-21. This recovery is predicated on the waning impact of earlier financial pressure currently weighing on activity in some large EMDEs, and on more benign global financing conditions than previously expected. Despite this projected recovery, per capita growth in a large number of EMDEs will remain insufficient to narrow income gaps with advanced economies - including in Sub-Saharan Africa, a region with a high concentration of poverty.

Sub-Saharan Africa is projected to continue to grow, rising from 3.4% in 2019 to 3.6% in 2020. However, there is tepid recovery in other EMDEs like Nigeria and Brazil. Though, with Nigeria joining other African countries to sign the agreement establishing the African Continental Free Trade Area (AFCFTA), there could be tremendous opportunities for Nigeria in the medium term. However, this could also create a nightmare situation for the country, unless the right policies and actions are implemented expeditiously to improve Nigeria's economic competitiveness.

**The Domestic Economy**

Nigerian economy is currently on a slippery slope of recovery and is projected to gain some steam in 2020, largely on the back of Government policy thrust to ensure that the economy stays on a growth trajectory while making strategic investment in critical infrastructure, stronger household spending, supported by the full implementation of the minimum wage increase. According to National Bureau of Statistics (NBS), Gross Domestic Product (GDP) experienced its second highest quarterly growth in four years after growing by 2.28 per cent in the third quarter of 2019, which represents the second-highest quarterly rate recorded since 2016. This is the ninth consecutive quarters of growth since the exit from recession. Considerable efforts were made at deepening the non-oil economic performance, with the non-oil sector contributing over 91.18 percent to GDP at second quarter 2019. Economic pundits see GDP growing 2.4% in 2020, while the Government projects around 2.93% growth

The outlook remains fragile, however, with weak revenues driving increase in debt service ratio**,** dampened by high unemployment, insecurity challenges, power shortages, volatility in oil prices and a more subdued global economic environment.

The exchange rate remained relatively stable since August 2018, despite decline in capital inflows, averaging at N306.86/US$. According to NBS, Consumer Price Index rose by 11.85 percent in November 2019, being 0.24 percent points higher than the 11.61 percent recorded in October 2019 due essentially to the land border closure. Except for a few months, inflation has continually declined since January 2017 from 18.72% to 11.85% in November 2019.

Perhaps, the Federal Government has manifested its intention to improve the economy, with the signing of the 2020 Appropriation bill into law, before the end of 2019. This restored the budget cycle to a predictable January - December fiscal year and will likely lead the government to return to international capital markets to finance a large part of its spending, particularly in infrastructure projects.

Key highlights of the budget of N10.594trillion, include, Capital expenditure – N2.465trn; Recurrent expenditure – N4.84trn; Debt servicing – N2.73trn; Statutory transfer N560bn. Major projects will cut across key sectors including Transport N7803bn, Power N352bn, Works N210bn, Agriculture N807.03bn, Education N11.44bn and others.

The Government, having observed that with low revenue to GDP ratio (currently at about 7%), there is need to pursue optimal revenue generation, introduced the Finance Bill 2019, aimed at amending some tax Acts in Nigeria including Value Added Tax- raising VAT from 5% to 7.5%, for the purpose of generating more revenue for the government to fund the 2020 budget. In addition to setting the tone for Nigeria's fiscal policy for 2020, the Bill seeks to promote fiscal equity, align domestic laws with global best practices, and support Micro, Small and Medium-sized businesses. Another major objective, is to increase stakeholder investments through the introduction of incentives.

In another development, Nigeria recently moved up the ladder in the ease of doing business index, as it ranks 131 out of 190 countries on the World Bank Doing Business Index, moving up 15 places from 146th position in the 2019 Report. The Report named Nigeria, for the second time, as one of the top 10 countries with the most notable improvements during the review period of the 12 indicators in the index, Nigeria improved significantly in “starting a business, dealing with construction permits, getting electricity, registering property, trading across borders and enforcing contracts” indices. Government is targeting to put Nigeria among the top 70 in the World Bank Doing Business Index by 2023.

The monetary authorities have achieved progress but key vulnerabilities points persist. The Central Bank of Nigeria (CBN) made progress instability in the foreign exchange market, improved liquidity in the market, and increase in foreign portfolio investments (FPI). However, there is still supply gap - foreign exchange demand exceeds foreign exchange supply year on year leading to depletion of the foreign reserves, so as to defend the Naira and expensive Open Market Operation instruments in a bid to attract FPIs.

The CBN maintained the Monetary Policy Rate (MPR) at 13.50 per cent and its home-grown heterodox policies are stimulating credit growth. The apex bank have introduced key initiatives including the Global Standing Instruction (GSI) to address the predatory impact of serial borrowers in the banking system, raising the Loan to Deposit Ratio (LDR) of banks from 60% to 65 per cent, to improve lending to the real sector of the economy and OMO restrictions which is increasing overall liquidity in the banking sector.

The CBN policy focus areas are expected to shape 2020 monetary and market developments. These areas include; promoting investments in the real sector to drive economic growth, driving inflation to single digit; and exchange rate stability to promote foreign direct investments. Others include, promoting a strong “balance of trade” to improve external reserves and access to credit and financial inclusion.

**The Leasing Industry**

The equipment leasing industry will continue to be the creative financing alternative, deepening its shares in the equipment finance market as more of the world’s equipment needs are being met through leasing. The industry is vibrant and resilient, delivering multiplicity of benefits to customers and generating estimated total annual volume of $1.5 trillion globally, accounting for 20% of total investment in equipment, contributing about 1.5% to GDP.

This development is expected to continue in the global space in 2020 and the years ahead, with the industry withstanding the adverse impacts of tax and regulatory changes and slow economy. However, the effects of these adverse variables are expected to be more visible in the mature markets. In the United States of America for instance, investment in equipment is expected to expand by 1.1percent and likely to post its weakest year of growth since 2016, as several headwinds such as the unresolved trade tensions and a slowing global economy took hold in 2019 and are reportedly expected to continue dragging on business confidence and investment in 2020.

The contracting volume in mature leasing economies – North America, Europe and Asia, notwithstanding, they still hold sway in the global industry accounting for more 95% of world volume. Africa represents less than 1% of global volume. The leasing market in much of sub-Sahara Africa is yet to be fully developed. The continent leasing volume stands at almost $41bn with a market potential estimated at $83bn.The top five countries (South Africa, Nigeria, Egypt, Morocco, Algeria) with the greatest leasing potential, contribute to more than three quarters that amount.

The Nigerian leasing industry continues to evolve, growing from the simple finance lease phase, through creative finance lease to operating lease in its movement towards new products development and eventually maturity in the years to come. The industry over the years maintained its resilient contributing considerably to capital formation in the economy. In 2018, outstanding lease volume stood at N1.68trillion up from N1.44trillion in 2017 representing a growth rate of 16.3 percent, bringing the cumulative volume in the past 10 years to about N8.3trillion. This is expected to reach N10 trillion when final figures for 2019 are finalised.

The industry has achieved consistent double digit growth rate over the years facilitated by market opportunities, enhanced lease awareness, increased investment and participants as well as relative stability in the macroeconomic environment. This trend is expected to continue with the increasing relevance of leasing to economic development, especially at these challenging times where the economy is in dire need to stimulate its productive capacity.

However, in order to maintain the relevance and growth trajectory of the leasing industry, it is important to address some major hiccups - funding, tax, regulatory etc, which have continued to constrain the faster development of the industry.

Essentially, in 2019 the Nigerian leasing industry witnessed in addition to the effects of the general macroeconomic environment:

- **The continued absence of appropriate funding mechanism in terms** of availability, variety and cost
- **Market focus on Small and medium markets** due to inadequate funds and expertise.
- **Continued predominance of finance lease**, mainly of general assets e.g. vehicles
- **New opportunities in construction industry, agriculture, mining and health care sectors**
- **Greater lease awareness and visibility for the industry** leading to new entrants and patronage
- **Low competition across market segments**, the extent of competition remained low due to fewer lessors compared to level of demand.
- **The coming into effect of International Financial Reporting Standard (IFRS 16.)** which replaced the old standard IAS17, and abolished off balance sheet financing
- **Slow turnover of equipment** due to high cost and equally necessitated the increased demand for fairly used assets especially vehicles.
- **Dwindling appetite from banks for direct leasing investment** due mainly to inadequate fiscal incentives and motivations amidst competing products.

- **Continued interest on the Equipment Leasing Act 2015,** especially from foreign investors but the delay in the inauguration of the Equipment Leasing Registration Authority, remains a major setback to the full realisation of the benefits of the Act.

- **Improved understanding on leasing intricacies** through various capacity building and advisory programmes of ELAN.

***Figure 1: The Nigerian Leasing Landscape in 2020***

- *The projected improved economy in 2020, increased government and private sector investment in key sectors, will impact positively on the leasing industry*
- *Small and medium tickets leases will continue to provide substantial profitability to lessors.*
- *Increased demand for fairly used assets and continued slow turnover of equipment*
- *The strong push for revenue across all fronts anchored by the Finance Bill 2019, will have diverse effects on the leasing industry*
- *The Stability in the foreign exchange environment is expected to continue as the Central Bank of Nigeria (*CBN*) maintains its forex intervention strategy*
- *Deeper credit penetration is expected, due basically to the increase of Loan to Deposit Ratio (LDR), albeit there may increase concentration* - prime customers will benefit more from the enhanced credit penetration and decreasing borrowing rates.
- *Funding for lease transactions will remain a major challenge*
- *More new entrants but weak competition.*
- *The gradual manifestation of the impact of the International Financial Reporting Standard (IFRS 16).*
- *Expected inauguration of the Equipment Leasing Registration Authority*

**The Nigerian Leasing Landscape in 2020**

***The projected improved economy in 2020, increased government and private sector investment in key sectors, will impact positively on the leasing industry*.** Specifically, these present immense opportunity:

- **Agriculture -** The Agricultural sector is sustaining its momentum as government intensifies its efforts to grow the sector to support the diversification agenda, create jobs and promote food security**.** The increasingly focus on agricultural development as a support mechanism for macroeconomic and non-oil growth, is expected to be enduring as government targets a growth rate of 8% for the sector in 2020 up from present average of 4%. Government support framework for the sector, include Zero percent import duty tariffs (custom, excise and value added) for import of agricultural equipment and agro-processing equipment, exemption of interest from tax on loans granted to agricultural activities, Agricultural Credit Guarantee Scheme which is up to 75% and various intervention funds.

The Government effort is further galvanised by the increasing interest from foreign development partners through various agencies, for instance the Department for International Development (DFID) under its funded *Propcom Mai-Karfi* programme have been engaged in mechanisation scheme and recently the United States Agency for International Development (USAID) launched a $300 million agribusiness investment in Nigeria.

Also, private investments are being made in the five major crops – rice, wheat, tomato, oil palm and cocoa which are actively promoted by the Central Bank of Nigeria. For instance Olam Group has established an integrated rice plant with the capacity to mill 36,000,00 tonnes per year on a 10,000 hectares farm, while Dangote Group is planning 150,000 hectares to produce up to 1million tonnes of rice for the domestic market.

**With all these, agriculture machinery investment growth will improve - more equipment will be required in preparation, processing, storage, packaging and distribution to realise the developmental objective for the sector.**

- **Infrastructure -** Infrastructure development is expected to witness more activities as government intends to invest more with support from the private sector. Government has a capital expenditure budget of N2.465trn for 2020 with several projects in roads, rail, and power taking priority. Nigeria's infrastructure deficit is estimated at $300billion and the country needs to spend on the average of $10billion annually in the next ten years to address the situation. The increased activities in this critical area will benefit the leasing industry - Construction machinery and Materials handling equipment demand will expand substantially.

- **Mining and Quarrying** is another rejuvenating sector that is gradually becoming the toast of both local and foreign investors, going by the current reforms undertaken by the Federal Government in the sector. Although the oil and gas sector has driven economic growth in recent decades, Nigerian mining offers considerable potential gains. Home to abundant, untapped reserves, and increasingly the focus of pro-business policies, the sector is poised for robust near-and mid term growth as investors move to capitalise on opportunities in over 44 known types of minerals of varying mixes and proven quantities.

Supported by a host of incentives, an increase in investment from large multinationals should help the government meet its mid-term growth targets. Although sector development remains nascent and is dominated by small-scale operations, the increased availability of geological data should support new investment and activity, significantly boosting its contribution to the broader economy in the coming years, even as it offers knock-on benefits like job creation and export diversification.

Under the Economic Recovering and Growth Plan (ERGP), the Federal Government envisages to grow the sector Gross Domestic Products (GDP) to N141 billion, an average growth of 8.54percent between 2017- 2020 from N1.3 billion in 2015. Government also set a target of attracting $17.4bn investment in solid minerals by 2020. The road map for growth is to increase the sector contribution to GDP to over 10% by 2026. Investors are taking note, and indicating interest. For instance, according to the Nigerian Investment Promotion Commission (NIPC), out of $15.15bn investment commitment in the first half of 2019, for 43 projects, mining and quarrying recorded $12.3bn an average 81 % of the commitment made. Also, a US based company, Seed Capital and Investment Company, has offered to invest US$50 billion in the Nigerian Mining Sector in the coming years.

**The manifestation of these investments and the active nature of the sector will stimulate more investment - extractive machinery and other supportive operational equipment. This portends immense opportunity for leasing.**

- **Manufacturing sector** despite the challenges that beset it, has witnessed good growth in recent years and is expected to continue to benefit from the policy thrust of government, especially in promoting locally made goods. The sector has recorded considerable success with the ban on some imported goods that can be produced locally. According to Naira metrics, a business intelligence firm, five local vegetable oil brands dominate the Nigerian Market due to the government's import ban. Similarly, the spaghetti manufacturing industry has recorded huge success in recent years. Nigeria is now the 12th largest instant noodle market globally. In addition, the government has highlighted some initiatives to boost manufacturing in Nigeria which include, incentives to support industrial hubs and recently tax policies that would encourage growth, especially for small and medium businesses.

**With the continued focus from the government, industrial investment growth will increase and leasing will play important role to meet the new demand.**

- **Creative Industry presents fresh opportunities to leasing as** is expected to get a boost in the coming years as part of government focus to create employment, especially for the youths. The Central Bank in collaboration with the Bankers' Committee in furtherance of this initiative has developed a Creative Industry Financing Initiative (CIFI). The initiative has four pillars, namely Fashion, Information Technology, Movie and Music. Also, the CBN also announced a 40 acre creative industry park to be developed around the national theatre with similar parks in kano, Port Harcourt or Enugu. The project is expected to take off early 2020.

- **Health, education, transportation and the dominant oil and gas,** will continue to offer exciting opportunities in 2020 and years to come.

These opportunities it must be noted, is not limited to the federal level as various states are equally striving on similar developmental path, unflinching diverse opportunities across the various sectors highlighted. In Lagos State for instance, the Government is continuing its massive infrastructure projects with renewed focus on developing water way transportation.

- ***Small and medium tickets leases will continue to provide substantial profitability to lessors.*** These segments represent over 80% of lease transaction spread and provide better margins, though with higher risk.

- ***Increased demand for fairly used assets and continued slow turnover of equipment*** necessitated by *higher* cost of new assets, which affects acquisition and replacement policy.

- ***The strong push for revenue across all fronts anchored by the Finance Bill 2019, will have diverse effects on the leasing industry.*** The increase in VAT for instance, will further make leasing transaction to be more expensive, especially in operating lease, where it will apply to rentals in addition to the cost of asset. The industry may however benefit from the transactions falling within the scope of the expanded exemptions, aimed at cushioning the effect of the increase in VAT.

The incentives given to small and medium scale companies in terms of exemption and reduction of companies' income tax respectively, may be of little direct significance as almost all leasing companies fall outside the threshold of below N25million or below N100million. However, the industry may benefit from the increased activities in the SMEs sector as a result of the incentives. Other impacting variables include, increase in Stamp duties, Introduction of early tax payment bonus, and additional treatment of withholding tax.

Essentially, the Bill contains provisions that have the capacity to boost the economy by stimulating the growth of small and medium scale enterprises and enticing foreign direct investment into Nigeria. These will have considerable bearing on the leasing industry.

The Government has announced that the presentation of a finance bill, will be done each year along with the budget to indicate Government fiscal policy thrust for the budget year. The good news is that, the leasing industry will now have better opportunity to advocate for appropriate tax regime that would further stimulate development.

- ***The Stability in the foreign exchange environment is expected to continue as the Central Bank of Nigeria (CBN) maintains its forex intervention strategy.*** This will bring about price stability of assets, enabling the lessor to take a position in lease pricing and other variables that affect the transaction as well facilitating appropriate over business strategy. It will also promote foreign direct investments in the leasing industry.

- ***Deeper credit penetration is expected, due basically to the increase of Loan to Deposit Ratio (LDR), albeit there may increase concentration*** **- prime customers will benefit more from the enhanced credit penetration and decreasing borrowing rates.** The banks will be looking at various product offerings to meet the new target and this may lead to renewed interest in leasing especially SMEs leasing. Also, leasing companies may also attract more credit from banks to finance leases, though this might not necessarily be the ideal funding mechanism for leasing.

- ***Funding for lease transactions will remain a major challenge –*** the predominance of short term funding sources with associated high cost**,** will continue to impact leasing activities in terms of pricing, duration, risk undertaking and volume

- ***More new entrants but weak competition.*** The industry will continue to attract new investors willing to exploit the immense opportunity in leasing. According to ELAN projection, 20 new companies are expected to join the Association in the coming year, bringing the total of registered lessors to 152. ELAN membership represents over 90% of formal lessors. However, this might not be sufficient to increase the level of competition in the industry, which is necessary to drive more volume and enhanced value add in terms of better services and solutions .

- ***The gradual manifestation of the impact of the International Financial Reporting Standard (IFRS 16).*** The IFRS 16 has been in operation for one year, though too early to assess its full effect, some of its implications will gradually become glaring from 2020, especially on transaction dynamics with respect to operating leases. The Standard has changed how the customers view leasing, the level of efforts required to account for leases will cause some customers to seek alternative. Also, some lessees may request shorter term or structures involving service contracts, while some may even do more leases because of the transparency the standard brings to their leasing activities.

It is important for the leasing industry to understand these changes and be proactive in meeting customers demand. One way to navigate this is for lessors to constantly communicate with their customers and reassuring them that many of the benefits of leasing still remain including partial off balance sheet finance.

- ***Expected inauguration of the Equipment Leasing Registration Authority*** will give full effect to the implementation of the Equipment Leasing Act 2015, enhancing investors' confidence and boost leasing activities. ELAN remains committed to the inauguration and smooth take – off of operation of the body and has put in place machinery to ensure that this is achieved in 2020.

**Navigating the Tides and Maximising the Gains**

Generally, notwithstanding the new and persisting challenges, from all indications 2020 portends a better year for the Nigerian economy and leasing industry. To take advantage of the numerous opportunities the market present and minimising risks, lessors must that take a proactive strategic posture. This will for instance require:

- ***Building strategic alliance within and outside the industry to strengthen capacity*.** The individualistic approach in the industry is limiting. Lessors for example, can pool resources together under a syndicated lease arrangement to scale up and enhance participation in some of the major opportunities and mitigate associated risks. This arrangement can also be used to engage government, financiers, development partners and other stakeholders to sell leasing and the preparedness of the industry to contribute more to the attainment of developmental projects. Presenting as a group, will enhance better access to incentives including intervention funds and other support schemes.

- ***Strengthening internal capacity to enhance processes and performance*.** This will involve continued learning and understanding of the leasing subject, product, market and business.

- ***Lessors should concentrate on areas where they can impact and control.*** This entails continually seeking creative funding options, operational efficiencies, influencing favourable customer behaviour through proactive engagement and exercising pricing discipline as well as promoting sound corporate governance.

ELAN as the umbrella Association for the industry, will continue to provide integral support in these critical areas, creating and facilitating the platform for the realisation of the corporate objects of stakeholders.