MERISTEM

Macro and Market Insight

August 2023

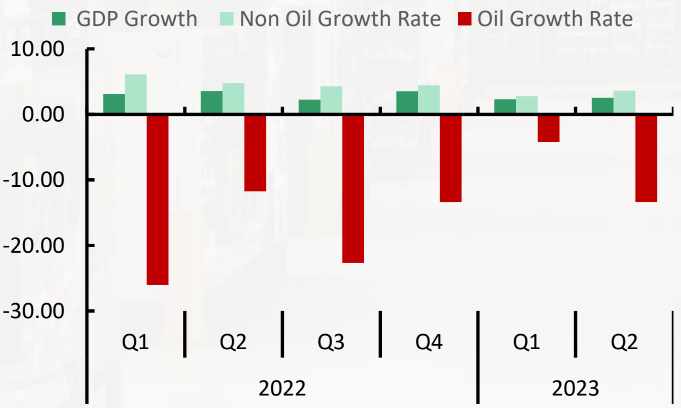
Macros

A Mixed Outlook for the Nigerian Economy

Review

In Q2:2023, Nigeria's Gross Domestic Product (GDP) grew by 2.51% YoY, (vs 3.54% YoY in Q2:2022) mainly owing to lower-than-projected performance in the oil sector during the quarter. Crude oil production volumes declined to 1.22mbpd (*vs 1.43 mbpd and 1.51 mbpd recorded in Q2:2022 and Q1:2023, respectively*) as the Petroleum and Natural Gas Senior Staff Association of Nigeria (PENGASSAN) strike in April 2023 as well as production losses on major terminals impacted the sector's output. As a result, the oil sector's real GDP contracted by **13.43% YoY** relative to **11.77% YoY** in Q2:2022. On the other hand, the non-oil sector grew by 3.58% YoY, (from 4.77% YoY in Q2:2022 and 2.77% in Q1:2023). This growth was primarily driven by impressive advancement in the information and telecommunication (+8.60% YoY), trade (+2.41% YoY), financial services (+26.84% YoY), and manufacturing (+2.20% YoY) sectors.

Chart 1: Total GDP, Non-oil GDP, and Oil GDP growth (%)

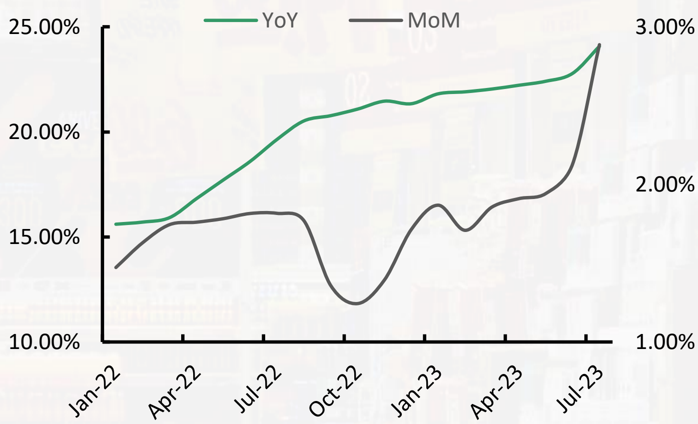


***Source:* NBS, Meristem Research**

Barring any external and unexpected shocks, we expect an improvement in real GDP performance in the second half of the year. This expectation is largely hinged on improvement in oil demand, increasing upstream investments and continuous resilience of the non-oil sector. Legacy issues such as unabating insecurity challenges and foreign exchange (FX) scarcity could however portend downside risks to our expectation. Consequently, we maintain our 2023FY GDP forecast of 2.94% YoY growth.

Nigeria's economy continued to grapple with high inflation, culminating in its peak level since September 2005 at **24.08% YoY** in July 2023 (vs 22.79% YoY in June 2023). Although we envisaged an upward trajectory, the actual inflation outcome exceeded our forecast of 23.65% by 43bps. Both the food and core indexes shot up by 26.98% YoY (vs 25.25% YoY in June 2023) and 41bps (20.47% YoY vs. 20.06% YoY in June 2023), respectively.

Chart 2: Headline Inflation Rate



Source:* *NBS, Meristem Research

The substantial increase in transportation costs owing to higher Premium Motor Spirits (PMS) prices and FX devaluation, were major triggering factors for the released inflation numbers. The National Bureau of Statistics (NBS) also redefined the components of the core index by excluding energy for the first time, a decision influenced by the expected volatilities in the price of energy products following the removal of fuel subsidies and FX devaluation.

Looking ahead, we expect high inflation to persist premised on the anticipation of the continued depreciation of the Naira and persistent challenges in the food sector which is envisaged to drive higher food inflation. In our opinion, these factors will continue to exert upward pressure on prices.

During the month, the NBS released the labour force statistics report for Q4:2022 and Q1:2023 with unemployment rate at 5.30% and 4.10%, respectively, from what was last published in Q4:2020 at 33.33%. The report highlighted the review of NBS' methodology in the collection of labour market information which is in line with the International Labour Organisation (ILO) guidelines.

A significant alteration introduced in the revised approach involves the enlargement of the working age population as well as the reclassification of the employment categories and the adoption of a new design in data collection. Prior to now, the working age population included those between ages 15 - 64 years of age, however, has been expanded to include individuals from ages 15 years and above. Another key change is the reclassification of those in employment to persons who work for at least one hour in any activity to produce goods and services (vs. a minimum of 20 hours in the old methodology).

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Also, the new approach includes the use of a longitudinal research design which involves the continuous collection of data over the period of 12 months compared to 17 -21 days per quarter. We note that the revision in the approach for estimating unemployment and labour statistics will result in lower unemployment figures going forward. This is because more individuals within the working age population , who were previously unable or unwilling to work, become available and seek employment.

On the fiscal side, President Bola Ahmed Tinubu inaugurated the Committee on Fiscal Policy and Tax Reform (PCFPTR) comprising of tax experts from both the public and private sectors as members. The Committee’s objective is to attain an 18.00% tax-to-GDP ratio in three years through tax harmonization, improved revenue collection and expanding the tax bracket. We expect the Committee's activities to improve the FG tax revenue collection in line with the administration's objective.

Elsewhere, the country's external reserves remain on a persistent decline, reaching a 24-month low of USD33.57bn as of September 1, 2023. While the Apex bank's interventions in the FX market have reduced significantly since the recent devaluation, the minimal accretion to FX reserves despite higher crude oil prices (due to lower crude oil production) remains a pain point, underscoring the depletion of Nigeria's FX reserves.

During the month, the Central Bank of Nigeria (CBN) released its financial statements, spanning a prior seven years period. Notably, we estimate the liquid portion of the external reserves (after accounting for illiquid instruments like derivatives, gold etc) to be as low as USD11.27bn further underscoring the fact that the nation's external sector appears to be in dire straits.

Unsurprisingly, the value of the Naira against the greenback also depreciated by 3.76% MoM and 5.45% MoM in both the official and parallel markets in August 2023.

Lastly, at the 15th annual BRICS summit held in South Africa, discussions were focused on strengthening economic collaborations amongst the member countries and expansion of the group. Officially, 6 countries were invited to join the group, namely Argentina, Egypt, Iran, Saudi Arabia and Ethiopia with admission taking effect from January next year.

While it remains unconfirmed if Nigeria officially applied to join the bloc, we do not rule out the possibility of Nigeria being considered for membership in the future. This comes as the initial phase of the bloc's expansion plan unfolds.

We expect that this move would solidify the bloc's power amongst other global institutions and drive investments amongst the member countries in the long term.

Key Expectations for September 2023

- ***Sustained upward trajectory in headline inflation.***
- ***Enhanced economic growth for the rest of the year to be driven by increased performance in the non-oil sector.***
- ***A 25bps increase in the Monetary Policy Rate (MPR) at the next monetary policy committee meeting later this month premised on the projected uptrend in headline inflation.***
- ***Continued depreciation of the Naira, primarily due to the existing FX supply shortage.***

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Equities

Sailing on Positivity: Bulls Forge Ahead

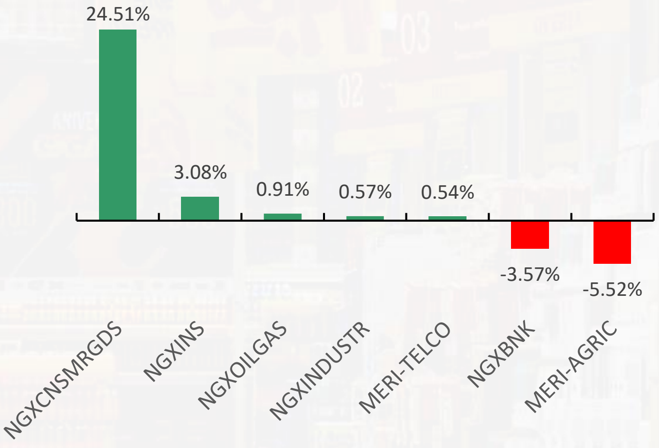
Review

In August, the bulls remained in control of the local bourse for the fourth consecutive month. The All-Share Index (NGXASI) gained +3.44% MoM to reach 66,548.99pts, thus, returning 29.85% Year to Date. Nonetheless, activity level dipped significantly as volume and value traded declined by -50.51% and -62.26% to 9.13bn units and NGN132.84bn, respectively. Similarly, the market breadth weakened to 0.84x from 1.40x in June. **GLAXOSMITH** (+87.84% MoM) and **DANGSUGAR** (+83.33% MoM) led the gainers' chart while **ETERNA** (-44.44% MoM) and **JOHNHOLT** (-40.45% MoM) led the losers.

A Spectrum of Mixed Sentiments

Performance was largely mixed amongst the sectoral indices on our radar. Positive sentiments prevailed in five (5) sectors - **NGXCNSMRGDS** (+24.51% MoM), **NGXOILGAS** (+0.91% MoM), **NGXINDUSTR** (+0.57% MoM), **NGXINS** (+3.08% MoM) and **MERI-TELCO** (+0.54% MoM), while **NGXBNK** (-3.57% MoM) and **MERI-AGRIC** (-5.52% MoM) closed the month in red. Buying activities picked up in the consumer goods sector following the proposed merger between **NASCON** and **DANGSUGAR**, which caused a positive ripple effect in the sector. Also, the Banking Index bucked its 3-month positive trend due to profit taking activities on tickers with sizeable gains- **FIDELITY** (-17.06% MoM), **JAIZBANK** (-23.47% MoM), **ETI** (-11.76% MoM) amongst others.

Chart 3: Monthly Sectoral Returns for August 2023



***Source:* Bloomberg, Meristem Research**

An Influx of H1:2023 Earnings Releases

During the month, companies posted their H1:2023 scorecards. **In our H2:2023 outlook, we highlighted that the financial services and Oil and Gas sectors are poised to benefit from the series of reforms implemented by the new administration**. True to that, the financial services and oil and gas sectors recorded impressive profitability while other sectors lagged primarily due to reverberations stemming from the foreign exchange liberalization. Notwithstanding, selected companies declared interim dividend as per their historical trend. *See table 1* for an overview of each sector's financial performance.

Table 1: Overview of Sectoral H1:2023 Results

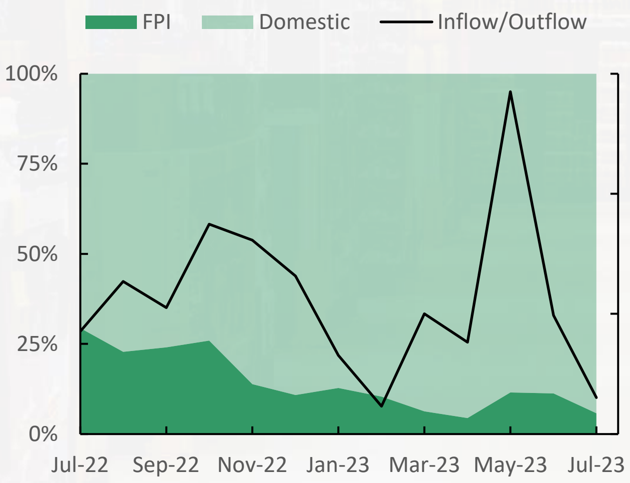
Sector	Performance	Key Drivers and Drags for H1:2023 performance
Agriculture	Mixed	Increased demand, FX gains and losses, High finance cost.
Banking	Positive	Increased interest income, FX revaluation gains.
Consumer goods	Mixed	Revenue expansion due to increased demand and upward price review on some products, high finance cost, high cost of production, FX loss.
Industrial Goods	Mixed	Upward price review, FX loss and high finance costs.
Insurance	Positive	Adoption of technology (increased efficiency), expansion across business segments, and FX gains.
Oil and Gas	Positive	Increase in revenue due to PMS deregulation and strong demand.
Telecommunications	Mixed	Revenue growth owing to increased data usage, High finance costs, FX loss.

Equities

Foreign Investors Cautiously Retreat

Following the initial surge in foreign portfolio participation in May and June, driven by the optimism surrounding the new administration's reforms and policy direction, the situation took a contrary turn in July. FPI participation began to diminish due to escalating uncertainties regarding Nigeria's exchange rate which raised concerns about fund repatriation, thus, prompting foreign investors to take profits early. Consequently, FPI contribution to total market activity waned (5.77%) to its lowest level in 2 months, as against c. 11% in May and in June. Concurrently, FPI outflow reached its highest since Nov 2021 at NGN30.09bn while inflow dropped to NGN9.45bn.

Chart 4: Participation in Nigerian Equities market



***Source:* Bloomberg, Meristem Research**

Notable Occurrences and Corporate Actions

IKEJAHOTEL announced its intention to raise additional capital by issuing 1.13bn units of shares to its existing shareholders through a rights issue. While the price is yet to be determined by the board of directors, the issue will be based on six (6) new ordinary shares for every eleven (11) existing ordinary shares held in the company. Also, this allocation is exclusively accessible to shareholders whose names are on the register as of December 13, 2022.

In addition, after fifty-one (51) years of operations in Nigeria, **GLAXOSMITH** disclosed the strategic intent of its parent company **GSK UK** to cease commercialization of its prescription medicines and vaccines in Nigeria through the GSK local operating companies and transition into a third-party direct distribution model for its pharmaceutical products. Subsequently, **GLAXOSMITH**'s share price surged by +87.84% MoM due to anticipation of cash distribution after the liquidation process.

In furtherance of the proposed merger of Dangote Sugar Refinery PLC, NASCON Allied Industries PLC and Dangote Rice Limited announced in July, **DANGSUGAR**, on August 30th, disclosed the modalities behind the proposed merger as agreed by all parties. As we noted in our report, eleven (11) ordinary shares of **DANGSUGAR** will be substituted for every twelve (12) ordinary shares of **NASCON** and seven (7) shares of **DANGSUGAR** will be substituted for one (1) of **DRL** shares. In response to this, investors' buying bias was sustained on both tickers due to expectations of a higher listing price of the new entity. Consequently, **NASCON** and **DANGSUGAR** gained +40.42% MoM and +83.33% MoM, respectively.

Summary of Key Expectations for September 2023

In our view, we expect the equities market to be largely mixed in September. We anticipate investors to continue to find favourable entry positions across tickers on the bourse and a sustained confidence on fundamentally strong tickers. Likewise, anticipation of impressive bank earnings releases and interim dividend declaration will likely sustain the positive momentum. Nonetheless, we expect profit-taking activities to drive the market occasionally as many tickers are trading at their year-high prices (levels beyond our valuations). Furthermore, we anticipate moderate participation of foreign investors due to existing macroeconomic issues in the country.

In general, we expect mixed sentiments to prevail in the market for September 2023.

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Equities

Table 2: ***Below is a list of some stock(s) with attractive dividend yields and price appreciation prospects, as well as recently marked-down stocks that investors can take advantage of.***

Ticker	Current Price (NGN)	Target Price (NGN)	Upside (%)	Closure Date	Dividend Declared (NGN)	Dividend yield %
FIDSON	15.87	22.47	+42%	14-July-2023	0.55	3.47%
FIDELITYBYK	8.45	9.25	+10%	15-Sep-2023	0.25	2.96%
OKOMUOIL	250.00	316.86	+27%	28-Apr-2023	12.00	2.13%
WAPCO	29.00	34.48	+19%	14-Apr-2023	2.00	6.90%

**prices are updated as of September 5th, 2023*

Fixed Income

Liquidity Sways Market Direction

Review

Similar to prior months in 2023, system liquidity remained the key determinant of the direction of yields in the domestic fixed income market in August. This was reflective in the four auctions that held during the period. Ahead of the first T-bills Primary Market Auction (PMA), interbank liquidity was NGN360.65bn pushing subscription to NGN836.30bn – five times the amount offered (NGN153.98bn). Similarly, the bid-to-cover ratio was higher at 5.43x (relative to 1.51x at the last auction in July), signifying improved investors' demand. Subsequently, stop rates on the 91-Day, 182-Day, and 364-Day instruments declined significantly to 5.00%, 5.90%, and 9.80% (from 6.00%, 8.00% and 12.15% at the last auction in July), respectively.

In a bid to manage the excess liquidity in circulation, stabilize foreign exchange and ensure that rates reflect market realities, the CBN rolled out OMO bills for the first time this year, offering NGN150bn across the trio maturities. In line with our expectation, the auction was met with high demand (especially on the 362-day), as it was oversubscribed by NGN157.93bn. Thus, the average stop rate settled at 12.49% (vs 8.53% at the last OMO auction).

Despite the negative interbank liquidity ahead of the second T-bills auction in August, the total subscription peaked to the highest so far this year (NGN1.54trn). Eventually, NGN302.21bn was allotted, bringing the overall bid-to-cover ratio to 5.09x. Notwithstanding, the average stop rate increased to 9.05% (vs 6.90% at the previous auction).

Table 3: Key Drivers of System Liquidity in August

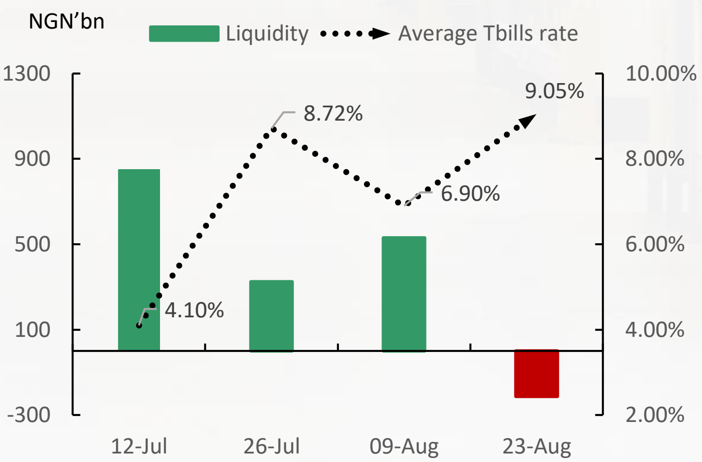
Event	Amount (NGN'bn)	Impact on Liquidity
FAAC Allocation	591.62	↑
OMO Auction	150.00	↓
Coupon Payment	7.00	↑
CRR Debit	NA	↓

Source: *CBN, FMDQ, DMO, Meristem Research*

At the FGN bonds' PMA, the DMO offered a total of NGN360.00bn across the four maturities. Relative to the auction in July, the total subscription in August was significantly lower (NGN312.56bn vs NGN945.14bn in July) due to tighter system liquidity. Consequently, marginal rates on the MAY-2029, JUN-2033, JUN-2038 and JUN-2053 instruments spiked by 135bps, 140bps, 110bps, and 155bps to 13.85%, 15.00%, 15.20% and 15.85%, respectively.

In the secondary market, the T-Bills market was predominantly bearish during the period, fueled by the anticipation of LDR debits which prompted sell-offs especially on the longer date bills. Thus, average yield peaked at 7.97% on 24th of August (from 6.72% at the end of July). However, due to inflows from FAAC distribution which drove interbank liquidity upward, average T-bills yield settled at 7.02% as at the end of August. Similarly, in the bonds market, sell-offs across the curve set the bearish mood as investors exited their positions to take advantage of higher yields. Consequently, average bond yield increased by 96bps to 14.06% in August.

Chart 5: Interbank Liquidity and Average T-Bills Rate (July – August 2023)

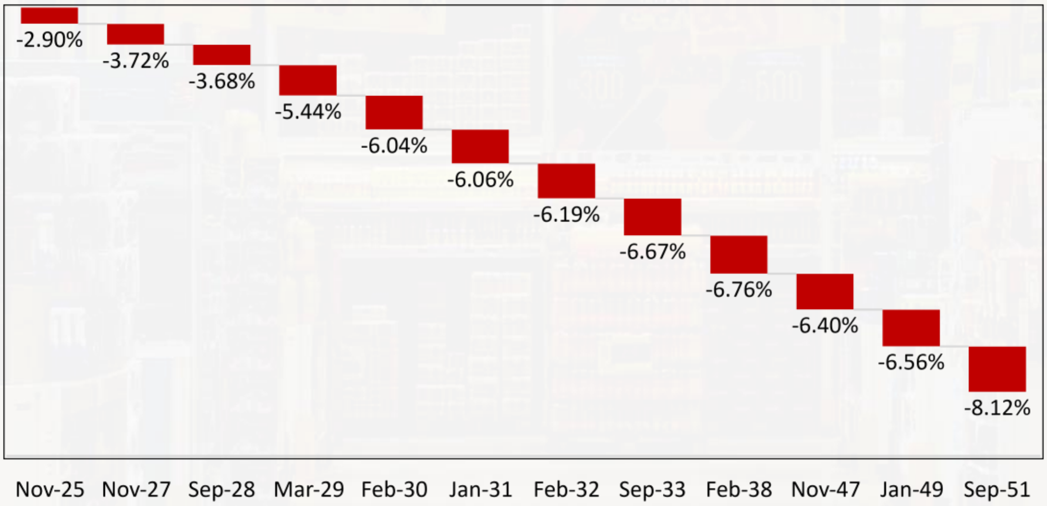


Source: *CBN, Meristem Research*

Fixed Income

In the Eurobonds market, the mood was also relatively mixed. Nigerian instruments started the month on a positive note, especially the long-dated instruments, as investors remained optimistic about implemented economic reforms. However, signals of another rate hike in the US given the hawkish stance of the US Feds in its July meeting, piloted a bearish sentiment in the market. Also, concerns around the country's low foreign exchange reserves gleaning from the CBN's financial statements released during the month, sparked selloffs across instruments. As a result, the average Eurobond yield edged higher by 108bps to 11.02% at the end of August.

Chart 6: **Price Returns of Nigerian Eurobond Instruments (August 2023)**



Source: ***DMO, Meristem Research***

Summary of Key Expectations for September 2023

In September, we expect the yields on Treasury instruments to trend upward. Chiefly, the system liquidity will remain the major determinant of the market's direction. Specifically, we consider the CBN's liquidity management strategies and the Government's need to prudently manage its borrowing costs as key drivers for this expectation. Another factor is the investors' quest and demand for higher yields to narrow the gap between their nominal return and the country's inflation rate.

Table 4: ***Recommended Nigerian Eurobond Instruments***

Security	TTM (Years)	Maturity Date	Coupon Rate	Yield to Maturity*	Amount Issued (USD'bn)
Jan-2049	26	21-Jan-2049	9.248%	11.530%	0.75
Nov-2047	24	28-Nov-2047	7.625%	11.245%	1.50
Feb-2032	9	16-Feb-2032	7.875%	11.136%	1.50
Sep-2051	28	28-Sep-2051	8.250%	11.671%	1.25

**** Please note that the YTM stated above are as at the time of this report, and thus are indicative. They can be different at the time of trade execution.***

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CONTACT INFORMATION

Brokerage and Retail Services
topeoludimu@meristemng.com (+234 905 569 0627)
adaezeonyemachi@meristemng.com (+234 808 369 0213)
contact@meristemng.com

Investment Banking/Corporate Finance
rasakisalawu@meristemng.com (+234 806 022 9889)
davidadu@meristemng.com (+234 810 940 4836)

Wealth Management
funmilolaadekola-daramola@meristemng.com (+234 803 355 0008)
crmwealth@meristemng.com (+234 01 738 9948)

Registrars
oluseyiowoturo@meristemregistrars.com (+234 802 321 0561)
www.meristemregistrars.com (+234 01 280 9250)

Group Business Development
sulaimanadedokun@mersitemng.com (+234 803 301 3331)
ifeomaanyanwu@meristemng.com (+234 802 394 2967)
info@meristemng.com

Trust Services
damilolahassan@meristemng.com (+234 803 613 9123)
trustees@meristemng.com

Investment Research
damilareojo@meristemng.com (+234 816 890 2771)
praiseihansekhien@meristemng.com (+234 817 007 1512)
research@meristemng.com

Client Services
adefemitaiwo@meristemng.com (+234 803 694 3034)
car@meristemng.com (+234 01 280 9250)

Meristem Finance Limited
olasokomubo@meristemfinance.com (+234 803 324 7996)
matthewawotundun@meristemfinance.com (+234 802 390 6249)

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