MERISTEM

Macro and Market Insight

September 2023

Macros

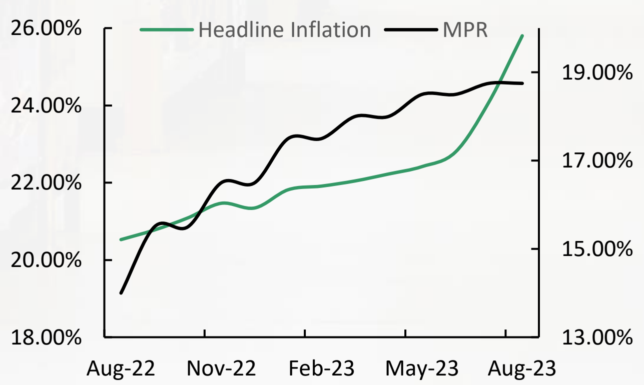
Key Developments Shape Economic Landscape in Q3

Review

The third quarter of 2023 ended with various activities happening in the fiscal and monetary space – the inauguration of a new tax committee, increased debt profile, confirmation of a new CBN governor and ministerial nominees, downgrade by FTSE Russell, persistently high inflation and continuous foreign exchange volatility.

To begin, headline inflation rate according to the National Bureau of Statistics (NBS), settled at 25.80% at the end of Q3 (vs 22.79% in June 2023). Existing supply chain challenges, such as poor infrastructure, and higher fuel prices have raised transportation costs for agricultural products, resulting in higher food prices. Thus, food inflation reached its 18-year peak at 29.34%. Additionally, the depreciation of the Naira in the I&E window (-80.25% YoY and -2.34% MoM) and a 6.40% depreciation in the parallel market in August led to increased costs for import-dependent categories like healthcare, clothing, and gas, resulting in higher prices for these items.

Chart 1: Headline Inflation Rate (YoY Change) and MPR



Source: NBS, CBN, Meristem Research

For September, we expect the price moderating effect of post-harvest supplies of staples such as maize, yam and vegetables to begin slowing down the pace of overall price growth. However, given that persisting issues linger in the agricultural value chain (coupled with potential for higher energy prices), we believe that food inflation is likely to sustain its northward movement.

Furthermore, rising global energy prices (influenced by Russia and Saudi Arabia's extended oil production cuts), combined with the ongoing depreciation of the Naira is projected to drive up the price of premium motor spirit (PMS) and other imported goods. We also expect the low base effect from September 2022 to further increase the inflation rate.

In its upcoming monetary policy meeting, we expect the committee to consider the impact of recent policy reforms, system liquidity and ongoing fluctuations in the foreign exchange market on Nigeria's raging inflation.

To address some of the issues affecting government revenue and the oil and gas sector, the Nigerian National Petroleum Company Limited (NNPCL) has undertaken some collaborations with major stakeholders. These include the one with Indorama Eleme Petrochemicals, aimed at exploring opportunities within Nigeria's hydrocarbon value chain and advancing natural gas production and utilization. Also, the NNPCL's is partnering with the Nigerian Content Development and Monitoring Board (NCDMB) and International Oil Companies (IOCs) to streamline oil contracting process to a maximum of 180 days. These developments are expected to reduce costs, improve overall efficiency in the oil and gas sector, improve government revenues and FX inflows and ultimately result in increased production volumes.

Also, the Debt Management Office (DMO) reported a significant +75.29% QoQ increase in Nigeria's total debt stock in Q2:2023. By June 2023, the total debt surged to NGN87.38trn, up from NGN49.85trn in March 2023. This notable increase can be primarily attributed to two key factors: the inclusion of the securitized FGN Ways and Means advance of the Central Bank of Nigeria (CBN), amounting to NGN22.71trn, and the effect of the Naira devaluation (*which saw exchange rates peak at NGN841.00/USD1.00 as of 30 June 2023 on the I&E window*) on the external debt component.

Macros

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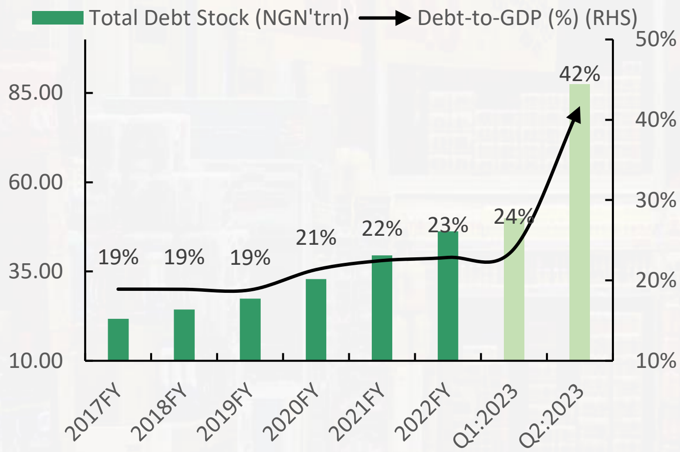
Chart 2: Nigeria's Debt Stock (NGN'trn) and Debt-to-GDP ratio (%) (RHS)



Source:* *DMO, Meristem Research

This raises concerns about Nigeria's fiscal metrics, particularly the debt-to-GDP ratio, which deteriorated to c.42% by June 2023 (as it moves closer to the FGN's self-imposed benchmark of 45% and IMF's recommendation of 55%). Although the body language of the government tilts towards limiting borrowing and reducing the government debt balance, we believe that the government would still rely on domestic debt funding given sub-par revenue performance to fund its budget deficits and thus, could potentially increase debt levels in the near term.

As the country's debt load continues to mount, we anticipate an accompanying rise in debt servicing obligations. This amplifies concerns over Nigeria's debt sustainability and heightens potential for downgrades and credit rating agencies. Nonetheless, there is optimism surrounding the reforms by the President's team, which aim to strengthen the government's revenue-generating capacity, potentially reducing reliance on debt to fund the budget.

Elsewhere, the country's external reserves declined by 2.29% in Q3:2023 settling at USD33.24bn (the lowest level since July 2021), compared to USD34.02bn at the quarter's outset. This decline can be attributed to the absence of accretion to the nation's reserves, primarily due to the ongoing challenges in the oil sector, insufficient foreign exchange revenue to bolster the reserve and low capital inflows. For the first time on record, the Naira crossed NGN1000/USD1.00 in the parallel market in September as demand for the greenback surged amidst the crippling FX supply. While we anticipate improved performance in the oil sector, we do not envisage significant additions to the reserves in the short term. Foreign capital is also likely to remain unattracted to investment in the country until current FX backlogs are cleared, restrictions on importation are lifted and there's significant improvement in the macroeconomic environment.

Key Expectations for October 2023

- ***Continued uptrend in headline inflation.***
- ***Low capital imports***
- ***A 25bps hike in the Monetary Policy Rate (MPR) at the upcoming monetary policy committee meeting based on the anticipated uptrend in headline inflation.***
- ***Sustained depreciation of the Naira due to inadequate supply of foreign exchange (FX).***

Equities

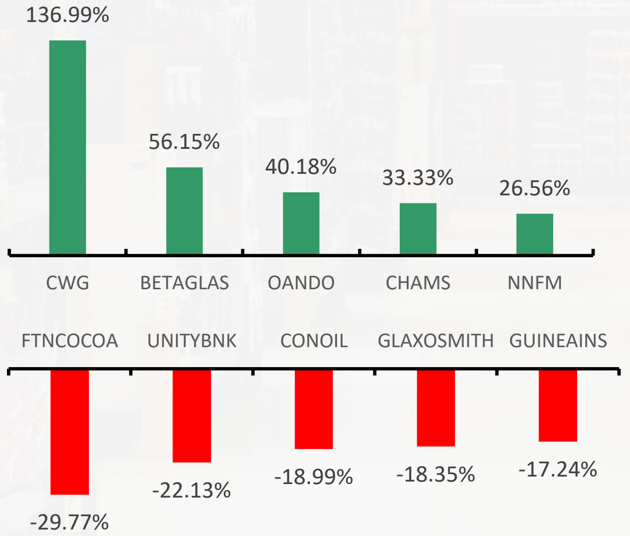
The Bears Resurface After a Four-month Long Hiatus

Review

In September, the bears overturned the upbeat mood in the market leading to the local bourse's first decline in five months. The All-Share Index (**NGXAS**I) shed 0.25% MoM to settle at 66,382.14pts with a Year-to-Date return of +29.52%. Nonetheless, activity levels remain elevated as both volume and value traded increased by 19.45% MoM and 8.03% MoM to 10.91bn units and NGN143.50bn, respectively. Similarly, the market breadth improved to 1.29x from 0.84x in August.

Assessing the Q3:2023 wholly, the market closed in the green zone for the fourth consecutive quarter (+8.88% QoQ).

Chart 3: Top Gainers and Losers for September 2023

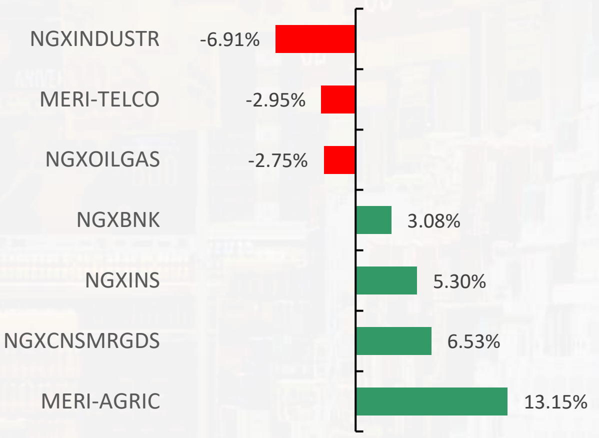


***Source:* Bloomberg, Meristem Research**

Sectoral Performances Take Diverse Turns

Performance varied across the sectoral indices we track. The bearish sentiment in the market was reflective in **NGXINDUSTR** (-6.91% MoM), **NGXOILGAS** (-2.75% MoM), and **MERI-TELCO** (-2.95% MoM) while **NGXBNK** (+3.08% MoM), **NGXCNSMRGDS** (+6.53% MoM), **MERI-AGRIC** (+13.15% MoM) and **NGXINS** (+5.30% MoM) gained during the month. Particularly, the industrial goods sector saw the highest decline due to investors' concerns about the likely downward price review of cement, thus, impacting the expectations of financial results of cement players. As such, sell-offs rocked **BUACEMENT** (-11.08% MoM) and **DANGCEM** (-5.56% MoM).

Chart 4: Monthly Sectoral Returns for September 2023



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

Market Giants Throw Their Weights

Despite the positive indicators (activity level, market breadth and sectoral performance), the market downturn was aggravated by sell-offs on large-cap stocks. Specifically, heavyweight tickers such as **BUACEMENT** (-11.08% MoM), **DANGCEM** (-5.56% MoM), **MTNN** (-3.83% MoM), **ZENITHBANK** (-4.41% MoM), **NESTLE** (-6.82% MoM), and **GTCO** (-6.13% MoM) recorded monthly losses. Collectively, these stocks account for 47.02% of the total market capitalization, thus, influencing market direction.

Macroeconomic Uncertainties Dampen Investors' Confidence

During the month, uncertainties around the domestic macro-economic landscape and developments from the monetary authority contributed to the negative market direction. Notably, FTSE Russell's (a primary provider of global market benchmarks and indices) downgraded Nigeria's classification from a frontier market to an unclassified market – *owing to the existing concerns on volatility of exchange rate and funds repatriation.* This immediately impacted the local bourse as the NGX-ASI lost 1.10% WoW when the disclosure was released.

MERISTEM

Equities

Notable Occurrences and Corporate Actions

Ellah Lakes Plc (**ELLAHLAKES**) disclosed its intention to raise NGN2.90bn in capital via a rights issue of 1.00bn ordinary shares at NGN2.90 per share on the basis of one (1) new ordinary share for every two (2) ordinary shares held, following approval from the Securities Exchange Commission (SEC). The qualification date for the issue is February 10, 2023, while the application is expected to open on October 9, 2023. Furthermore, compared to its closing price of NGN4.08 as of 29th September 2023, the proposed price presents an upside potential of 46.69% for qualifying shareholders who are willing to subscribe to the issue. **Given the firm's inconsistent corporate governance practices and weak fundamentals, we do not recommend subscription to the rights issue for investors.**

In addition, Fidelity Bank Plc. (**FIDELITYBK**) announced the completion of its 100% acquisition of Union Bank UK Plc (UBUK) following the Bank of England's Prudential Regulatory Authority (PRA) approval. This move aligns with the bank's expansion strategy to extend its operations beyond the Nigerian market. **We do not expect this acquisition to have an immediate impact on FIDELITYBK's profitability as UBUK has been reporting losses in recent years. However, the successful implementation of turnaround strategies by FIDELITYBK will be instrumental in creating value for its shareholders in the long term**. The ticker gained 17.73% MoM to close the month at NGN8.30.

Also, PZ Cussons Nigeria Plc (**PZ**) revealed that its majority shareholder (PZ Cussons Holdings Limited) has offered to purchase all outstanding shares held by minority shareholders in PZ at a price of NGN21.00 per share and subsequently delist from the Nigerian Exchange to become a private company. The disclosure of a buyback sparked buying interest on the ticker as it gained 14.29% MoM to reach NGN20.00, thereby presenting an upside potential of 5.00%. **However, since the buyout is still pending approval from regulatory authorities and minority shareholders have been reported to reject the offer, we advise cautious trading on the ticker.**

Oando Plc. (**OANDO**) announced its agreement with ENI – *an Italian multinational energy company* – to acquire 100% of ENI's outstanding shares of Nigerian Agip Oil Company Limited (NAOC Ltd). Still subject to regulatory approvals, the proposed transaction if successful has the potential to significantly augment OANDO's production capacity and bolster its position within the Nigerian upstream oil and gas sector. Moreover, with the release of its 2021 financials during the month and intention to delist from the Nigerian Exchange as disclosed earlier this year, investors are expectant of a higher price settlement. As such, the ticker gained 40.18% MoM to NGN7.85. **However, considering that the ticker is currently trading above the company's proposed buyout price of NGN7.07, we recommend existing investors to retain their positions while potential investors are advised to trade cautiously.**

Summary of Key Expectations for October 2023

We anticipate a predominantly mixed market sentiment in October, driven by various factors. While we foresee investors engaging in targeted bargain hunting activities on stocks that pose appealing entry points, we however note that the unfavourable macroeconomic indicators could persistently weigh on market momentum. Overall, we expect a blend of sentiments to influence market activities in October.

Table 1: ***Below is a list of some stock(s) with price appreciation prospects that investors can take advantage of.***

Ticker	Current Price (NGN)	Target Price (NGN)	Upside (%)
AIICO	0.69	0.79	+15%
FIDSON	14.86	22.47	+51%
GTCO	35.20	45.70	+30%
WAPCO	29.50	34.48	+17%

**prices are updated as of October 3rd, 2023*

Fixed Income

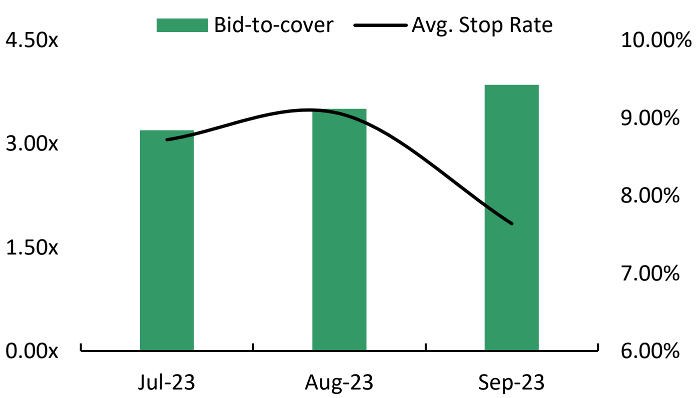
Liquidity Trend and Rate Rhythm

Review

In line with previous trend, three Treasury Bills' Primary Market Auctions (PMA) were held in September to mark the end of the third quarter. In September, the Central Bank of Nigeria (CBN) offered and successfully raised a total sum of NGN544.05bn – the highest on record. Across these PMAs, an overall subscription of NGN2.31trn was recorded (3.07% lower compared to August, which had only two auctions). This can be attributed to significantly lower interbank liquidity levels during the period. To put this into perspective, the average interbank liquidity reported by the CBN for September was NGN65.87bn (vs NGN272.43bn in August). Consequently, the total subscription-to-offer and bid-to-cover ratio in September (4.24x) stayed lower than the figure recorded in the previous month (5.20x), indicating reduced investors' demand for Treasury instruments during the period. Notwithstanding, stop rates on the 91-Day, 182-Day, and 364-Day instruments fell by 20bps, 145bps, and 260bps to 4.99%, 6.55%, and 11.37%, respectively.

At the bond Primary Market Auction (PMA) for September, the Debt Management Office (DMO) reopened the APR-2029, JUN-2033, JUN-2038, and JUN-2053 instruments. Therefore, the DMO offered a total of NGN360.00bn across the four maturities (NGN90.00bn each). Similar to the T-Bills market, investors' participation at the auction was lower, evinced by the lower subscription (NGN291.00bn vs. NGN312.56bn in August) and lower bid-to-cover ratio (1.16x vs. 1.37x in August). Thus, marginal rates on the MAY-2029, JUN-2033, JUN-2038 and JUN-2053 instruments rose by 65bps, 45bps, 35bps, and 40bps to 14.50%, 15.45%, 15.55% and 16.25%, respectively.

Chart 5: Bid-to-Cover Ratio and Average T-bills Rate (Q3:2023)



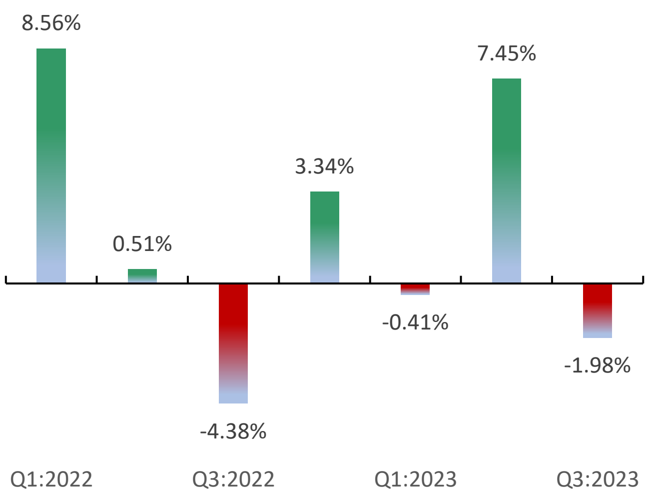
Source:* *CBN, Meristem Research

Worsening Macroeconomic Conditions Dissuade Investors

Activities in the secondary market reflected realities of the primary market during the period. Average yields in the T--Bills market peaked at 8.30% before settling at 7.86% (higher than 7.03% at the end of August). In the bonds market, average yield rose to 14.48% (vs 14.06% at the end of August).

Speaking to Q3:2023, the Nigerian bonds market recorded its worst quarterly performance since Q3:2022. In fact, the S&P FMDQ Nigeria Sovereign Bond Index (an index which tracks the performance of local currency denominated FGN debt) lost 1.98% QoQ. This can be largely attributed to the worsening macroeconomic conditions, leading to selloffs from investors as they continue to seek higher incentives to compensate for higher perceived credit risk.

Chart 6: S&P FMDQ Nigeria Sovereign Bond Index QoQ Performance



Source:* *S&P Global, Meristem Research

Expectations for October

- *October's yield dynamics will be influenced by multiple factors, with system liquidity playing a pivotal role.*
- *Expected inflows from bond coupon payments (NGN29.05bn) and FAAC allocation to boost liquidity.*
- *CBN's ongoing liquidity management efforts in response to rising inflation and macroeconomic concerns may trigger additional selloffs.*
- *Anticipating higher yields on Treasury instruments in October owing to these factors.*

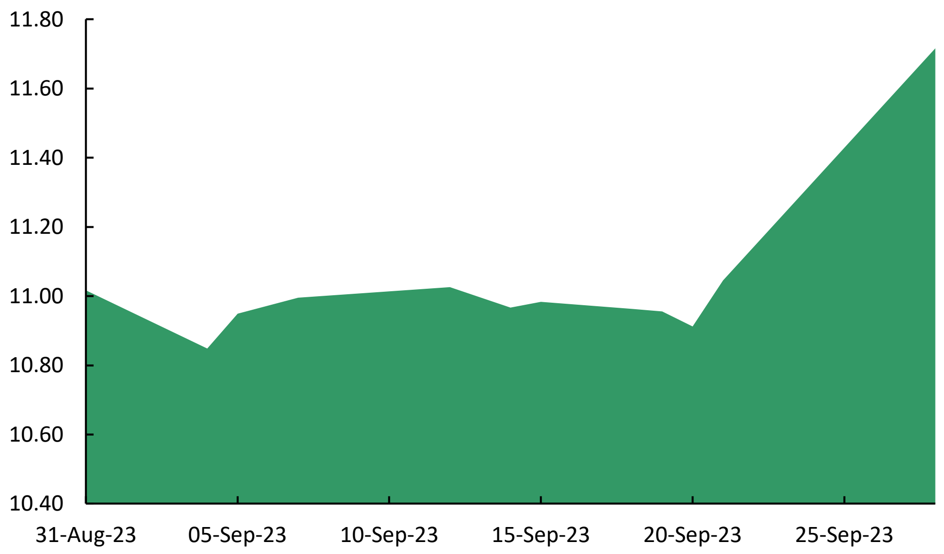
Fixed Income

In the Eurobonds market, investors sold-off in sizable volumes across all instruments except the NOV-2025, pushing average yield to 11.72% in September (vs 11.02% at the end of August). In our opinion, the Fed's hawkish tone on a likely rate hike this year and expectation for fewer rate cuts in 2024 sparked reactions from investors to take a short position on some Nigerian instruments in the Eurobond market.

Expectation for October

- *We expect the prevailing concerns to drive average Eurobond yield higher*

Chart 7: **Average Eurobond Yield in September (%)**



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

Summary of Key Expectations for October 2023

In October, the prevailing influence on yields is anticipated to be determined by several factors including system liquidity. On the supply end, inflows from bond coupon payments (NGN29.05bn), and FAAC allocation are anticipated to bolster system liquidity. However, the CBN's efforts to continuously manage system liquidity amidst the rising inflation and lingering concerns about the macroeconomic landscape could spark further selloffs. Thus, we expect a relatively higher yield on Treasury instruments in October. In the Eurobonds market, we expect the prevailing concerns to drive average Eurobond yield higher.

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