MERISTEM

External Sector Commentary

…Recovery Contingent on Continuous Strategic Actions

November 2023

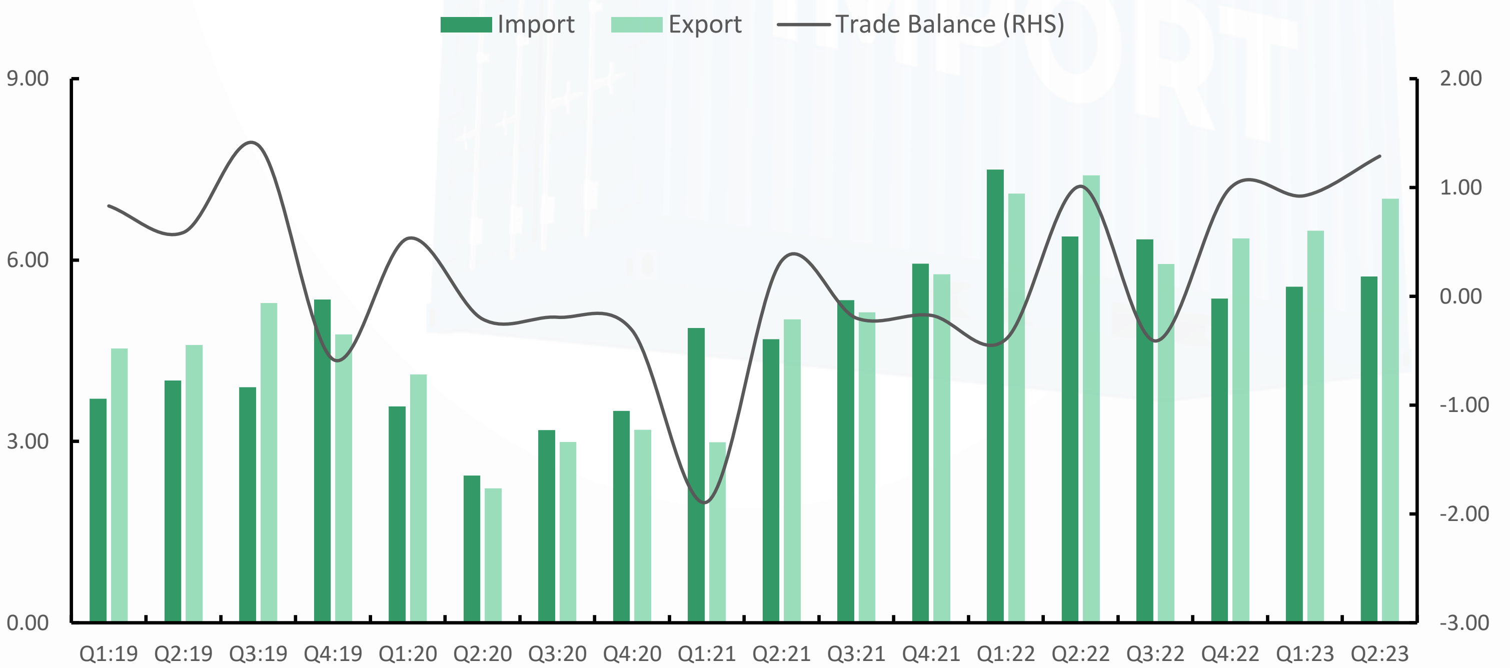
Trade Flows

…Trade Surplus Anchored on Lower Imports

Data suggests that Nigeria's external position remains weak as implied by key economic fundamentals (balance of payments, capital importation and foreign trade data). According to available data as of Q2:2023, while the current account and trade balance increased by 18.46% YoY and 27.37% YoY, respectively, the decline in crude oil prices (average of USD76.97 in Q2:2023 vs USD130.10 in Q2:2022) during the period resulted in lower exports value during the period.

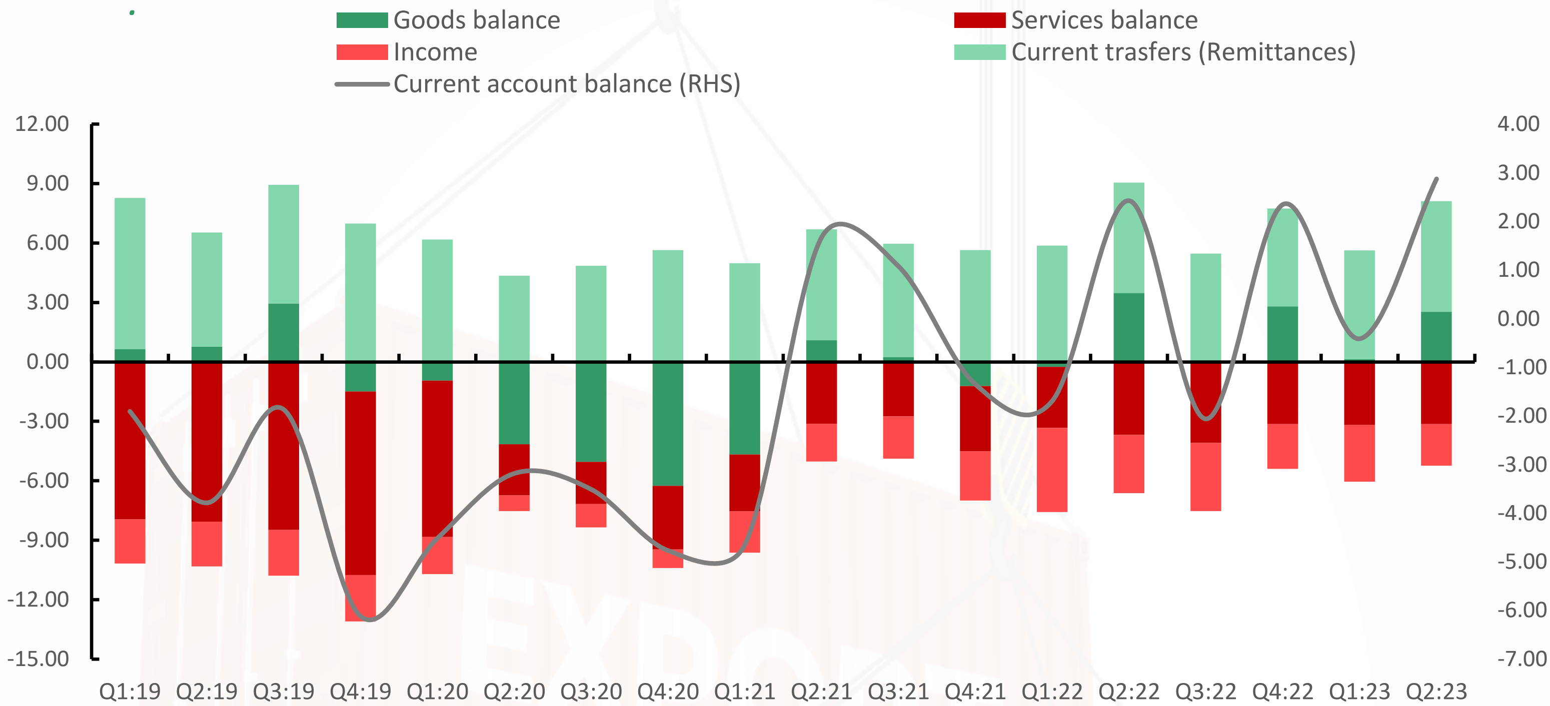
The data released by the National Bureau of Statistics (NBS) on foreign trade for the period reveals that the country's total trade dropped significantly by 12.68% YoY in H1:2023 and by 7.60% YoY in Q2:2023. Exports declined by 6.90% YoY in H1:2023 and 5.20% in Q2:2023 standalone, while total imports plunged by 18.71% YoY in H1:2023 and 10.37% YoY in Q2:2023. Data released by the Central Bank of Nigeria (CBN) on balance of payment also shows that oil and gas exports in the goods account sub-section declined by 24.52% YoY. Thus, the current account and foreign trade surplus balances recorded during the period were mainly due to workers' remittance inflows and lower import bill. Although a lower import bill appears positive, we opine that this is a consequence of the FX illiquidity and unavailability in Nigeria and not necessarily a result of import substitution.

Chart 1: Quarterly Foreign Trade (2019-2023) NGN'trn



***Source:** National Bureau of Statistics, Meristem Research*

Chart 2: Quarterly Current Account (2019-2023) USD'bn



Source: *National Bureau of Statistics, Meristem Research*

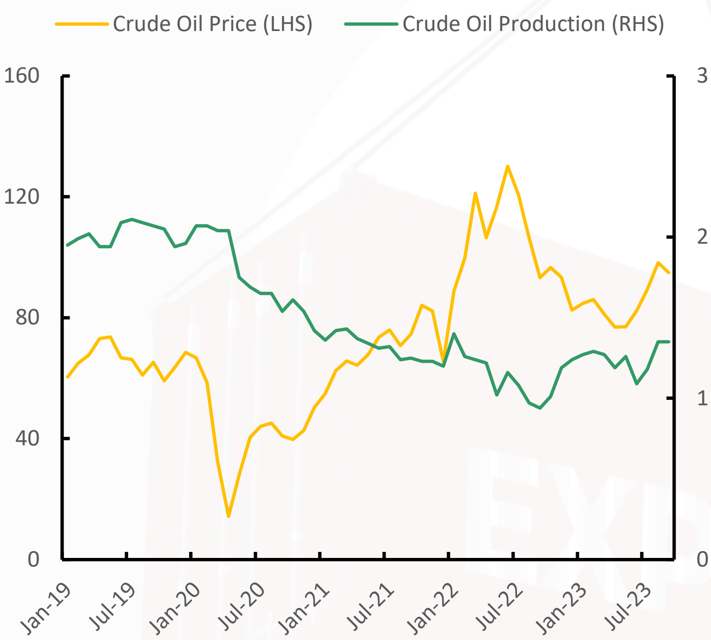
The data reflects the impact of the lower commodities prices compared to the same period last year as the impact of the Russia-Ukraine crisis on rising prices waned and oil supply increased. This also showed the impact of the slowdown in global economic activities, and a reallocation of commodity trade flows. Hence, the drop in the country's export levels was unsurprising given the challenges faced in the global oil market. Also, the country's inability to increase crude oil production to pre-pandemic levels significantly impacted oil exports during the period.

Crude oil exports, which account for c.80% of total exports, declined by 6.89% YoY in H1:2023. Across most emerging, developing and commodities trading economies, the story is similar as depreciating currencies and a slowdown in global demand impacted their respective external sectors, bringing down the volume of total trades.

Furthermore, we highlight that compared to what was obtained in the first half of 2022 (*when India was the favoured destination*), Europe (Netherlands) returned as the top destination for Nigeria's export making up 47.46% of total crude & other oil exports in H1:2023. While Spain was the 5th ranked destination of exports (trailing behind United States, Indonesia and France), re-exports to the country topped the charts further elevating total exports to the European region.

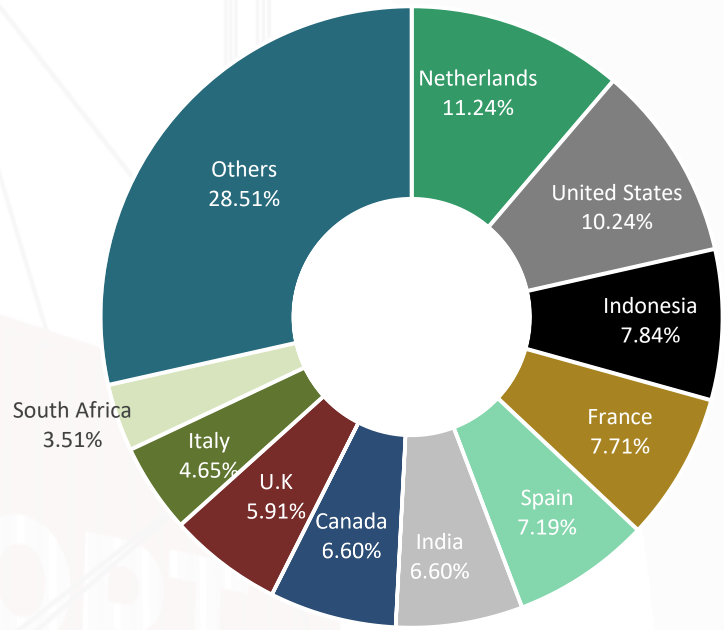
For the rest of the year, the trajectory for will depend on the economic growth or decline experienced by Nigeria's trading partners. Economic growth in the European region has been largely modest (0.1% QoQ in Q1 and 0.3% QoQ in Q2:2023) and is expected to settle at 1.30% in 2023 (vs. 2.70% in 2022).

Chart 3: Historical crude oil price (USD) and crude oil production (mbpd) (2019-2023)



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

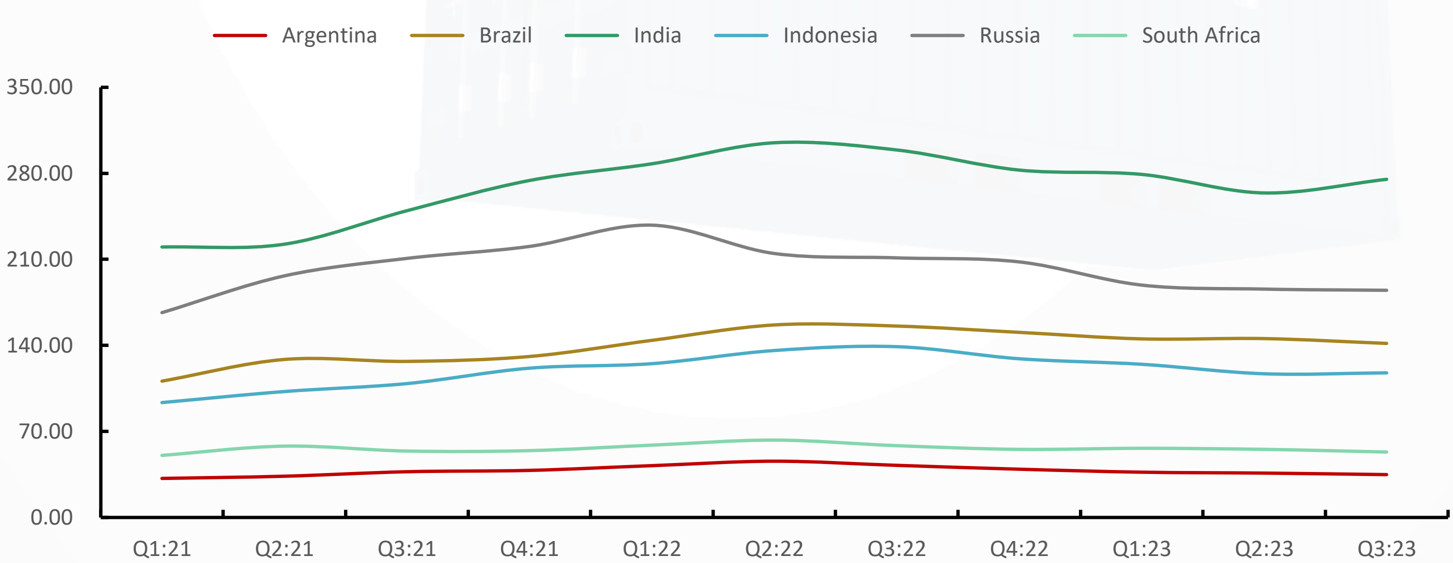
Chart 4: Graph of Top Export Destinations



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

The IMF also projects that the Asian region should grow by 4.2% in 2024, slower than the growth forecasted for 2023 (+4.60%). This does not stir optimism for a resurgence in export volumes in the second half of 2023 and in 2024. While we expect the relative stability of oil prices and improving oil production volumes thus far in the second half to provide some support for oil exports and, consequently, total exports, the implementation of agreed OPEC oil cuts will limit oil production in the coming year.

Chart 5: Total Trade Trend in Emerging Markets (2019-2023) USD 'bn



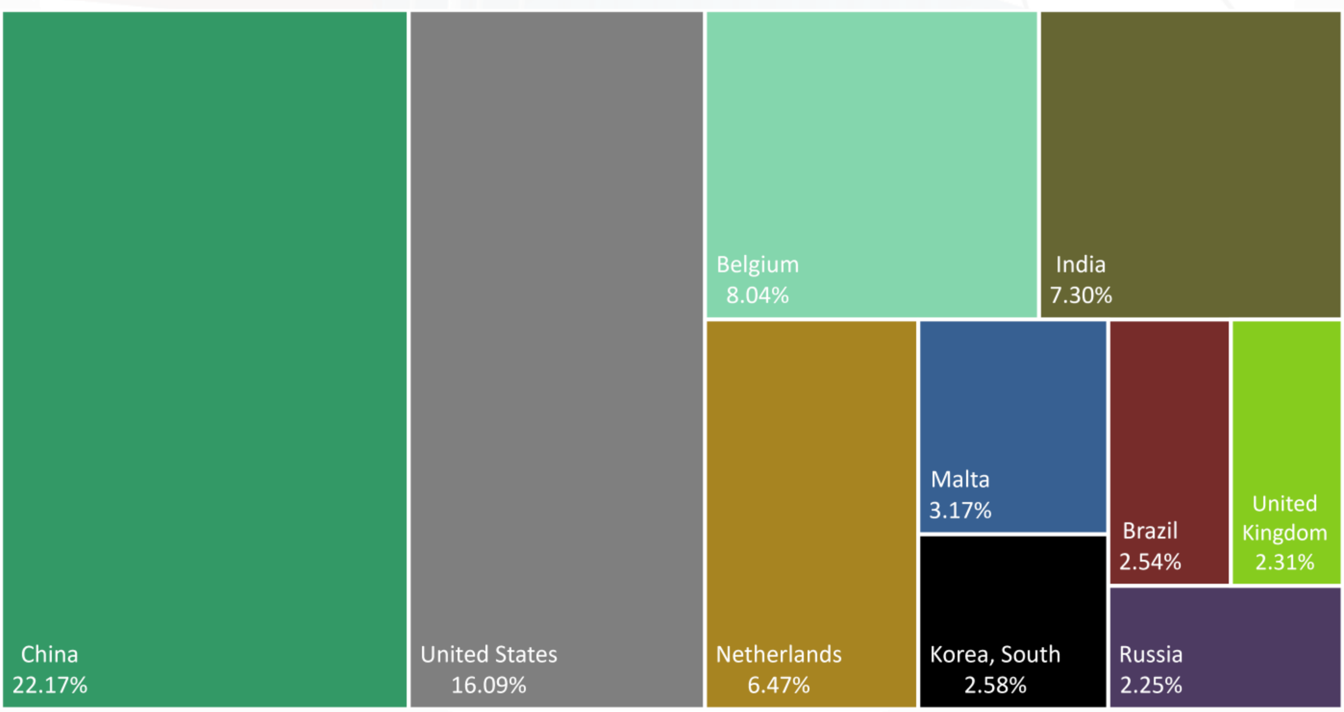
***Source:** OECD, Meristem Research*

On the import side, despite the decline in the import bill, the import statistics were largely the same. The Asian (particularly China) and European regions were Nigeria's main imports sources for the period, with China being the single largest exporter to Nigeria, accounting for 22.17% of total import.

Mineral products, machinery and appliances remain the main imported items (though the total value is yet to hit pre-pandemic volume). Others notable exporters to Nigeria during the period were – the United States (16.09%), Belgium (8.04%), India (7.30%) and Netherlands (6.46%). Also, we highlight that c.71% of oil products came in from Europe, while manufactured goods (c.53%), raw materials (C.41%) and Agricultural goods (c.53%) came in from Asia (particularly China).

Going forward, we expect the positive trade balance to be sustained. This is due to several factors which include: Improving oil production, naira devaluation which makes export cheaper and expected lower import bill. Our projection of lower import bill is anchored on the expectation that FX illiquidity is likely to persist in the short term as foreign capital into the country remains constricted.

Chart 6: Graph of Top Import Destinations



Source: NBS, Meristem Research

Capital Importation

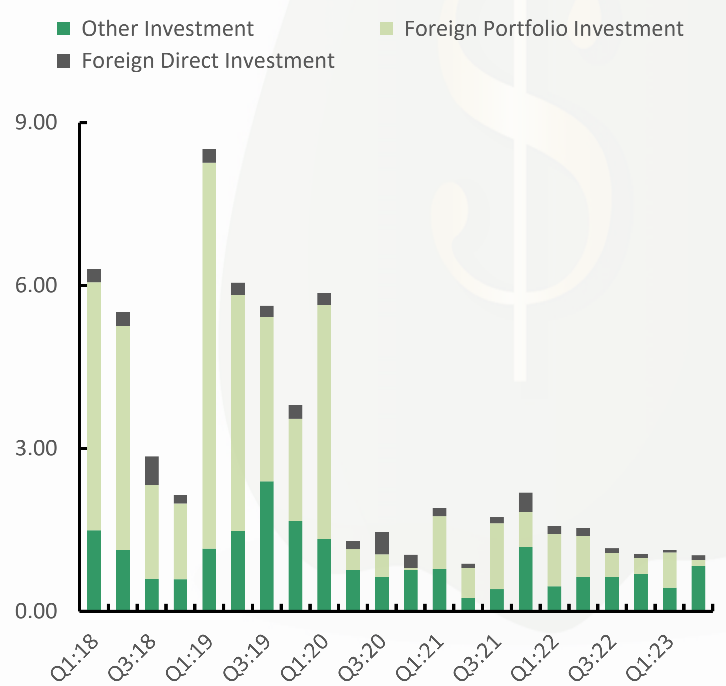
…Weak Inflows Persist Post-Pandemic

Given the country's weak macroeconomic indicators, impact of FX illiquidity on capital repatriation, the unattractive yield environment, alongside rising yields in developed markets (safe havens), it comes as no surprise that the influx of foreign capital into Nigeria remained low in the first half of 2023. This has largely persisted since the panic caused by the spread of the Corona virus pandemic triggered a significant wave of capital outflows from emerging markets.

Data from the National Bureau of Statistics shows that total capital inflow in H1:2023 declined to USD2.16bn indicating a decline of 30.42%YoY from USD3.11bn in H1:2022. On a quarterly basis, the total inflow in Q2:2023 (USD1.03bn) represents the lowest level of capital inflows in eight consecutive quarters (since Q2:2021).

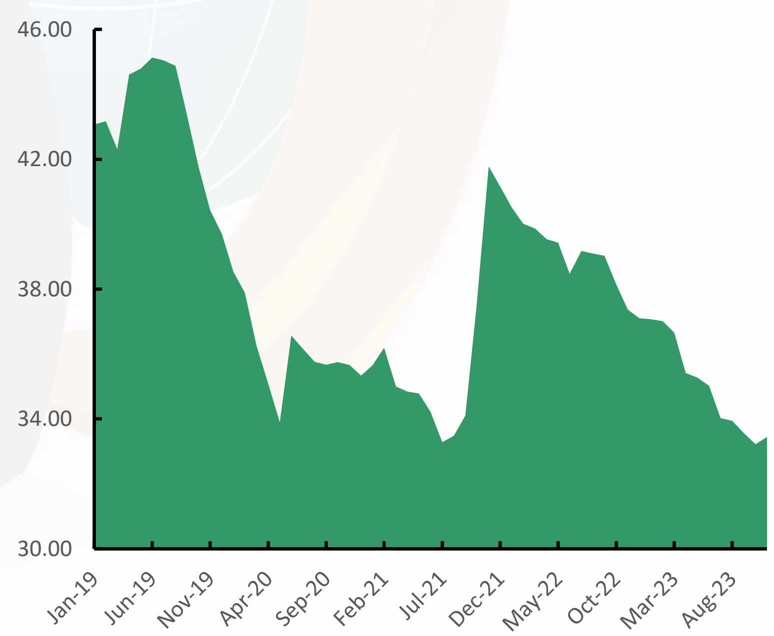
Foreign Portfolio Investment (FPI) declined by 85.89% YoY or 83.54 QoQ, to USD106.85mn, Foreign Direct Investment (FDI) fell by 41.54% YoY, but increased compared to Q1 by 80.71% QoQ to USD86.03mn. Other Investment Inflows however improved by 32.73% YoY and 92.16% QoQ to USD837.34mn.

Chart 7: Capital Importation (2018-2023) USD'bn



Source: NBS, Meristem Research

Chart 8: External Reserves (2019-2023) USD'bn

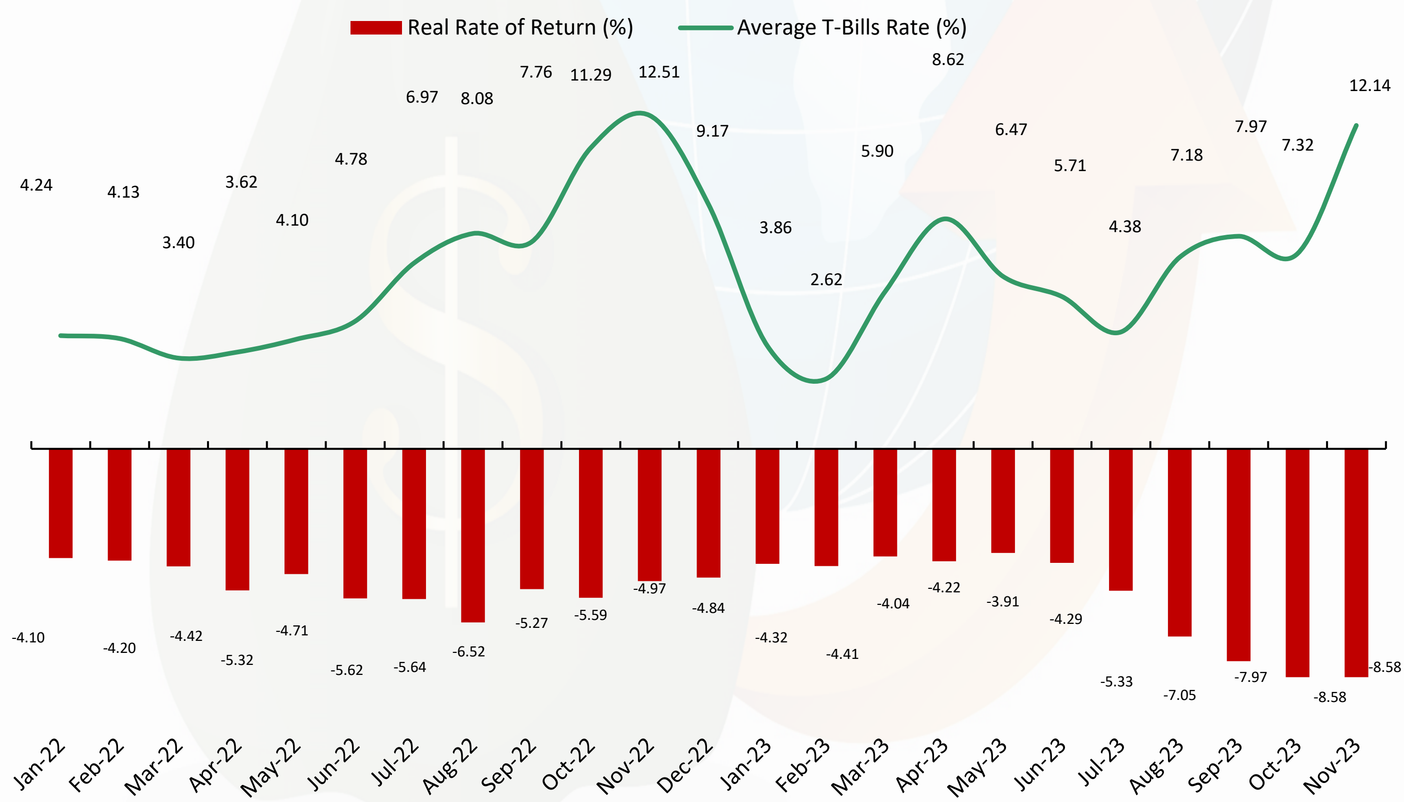


Source: CBN, Meristem Research

Over the past six (6) years, most of Nigeria's foreign capital has largely come from demand for money market instruments (which constitutes c. 73% of FPI), thus FPI inflows accounted for an average of c.60% of total capital over the period. In Q2:2023 however, the streak was reversed as FPI inflow made up only 10.37% of total capital with foreign investments in money market instruments declining by 96.91% YoY. In our view, the fact that the monetary policy rate has little or no signaling effect to fixed income yields and the low & unattractive yields in the fixed income market all through H1:2023, are primary catalysts for the low demand.

The significant decline in capital inflows and lower crude oil exports (as discussed earlier) have exacerbated the balance of payment challenges sparking a continuous decline in external reserves. As mentioned, the current account remains in a precarious situation as its surplus was mostly funded by a lower import bill and workers remittance inflows (which does not constitute accretion to the external reserves). Thus, the need to attract foreign capital to support the external reserves position cannot be over-emphasized.

Chart 9: Average Treasury Bills Rate and Real Rate of Return (2022-2023)



***Source:** FMDQ, Meristem Research*

The CBN undertook some recent policy changes which we view as steps in the right direction to resolving the country's exchange rate dilemma. These steps include:

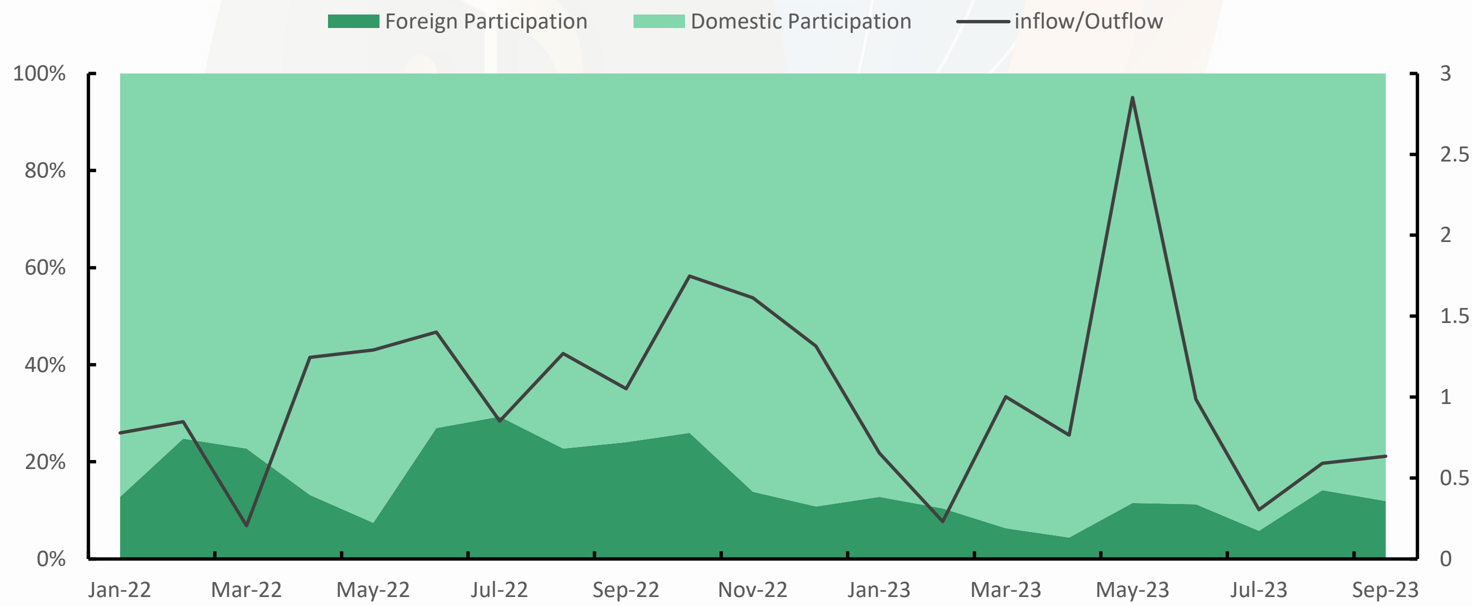
- lifting the 8-year restriction on 43 items banned from sourcing FX at the official window,
- the collapse of multiple official FX window,
- re-introduction of willing buyer-seller module at the FX windows
- and the clearing of c.10% of existing FX backlogs

If continuous implementation persists, we expect these policies (*in conjunction with other variables such as increased interest rate environment and improved macroeconomic outlook*) to improve Nigeria attractiveness as an investment destination for foreign capital in the medium to long term.

Already, so far in H2:2023 (especially in Q4), fixed income yields have largely risen from their previous levels (see chart 8 above). The CBN has also conducted three (3) Open Market Operation (OMO) auctions with yields as high as 17.98% on the longest end of the curve in the latest auction on (1st November 2023). We believe this would significantly serve to increase the attractiveness of Naira assets to both domestic and foreign investors. Furthermore, an assessment of the Nigeria Exchange Group's (NGX) data on foreign investment in the equities market also depicts an improvement in foreign investors participation (c. 12% as of Q3:2023 vs c.11% in Q2:2023 and c.6% in Q1:2023). Also, foreign inflow stood at NGN13.67bn, bringing the inflow/outflow ratio to its 3-month high of 0.63x.

We expect foreign portfolio inflows data for the second half of 2023 to reflect this improved fundamentals.

Chart 10: Graph of Foreign participation in NGX in % and chart of inflow/outflow ratio (2022-2023)



Source: NGX, Meristem Research

Contact Information

Investment Research
research@meristemng.com

Praise Ihansekhien
praiseihansekhien@meristemng.com

Corporate websites: www.meristemng.comwww.meristemwealth.comwww.meristemregistrars.com

Meristem Research can also be accessed on the following platforms:
Meristem Research portal: research.meristemng.com
Bloomberg: MERI <GO>
Capital IQ: www.capitaliq.com
Reuters: www.thomsonreuters.com
ISI Emerging Markets: www.securities.com/ch.html?pc=NG
FactSet: www.factset.com

IMPORTANT INFORMATION: DISCLAIMER

Meristem Securities Limited (''Meristem'') equity reports and its attendant recommendations are prepared based on publicly available information and are meant for general information purposes only and it may not be reproduced or distributed to any other person. All reasonable care has been taken to ensure that the information contained herein is not misleading or untrue at the time of publication; **Meristem** can neither guarantee its accuracy nor completeness as they are an expression of our analysts' views and opinions.

Meristem and any of its associated or subsidiary companies or the employees thereof cannot be held responsible for any loss suffered by relying on the said information as this information as earlier stated, is based on publicly available information, analysts' estimates and opinions and is meant for general information purposes and should not be construed as an offer to buy or sell or a solicitation of an offer to buy or sell securities or any financial instruments. The value of any investment is subject to fluctuations, i.e. may fall and rise. Past performance is no guide to the future. The rate of exchange between currencies may cause the value of investment to increase or diminish. Hence investors may not get back the full value of their original investment. Meristem Securities is registered with the Securities and Exchange (SEC) and is also a member of The Nigerian Stock Exchange (The NSE). Meristem Securities' registered office is at 20A Gerrard Ikoyi, Lagos, Nigeria. Website: www.meristemng.com; Email: research@meristemng.com.