MERISTEM

Macro and Market Insight

October 2023

Macros

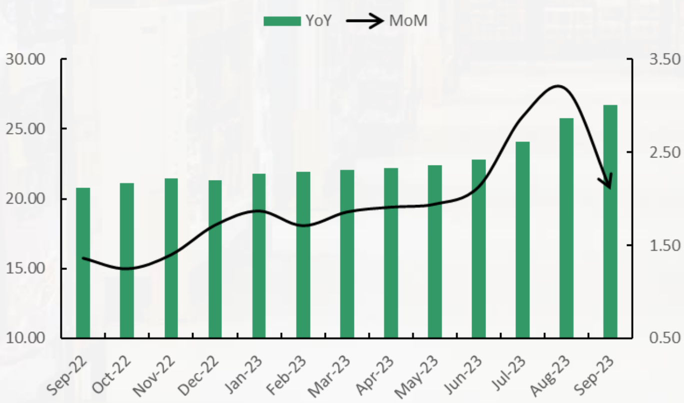
Challenges Persist in Nigeria's Macroeconomic Landscape

Review

In October, the macroeconomic landscape in Nigeria showed little deviation from previous months. The swift and widespread impact of Naira depreciation, combined with the surge in oil prices, has continued to exert upward pressure on prices. According to the National Bureau of Statistics (NBS), the headline inflation rate for September 2023 climbed further to 26.72% YoY, marking an uptick from the 25.80% YoY reported in August 2023.

Food prices within the country remain elevated, as evidenced by a 30.64% YoY increase in the food index. Nevertheless, post-harvest season supplies softened the impact of this food index rise (2.45% MoM vs. 3.87% MoM in August 2023). Furthermore, the core index rose to 21.84% YoY due to the Naira depreciation, heightened diesel prices and the global surge in crude oil costs.

Chart 1: Headline Inflation Rate (YoY and MoM)



Source:* *NBS, CBN, Meristem Research

In the near term, we anticipate continued high headline inflation due to several factors.

- **Heightened concerns about the Northern Nigeria region facing flash floods from increased rainfall and dam outflows in Cameroon.**
- **Rising transportation costs for food items and existing agricultural challenges which are likely to push up the food index.**
- **Furthermore, the weakening currency's impact on imported inflation and import dependent items**
- **Expected increases in energy costs, partly due to OPEC+ supply cuts and the ongoing Middle Eastern conflict.**

The National Upstream Petroleum Regulatory Commission (NUPRC) reported that Nigeria's crude oil production for September rose to 1.35mbpd compared to 1.18mbpd in August 2023. This marks the highest production level since January 2022. The government's heightened efforts to address security concerns in the oil-producing regions, alongside enhanced surveillance and security measures aimed at curbing crude oil theft and vandalism contributed to the rise in production levels during the month. Despite the increase in production volume, we note that this is still below the OPEC+ production quota of 1.80mbpd. Looking ahead, unless any unforeseen operational issues or sudden terminal closures occur, we envisage that oil production levels will maintain their upward trend. However, increased arbitrage activities (oil theft and pipeline vandalism) remain a potential risk to this outlook.

According to the Budget Office of the Federation, the Federal Government has proposed a budget of NGN26.01trn for the 2024 fiscal year (19.15% up from last year's budget). 65.21%, of the budget is projected to be funded by government revenue, resulting in a deficit of NGN9.05trn. This budget is contingent on several key assumptions, including a projected oil price of USD73.96/bl, an NGN700.00/USD exchange rate, and a planned oil output 1.78mbpd.

In our view, while the country's oil production volume has been on the rise recently, achieving the daily target of 1.78mbpd requires the government to ramp up measures to prevent theft and also increase investments in the oil sector. Additionally, considering the persistent illiquidity in the foreign exchange market, we do not envisage a significant reversal in the Naira depreciation trend in the short term. We opine that the naira faces the risk of depreciating further than the projected range unless the government can implement a long-term solution and significantly boost liquidity in the market.

Macros

Challenges Persist in Nigeria's Macroeconomic Landscape

During the month, the Central Bank of Nigeria (CBN) lifted the 8-year long restriction of some 43 items from access to FX on the official window. This development follows the CBN's liberalization of the of the exchange rate regimes earlier in the year. In the light of this announcement, importers and manufacturers dealing in these items are now able to obtain FX through the official I&E Window (now NAFEM). Manufacturers and importers, in response to these restrictions, sought foreign exchange from the parallel market, contributing to the persistent depreciation of the Naira in the parallel market. Correspondence from financial institutions and Airline operators also indicate that the CBN has begun to clear existing backlogs of FX forwards owed to these institutions.

While the lifting of the 8-year long restriction signals a positive move to alleviate pressure in the parallel market, its immediate impact may be constrained by limited foreign exchange availability. Additionally, this shift will heighten the demand for foreign currency through official channels. Thus, to achieve a more sustainable solution that strengthens the Naira and minimizes foreign exchange fluctuations, we opine that the government needs to prioritize increasing FX supply and enhancing our export capacity.

Elsewhere, the World Bank in its recent outlook projected that Nigeria's economy would rise by 2.90% in 2023. The prognosis hinges on the continued depreciation of the Naira, which is anticipated to exert pressure on the non-oil and oil sectors. Simultaneously, the IMF revised its 2023 growth estimate for Nigeria from 3.20% to 2.90%, citing lower oil and gas production as the primary driver of this adjustment.

Notably, these projections closely align with our own projection of 2.94% YoY for Nigeria's GDP growth in the fiscal year 2023. Our outlook is based on our expectation of a slight improvement in the oil sector and a better performance in the non-oil sector.

In Q2:2023, Nigeria's total capital inflows declined by 32.90% YoY and 9.04% QoQ to settle at USD1.03bn. The decline is predominantly owing to a substantial drop in foreign direct investment (-41.54% YoY) and portfolio investment (-85.89% YoY). Notably the banking sector's contribution to total capital inflow dwindled to 18.89% in Q2:2023 from 26.89% in Q1:2023 and 39.21% in 2022FY.

The oil and gas sector however registered zero capital inflow in Q2:2023, raising doubts about the outlook of expansion in this industry. In our opinion, the country's worsening macroeconomic landscape — high inflation, foreign exchange (FX) illiquidity, and sluggish economic growth have all contributed to this challenging economic environment, making Nigeria less appealing to foreign investors.

We do not expect a significant increase in capital inflows in the near term due to the ongoing structural challenges that discourage foreign investment. However, we maintain an optimistic outlook, considering that the effective implementation of reforms will send positive signals to foreign investors and may improve the country's capital inflow position in the future.

The Business and Property Court in London has rendered a ruling that nullifies the USD11.00bn damages claim that Process and Industrial Development Ltd (P&ID) had brought against the Federal Government of Nigeria for the unsuccessful gas processing arrangement that was signed in 2011. Citing that the award was gained fraudulently, and that the procurement process breached public policy, the London court annulled the implementation of the USD11.00bn arbitration verdict.

We view this ruling a positive development, particularly in the light of Nigeria's financial constraints and limited external reserves.

Key Expectations for November 2023

- ***Sustained northward trajectory in inflation.***
- ***Capital inflows to further decline.***
- ***A 25bps hike in the Monetary Policy Rate (MPR) at the upcoming monetary policy committee meeting based on the projected sustained headline inflation uptrend.***
- ***Continuous depreciation of the Naira amidst unrelenting FX illiquidity.***

MERISTEM

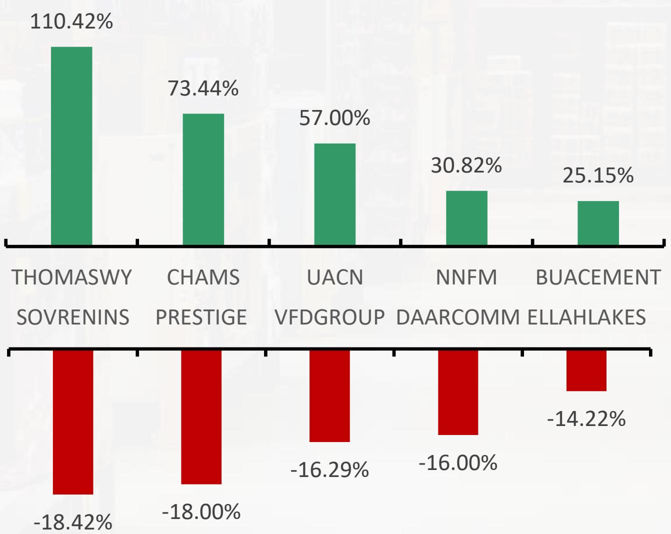
Equities

Local Bourse Exhibits Resilience Despite Unstable Macros

Review

In October, the Nigerian equities market was characterized by both bearish and bullish sentiments, but ultimately, the local bourse finished the month in the green territory. The All-Share Index (**NGXASI**) gained 4.30% MoM to reach 69,236.19pts while the Year-to-Date return climbed to +35.09%. The market breadth remained above the 1.00x mark at 1.39x (vs 1.29x in September). Despite this positivity, trading activity levels decreased to its lowest in 6 months – both volume and value traded declined by 37.09% MoM and 26.49% MoM to 7.05bn units and NGN148.03bn compared to 11.20bn units and NGN148.03bn last month, respectively.

Chart 3: Top Gainers and Losers for October 2023

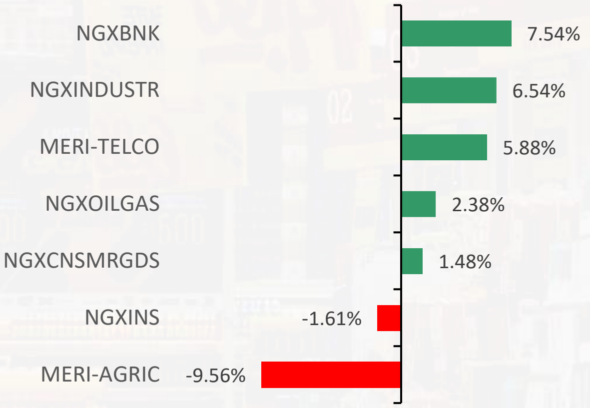


Source: Bloomberg, Meristem Research

Sectoral Performance Tilted to the Positive

Reflecting the positive sentiment in the market, five of the seven sectoral indices in our purview recorded month-on-month gains – **NGXINDUSTR** (+6.54% MoM), **NGXOILGAS** (+2.38% MoM), and **MERI-TELCO** (+5.88% MoM) while **NGXBNK** (+7.54% MoM) and **NGXCNSMRGDS** (+1.48% MoM) while **MERI-AGRIC** (-9.56% MoM) and **NGXINS** (-1.61% MoM) ended the month in red due to profit taking activities. Notably, the Telecoms sector ended its 4-month consecutive decline as the interim dividend declaration by **AIRTELAFRI** (+19.39%) sparked buying interests on the ticker. Also in the industrials goods sector, investors interest on **BUACEMENT** (+25.15% MoM) picked up following the announcement of a reduction in ex-factory cement prices which is expected to boost sales volume and revenue expansion for the firm.

Chart 4: Monthly Sectoral Returns for October 2023



Source: Bloomberg, Meristem Research

Investors' Unfazed by MSCI Reclassification

The Morgan Stanley Capital Index (MSCI), *a renowned provider of benchmark indices and portfolio analysis tools,* has reclassified the Nigerian stock market from Frontier markets to Standalone market status, effective January 2024. The move to reclassify comes in response to the challenging macroeconomic conditions in Nigeria, specifically the issue of foreign exchange illiquidity which has adversely impacted the flow of funds and repatriation. While this marks the second of such reclassification in recent times (*the first being the FTSE Russell's last month*), the market reaction was relatively muted as the bourse lost 0.18% on the day of the announcement and closed the week with a 0.33% WoW gain. Nonetheless, this development likely contributed to investors' inclination to trade cautiously, evident in the substantial reduction of activity levels (volume and value traded) during the month.

Companies Post their 9M:2023 Earnings Scorecards

Companies' performance in the 9M:2023 financial period closely mirrored that of H1:2023. As expected, the Financial Services sector (Banking and Insurance) maintained its outstanding performance owing to foreign exchange gains and high interest income. In contrast, other sectors (like telecoms and breweries) displayed worse results as the exposure of their cost items to forex volatility drove profitability downwards. Across all sectors, operating expenses continued to surge as the persistent inflation levels in the country exerted pressure on expenses.

For sectoral performance overview, please refer to Table 1, and you can find our detailed earnings updates *here.*

Equities

Table 1: Summary of Sectoral 9M:2023 Financial Performance

Sector	Performance	Key Drivers and Drags for 9M:2023 Results
Agriculture	**Positive**	**Drivers:** Higher CPO prices and Backward integration. **Drags**: High cost of sales, OPEX and Finance cost
Banking	**Positive**	**Drivers:** Revaluation gains, High interest environment and Digital banking **Drags**: FX short position and impact of high interest regime on interest expense
Consumer Goods	**Negative**	**Drivers:** Increased demand due to essential nature of the products and Higher prices. **Drags**: Higher costs and FX losses
Healthcare	**Positive**	**Drivers:** Upward price review and product innovations **Drags:** High costs of Active Pharmaceutical Ingredient (API) importation and OPEX
Industrial Goods	**Mixed**	**Drivers:** Increased Infrastructural activities and higher prices **Drags**: Higher finance costs and FX losses
Insurance	**Mixed**	**Drivers:** Expansion in gross premiums and FX gains **Drags**: Higher OPEX and Higher Underwriting Costs.
Oil and Gas	**Positive**	**Drivers:** Higher oil prices due to price volatility in the global market **Drags**: Weak demand due to higher pump prices
Telecommunications	**Mixed**	**Drivers:** Higher mobile and data subscriber base, Growth in data usage per user. **Drags**: Higher finance costs due to increased borrowings and FX revaluation loss.

Source:* *Companies' Financials, Meristem Research

Notable Occurrences and Corporate Actions

VFD Group Plc (**VFDGROUP**), a proprietary investment company has successfully listed on the Nigerian stock exchange (NGX) via a "Listing by Introduction" process, following its voluntary delisting of its 190.00mn shares from the NASD OTC securities exchange. This listing will aid capital raising, enhance the group's visibility and contribute to the deepening of the Nigerian capital market. Despite listing at NGN244.80, VFDGROUP gained 9.96% on its listing day, but declined by c.19% MoM settling at NGN205.00. **We advise investors to be cautious while trading the counter.**

In addition, BUA Cement (**BUACEMENT**) announced its decision to reduce its cement prices to NGN3500 per bag (from NGN 4000 ex-factory prices), effective on the 2nd of October. This move aligns with the company's commitment to increasing development in the construction sector. Consequently, buying interest on the ticker led to a MoM growth +13.83% to NGN107.00. **Given the firm's expansionary strategy and intentions to review its product prices further upon completion of the 6MMTPA plant in Sokoto. We project increase sales volumes, which should translate to improve topline. We, however, retain our "SELL" recommendation on the ticker, as it remains overvalued.**

In addition, Guinness Nigeria Plc. (**GUINNESS**) announced its intentions to cease the importation and distribution of international Premium Spirits brands (Baileys, Johnny Walker & Singleton). The company sited the issues surrounding FX volatility and illiquidity as a driver for the decision. nonetheless, following the announcement, **GUINNESS** share price remained unchanged at NGN65.00. **The divestment of the spirits segment (*which contributes c. 6%-8% of GUINNESS's revenue*) is expected to enhance operational efficiency, but its impact on the firm's 2024FY financial performance will likely be limited as it will be implemented in the final quarter. However, this move poses the risk of losing a competitive edge and a portion of its product portfolio. We have reviewed our target price to NGN74.51, which represents an upside potential of 14.63% from its current price of NGN65.00, thus, recommend a BUY on the ticker.**

Following the Tax Appeal Tribunal's ruling that ordered MTN Nigeria Communications Plc (**MTNN**) to pay USD135.70mn (c. NGN105.32bn) to the Federal Inland Revenue Service (FIRS) on charges of tax evasion during the 2010-2017 financial years, **MTNN** has announced its decision to appeal the decision. **It's worth noting that the imposed fine is substantial (c.31% of the company's earnings for 2022) and has the potential to significantly impact the subsequent bottom-line if the appeal upholds the current ruling. This, coupled with MTNN's underwhelming performance in 9M:2023, led to a 6.28% month-on-month decline in the company's stock during the month. We, nonetheless, retain our BUY recommendation on the ticker.**

Equities

Summary of Key Expectations for November 2023

In November, we anticipate mixed market sentiments albeit with a tendency toward positivity. We anticipate that the market is likely to uphold its optimistic outlook, hinged on dividend declarations and the general 9M:2023 earnings season frenzy. However, the unstable macroeconomic conditions is expected to continue to impact trading activities level in the market as investors continue their cautious trading approach. Overall, we expect a blend of sentiments to shape 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 (%)
CUSTODIAN	7.00	8.28	+18%
GTCO	35.15	45.70	+30%
MTNN	234.0	267.86	+14%
OKOMUOIL	236.80	323.65	+37%
WAPCO	29.50	34.48	+17%

**prices are updated as of November 6th, 2023*

Fixed Income

Treasury Yields to Maintain Upward Trajectory

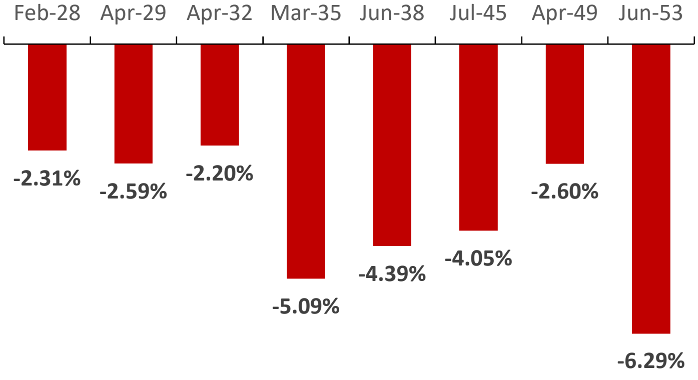
Review

The mood in the fixed income market was largely bearish in October as the improved system liquidity broadly determined the level of activity in the market. Specifically, the average system liquidity during the period increased to NGN552.58bn in October (vs. NGN60.12bn in September 2023) and remained a key determinant of rates' direction at the primary and secondary markets.

At the FGN Bonds' Primary Market Auction (PMA), the Debt Management Office (DMO) offered a total of NGN360.00bn across the four re-opened instruments - APR-2029, JUN-2033, JUN-2038, and JUN-2053. Total subscription level increased by 31.64% MoM to NGN383.10bn while a total of NGN334.75bn was allotted (vs. NGN251.50bn at the previous auction). Thus, the marginal rates on the APR-2029, JUN-2033, JUN-2038 and JUN-2053 instruments rose by 40bps, 30bps, 25bps, and 30bps to 14.90%, 15.75%, 15.80% and 16.60%, respectively.

At the T-bills PMAs, the CBN offered a total of NGN144.69bn, the lowest in 2023. At the first auction, the bid-to-cover ratio rose to 8.78x (vs. 4.44x at the last auction in September) due to the lower amount allotted (NGN36.56bn). Consequently, the average stop rate declined to 6.01% from 7.64% in September. However, at the second auction, the Bid–to-cover declined to 1.72x due to the higher allotment, thus pushing the allotment-to-offer to 3.42x (vs. 1.00x at the first auction. As a result, the stop rates on the 91-day, 182-day and 364-day instruments jumped by 232bps, 389bps and 375bps to 5.99%, 9.00% and 13.00% respectively.

Chart 5: MoM returns on selected FGN Bond Instruments in October 2023



Source: FMDQ, Meristem Research

Liquidity Management Measures Sway Yields Direction

Towards the end of the month, the monetary authority utilized some tools to mop up inter-bank liquidity. For context, the CBN lifted the ceiling on the Standing Deposit Facility (SDF), thereby allowing commercials banks to place more idle funds with the CBN at a rate of 15.75% (MPR minus 300bps). This immediately Impacted inter-bank liquidity as it plunged to NGN34.19bn as of 31 October. As a result, the open policy rate (OPR) and overnight rate (OVN) spiked by 129bps and 131bps to 15.60% and 16.50% respectively on the same day. Also, the apex bank floated an OMO auction at the end of the month for the second time this year, offering a total of NGN400bn across 4 maturities - 99-day, 183-day, 267-day and 365-day (vs. NGN150bn across 3 maturities at the last auction in August). Consequently, the average stop rate increased to 15.25% (vs. 12.49% at the last auction).

In the secondary market , the average yield on T-Bills spiked to 11.40%, from 8.30% in September as liquidity thinned and investors sold off on existing bills in anticipation of higher rates in forthcoming PMAs. Similarly, the average yield in the bonds rose to 15.10% (vs. 14.16% in September).

Expectations for November

We expect system liquidity to continue to chiefly dictate the mood in the fixed income market in November, driven by the expected FAAC allocation and coupon payments during the month. On the other hand, the CBN's liquidity management strategies and expected MPR hike should tighten system liquidity during the month. Taking all these factors into consideration, we expect a continued uptick in yields on treasury instruments in November.

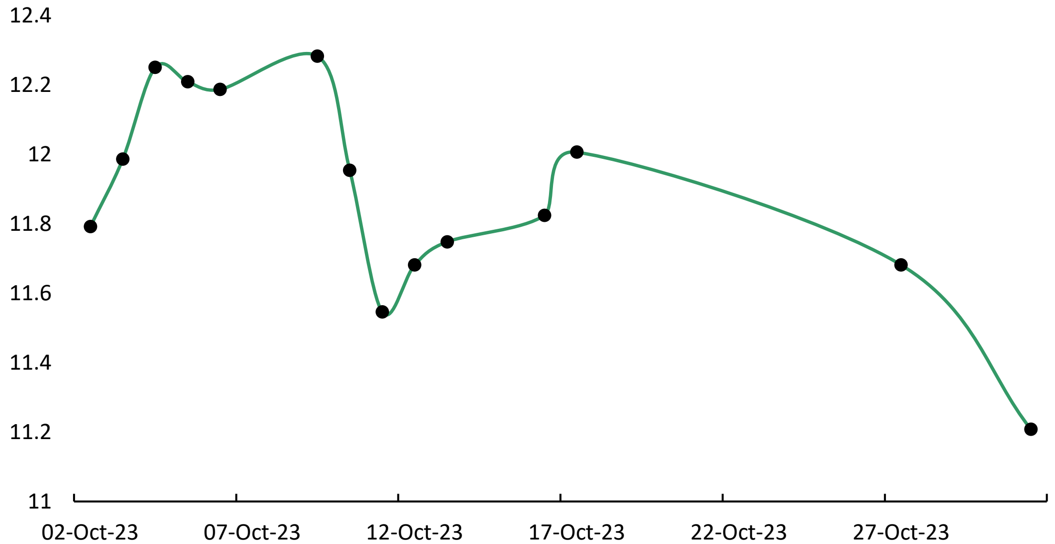
Fixed Income

In the Eurobonds market, we noted mixed sentiments with investors initially adopting a watch-and-see approach towards trading Nigerian instruments. However, at the tail end of the month, less uncertainty around the country's political landscape following the Supreme Court's confirmation of the President's electoral victory and the Finance Minister's disclosure of an expected USD10.00mn inflow in the near term, spurred positive sentiment in the market. These, coupled with the Fed's decision to again hold rates, fueled renewed optimism amongst foreign investors. Resultantly, the average Nigerian Eurobond yield fell by 58bps to 11.21% from 11.79% at the beginning of the month.

Expectation for November

Our expectation for November is that the ongoing macroeconomic developments, including the clearing of the foreign exchange (FX) backlog and the anticipated influx of liquidity, will maintain a positive and bullish sentiment in the Eurobond market.

Chart 6: **Average Eurobond Yield in October (%)**



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

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