MERISTEM

Macro and Market Insight

May 2024

Macros

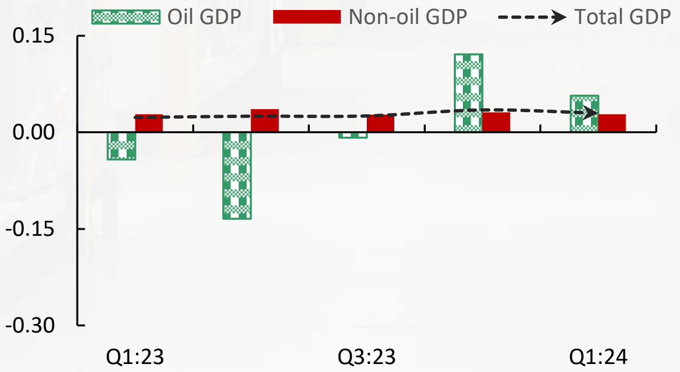
Economic Expansions Amidst Tighter Monetary Course

Review

In May, several significant developments influenced Nigeria's macroeconomic environment. These include the release of the country's Q1:2024 growth figures and monetary policy decisions. Additionally, inflation continued its upward trend as general price levels remained elevated during the month.

According to the National Bureau of Statistics (NBS), Nigeria's Gross Domestic Product (GDP) grew by 2.98% YoY in Q1:2024 to NGN18.28trn from NGN17.75trn in Q1:2023. This expansion was driven by the non-oil sector, which saw a 2.80% growth (compared to 2.77% in Q1:2023), and a 5.70% YoY increase in oil sector output during the period (a significant improvement from the 4.21% contraction in Q1:2023). The oil sector's modest growth is attributed to a slight increase in crude oil production volumes, which rose to 1.57 million barrels per day (mbpd) from 1.51mbpd in Q1:2023 and 1.55mbpd in Q4:2023. Meanwhile, the non-oil sector's expansion was driven by the outstanding performance of the financial and insurance sector, which surged by 31.24% YoY, building on its impressive 21.37% growth in Q1:2023.

Chart 1: Real GDP Growth (% YoY)



Source: NBS, Meristem Research

Going forward, we expect oil output to improve due to the reopening of the terminal under maintenance, pipeline repairs, and resumed production at the Awoba terminal. Additionally, it is expected that recent government fiscal incentives could boost output in the sector in the medium to long term.

OPEC's data, which shows that Nigeria's crude oil production increased to 1.28mbpd in April 2024, up from 1.23 mbpd in March, further supports this outlook.

Furthermore, we foresee a sustained resilience for the non-oil sector hinged on enhanced performance in certain subsectors like finance and insurance.

A potential GDP rebasing later this year also holds growth promise for output. However, the recent aggressive interest rate hikes may constrain short-term expansion activities, especially in the real sector.

Inflation

The NBS reported that Nigeria's headline inflation continued its upward trend, with April's figure rising to 33.69% YoY from 33.20% YoY in March 2024. This increase was driven by concurrent rises in food and core inflation, which reached 40.53% and 26.84%, respectively, up from 24.61% and 20.14% in April 2023 (and 40.01% and 25.90% in March 2024). The food index's persistent uptrend can be linked to structural and infrastructural deficits in the agricultural sector, supply chain constraints, and insecurity in food-producing regions. Similarly, the core index's uptick was driven by the continued depreciation of the Naira (-5.86% in April) and an upward revision of the electricity tariff during the period. On a monthly basis, headline, food and core inflation rates decelerated to 2.29%, 2.50%, and 2.20%, respectively, from 3.02%, 3.62% and 2.54% in March 2024.

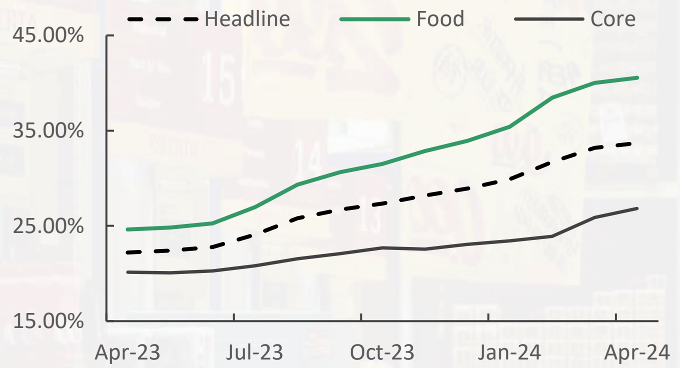
In the short term, we expect inflationary pressures to persist due to exchange rate fluctuations and insecurity in food-producing regions. Additionally, recent developments such as the electricity tariff hike, federal government wage increases, and the introduction of credit facilities through CREDICORP may exacerbate these pressures. However, government initiatives to enhance food supply, including year-round farming and production of select food items across 15 states, along with the high base effect from the previous year, could help moderate inflation figures.

Monetary Policy

Subsequently, at its third meeting of the year, the Monetary Policy Committee (MPC) maintained its hawkish stance, raising the monetary policy rate by 150bps to 26.25% from 24.75%. The MPC observed a recent moderation in Nigeria's headline, food, and core inflation increases, particularly in the month-on-month figures, suggesting that the central bank's hawkish stance is starting to produce the desired results. However, the committee retained all other parameters at their current levels.

Macros

Chart 2: Trend in Headline, Food, and Core Inflation (% YoY)



Source: NBS, Meristem Research

In a recent announcement at its annual summit, the African Development Bank (AfDB) pledged USD2.90bn for agricultural development in Nigeria and other African countries. This funding comes after the creation of agencies responsible for executing the Country Food and Agriculture Delivery Compacts established last year.

Coupled with recent government initiatives to ensure food security, this investment is expected to significantly boost the country's agricultural sector. We foresee an increase in crop production and food supply, which should help alleviate food inflation in the medium term.

Exchange Rate

In a bid to stabilize the foreign exchange (FX) market and enhance transparency, the Central Bank of Nigeria (CBN) introduced new guidelines for Bureau De Change (BDC) operators. These guidelines mandate a fresh application process for new licenses under a tiered system. Tier 1 BDCs, which operate nationwide, must have a minimum capital of NGN2.00bn. In contrast, Tier 2 BDCs operating within a single state or the Federal Capital Territory (FCT) need NGN500.00mn. Also, the new circular removes the non-refundable renewal fee of NGN5.00mn for Tier 1 and NGN1.00mn for Tier 2, as well as the mandatory caution deposit of NGN200.00mn for Tier 1 and NGN50.00mn for Tier 2. In addition, existing BDCs were given a six-month period to comply with these new requirements.

We believe this initiative would ensure that there are no duplicated licenses, enhance corporate governance, ensure financial compliance, as well as bolster anti-money laundering measures. By fostering transparency and efficiency with FX transactions, this move is expected to make foreign currency more accessible to customers with a more organized and structured sector. While we acknowledge the CBN's efforts to regulate BDCs properly and ensure stability in the FX market, we still opine that the sustained strength of the Naira relies heavily on a steady influx of foreign exchange into the country, particularly from foreign direct investments.

Summary of Key Expectations for June 2024

- ***A persistent rise in headline inflation, however, at a slower pace.***
- ***Sustained economic growth, driven by increased oil production and strengthened performance in the non-oil sector.***
- ***Sustained currency stability which relies heavily on CBN reforms aimed at curbing speculation, enhancing liquidity, and increasing foreign inflows into the FX market.***

Equities

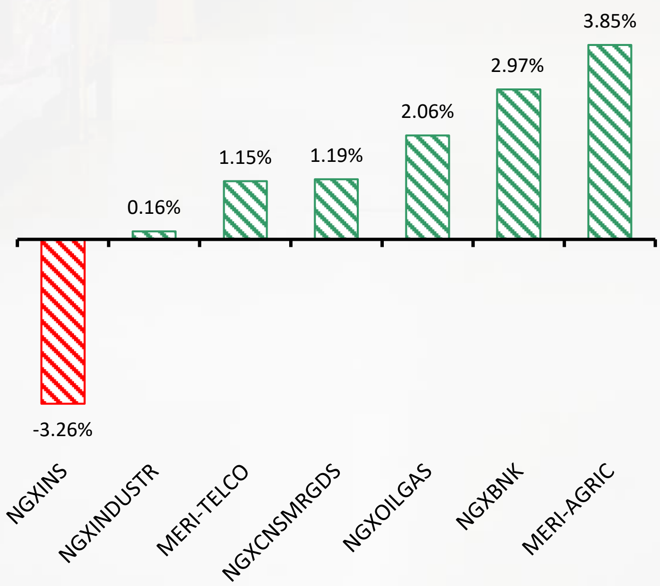
Bell-Weathers Propel Domestic Equities Shop to a Marginal Gain

Review

After a predominantly bearish month, the bulls regained their dominance on the local bourse towards the end, spurred by gains in some bellwether tickers. Consequently, the All-Share Index (**NGXASI**) posted a 1.09% MoM marginal increase to reach 99,300.62pts, while year-to-date advanced to 32.80%. Trading activity remained relatively consistent with last month's, showing slight variations. Volume traded rose by 1.69% MoM, reaching 8.44bn units from 8.30bn units, while the value traded slightly declined by 0.93% MoM to NGN165.10bn from NGN166.66bn in April. Reflecting the enhanced market sentiment, the market breadth improved significantly to 0.95x from 0.23x, with 53 tickers recording gains and 56 experiencing price declines.

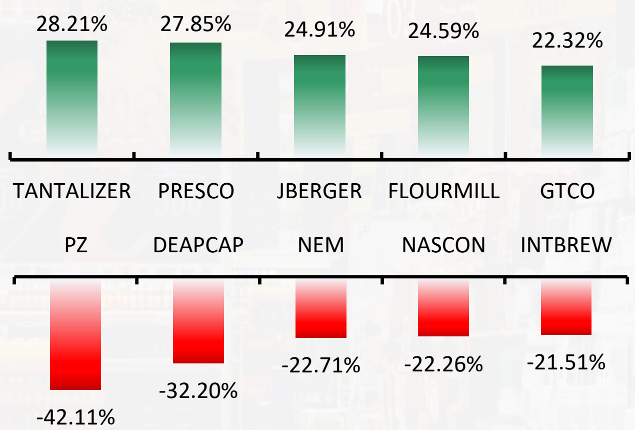
In the same vein, the tides turned green across sectoral indices under our coverage, safe for **NGXINS** (-3.26% MoM) which closed down due to lower-than-expected dividend declarations from insurance ticker despite their impressive financial performance. For the first time in two (2) months, the Banking Sector saw renewed buying interests as it gained +2.97% MoM due to investors' clarity on the direction of the banks' recapitalisation plans and the attractive prices of banking tickers.

Chart 3: MoM Sectoral Returns in May-2024



Source: Bloomberg, Meristem Research

Chart 4: Top Gainers and Losers for May 2024



Source: Bloomberg, Meristem Research

Other Notable Occurrences and Corporate Actions

NNPCL has approved the sale of ExxonMobil's 40.00% stake in Mobil Producing Nigeria Unlimited (MPNU) to Seplat Energy Plc (**SEPLAT**). This follows a two-year delay since SEPLAT announced its acquisition plans in MPNU and a court order by NNPCL refuting the sale. **We expect this to improve the company's production capacity and ultimately boost its profitability for 2024FY**. Following the announcement, the ticker gained +10.00% to reach its historical high of NGN 3,410.00. Since we had taken the finalisation of the acquisition into consideration beforehand, we retain our 2024FY target price of NGN3,546.42 per share. With a +4.00% upside potential, we recommend a **HOLD**.

Transnational Corporation Plc (**TRANSCORP**) disclosed its intention to restructure its share capital by reducing the number of its issued ordinary shares. This will involve the reductions of share capital and number of outstanding shares to **NGN5.08bn** and **10.16bn** ordinary shares, respectively. The existing issued shares will be consolidated on a 1 for 4 basis, meaning that every four (4) shares currently held in **TRANSCORP** will be converted to one (1) share. Concurrently, there will be a proportional upward adjustment in the share price of **TRANSCORP** on the exchange. **The value of shareholders' holdings will remain unchanged, eliminating the risk of dilution. This is expected to provide shareholders with confidence in the stability of their investment.**

Equities

However, the reduction in the number of shares may lead to decreased liquidity of the stock on the exchange.
The uncertainty around the process triggered panic selling as the ticker lost 17.14% MoM to settle at NGN11.60. *See our detailed analysis of the restructuring here.*

Following its announcement of a USD379.9mn convertible loan from its parent company (AB InBEV Nigeria Holdings), International Breweries Plc (**INTBREW**) has disclosed a rights issue of 161.17bn ordinary shares of 2kobo each at NGN3.65 per share to complete the transaction. The basis of the issue is six (6) new ordinary shares for every one (1) existing ordinary share held. **While this conversion will dilute investors' shareholdings in the company, it will reduce INTBREW's debt burden, mitigate exposure to foreign exchange losses, and ultimately improve the company's profitability.**

As part of the ongoing recapitalization process in the Nigerian banking sector, Sterling Financial Holdco (**STERLINGNG**) is seeking shareholder approval for a NGN200.00bn capital raise through rights issues, private placements, and public offerings. Similarly, FCMB Group Plc (**FCMB**) has announced its intention to raise additional capital of up to NGN150.00bn or its equivalent in other currencies through the issuance of ordinary shares, preference shares, convertible or non-convertible notes, and bonds.

Summary of Key Expectations for June 2024

In the same vein as the trends seen in the past three months, we anticipate a continuation of mixed sentiments on the bourse to continue in June, although with a positive bias. While investor sentiment towards equity assets remains somewhat tepid, there is a growing sense of optimism, especially in the banking sector, where current prices offer very attractive entry points.

However, ongoing developments in the macroeconomic landscape are expected to intermittently influence market reactions this month. Investors are particularly attuned to reforms in the macroeconomic space, as these changes can significantly impact their expectations regarding companies' financial performance for the year. These factors may either hinder or stimulate market activity, especially as H1:2024 comes to an end.

Additionally, we emphasize that there isn't widespread positivity for the stock market yet. Rather, certain stocks and sectors will experience occasional upswings during the month.

Eurobonds

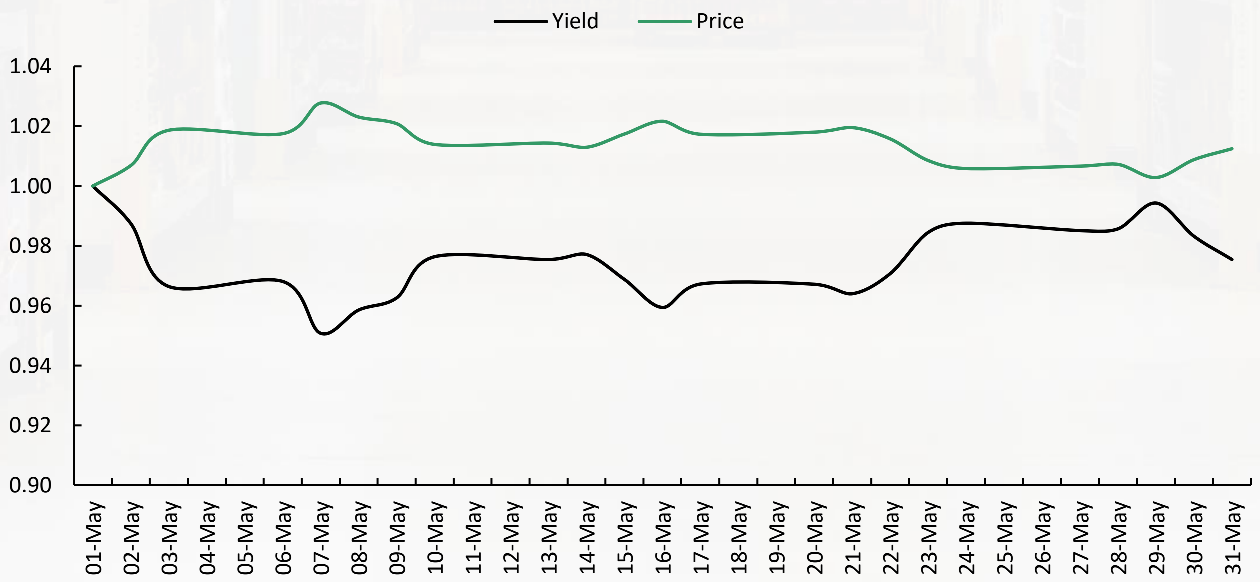
US Economic Signals Boost Nigerian Bond Market

The Nigerian Eurobonds market experienced a predominantly bullish performance, driven by heightened buying interest across all maturities, with a notable focus on the shorter end of the curve. This surge in demand was spurred by various macroeconomic indicators from the US, including a slowdown in inflationary pressures and a lower-than-expected GDP growth of 1.30% for Q1:2024, down from the previously reported 1.60%, reflecting a deceleration in consumer spending. Additionally, the Fed's hawkish minutes also contributed to the bullishness of the African Eurobonds market. Consequently, average Eurobond yields declined by 10 basis points to 9.69%, a decrease from 9.79% at the end of April.

Expectations

We anticipate the bullish sentiment on Nigeria’s Eurobonds to persist in June, driven by expectations of slower inflation in the US, which will likely shape investors’ perspectives.

Chart 5: Average Eurobond Yields in May 2024



Source: DMO, Meristem Research

Domestic Fixed Income

Momentum Slows on Treasury Yields Trajectory

Review

The activities in the local debt market in May were characterised by the conduct of three primary market auctions (two Treasury Bills and one Bond). The monetary authority also continued to effectively manage system liquidity by rolling out three Open Market Operations (OMO) auctions during the month.

At the T-bills auction, the Central Bank of Nigeria (CBN) offered a total sum of NGN688.34bn, higher than the NGN292.21bn offered in April. However, demand fell marginally, evinced by the total subscription (NGN2.51trn vs NGN2.58trn in April). Thus, the subscription-to-offer ratio declined to 3.64x (vs 8.82x in April) due to the higher offer amount. Also, the total amount allotted in May printed lower (NGN913.65bn vs. NGN1.31trn in April). Consequently, the average bid-to-cover ratio increased to 2.74x (vs. 1.96x in April). While the stop rates on the trio instruments remained unchanged in the first auction, the second auction witnessed a slight uptick on the 91-day and 182-day instruments (26bps and 45bps to 16.50% and 17.45%, respectively). However, the stop rates on the 364-day instrument declined by 1bps to 20.69%.

Similarly, at the FGN Bonds' Primary Market Auction (PMA) where the Debt Management Office (DMO) reopened two instruments –APR 2029 and FEB 2031, and a new issue- MAY 2033. The total subscription printed is NGN551.32bn with a total allotment of NGN380.77bn. Thus, the bid-to-cover ratio stood at 1.45x (vs. 1,47x at the previous auction in April). As a result, the marginal rates on the APR 2029 and FEB 2031 instruments declined by 1bps each to 19.29% and 19.74%, respectively, while the rate on the MAY 2033 printed at 19.89%.

At the OMO auctions for the month, NGN950.00bn was offered across three instruments. Despite the lower demand, evinced by the subscription-to-offer ratio (2.00x vs. 4.00x in December 2023), the CBN raised a total of NGN1.00bn across the three OMO auctions with the average stop rate at 13.50% (vs. 9.00% in December 2023).

The secondary market mirrored the activities of the primary market as mixed sentiment prevailed during the month. For context, the average T-bills yield fell to as low as 4.00% as of 12th January 2024, driven by robust system liquidity during the period. However, at the end of the month, the average yield stood at 7.84% (vs 8.18% in December 2023). Conversely, the secondary market for bonds was bearish as the average bond yield rose to 14.49% from 14.19% in December 2023.

In the secondary market, the negative system liquidity spurred sell-offs as average T-bills yield rose by 116bps to 20.13% in April (vs. 18.97% in March 2024) and average bond yields closed at 19.05% in April from 18.54% in March.
Sentiment was largely mixed in the secondary market for T-Bills and Bonds. The T-Bills experienced some bearishness as yields rose by 159bps to 21.72% (vs. 20.13% in April 2024). On the other hand, the bonds market was largely bullish as the average yield fell to 18.69% at the end of May from 19.05% in April, driven by an improvement in the financial system liquidity (NGN580.71bn vs –NGN116.33bn at the end of April).

Summary of Key Expectations for June 2024

We expect the monetary authority's active liquidity management measures to spur marginal upticks in yields for both treasury bills and bonds. However, the government's lower borrowing need, particularly from the T-Bills auction (NGN494.07 in June), may dampen investors' demand. Also, efforts to effectively manage the government's borrowing cost by maintaining treasury rates at current levels may continue to influence yields direction in June.

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