MERISTEM

Macros and Market Insight

August 2024

Macros

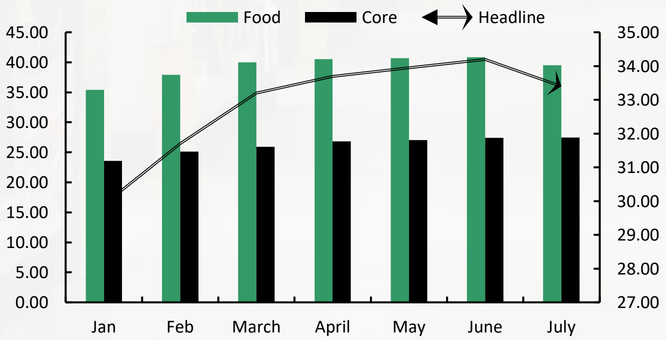
Positive Shifts Brighten the Macroeconomic Horizon

Review

In August, Nigeria's macroeconomic landscape was shaped by several significant developments. These include the release of July's inflation figures, Q2:2024 GDP data, and a notable increase in remittance inflows. Additionally, the reintroduction of the RDAS, the publishing of key macroeconomic reports by the CBN, and a rise in crude oil production for July were also notable events.

According to the National Bureau of Statistics (NBS), Nigeria's inflation rate came in lower at 33.40%YoY, representing a 79bps decline from 34.19% in June 2024 and marking the first disinflation since December 2022. The decline was primarily driven by an ease in food inflation to 39.53%YoY (vs. 40.87%YoY in June 2024). Notably, there was a drop in the average price of food items like Tomatoes, Fish, Meat etc. Contrarily, core inflation increased by 18bps to 27.47%YoY, compared to 27.40%YoY in June 2024. The northward movement was driven by the depreciation of the NAFEM rate (6.87% MoM to NGN1,608.73/USD) during the period.

Chart 1: Trend in Headline, Food and Core Inflation (% YoY)



Source: NBS, Meristem Research

We expect a continued moderation in headline inflation, driven by:

- **A reduction in food prices supported by the 150-day duty-free import window for key food items, year-round planting initiatives, and the nationwide distribution of 2,700 fertilizer trucks. The upcoming harvest season for crops like beans, yam, and ginger is also expected to boost supply and lower prices.**

- **The high base effect from August 2023 which will contribute to the downward trend, though FX volatility may keep upward pressure on the core index.**

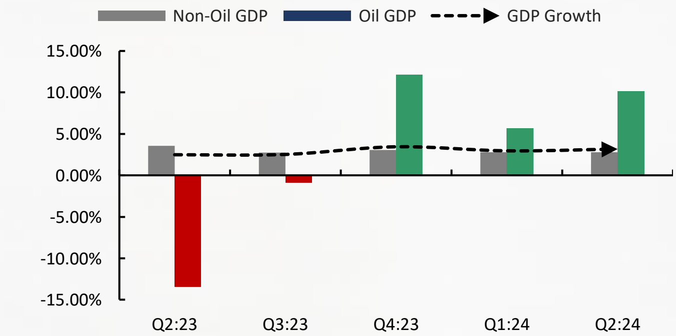
The Central Bank of Nigeria (CBN) resumed the publication of key macroeconomic reports, including the Business Expectation Survey (BES), the Inflation Expectation Report, and the Purchasing Managers' Index (PMI), which tracks the performance of economic activity.

According to the July PMI data, economic activity remained in contraction, registering 49.70 pts (below the 50-pts threshold), though improving from June's 48.80 pts. The overall decline reflects slower growth in new orders and employment, influenced by FX depreciation and rising cost pressures. By sector, services expanded for the second consecutive month at 50.30 pts, while industry (48.30 pts) and agriculture (49.70 pts) experienced a slower pace of contraction compared to June.

In Q2:2024, the Nigerian economy expanded by 3.19% YoY vs 2.51% in Q2:2023 and 2.98% in Q1:2024. This growth was largely driven by gains in both the oil and non-oil sectors. Oil GDP increased by 10.15% (vs 13.43% in Q2:2023), supported by higher average production volumes of 1.41mbpd, up from 1.22mbpd in Q2:2023, though slightly lower than the 1.57mbpd recorded in Q1:2024 highlighting the base effect impact on Q2:2024's growth. The rise in Q2:2024's production was spurred by output growth across major terminals- Bonny (+40.13%), Qua Iboe (+17.12%), Forcados (+3.87%), and Tulja-Okwuibome (+39.09%).

The non-oil sector, however, recorded slower growth at 2.80% YoY, down from 3.58% in Q2:2023, largely due to challenging macroeconomic conditions such as rising inflation and higher interest rates, which weighed on productivity. Sectoral performances were mixed: Agriculture grew by 1.41%, Manufacturing by 1.28%, and Information & Communication by 4.44%, all at a slower pace compared to the previous year. Meanwhile, the Financial and Insurance sector stood out, maintaining strong growth of 28.79%, up from 26.84% YoY.

Chart 2: Real GDP Growth Rate (YoY)



Source: NBS, Meristem Research

Macros

In the near term, we expect oil production to improve, bolstered by the commencement of output from the new Madu Field and the resumption of operations on the Trans-Niger pipeline, which had been earlier suspended for maintenance. Additionally, the government's ongoing efforts to enhance security around oil infrastructure, along with the recent auction of oil blocks to new operators, are likely to stimulate exploration activities and further increase production.

On the non-oil side, the sector is expected to remain under pressure due to prevailing macroeconomic challenges. However, expectations of less volatility in the exchange rate and the possibility of a more accommodative monetary policy by the Central Bank of Nigeria (CBN) offer some relief and potential upside.

The Central Bank of Nigeria (CBN) reported a 130.00% surge in remittance inflows for July, reaching USD553.00mn. This sharp increase was mainly attributed to recent policy measures, including the issuance of licenses to new International Money Transfer Operators (IMTOs) and the adoption of the willing buyer-willing seller model to boost liquidity in Nigeria's foreign exchange market. Additionally, the CBN reintroduced the Retail Dutch Auction System (RDAS) to address unmet foreign exchange demand, auctioning a total of USD876.26mn to end-users at a cut-off rate of NGN1,495/USD. Consequently, the official exchange rate saw a slight appreciation, improving by 0.46% to NGN1,593.62/USD. **While these initiatives are expected to enhance transparency, attract more dollar inflows, facilitate price discovery, and ease demand pressure in the official FX window, we believe that sustainable long-term improvements, including a stronger Naira, depend on more fundamental reforms. These include boosting foreign direct investment (FDI), strengthening non-oil exports, and implementing policies that drive broader economic productivity and growth.**

The Federal Government has authorized the Nigerian National Petroleum Company (NNPC) Ltd to utilize NGN2.10trn from its 2023 final dividends owed to the federation to cover petrol subsidies from August to December 2024. In addition, the government has suspended payments of 2024 interim dividends, royalties, and taxes to the Federal Government for the remainder of the year. These measures are intended to reconcile gaps in PMS imports between the NNPC and the Federation, manage the rising subsidy costs borne by the corporation, address foreign exchange discrepancies, and bolster NNPCL's cash flow. **Looking ahead, this move is expected to improve NNPC's operational efficiency and liquidity while alleviating petrol supply constraints. On a larger scale, the reinstatement of subsidy payments is likely to increase government expenditure in the short term, while the reduced inflow of dividends and royalties into the Federation account will likely constrain fiscal revenues, placing additional pressure on the government's ability to finance other critical sectors of the economy.**

Summary of Key Expectations for September 2024;

- ***A moderation in the inflation rate, largely driven by the upcoming harvest season and a higher base effect of 2023.***
- ***Sustained economic growth, driven by improved oil production and a slight improvement in the non-oil sector.***
- ***Sustained Naira stability hinged on the CBN's efforts at reducing speculative activities, improving market liquidity.***

Equities

Mixed Market Dynamics: Profit-Taking Amidst Sectoral Gains

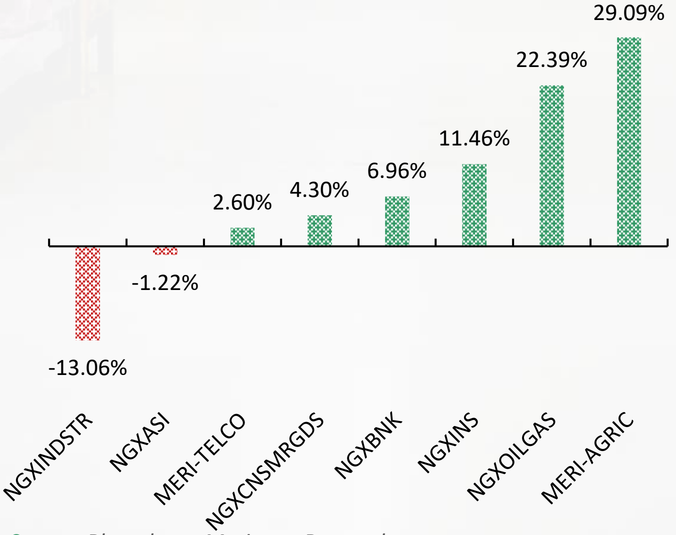
Review

The Nigerian equities market closed on a bearish note in August 2024 as the All-Share Index **NGXASI** printed -1.22% MoM loss to decline to 96,580.01pts, bringing the year-to-date return to 29.16%. Contrastingly, performance of sectors under our coverage were predominantly bullish as **NGXOILGAS** (+22.39%), **NGXBNK** (+6.96%), **NGXINS** (+11.46%), **NGXCNSMRGDS** (+4.30%), **MERI-AGRIC** (+29.09%), and **MERI-TELCO** (+2.60%) yielded positive returns. However, **NGXINDUSTR** (-13.06%) declined during the period due to profit taking activities on tickers that had previously gained.

During the month of August, **RTBRISCO** (+367.11%), **OANDO** (+207.60%) and **IMG** (+84.62%) gained significantly. On the other hand, **THOMASWY** (-19.49%), **BUACEMENT** (-19.21%) and **CWG** (-13.39%) posted the highest losses.

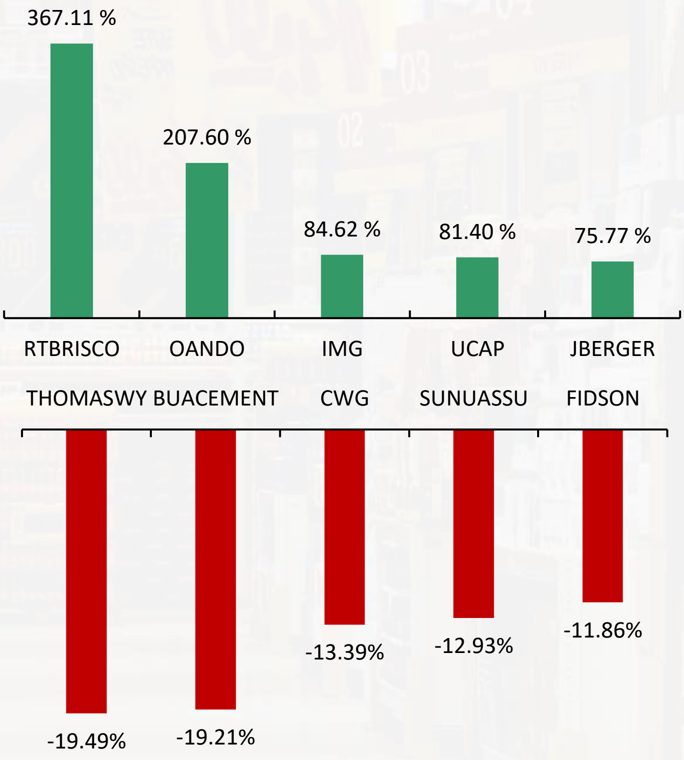
The overall market losses were driven by profit-taking in industrial and consumer goods stocks, a challenging macroeconomic environment, and persisting fund flow into the fixed-income market as rates are still elevated. The bullish performance was supported by stocks that have previously shed, increased activity in OANDO following its acquisition of Nigerian Agip Oil Company (NAOC), position-taking in tickers like **OKOMUOIL**, which announced an interim dividend, and a gradual renewal of investor confidence in the market.

Chart 3: MoM Sectoral Returns in August 2024



Source: *Bloomberg, Meristem Research*

Chart 4: Top Gainers and Losers for August 2024



Source: *Bloomberg, Meristem Research*

Other Notable Occurrences and Corporate Actions

In August, Oando Plc successfully finalized its USD783mn acquisition of Nigerian Agip Oil Company (NAOC), a subsidiary of Eni, after receiving the necessary approval from the Nigerian Upstream Petroleum Regulatory Commission (NUPRC). This acquisition marks a significant milestone for Oando, coming after a thorough nine-month regulatory review. By acquiring NAOC, Oando has doubled its stake in Oil Mining Leases (OMLs) 60, 61, 62, and 63, increasing its ownership from 20% to 40%. This expanded stake is expected to enhance Oando's production capacity and strengthen its position within Nigeria's oil and gas sector, setting the stage for potential growth and increased market influence. **We expect this expanded stake to significantly enhance Oando's production capacity. By revitalizing these previously underutilized assets, Oando is poised to boost its total reserves, strengthen investor confidence in Nigeria's oil and gas sector, and contribute to an increase in the country's oil output as these operations ramp up.**

Equities

Additionally, the Central Bank of Nigeria approved the merger between Providus Bank Limited and Unity Bank Plc, marking a notable milestone as the first merger since the recapitalization exercise. Also, the CBN also approved a financial accommodation of approximately NGN700bn, structured as a 20-year term loan, to ensure the operational stability of the merged entity. **We expect this development to boost investor confidence, especially in light of the ongoing recapitalization efforts within the banking sector. This is anticipated to alleviate concerns that have emerged following the collapse of Heritage Bank, signaling a more robust and stable financial environment in Nigeria.**

Also, Zenith Bank Plc (**ZENTIHBANK**) is set to raise NGN290bn through a Rights Issue and a Public Offer to comply with the CBN revised capital requirements. The Rights Issue will offer 5,232,748,964 shares at NGN36.00 each to existing shareholders on a one-for-six basis, while the Public Offer will provide 2,767,251,036 shares at NGN36.50 each to new investors. **We expect this initiative to strengthen the bank's capital base and support its growth.**

In another key development, Dangote Oil Refining Company (DORC) is planning to sell 12.75% stake in its refinery to new investors, as reported by Fitch. This follows the decision by NNPC Limited to reduce its intended stake from 20.00% to 7.25% primarily due to liquidity challenges. The proceeds from the sale is intended to service maturing obligation in August 2024. **We expect this divestment to provide some financial relief and help address the group's liquidity concerns.**

Also, IHS Nigeria, a subsidiary of HIS Holding Limited, and MTN Nigeria (**MTNN**) announced an agreement to renew and extend their tower lease agreements until December 2032. The revised contracts include updated financial terms that more effectively balance local and foreign currency components. Notable changes includes the reduction of the USD-indexed component linked to a discounted US Consumer Price Index (CPI) and making leases predominantly Naira-linked. Additionally, the revised agreements cap the Naira CPI escalator and discontinue technology-based pricing, shifting payments for upgrades to a model based on tower space and power usage. **We expect these changes to improve MTNN's operational efficiency by reducing exposure to foreign exchange fluctuations and potentially lowering forex losses.**

Summary of Key Expectations for September 2024

In September, we anticipate a mixed market sentiment, though it is expected to lean towards positivity. This optimistic outlook is supported by projections of a market recovery by the end of Q3:2024, driven by strong earnings expectations, moderating inflation figures, and anticipated monetary easing from the Monetary Policy Committee. While the market may experience some fluctuations and uncertainties, the overall trend is likely to be positive, with improving corporate earnings and a more stable inflation environment contributing to a generally favorable investment climate.

Fixed Income

From Bearish Beginnings to Bullish Trends

Review

In August, the fixed-income market opened on a bearish note, with yields rising in response to the July monetary policy decision that raised the benchmark rate by 50bps to 26.75%. The month saw the execution of four primary market auctions, consisting of two Treasury Bills (T-Bills) and two Bonds, including a domestic FGN bond and the introduction of a domestic dollar bond. Additionally, the monetary authorities focused on managing system liquidity and attracting foreign inflows by conducting two Open Market Operations (OMO) auctions. However, towards the end of the month, yields began to decline, indicating the effectiveness of the government's debt management strategy.

At the T-Bills Primary Market Auction (PMA) in August, the CBN offered a total of NGN626.07bn, significantly lower than the NGN1.93trn offered in July. Despite this reduction, demand surged (higher than the demand of 1.12 recorded in June), with total subscriptions reaching NGN1.51trn, up from NGN582.93bn, driven by high system liquidity averaging NGN343.98bn in August. As a result, the subscription-to-offer ratio jumped to 2.41x from 0.30x in July, indicating heightened demand. The total amount allotted also increased to NGN507.12bn, compared to NGN485.23bn in the previous month. Consequently, the average bid-to-cover ratio rose to 2.98x, up from 1.20x in July. While the stop rates for the three instruments remained unchanged during the first auction in the month, the second auction saw marginal declines of 30bps, 30bps, and 99bps for the 91-day, 182-day, and 364-day instruments, respectively, bringing them to 18.20%, 19.20%, and 20.90%.

The bond market experienced notable shifts during the period as the Debt Management Office postponed its auction by a week and reduced the offer size from NGN300bn to NGN190bn. This move suggests a possible reduction in the government's borrowing needs, potentially due to frontloaded borrowing in Q1:2024, a shift toward an expansionary environment, or the exploration of other funding options such as domestic dollar bonds. The auction involved the reopening of three bonds—APR 2029, FEB 2031, and MAY 2033—with total subscriptions reaching NGN460.18bn and NGN374.75bn allotted, resulting in a slightly lower bid-to-cover ratio of 1.23x compared to 1.24x in July. As a result, marginal rates for the FEB 2031 and MAY 2033 bonds declined by 1bps and 48bps, respectively, to 19.89% and 19.74%, while the APR 2029 bond saw a marginal increase of 41bps to 20.30%.

During this month's OMO auctions, the Central Bank of Nigeria offered NGN2.35trn across three instruments, marking a significant increase compared to NGN900.50bn in June, as no OMO auctions took place in July. Despite the larger offer, heightened demand led to NGN1.63trn being raised, with total subscriptions reaching NGN1.66trn. This move aligns with the government's broader liquidity management strategy. Consequently, average stop rates for the 91-day, 175-day, and 364-day instruments declined to 18.49%, 19.29%, and 21.93%, respectively, down from 18.74%, 19.54%, and 22.37% in June. This reduction in OMO stop rates further reinforces the ongoing trend of easing rates in the fixed-income market.

In an effort to stabilise the foreign exchange market, the FG introduced a new domestic dollar bond in August, launching a Series 1 issuance valued at USD500mn as part of a broader USD2bn program. The bond offers a 9.75% yield and a five-year maturity, designed to attract foreign inflows and provide a stable medium-term investment option while supporting the Naira. Approved by the CBN, this bond can be classified as a liquid asset for banks' liquidity ratio calculations, making it eligible for investment by pension funds and broadening its potential investor base.

Meanwhile, the secondary market traded on a bullish note, with average T-bill yields declining to 21.21% (down from 25.18% in July), and average bond yields falling to 18.96% (from 19.76% in July), reflecting improved system liquidity and reflecting the overall mood in the fixed income space.

Outlook:

We anticipate a sustained gradual downtrend in yields, as the spiking yields in the fixed income market are beginning to wane off as evidenced by reduced auction offers and declining yields, even in OMO auctions. Although, yields are still expected to remain at elevated levels as liquidity will play a crucial role in influencing rates movement.

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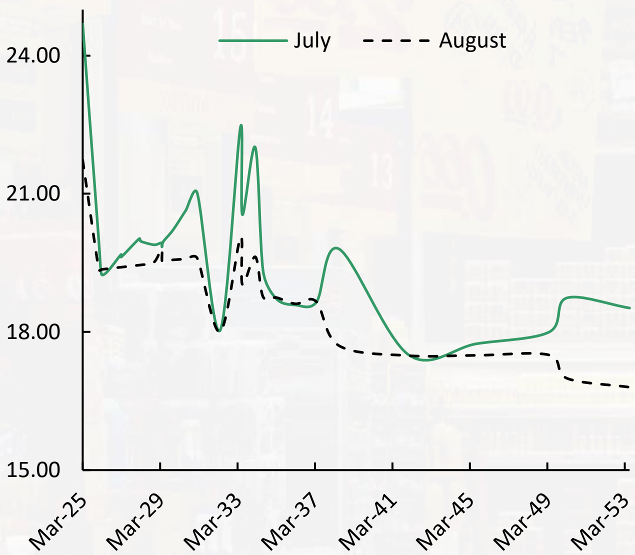
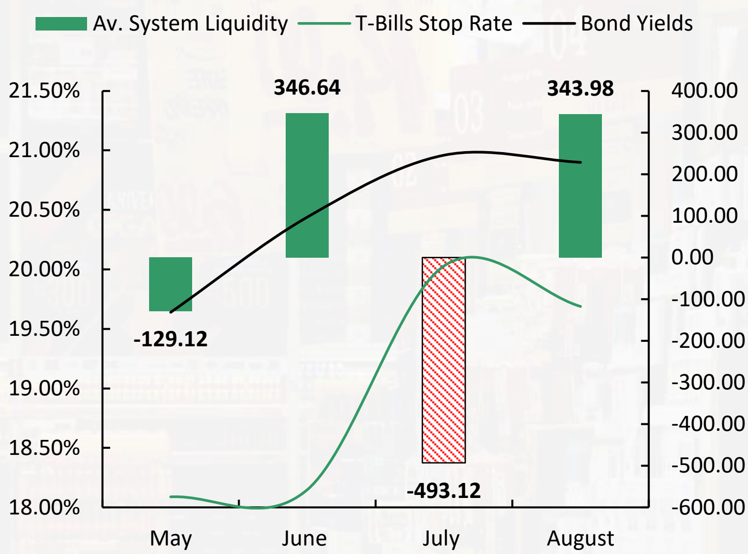
Eurobonds

Chart 5: Yield Curve Across Maturities in July and August 2024



Source: FMDQ, Meristem Research

Chart 6: System Liquidity, Average T-Bills Stop Rate and Average Bond Marginal Rates from May to August 2024



Source: DMO, CBN, Meristem Research

Declining Yields Signal Renewed Investors Confidence

The Nigerian Eurobonds market was posed with mixed performance. The month began with relatively high yields as we saw yields increase to 11.46% in the first week of August. As the month progressed, a downward trend began, indicating a growing demand for the Eurobond instruments as the yield fell to 10.55% at the end of the month. The bullish momentum in the Nigerian Eurobond market reflects a shift in market sentiment as investors became more optimistic about Nigeria's fiscal management. Also, expectations of easing interest rates in developed markets further bolstered investor's sentiments. As global interest rates showed signs of decline, Nigerian Eurobonds became more appealing to investors seeking higher yields compared to those available in advanced markets. When compared with July, the average yield was bearish as average yields increased to 10.96% (vs 9.81% in July). In August, there was increased demand for the FEB-2038, FEB-2030 and NOV-2047 Eurobonds, evinced by price increases to USD80.48, USD90.71 and USD75.63 (vs USD77.98, USD73.28, USD87.90 in July).

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