MERISTEM

Macros and Market Insight

October 2024

Macros

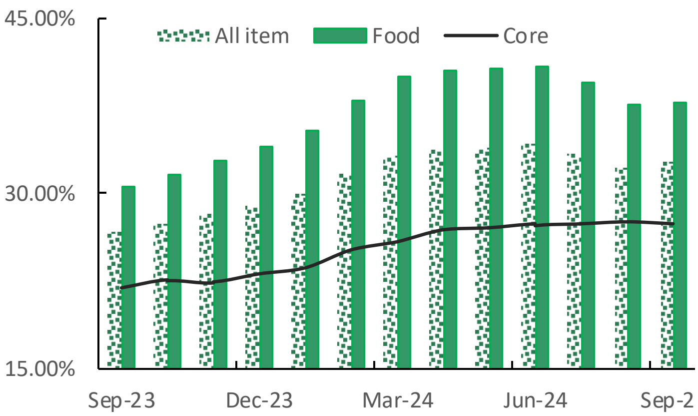
October's Economic Report Card: From Recovery to Relapse

Review

In October, significant events that shaped the domestic economy included an uptick in September's inflation figures, signalling continued price pressures, a decline in oil production volumes, and a notable decrease in capital importation.

The National Bureau of Statistics (NBS) reported that Nigeria's inflation rose to 32.70% YoY in September 2024, up from 32.15% YoY in August 2024. This uptick was primarily driven by food inflation, which increased to 37.77%, reflecting higher prices of staples like yam and maize. Food prices were exacerbated by flash floods in key agricultural regions and rising logistics costs linked to recent fuel price hikes. In contrast, core inflation eased slightly to 27.43% YoY (vs 27.58% YoY in August). On a monthly basis, headline inflation and food inflation increased by 2.52% MoM and 2.64% MoM, respectively (vs 2.22% and 2.37% in August). Conversely, core inflation eased by 2.10% MoM (vs 2.27% in August).

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



Source: NBS, Meristem Research

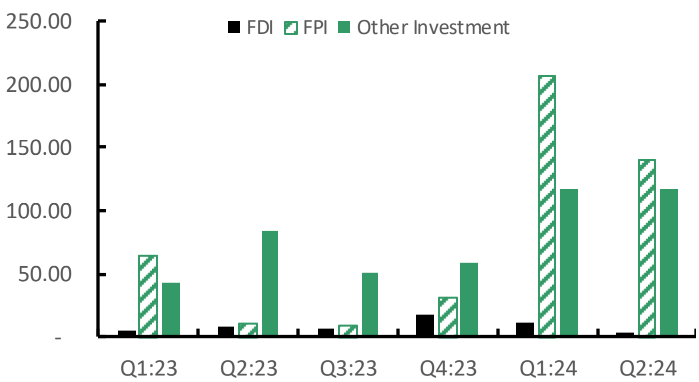
- We expect a further uptrend in food inflation due to lower-than-expected agricultural yields and elevated transport costs. Additionally, heightened demand as the festive season approaches is expected to put upward pressure on food prices.

- We also expect an uptick in core inflation in the near term, driven by higher transport costs and continued volatility in the country's FX market.

The NBS also reported that Nigeria's capital importation for Q2:2024 printed at USD2.60bn, representing a significant increase of 152.81% YoY from USD1.03bn in Q2:2023. However, this figure reflects a decline of 22.85% QoQ from USD 3.38bn in Q1:2024. The drop was driven by sharp declines in Foreign Portfolio Investments (FPI), which fell by 32.32% QoQ, and Foreign Direct Investments (FDI), which dropped by 74.97% QoQ, alongside a slight dip of 0.95% QoQ in other investments. We attribute this drop to reduced investor confidence and interest in the Nigerian market due to the volatility of the exchange rate during that period.

We anticipate sustained foreign portfolio investment (FPI) inflows, supported by an elevated yield environment and rate cuts in advanced economies, which enhances the appeal of emerging market instruments like Nigeria. However, persistent Naira volatility may temper investor's interest.

Chart 2: Capital Importation Trend (QoQ in USD'mn)



Source: NBS, Meristem Research

The International Monetary Fund (IMF) revised Nigeria's 2024 economic growth forecast in October to 2.90%, down from 3.10% in July and 3.30% in April. This adjustment reflects ongoing challenges, including security issues in oil-producing areas, severe flooding, worsening food insecurity, and a softer-than-expected economic performance in H1:2024.

Moving forward, growth prospects appear constrained due to low production volumes in the oil sector, persistent inflationary pressures, exchange rate volatility, and elevated borrowing costs weighing heavily on the real sector. Consequently, in alignment with IMF's recent downward revision, we expect GDP to expand by 2.81% YoY in 2024FY, a downward revision of 3.14%YoY in H1:2024

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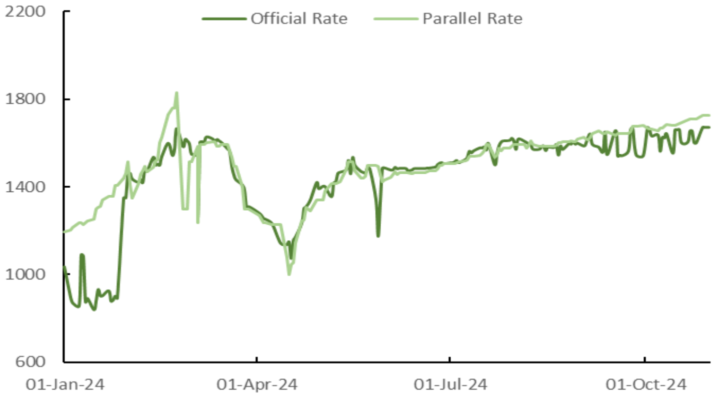
Chart 3: NAFEM Rate and Parallel Market Rate (NGN/USD)



Source: FMDQ, Meristem Research

In October, the foreign exchange (FX) market was relatively volatile, with the Naira depreciating from an average of NGN1,589.86 to NGN1,63.11, indicating a 2.77% MoM decline. This decline was driven by ongoing demand pressures prevalent in the country's exchange rate market.

Furthermore, the CBN recently introduced the Electronic Foreign Exchange Matching System (EFEMS) for the Nigerian Foreign Exchange Market (NAFEM). This platform will provide authorized dealers with a centralized platform to conduct all interbank FX transactions. In partnership with the Financial Markets Dealers Association of Nigeria (FMDA), the CBN will also publish trading rules along with real-time buy and sell order data from EFEMS. A two-week trial is set for November, with full implementation planned for December 1, 2024.

We believe that EFEMS, once fully operational, could enhance the CBN's regulatory oversight, improve market transparency, and help stabilize FX rates by curbing speculative trading. We also anticipate continued downward pressure on the Naira due to rising demand for FX. However, certain factors, including the potential supply of refined petroleum products from Dangote Refinery (which could reduce demand for FX for importation), increased domestic oil production (which could boost oil receipts), and ongoing interventions by the Central Bank of Nigeria (CBN), could help mitigate this depreciation in the short term.

The Federal Government has officially implemented zero Value Added Tax (VAT) and excise duties on pharmaceutical products and medical devices, including Active Pharmaceutical Ingredients (APIs), medical textiles, needles, and syringes. This follows an executive order signed by the President earlier this year to ease rising production costs amid persistent inflation. Additionally, VAT exemptions have been formalized for essential energy products and infrastructure, along with tax incentives for deep offshore oil and gas production.

The exemptions cover diesel, feed gas, liquefied petroleum gas (LPG), compressed natural gas (CNG), electric vehicles, liquefied natural gas (LNG) infrastructure, and clean cooking equipment. These measures, which build on a temporary VAT exemption on diesel enacted in October 2023 aligns with the administration's agenda to stimulate investment and growth in key sectors while enhancing Nigeria's global competitiveness in energy.

We anticipate that these initiatives will help lower the prices of medical products, offering critical relief to both manufacturers and consumers in the healthcare sector in the near term. For the energy sector, we believe the VAT exemption initiative could attract more investment into deep offshore oil & gas production and renewable energy. This could help improve production volumes and ultimately profit margins for oil and gas companies. However, a downside to this remains the potential reduction in tax revenue from VAT for the government.

The Nigerian Upstream Petroleum Regulatory Commission (NUPRC) reported a 2.22% decrease in crude oil production for September, with output falling to 1.32 million barrels per day (mbpd) from 1.35 mbpd in August. The decline was mainly due to reduced production at key terminals, including Forcados (-19.03%), Qua Iboe (-7.80%), Odudu (-4.66%), and Escravos (-3.46%). However, production gains were recorded at Brass (+18.77%) and Tulja-Okwuibome (+1.08%) terminals. Looking forward, we expect a recovery in oil production in the near term, driven by government efforts to boost investment and strengthen security in the oil and gas sector.

Summary of Key Expectations for November 2024;

- ***Further increase in the inflation rate, largely driven by an uptrend in both the food and core index.***
- ***Improved oil production hinged on increased output from terminals and several initiatives by the government to enhance security along oil infrastructure.***
- ***Moderated economic growth due to insecurity in oil-producing areas, limited expansion in the real sector, and food insecurity***

Equities

Amid Beam and Dim: Piloting Equity Assets

Review

In October, the sentiment in the Nigerian equities market shifted, contrasting with the positive mood observed in the previous month. A bearish trend prevailed, leading to a monthly decline of 0.92% in the NGX-ASI, which settled at 97,651.23 points. Consequently, the market's year-to-date (YtD) return fell to 30.60%, down from 31.81% in September.

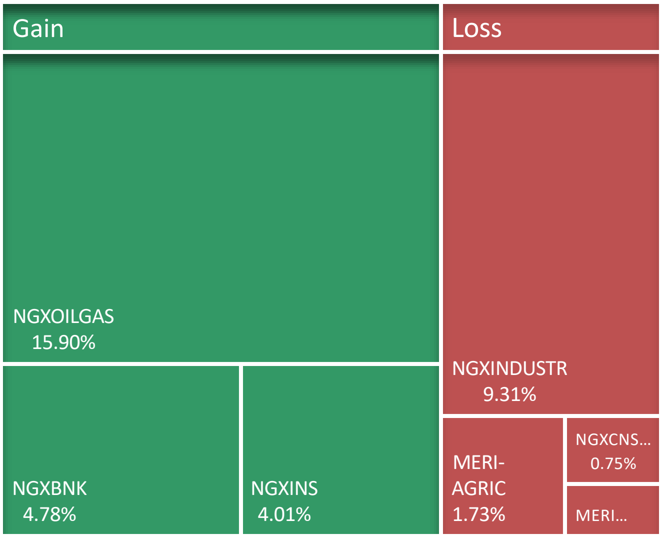
Investor activity was primarily marked by selling pressures on major banking stocks, including **ACCESSCORP**, **GTCO**, FBNH, and ZENITHBANK, as well as on large-cap stocks like **DANGCEM**, **WAPCO**, and **BUACEMENT**. This selling pressure outweighed buying interest in SEPLAT, which received approval for its acquisition of Mobil offshore assets, and in **ARADEL**, which debuted on the local exchange on October 14th.

Other Notable Occurrences and Corporate Actions

During the month, Aradel Holdings Company (**ARADEL**) was listed on the Nigerian Stock Exchange (NGX), following its delisting from the NASD-OTC exchange. The company listed 4.34bn ordinary shares, following a stock split of twenty-for-one, at 50 kobo each. The shares were valued at NGN702.69 per share, resulting in a total market capitalization of NGN 3.05trn.

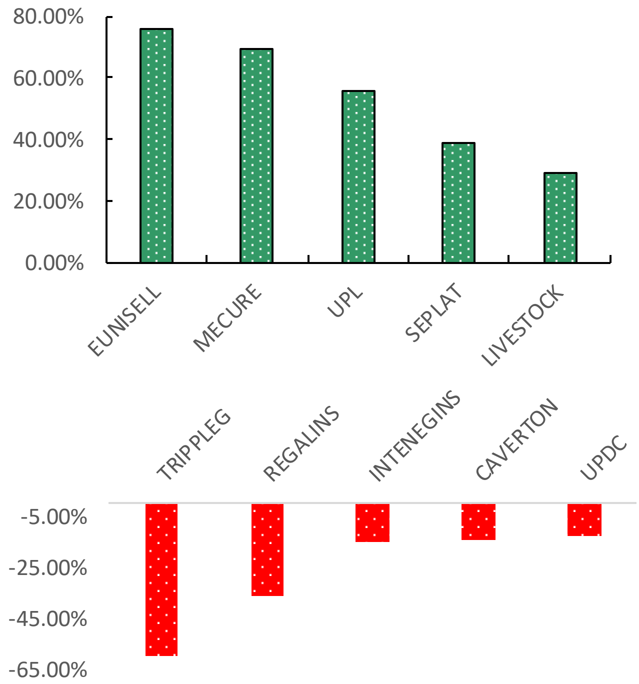
Also, Transnational Corporation Plc (**TRANSCORP**) delisted from the local exchange as part of a share capital restructuring initiative. This restructuring consolidated the company's issued shares at a ratio of one for every four shares held, reducing the number of issued and fully paid shares from 40.60bn to 10.20bn. Although the share count decreased proportionately, the overall value of shareholders' investments remained unchanged, with no dilutive impact on the shareholders. The company subsequently re-listed on the exchange after completing the restructuring process.

Chart 4: MoM Sectoral Returns in October 2024



Source: Bloomberg, Meristem Research

Chart 5: Top Gainers and Losers in October 2024



Source: Bloomberg, Meristem Research

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Equities

Foreign outflow muted by Domestic Dominance

Our assessment of market dynamics during the month indicated that foreign investors' participation in the local stock market has declined further. This trend is primarily due to diminishing confidence among foreign investors, which may be influenced by foreign exchange volatility and weakening macroeconomic indicators. As a result, overall investor sentiment towards the equities market has staggered. For context, recent data from the Nigerian Exchange (NGX) shows that foreign investors' participation in the market has dropped to a single-digit, 8-month low of 8.40%. This decline was driven by a significant net foreign outflow of NGN18.89bn, marking the highest monthly outflow since April 2024. Consequently, the year-to-date (YTD) foreign net outflow increased to NGN74.90bn, a substantial rise from the NGN40.16bn recorded during the same period in 2023. The inflow/outflow ratio also fell to 0.37x, its lowest level since July 2023. Meanwhile, the total value traded in the market surged by 29.90%, reaching NGN493.01bn in October. This increase was primarily driven by strong domestic players' activity, which has chiefly influenced market direction.

Table 1: Meristem Half-Year 2024 Strategic Portfolio

TICKER	NM	ROE	ROA	TP	Avg. Cost	CP	% Gain	P. Weight	Weighted Portfolio Return
ACCESSCORP	16.00%	28.00%	2.00%	24.49	18.95	22.05	**16.36%**	7.29%	1.19%
AIICO	39.00%	33.00%	6.00%	1.54	0.97	1.21	**24.74%**	8.69%	2.15%
CAP	15.00%	22.00%	17.00%	39.49	36.00	38.50	**6.94%**	3.73%	0.26%
CONOIL	5.00%	30.00%	12.00%	126.50	105.00	189.30	**80.29%**	4.24%	3.40%
FIDELITYBK	16.00%	25.00%	2.00%	13.32	10.20	14.30	**40.20%**	6.87%	2.76%
GTCO	67.00%	47.00%	7.00%	59.28	45.00	53.70	**19.33%**	8.96%	1.73%
MANSARD	40.00%	55.00%	12.00%	6.27	5.41	5.80	**7.21%**	3.94%	0.28%
MAYBAKER	10.00%	15.00%	6.00%	7.77	5.90	7.00	**18.64%**	6.76%	1.26%
MTNN	-52.00%	147.00%	-18.00%	266.87	214.00	175.10	**18.18%**	5.87%	-1.07%
OKOMUOIL	35.00%	47.00%	21.00%	316.66	291.50	338.10	**15.99%**	7.78%	1.24%
STANBIC	25.00%	29.00%	3.00%	69.94	52.00	58.85	**13.17%**	7.56%	1.00%
TOTAL	4.00%	34.00%	3.00%	427.92	388.90	673.90	**73.28%**	3.05%	2.24%
UBA	25.00%	27.00%	3.00%	29.25	22.45	29.80	**32.74%**	7.19%	2.35%
UCAP	58.00%	12.00%	1.00%	27.30	26.50	18.25	**31.13%**	1.59%	-0.50%
WAPCO*	37.00%	11.00%	7.00%	58.43	34.05	38.50	**13.07%**	9.26%	1.21%
ZENITHBANK	33.00%	31.00%	4.00%	46.18	35.70	39.95	**11.90%**	7.20%	0.86%
Exp Return								100.00%	**20.38%**

The return on our strategic equity portfolio constructed at half year stands at 20.38%. This was supported mainly by our fairly weighed position in **CONOIL**, which saw an 80.29% increase, and our substantial weight in **FIDELITYBK**, rising 40.20% since July 2024. These allocations contributed significantly, adding 424bps and 687bps to the overall portfolio performance, respectively.

However, portfolio gains were partially moderated by our positions in **MTNN** and **UCAP**, which have declined by 18.18% and 31.13% since July, respectively, acting as drags on overall performance.

Equities

Summary of Key Expectations for November 2024

In November, we expect market sentiment to be mixed, influenced by various factors. On the positive side, we anticipate strong performance from the banking and oil and gas sectors, along with potential recoveries in other sectors, which could provide attractive entry points for investors. Additionally, the release of the 9M:2024 earnings reports may further enhance positive sentiment, as investors look to position themselves in anticipation of full-year results and to qualify for dividend payments. However, we note that a northward movement in treasury yields may occasionally shift investor interest towards fixed-income assets. Overall, we forecast an ultimately bullish tilt for the Nigerian Equities Market in November.

Equities Strategy for November 2024

As we approach the end of the year, we expect investors to focus more on fundamentals, which are likely to influence trading activities in November. In our opinion, the current macroeconomic environment is quite favourable for the oil & gas sector. Also, companies with low leverage and minimal foreign exchange exposure are expected to be shielded from the effects of elevated interest rates and currency volatility. Consequently, we anticipate increased investors' interest in stocks that exhibit this combination of characteristics. Additionally, we believe that strong-performing stocks that experienced price declines in October may present attractive buying opportunities.

Based on our expectations, below is a list of stocks poised for price appreciation in November that investors can add to their portfolios while taking profits on stocks that have realised substantial gains.

Table 2: Equities Strategy for November 2024

Tickers	Current Price (NGN)	Advised Entry Price (NGN)	Target Price (NGN)	Upside Potential
ZENITHBANK	42.65	42.65	46.18	8.28%
OKOMUOIL	338.10	335.00	376.44	12.37%
AIICO	1.18	1.15	1.54	33.91%
UACN	20.50	20.00	26.55	32.75%
UCAP	17.60	17.60	27.30	55.11%

Fixed Income

Riding the Wave of Rising Yields and Tightening Liquidity

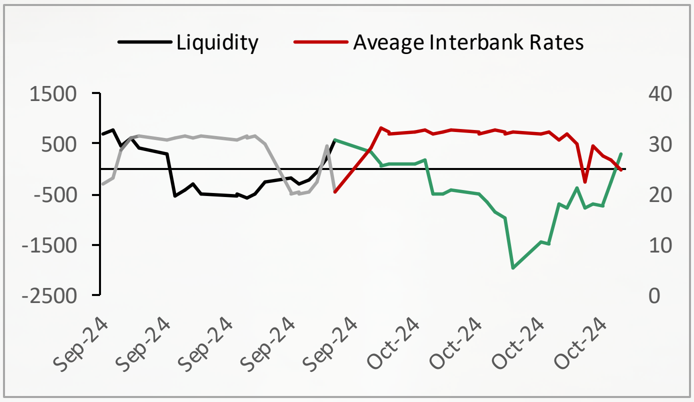
Review

In October, the fixed-income market experienced a bear flattening, marked by a sharp rise in yields at the short end of the curve compared to the longer end. This shift was driven by worsening macroeconomic conditions.

As reported by the NBS, inflation data showed an upward trajectory (32.70% YoY vs 32.19% YoY in September) which heightened market anxieties. This spike has deepened market concerns and heightened expectations of further monetary tightening by the CBN. As a result, investor sentiment in the secondary market turned more cautious, with increased risk aversion driving trading behaviour, particularly in longer-term securities.

Furthermore, there were increased activities on the CBN discount window compared to September as banks scrambled to meet their liquidity needs. Average system liquidity for the period worsened to NGN538.25bn from NGN26.13bn in the previous month, despite the NGN14.39bn coupon inflow and FAAC inflow of NGN1.29trn during the month. This liquidity strain pushed short-term borrowing rates higher, with OBB and O/N rates peaking at 32.28% and 32.58%, respectively, on October 17th (vs 29.69% and 29.97% in September), signalling that banks borrowed more than they deposited during the period. Additionally, the CBN's Open Market Operations (OMO) led to a net liquidity outflow of NGN1.18trn, further tightening liquidity conditions and driving effective discount window rates to an average of 33.05%

***Chart 6:* System Liquidity (LHS) and Average Interbank Rate (RHS) for September and October in NGN'bn**



Source: CBN, Meristem Research

At the T-bills Primary Market Auction, the CBN offered a total of NGN456.57bn across the three maturities – (91-day, 182-day and 364-day) up from NGN419.58bn in the previous month). Total subscription dropped to NGN763.12bn (vs NGN927.15bn in September), while total allotment matched the NGN456.57bn offered, compared to NGN399.76bn last month. This resulted in the bid-to-cover ratio declining to 1.67x from 2.32x in September, reflecting softer demand amid liquidity constraints. Stop rates remained unchanged at 17.00% and 17.50% for the 91-day and 182-day tenors, respectively, while the 364-day rate rose by 78bps to 20.65%, signaling increased demand for risk premium on the longer maturity.

Furthermore, in the bond PMA held during the month, the debt management office (DMO) offered a total of NGN180.00bn in re-openings of APR-29 and FEB-31 maturities. Consequently, the bid-to-cover ratio stood at 1.34x (vs 1.57x in the last auction). The marginal rate on the instruments printed at 20.75% and 21.74% (vs 19.00% and 19.99% in September) respectively. This suggests that investors demanded higher yields to compensate for perceived risks.

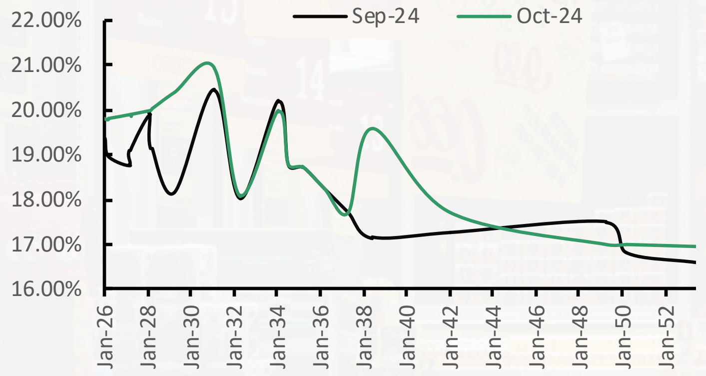
Also, in line with the CBN's ongoing effort to manage system liquidity, two Open Market Operation (OMO) auctions were conducted. Investors' demands were notably concentrated on the long end, with no subscription for the short and mid-end offerings. Meanwhile, a total of NGN800bn was offered, marking a 36.00% decline from the amount offered in August, with an increase in stop rates to 24.32% from 21.80% in the last auction in September. However, due to strong demand for the bills, stop rates in the second auction declined marginally to 24.30% with total subscription reaching NGN908.23bn.

In the secondary market, demand for short-dated instruments declined as the cost of holding these assets became less attractive amid system illiquidity. This led to higher yields at the front end of the curve, despite the broader bullish environment observed earlier in the year. However, pockets of demand persisted in longer-term securities, driven by investors' strategic focus on locking in yields before further rate hikes. Overall, average T-bills and bond yields advanced to 24.12% and 19.49% respectively (vs 21.92% and 18.77% in September).

Fixed Income

Eurobonds

*Chart 7: **Bond Yield Curve – September and October - in %***



Source: FMDQ, Meristem Research

The spread between Investment Grade (I) corporate bonds and Government (G) bonds remained narrow, with the I-G spread hovering at 3.11% (vs 2.89% in September), reflecting slightly higher but moderate credit risk perceptions for top-tier corporate issuers compared to government debt. This means that investors are gradually having a shift in appetite towards a safer instrument (treasury) as average yield edged up to 22.80% (vs 21.66% in September) at the end of October. In November, we do not expect more corporate issuances as companies tend to focus more on short-term financing (commercial papers) for their working capital needs.

Outlook:

Looking ahead, the bear-flattening trend in the curve is expected to persist in November, as we expect the MPC to further raise the MPR at their next meeting on the 25th and 26th of November. System liquidity will remain a key factor in shaping yield movements, with fluctuations likely. Inflows from T-Bills maturity (NGN1.12trn) and bond coupon payments (NGN166.62bn) across the MAY-29, NOV-29, and MAY-33 maturities, are expected to alleviate liquidity constraints and place downward pressure on yields.

Given the weaker-than-expected economic performance in H1:2024, we anticipate that investors will increasingly gravitate towards the longer end of the curve, seeking more stable returns. As such, we foresee continued volatility in the short-term, but a general preference for longer-dated instruments.

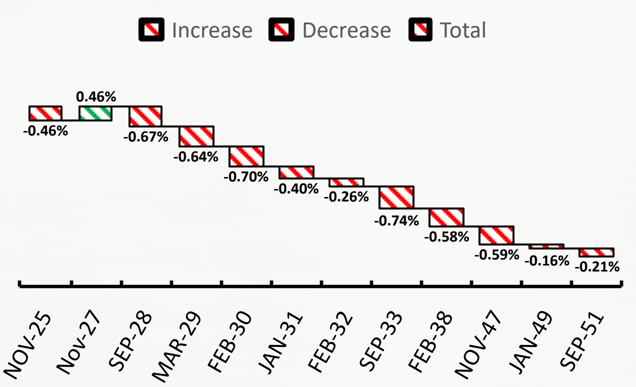
Gathering Clouds of Rising Yields

The performance in the Nigeria Eurobonds market was mixed, titling more towards a bearish bias. Early in the month, bullish sentiments emerged as investors cherry-picked across the curve at attractive levels following the release of the US Consumer Price Index (CPI), which revealed annual inflation easing to 2.40%, down from 2.50% in August. As a result, average yields gradually declined to 9.11%. However, this bullish momentum was halted mid-month due to deteriorating macroeconomic fundamentals within the domestic economy, revealed by the National Bureau of Statistics (NBS) reporting an increase in annual inflation to 32.70% after two consecutive months of declines. Additionally, robust US retail sales data fueled bearish sentiments, raising concerns about the US economy and expectations of a possible rate cut in November. Consequently, average yields gradually expanded to 9.58% towards the end of the month. Moreover, the S&P/FMDQ Nigerian sovereign bond index returned -0.30% (vs 3.77% in September).

Outlook:

The upcoming Fed decision, combined with the potential for higher inflation and rate hikes under a Trump-led administration, is expected to drive U.S. Treasury yields higher, making them more attractive to global investors. This scenario could lead to capital outflows from Nigerian Eurobonds as investors seek safer, higher-yielding U.S. assets. As a result, Nigerian sovereign instruments may face rising yields to remain competitive, with selling pressure increasing due to reduced demand and heightened risk perception.

*Chart 8: **Nigerian Eurobond MoM price change***



Source: DMO, Meristem Research

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