July 2020

THE INVESTOR

Q2 Macroeconomic Review - Nigeria

AfriKnowledgeBank

Watching Africa Move

AT A GLANCE…

Towards the end of Q1, we saw oil prices drop significantly to record lows, which adversely affected the country's FX reserves and reduced investor confidence. As a result, we witnessed a 15 percent devaluation of the official Naira exchange rate from N307/$ to N360/$ and a drop in total capital imported to Nigeria by 31.2 percent y/y. Although oil prices rebounded in Q2 as global demand slightly recovered, Nigeria continues to face another problem; Inflation.
The coronavirus pandemic has placed a considerable constraint on aggregate demand, which has given central banks the ability to execute low-interest rates without fear of inflation skyrocketing. The case was different for Nigeria in Q2. Headline inflation (y/y) rose to 12.40 percent in May 2020 from 12.34 percent in April 2020 with food inflation(y/y) increasing from 14.33 percent in April 2020 to 15.04 percent in May 2020.
While the increase is understandable as border closure and travel restriction exerted pressure on the cost of goods and services, we expect less pressure in Q3 as economies reopen globally.

GDP growth as of Q1 2020		+2.55%	
Inflation as at May 2020	Month-on-Month %	Year-on-Year %	12 Month Avg.Chg%
CPI Inflation	1.17	12.40	11.79
Food Inflation	1.42	15.04	14.33
Core Inflation	0.88	10.12	9.27

*source: NBS

Real GDP grew by 1.87 percent in Q1 compared to the 2.55 percent increase in the preceding quarter.

FX Reserves (US$ bn)	Close	1M%	3M%
As at 25/06/2020	$36.22	0.99	1.32

*Source: Central Bank of Nigeria -30-day moving average figure

Official Rate (USD)	N360
Monetary Policy Rate	12.5%
Crude Oil Price	$42.94

*Source: CBN as at 30/06/2020

NSE ASI Statistics as at 29/06/2020	
Current	24,858.89
Previous	24,829.02
Day Change	0.12%
YTD Return	-7.39%
YTD High	29,710.56
YTD Low	20,669.38
52wk High	29,966.87
52wk Low	20,669.38

*Source: NSE

Fixed Income Mark-to-Market	Tenor	TTM	Yield%
Nigerian Treasury Bill	364D	227D	3.06
8.50% FGN 20-NOV-2029	10yr	9.39Y	9.76

*Source: FMDQ as at 29/06/2020

MACRO POLICIES

Monetary Policy

In Q1 2020, the CBN had explored a broadly expansionary monetary policy stance aiming to increase activity in the real sector, as evidenced by increased LDR requirements for banks and reduced interest rates. The monetary policy stance is, of course, necessary as aggregate demand has slowed as a result of the coronavirus pandemic. However, it leaves the apex bank with a tough decision to make, lower policy rates and risk high price levels or increase policy rates and risk economic contraction.

Following the global theme of lowering interest rates to stimulate economic growth, the CBN opted to maintain a relaxed policy stance. While most advanced economies remained largely below their 2 percent target inflation rates, Nigeria witnessed a rise in inflation for the 9th consecutive month. Both the Food and Core inflation sub-index rose to their 26-month and a 22-month high of 15.04 percent y/y and 10.12 percent y/y, respectively. This rise in inflation could be attributed to supply-side factors such as the rise in the parallel market exchange rate and border restrictions.

FX Policies.

Portfolio flow reversal from emerging and developing economies continued as investors rebalance their portfolios towards cash and gold. According to NBS, total capital imported to Nigeria has declined by 31.2 percent y/y in Q1 2020, with foreign direct inflow accounting for 3.7 percent of gross investment inflow while foreign portfolio investment accounted for 73.6 percent. Some analysts believe that the significant drop in capital inflows was as a result of CBN's failure to unify its multiple exchange rates despite the significant pressure on external reserves resulting from the decline in oil prices.

Although oil prices have recovered and external reserves replenished, the pressure to unify notably from organizations like the world bank continued. At an investors conference held by Citibank, the Governor of the CBN, Godwin Emefiele confirmed that the CBN would continue to pursue the unification of its multiple fx rates around its Nafex rate. If this is followed through, we foresee more currency movement as the Naira moves towards a 'fairer equilibrium.'

Monetary Policy Rate (MPR)

Despite the increase in inflation in May, the central bank explored expansionary monetary policy to stimulate the economy due to the hard-hitting effects of COVID-19 restrictions on the economy. At the May 2020 meeting, the Monetary Policy Committee (MPC) noted the importance of policy to strike a balance between supporting the recovery of output growth while maintaining sustainable inflation, exchange, and interest rates.

Tightening the rate at a time of constrained global demand could put further pressure on output and increase the cost of credit. While loosening the rate could lead to excess liquidity, overshoot the economy's absorptive capacity, and accelerate inflation. Based on current realities of weak aggregate demand, the MPC noted that if continued stimulus programs were in place, we could expect positive growth in Q4. Hence, the committee decided by unanimous vote to reduce the monetary policy rate (MPR) by 100 basis points.

MPR	Reduce to 12.5%
Asymmetric Corridor	+200/-500 basis points around the MPR
CRR	Retain at 27.5%
Liquidity Ratio	Retain at 30%

*Data from CBN

Our Outlook

The CBN's approach to pursuing expansionary monetary policy is in line with the need to fund economic activities and boost recovery. Therefore, expect monetary policy to remain reasonably relaxed until the coronavirus pandemic's lagged effect manifests in the economy.
In terms of inflation, we predict relaxed pressures on price levels as global supply chains recover, and borders reopen.

*Data from CBN

Fiscal Policies

The start of Q2 witnessed the highest drop in crude oil prices in about 20 years. Crude oil prices fell from a high of \$68.9/b in January 2020, to a low of \$19.3/b in April 2020. Therefore, Nigeria's fiscal policy stance was based on the need to boost government revenue and alleviate the economic impact of COVID 19 on the economy. Some Fiscal policy interventions introduced in Q2 include:

- Further extensions of lockdown due to rising COVID cases
- Adjustment of the 2020 budget, the effect of which was an increase in the projected budget deficit from N2.175tn to N4.95tn and a reduction in the oil benchmark price from \$57/b to \$30/b
- Disbursement of \$3.4bn emergency financing under the International Monetary Fund (IMF) Rapid Financing Instrument (RFI).
- Reduction in the pump price of petrol from N145/litre to N123.5/litre
- Delay in electricity tariff hike
- Suspension of deductions of loans and bailout funds from states' monthly allocation for one year.

Fiscal Policy Outlook

Due to the brief decline of oil prices and the coronavirus pandemic's emergence, the need for a more robust revenue base for the federal government is increasingly important. We expect the government to revisit its tax system to increase government revenue and avoid the CBN financing its deficits. While the tightening will not happen immediately as the economy recovers, the longer-term impact is immense. It remains necessary for the Nigerian government to seek out more effective tax collection procedures and see them to completion.

ASSET CLASSES

Equities

Past performance is not a reliable indicator of future returns.

Although the equities market was mostly bearish in the first quarter of 2020, we witnessed a slight improvement in Q2 as the All-Share Index (ASI) increased by 16.5 percent QTD. This increase primarily reflects restored confidence as a positive outlook on the global oil market emerges. As liquidity continues to wash the market, we expect an increase in the value of companies previously suppressed by the damaging effects of COVID-19.
In terms of corporate action, FBN Holdings Plc joined the likes of Union Bank in plans to streamline business operations to focus on growth opportunities. In June, FBN Holdings Plc announced the completion of the sale of its 65.0% stake in FBN Insurance Limited to Sanlam Emerging Markets Limited.

Sector Winners and Losers

Weak demand and low oil prices suppressed returns in the equities market in Q1, with some spill over effects into Q2. With no surprise, the consumer goods sector topped the list of losers declining by 26.98 percent YTD at the close of business in June. Following the CG sector, the oil and gas fell by 24.37 YTD, as the demand for oil still falls short of expectations.

Although not adequately represented in the stock market, we expect to continue to see the rise in telecommunications as the country increases its digital footprint with MTN and Airtel being major players.
Furthermore, we believe that with pressure to maintain a well-capitalized balance sheet, the banking sector will be able to absorb some projected losses from bad debt.
Looking forward, determining the stocks that will be good is a question of the companies that can operate digitally and drastically reduce capital expenditure.

Performance by Sector

26/06/2020	MtD	QTD Chg%	YTD Chg%
NSE-Banking Index	-4.87	22.66	-18.92
NSE Consumer Goods Index	1.86	32.99	-26.98
NSE Oil/Gas Index	-13.03	-7.76	-24.37
NSE Industrial Goods Index	-0.81	14.87	11.10
NSE Insurance Index	-1.78	8.43	2.90

*Source: NSE

*Data from NSE

Fixed Income

The fixed income market experienced a downward shift in the yield curve (i.e., yields dropped across different fixed income maturities due to the increase in the prices of these instruments) following the rebound in the global economy and the subsequent recovery of oil prices. The CBN has significantly reduced intervention through lower dollar supply to the I & E window, which helped trap FPIs from repatriating capital and resulted in increased liquidity and demand for local securities such as OMO.

Due to these factors, average yield at the OMO market decreased to 5% levels from about 15% in Q1, while long term FGN bonds saw a decline to 10.0% levels in Q2 compared to 12% in Q1. The Nigerian Treasury Bills market remained relatively depressed due to excess demand, with yields ranging from 2% to 4%.

The Eurobond market saw a significant rebound in prices resulting in gains for investors who took advantage of the extremely low prices in March as advised by our earlier report. The recovery of this market was due to an increase in investor confidence due to an improved outlook for the economy reflected in the improvement in oil prices and the financial assistance gotten from multilateral agencies, which helped shore up Nigeria's foreign reserves. As a result, the average yield in FGN Eurobonds declined to 8% at the end of Q2 compared to 12% in March 2020.

Rating Agency	Rating	Outlook
Fitch Ratings	B	negative
Moody's Investors Service	B2	negative
Standard & Poor's	B-	-

Fixed income outlook: The way forward

In Q3, the fixed income market's path hinges on the ability for policymakers to maintain a balance between policy stability and protecting the economy to ensure improved investor confidence. Due to the global monetary policy easing and dovish domestic monetary policies, interest rates are likely to remain low in the short term. Longer-term outlook remains hazy due to heightened uncertainty in the global economy and the risks of the second wave of the virus. Should these risks crystalize, interest rates are likely to be volatile and may likely move upwards; therefore, we advise that investors maintain a short duration by staying on the shorter end of the yield curve when taking fixed-income investment decisions in order to lock in opportunities for higher yields as they come.

Commodities

The first quarter's headline was the collapse in crude oil prices as the commodity witnessed a double attack from low demand and excess supply. Fortunately, the second quarter came with a more favourable treatment for the commodity.
As countries start to ease the lockdown rules, OPEC+ agreed to reduce oil supply to curtail some of the adverse effects of reduced oil demand. In May 2020, global supply fell by 12 million barrels per day (mb/d) year-on-year, due to the roughly 9.4 mb/d of cuts from OPEC+. As a result, oil prices rose from \$19.3/b in April 2020 to a little over \$40/b in June 2020.
According to a new report from the International Energy Agency (IEA), oil demand may not recover to pre-pandemic levels until 2022.

MARKET DATA – Week Close 26/06/2020

Top Five Performers

Company	Close	Gain (N)	% Change
AIRTEL AFRICA PLC	328.70	29.80	9.97
ASSOCIATED BUS COMPANY PLC	0.56	0.05	9.80
NESTLE NIGERIA PLC.	1200.00	105.50	9.64
WEMA BANK PLC.	0.60	0.05	9.09
UACN PROPERTY DEVELOPMENT COMPANY PLC	0.99	0.08	8.79

*Source: NSE

Top Five Decliners

Company	Close	Loss (N)	% Change
P Z CUSSONS NIGERIA PLC.	3.85	-1.05	-21.43
GLAXO SMITHKLINE CONSUMER NIG. PLC	5.85	-1.25	-17.61
PRESTIGE ASSURANCE PLC	0.47	-0.10	-17.54
DANGOTE SUGAR REFINERY PLC	11.90	-2.40	-16.78
CHAMS PLC	0.22	-0.03	-12.00

*Source: NSE

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