United Capital

Global Macro

H1-2023 Review & H2-2023 Outlook

Global growth has stabilised, but the improvement is fragile…

- During H1-2023, the global economy showed promising signs of a gradual recovery, despite facing significant challenges from the pandemic and Russia's unprovoked war on Ukraine. China's economy bounced back vigorously after reopening, while supply-chain disruptions eased, and the impacts on energy and food markets caused by the war subsided. These positive developments indicate a potential path towards economic recovery on the global stage.

- China's economy experienced a notable growth of 2.2% quarter-on-quarter, attributed to a robust revival in both exports and consumption. The lifting of Covid-19 restrictions played a significant role in the rapid recovery of the services sector, and property sales have also stabilized. These positive indicators reflect the resilience of China's economy and its progress towards recovery from the impacts of the pandemic.

- In Q1-2023, the US economy recorded a growth rate of 0.3% quarter-on-quarter, which was half the increase of 0.6% observed in Q4-2022. The composition of US growth during this period showed strong consumption and a rise in exports, but these were offset by a contraction in investment, marking the fourth consecutive quarterly decline and a decrease in inventories. These factors contributed to the overall growth rate, indicating a mixed performance of different sectors in the US economy during the specified quarter.

- In the Euro Area, overall growth printed at 0.1% in Q1-2023. Notably, Italy and Spain showed the strongest gains, with a growth rate of 0.5% each. France recorded a more modest gain of 0.2%, while Germany, after a contraction of 0.5% in Q4-2022, saw zero growth (-0.3%) during Q1-2023. These diverse performances among the Euro Area countries highlight variations in economic conditions and growth trajectories across the region during the specified period.

…Developments in the US and China Shaped the World's Economy

- In spite of the positive factors such as lower food and energy prices and improved supply-chain functioning, risks in the US economy remained elevated due to the increased fragility of the financial system. These lingering risks could have implications for economic stability and warrant careful monitoring and management by policymakers to ensure sustained growth and resilience in the face of potential challenges.

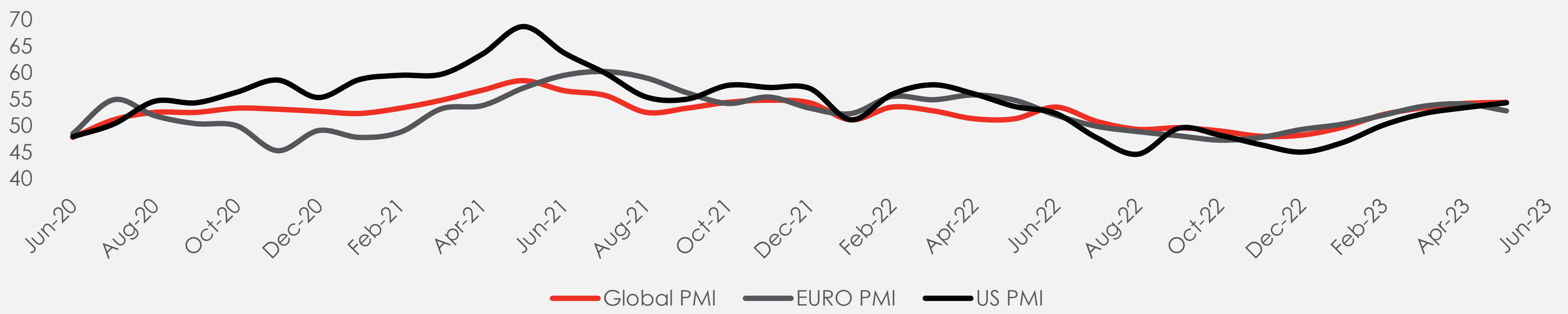
- In H1-2023, the major forces that shaped the world economy in 2022 persisted, albeit with varying intensities. High debt levels continue to limit the flexibility of fiscal policymakers to respond to new challenges. Commodity prices, which soared following Russia's invasion of Ukraine, have moderated, but the ongoing war and geopolitical tensions pose continued uncertainties.

- COVID-19 outbreaks have affected global economies, with countries like China facing significant impacts. Nevertheless, economies like China appear to be recovering, easing supply-chain disruptions. However, China's recovery has not met expectations, as challenges persist in various sectors. These include excess capacity in manufacturing, a short-lived recovery in the housing market, deleveraging of the household sector, elevated youth unemployment, and strains in local public finances.

- Overall, these ongoing factors shaped the world economy in H1-2023, influencing economic outlooks and policymakers' responses to new challenges. The interplay of these forces will continue to impact global economic growth and stability going forward.

Global composite PMI has expanded 6.0% y/y to 54.4 in May-2023

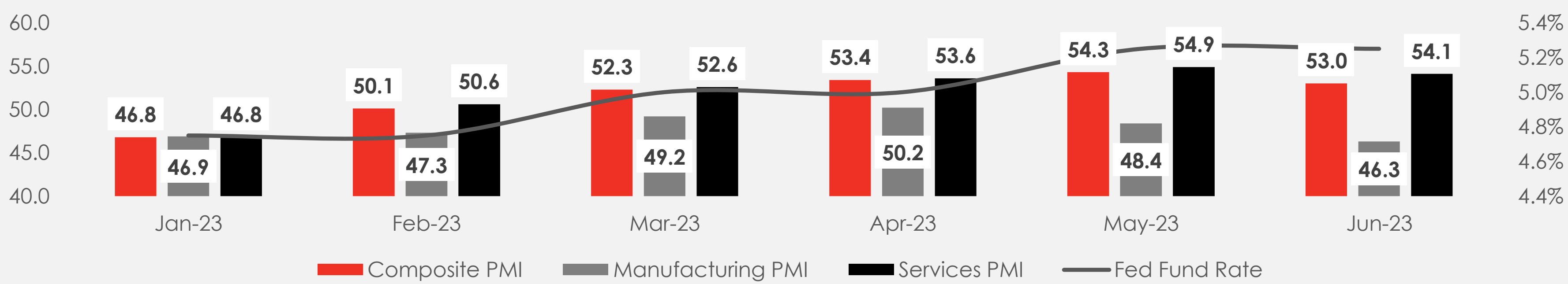
Composite PMI



Source: Bloomberg, United Capital Research

The continued hawkish stance of the US Fed has reduced economic activity, driven mainly by the contraction in the Manufacturing sector.

US PMI Composite, Manufacturing & Services vs Fed Rates



Source: Bloomberg, United Capital Research

The Global Economy: A Slow But Steady Recovery…

The Intelligent Choice

Outlook

- Global economic growth is projected to decelerate to 2.1% in 2023, a considerable drop from the robust 5.7% growth observed in 2022. This slowdown is primarily attributed to the ongoing war in Ukraine, which has substantial repercussions on the global economy. The conflict is leading to higher commodity prices, disruptions in supply chains, and Russia's utilisation of energy supplies as a weapon.

- The economic consequences of the war are particularly severe in Germany and Central Europe, where the impact is strongly felt. These developments pose significant challenges to the stability and performance of the global economy in the current year.

- The economic outlook for the United States appears negative, evident from both restrictive monetary policy and weak leading economic indicators. The country is expected to experience a sharp slowdown in annual growth, with a projected rate of 1.0% in 2023. This deceleration is due to consumer spending becoming unsustainable amid high inflation and a significant increase in interest rates.

- The Federal Reserve (Fed) has already implemented multiple rate hikes over the past 14 months, and it is nearing the peak for the federal funds rate. Additionally, credit standards are tightening, and the Fed staff are forecasting a possible recession in the future. These factors collectively indicate challenging economic conditions in the US for the coming year.

Developments in China and the US to play key role…

- The economic outlook for the Eurozone is increasingly pessimistic, with some experts arguing that a recession has already begun, evident from negative GDP growth reported in both Q4-2022 and Q1-2023. Despite a tight labour market with low unemployment and accelerating wage growth, the European Central Bank (ECB) raised the deposit rate and signalled another rate hike, adding strains to the eurozone economy due to monetary tightening. Moreover, the waning recovery in China poses a challenge as it is an essential export market for the Eurozone.

- Currently, the Euro is supported by the ECB's hawkish stance, but there is potential for downward pressure in the medium term if the central bank makes policy mistakes. These factors together highlight the vulnerabilities and uncertainties facing the Eurozone's economic performance in the near future.

- China's economic rebound has encountered stagnation, necessitating a boost in confidence as growth is anticipated to slow in Q2-2023. The manufacturing and property sectors are major contributors to the downward pull on growth. Unlike in developed countries, excess savings in China are relatively lower and less likely to be spent, as they have been accumulated without significant fiscal stimulus support. Moreover, the Chinese property market is facing challenges with elevated credit spreads and a sluggish recovery. These factors present hurdles to China's economic recovery and require careful attention and supportive measures to stimulate growth and bolster confidence in the economy.

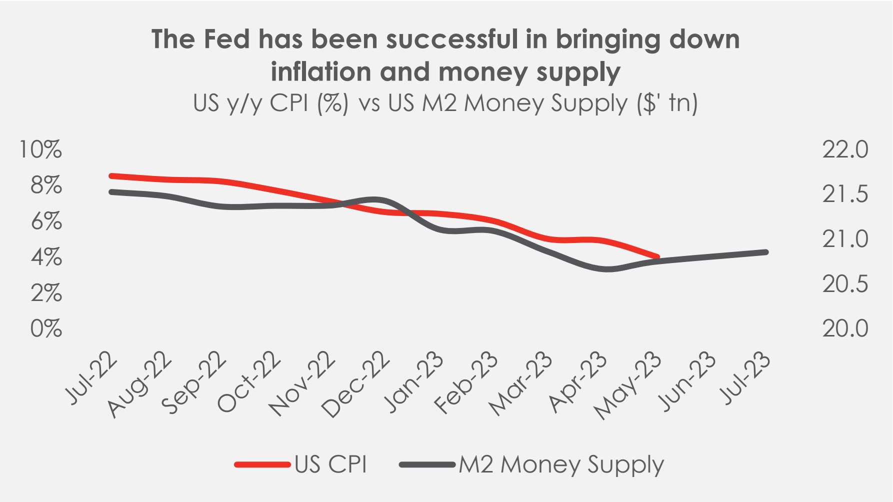
- We expect recovery to be back on track in H2-2023 as labour market conditions improve and the government increases policy. We expect a 6.0% growth in 2023 and 6.1% in 2024

Global Inflation Review

- Global central banks' active monetary policy decisions have helped calm the knock-on effects of the Russian-Ukraine war, which caused supply chain disruptions and price increases.
- In the United States, headline inflation has been gradually easing since the beginning of the year, reaching 4.0% in May 2023, the lowest rate recorded since May 2021. This 250 basis points year-to-date drop in inflation can be attributed to the hawkish stance of the US Federal Reserve, which has implemented a total of 125 basis points increase in the benchmark interest rate. The consistent decline in money supply has also contributed to the moderation of headline inflation, with the US M2 supply decreasing by approximately 3.1% year-on-year to $20.85 trillion.
- In the Eurozone, inflation decreased to 6.1% in May 2023, varying from approximately 3.6% in Luxembourg to 21.5% in Hungary. The European Central Bank's (ECB) hawkish stance has effectively curbed headline inflation by 310 basis points year-to-date. However, the money supply in the region increased by 3.5% year-on-year, reaching $160.89 trillion, which has slowed down the decline in headline inflation.
- The downtrend in inflation is also driven by falling food prices, influenced by various factors such as the resumption of exports from Ukrainian ports under the Black Sea Grain Initiative and reduced transportation costs due to the decline in crude oil prices. The FAO Food Price Index declined by 21.4% year-on-year in May-2023 to 124.3.
- Although headline inflation rates are declining, core inflation in the US and Europe remains high, driven by increasing service prices (e.g., housing, insurance, transport) and labour costs with robust wage growth. In May 2023, services prices excluding energy services rose by 6.6% year-on-year in the US, while real average hourly earnings increased by 1.3%, seasonally adjusted.

Outlook

- Inflation remains a persistent issue despite global interest rate hikes, and it is projected to stay above target ranges by the end of 2024. These economic headwinds pose considerable obstacles to Nigeria's economic stability and growth trajectory.
- Policymakers will need to carefully navigate these challenges and implement appropriate measures to address the inflationary pressures and ensure sustainable economic development in the face of global economic uncertainties.
- Nigeria's economy faces challenges amid stabilising but tough external financing conditions for frontier markets. Deteriorating growth prospects, higher borrowing costs, limited access to international capital markets, high inflation, and record debt levels further add to the difficulties.
- Inflation is predicted to stay above central bank targets in H2-2023. The United Nations forecasts a global inflation decline from 7.5% in 2022 to 5.2% in 2023, primarily driven by lower food and energy prices, along with a softening in global demand.
- In developed countries, headline inflation is projected to gradually decrease from 7.8% in 2022 to 4.8% in 2023. However, inflation is expected to remain significantly above the average of 3.1% observed during the period from 2000 to 2019.


The Fed has been successful in bringing down inflation and money supply
US y/y CPI (%) vs US M2 Money Supply ($' tn)
10%
8%
6%
4%
2%
0%
22.0
21.5
21.0
20.5
20.0
Jul-22
Aug-22
Sep-22
Oct-22
Nov-22
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Jan-23
Feb-23
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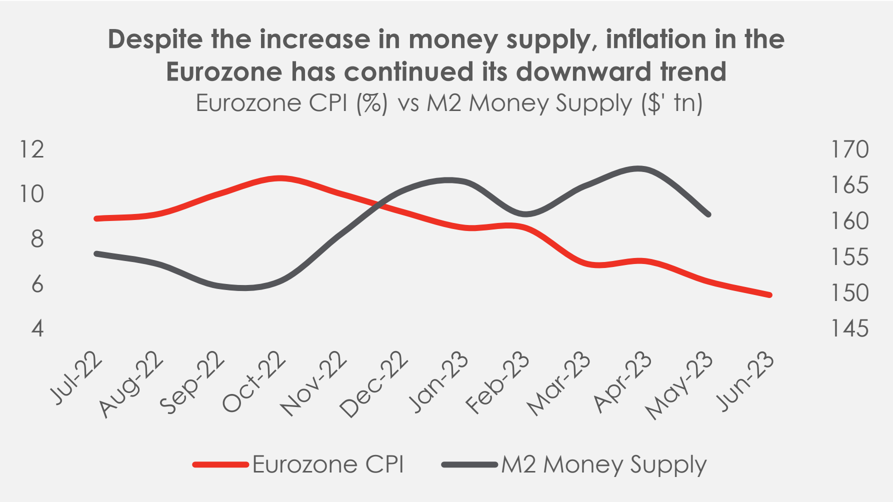
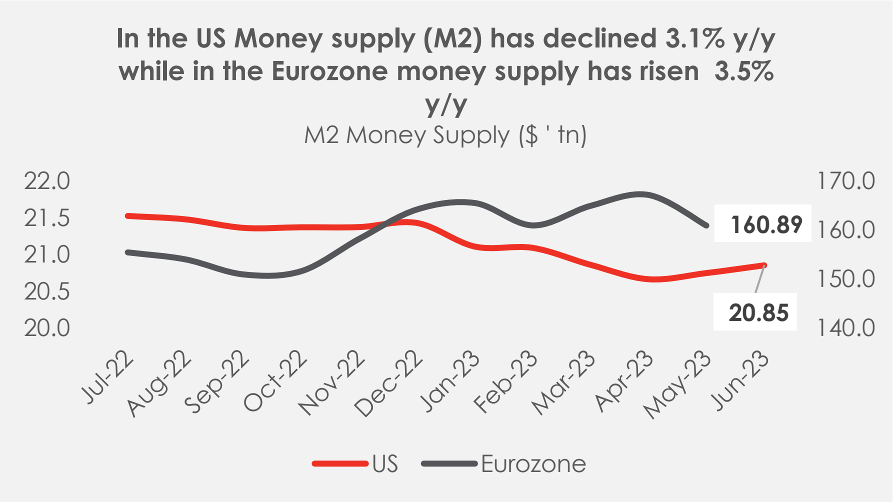
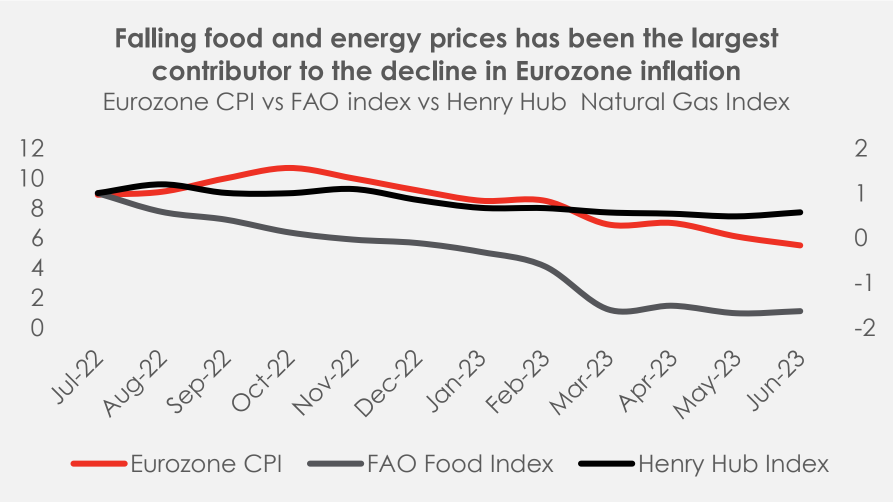
Jul-23
US CPI
M2 Money Supply


Despite the increase in money supply, inflation in the Eurozone has continued its downward trend
Eurozone CPI (%) vs M2 Money Supply ($' tn)
12
10
8
6
4
170
165
160
155
150
145
Jul-22
Aug-22
Sep-22
Oct-22
Nov-22
Dec-22
Jan-23
Feb-23
Mar-23
Apr-23
May-23
Jun-23
Eurozone CPI
M2 Money Supply


In the US Money supply (M2) has declined 3.1% y/y while in the Eurozone money supply has risen 3.5% y/y
M2 Money Supply ($ ' tn)
22.0
21.5
21.0
20.5
20.0
170.0
160.0
150.0
140.0
160.89
20.85
Jul-22
Aug-22
Sep-22
Oct-22
Nov-22
Dec-22
Jan-23
Feb-23
Mar-23
Apr-23
May-23
Jun-23
US
Eurozone


Falling food and energy prices has been the largest contributor to the decline in Eurozone inflation
Eurozone CPI vs FAO index vs Henry Hub Natural Gas Index
12
10
8
6
4
2
0
2
1
0
-1
-2
Jul-22
Aug-22
Sep-22
Oct-22
Nov-22
Dec-22
Jan-23
Feb-23
Mar-23
Apr-23
May-23
Jun-23
Eurozone CPI
FAO Food Index
Henry Hub Index

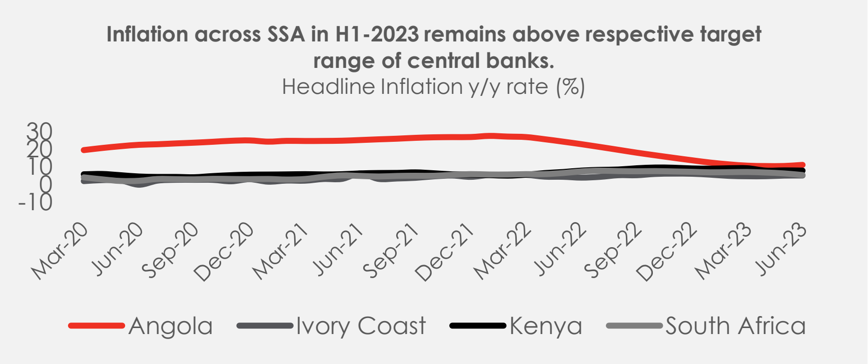
SSA Macro
H1-2023 Review

SSA Inflation Review

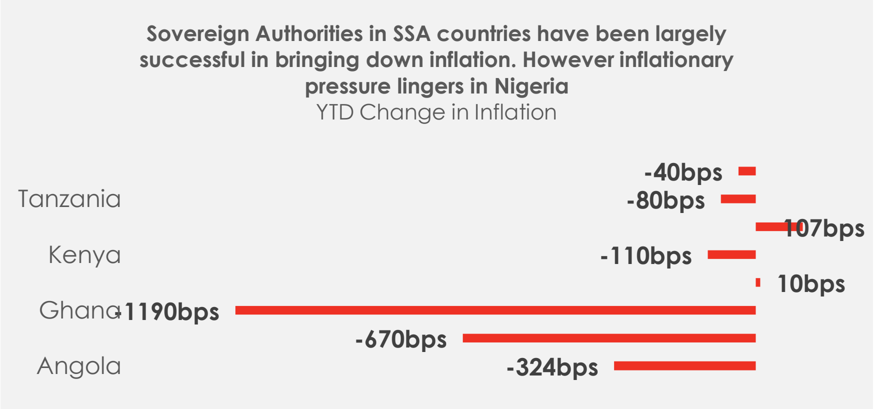
- In H1-2023, the market outlook for inflation in the SSA region seemed to improve, suggesting that inflation could still decelerate faster than the consensus expectation. Downward pressure on consumer prices stems from receding global inflation due to lower international oil and food prices. The region is a large importer of both items, which average 50.0% of the region's consumption basket. Also, weaker domestic demand in individual countries is progressively wearing away the pricing power of suppliers, containing suppliers' ability to pass on costs to consumers. The substitution and income effects are in full swing.

- However, African economies face an uphill task in taming inflation. For currencies pegged to the Rand (ZAR), i.e., South Africa (CPI = 6.3% y/y), Lesotho (CPI = 6.9% y/y), and Namibia (6.29% y/y), the inflation target is set at 6.0%. These countries have kept inflation close to its ceiling. In the case of the West African Economic and Monetary Union (WAEMU) and the Central African Economic and Monetary Community (ECCA), these currencies are pegged to the euro and have a 3.0% inflation ceiling. In these countries, inflation is trending towards the target, although Senegal (8.3%), Guinea Bissau (10.0%), Cameroon (7.3%) and DR Congo are well above the target. In Ghana, May-2023 CPI printed at 42.2%, down from its 54.1% high in Dec-2022 but well above its 8.0% target.

- The IMF projects the median inflation for the region to be at 5.0% y/y by Dec-2024. However, a notable downside risk to this expectation is a global downside scenario, whereby worsening geoeconomic fragmentation, whereby countries cluster into trading blocks, has negative spillover effects on SSA. What is more probable, however, is that inflation proves stickier than expected in developed economies, which could induce further monetary policy tightening.



Source: Bloomberg, United Capital Research

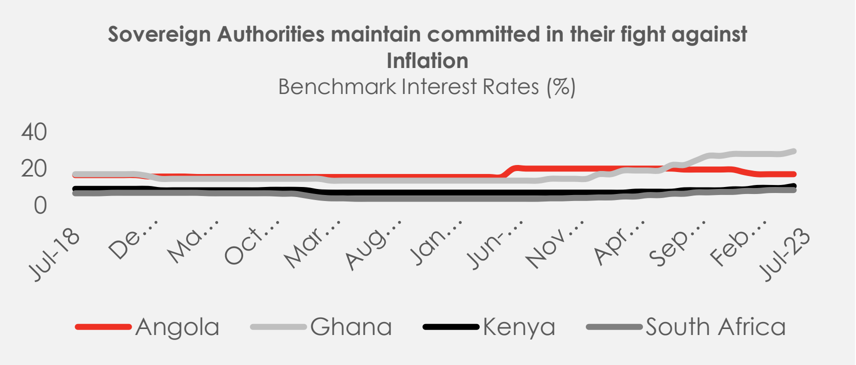


Source: Bloomberg, United Capital Research

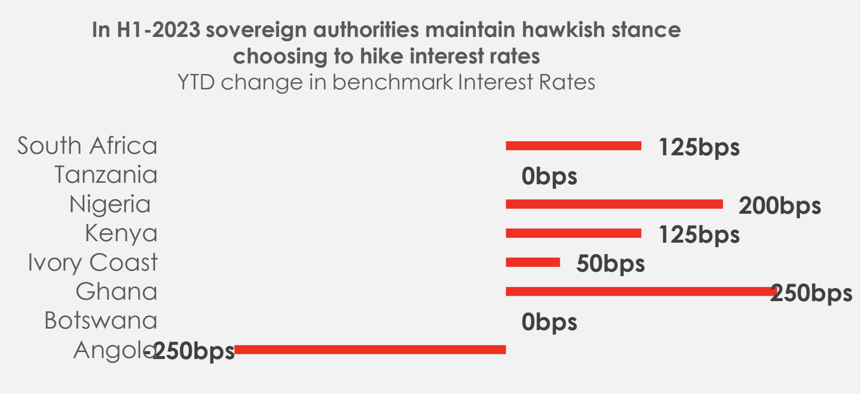
SSA Monetary Policy Review

- The thread of the 2020s has been characterised by the confluence of ineluctable and monumental exogenous shocks to the global economy. Following the economic shutdown due to COVID-19, the world benefited from an unprecedented enactment of expansionary fiscal and monetary policies to jolt economic activity. In the face of high and sustained inflation, major central banks, led by the U.S. Federal Reserve, combated inflation in an unprecedented pace of monetary tightening. This put an end to over a decade era of low interest rates. Most emerging economies, facing a strengthened US Dollar and the risk of capital flight followed suit and hiked policy rates.

- Tightening global financial conditions have affected SSA economies in several ways. It has increased risk aversion for SSA debt and equity investments, pushing prices lower. It has also boosted the cost of servicing foreign currency-denominated debt by raising interest payments. In efforts to check these and incentivise foreign portfolio investments, Central Banks of major African economies such as the South African Reserve Bank, Central Bank of Nigeria, Bank of Ghana, and Central Bank of Kenya, continued to tighten their monetary policies in H1-2023. The exception is Angola's Banco Nacional de Angola which has maintained its dovish stance, given the sharp decline in its headline inflation (from a high of 27.66% in Jan-22 to 10.62% in May-2023).



Source: Bloomberg, United Capital Research



Source: Bloomberg, United Capital Research

Nigerian Economy

H1-2023 Review

Overall Economic Growth – Real Gross Domestic Product (GDP)

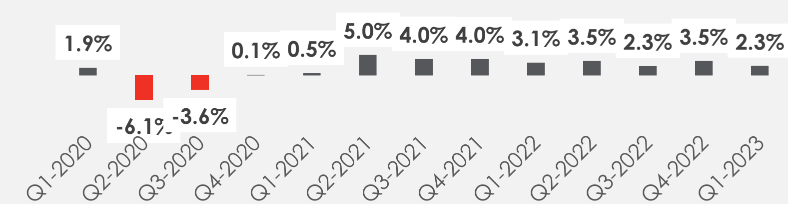
- In spite of the high oil prices experienced since 2021, the Nigerian economy has not witnessed the usual boost it had historically enjoyed from such favourable conditions. On the contrary, during this period, macroeconomic stability has weakened, marked by declining oil production, the burden of a costly petrol subsidy consuming a substantial portion of gross oil revenues, exchange rate distortions, monetisation of the fiscal deficit, and soaring inflation rates. This decline in economic performance is evident in the GDP growth rate, which fell to 2.31% in the first quarter of 2023. This marks a decrease from 3.11% recorded in the first quarter of 2022 and 3.5% in the fourth quarter of 2022, as reported by the Nigerian Bureau of Statistics (NBS).
- In Q1 2023, the non-oil sector, which has been the major driver of growth in recent quarters, experienced a growth rate of 2.77%, which was lower than the growth rates of 4.44% and 6.08% recorded in Q4 2022 and the corresponding quarter of 2022, respectively. This slowdown can be attributed to the effects of the CBN demonetisation policy, which led to a scarcity of the national currency (naira), subsequently resulting in a deceleration of economic activities. Additionally, the buildup to the general elections during this period might have contributed to uncertainty and cautiousness among businesses and investors, further impacting the non-oil sector's growth.
- In Q1 2023, the oil sector, which had been experiencing a recession, showed a significant improvement with a growth rate of -4.21%. This marks a notable recovery compared to the sharp decline of -26.04% in Q1 2022 and the moderate performance of -13.38% in Q4 2022. The positive upturn can be attributed to increased crude oil production during the quarter. The average daily production (including condesates) in Q1 2023 reached 1.52 million barrels per day (mbpd), surpassing the previous year's daily average of 1.49 mbpd recorded in Q1 2022.

…The Non-Oil Sector Remained Key Driver

- The oil sector's contribution to the total GDP was 6.21%, which reflects a decrease from the corresponding figure of 6.63% recorded in Q1 2022. However, this decline still represents an improvement from the contribution of 4.34% in Q4 2022. Despite the dip in Q1 2023, the oil sector's performance shows a positive trend compared to the previous quarter, indicating a potential rebound after the challenges faced in the past. The improvement in the oil sector's performance in Q1 2023 can be attributed to several factors, including enhanced production volumes due to improved security measures on oil pipelines and a crackdown on oil theft. These efforts have contributed to a more stable and secure environment for oil production activities. Crude oil production (including condensates) averaged 1.52 million barrels per day (mbpd) in Q1'23, which is a significant increase from the production levels in the preceding quarter of 1.35mbpd. This boost in production has positively impacted the overall performance of the oil sector.

Economic growth slowed in Q1-2023 to 2.3% y/y due to the impact of the cash crunch which arose from the Naira redesign policy during the period

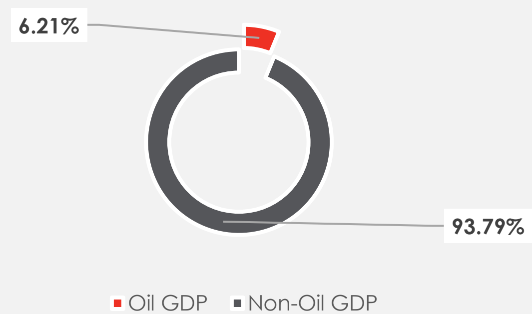
GDP y/y Growth



Source: National Bureau of Statistics (NBS), United Capital Research

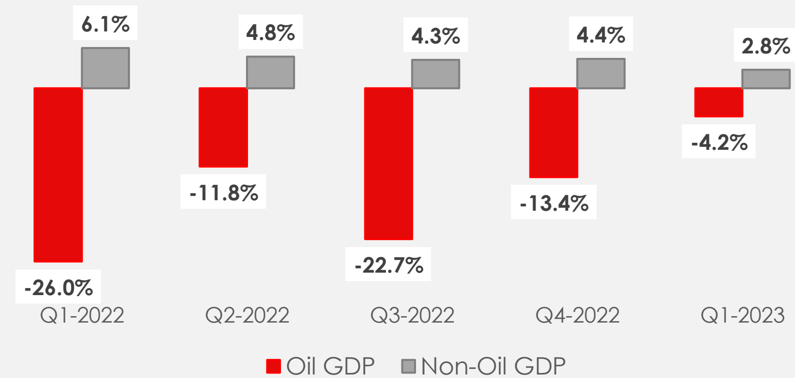
The oil sector's contribution remains abysmal to Nigeria's economic growth

Contribution to GDP



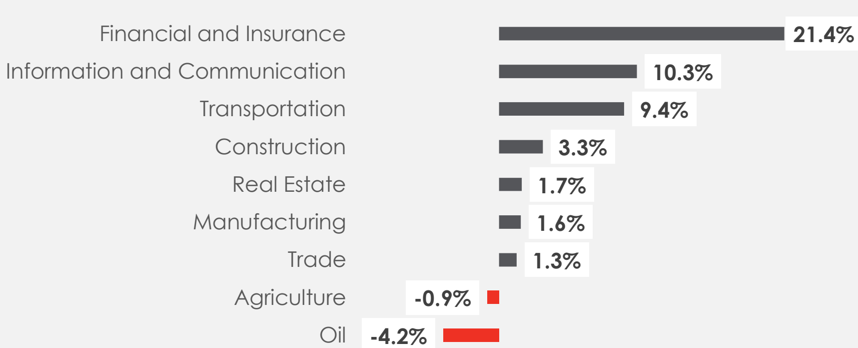
Source: National Bureau of Statistics (NBS), United Capital Research

Oil Growth vs Non-Oil Growth Rates



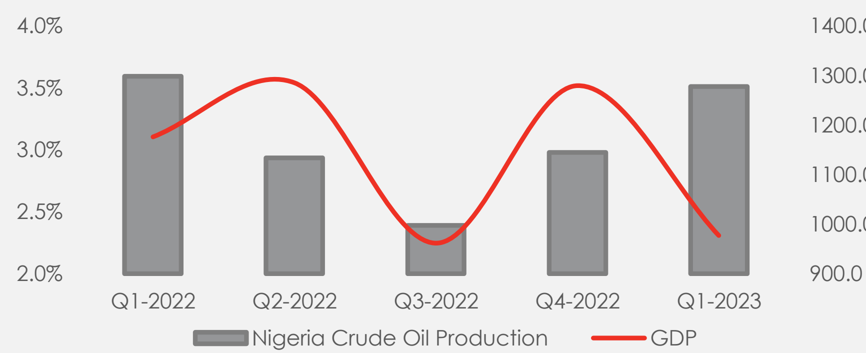
Source: National Bureau of Statistics (NBS), United Capital Research

Performance of Key Sectors in the Nigerian Economy



Source: National Bureau of Statistics (NBS), United Capital Research

Crude Oil Production vs GDP



Source: National Bureau of Statistics (NBS), NUPRC, United Capital Research

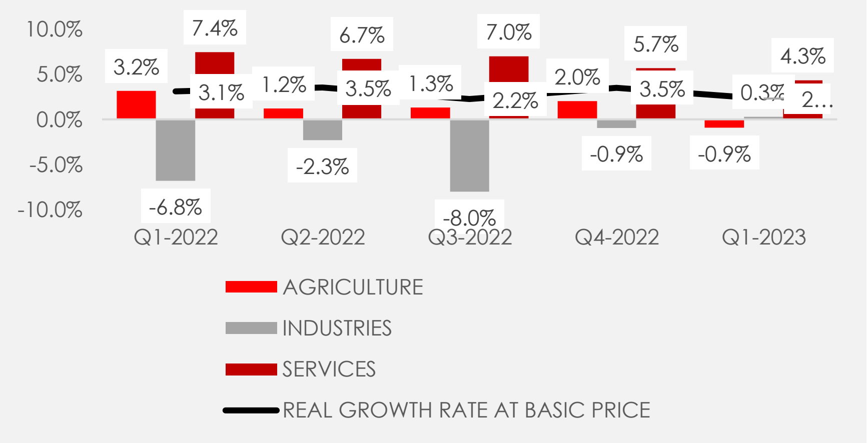
Sectorial Analysis of GDP

- The service sector emerged as the primary catalyst for growth, registering an impressive 4.35% expansion and accounting for a substantial 57.29% contribution to the overall GDP. The sector experienced a notable year-on-year growth of 4.4%, primarily propelled by significant advancements in the Financial & Insurance sub-sector, which recorded a remarkable 21.4% growth, and the Information & Communication sub-sector, which achieved a substantial 10.3% growth. These impressive expansions were largely attributed to the widespread adoption of 5G technology and the government's efforts to promote financial inclusion throughout the country. These positive developments have played a crucial role in driving the overall growth and progress in the sector.

- The agricultural sector experienced a decline of -0.90% in Q4 2022, which was lower than the growth rate of 3.16% observed in Q1 2022 and 2.05% in Q4 2022. Despite contributing 21.66% to the overall GDP, the slowdown in the sector can be attributed to the increasing insecurity in the country's food belt. This contraction was primarily caused by a slowdown in crop production, which was a result of the cash crunch that affected farmers' ability to settle their laborers and acquire necessary farming inputs. As a consequence, the sector's performance in the first quarter of 2023 fell below its 5-year average growth rate of 2.1%.

… The Services Sector Was The Primary Growth Catalyst

- During Q1 2023, the industrial sector exhibited positive signs of progress, marking a growth of 0.31%. This stands in stark contrast to the -6.81% decline experienced in Q1 2022 and the -0.94% decline recorded in Q4 2022. Notably, the industrial sector's contribution to the GDP amounted to 21.05% in Q1 2023. In Q1-2023, the industrial sector experienced a notable rebound, showing positive growth of 0.3% year-on-year. This positive performance comes after previous periods of negative growth. The main contributors to this growth were the Manufacturing sub-sector, which expanded by 1.6% year-on-year, and the Construction sub-sector, which saw a significant expansion of 3.3% year-on-year. These expansions in the Manufacturing and Construction industries played a crucial role in driving the overall growth of the industrial sector during the mentioned period.



Source: National Bureau of Statistics (NBS), United Capital Research

Q2 Economic Performance

- In H1-2023, the Nigerian economy experienced a slowdown due to the effects of the Naira redesign policy and cash crunch. These factors contributed to a decline in economic activities, leading to Nigeria's Purchasing Managers' Index (PMI) falling into the contractionary region, recording 44.7 points in February 2023 and 42.3 points in March 2023.

- During this period, there was a significant reduction in the amount of currency in circulation and currency outside the banks, with declines of 70.4% and 62.5%, respectively. This resulted in the levels dropping as low as 0.8 trillion Naira and 1.2 trillion Naira, respectively.

- However, Q2 2023 showed stronger growth as the PMI returned to expansionary territory in April, indicating a recovery from the cash crunch that affected economic activity in Q1 2023. The Central Bank of Nigeria's (CBN) announcement in March that it would allow old naira notes to remain legal tender until the end of 2023 improved cash. As a result, consumer activity is likely to have increased in Q2 2023, leading to firms scaling up production and higher purchasing activity. This improvement in economic conditions is expected to bolster growth in the second quarter of the year.

- Nigeria's oil production in H1 2023 averaged 1.2 million barrels per day (mbpd), experiencing a slowdown from the strong momentum it had in January and February 2023. Notably, in April 2023, oil output fell below 1.0 mbpd, which is below the OPEC production quota set at 1.8 mbpd. This indicates that Nigeria's current oil production is below par and there is room for improvement in optimizing its oil revenue generation.

A Performance Dictated By Stubborn Headwinds…

- In June 2023, the Organisation of Petroleum Exporting Countries (OPEC) made a decision to cut Nigeria's oil production level by 20.7% to 1.39 mbpd, effective from January 2024. However, until the end of 2023, the current production quota would be maintained. This decision comes as a response to the challenges faced in maintaining the desired oil output and aligning with OPEC's production targets.

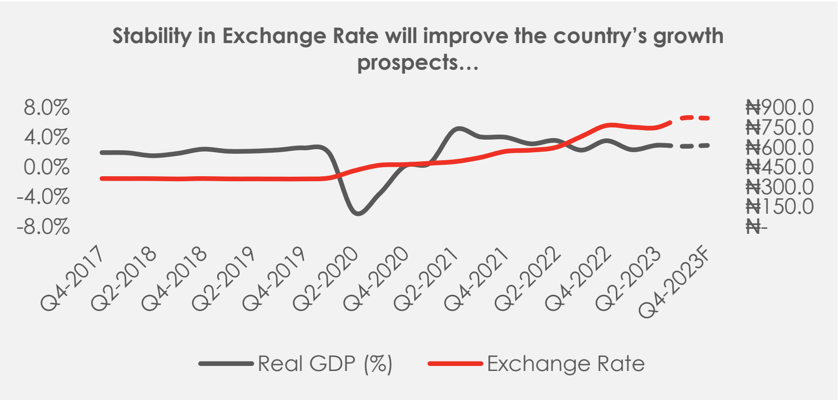
- During H1 2023, Nigeria witnessed varied impacts on economic growth and specific sectors due to key government policies. The Naira redesign policy, unification of exchange rates, and removal of petrol subsidy were noteworthy policy changes during this period. Among the affected sectors, the manufacturing industry experienced significant challenges.

- The manufacturing sector had already been grappling with issues such as high lending rates, elevated foreign exchange rates, and a scarcity of foreign exchange. These factors were adversely affecting businesses within the sector. However, in Q2 2023, the manufacturing industry faced additional policy changes that worsened its prospects, compounding the existing difficulties.

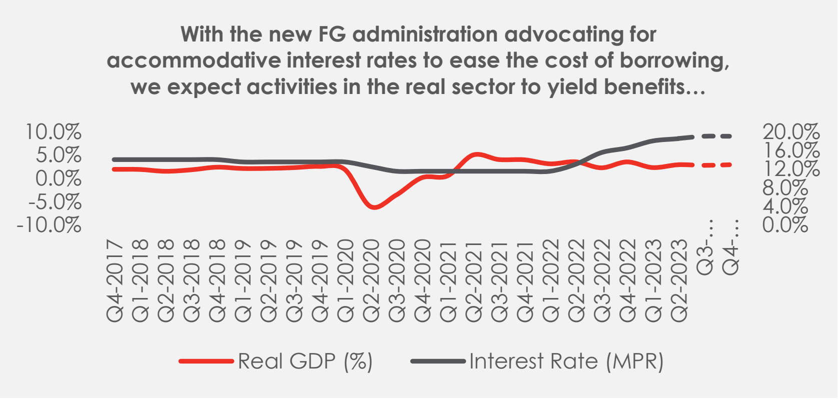
- In Q1 2023, the growth rate of the manufacturing sector in Nigeria decelerated to 1.16%, a significant decline from the growth rate of 2.83% recorded in Q4 2022.

Outlook

- The uptick in economic activity witnessed in Q2 2023 is not expected to be sustained in the second half of the year (H2 2023) due to soaring consumer prices resulting from President Bola Tinubu's economic reforms. Following Tinubu's announcement in May, the fuel subsidy was canceled, leading to a sharp increase in retail pump prices to NGN500-600 (USD0.64-0.77) per litre, nearly a 300% rise from the previous official price of NGN185. Additionally, the suspension of the former CBN Governor, Godwin Emefiele, paved the way for the unification of all exchange rate windows, leading to a significant devaluation of the naira by 40% against the US dollar since the exchange rate's liberalisation on June 16.
- These reforms will exert substantial upward pressure on consumer prices in H2 2023, with inflation projected to average 25.1% for the entire year, marking the highest annual rate since the 1990s. As a result, consumers' purchasing power will be significantly eroded, clouding the outlook for private consumption in the latter half of the year.
- In H2 2023, we anticipate that the non-oil sector will continue to be the main driver of growth, particularly led by the service sector. The growth in the service sector is primarily attributed to the Information and Communication Technology (ICT) and financial sectors.
- The introduction of 5G networks and mobile money services, along with the expansion of the banking sector balance sheet, supported by the current administration's efforts to enhance consumer spending, are expected to play a significant role in this growth.
- Additionally, improvements in the export position are likely to further boost the trade sector during this period.



Source: National Bureau of Statistics (NBS), FMDQ, United Capital Research



Source: National Bureau of Statistics (NBS), FMDQ, United Capital Research

Inflationary Environment

- Since 2016, Nigeria has been grappling with persistent double-digit headline inflation, with no signs of significant improvements. Inflation is primarily caused by cost-push factors rather than demand-pull effects. This means that the price increases are not driven by higher consumer demand but rather by elevated raw material costs for manufacturers and a global inflationary environment. Given Nigeria's heavy reliance on imports, pressures on Foreign Exchange (FX) and high global costs play a significant role in driving the rising inflationary trends in the country.

- In H1 2023, Nigeria continued to experience sustained inflationary pressures in spite of the hawkish Monetary Policy Committee's stance on the economy. The latest inflation data revealed a further surge to 22.79% year-on-year in June 2023, up from 22.41% in May 2023. The primary factors driving this inflation were elevated food & non-alcoholic beverages, utilities & energy, clothing & footwear, and transport costs

- Food inflation, a significant component of the Consumer Price Index (CPI) basket, surged to 25.25% year-on-year as of June 2023, up from 20.60% in May 2023, compared to an average of 20.9% in 2022. The Naira redesign policy and cash crunch had adverse effects on the nation's food supply, disrupting farming activities, as evident from the Agricultural sector's contraction in Q1 2023. As a result, the cost of food items increased. Additionally, the devaluation of the Naira further inflated the cost of imported goods, given Nigeria's substantial import bills, which amounted to N5.6 trillion in Q1 2023

- Core inflation in Nigeria rose to 20.3% year-on-year in June 2023 from 16.1% in FY-2022. The increase was driven by elevated global energy prices, which affected domestic energy, transportation, housing, and utility costs. Furthermore, the depreciation of the Naira to N400/$ also contributed to the overall price growth during this period

Legacy Inhibitions Remained Unabated…

- In H1 2023, inflation followed a continuous upward trajectory, reaching a 19-year high of 22.79% in June 2023. This significant increase indicates a substantial 97 basis points rise between January and June of this year, reflecting the persistent and accelerating inflationary pressures in the country during the period.

- The elevated inflation in June was attributed to heightened price levels across all components of the inflation basket. This increase was driven by various structural anomalies and policy shocks, which had an impact on the overall economy and contributed to the rise in consumer prices during the period.

- The steady rise in inflation is influenced by several structural shocks. These shocks include the closure of borders, which has limited the supply of certain goods, insecurity in the food-producing regions of the country, devaluation of the naira, imported inflation, high fuel pump prices and the increase in electricity prices. These factors have collectively contributed to the continuous increase in consumer prices and overall inflationary pressures in the country.

- Since March 2021, the Central Bank of Nigeria (CBN) has adopted a hawkish posture in an effort to control inflation. However, despite this approach, it appears that inflationary pressures have not been effectively curbed. The measures taken by the CBN have not yielded the desired results in bringing down inflation to the desired levels. As a result, inflation has persisted at elevated levels, posing ongoing challenges to the country's economic stability and the cost of living for citizens.

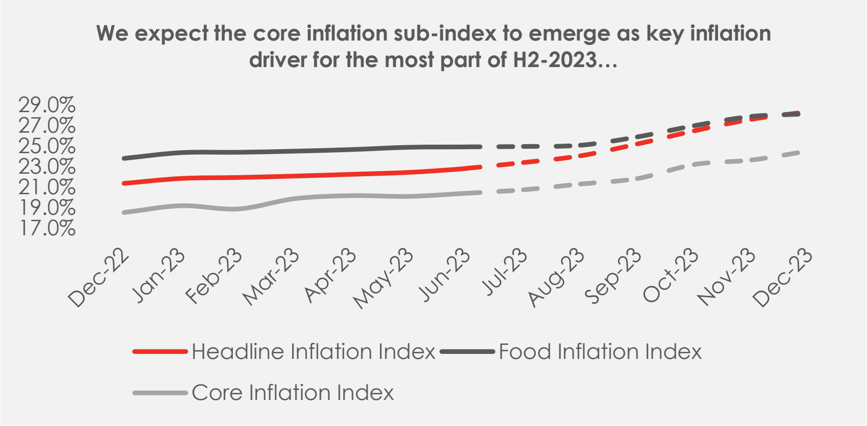
- Since March 2022, the Monetary Policy Committee (MPC) has taken significant measures to combat inflation by raising the Monetary Policy Rate (MPR) by 700 basis points, bringing it to 18.5%. This is the highest MPR recorded in the country since the rate was adopted in 2006.

… A Demand-Pull Inflation Negates Monetary Policy Efforts

- Despite these efforts, the inflationary pressures and other economic challenges have led to adverse consequences. According to the World Bank, between January and May 2023, a concerning 4 million Nigerians have fallen below the poverty line.
- Between January and June 2023, the food index in Nigeria expanded by 93 basis points (bp), indicating a significant increase in food prices during this period. Food inflation reached 25.25% in June, rising from 24.82% in May and 24.32% in January.
- The surge in food inflation was primarily driven by price increases in key food categories such as Meat, tubers, vegetables, and oils. These essential food items experienced notable price hikes, contributing to the overall inflationary pressures in the country.
- In H1 2023, core inflation witnessed an increase of 114bps basis points (bp), with the rate rising to 20.30% in June, slightly down from 20.06% in May and 19.16% in January.
- The core inflation component was mainly influenced by factors related to foreign exchange (FX) and the devaluation of the naira. These factors had a significant impact on the cost of imported goods and services, contributing to the overall rise in core inflation during the specified period.

Outlook

- In H2 2023, several price triggers, including the increase in PMS prices, currency pressure from the unification of exchange rates, and the potential electricity tariff increase, are expected to drive inflation higher.
- Additionally, policy measures such as the implementation of importation duties on selected goods and new taxes from the finance act are likely to contribute significantly to the rise in headline inflation during this period.
- These factors combined pose challenges to inflation control and warrant close monitoring by policymakers to ensure economic stability.



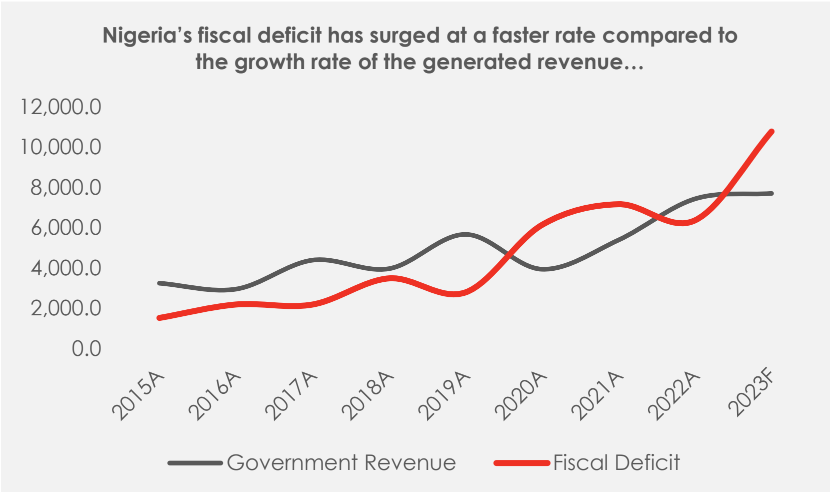
Source: National Bureau of Statistics (NBS), FMDQ, United Capital Research

FGN Budget Performance

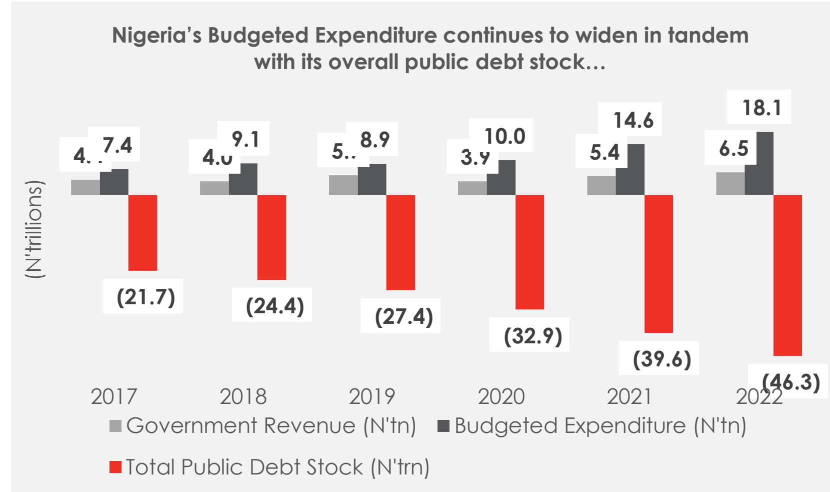
- During the period, the Federal Government's revenue generation remained lackluster, with data from the Central Bank of Nigeria (CBN) indicating that it generated N478.6bn in Feb-2023. This marks a 7.7% decline from the N518.5bn generated in Jan-2023 and a significant 42.4% decrease from the N830.8bn pro-rated budget estimate.
- During the review period, a decline in revenue generation was observed, primarily attributed to a decrease in Company Income Tax (CIT). This reduction in tax income for the government was a result of reduced business activities, largely affected by the Naira redesign policy and cash crunch experienced in Q1-2023. The policy's impact on businesses and companies led to lower revenue and income, consequently affecting the government's tax collections.
- In Feb-2023, oil revenue receipts declined compared to the previous month, primarily due to a decrease in Petroleum Profit Tax and Royalties. Historically, oil revenue has consistently fallen short of its budget estimate, largely due to lower-than-expected oil production levels. The country's oil output continues to be hampered and remains below its OPEC production quotas due to oil theft and pipeline vandalism in the Niger Delta region. In H1-2023, oil output further moderated, reaching as low as 1.0 million barrels per day (mbpd) in Apr-2023.
- In Feb-2023, government expenditure rose by 5.9% to N991.6bn from N936.2bn in Jan-2023. The majority of this spending was allocated to recurrent expenditure, accounting for 84.7%. The increase in government spending on debt servicing and non-debt costs contributed to the rise in recurrent expenditure during this period.

Government Revenue

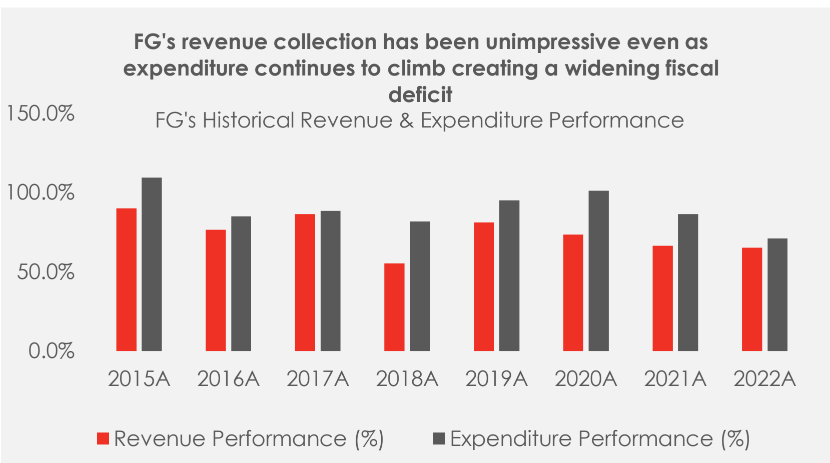
- Despite the significant rise in global energy prices, Nigeria has not experienced the anticipated benefits. While oil prices surged by 150.0% from 2020 to 2022, the country's revenue generation did not witness a corresponding boom. This lack of substantial revenue increase is attributed to Nigeria's challenges in oil production since 2021, leading to a missed opportunity to capitalise on its revenue-earning potential.
- Due to the decline in revenue collection from oil receipts, the Nigerian government has experienced an expansion of its fiscal deficit, reaching 5.0% and above since 2021. This has had significant implications for the overall government revenue situation.
- This has majorly been compounded by the deductions for fuel subsidies, which are directly taken from the revenue generated from oil exports. Notably, in 2022, the forgone fiscal revenue amounted to N4.5 trillion, equivalent to 2.2% of the country's Gross Domestic Product (GDP) during that period.
- Over the years, there has been a significant widening of the variance between oil revenue and debt servicing costs due to consecutive depletion of oil revenue receipts over almost a decade.
- In Feb-2023, the debt service to oil revenue ratio surged to 132.6%, witnessing a significant rise from 49.6% in Jan-2023. The increase can be attributed to a sharp decline in oil revenue receipts, which fell by 60.2% to N308.1 billion in Feb-2023 compared to N774.2 billion recorded in Jan-2023.



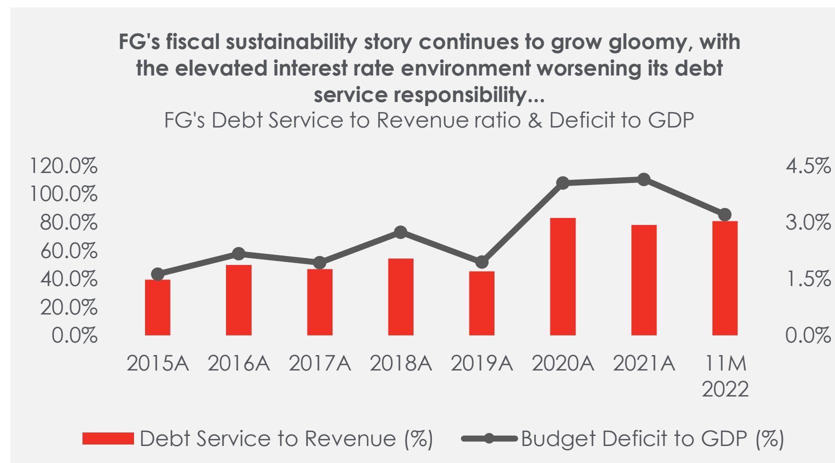
Source: Bloomberg, United Capital Research



Source: Bloomberg, United Capital Research



Source: Bloomberg, United Capital Research



Source: Bloomberg, United Capital Research

Government Debt

- Nigeria has relied heavily on debt to finance its expenditure, driven by revenue shortfalls and a growing government deficit. In Q1-2023, the country's total public debt reached N49.9 trillion, showing a significant 7.8% quarter-on-quarter increase from the N46.3 trillion recorded in Q4-2022. Additionally, this represents a substantial 19.8% year-on-year increase compared to the N41.6 trillion reported in Q1-2022.

- The data indicates that the majority of the total debt stock in Nigeria is attributed to domestic debts, accounting for 60.6% of the total. Over the specified period, domestic debts experienced significant growth, increasing by 9.7% quarter-on-quarter (q/q) and 20.9% year-on-year (y/y) to reach N30.2 trillion from N27.6 trillion in Q4-2022 and N25.0 trillion in Q1-2022, respectively. This highlights the government's heavy reliance on domestic debt borrowings to address budget deficits and fund recurrent expenditures.

- During H1-2023, Nigeria refrained from participating in the international market for foreign debt due to the elevated global borrowing costs. Nevertheless, the country saw a significant 18.2% year-on-year increase in foreign debt, reaching N19.6 trillion. This growth can be attributed to the 10.9% depreciation of the Naira during the same period, which affected the value of the foreign debt denominated in the local currency.

- In May, the National Assembly granted approval for the securitisation of the N22.7 trillion overdraft provided by the Central Bank of Nigeria (CBN) to the Federal Government (FG) through its Ways and Means Policy. The Ways and Means provision allows the government to access short-term or emergency loans from the CBN to address temporary budget shortfalls while adhering to statutory restrictions.

- According to the CBN Act 2007, the maximum limit for Ways and Means Advances from the apex bank was set at 5.0% of the prior year's revenue. However, in June 2023, the National Assembly approved an amendment to the Act, increasing the ceiling on such advances to 15.0% from the previous 5.0%. This amendment provides the government with a larger borrowing capacity from the CBN, which, in turn, exacerbates Nigeria's existing debt sustainability concerns

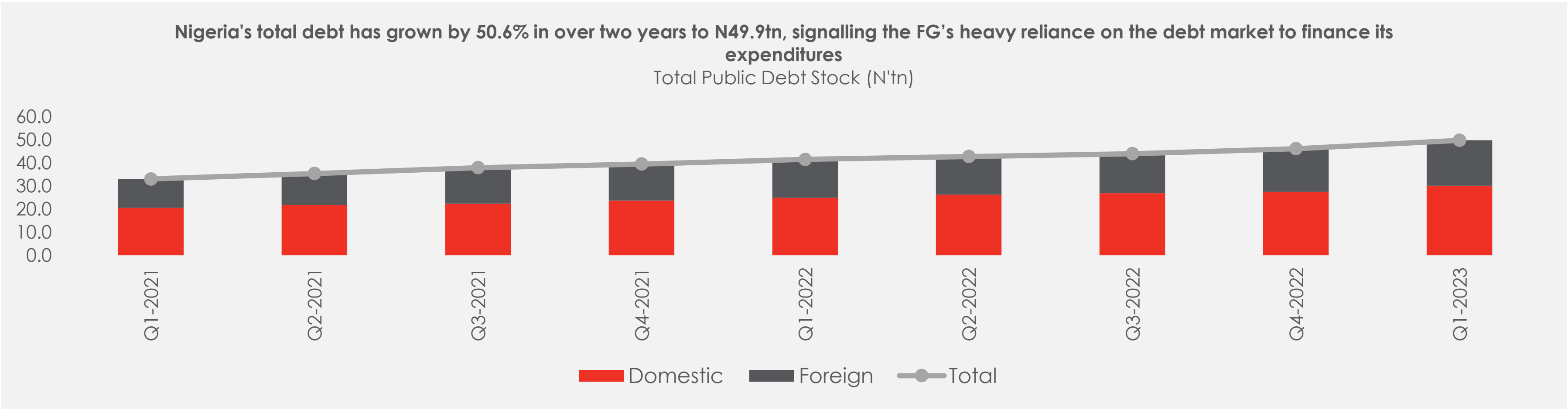
Debt Servicing

- During Q1-2023, Nigeria's expenditure on domestic debt servicing amounted to N874.1 billion, marking a significant 114.9% increase from the figures of N406.8 billion in Q4-2022 and a 30.7% climb from N668.7 billion recorded in Q1-2022. This surge in spending can be attributed to the heightened domestic borrowings during the period, with the Federal Government (FG) increasing its bond auction offers to N360.0 billion in 2023, as opposed to previous offers of N225.0 billion.

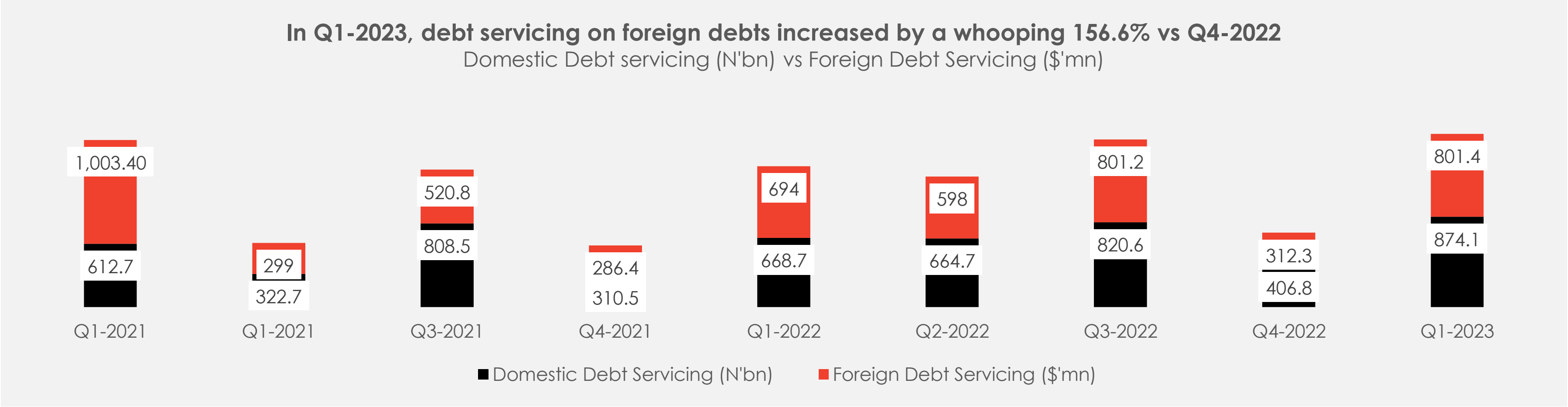
- In Q1-2023, the government's expenditure on servicing foreign debts amounted to $801.4 million, indicating a substantial 156.6% increase compared to the $312.3 million spent in Q4-2022. This translates to N368.9 billion in Naira terms, calculated based on the exchange rate of N460.3 per US Dollar at the end of the quarter.

- Going forward, the recent unification of the Naira across all foreign exchange market segments has resulted in a significant depreciation of the Naira to as low as N770.0/$ in the Investors and Exporters (I&E) window. As a consequence, the value of foreign debts denominated in Naira will rise substantially, reaching as high as N32.4 trillion.

- Consequently, the Nigerian government (FG) would need to generate more revenue or resort to additional domestic borrowing to cover its expenses and interest payments.



Source: Debt Management Office (DMO), United Capital Research



Source: Debt Management Office (DMO), United Capital Research

Monetary Policy Environment & Financial Development

H1-2023 Review

Review – Hawkish Monetary Policy Tone

- In H1 2023, the Monetary Policy Committee (MPC) of the Central Bank of Nigeria maintained its hawkish stance by raising the Monetary Policy Rate (MPR) by 200 basis points (bp). At its meeting on 23-24 May, the MPC increased the key rate to 18.50% from 18.00%, marking the seventh consecutive hike since May 2022, resulting in a total tightening of 700 basis points.

- The decision to raise rates was unanimous, with all 11 committee members voting in favor, with 10 members supporting a 50 basis point increase and one member favoring a 25 basis point hike. The MPC did not make any changes to the asymmetric corridor, cash reserve ratio, or liquidity ratio.

- The decision to continue the tightening cycle was driven by the sustained acceleration of price pressures, with inflation rising to 22.2% in April from 22.0% in March. The MPC noted that both demand- and supply-side factors contributed to the ongoing uptrend in inflation. However, it emphasized that without the previous rate hikes, inflation would have reached even higher levels. The committee also acknowledged that economic growth had eased in Q1, which influenced the decision to implement a smaller interest rate hike compared to previous meetings.

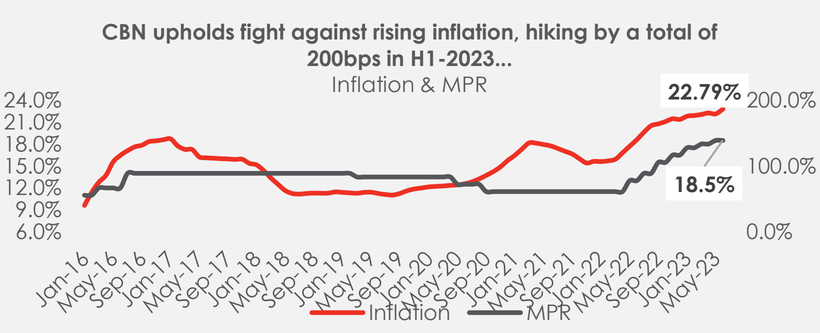
- Despite the MPC's persistent rate hikes, the correlation between money supply and inflation in Nigeria stands at x, indicating a very low relationship. This suggests that changes in the money supply have limited impact on inflation levels in the country.

- On the other hand, current inflation levels show a strong correlation with the parallel FX rates, as evidenced by a correlation of x. This indicates that the fluctuations in foreign exchange rates have a more significant influence on inflation levels in Nigeria.

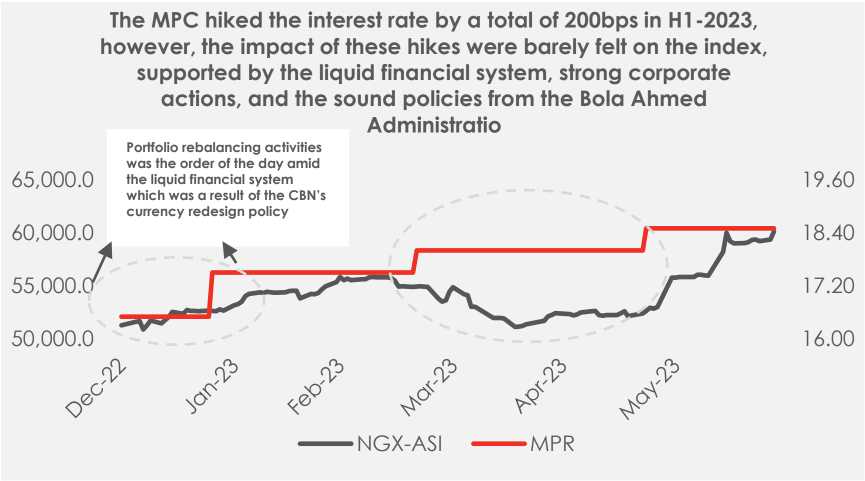
- The strong correlation with FX rates and the low correlation with money supply highlight the ineffectiveness of the MPC's rate hikes in controlling inflation. Other factors, particularly those related to foreign exchange rates, appear to be playing a more dominant role in driving inflationary pressures in the country. As a result, the MPC's efforts to control inflation through rate adjustments may be less impactful in the current economic environment.

- In recent times, the MPC has prioritized currency stability and focused on attracting Foreign Portfolio Investments (FPIs) despite elevated interest rates in developed countries, prioritizing these objectives over the real economy.

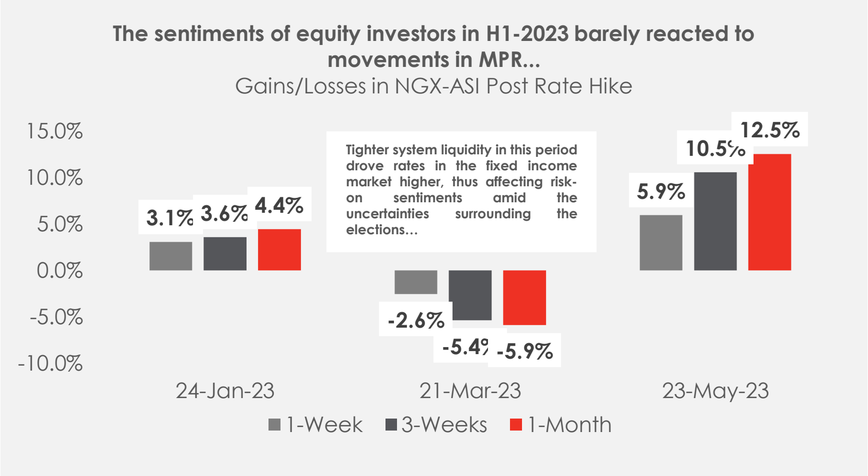
- However, the MPC's persistent rate hikes have led to a substantial increase in the cost of borrowing, adversely affecting sectors such as manufacturing and hindering the purchasing power of citizens.



Source: Debt Management Office (DMO), United Capital Research



Source: NGX, CBN, United Capital Research



Source: NGX, United Capital Research

Reflection:

- The Nigerian stock exchange was met with a fantastic first half in 2023. Key fundamentals helped the performance of the index within this period. Those fundamentals will be examined in further slides.
- Looking at the existing inverse relationship between the Monetary Policy Rate (MPR) and the NGX-ASI, we observed that this relationship weakened in H1-2023, as other key fundamentals drove overall investors' sentiments, particularly the liquidity fundamental, which caused a depression in the interest rate environment, thus spurring risk-on sentiments.
- After the first MPR hike in Jan-2023, investors barely responded, owing to the very liquid financial system at that time, which came on the back of the CBN's redesign policy that brought back a lot of liquidity into the financial system. In a nutshell, the depressed interest rate environment supported investors' sentiments toward the Nigerian equities market.
- As the liquidity in the financial system dried up, on the back of aggressive CRR debits, rates began to tick higher.
- With the cloud of uncertainties in the macroeconomic environment on the back of the 2023 presidential election, investors' switched more toward risk-off sentiments.
- As a result, we observed a switch back toward the fixed-income market, significantly spurred by the improved rates at that time.
- With companies outperforming in their FY-2022 financials, we observed mild buy-interests across different sectors like the Banking and Consumer goods sectors (FMCG firms in particular). However, the cloud of uncertainties kept investors' interest in listed corporates suppressed.
- The market went into a rally in the aftermath of the last hike in May, driven by the sound policies and appointments of the new administration.

Examining Key Events in H1-2023

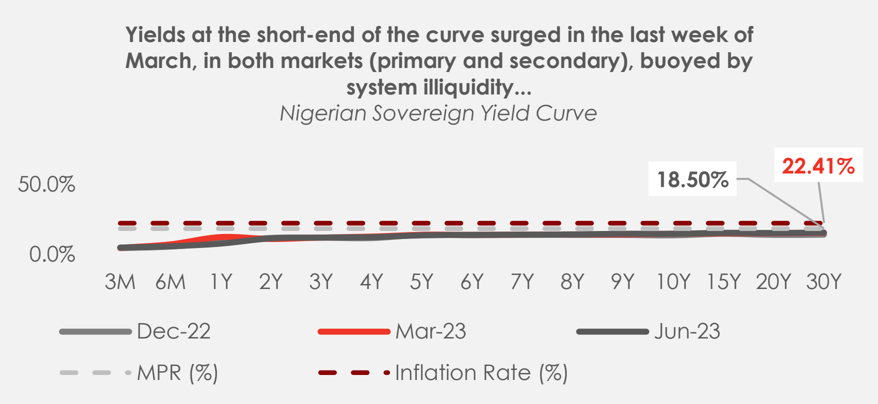
❑ Key Events in Q1-2023

- **Depressed Yield Environment in the Fixed Income Market**: In Q1-2023, the financial system was mostly awash with liquidity. This came as an impact of the CBN's redesign policy in November 2022. During this period, c.N2.3tn of currency in circulation (old naira notes) found its way back into the financial system. As a result, yields in the fixed-income market tapered significantly. Hence, investors leaned more toward their risk-on nature. Bargain-hunting exercises persisted through Q1-2023, as most listed corporates were undervalued in the aftermath of the strings of hawkish stances by the CBN in FY-2023.
- **The 2023 Presidential Election:** As the first quarter of 2023 came to a wrap, clouds of uncertainties emerged across board, dampening investors' appetite for risks. Hence, the equities market went into a lull, in tandem with the low risk appetite.

❑ Key Events in Q2-2023

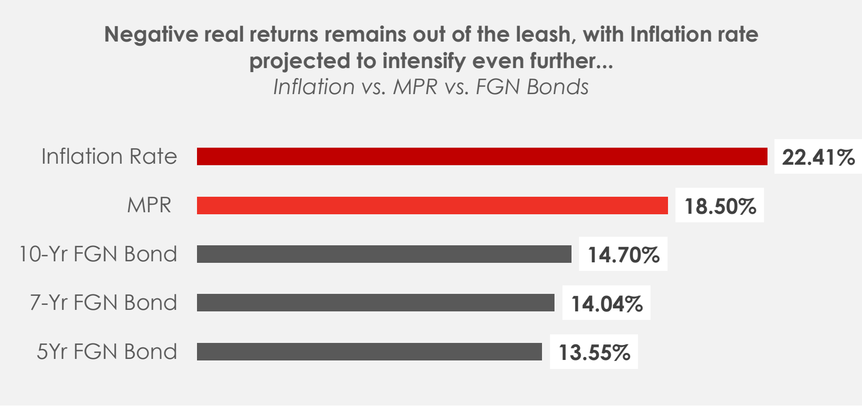
- **Improved Yields In the Fixed Income Market**: Owing to aggressive CRR debits, the liquidity from Q1-2023 soon dried up. Improved rates in the fixed-income market and negative expectations of the cash crunch situation on the Q1-2023 performance of listed corporates, reversed the index's YTD gains in April-2023. Investors' risk-off sentiments during this period drove an increased appetite for fixed-income instruments, at the detriment of the equities market.
- **Improved System Liquidity and Earnings Season**: Before the end of April 2023, positive sentiments returned as rates in the fixed-income market began to taper owing to the fresh liquidity that trickled into the system from Bond maturity (N736.0bn), and coupon payments (N236.0bn). Strong and Impressive FY-2022, and Q1-2023 earnings performance from listed corporates also helped investors' sentiments toward the local bourse.
- **The Inauguration Speech of President Bola Ahmed Tinubu (GCFR):** The President-Elect's Inauguration speech caused renewed hopes in the macroeconomic environment, which tricked into the equities market. Positive appointments and policies from the new administration further spurred hopes, as they were mostly directed toward improving the investors' confidence (both local and foreign, mostly foreign). Among the pronouncements that spurred hopes include; the affirmation of the elimination of the petrol subsidy program, the removal of multiple taxations for foreign investors, the unification of exchange rates, and the promise of ease in the repatriation of FOREX by foreign investors.
- **The Suspension of the Ex-CBN Governor, Mr Godwin Emefiele:** The suspension of the former CBN governor signaled the beginning of a new era for the Banks and the capital market. Investors' sentiments were significantly spurred, particularly toward the Banks, and trickled to other sectors. Hence, the rally induced by the President's inauguration was sustained.
- **Political Appointments, Favourable Policies, and Sustained Liquidity in the Financial System:** During the inauguration speech of the President-Elect disclosed his administration's support for a lower interest rate regime, as it looks to encourage credit culture in the real sector, thus improving overall access to credit. This served as an incentive for the CBN to keep the financial system liquid, thus forcing rates lower. The depressed yield environment in the fixed-income market bolstered investors' mood for the rest of Q2-2023. Also, Positive Political appointments and capital market / real sector-friendly policies by the new administration supported investors' mood through Q2-2023.

…Yields from the mid-long end of the curve barely improved in H1-2023



Source: Bloomberg, United Capital Research

…Negative real returns remained the order of the day in H1-2023

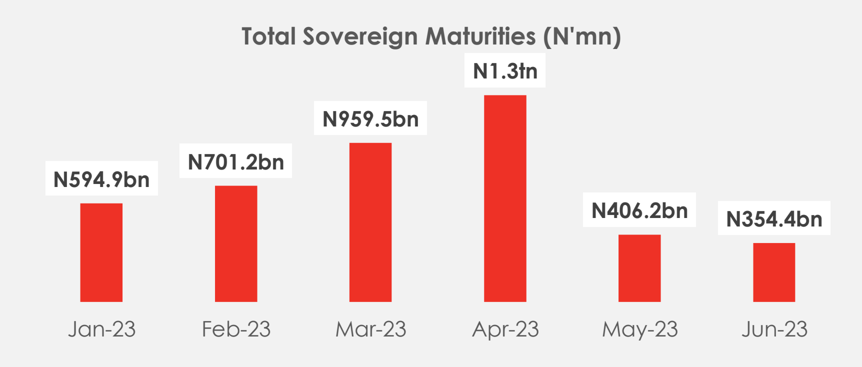


Source: Bloomberg, United Capital Research

H1-2023 Fixed Income Market Review

- In the first half of 2023, liquidity was "KING", as it majorly determined the direction of yields in the fixed income market (particularly at the short-end of the curve.
- In Q1-2023, yields in the fixed-income market were mostly depressed due to the liquidity from the inflow of N676.2bn into the financial system, which came on the back of the CBN's Naira redesign policy. Private issuers utilised this period to raise cheap debt.
- In March, the system experienced a period of deficit. This was so because the CBN aggressively debited the Banks (CRR) with a discretionary orientation.
- In the aftermath of the heavy liquidity in April-2023, other inflows including OMO maturities, coupon payments, CRR refunds, FX maturities, and FAAC payments, kept yields depressed in the fixed-income market.

…51.6% of total expected liquidity for 2023 hit the system in H1-2023



Source: Bloomberg, United Capital Research

Monetary Policy vs Fixed Income (H1-2023)

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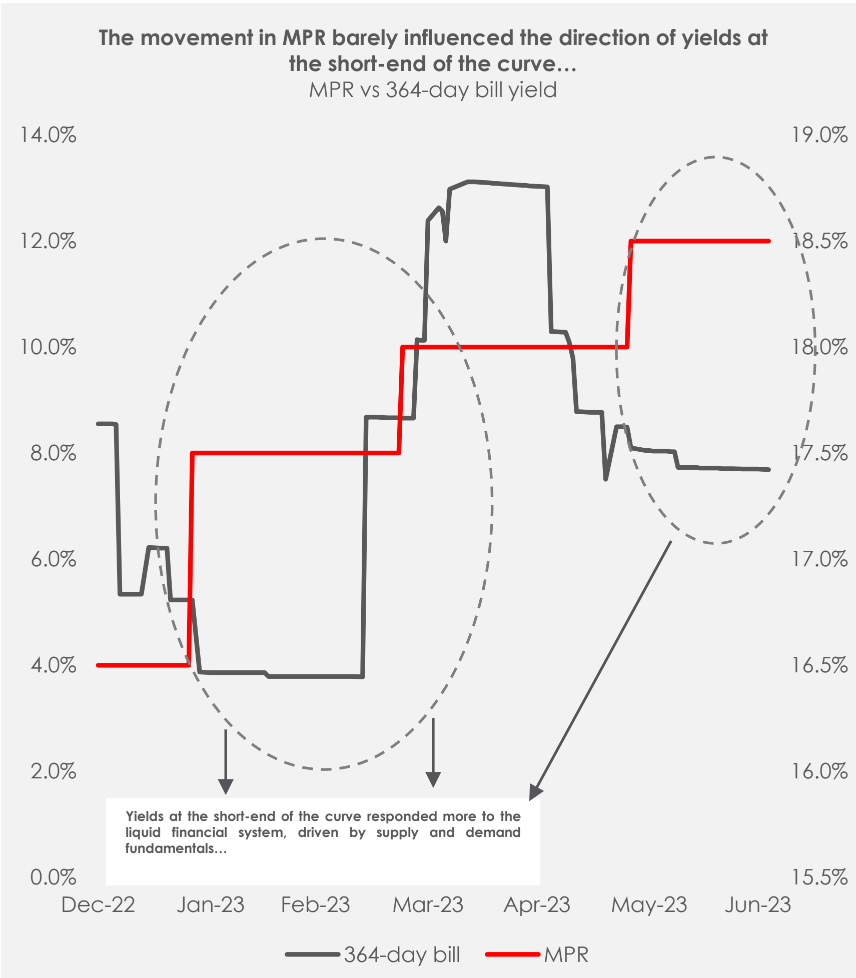
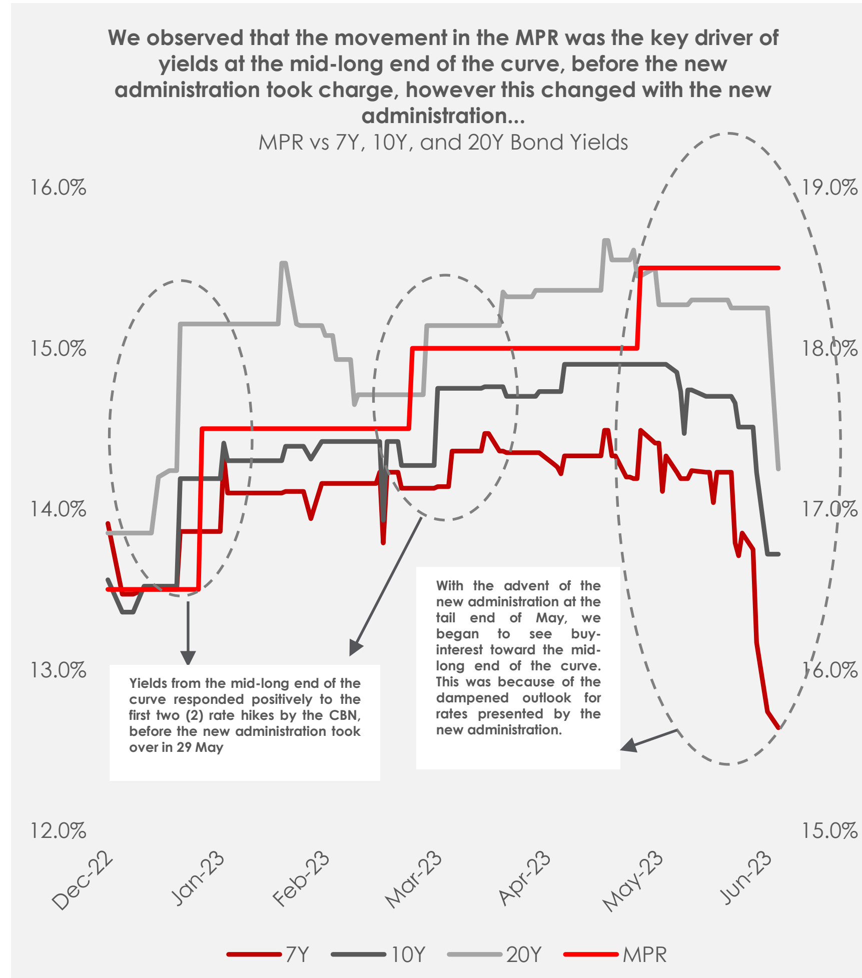


Source: NBS, CBN, United Capital Research



Source: NBS, CBN, United Capital Research

System Liquidity Drove Yields at the Short-end of the Curve, Also Played Key Role in NGX-ASI Movement…

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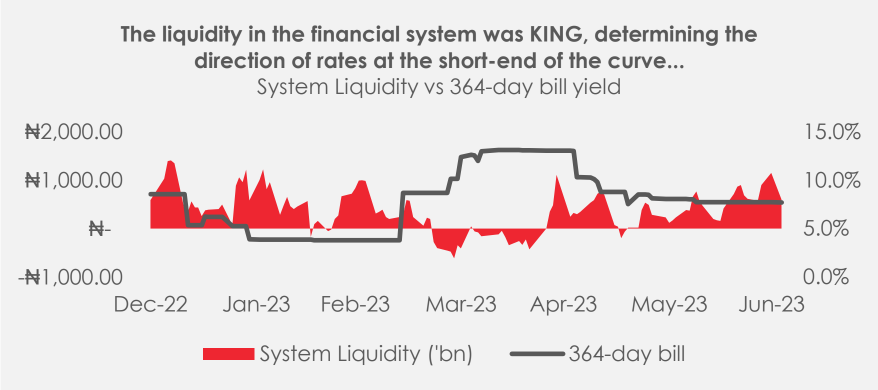
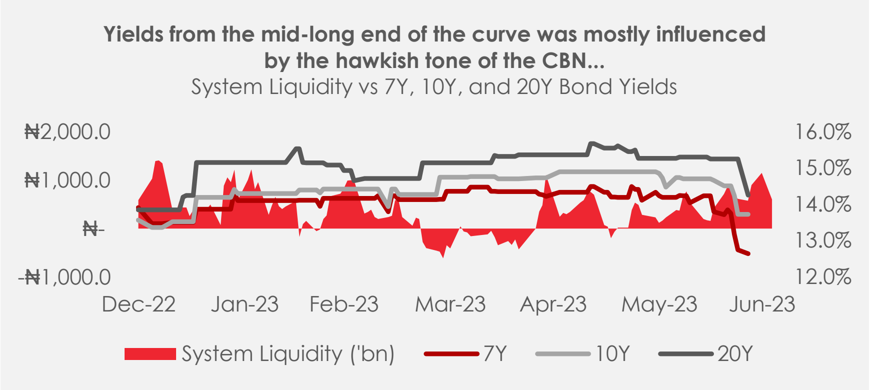
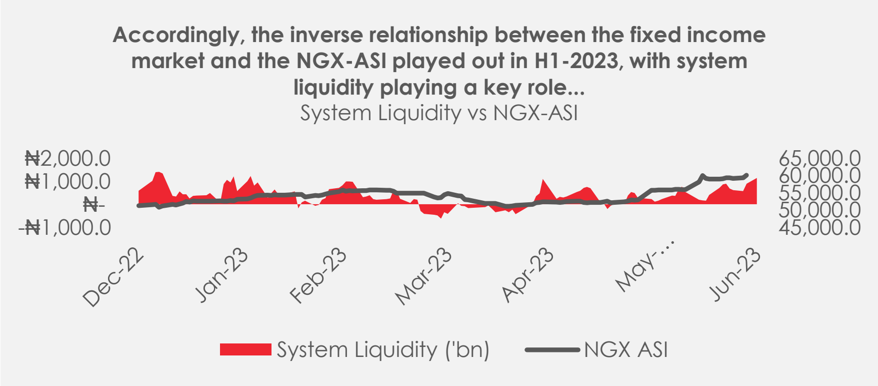


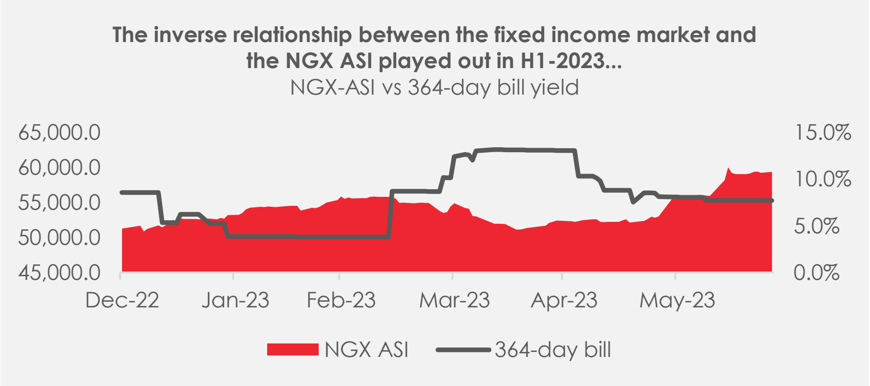
Source: CBN, FMDQ, United Capital Research



Source: CBN, FMDQ, United Capital Research



Source: CBN, FMDQ, United Capital Research



Source: NGX, FMDQ United Capital Research

Corporate Bonds Review

- Three (3) corporate bonds with a total face value of N227.4bn were listed on the FMDQ Exchange in Q1-2023, representing an 8.8% q/q decline from Q4-2022 corporate bond listings (five (5) corporate bonds listings with a total face value of N249.4bn).
- The issuers of the corporate bonds listed in Q1-2023 emanated from the Manufacturing and Telecommunications sector. The Outstanding value for corporate bonds increased q/q by 14.7% (N206.5bn) to N1.6trn.

Average Coupon Rates for Listed Corporate Bonds

Tenor (years)	Q1-2023	Q4-2022	Trend
<=5	13.50%	14.25%	▼
>5 - 10	15.63%	13.58%	▲
>10 - 20	-	-	N/A
>20	-	-	N/A

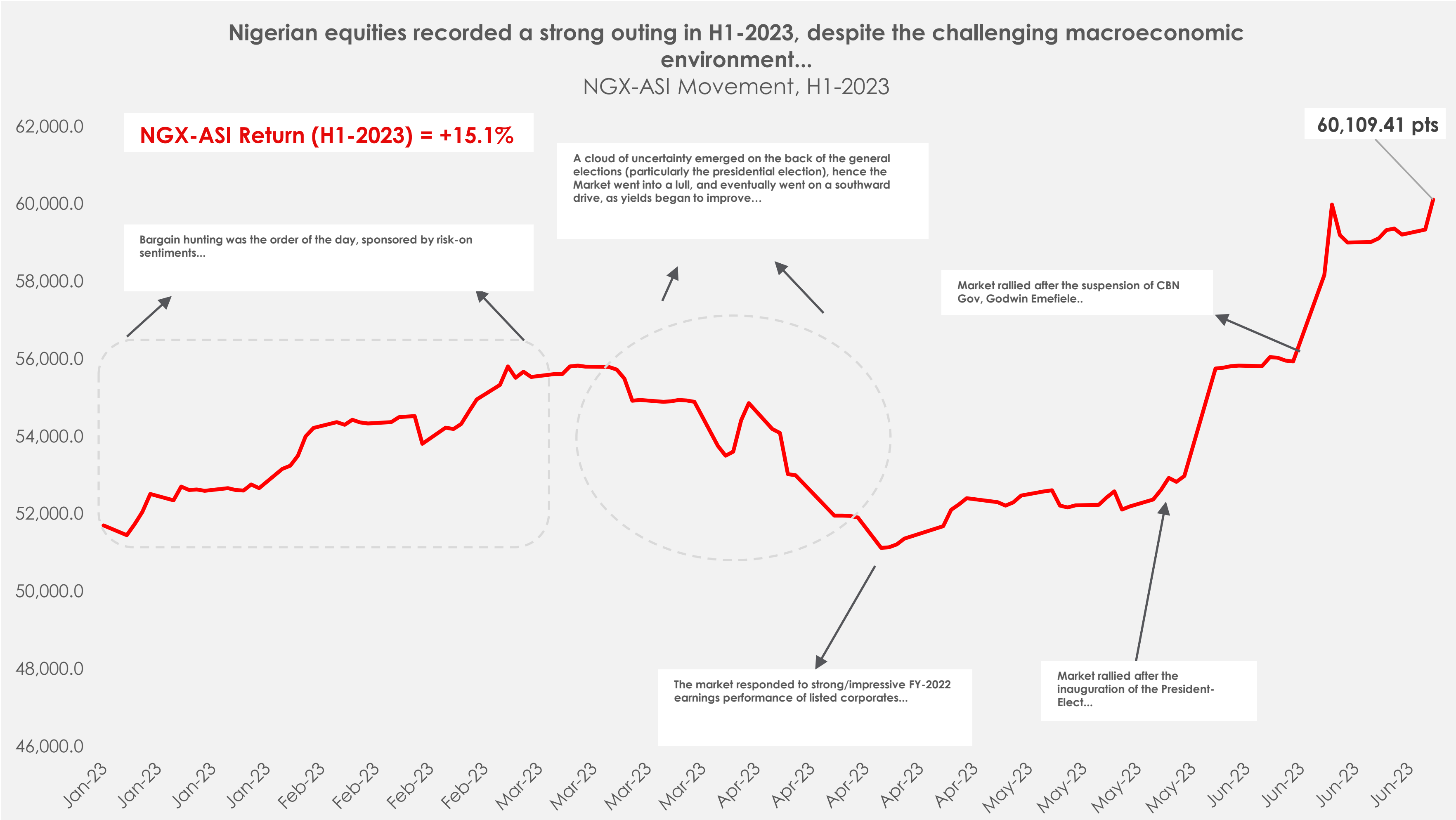
Commercial Papers (CP) Review

- In Q1-2023, a total of sixty-three (63) CPs with a total face value of N539.2bn were quoted on FMDQ Exchange, representing a q/q increase of 262.6% (N390.5bn), from Q4-2022 CP quotations (forty-four (44) CPs with a total face value of N148.7bn).
- The issuers of CPs quoted in the FMDQ Exchange in Q1-2023 were mainly from the Financial Services, Agriculture, Manufacturing, Real Estate, and Telecommunications Sectors.

Average Discount Rates for Quoted CPs

Tenor (days)	Q1-2023	Q4-2022	Trend
<90	17.92%	15.22%	▲
91 - 180	14.91%	16.09%	▼
181 -270	15.61%	16.15%	▼

NGX-ASI Movement (H1-2023)



Source: NGX, United Capital Research

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All the sectors under our coverage closed in the green zone at end of H1-2023, the Oil & Gas sector outperformed in Q2-2023 after the petrol subsidy removal was affirmed...

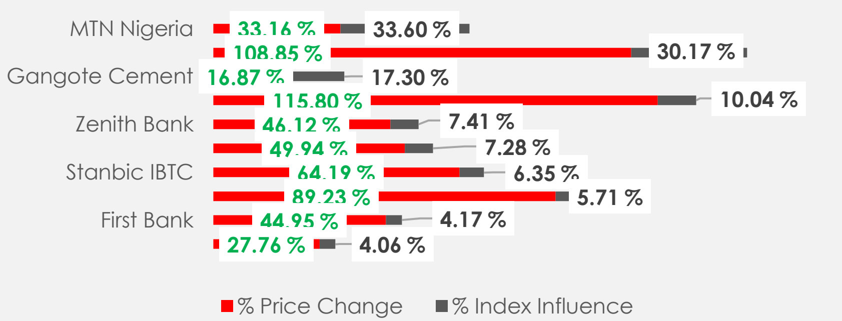
NGX Sector Analysis, H1-2023

Source: Bloomberg, United Capital Research

- The Nigerian exchange was met with volatility in H1-2023, amid the challenging macro environment. The Banks outperformed market expectations in their earnings performance, amid their exposures in Ghana's fixed-income market.
- Increased bargain hunting across the following listed equities drove the bourse's positive performance for the period; MTNN (+33.2%), BUAFOODS (+108.9%), DANGCEM (+16.9%), GEREGU (+115.8%), ZENITHBA (+46.1%), GTCO (+49.9%), STANBIC (+64.2%), and ACCESSCORP (+89.2%).
- Downstream Oil and gas players gained massive traction in Q2-2023, sponsored by the petrol subsidy removal, which improved their valuation.
- Overall, Investors' traction for risk in H1-2023 also played a massive role with respect to their appetite for the equities market, supported by strong and resilient revenue and earnings performance.

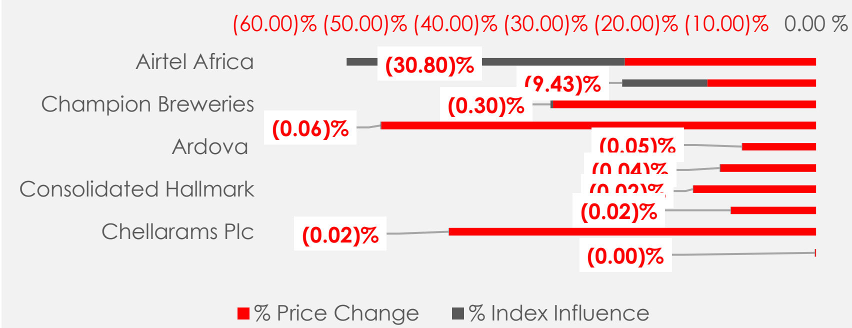
…Five (5) out of Ten (10) Top Index Movers were the Banks

Top Ten (10) Index Movers in H1-2023 (by Index Influence (%))



Source: Bloomberg, United Capital Research

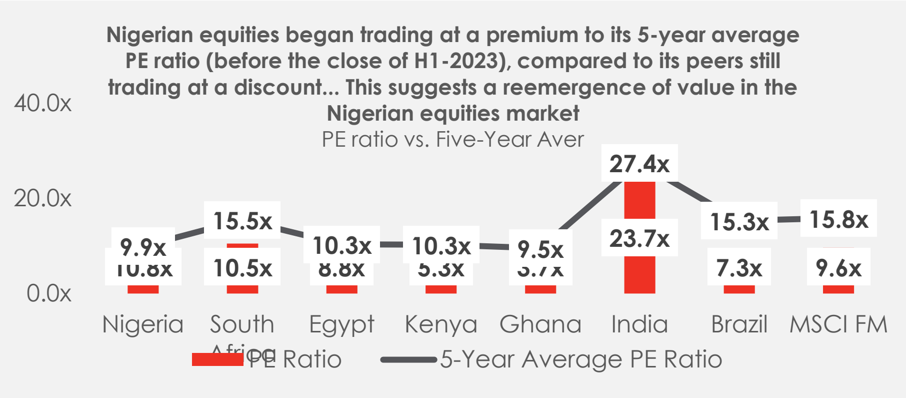
Top Ten (10) Index laggards in H1-2023 (by Index Influence (%))



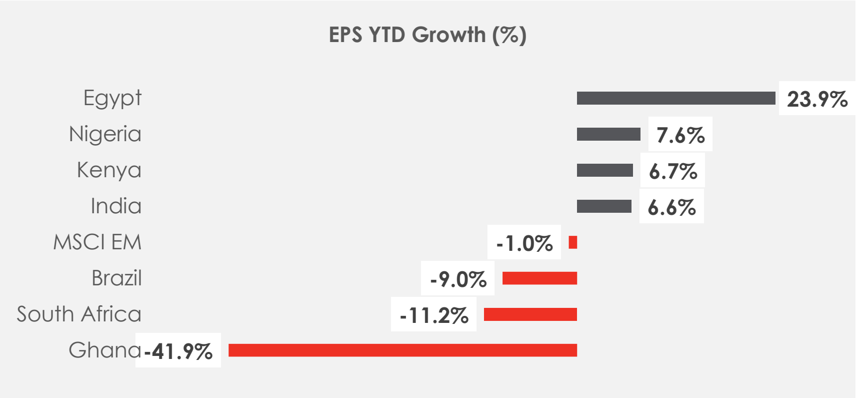
Source: Bloomberg, United Capital Research

Nigerian equities mostly traded at a premium in H1-2023, compared to their peers…

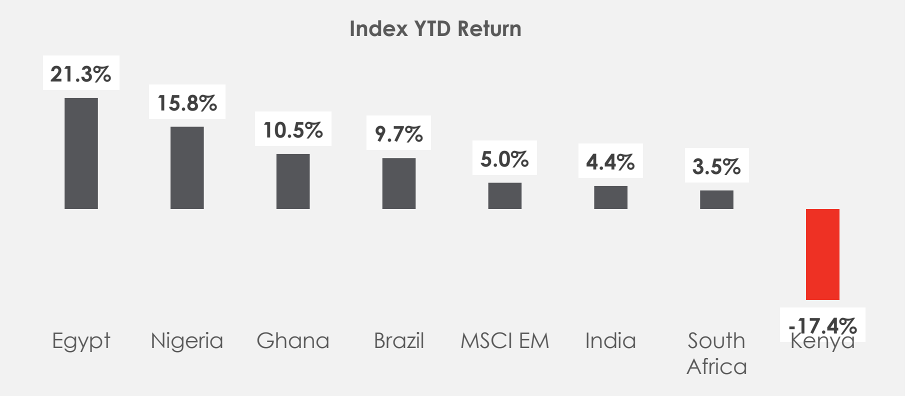
United Capital
The Intelligent Choice



Source: Bloomberg, United Capital Research



Source: Bloomberg, United Capital Research

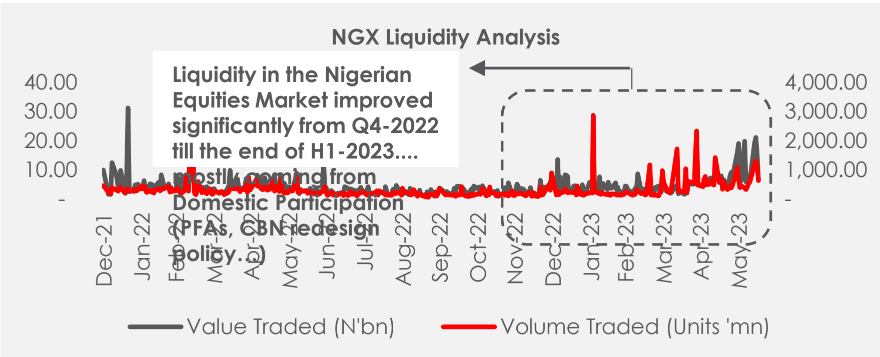


Source: Bloomberg, United Capital Research

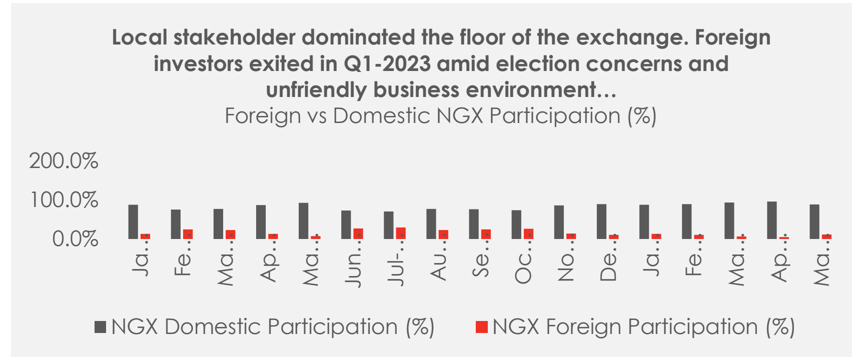
Reflection:

- The Nigerian equities remained resilient against all odds. Emerging from a rollercoaster year in 2022 (underpinned by stings of rate hikes) the local bourse remained attractive to domestic investors.
- Strong corporate actions and earnings performance ejected value back into the market. Investors were impressed, which led to increased bargain-hunting exercises in Q1-2023, amid the depressed yield environment.
- In terms of earnings per share (EPS) growth in H1-2023, Egypt outperformed Nigeria. We attribute the slower growth in earnings to the cash crunch situation in Q1-2023.
- Some other factors that suppressed the earnings potentials of the index include, the elevated cost of borrowing in the real sector and foreign exchange losses.

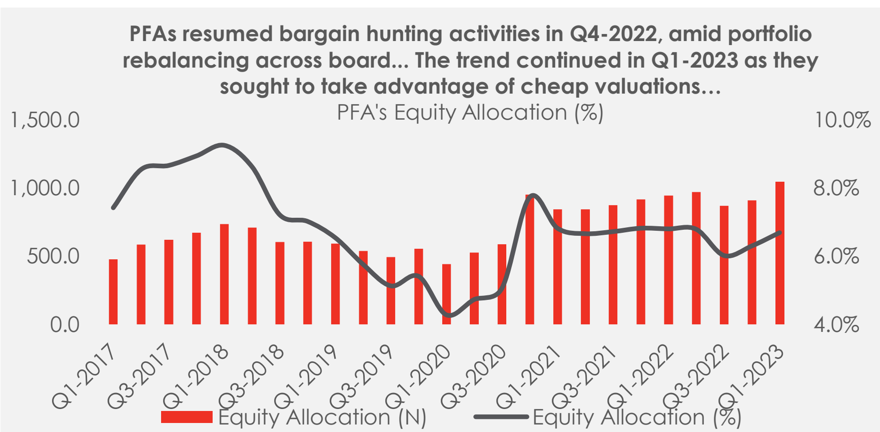
United Capital
The Intelligent Choice



Source: NGX, United Capital Research



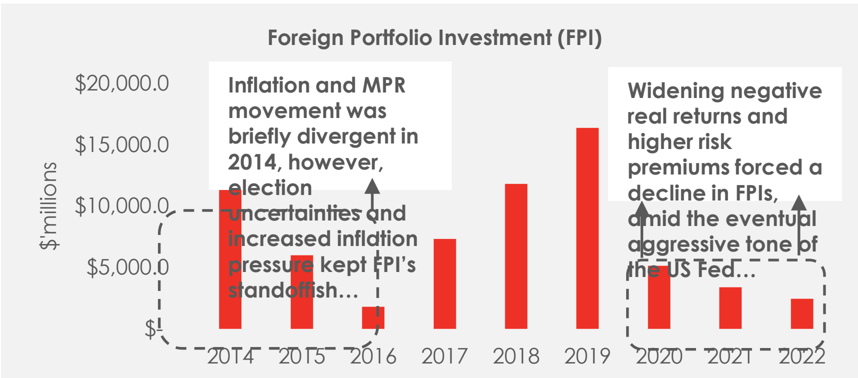
Source: NGX, United Capital Research

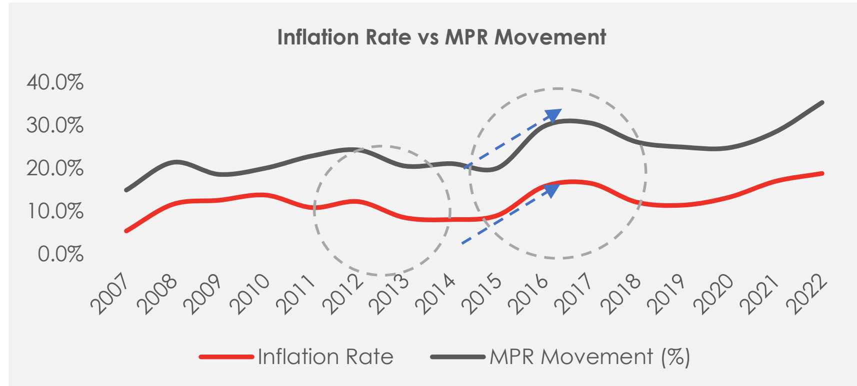


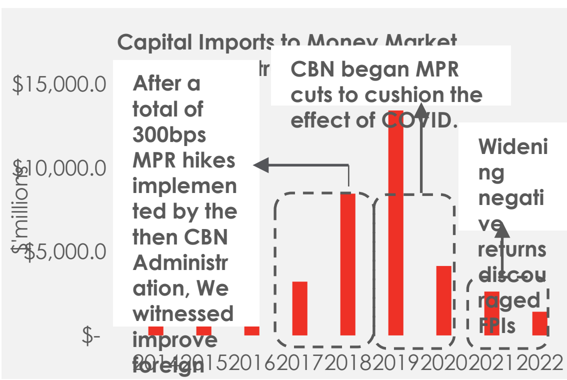
Source: Pencom, United Capital Research

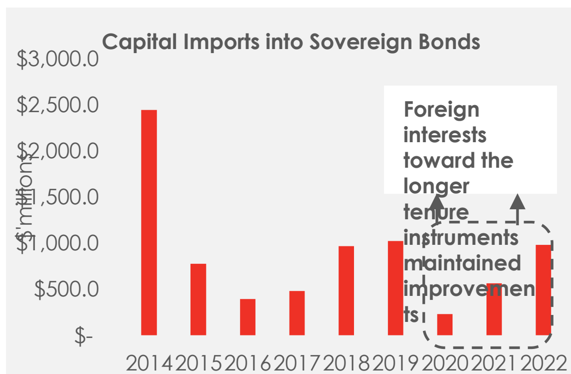
- Amid political tension, high inflationary pressure, and scarcity of foreign exchange, foreign investors' inflow in the stock market (NGX) dropped to N53.7bn in Q1-2023 from N128.9bn reported in Q1-2022. PFAs contributed immensely to the liquidity of the exchange, improving participation by 14.9% in Q1-2023, from N908.0bn in Q4-2022 to N1.0trn.
- Some key factors that also contributed to the deterioration of foreign participation include; elevated inflation rate, taxation of market instruments, especially, capital gain tax, a disincentive to investors, multiple taxation, foreign exchange losses, etc.
- The NGX Domestic and Foreign Portfolio Investment Report for May-2023 revealed that foreign transactions rose by 337.6% m/m to N37.2bn from N8.5bn recorded in Apr-2023. Foreign transactions accounted for 11.5% of total transactions in the month of May up from 4.4% recorded in Apr-2023.
- Foreign Investors began responding to improved economic growth prospects, and more friendly policies pronounced by the new administration led by President Bola Ahmed Tinubu (GCFR).

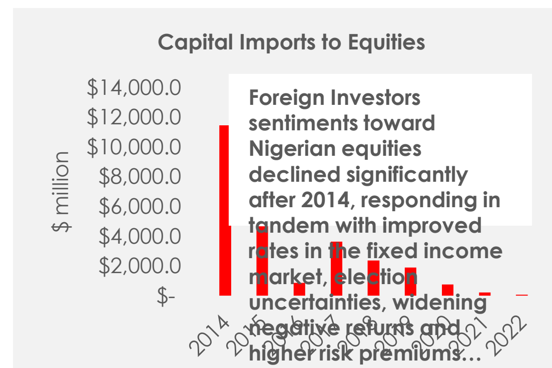
Supporting Charts







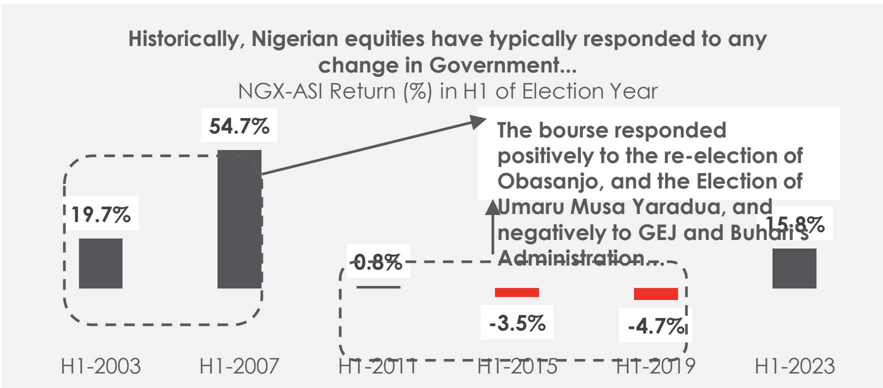




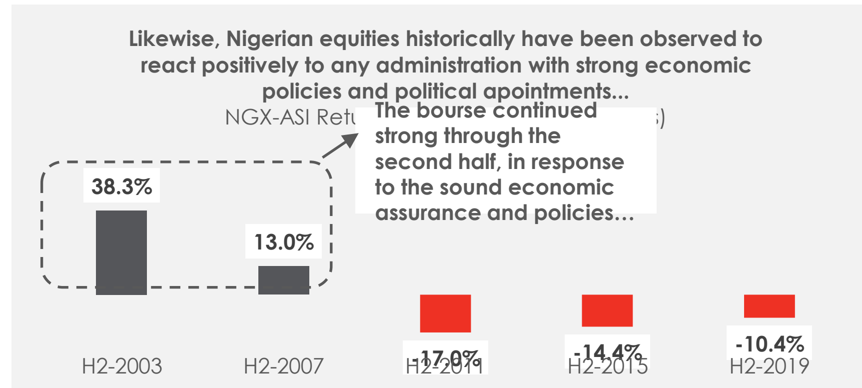
Monetary Policy Environment & Financial Development

H2-2023 Outlook

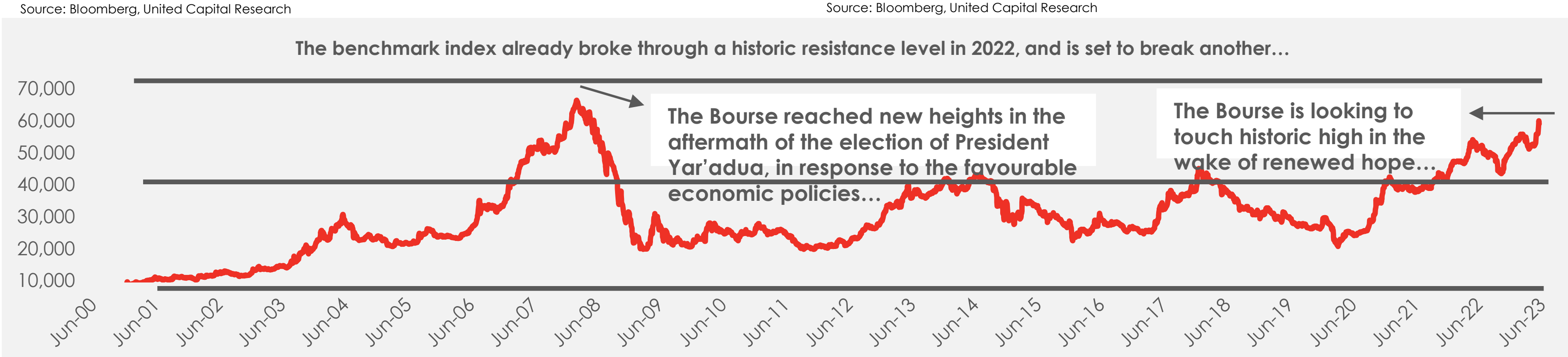
Record Historic High Not Far From Reach…



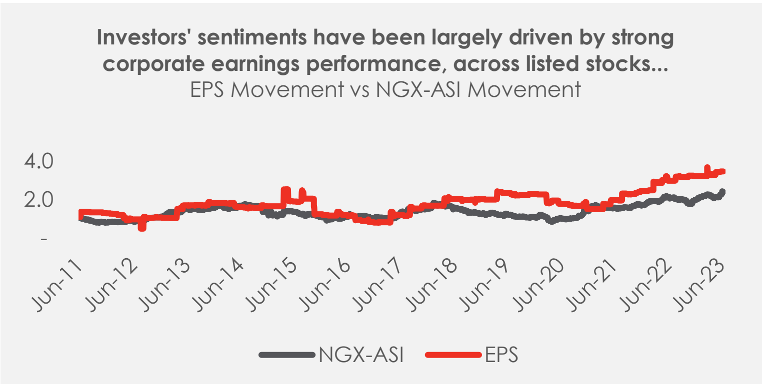
Source: Bloomberg, United Capital Research



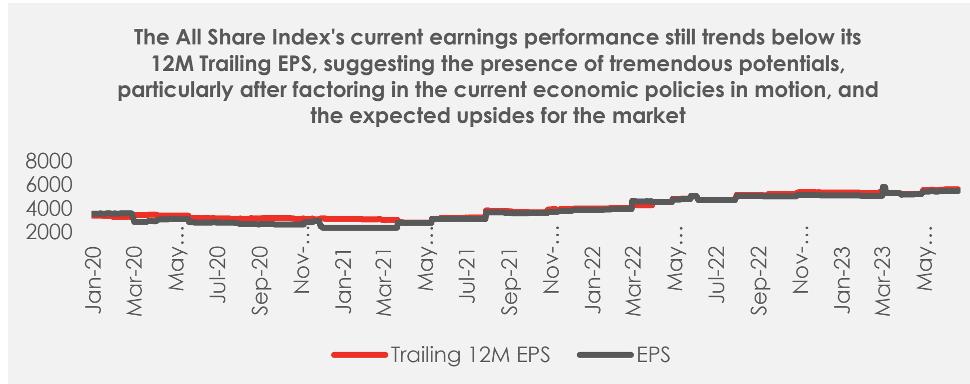
Source: Bloomberg, United Capital Research



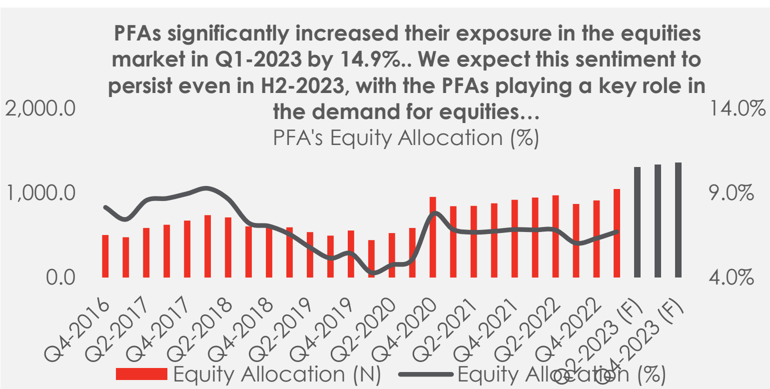
Source: Bloomberg, United Capital Research



Source: Bloomberg, United Capital Research



Source: Bloomberg, United Capital Research



Source: Pencom, United Capital Research

Outlook

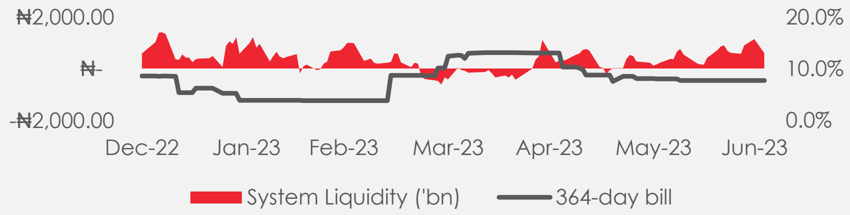
- Investors sentiments have been largely driven by strong corporate actions, earnings performance, positive fiscal and political developments.
- The administration of President Bola Ahmed Tinubu (GCFR), has strongly cast its weight toward improving credit culture in the real economy. In further context, they are looking to improve the accessibility of credit by keeping the interest rate environment suppressed.
- Keeping in view that two key factors which have kept the development of the real sector suppressed (elevated interest rate and foreign exchange losses), we expect the new policies of the new administration particularly the "Unification of the exchange rate", and "Advocacy for a Lower Interest rate Environment" to stand as a significant upside for the earnings performance of listed Nigerian corporates, which will bolster investors confidence toward listed corporates, particularly in earning seasons (H1-2023, and Q3-2023 earnings season).
- On the demand side for equities, we expect PFAs to continue to play a significant role.

- In the second half (H2) of 2023, we expect some key factors to play a significant role in the performance of the capital and fixed-income markets. These factors include the depressed yield environment, monetary policy rate, cash reserve ratio (CRR), strong earnings performance, improved foreign participation, and the crystallisation of the new policies introduced by the new administration. Expounding on the outlined factors,

- **System Liquidity**: We have examined the key role that system liquidity played in the dynamics of the Nigerian financial markets. Its influence was visible across board. However, supply and demand fundamentals were able to keep rates suppressed at the short-end of the curve, outweighing the prevailing demand for higher rates by Fund Managers and Treasuries. Fixed income yields from the mid-to-long end of the curve were mostly driven by the successive rate hikes in H1-2023. In H2-2023, we expect the system liquidity to play a vital role once more, determining the direction of rates across the curve, and the overall sentiments In the Nigerian Capital Markets.

The liquidity in the financial system was KING, determining the direction of rates at the short-end of the curve...

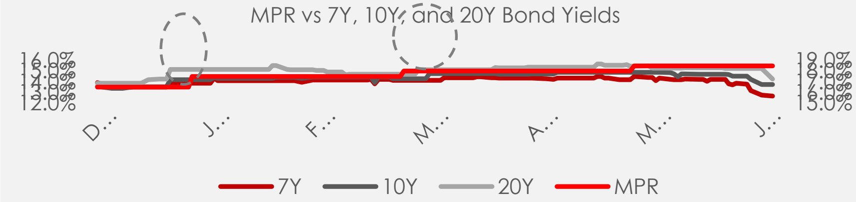
System Liquidity vs 364-day bill yield



Source: Bloomberg, United Capital Research

We observed that the movement in the MPR was the key driver of yields at the mid-long end of the curve, before the new administration took charge, however this changed with the new administration...

MPR vs 7Y, 10Y, and 20Y Bond Yields



Source: Bloomberg, United Capital Research

Monetary Policy Rate (MPR): Under the leadership of the previous Emefiele-led CBN administration, there was a determined effort to address the challenge of elevated inflation rates through the use of the Monetary Policy Rate (MPR). However, despite their resilience and dedication, the desired objective of taming inflation was not successfully achieved. Efforts to reduce inflation faced challenges as analysts discovered that the inflation in Nigeria is primarily driven by "cost-push" factors rather than "demand-pull" factors. It is fine to note that movement in MPR has a direct correlation with the direction of yields from the mid-long end of the curve. In H2-2023, we expect the MPR to play little or no role in the direction of yields at the short-end of the curve. The new CBN administration has aligned with the objectives of the new administration to reduce interest rates. Thus, we expect an expansionary monetary policy regime in this new administration, aimed at stimulating activities in the real sector to encourage lending at lower interest rates. As a result, we expect a relief in the upward trend of interest expense of corporates in H2-2023.

Cash Reserve Ratio (CRR): Supporting the objectives of the new administration, we have already witnessed the new CBN administration tilting back to the 32.5% CRR debit fixed rate. CRR refunds to the tune of N600.0bn were conducted in June, which significantly boosted the liquidity of the financial system, adding a vignette to the tone of the depressed interest rate environment. We expect the new status quo to greatly influence the liquidity in the financial system, albeit on a positive note.

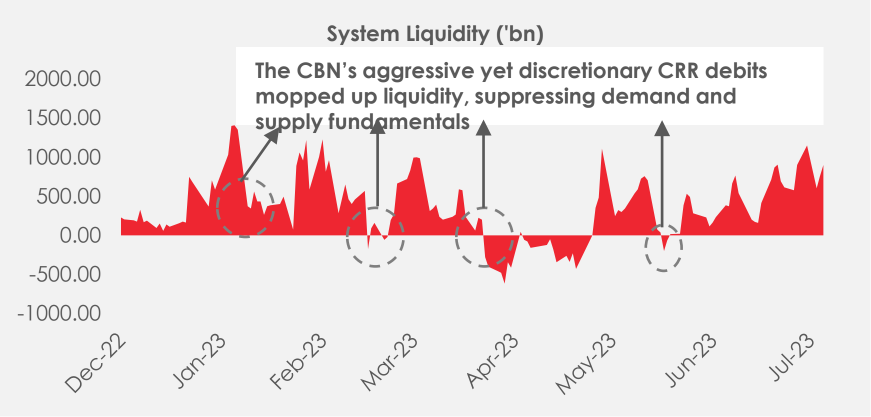
Strong earnings performance: The first half of 2023 was marked with intrusive macroeconomic disturbances, distorting overall economic activities. Accordingly, the country's PMI was met with a sharp decline, particularly in Q1-2023, falling by 22.5% print at 42.3pts in Mar-2023 from 54.6pts in Dec-2022. To the marvel of the broad-based investor platform of the Nigerian capital markets, most listed corporates were able to ride on the waves, maintaining profitability. Corporates were rewarded in Q1-2023, for their consistent profitability amid the challenging macroeconomic environment. We expect the earnings performance of listed corporates to improve in Q2-2023, as we note that the cash crunch situation eased greatly in Q2-2023 after the CBN opted to align with the directive of the Supreme Court to suspend the Naira Redesign Policy.

Looking ahead to the rest of H2-2023, listed corporates will continue to thrive, as the new administration's policies crystalise. It will be a "windfall gain" scenario, where corporates continue to improve their earnings performance, even amidst the intensifying inflation numbers. FMCG firms have the advantage of transferring cost burdens to consumers. Some premium brewers like Nigerian Breweries and Guinness Nigeria will continue to reap benefits from their premiumization strategy. The banks will outperform in the second half, making them a choice sector to exploit in the Nigerian Stock Market (hinged on the CBN's new orientation, which aimed at improving the liquidity of banks, via favourable policies).

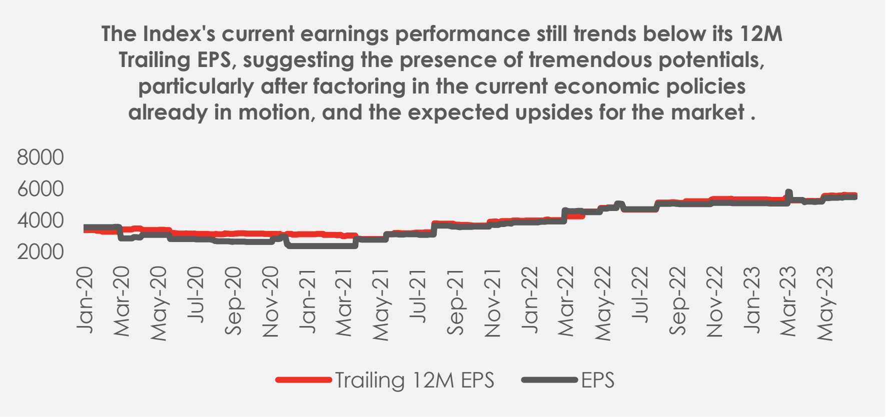
What will be the impact of the unification of exchange rates and the devaluation of the Naira at the NAFEX window on the profitability of listed corporates?

As evident in the Q1-2023 financial results of some listed corporates in the Industrial goods and Consumer goods sector, the crystallization of foreign exchange losses is inevitable for companies that import their key raw materials. However, we have seen some of these corporates on a conscious path to reduce foreign exchange exposure by initiating projects aimed at sourcing key raw materials locally. Some Brewers like Nigerian Breweries (NB) have towed this path. In May 2019, Nigerian Breweries announced that it has achieved 57.0% of its 60.0% 2020 target for local sourcing of raw materials. In the FMCG sub-sector, Nestle disclosed in June-2023, an ongoing process, set to develop local suppliers of vegetables and spices used in maggi products. Also, the company has plans to replace imported corn starch in Nigeria with cassava starch. This helped seven (7) local suppliers boost capacity to meet the company's supply needs.

Overall, we expect foreign exchange losses to remain a significant down risk to profit maximization in some listed corporates. However, with the implementation of policies aimed at improving the overall economic output of the Nigerian economy amid the vast opportunities presented, we expect listed corporates to remain resilient in their earnings performance, with most corporates opting to switch to local sourcing of raw materials. This presents further opportunities for corporates as there exist tremendous incentives to increase investments in the local economy, sourcing raw materials locally and producing enough for exports.



Source: Bloomberg, United Capital Research



Source: Bloomberg, United Capital Research

Overall, we anticipate a broadly favorable market for the Equities Market in H2-2023, supported by the above expectations. For the fixed-income market, we believe the new administration's objective to dampen the interest rates environment will continue to provide enough incentive for the CBN to leave the financial system mostly liquid, in a bid to stimulate activities in the real sector. The MPR and improved foreign participation are two (2) strong factors to determine the trend of yields from the mid-long end of the curve.

That said, we forecast that the equities market will be the most favorable market segment for both foreign and local investors. A strong incentive will be the cheaper Naira, removal of multiple taxations, and easy repatriation of FX by foreign investors.

External Sector

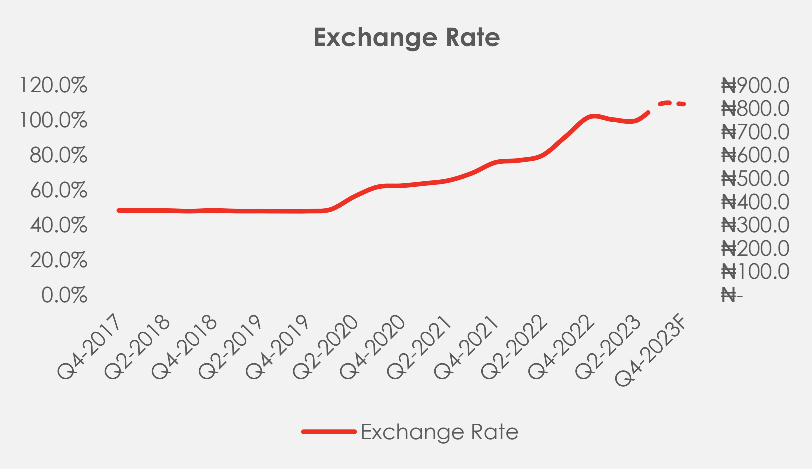
H1-2023 Review

Exchange rates Review

- In H1 2023, the Nigerian Naira experienced a significant decline of x% in its value. This accelerated devaluation was primarily triggered by the collapse of all official foreign exchange (FX) windows into the Import & Export (I&E) window. The directive to merge the FX windows came from President Ahmed Bola Tinubu and was implemented by the Central Bank of Nigeria (CBN).
- The merging of the official FX windows into the I&E window had a pronounced impact on the Naira's exchange rate, causing a rapid depreciation in its value. This decision was taken as part of the government's efforts to streamline and manage the country's foreign exchange policies and operations.
- On June 30th, 2023, the Nigerian Naira experienced a significant depreciation, falling to N760/$ from an unspecified value (Nx/$) on January 2nd, 2023. This sharp decline in the Naira's value triggered various market reactions, including the relative stability of the external reserve.
- To address the situation, the Central Bank of Nigeria (CBN) implemented a series of policy measures. These included reintroducing the "willing buyer, willing seller" model at the Import & Export (I&E) Window, pegging the operational rate of all government transactions at the weighted average rate of the preceding days' transactions, and lifting trading limits on oversold foreign exchange (FX) positions while setting it to nil on overbought positions.
- Additionally, the CBN reintroduced the two-way quotes system with a bid-ask spread of N1:00, which aimed to bring more transparency and flexibility to the FX market.
- These measures were taken to address the rapid depreciation of the Naira and stabilize the FX market. However, their effectiveness and impact on the overall economy would depend on various economic factors and market dynamics.
- As of June 30th, 2023, both the RT200 rebate Scheme and the Naira4Dollar remittance scheme have been discontinued.

Outlook

- In H2 2023, we anticipate a moderate disparity between the FX rates at the parallel market and the official market, with the parallel market experiencing higher demand pressure.
- However, the opening of the Dangote refinery could potentially alleviate some exchange rate pressures if it becomes operational before the end of the year. This development may have a positive impact on the exchange rate dynamics and help mitigate the disparities between the two markets.



Current Account

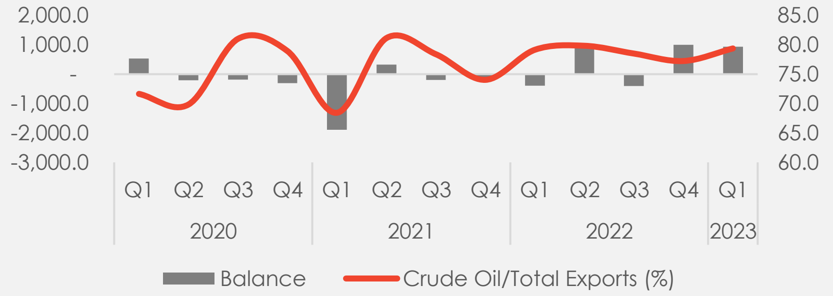
- In Nigeria as in most African states, primary commodities dominate export trade. These export earnings are in turn used to finance imports of manufactured goods for consumption and investment purposes. Nigeria exports primarily Petroleum oils, Natural gas, and other raw materials such as Urea, Cocoa, and Sesamum seeds etc. The country imports secondary products such as chemicals, machinery, transport equipment, and manufactured goods etc. Despite the Nigerian government's implementation of various measures to promote exports, such as the Export Expansion Grant (EEG), and the launch of the Nigerian Development Plan (NDP) 2021-2025, non-oil exports account for a meagre share of total exports. The dependence on commodities, particularly oil, for export has caused Nigeria to become especially vulnerable to global oil price fluctuations. Consequently, Nigeria's trade balance is structurally positive, but it occasionally turns negative when oil prices and production drop.

- Nigeria recorded a trade surplus position of N996.8bn in Q1-2023, (2.0% of GDP). As expected, high crude oil prices supported export earnings. Total exports in the quarter rose by 2.0% q/q but declined 8.7% y/y. Export growth correlates with crude oil exports which accounted for 79.4% of the value of export traded products. Similarly, total imports rose by 3.7% q/q on the back of the importation of manufactured goods and other petroleum products. However, imports declined by 25.8% y/y. Imports accounted for 46.2% of trade. Total trade in the period stood at N12.0tn (23.5% of GDP) from N11.7tn in Q4-2022 (20.7% of GDP). However, foreign trade declined by 17.5% y/y (formerly N14.6tn or 32.2% of GDP).

- In H2 2023, we anticipate the Current Account to stay positive, benefiting from improved export conditions as crude production recovers and import demand weakens. Additionally, the devaluation of the naira at the official window is expected to boost exports and make imports relatively more expensive, further contributing to the positive Current Account balance. These factors are likely to support the country's external trade position during the specified period.

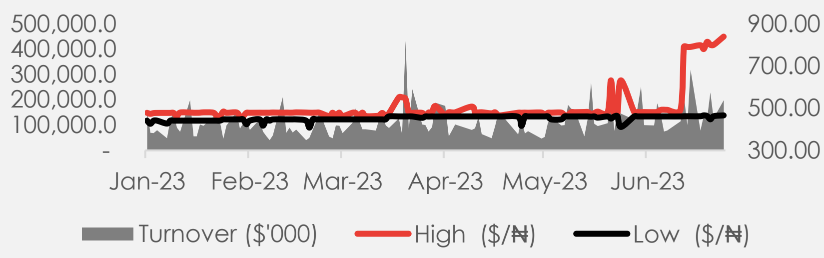
Nigeria has seen improved BOP following a mild recovery in oil production

Foreign Trade Balance (N'bn) and share of crude oil exports (%)



External Sector's Supporting Charts

We expect liquidity in the I&E window to reflect market conditions in the long-run.
I&E FX Window Daily Market Activity

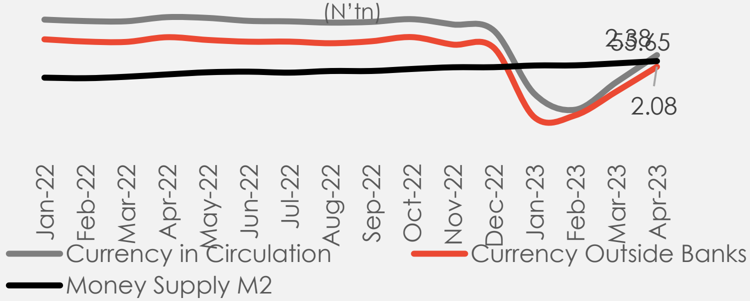


Source: FMDQ, United Capital Research

We expect the Naira to depreciate further in the short-term with but rally in the coming months
Performance of the Naira

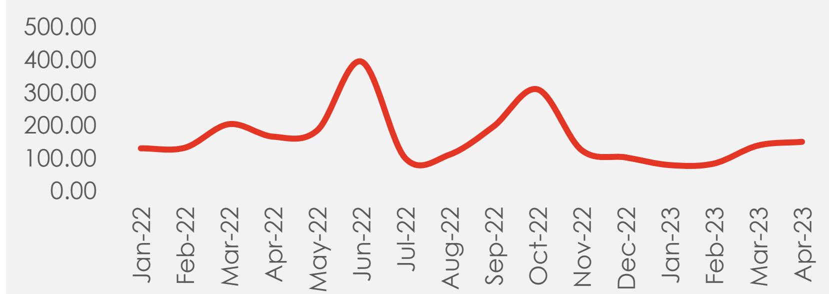
Source: Bloomberg, United Capital Research

Ongoing monetary expansion is set to result in further depreciation of the Naira
(N'tn)



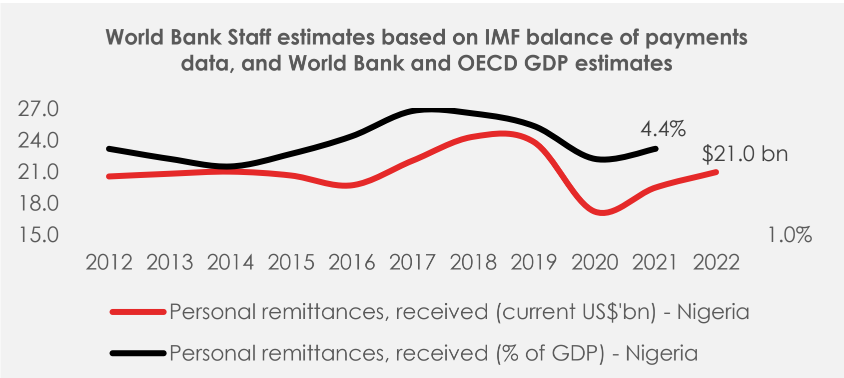
Source: Bloomberg, United Capital Research

Remittances are expected to decline in 2023
Total Direct remittances ($'mn)

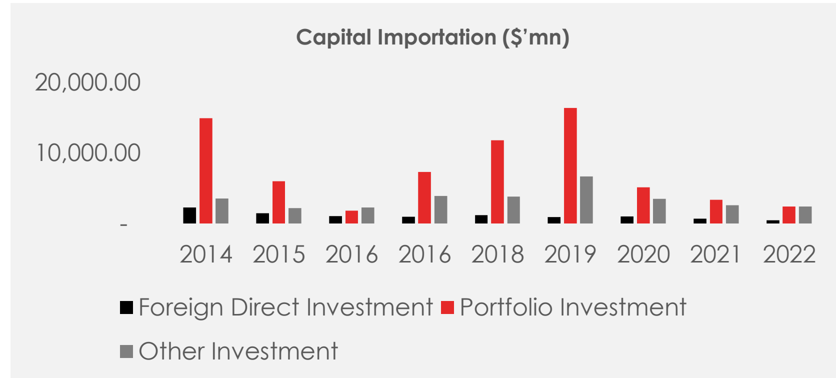


Source: Bloomberg, United Capital Research

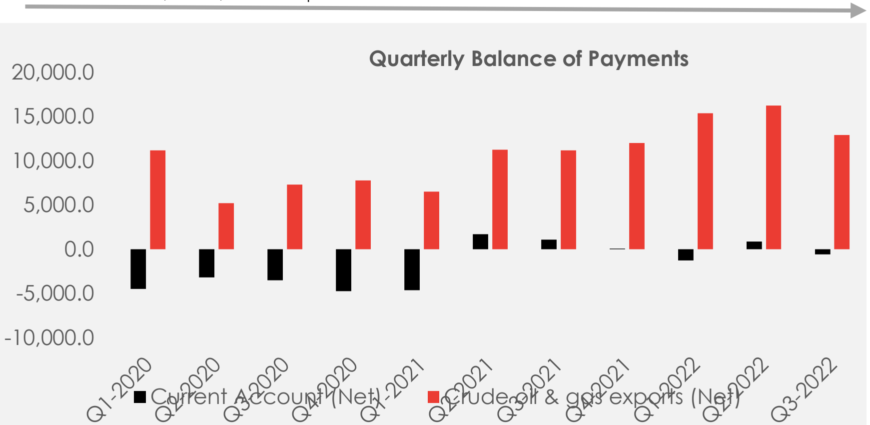
External Sector's Supporting Charts



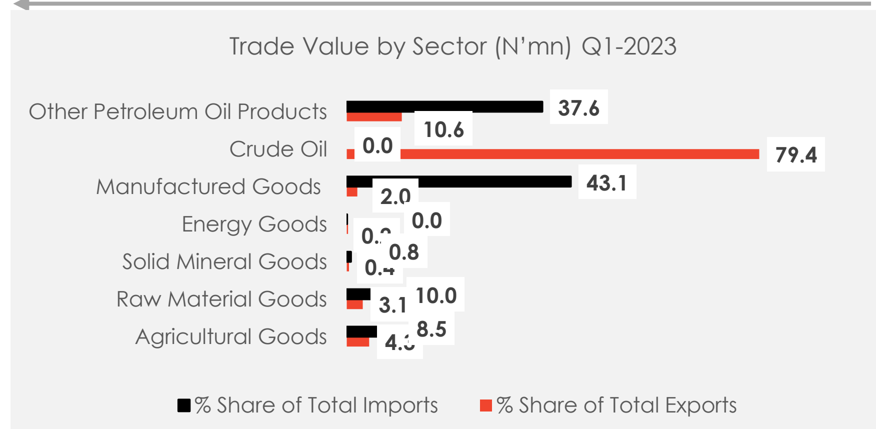
Source: World Bank, OECD, United Capital Research



Source: NBS, United Capital Research



Source: CBN, United Capital Research



Thank You