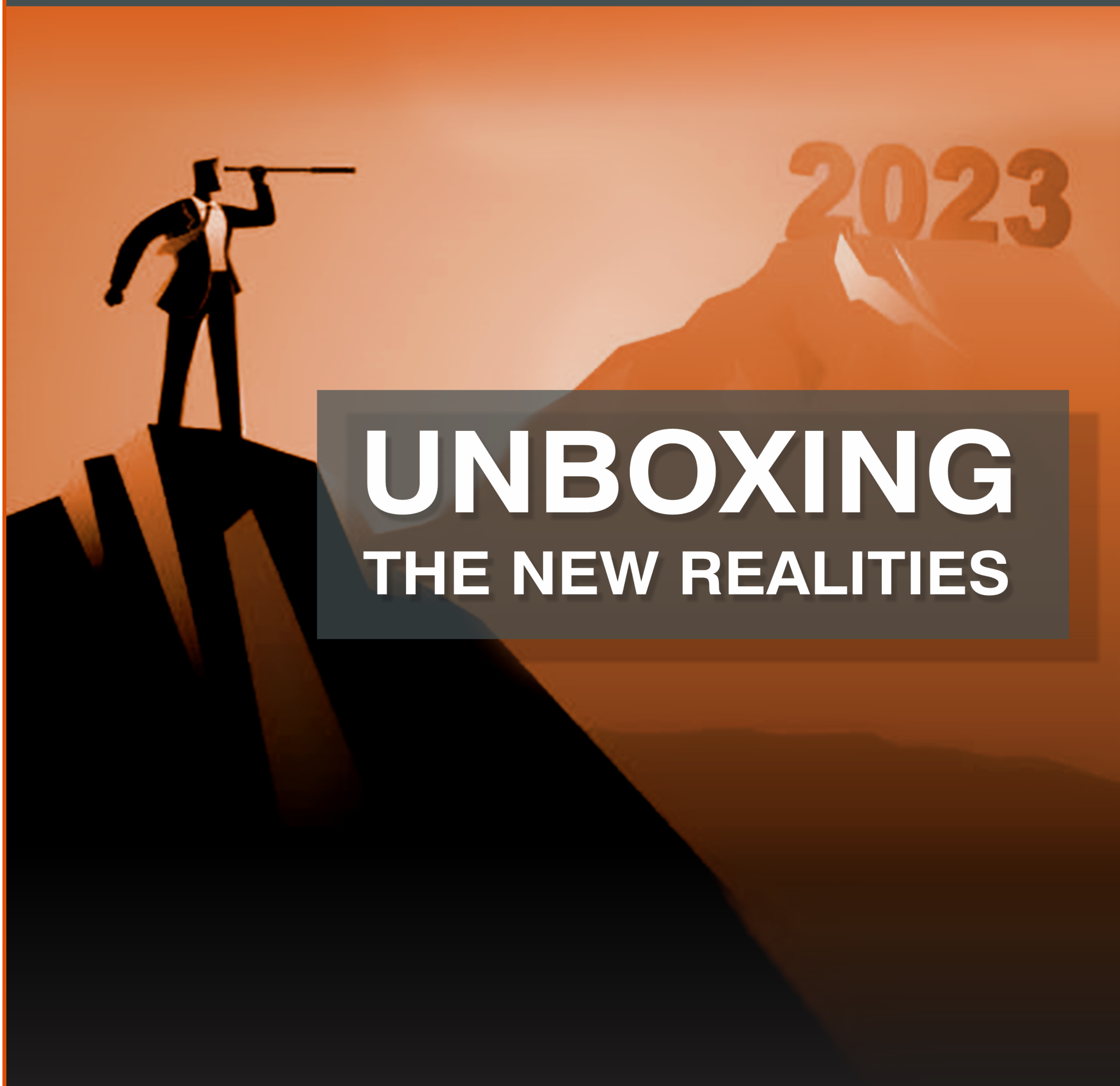
INVESTMENT ONE

2022 REVIEW AND 2023 MACRO-ECONOMIC AND FINANCIAL MARKETS OUTLOOK



UNBOXING
THE NEW REALITIES

9th January, 2023

Executive Summary

On a global scale, expectations regarding sustaining the economic growth witnessed in the prior year, though at a slower pace, were dashed, no thanks to Russia's invasion of Ukraine. This inadvertently led to many nations across the globe experiencing record-high inflationary pressures and the monetary policy tightening by global central banks that followed. Also, the zero-covid policy in China, remained an impediment to growth. Against this backdrop, major economies across the world witnessed a slowdown in economic activities as the cost-of-living crisis, exacerbated by the surge in energy and food prices, combined with aggressive policy moves by monetary authorities, weighed on economic activities.

In 2023, the uncertainty around economic growth performance will be more pronounced owing to the growing risk of a global recession as monetary and fiscal tightening are expected to come full circle in 2023. More so, the geopolitical tensions, with no end in sight or peace talks in motion, remain a headwind to global growth. According to the International Monetary Fund (IMF), global growth is expected to slow to 2.70% in 2023, with a 25% probability that it could fall below 2.00%.

The local economy remained resilient as growth was maintained through the year as of Q3 2022, still on the back of the non-oil sector's impressive performance. The oil sector maintained an underwhelming performance as theft and vandalism remained the order of the day. Overall, we anticipate GDP growth to be sustained in the year at around 3.00% driven by steady positive movement in the non-oil sector with remarkable support from the ICT sector. However, major downside risks to growth include the possible removal of fuel subsidy, unabating insecurity concerns, rising interest rates, and FX illiquidity.

Following suit with the global economy, Nigeria's inflationary pressures worsened in 2022, starting the year at 15.60% and settling at 21.47% as of November. Going into 2023, we expect to see continued elevated consumer prices as the supply-driven factors linger.

For Foreign exchange, while the rising oil production volume is slightly positive for oil earnings and, by extension, the reserves, we still think increased subsidy payments should reduce oil inflows, though the likely suspension of this cost in the second half of the year should be positive for reserves, as we also expect the Dangote Refinery to begin operations in 2023, which may bode well for FX savings and inflows.

In the fixed income space, we expect interest rates to remain elevated on the back of higher inflation expectations, the restrictive stance of global monetary authorities and our apex bank, election uncertainties and outcome, and the steep borrowing plans of the fiscal authorities. While we expect liquidity levels to determine the direction of yields in this space, our base-case scenario is a tepid rise in interest rates on a y/y basis.

The equities market defied the odds in 2022, staging an upbeat performance irrespective of the risk-off sentiments that rattled the global equities market. On a balance of factors, despite the challenging economic environment and mounting political risk, we are cautiously optimistic of a positive turnout in 2023. However, the big elephant in the room, the 2023 general elections, remains a major concern. Irrespective, barring any damning post-election outcome, we expect the significant dominance of local players, resilient earnings performance, and tepid movement in fixed income yields to bode well for equities this year.

Contacts:

Oluwasanmi Akosile
Oluwasanmi.Akosile@investment-one.com

Hannah Agbai
Hannah.Agbai@investment-one.com

Ayomikun Awolo
Ayomikun.Awolo@investment-one.com

Richard Lawal
Richard.Lawal@investment-one.com

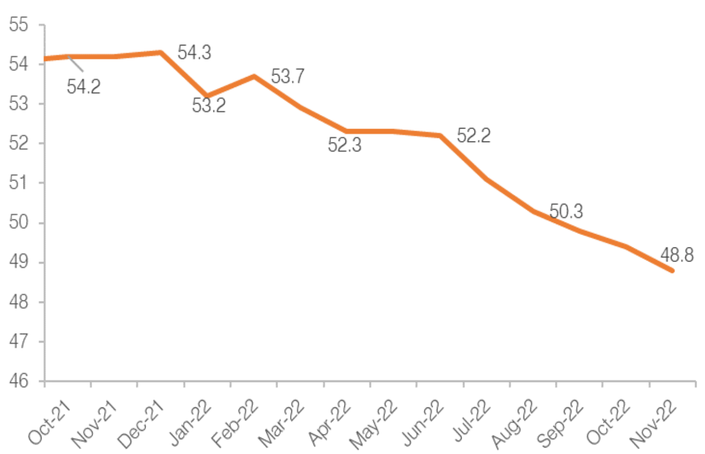
Benedicta Ezeobi
Benedicta.Ezeobi@investment-one.com

Tobiloba Oyawoye
Tobiloba.Oyawoye@investment-one.com

Weak Global Growth

At the start of the year, the global economy was projected to consolidate on the recovery made in 2021, albeit at a slower pace. The headwinds to growth such as the covid-19 outbreaks, mounting inflationary pressures, supply side bottlenecks and liquidity glut were estimated to ease out by the 2nd half of the year, even as most central banks were expected to reconsider their accommodative stance during the year. However, things turned awry as the geopolitical conflict between Russia and Ukraine exacerbated inflationary pressures, commodities prices such as energy and food, and supply chain disruptions. Thus, we saw central banks embark on the most aggressive monetary policy tightening seen in decades to tame runaway inflation, at the expense of growth.

Weakness in Global Manufacturing PMI

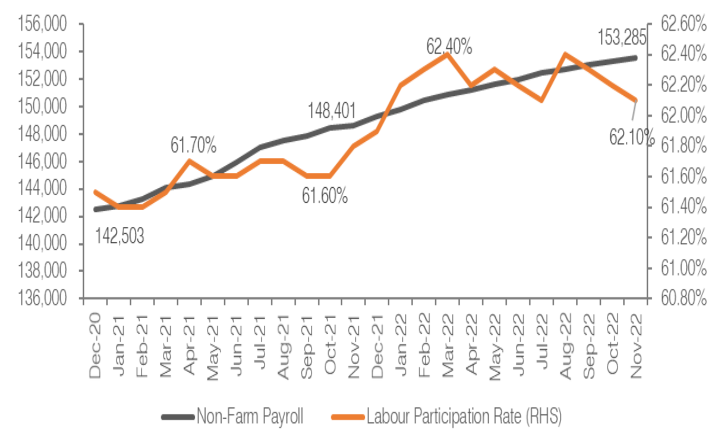


Source: Bloomberg, Investment One Research

Contraction in US. Economy

Economic growth in the United States weakened as the economy contracted (a technical recession) in H1 22, before making a recovery in Q3 22. The weaker outturn in growth was on the back of decline in consumer spending - as elevated inflation weighed on consumption, decrease in investments, and supply chain issues which affected trade. Despite hawkish moves, the labour market remained resilient on the back of rising wage growth - albeit at a slower pace than inflation, unemployment rate (3.70%) at its lowest in decades and supply demand imbalances in the job market.

Resilience in the US Labor Market



Source: Bloomberg, Investment One Research

Nonetheless, we saw a slowdown in the housing market as the FED's hawkish stance led to a rapid rise in mortgage rates which weighed on house sales and demand for housing. Specifically, the 30yr mortgage rates touched 7.35% during the year, from 3.10% at the end of 2021 while home sales and housing starts declined by 37.00% and 24.00% respectively on a YTD basis.

Fragile Growth in the Eurozone

Elsewhere, growth dampened in the Euro Area as the Russia invasion of Ukraine and the ensuing energy crisis worsened inflationary pressures, cost of living and business productivity. Recall that Russia supplied 40% of Europe's gas which made the Union vulnerable. As such, growth remained fragile against the backdrop of energy woes and tighter monetary conditions in the region. Thus, growth slowed down to 0.30% y/y in Q3 2022.

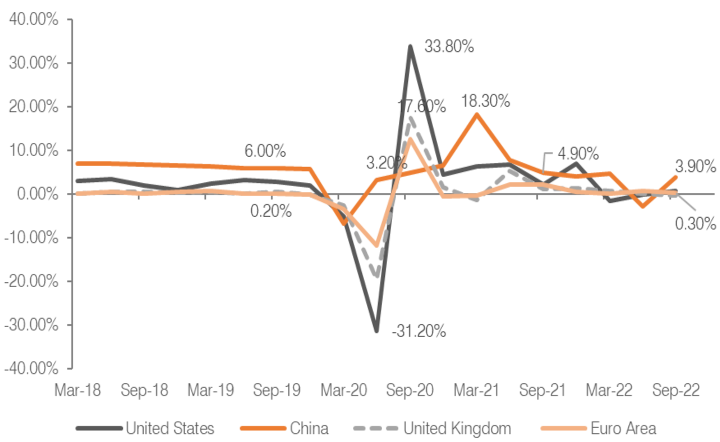
Fragile Growth in the Eurozone

The elevated inflation and restrictive financial conditions worsened growth prospects in United Kingdom, even as the economy is yet to fully recover from the aftermath of the pandemic and Brexit. Thus, economic activities remained weak in the first half of the year and in Q3 2022, the economy recorded its first contraction (-0.20% y/y) amid rocketing energy bills and cost of living crisis.

Covid Woes Weigh on China

In addition to exogenous hurdles that affected the global economy, country-specific challenges in China such as the strict zero covid policy and widespread lockdowns in place suppressed economic activities. More so, the slowdown in the property market – which represents one-fifth of economic activity further limited growth. On that note, growth slowed down to 3.90% y/y in Q3 2022, from 4.90% in Q3 21.

GDP growth rates over the previous Quarter



Source: Bloomberg, Investment One Research

Deceleration in Growth in SSA region

Just like the developed economies, the narrative remained the same in Sub-Saharan Africa as slowdown in global growth, soaring inflation exacerbated by the war in Ukraine and a tightening in global financial conditions weighed on growth. In addition, capital flight due to elevated global interest rates made the region vulnerable to rising debt distress.

Outlook: Growing Recession Risk

Economic uncertainty continues to affect every advanced economy as inflation, alongside the prospects of a central bank-induced recession, is threatening to undo progress toward economic recovery.

The growing risk of recession has been front and centre in the past few months as the impact of global monetary and fiscal tightening are expected to come full circle in 2023. More so, the geopolitical tensions with no end in sight or peace talks in motion remains a headwind to global growth. According to the International Monetary Fund (IMF), global growth is expected to slow to 2.70% in 2023 - with a 25% probability that it could fall below 2%. In addition, the Fund forecasts two consecutive quarters of negative growth for more than a third of the world's economy, as growth in the three largest economies—the United States, the European Union, and China stalls. The fragile growth outlook is hinged on the restrictive financial conditions, elevated inflation, weak growth in China resulting from the covid-zero policy and slump in property market, and the lingering effect of the Russia/Ukraine war.

In the United States, leading indicators such as the yield curve inversion, manufacturing PMI and housing market amidst others have been flashing recession signals. The US economy is projected to grow by 1.0% y/y in 2023FY, lower than the slow growth of 1.6% y/y in 2022E. While a slowdown in the housing market should continue to weigh on economic growth, inflation rates may fall as housing and rent prices move towards an equilibrium. More so, the impact of a housing downturn on delinquency and default rates is also likely to be lower than that experienced during the great financial crisis.

Elsewhere, wage pressures remain a major concern for the FED, given how resilient the labour market has been. If wage inflation eases faster, this should be a tailwind for the economy as the Fed might be able to engineer a soft landing, even as the unemployment rate races higher. Nonetheless, we expect the higher interest rate and elevated inflation to pressure consumption, investments, and the economy at large. We see a shallow period of contraction if a recession occurs, albeit economic activity is expected to remain sluggish as the FED continues the fight against inflation.

For the Eurozone, economic activity is projected to grow 0.5% y/y in 2023FY, significantly lower than growth of 3.10% y/y in 2022E. As the geopolitical conflicts lingers, the Eurozone remains vulnerable to economic downturn from energy shocks. Of recent, amidst falling natural gas prices and a mild autumn, the zone was able to completely fill up its gas storages which should help avoid energy rationing in the near term. However, a difficult 2023 European winter for energy should spell doom for the economy even as fiscal stimulus partly offsets the high prices. Elsewhere, monetary policy is expected to remain tight amid elevated inflation which should weigh on demand and growth.

Elsewhere, the United Kingdom is yet to fully recover from the covid 19 pandemic, and we believe that growth may continue to shrink as obstacles such as supply chain issues, labour shortages due to Brexit, sticky and elevated inflation, widespread strikes due to high cost of living, high interest rates and declining investments dominate in the near term. According to the IMF, growth is projected to slow down to 0.30% y/y in 2023FY, compared to 3.60% y/y in 2022E.

Growth in China is expected to be positive on the back of relaxation of the strict covid rules which should bolster growth, albeit we believe that the country might struggle in the first half of the year as it navigates living in a world with covid and widespread infections. We expect vaccination to ramp up and hasten the process. While exports might slow down among contraction in the global economy, we think that sustained infrastructure spending and stimulus to the property sector are obstacles to an improved economic backdrop in 2023. Economic activity is projected to grow 4.40% FY 2023, compared to 3.20% in 2022E, according to the IMF.

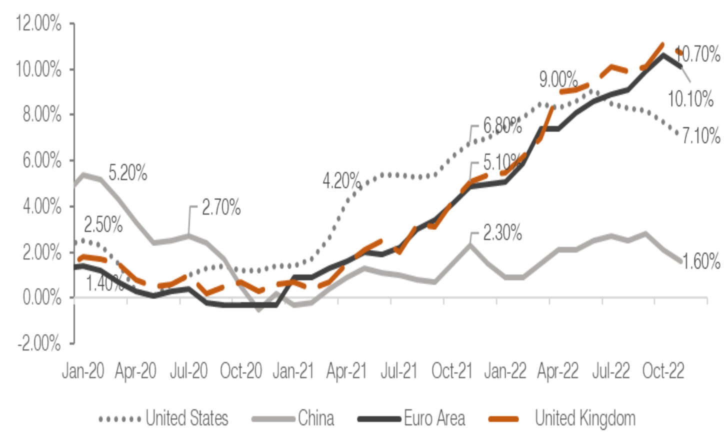
With projection of fragile growth in the global economy, we believe that growth in SSA region should remain weak due to their reliance on happenings in the global environment. Furthermore, endogenous challenges such as deteriorating macro fundamentals should continue to hamper growth. However, with the expected slight ease in global financial conditions, this should be positive for the region amongst capital inflows and access to the international capital market.

Global Inflation at Lofty Heights

Monetary policy tightening was the prevalent theme in the global economy as the heightened liquidity (buoyed by historic low policy rates), strong demand recovery, worsened supply chain bottlenecks, and the negative shock to commodities drove inflation to new highs. In addition, the robust wage growth in advanced economies between a tight labour market – reflecting historically low unemployment and a high ratio of job openings per unemployed person, fuelled demand push inflation and inflation expectations. As such, major central banks across the globe accelerated monetary policy normalization to curb spending, despite the growing risk to growth.

We saw inflation in advanced economies rise to lofty heights due to the reasons above. US inflation reached its highest levels in about 40 years at 9.10% y/y in June 2022. In the same vein, Euro Area saw inflation reach 10.60% y/y in October 2022, while the UK saw annual inflation of 11.10% y/y in October 2022.

Inflation at Lofty Heights



Source: Bloomberg, Investment One Research

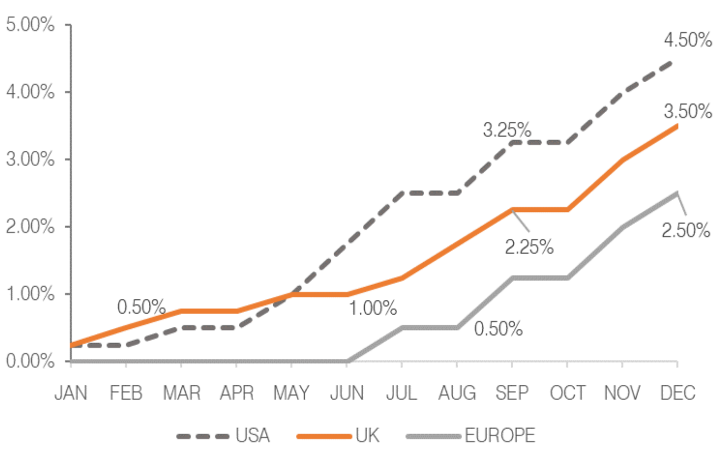
The Year of the Hawks

Regarding monetary policy, the United States Federal Open Market Committee (FOMC) increased the key policy rate by a cumulative 425bps in 2022 to the Federal fund target range of 4.00% - 4.50%. On the flip side, the rapid tightening of monetary conditions led to a powerful appreciation of the US dollar against most other currencies.

Given that the Fed signalled higher terminal rate at its last meeting, we opine that we might see a peak at 5.00% - 5.25% target range for the 1st half of the year.

Similarly, in Europe, the Governing Council of the European Central Bank (ECB) raised the key policy rate by 250bps to 2.50% in 2022 while the interest rates on the Deposit Facility and Main Refinancing Operations increased 100bps apiece to 2.00% and 2.50%, respectively. At the last meeting, policymakers alluded to rates rising further due to a substantial upward revision to the inflation outlook. Inflation forecasts were revised higher, with average inflation seen reaching 8.4% in 2022 before decreasing to 6.3% in 2023. As such, we opine that policy rate might peak at 3.25%.

Policy rate at levels not seen in decades

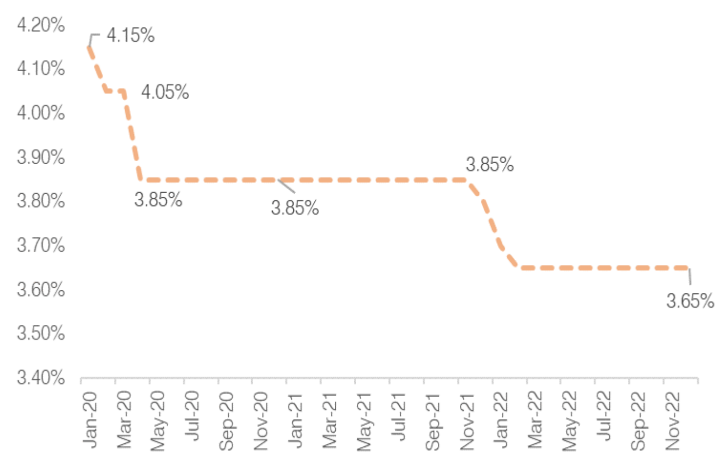


Source: Bloomberg, Investment One Research

The narrative remained the same as the Bank of England (BOE) cumulatively raised the policy rate by 325bps in 2022 to a 14-year high of 3.50%. The central bank's projections suggested the CPI inflation has reached its peak and expected to remain very high in coming months. With regards to the terminal rate, we recall that the Governor, at the November meeting, indicated that the market was pricing in a higher terminal rate at 4.70%, thus rates might peak at 4.50%. Also, at the December meeting, we saw divergence in voting patterns as some members preferred to maintain rates unchanged. We think that the BOE would be the first to crack with regards to change in monetary stance by keeping rates steady earlier than other apex banks.

Compared to other central banks, there was divergence in monetary policies as the People's Bank of China (PBOC) maintained a dovish stance on the back of weak economic growth driven by the widespread lockdowns and contraction in property market.

Accommodative monetary policy stance in China



Source: Bloomberg, Investment One Research

Outlook: The Pace of the Disinflationary Trend Matters

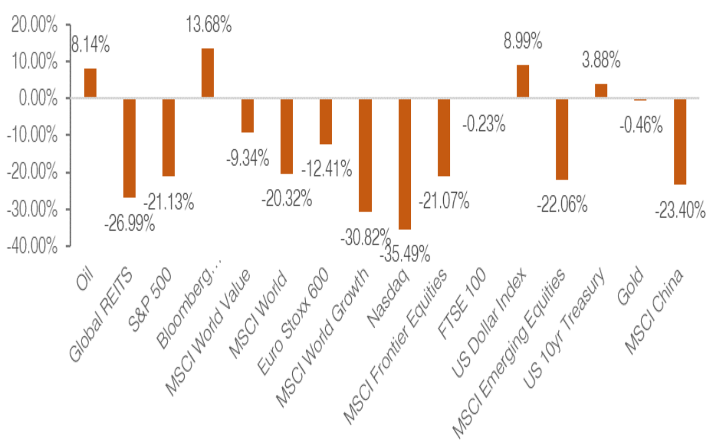
Global inflation appears to have peaked alongisde ease in some of the drivers of inflation. Nonetheless, the pace of disinflation matters as this dictates the path of interest rates in 2023. We think that the re-opening of the Chinese economy should further ease supply chain pressures. However, the disinflationary trend is likely to be fraught with challenges such as wage pressures, geo-political instability, and fluctuating energy prices. Thus, we think that inflation will most likely remain elevated for a while and above Central Banks' target of 2.00%. A slow retreat in inflation would put central banks in a tight spot as they balance dealing with stubborn inflation against the detrimental impact of higher rates on economic growth.

While most Central Banks are beginning to acknowledge the risk to growth and a slowdown in the pace of tightening, we expect the tight monetary policy stance to remain in place in HI 2023. High inflation and central bank resolve to bring inflation down to 2.00% make a pivot towards rate cuts in 2023 unlikely. With expectation of an elevated interest rates environment, a pause in rate hiking cycle in the 2nd half of the year amongst softer macro-economic backdrop is not farfetched.

A Terrible Year for Most Asset Classes

Major asset classes recorded the worst selloffs observed in history against the backdrop of hawkish policies to tame inflationary pressures, rising interest rates, adverse impact of the geopolitical conflict and recession worries. In addition, the appreciation of the US dollar against major currencies weighed on performance of other asset classes, due to the appeal of the greenback as a safe haven asset. On the flip side, commodities especially Oil was an outlier on the back of supply and demand imbalances.

Asset Performance in 2022



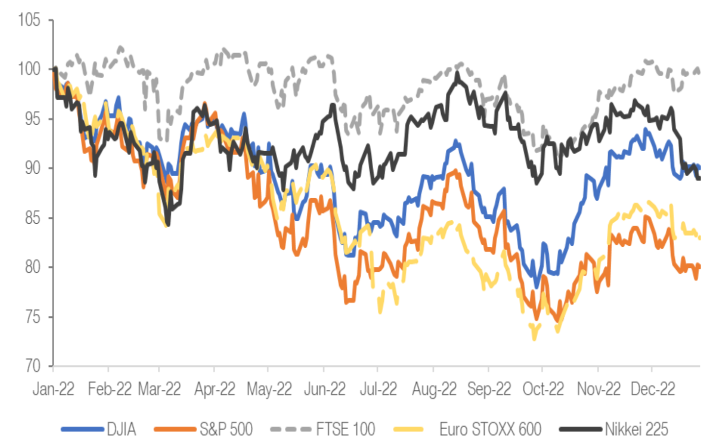
Source: Bloomberg, Investment One Research
**Data Factored to 100*

More Volatility to Come

In the equities space, we believe that volatility still abounds as we are not out of the tunnel yet. While the market is forward looking and the possibility of a recession slightly priced in, earnings estimates are yet to reflect the impact of elevated interest rates on companies' performance and growth. However, the possibility of the massive selloff witnessed in 2022 is unlikely given the peak in inflation and a pivot to a less hawkish stance i.e., a pause in H2 2023. This should be supportive of the equities market thus fanning the flames of a possible recovery of the drawdowns recorded in 2022.

The 1st half of the year should continue to favour defensive, value and dividend paying stocks (Healthcare, Consumer staples amidst others). We think that rotation to technology, growth and cyclical stocks is not farfetched as uncertainties ease in macro economic conditions in the 2nd half of the year. While the energy sector should benefit from China re-opening and supply/demand imbalances, transition to green energy and environmental, social and governance (ESG) concerns remain.

Equities Market in 2022*



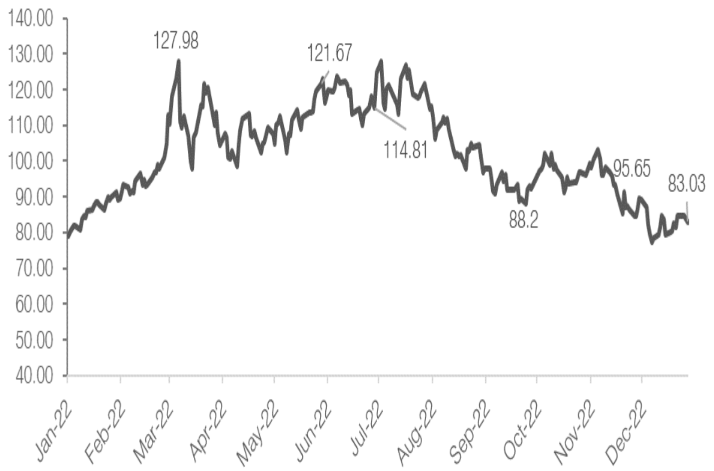
Source: Bloomberg, Investment One Research
**Data Factored to 100*

Oil: Higher Highs in H1 22 but Lower Lows in H2 22

The first half of the year was extraordinary for the energy market as oil prices resumed the year strongly amid tight supply (sustained production issues in some OPEC countries), fall in oil inventories and resilient recovery in demand. The supply disruptions due to the geopolitical tensions further stoked the bullish momentum as Brent prices touched highs of $121 per barrel in June 2022. To address rising oil prices between tight supply, the US authorised the release of 180.00 million barrels from its Strategic Petroleum Reserves (SPR), alongside an additional release of 60 million barrels from the International Energy Administration.

However, the 2nd half of the year came with challenges that supressed bullish proceedings in the market. First was the restrictive monetary policy stance by the FED, higher interest rates and a stronger dollar. In addition, China's zero covid policy and recession worries on global demand outlook also contributed to the bearish bias. In response to concerns about demand, OPEC cut production significantly by 2million barrels per day from November till the end of 2023. This cut was effective in the short run as it buoyed positive sentiment; however, prices continued its southward

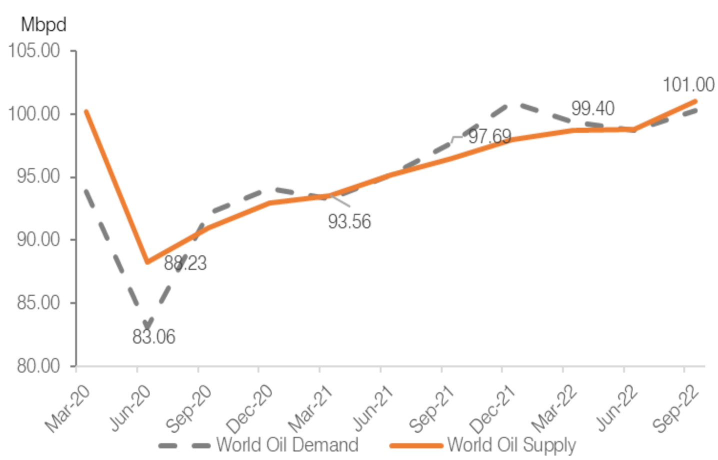
Oil Price Trend in 2022



Source: Bloomberg, Investment One Research

Despite the tight supply in the market i.e., declining inventories, OPEC underproduction due to divestments or move to greener energy and embargo on Russian oil by the European Union which began in December, the weak demand outlook dominated market sentiment negatively in the 2nd half of the year. Resultantly, oil prices increased by 8.14% to close the year at $83.03 per barrel.

World Oil Supply vs. Demand



Source: IEA, OPEC, Bloomberg, Investment One Research

Outlook: Risks Skewed to the Upside in the Medium Term

With increasing risk of a recession in the global economy, global oil demand is expected to be weak in 2023. For context, recent data from International Energy Agency (IEA) forecasts that demand growth will slow to 1.6 mb/d in 2023, down from 2.1 mb/d in 2022, amid mounting economic headwinds. However, we opine that the reopening of the Chinese economy and relaxation of covid regulations should support demand. Furthermore, a slower pace in rate hikes and softer greenback should support demand.

With regards to supply, the factors driving the tight supply in the market are still in place such as declining inventories, underproduction by OPEC members, embargo by the European Union and the G7 price cap on Russian oil. We believe that OPEC+ would continue to be proactive in the market and try to strike a balance between demand and supply. Consequently, oil prices should average $90 per barrel in 2023.

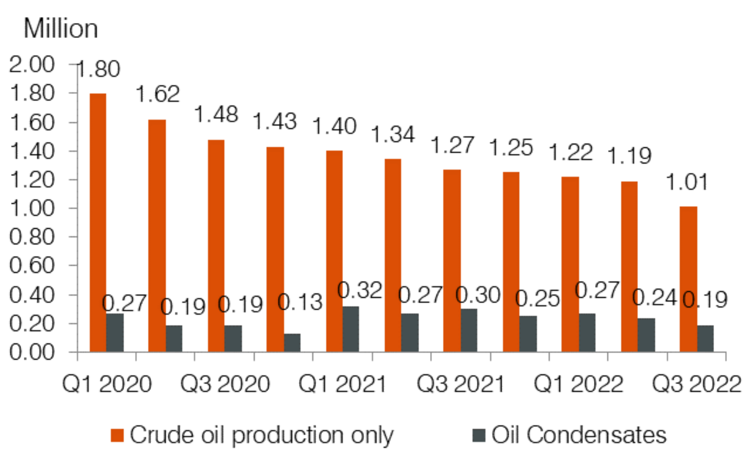
To sum it up, we opine that oil prices should sustain its bearish trend for the 1st half of the year, albeit the risks are skewed to the upside in the other half of the year. Nonetheless, development in the Russia/Ukraine war is a major event to look out for. An escalation or de-escalation of the conflict should increase volatility and swing market in either direction significantly.

Positive but Weak Growth

The Nigerian economy, measured by Gross Domestic Product (GDP) maintained its positive trajectory through 2022, consolidating on the growth recorded post pandemic. However, growth was weak in the year as challenges such as dismal production volumes, currency pressures, trickle down effects of the geopolitical conflicts and unabating inflationary trend undermined economic activities across the nation. As such, GDP grew by 2.25% y/y in Q3 2022, which was predominantly buoyed by positive performance in the non-oil sector whilst the oil sector continued to shrink.

Specifically, Nigeria struggled to meet OPEC production quota of 1.80mbpd as average daily production volume stood at 1.20mbpd in Q3 2022, compared to 1.57mbpd and 1.43mbpd from Q3 2021 and Q2 2022 respectively. Consequently, the oil sector remained in a contractionary phase with a negative real growth of 22.67% in Q3 2022 due to lingering impediments such as heightened theft, pipeline vandalism and divestment of international oil companies from the shores of Nigeria among transition to green energy. Irrespective of efforts such as award of pipeline surveillance contract to security agencies to mitigate against unabating theft and other criminal activities across various oil fields in the country, we expect gradual improvement in the oil sector as production

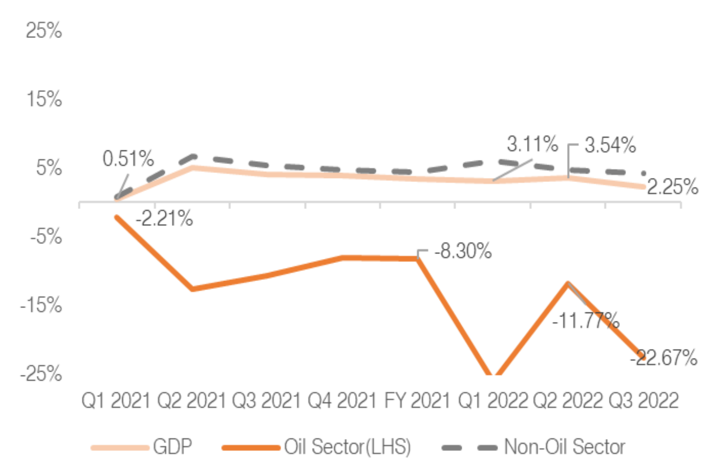
Nigeria's Oil Production Under Pressure



Source: NBS, Investment One Research

The agricultural sector witnessed growth in the year despite hurdles confronting the sector in recent months. Precisely, the sector recorded marginal growth of 1.34% in Q3 2022, 12bps higher than 1.22% printed in the same period in the previous year. We posit that performance in the agricultural space remain sub-par and below potential basically on the back of poor road transportation network and more importantly, the persistent insecurity issues which has continually discouraged farmers from food production. Notwithstanding, we expect the sector to remain resilient and record further improvement as government put satisfactory plans in place to quell insecurity and address other infrastructural inadequacies across the nation.

Positive But Weak Growth

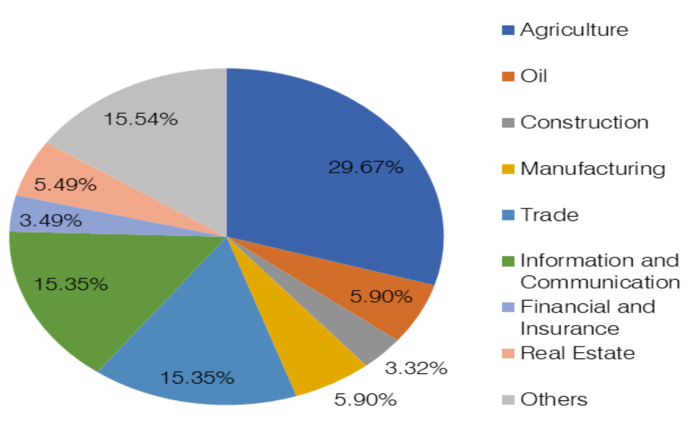


Source: NBS, Investment One Research

In the manufacturing space, growth was below potential in 2022 due to various difficulties as the manufacturing sector recorded its first contraction since the pandemic-induced recession in 2020. Notably, the sector shrank by 1.91% in Q3 2022, relative to the 4.29% growth in Q3 2021. The decline in the sector may not be unconnected to FX liquidity constraints, high inflation and other challenging macroeconomic conditions hindering business activities. Going forward, we expect the manufacturing sector to remain pressured on the back of currency challenges as well as elevated inflation. In addition, the possible removal of fuel subsidy poses a risk to the downside for the sector given that energy cost could further spike, increasing overall operating cost while higher prices could also erode consumer spending.

In the finance and insurance sector, growth totalled 12.70% in the third quarter of 2022. This was lower than the 23.23% growth in the corresponding period of 2021 due to tough operating environment and rising inflationary pressures. Nevertheless, the sector's contribution to GDP increased from 3.16% recorded in Q3 2021 to 3.49% in the third quarter in 2022 showing some level of resilience in the financial sector despite economic obstacles. In 2023, we see further growth in the sector with expectations that recent policies by the Central Bank of Nigeria (CBN) to foster cashless transactions will spur more activities and increase revenue generation for banks and other financial institutions as many amongst the unbanked populace will be pulled into the financial system.

GDP Sectoral Contribution



Source: NBS, Investment One Research

The Information and Communication (ICT) sector continued in an impressive fashion in line with recent trend. As such, growth stood at 10.53% in Q3 2022, which was higher than the 9.66% recorded in the same quarter in the previous year. Meanwhile, the sector made contribution of 15.35% to total real GDP in Q3 2022 which was higher than 14.20% recorded in the corresponding quarter of 2021. The positive performance in the ICT sector can be largely attributed to activities in the telecommunications sub sector amid substantial investment and technological advancement in that space.

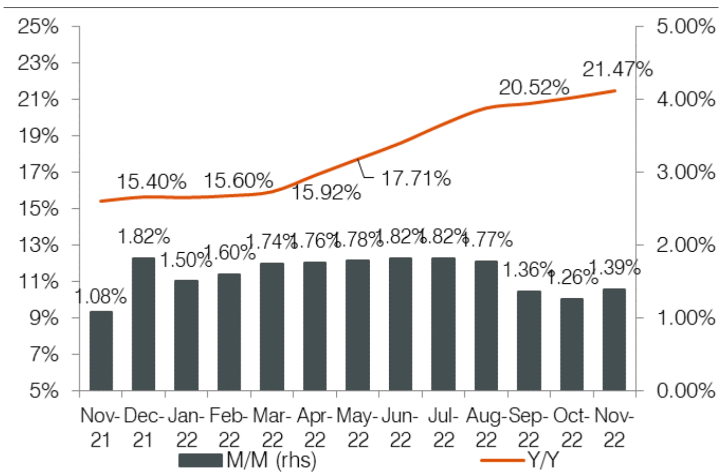
We expect further growth in the ICT sector should be buoyed by increased access to Payment Service Banks (PSBs) for financial inclusion and other alternative banking and payment services especially in rural areas where there are limited traditional banks.

Overall, we anticipate GDP growth to be sustained in the year at around 3.00% driven by steady positive movement in the non-oil sector with remarkable support from the ICT sector. We also expect gradual improvement in the oil sector with plans in place to tackle theft and other niggling challenges already yielding notable results. However, major downside risk to growth includes possible removal of fuel subsidy, unabating insecurity concerns, rising interest rates and FX illiquidity.

Nigeria Inflation Review

In the year 2022, headline inflation remined upbeat as consumer prices climbed fresh highs for ten consecutive months to settle at 21.47% in November 2022 (the highest record since September 2005) from 15.60% at the start of the year in January 2022. Notably, price pressures were broad based given the consistent upward shift in the food and core sub-indexes. We are of the view that rising inflationary pressures may not be unconnected to spill-over effects of the geopolitical tensions between Russia and Ukraine, elevated energy prices, global supply chain disruption, shortage of food production due to insecurity and rise in prices of imported goods driven by currency depreciation.

Headline Inflation Trend



Source: NBS, Investment One Research

Outlook: Inflation to Remain Elevated

Going into 2023, we expect consumer prices to remain pressured and hover at elevated levels. Although, cumulative monetary policy tightening by the CBN in 2022 should dampen consumer spending, we do not expect a significant decline in prices given that major contributors to inflation are cost-push or supply driven. Therefore, we believe that structural impediments and other supply side factors should outweigh the impact of subdued demand. However, we opine that the high base effect may provide some respite for spiralling inflation.

Food: Supply and Demand Imbalance

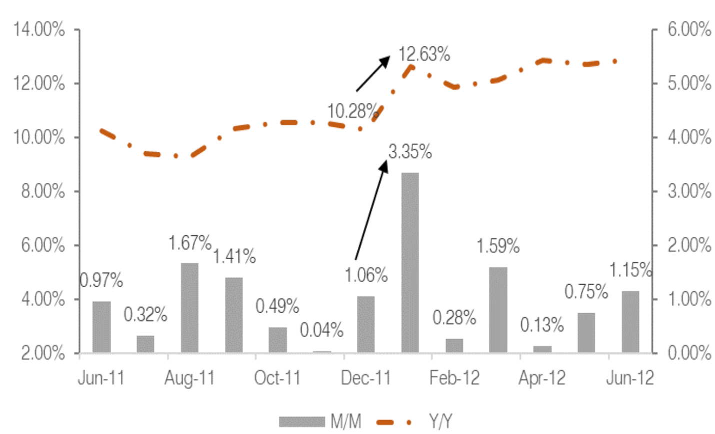
Movement in the prices of food plays an integral role in determining the dynamics of inflation in Nigeria since the food sub-index constitutes over 50% of Consumer Price Index (CPI). It is therefore imperative to access factors that have affected food prices in 2022 and what to expect going forward. In 2022, food inflation jumped to a 17-year high of 24.13%, significantly above the 17.13% increase recorded in January 2022. The spike in food prices can be attributed to the rise in cost of production driven by supply chain disruption which emanated from the pandemic and the Russia-Ukraine war. In addition, the insecurity in food producing parts of the nation has contributed majorly to the pressure on food prices as farmers are unwilling to take the risk of cultivating without yielding any substantial output. We also highlight the downside risk from the unprecedented flood in major parts of the country that eroded crop produce and exacerbated the poor road transport network. More so, the imported food index rose to a 5-year high of 18.23% in November 2022 on the back of FX illiquidity and persistent depreciation in the value of the naira. These factors put together have hampered food supply which led to the significant uptick in the prices of food. Going forward, as supply of food continue to struggle to catch up with demand due to shortage of food production amongst other fundamental challenges, we expect further pressure on food inflation.

Rising Energy Cost and Fuel Subsidy

Talks about a potential removal of subsidy payment on Premium Motor Spirit (PMS) popularly known as petrol has lingered in recent years, however, there has been no enthusiasm to implement the policy.

In 2022, energy cost rose to a significant high due to the war-induced supply chain disruption and local distortion in transport of petroleum and supply infrastructure as diesel prices jumped to about N800, 215% higher than N254 per litre in 2021. Similarly, pressure on PMS has persisted in recent months on the back of dispute relating to production and landing cost between marketers and depot owners amidst other challenges, causing a surge in petrol pump price in most parts of the country. According to the Nigerian National Petroleum Company Limited (NNPCL) PMS will cost N462 per litre without government subsidy, implying that there could be an increase of about 172%, relative to the last prevailing price of N170 per litre. In our view, we opine that payment of subsidy by the government on PMS is becoming unsustainable considering the fiscal challenges confronting the nation. Also, with the emergence of a new government, we expect a strong political will to end subsidy payment later in the year in tandem with the promise made by the current administration. Therefore, we believe that the removal of fuel subsidy will drive inflation upwards in 2023 given that higher cost of transportation will likely transcend to the cost of other goods and services. However, we opine that the effect of the removal of subsidy might be minimal if the Dangote refinery commences operation, with landing cost expected to be saved.

Inflation Spiked During 2012 Fuel Subsidy Removal



Source: NBS, Investment One Research

Election Activities and Spending

Major political parties have intensified preparation and campaign rallies ahead of the highly anticipated 2023 general elections in Nigeria, therefore, we expect significant spending in Q1 2023. We opine that the ruling party and other frontrunners will prioritize social spending in a bid to win the presidential election. This would mean more money (compared to non-election years) for low-income households, elderly, unemployed and youths in various parts of the country. We are of the view that this would serve as a boost to consumer spending which would put further pressure on headline inflation especially in the early period of the year. In addition, the political instability as well as uncertainties relating to the election will play a crucial role in terms of security concerns across the nation, with more attention in Northern parts of the nation where there have been lingering challenges. We opine that this may affect food production and other economic activities in the first quarter of the year, leading to higher prices.

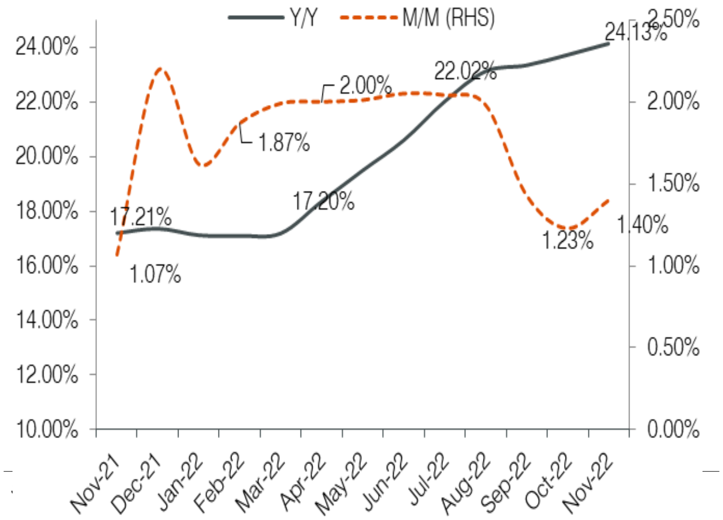
Our Scenarios

Our base-case scenario is based on the presumption that the new government might not be quick to implement new policy adjustments and maintain the status quo as regards energy prices and little or no improvement in security challenges. Consequently, we expect inflation to average 18.00% y/y for 2023.

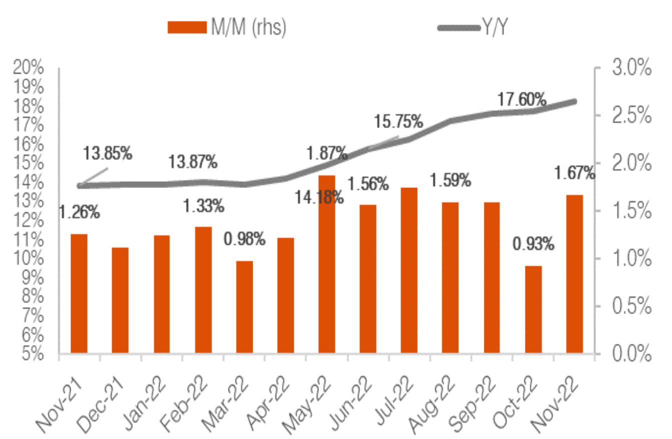
Our best-case scenario is premised on the expectation of harmonious election activities, suspension of removal of fuel subsidy, with no significant increase in cost of energy and restoration of serenity to security threatened regions which would boost food production and supply. Hence, we project a 15.00% y/y average rise in inflation for the year.

Our worst-case scenario is hinged on the assumption that the insecurity in major parts of the country escalates, FX liquidity constraint lingers and stoke further pressure on imported food inflation. Similarly, the fuel subsidy removal, spike in energy prices and a chaotic election pose substantial threat to inflation figures. As such, we envisage that inflation would hover at around 25.50% y/y in 2023.

Food Sub-Index Trend



Core Inflation Running High



Source: NBS, Investment One Research

2022 Budget: Continued Rhetoric of Unimpressive Budget Performance

The 2022 budget of "Economic Growth and Stability" was the third consecutive one to follow the January-December budget cycle as well as continuing the historical trend of an underwhelming performance. The 2022 Appropriation act presented by the president to the National Assembly in October 2021 constituted an aggregate expenditure of N16.39 trillion with revenue target of N10.13 trillion. Meanwhile, the budget size was revised upwards to N17.13 trillion on the back of an increase in the budget's oil price benchmark to $62pbl from $57pbl to reflect current market realities.

Barely two months into the year, a supplementary budget of about N2.56trillion was created and sent to the legislative chambers for Approval. This was done to cater for fuel subsidy after its removal was suspended by the fiscal authorities in January. Recall that in the last quarter of 2021, the Minister of Finance announced that fuel subsidy was going to be jettisoned by mid-year and only provisions for the first six months was factored into the full year budget. To provide more context to this, a sum of N443.00 billion was earmarked for subsidy financing and at the point of suspension of the removal, the Nigerian National Petroleum Company Limited (NNPCL) made it known that it will cost the nation about N4.00 trillion. The differential between the initially budgeted sum of and the request by the NNPCL was responsible for the supplementary budget which invariably raised the budget size and deficit to N19.69 trillion and N8.95 trillion, respectively. Whilst the fiscal authorities exclaimed that the suspension was hinged on the attendant effect on inflation vis-a-vis the high cost of living and economic hardship on the most vulnerable, we are of the opinion that the move was more politically minded than economically rational as FG's willingness to dance to the tune of the populace was paramount considering the coming elections. Nonetheless, optimism about the completion of the Dangote refinery is expected to cushion the effect of subsidy removal and possibly aid a gradual phase out.

Moving further, in no surprising manner, as revealed by the latest budget implementation report (January-August) from the budget office of the federation, the 2022 budget scorecard has thus far recorded a poor performance.

Starting with the revenue segment, the FG recorded a total revenue of N4.23 trillion within the eight months period, an underperformance of 36.30% as against the pro-rated N6.65 trillion. This was primarily on the back of the significant shortfall recorded in the oil-revenue which underperformed by 72.90% (pro rata: N1.46 trillion vs actual: N395.06 billion). Sadly, Nigeria was incapable of maximising the gains from the rally in crude oil prices witnessed particularly in the first half of the year as low oil production and increased under-recovery cost for PMS were the two major deterring factors. On the positive side, non-oil revenues printed slightly positive, recording an overperformance of 2.90% in the period under review. This was primarily buoyed by the outperformance of 36.30% recorded in Companies Income Tax (CIT) (pro rata: N606.20 billion vs actual: N826.27 billion), albeit, Value Added Tax (VAT), Customs Revenues and Federation Account Levies lagged by 0.40% (pro rata: N211.13 billion vs actual: N210.36 billion),16.20% (pro rata: N556.08 billion vs actual: N465.79 billion) and 25.50% (pro rata: N47.98 billion vs actual: N35.76 billion) respectively.

On the expenditure front, the FG seemed to have curtailed expenses within the period as revenue estimates were largely unmet. In details, aggregate expenditure underperformed by 17.20%, meaning 82.80% (N9.56 trillion) was spent out of the pro-rated sum of N11.55 trillion. Recurrent expenditure seemed to have been a bit modest as the FG expended an actual amount of N7.24 trillion out of the pro-rated budget of N7.40 trillion, recording a performance of 97.90%. Non-Debt Recurrent Expenditure fell short by 21.70% as N3.71 trillion was expended out of the N4.74 trillion. This was driven by the underperformance of personal costs (MDAs), personal costs (GOEs), pension and gratuities and Overheads (GOEs) which lagged by 4.80%, 34.10%, 33.00% and 55.00% respectively.

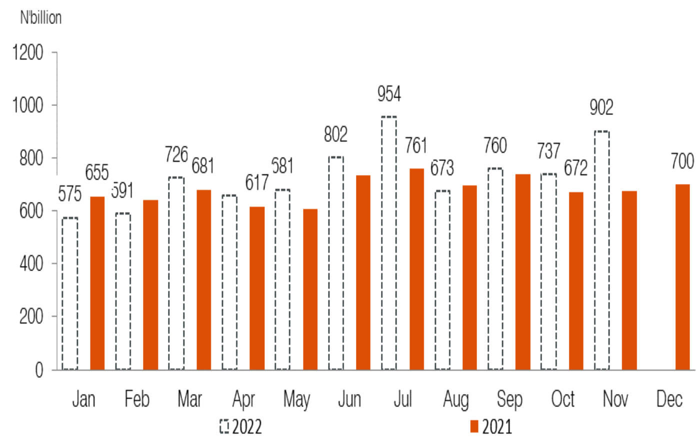
Notably, the FG incurred a sum of N1.03 trillion interest payment on ways and means advances which was not included in the 2022 budget being the primary driver for the overshot for debt service. As a result, debt service to revenue ratio for the period printed at 83.00%. As expected, less funds were channelled towards capital projects with an underperformance of 50.80% (pro rata: N3.61 trillion vs actual: N1.78 trillion) recorded. On the back of revenue shortfalls outstripping the underperformance in expenditure, fiscal deficit for the period settled at N5.33 trillion, 8.78% higher than the pro-rated budget of N4.90 trillion. For full year 2022, we estimate revenue figures printing at N 6.35 trillion an underperformance of 36.00% relative to the full year revenue target of N9.97 trillion. For expenditure, we see an actual of N14.34 trillion, a lag of 17.00% compared to the budgeted N17.32 trillion, while we expect budget deficit to settle at N8.00 trillion.

FAAC: Record Highs amid Lean Oil Revenues

Despite oil revenues recording significant shortfalls for a better part of the year (72.90% underperformance as of 8M 2022) the FG intensified efforts on its non-oil revenue sources to keep Federal Accounts Allocation Committee (FAAC) disbursements upbeat. Although starting the year on a low pedestal of N575.00 billion (lowest since May 2020: N547.31 billion), FAAC pay-out was on the rise for most months of the year - precisely 8 out of 11 months (Jan-Nov) as Companies Income Tax, Value Added Tax, Petroleum Profit Tax and Import & Excise Duties buoyed revenue generation for the three government tiers. Against this backdrop, we highlight that FAAC disbursement hit an all-time high. Notably, FAAC allocations hit an 8-year high in July 2022 (N954.09 billion) and rose by 7.57% year on year to an average of N732.00 billion in 2022, highest level since 2012.

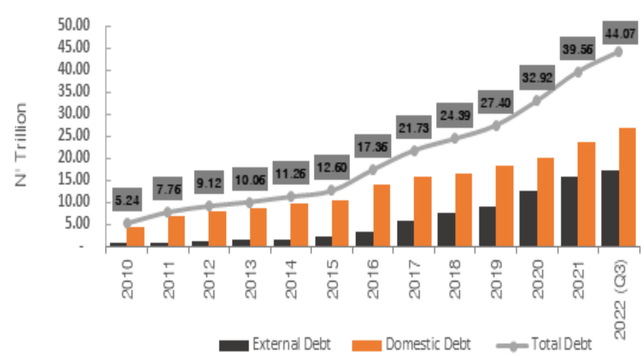
For FY 2023, we expect to see a more concerted effort from the FG to improve inflows from non-oil revenue sources as non-oil revenue in the 2023 budget constitutes c.80%.00 of total revenue compared to 74.00% of the previous year. Accordingly, this should continue to cover up for the lags in oil revenues until production is significantly ramped up and subsidy payments phased out.

FAAC Pay-outs in 2022



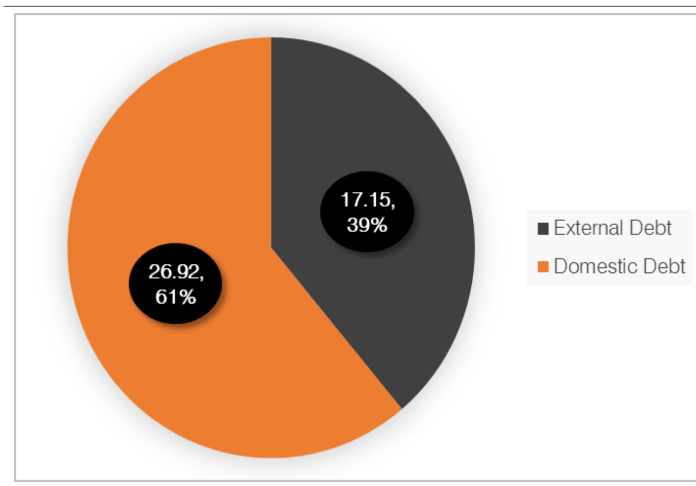
Source: DMO, Investment One Research

No Respite in Sight to a Rising Debt Profile



Source: DMO, Investment One Research

External vs Domestic Debt Stock



Source: DMO, Investment One Research

2023 Budget: Mounting Fiscal Deficit

In a bid to ensure the timely passage of the appropriation bill and the consistent follow through with the January-December budget cycle, which has been the trend in recent years, the President presented the 2023 budget to both chambers of the legislature in October. The 2023 budget, which is the eighth and final one of the incumbent administration was christened: "Budget of Fiscal Sustainability and Transition". At the point of presentation to the National Assembly, the budget contained an estimated expenditure of N20.51 trillion and revenue of N9.73 trillion. However, at the point of passing the bill, the National Assembly raised the budget size to N21.82 trillion, 6.39% (N1.32 trillion) higher than the initial N20.51 trillion and 25.98% beyond N17.32 trillion for 2022, while the projected revenue figure of N9.73 trillion represents a decline of 2.41% relative to that of the previous year which stood at N9.97 trillion. The upward revision by the legislative chambers reflected increases in capital expenditure, debt servicing and additional provisions to the Independent National Electoral Commission and National Population Commission ahead of the forthcoming general elections and population census respectively.

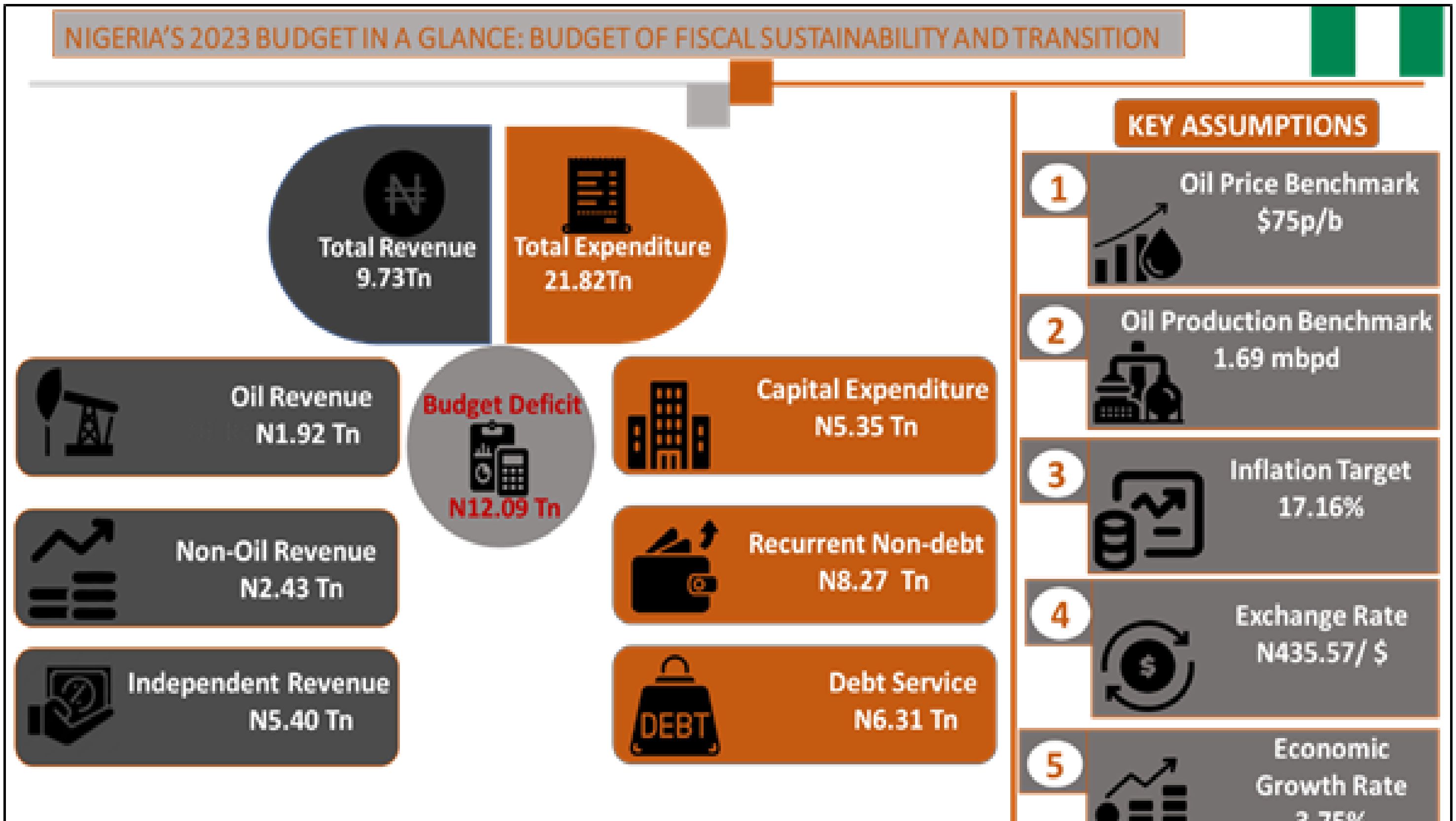
On the back of this, budget deficit for 2023 is expected to amount to N12.09 trillion, a significant jump of 64.49% when compared to N7.35 trillion for 2022. The 2023 proposed budget deficit represents 5.38% of GDP and above the 3.00% threshold set by the Fiscal Responsibility Act of 2007. According to the President, the need for more concerted efforts to tackle the persistent security challenges necessitated the deficit. On that note, the government intends to finance majorly through fresh borrowings of about N8.80 trillion, privatization proceeds of N206.18 billion and bilateral & multilateral loans of about N1.77 trillion for special development projects.

A breakdown of the expenditure segment shows that recurrent (non-debt) expenditure was allocated N8.27 trillion (38.00% of the total budget), an increase of 16.64% from N7.09 trillion in 2022. Debt service amounts to N6.60 trillion (30.00% of the total budget), 66.67% higher than the projected N3.96 trillion for 2022. This would lead to an estimated debt-service to revenue ratio of 68.00% in 2023, higher than the 40.00% projection for 2022. Furthermore, a total of N5.90 trillion (27.00% of the total budget) was earmarked for capital expenditure, an increase of 7.86% from N5.47 trillion estimated for 2022.

On the revenue front, oil revenue is estimated at N1.92 trillion (20.00% of the total revenue), a significant decline of 42.86% compared to N3.36 trillion for 2022. Meanwhile, non-oil revenue was projected at N7.81 trillion (80.00% of the total revenue) for 2023.

In addition, a few assumptions were laid out which includes, oil price benchmark of $75.00 per barrel, oil production benchmark of 1.69 million barrels per day, exchange rate target of N435.57/$, inflation target of 17.16% and GDP growth rate of 3.75%. For us, we highlight the fact that about 55.41% of the total budget is projected to be funded with borrowed funds, while revenue is expected to fund just 44.59%, implying that for 2023, the federal government would need more borrowed funds than the revenue it can generate to meet its obligations.

Therefore, considering the historical trend of gross underperformance in revenue actualization, we posit that the actual deficit will overshoot the proposed N12.09 trillion, inevitably leading to further worsening of its debt status. Our postulation of a continued shortfall in revenue for 2023 is primarily hinged on the unrealistic oil production benchmark of 1.69 million barrels per day (bpd), considering that in 2022 oil production performed abysmally. For clarity, average oil production printed at an all-time low of 1.37 million bpd in 2023 (Q1-Q3) according to the National Bureau of Statistics (NBS) and according to the Nigerian Upstream Regulatory Commission (NURPC), Nigeria losses about 100kbpd to oil theft. Whilst we are very much optimistic of a good turnout for non-oil revenues in line with the expected implementation of the 2022 Finance Act, we opine that oil revenues will likely remain subdued, albeit at a slower pace compared to 2020 & 2021 on the back of efforts by the FG to clampdown on oil theft and pipeline vandalism.



Source: Ministry of Finance, Budget and National Planning, Budget Office of the Federation, Investment One Research

Thus, we expect to see the debt service to revenue ratio print higher than the estimated 68.00% as well as a sizeable jump in the nation's debt stock, which currently stands at N44.06 trillion (excluding the Ways and Means advance of about N22.00 trillion from the CBN) as at Q3 2022. To avert a worsening fiscal state, we opine that the Federal Government should intensify its efforts towards improving its revenue base, particularly with respect to the oil sector, embrace public-private partnerships, be more intentional about attracting foreign investors with the enactment of the right policies so as to reduce the heavy dependence on debt funding and toe the path of fiscal responsibility through the blockage of fiscal leakages vis-a-vis curtailing governance cost, without which the fiscal sustainability tag of the budget would be a mirage.

Breakdown of FGN 2023 Proposed Budget (N'trillion)

Budget Line Items	2023 (Estimates)	2022 (Revised)
Aggregate Revenue	9.73	9.97
Oil Revenue	1.92	2.19
Non-Oil Revenue	2.40	2.26
Other Revenues	5.4	5.32
Aggregate Expenditure	21.82	17.32
Non-Debt Recurrent	8.30	7.11
Debt Service	6.60	3.98
Capital Expenditure	5.90	5.42
Fiscal Deficit	12.09	7.35
Fiscal Deficit (% of GDP)	5.38	3.10

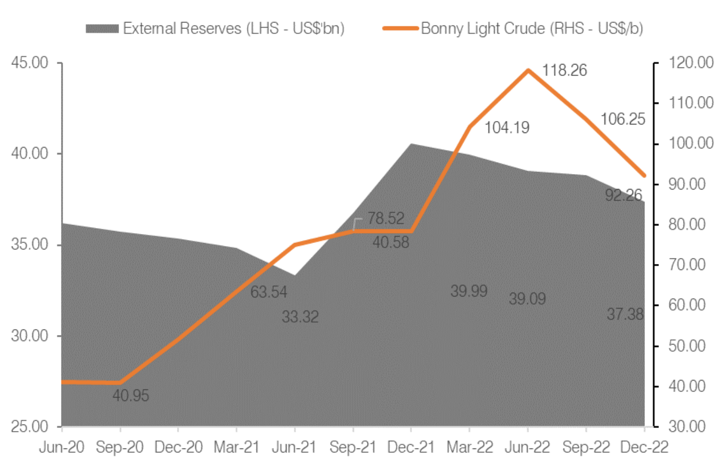
Source: Budget Office, Investment One Research

Unrelenting Pressure on the Naira

In 2022, the higher oil price but low reserves conundrum continued to torment the local currency. As such, the pressure on the exchange rate intensified buoyed by the low accretion to reserves. Despite Brent trading at multi-year high, the impact on foreign reserves was limited given the country's low production and elevated subsidy payments. Resultantly, FX reserves declined by 8.93% to close at $36.96 billion as at FY 2022.

In a bid to reduce the pressure on the Naira, the CBN introduced the RT200 non-oil export proceed repatriation rebate scheme to enhance FX inflow, diversify the sources of foreign inflow, increase the contribution of non-oil exports, ensure stability and sustainability of FX inflows, and support oriented companies to expand their export operations and capabilities. The rebate scheme rewarded exporters with the payment of N65 for every US$1 repatriated and sold at the IEFX Window to Authorized Dealer Banks (ADBs) for other third-party use, and N35 for every US$1 repatriated and sold into IEFX for eligible transactions only.

FX Reserves Position viz-a-viz Crude Oil Prices

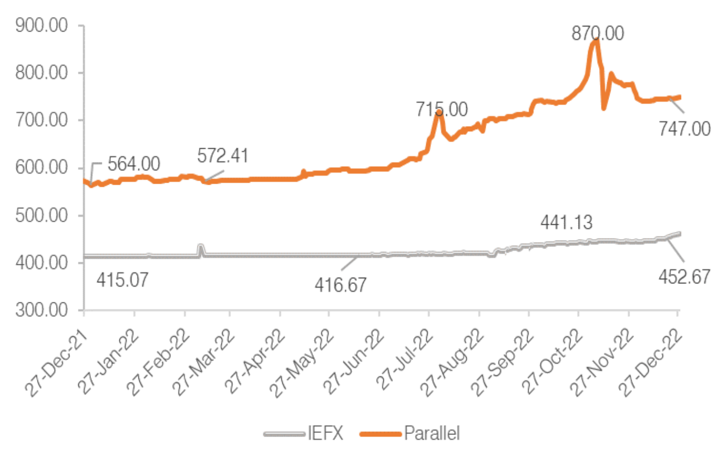


Source: CBN, Investment One Research

Consequently, the incentive was positive at the IEFX window as inflows from exporters rose to US$4.93 billion as at FY 2022, 117.18% higher than the US$2.27 billion recorded in FY 2021. On the flip side, CBN's participation and FPI inflows via the IEFX window recorded lower activities as it crashed by 50.58% and 53.45% to $2.08 billion and $1.28 billion, respectively.

At the IEFX window, Naira continued to lose value against the USD, as it depreciated by 3.79% to close at N451.50/$ against the backdrop of declining reserves, low foreign portfolio inflows and diaspora remittances. In the same vein, the tight liquidity conditions driven by little or no supply with expanding demand, political activities and speculative demand drove the black-market rate to new lows. We highlight that the pressure on the Naira at the black market worsened as the CBN's decision to redesign the Naira notes in a short timeframe triggered intense speculation, and a switch to the greenback by some currency hoarders. As such, the scarcity in the FX market intensified, with the Naira plummeting to N800/$ during the year. As a store of value, the market seems to have lost confidence in the currency thus, exacerbating the rotation from local assets to foreign assets. Overall, Naira depreciated at the black market by 42.31% to close at N750.00/$. Resultantly, the spread between the official and black market widened and oscillated within the range of N300.

Depreciation across FX segments



Source: CBN, Investment One Research

Outlook: No Respite for the Naira

In 2023, a combination of limited inflows from crude oil sales, fragile capital flows and foreign remittances, would continue to hurt the Naira.

While the rising oil production volume is slightly positive for oil earnings and by extension, the reserves, we still think that crude oil production of less than 2.00million barrels is unlikely to significantly move the needle on exchange rate. In addition, elevated subsidy payments should curtail oil inflows, albeit the likely suspension of this cost at the 2nd half of the year should be positive for the reserves.

With yields expected to remain elevated in the global economy, the return of foreign portfolio investors seems remote until risk adjusted returns becomes attractive. More so, the weak macro backdrop and lack of flexibility in exchange rate management remain a headwind for capital flows. With the likelihood of Eurobond borrowing slim, the possibility of an influx of the greenback to support the Naira looks unrealistic. However, the continual success of the RT200 FX scheme is a tailwind for the currency at the official market.

While the nation's FX reserves may proffer support for the currency, we highlight that the CBN will continue to allow the Naira to weaken to c. N480/$ - ₦490.00/$ at the IEFX window during the year to aid marginal improvement in balance of payment. As such, we opine that we might not see a devaluation in the Naira beyond that level.

At the parallel market, we expect pressures to persist on the back of tight dollar liquidity and speculative demand. However, we believe remittances might provide a respite but not enough to quell the pressure on the exchange rate. Regardless, we do not dismiss the ability of the CBN to use unorthodox means to shore up the currency, just like they did with the Naira for dollar scheme and RT200 FX rebate scheme.

Elsewhere, the $500 million Eurobond maturity due in July should further strain the nation's reserves.

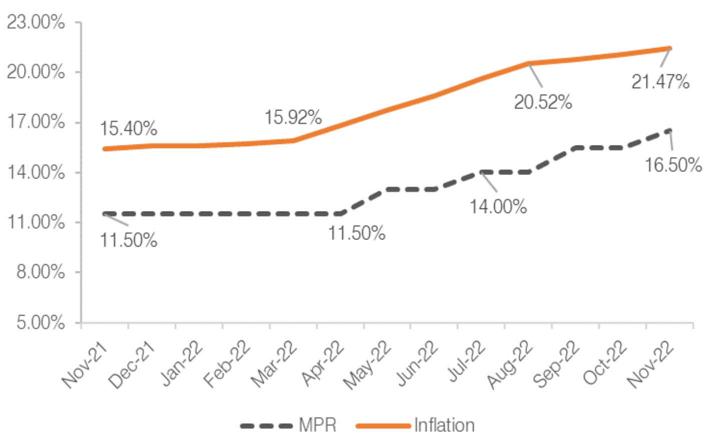
On the positive side, the commencement of operations at Dangote Refinery, slated for 2023, may bode positively for the economy given potential FX savings and inflows.

When we factor in the new administration, it is hard to envisage a dramatic shift in approach to foreign exchange management, say to introduce a floating exchange rate regime. Also, Governor Emefiele's tenure will come to an end in June 2024, so we do not see any change in FX management. However, if he is removed by legislature and another Governor is appointed, an appreciation in the currency is likely as the market would price in the end of unorthodox policies.

Restrictive Monetary Stance

In 2022, the apex bank switched to restrictive monetary stance as the unabating inflationary pressures, tightening in global financial conditions and the pass-through effect of the geopolitical tensions amidst others triggered the need to increase rates. In total, the monetary policy committee (MPC) cumulatively raised rates by 500bps during the year to 16.50%, the highest policy rate in about two decades. In addition, the MPC further increased the Cash Reserve Ratio by 500bps to 32.50% while maintaining the asymmetric corridor of +100/-700 basis points around the MPR; and cash reserve ratio at 27.50%.

MPR vs Inflation



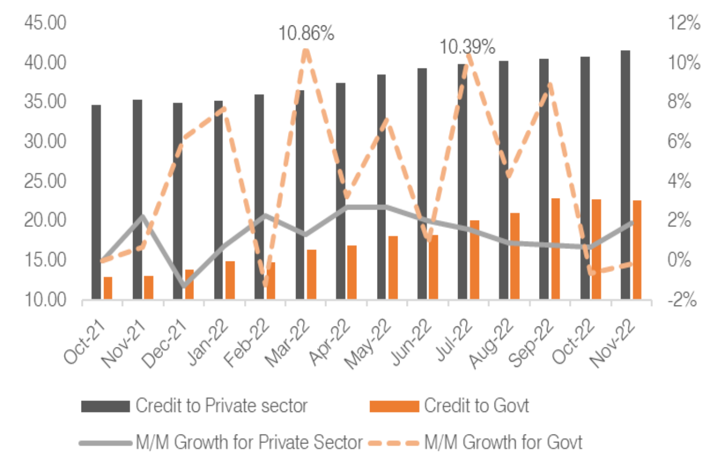
Source: CBN, NBS, Investment One Research

FGN Continues to Plug Budget Shortfall with the Ways and Means

Despite restrictive monetary policies, liquidity remained buoyant in the market as broad money (M3) and narrow Money (M1) aggregates rose at annualized rates of 20.83% and 18.02% to N21.50 trillion and N51.79 trillion respectively as at November 2022. Elsewhere, we highlight that the government continued to utilize financing from CBN to plug fiscal deficit as credit to government ballooned by 69.36%% to N22.64 trillion as at November 2022. We believe that the government crowded out private sector investments amid rising rates and utilization of the CBN deficit financing, thus lending to the private sector slowed to 19.07% to N41.58 trillion (as at 11M 2022).

To securitize the Ways and Means, the president approved the conversion of the N22.00 trillion borrowing to 40-year bond at an interest rate of 9%, which would be included in the government debt profile, subject to the approval of other relevant bodies such as the FEC and the national assembly. However, the senate rejected the restructuring of the government borrowings from CBN.

Credit to the Private Sector and Government (N''trillion)



Source: CBN, Investment One Research

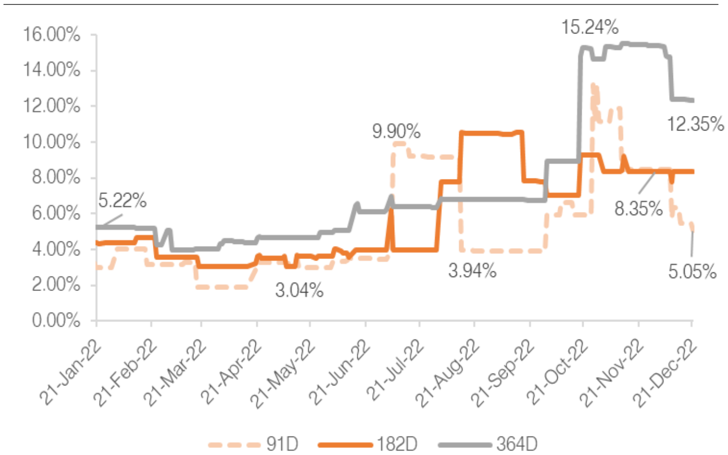
Expensive Borrowing from the Eurobond Market

During the year, the Federal Government accessed the international debt market and raised $1.25billion at a steep yield of 8.38% for a 7yr maturity. Given the hike in rates in developed economies, this rate was priced higher than the 6.13% offered on the same tenor at the last Eurobond issuance in 2021. The proceeds of the issuance were channeled towards financing critical capital projects in the 2022 budget to bridge the deficit gap in infrastructure and strengthen economic recovery.

Yields Trend North

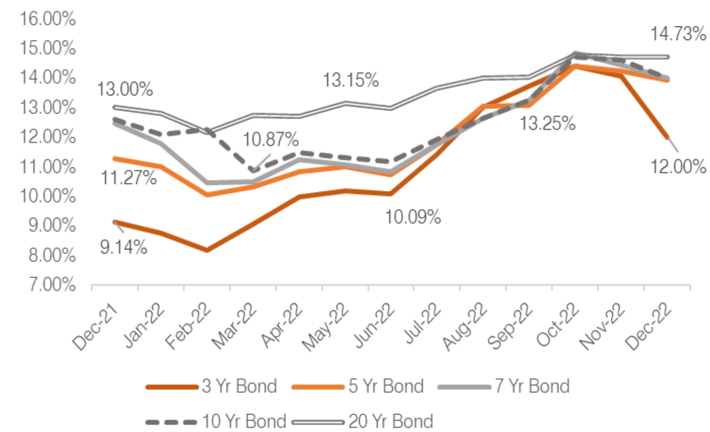
Contrary to our expectations of rising stop rates at the beginning of the year, rates trended downwards in Q1 2022. The downward trajectory in stop rates was driven by elevated liquidity in the system given the huge OMO and bond maturities and expiration of the tax waiver granted to financial instruments (ex FG Issued Bonds). Consequently, investors were mandated to pay income tax on corporate bonds and short-term securities. Given the waiver on FGN bonds, government bonds on the short end of the curve were attractive for investors (compared to buying short term securities i.e., treasury bills). Resultantly, the fixed income market in the first quarter of the year was characterized by bullish momentum and sustained decline in yields on FI instruments in the secondary market. However, in Q2, we saw a reversal in the bullish momentum against the backdrop of tightened liquidity conditions, expanding fiscal deficit and increased supply of instruments as evidenced by the DMO calendar (N225billion vs N150billion per month). Although we expected a sharp rise in stop rates/yields in the 2nd quarter given the huge fiscal deficit, we witnessed a tepid/gradual movement in rates as the DMO controlled borrowing cost while sustaining investors interest at the long end.

The Direction was UP in the Treasury Bills Space



Source: CBN,, Investment One Research

Northward Movement in Yield in the Bond Market



Source: CBN,, Investment One Research

Initially, the impact of the surprise hike in MPC rate was short lived as yields moved in mixed directions in the secondary market. However, amid sustained aggressive stance of the apex bank in H1 2022, we saw yields expand in tandem with rising rates at the primary market.

On a y/y basis, yields for the 91-day, 182-day and 364-day treasury bill increased to 5.93%, 5.57% and 8.29% respectively in December 2022 - higher than 3.82%, 4.32% and 5.24% respectively in December 2021. Similarly, the bond market witnessed upward retracement as yields settled at 13.93%, 13.99% and 13.85% y/y respectively (higher than 11.27%, 12.60% and 13.00% y/y as of December 2020) for the 5year, 10year and 20years benchmark bonds, even as the DMO borrowed N3.06trillion in 2022 – compared to N2.71 trillion in 2021.

Outlook: Tepid Rise in Interest Rates

The 1st half of the year should be mired with political events and subdued economic activities. We envision an investment climate (before the election and swearing in activities) that would be characterized with volatility amid domestic political risk and global concerns.

In the fixed income space, we expect interest rates to remain elevated on the back of higher inflation expectations, restrictive stance of global monetary authorities and our apex bank, election uncertainties/ outcome and the steep borrowing plans of the fiscal authorities. While liquidity levels will determine the direction of yields, our base case scenario is for a tepid rise in interest rates.

Just like we opined in our global outlook, a cut in interest rates seems unlikely as the FED continues to tame inflation to its target level, thus we expect global financial conditions to remain tight, albeit not as aggressive as what we saw in 2022. With financial conditions tight, access to the foreign market remain limited thus, the possibility of a Eurobond issuance looks slim as it would come with a steep cost. Ultimately, the fiscal authorities will most likely rely on local borrowings, bilateral and multilateral organisations to fund the budget deficit.

Monetary Policy To Remain Tight

Given heightened inflationary pressures in the economy, we expect monetary policy to remain restrictive with rate hikes of c. 50 – 100bps during the year. Admittedly, we see a pause to a slower pace in rate hikes as the apex bank assess the efficacy of the previous rate hikes on the economy given that monetary policy transmission mechanism works with a lag. A loosening stance by the apex bank in 2023 is unlikely as it could undo gains achieved through tightening and impact inflation negatively.

Liquidity Conditions Supports a Slight Tilt in Rates

Considering the demand side, liquidity conditions should be supportive especially in H1 of the year due to coupon inflows of N970.69 billion and bond maturities of N735.96 billion respectively. As such, we believe that this should be a headwind to a jump in interest rates.

Rates Should Remain Largely Controlled by the DMO, despite the Huge Fiscal Deficit

On the supply side, we believe that the projected fiscal deficit should overshoot, considering the typical underperformance of revenue. The projected fiscal deficit of N12.09 trillion would be majorly financed with local borrowings of N8.80 trillion – 40.80% higher 2022F, multilateral/bilateral loan drawdowns (NGN1.77 trillion) and privatisation proceeds (NGN206.18 billion). We see a strong possibility of the DMO frontloading these issuances early in the year due to supportive liquidity conditions in H1 2023. However, if history is to repeat itself, the supportive liquidity condition should cap any significant spike in interest rates.

Just like what we saw in 2022, the government controlled borrowing cost despite thin liquidity levels. The spike in interest rates we saw in H2 22 was in reaction to tightening by the monetary authorities, although it started to wear off as at the last large rate hike in December 2022. We think that the government might be able to replicate same despite the huge supply of bonds in its arsenal, thus putting a lid on a jump in interest rates.

Post Election Debt Management

Elsewhere, the outcome of the presidential election will provide direction on fiscal consolidation, albeit we do not expect significant changes in debt management. Although, a key factor to look out for is the securitization of the Ways and Means (N22.67trn as at Oct 2022) and if the government will completely pivot from utilizing credit from the CBN. A sharp rise in interest rates should materialize if the government significantly reduces its reliance on borrowings from the apex bank.

Assessing both the demand and supply dynamics suggests that fixed income investments in 2023 will remain volatile as interest rates fluctuates in either direction. However, our bias is tilted towards a decline in yields in the first half of the year with occasional upward pressure as liquidity levels determine the direction of rates. In the second half, we might see northward repricing in yields. Overall, we expect to see limited rise in rates for FY 2023, barring any major disruption in the market.

Defying the Odds

The Nigerian equities market staged a bullish performance for the year 2022, as the All-Share Index ended the year at 19.98%. This marked the third consecutive year-on-year gain (2020: +50.03%, 2021: +6.07%). Suffice to say that the positive momentum recorded in 2022, came above market expectations given a couple of hurdles that surfaced in the course of the year; from record-high inflation to aggressive hawkish moves of the apex bank, dampened macros, and notably, the sprouting election jitters. Although the market appeared to have had a smooth ride in the first half of the year, the intense sell-offs seen at the beginning of H2 fuelled expectations of a mixed bag performance for the full year 2022, but the market closed on a higher-than-expected positive footing.

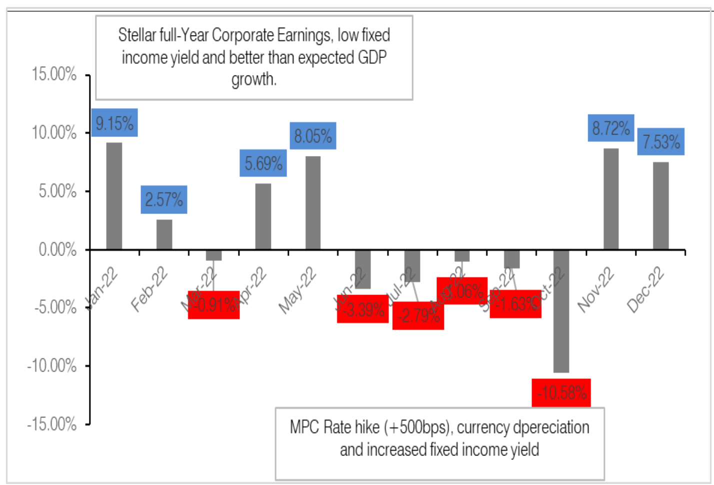
From a quarterly perspective, the local bourse kicked off the year on a strong note, recording a positive performance of 9.95% in the quarter (January: +9.15%, February: +2.25%, and March: -0.77%). The bullish performance can largely be attributed to investors' sentiments driven by corporate actions and impressive earnings releases coupled with unattractive rates in the fixed income space. Notably, BUAFOODS, a consolidation of five food businesses (pasta, edible oil, sugar, rice, and flour), was listed by introduction on the exchange, with a total of 18 billion ordinary shares admitted to trading at N40 per unit and a market capitalization of N720 billion. Upon listing, the stock joined the top 10 most capitalized companies in addition to being the second most capitalized consumer goods company on the exchange. Also, Dangote Cement Plc's tranche 2 share buy-back at the average price of N276.89 and the significant buy-interests in AIRTELAFRI and MTNN upon receipt of their Payment Service Bank licenses buoyed sentiment.

In the second quarter, positive momentum boosted further as the bourse gained 10.28% (April: +5.69%, May: +8.05%, and June: -3.39%). Despite the aggressive hawkish move by the CBN, which started with a 150bps hike in the monetary policy rate in May to begin its fight against inflation, the stellar first quarter earnings recorded by corporates and tepid yield movement in the fixed income space remained the primary drivers for the upbeat performance in Q2.

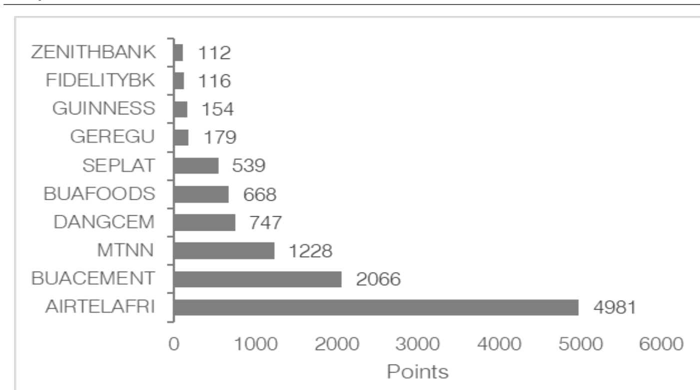
Notably, the benchmark index hit a multi-year high of 54,000pts with bellwether names such as DANGCEM, MTNN, and AIRTELAFRI hitting all-time highs on the back of investors' bargain-hunting. We highlight that as of H1 2022, the local bourse recorded the second-best performing stock market in the world as the spill over effect of the Russian-Ukraine tensions and monetary policy normalization in advanced economies spurred risk-off sentiments across the globe.

However, tides turned in Q3 and the bears trooped in to gain dominance. In details, the bourse closed negatively for the quarter by 5.53% (-2.79%, -1.06%, and -1.30% for July, August, and September, respectively). This represented the first and only quarterly decline for the year as investors (both retail and institutional) shifted their focus to the fixed income market as yields became more attractive in tandem with the hawkish moves of the apex bank as we saw another 250bps hike in rates (100bps in July and 150bps in

Equities Market Monthly Return



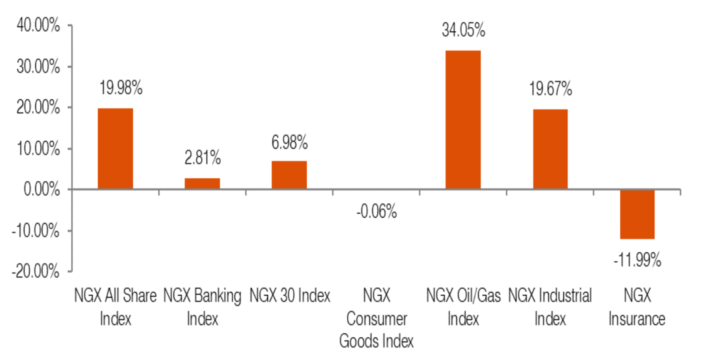
Top Market Movers in 2022



Source: NGX, Bloomberg, Investment One Research

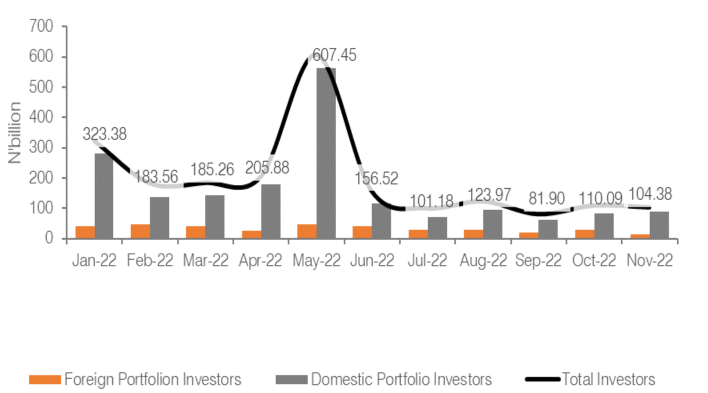
On a final note, in Q4, the bourse rebounded by 4.54% after the market recorded its fifth consecutive monthly loss in October (-10.58%). Despite the additional 100bps hike in rates at the last MPC meeting for the year, sentiment was upbeat on the back of investors cherry picking specific bellwether names, particularly in the telecoms, banking, and industrial sectors. Furthermore, early positioning by alpha-seeking investors on dividend-paying names as dividend yields became more appealing, as well as possible year-end portfolio rebalancing by asset and portfolio managers.

Sectorial Performances in 2022



Source: NGX,, Investment One Research

Foreign Apathy Lingers



Source: NGX,, Investment One Research

Outlook: Cautiously Optimistic Despite Headwinds

In 2023, we expect the positive momentum for the past three years to be sustained albeit at a moderate pace. A major catalyzing factor is the bullish sentiment expected in Q1 to be buoyed by investors positioning ahead of 2022 full-year corporate disclosures and possible re-investment of dividends earned. Notably, another eventful factor that should buoy sentiments in the market is Dangote Cement Plc's share buyback of up to 1,687,355,925 (10%) of its issued shares which has been unanimously approved by the shareholders at the last Extra-ordinary General Meeting (EGM) held in December 2022.

Further into the year, the direction of market performance will be largely determined by the trio impact of fixed income yields in tandem with monetary policy, corporate actions, and election turnouts.

Ditto to our outlook of tepid movement in yields in the fixed income space and expectations of a less aggressive hawkish tone from the CBN, negative real returns should remain relatively high in the fixed income space giving room for alpha-seeking investors diverting more funds to equities as it remains a solid channel for positive real returns.

For Corporate earnings, we are cautiously optimistic of a positive earnings performance in 2023 given the negative impact of high inflation pressures, increased monetary policy tightening and FX instability. Although we expect a broad-based resilient performance, we do not see a significantly upbeat performance as the aforementioned factors remain deterrents.

Will Election Fears Pose a Downside Risk?

Absolutely, election jitters and heightened political risk in 2023 are key factors that will influence investors' sentiments towards the equities market, particularly considering that it is an election that would herald a change of the presidential baton. Considering the "do or die" nature of election affairs in Nigeria and the instability that comes with policy enactments and reforms as well as the uncertainty of a peaceful post-election season, equity investors tend to take a standoffish position towards the market as they take flight to safe havens. We highlight that the last three election years ended on a negative note for the market (2019: -14.60%, 2015: -17.36% and 2011: -16.31%) owing to the significant participation of foreign investors and the negative sentiments exhibited towards election seasons as propelled by the aforementioned factors. It is worthy of note that foreign investors' participation in the local bourse was quite significant over these periods, printing at 49.00%, 54.00% and 66.00% for 2019, 2015, and 2011, respectively, while as of November 2022, foreign investors only constitute 17.00% of total market participation. For us, we think the change in structure with respect to investor participation will bode well for market performance, mitigating any significant potential downside risk from the electioneering process.

Post-election, barring any heated tensions from the election with respect to who clinches the presidential seat, we expect to see a positive turnout in the bourse on the back of our opinion of the three major candidates being pro-market. Thus, economic policies that will likely ensue from the new administration will put the economy on a positive trajectory and buoy in-

Base Case Factors
1. Neutral Corporate Earnings Performance
2. Tepid Movement in Fixed Income Yields.
3. Positive Election Turnouts
4. Stable Economic Growth

Bull Case Factors
1. Better than Expected Corporate Earnings Performance
2. Significant Drop in Fixed Income Yields.
3. Positive Election Turnouts
4. Positive Economic Growth

Bear Case Factors
1. Lackluster Corporate Earnings Performance
2. Spike in Fixed Income Yields.
3. Negative Election Turnouts
4. Negative Economic Growth

Scenario Analysis	Market Return
Base Case	+5.06%
Bear Case	-12.07%
Bull Case	+25.36%

Equities Market Monthly Return Since 2000

	January	February	March	April	May	June	July	August	September	October	November	December
2000	9.24%	3.53%	0.18%	-1.23%	3.44%	6.09%	6.71%	7.15%	-1.29%	1.60%	-3.69%	13.58%
2001	8.42%	4.39%	-0.23%	4.71%	5.86%	7.72%	-3.30%	-2.34%	-0.53%	7.95%	0.70%	-1.85%
2002	-2.86%	-0.64%	5.98%	1.65%	0.76%	8.31%	0.14%	-1.05%	-4.19%	-4.00%	2.50%	4.43%
2003	9.57%	2.78%	-0.46%	-0.86%	4.44%	3.14%	-3.90%	10.49%	6.17%	14.44%	3.07%	4.02%
2004	13.03%	9.18%	-7.67%	13.27%	6.92%	4.17%	-6.32%	-12.15%	-4.55%	2.73%	3.07%	0.10%
2005	-0.94%	-4.86%	-5.79%	6.19%	-2.59%	0.80%	1.61%	2.12%	10.10%	5.02%	-5.87%	-1.78%
2006	-1.01%	1.16%	-2.58%	-0.15%	6.20%	5.72%	6.57%	18.71%	-1.64%	0.27%	-3.10%	4.92%
2007	10.83%	10.73%	6.69%	8.44%	4.32%	4.42%	3.29%	-6.15%	0.94%	-0.05%	7.94%	7.01%
2008	1.00%	11.11%	-2.96%	-5.87%	-0.86%	-5.06%	-3.67%	-10.02%	-3.29%	-21.40%	-9.08%	-4.78%
2009	-30.63%	7.17%	-15.08%	7.56%	39.09%	-11.62%	-3.67%	-9.01%	-4.10%	-1.18%	-3.64%	-0.87%
2010	8.49%	1.73%	-5.36%	1.88%	-1.02%	-2.96%	1.86%	-6.17%	-5.07%	8.64%	-1.11%	0.02%
2011	8.32%	-3.03%	-5.36%	1.71%	3.29%	-3.43%	-4.62%	-9.78%	-5.23%	2.76%	-4.45%	3.64%
2012	0.70%	-3.60%	2.63%	7.06%	-0.20%	-2.12%	6.77%	2.99%	9.52%	1.61%	0.24%	5.98%
2013	13.44%	3.84%	1.39%	-0.29%	13.02%	-4.31%	4.84%	-4.39%	0.93%	2.84%	3.45%	6.19%
2014	-1.83%	-2.50%	-2.05%	-0.68%	7.77%	2.43%	-0.91%	-1.34%	-0.78%	-8.88%	-8.01%	0.33%
2015	-14.70%	1.83%	5.48%	9.31%	-1.15%	-2.49%	-9.79%	-1.64%	5.16%	-6.49%	-6.18%	4.59%
2016	-16.50%	2.74%	2.99%	-0.96%	10.41%	6.96%	-5.36%	-1.47%	2.67%	-3.94%	-7.27%	6.47%
2017	-3.12%	-2.72%	0.74%	0.98%	14.48%	12.27%	8.24%	-0.96%	-0.18%	3.50%	3.45%	0.79%
2018	15.95%	-2.28%	-4.21%	-0.57%	-7.67%	0.46%	-3.29%	-5.86%	-5.97%	-0.92%	-4.90%	1.80%
2019	-2.78%	3.81%	-2.14%	-6.06%	6.55%	-3.55%	-7.50%	-0.69%	0.38%	-4.60%	2.44%	-0.59%
2020	7.46%	-9.11%	-18.75%	8.08%	9.76%	-3.12%	0.88%	2.57%	5.96%	13.76%	14.78%	14.92%
2021	5.32%	-6.16%	-1.90%	2.04%	-3.52%	-1.38%	1.69%	1.74%	2.55%	4.52%	2.88%	-1.23%
2022	9.15%	2.57%	-0.91%	5.69%	8.05%	-3.39%	-2.79%	-1.06%	-1.63%	-10.58%	8.72%	7.53%

Source: NGX, Bloomberg, Investment One Research

Our Expectations Based on The Presidential Candidates' Manifesto

If Atiku Abubakar Wins,

- Business-friendly policies with a focus to attract foreign capital inflows and boost GDP growth.
- Privatisation of moribund governments unproductive and inefficient public assets.
- Increased public-private partnership- with respect to infrastructural development.
- Boost Investors Sentiment towards the equities market.
- Stem Insecurity Woes

If Peter Obi Wins,

- Impressive decline in governance cost and improved fiscal conditions in the long run.
- Increased infrastructural spending, particularly towards education, health, transportation and technology.
- Enactment of policies favourable to the business and investment climate.
- The push to eradicate petrol subsidy, albeit to be deterred by labour forces.
- Tackle the menace of heightened Insecurity
- Foster unity through tapering of ethnic-religious segregation.

If Tinubu Asiwaju Wins,

- Increased infrastructural spending.
- Steady improvement in revenue generation given his antecedent as former governor of Lagos state.
- Gradual decline in unemployment rate on jobs that would be created from infrastructural spending and development.
- A revival of the agricultural sector; this should increase the sector's contribution to the GDP and improve export earnings.
- Tackle inflation by dealing with the supply side factors (particularly food security) and this should reduce the burden on the monetary policy authorities.

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Address:

Investment Management & Research

INVESTMENT ONE Financial Services Limited

37, Kofo Abayomi Street,

Victoria Island, Lagos.

Nigeria

Email: research@investment-one.com

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