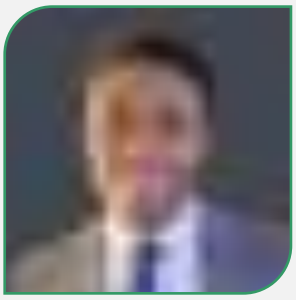
MERISTEM

DARK CLOUDS ON THE HORIZON

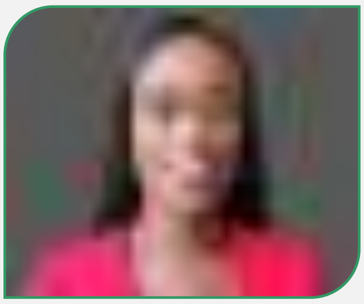
...Any Silver Lining?

The Team



Damilare Ojo, CFA, AFM
damilareojo@meristemng.com

Team Lead,
Investment Research



Praise Ihansekhien, ACCA
praiseihansekhien@meristemng.com

Deputy Team Lead
Macros, Healthcare

Samuel Banmeke, FMVA
samuelbanmeke@meristemng.com

Fixed Income,
Insurance & Industrial Goods

Abdullateef Grillo
abdullateefgrillo@meristemng.com

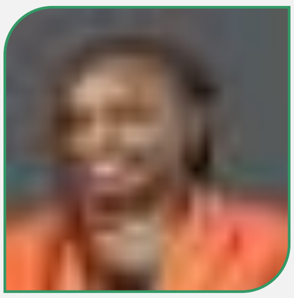
Equities, Telecoms

Juliana Ogunkoya
julianaogunkoya@meristemng.com

Fixed Income, Consumer Goods &
Breweries

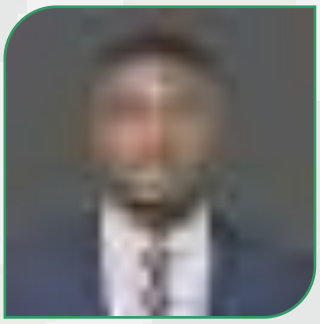
Sodiq Safiriyu, ACA
sodiqsafiriyu@meristemng.com

Fixed Income, Banking



Bolade Agboola
boladeagboola@meristemng.com

Macros, Energy



Moshood Kazeem
kazeemmoshood@meristemng.com

Equities, Banking

Ayomide Salami, ACA
rilwanatsalami@meristemng.com

Macros, Agriculture &
Breweries

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Lower Growth Prospect but Inflationary Pressure to Subside

The outlook for global growth in 2023 is moderate, with a third of the world economy expected to experience a technical recession. While some economies, particularly U.S.A, might escape a recession, some others, like the U.K., might not be able to prevent it. Following decade-high inflation, global monetary policy was hawkish in 2022. In 2023, a gradual monetary pivoting is expected, but inflation is not likely to fall to the 2% target until at least 2024. Meanwhile, asides any other unforeseen shocks to the global economy, the prevention of a new wave of Covid-19 as well as the path of the Eastern European crisis are critical themes to watch out for in 2023.

Sub Saharan Africa 22

Rising Pressure on Public Finance

In addition to existing macroeconomic challenges, including slow economic growth outlook, high and rising inflation, as well as currency weakening, public finance has been under pressure in many SSA countries. This has, in turn, raised concerns about debt sustainability which we think might worsen in 2023 especially given the exogeneous risks being faced.

Domestic Economy 27

Slower Growth, Higher Inflation, Debt Sustainability, and Politics

The consensus expectation is for Nigeria's real GDP growth to be slower in 2023. Inflation is expected to remain elevated in light of the lingering fuel scarcity and the expected phased fuel subsidy removal. Thus, we see a possibility of an additional 200bps hike in the MPR. Elsewhere, a rising concern is on debt sustainability which we think might trigger another downgrade in the country's credit rating. Meanwhile, the President has signed the 2023 Appropriation Act – budget size of NGN21.83trn - into law, with a deficit of NGN10.78trn which would be financed mainly through local borrowing, further worsening the debt sustainability metrics. Meanwhile, much on the domestic scene depends on the policy initiatives of who wins the 2023 Presidential election.

Domestic Equities Market 48

Modest Outlook for the Local Bourse

After gaining c. 20% in 2022 (2% below our forecast of 22%), our model predicts a return of 10.50% for the equities market in 2023. This is a cautiously optimistic outlook as the macroeconomic environment is expected to pose some challenges for corporates.

Domestic Fixed Income Market 75

Higher Yield Expected Amid Some Volatility

While some volatility is expected, our outlook is for higher yields in 2023. This is premised on the expected huge borrowing by the FGN to finance the 2023 budget deficit and the expected hike in the MPR. However, there are risks to this outlook.

Investment Strategy 80

Based on our expected dividend yield and potential capital gains, we have handpicked stocks with a potential to maximise return. For fixed-income instruments, we recommend a duration management strategy with a tilt towards short duration instruments premised on our view of the direction of yields in 2023.

Alternative Investments 86

Executive Summary

The themes that shaped the global scene in 2022 were predominantly the Russia-Ukraine war, its push on commodities prices, and its impact on price levels. With shortage of gas supply from Russia especially in Europe, inflation rate rose to decade-high in various countries. As a result, monetary policy authorities have not been sparing in their move to fight rising prices, hiking rates aggressively. From various indications including gradually abating inflation and monetary policy tones, monetary pivoting is underway. Nonetheless, the effect of the accumulated rate hikes is expected to lead to a slowdown in some economies, including China which is still battling with Covid-19 cases and the property sector crisis.

In the face of the risks to the global economy in 2023, the IMF has lowered its growth forecast for SSA to 3.70% from 4.00%. Generally, weakening currency amid rising inflation has triggered more capital outflow in addition to many SSA countries being unable to tap the Eurobond market in 2022. More so, public debt has come under severe pressure, triggering rounds of credit rating downgrades. These pressures are expected to remain in 2023.

Nigeria's real Gross Domestic Product (GDP) sustained an upbeat in 2022, expanding by 2.25% YoY in Q3:2022. The oil sector maintained a slide, owing to familiar issues of oil theft and pipeline vandalism. The non-oil sector has been the driver of the country's output. We expect growth to slowdown in 2023 as the effects of the recent flooding will be felt in the agricultural sector, and the monetary policy tightness would slow the real sector.

Throughout 2022, Nigeria's inflation rate maintained an upward trend, reaching a 17-year peak of 21.47% in November 2022 due to persistent fuel scarcity, fluctuation in the NGN/USD exchange rate, and natural disaster, in addition to the effect of imported inflation and persistent domestic structural challenges. In turn, the Monetary Policy Committee (MPC) raised the Monetary Policy Rate (MPR) accumulatively by 500bps to 16.50% and also raised the Cash Reserve Ratio (CRR) by 500bps to 32.50%. Additionally, the Central Bank of Nigeria (CBN) has moved to reduce the amount of money outside of the banking system by mopping up the old currency notes while concurrently redesigning the Naira note.

The equities market had a rather divergent two-halves in 2022, although overall, it had a positive outing. We are optimistic, although cautiously, about gains in 2023 hinged on good corporate performance and dividend prospect. Also, relative undervaluation presents a buying opportunity for investors with long term objectives.

The sudden turn in monetary policy direction around mid-2022 propelled fixed income yield upwards. However, yields began a downtrend at the tail-end of the year. In 2023, the outlook is for fixed income yields to increase, although at a gradual pace. The reason is due to the offsetting effects of the expected higher FGN borrowings as a result of higher budget deficit, and the expected high system liquidity from coupon payments and bond maturity, especially in the first half of the year.

Global
Economy

Global Economy

In The Throes of War: How Long Will It Continue?

The Russo-Ukrainian war upended global economic recovery prospects for 2022. For many countries around the globe, the economic crisis which ensued following the war outbreak changed the course of growth as they recorded significant disruptions to supply chain, international trade, energy supply shocks and decades-high inflation numbers. The war which has lasted for ten months has taken twists and turns as the warring parties intensify efforts and resources to emerge as winners.

In the aftermath of Russia's invasion, the US, along with its allies and partners imposed a series of financial sanctions and export controls on Russia's economy. The actions targeted Russia's economy, financial system and access to vital technology and airspace.

Table 1: US and Allied Partners' Sanctions on Russia

Category	Sanction	Russia's Response
Financial	• Restriction of the largest Russian financial institutions (SBERBANK and VTB Bank) and their subsidiaries from the U.S. financial system. • Restriction of Russia's access to US and EU's capital markets. • Ban on transactions with the Russian Central Bank, National Wealth Fund of the Russian Federation, and the Ministry of Finance of the Russian Federation. • Barring of Russian banks from SWIFT usage • Ban on provision of crypto wallets	• Partnership with China to accelerate the use of China's Cross-Border Interbank Payment System (CIPS) • Promoted the use of Sistema Peredachi Finansovykh Soobscheniy (SPFS), for domestic transaction. SPFS is Russian version of SWIFT
Energy	• Germany halted the certification of Nord stream II pipeline • Embargo on import of Russia oil and coal • Price cap on maritime transport of Russian oil and petroleum products. • Ban on export of oil refining technologies to Russia. • Ban on new investments in Russian energy and mining sector	• Demand payment in rubles for its energy exports. • Halt in gas delivery to countries that don't meet payment terms. • Ban on oil export to countries that implement price cap
Defense	• Restriction of Russian ministry of defence access to U.S. export including software, technology, and equipment • EU ban export of drone engines and other military technology to Russia.	• Import of military technology and equipment from Iran and other regional allies.
Transport	• Closure of EU's airspace and port to Russia • Ban on Russian road transport operators	
Raw Material and Goods	• Ban on export of luxury goods to Russia. • Ban on import of steel, iron, wood, cement, paper, plastics, seafoods, spirits and gold from Russia.	
Services	• Ban on provision of architectural and engineering services to Russia. • Ban on IT consultancy, legal advisory advertising, and market research services.	
Asset Freeze and Travel Ban	• The US and EU travel ban on Russia • Suspension of visa facilitation provision for Russian diplomat and businessmen.	

Humanitarian, Military and Financial Support for Ukraine

Beyond the sanctions and boycotts, monetary support for Ukraine from other countries has also been a major theme over the past ten months. According to data from Kiel Institute for World Economics (Ukraine support tracker database), EUR113.11bn in humanitarian, military and financial assistance have been committed to Ukraine by governments all around the world as of 20th November 2022.

Being one of the hardest hit by the war, the European Union is so far the most supportive of Ukraine's ongoing defensive effort, having committed EUR51.84bn, representing 45.83% of total commitments. While the United States alone has committed EUR47.82bn (42.28%).

Multilateral institutions have also rendered support to Ukraine, the World Bank Group has committed EUR7.53bn while the International Monetary Fund (IMF) has committed EUR2.17bn. Overall, Kiel Institute for World Economics reports that multilateral institutions have committed EUR11.78bn to Ukraine's defence efforts.

Chart 1: Bilateral Assistance Overview (EUR'bn)

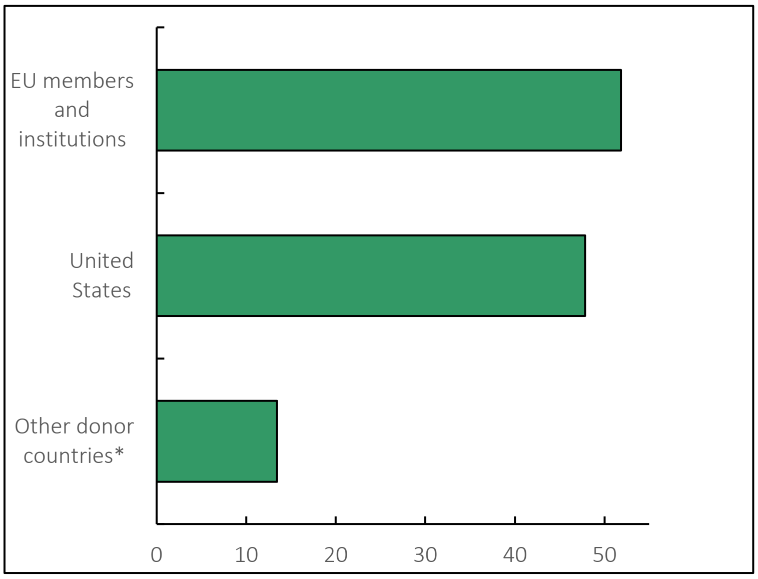
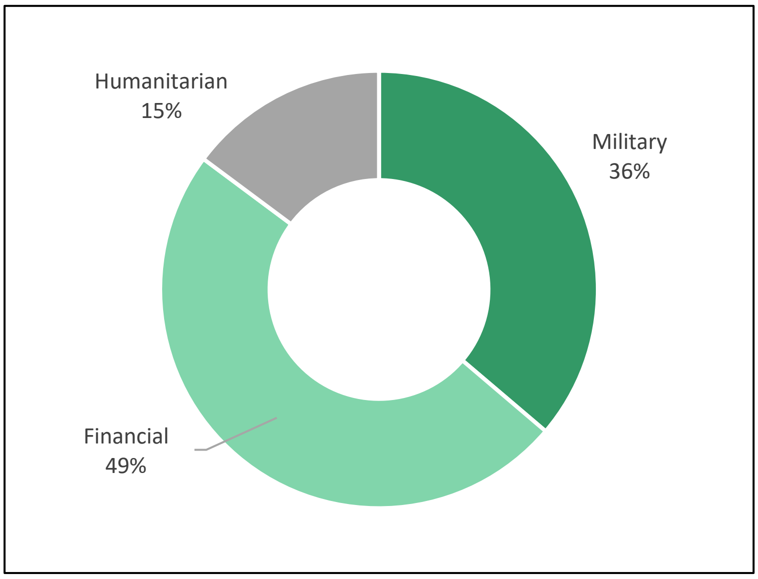


Chart 2: Forms of Financial Assistance



Source: Kiel Institute for World Economics, Bloomberg, Meristem Research

**Other donor countries include the Anglosaxon Countries (except the US), China, Japan, South Korea, Taiwan, Turkey, Norway and Switzerland and India.*

Given that Ukraine's military strength pales in comparison to Russia's, the war is being sustained largely due to military and financial aids from Western countries especially the US. Considering the geopolitical costs of losing the war to both sides, the probability of either side backing out is low. According to Russian President (Vladimir Putin), the threat of a nuclear war is rising and Russia may consider the use of nuclear weapons as a response to certain attacks. For Ukraine, the war means more casualties, given that the major battle grounds are on its soil. Thus, its determination to continue the war will be the primary factor in determining its duration.

Currently, Russia's strategy is to destroy Ukraine's energy infrastructure aiming to use the cold winter to break Ukrainians' resolve. Whether this strategy will be successful is unclear but considering recent build up of extra forces by Russia and the signing of National Defence Authorization Act (NDAA) by President Joe Biden, (which increases the amount of money allocated to the Ukraine war) as well as the promise to send advance missile system, we believe the war is far from over.

Global Growth

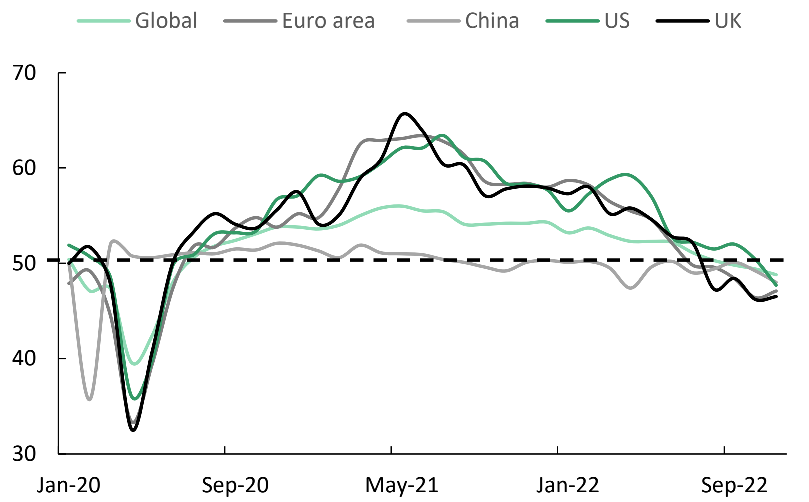
Multiple Shocks Impairing Growth Prospect

While the global economy is yet to recover from the lesion sustained during the pandemic, the emergence of multiple economic shocks reversed the initial positive economic growth prospect sustained at the start of the year.

Since the post-covid partial recovery, the global economy has been confronted with tough challenges stemming from the cost of living crisis due to elevated inflationary pressures, the Russia-Ukraine war, which has caused severe energy and commodity price shock, and the resurgence of COVID-19 cases in some parts of the world (e.g. China) resulting in further lockdown restrictions and property slump.

Furthermore, monetary authorities' action (tightening policy) to curtail the persistently-high inflation has taken a toll on global demand. The most recent Purchasing Managers' Index (PMI) further reflects the slowdown in broad economic activities and manufacturing momentum, as the global PMI has sustained a downward trend since May 2022. According to the data from S&P Global, the global PMI points settled lower at 48.80pts in November 2022 from 54.20pts recorded in the same period last year.

Chart 3: Movement in the Global Purchasing Manager's Index



Source: S&P Global, Meristem Research

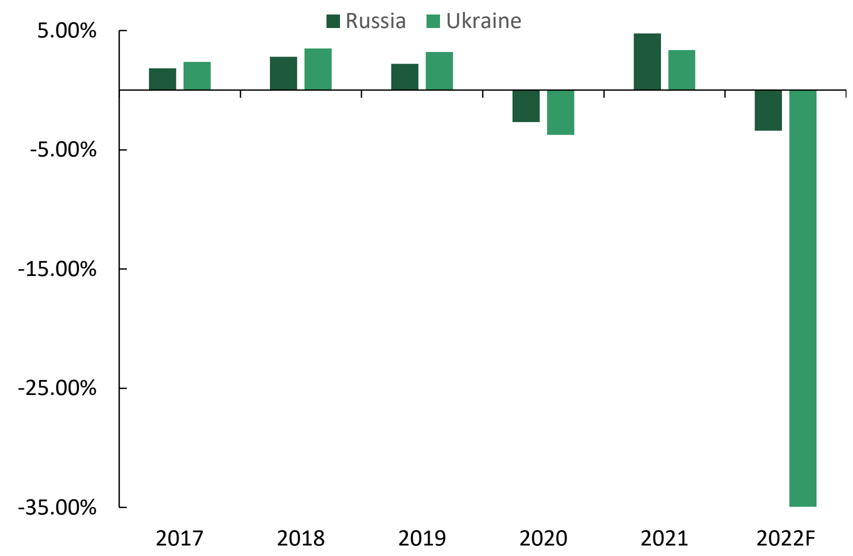
To What Extent has the Russia-Ukraine Crisis Impacted Global Growth?

As highlighted earlier, the Russia-Ukraine war has not only sparked significant societal imbalance across vulnerable regions but has led to a severe energy crunch, supply chain disruption, financial linkages, and limited availability of key commodities. The most vulnerable regions have deeply felt the economic effect of the war due to Russia and Ukraine's non-negligible role in global supply chain activities (for commodities like gas, oil, metal, corn, wheat and other grains)

Although major economies (including the US, China, Euro Zone, and America) have also felt the brunt of the rising commodity prices, the lower-income households and countries with long-term commercial ties with Russia have been more affected.

Thus, the war has degraded the global economic recovery, contributing to slower growth and triggering a further increase in inflation. As a result, Russia and Ukraine are expected to experience significant economic contraction in 2022, with growth rates projected by the IMF to settle at -3.41% and -34.95%, from 4.75% and 3.35% recorded in 2021, respectively.

Chart 4: Russia and Ukraine Growth Trajectory



Source: International Monetary Fund, Meristem Research

The GDP contraction in Russia reflects the impact of the numerous economic sanctions imposed on the nation's economy in an effort to halt the ongoing funding and protracted nature of the conflict. For Ukraine, the severe economic contraction has been a direct result of the invasion, destruction of infrastructure and displacement of its citizen.

Overall, with no sign of a resolution to the Russia-Ukraine conflict, it is anticipated that economic growth in the both countries would stagnate further in 2023 and the negative effects on the world economy will continue.

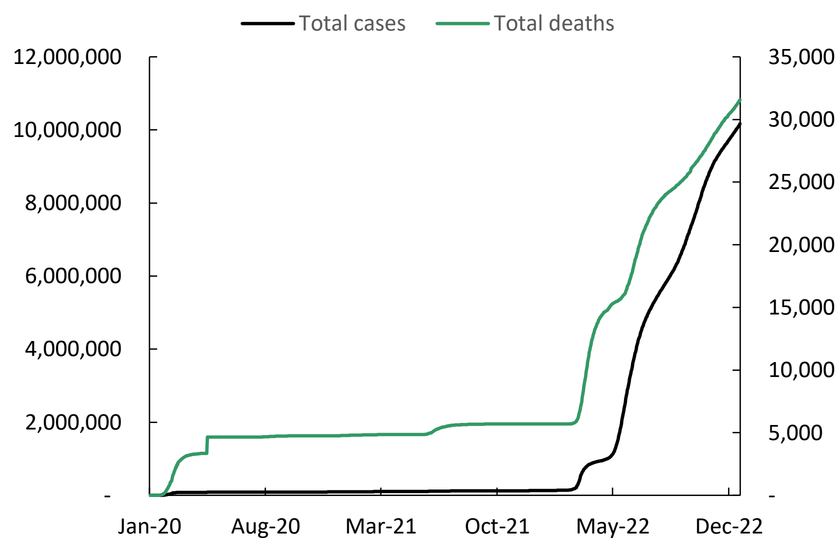
While the war dialled down concerns about the spread of the coronavirus, we posit that the latter's resurgence in major cities (China and US) also pose a challenge to global economic growth this year.

Is China Really an Economic Growth Engine?

Although the impact of the COVID-19 pandemic has moderated significantly in most economies, China (the world's second-largest economy) has continued to grapple with rising COVID-19 cases and high death rates amongst the unvaccinated population. The Chinese government's zero COVID strategy to curtail the virus's spread, adversely impacted its domestic economy (as significant manufacturing and trade hubs shut down operations). This also strained global supply chains as major economies rely on China as a key trading partner. The conflict in China's real estate market, which began in 2020, is another significant issue affecting the country's economy. After undergoing a severe fall since the start of the real estate crisis, it has significantly added to the economy's precarious situation.

Due to the existing bottlenecks, China is expected to end 2022 on a slower growth pace, with the IMF projecting a GDP growth rate of 3.21% YoY in 2022 from 8.08% YoY growth recorded in 2021.

Chart 5: China's Covid Cases and Death

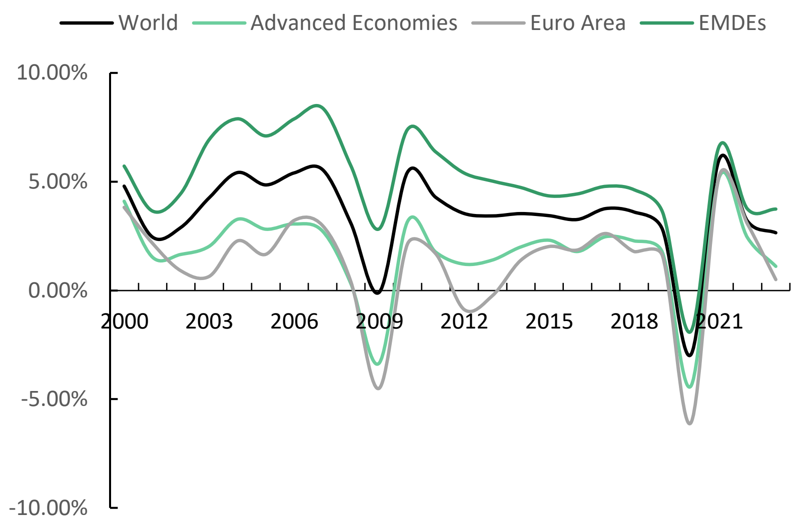


Source: World Health Organization, Meristem Research

Recently, China announced a change to the status quo, through its decision to lift the strict zero-COVID policy and implement a more flexible COVID-19 control technique.

Thus, an improvement in domestic and global supply chain activities is anticipated, which should support growth in 2023. Thus, based on IMF's estimate, China's economy is expected to grow by 4.44% YoY in 2023, signalling an improvement from the 2022 growth projection.

Chart 6: Global Economic Growth Trend



Source: International Monetary Fund, Meristem Research

What Should the Global Economy Expect?

In light of the projected headwinds, major economies are on the brink of recession, with the IMF projecting that a third of the global economy will experience a technical recession in 2022. Consequently, global growth is expected to slow down in 2022 – (3.20% from its earlier estimation of 3.60%, representing the weakest growth recorded since 2001). Growth is expected to be even slower in 2023 (2.70%), falling short of the pre-pandemic performance and the substantial rebound recorded in 2021. Moreover, some major economies have already recorded a contraction in their respective growth number in 2022.

The US GDP contracted by -0.60% in the first half of 2022, China recorded a slowdown in GDP in Q2:2022 and the Euro area's GDP also contracted in the second half of 2022.

While it is expected that the spill-over effects of China's erstwhile zero-Covid approach would gradually diminish, the ongoing crisis between Russia and Ukraine still heralds some uncertainty. Thus, in line with IMF projection, Europe and UK are anticipated to experience a mild recession, China is likely to gradually recover following the reopening of its economic activities, while the US and other emerging economies will show some level of stability.

Global Inflation

Weaponizing Energy Supply to Europe: Winter is Here!

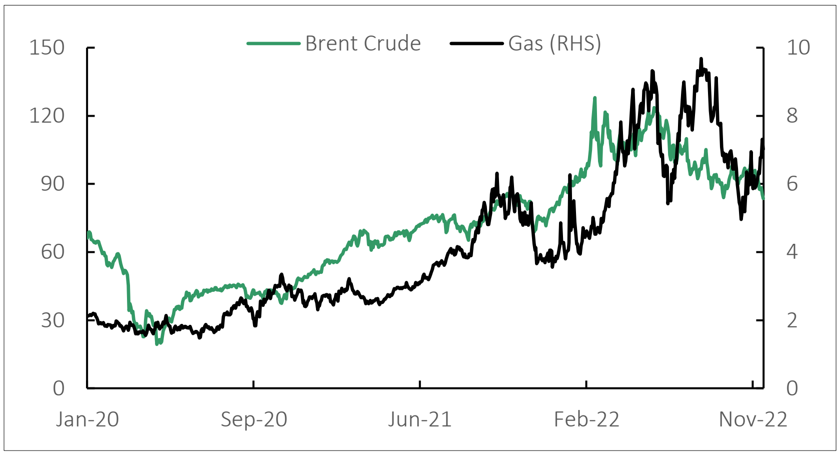
According to the International Energy Agency (IEA), Russia is one of the global top three producers of crude oil, together with Saudi Arabia and U.S.A. In 2021, Russia supplied c.14% of the world's total supply of crude and condensate. Thus, Russia's position as a significant supplier of fossil fuel has triggered a global energy crisis.

Thus, Europe's exposure to energy imports from Russia (a fifth of total Europe's refined outputs), has made the region the worst hit by the energy crisis that has ensued. Moreso, Europe previously imported the bulk of its natural gas from Russia through the Nord Stream pipeline. However, Europe sanctions to stifle Russia's financing source for the war (revenue from oil and natural gas was c. 45% of Russia's budget in 2021) has resulted in zero-supply of gas from Russia to Europe.

We posit that Europe's search for alternative sources of gas supply is a challenge due to the large-scale investments required to set up a plant. Thus, as an alternative, some European countries are going the route of keeping some of their nuclear plants open for longer than initially intended despite their commitment to cleaner energy.

Also, deals for gas supplies are being sought with other countries. For context, Germany recently secured a deal with Qatar for gas supply (sub-3billion cubic metres). However, this would only have a minimal impact in fixing the gap as it represents just about 6% of Germany's import from Russia in 2021 and the supply will not commence until 2026.

Chart 7: Trend of Brent Crude and Gas Prices



Price of Brent Crude in USD/barrel; Price of Gas in USD/MMBtu

Source: Bloomberg, Meristem Research

In addition, Russia is capitalizing on Germany's reluctance to approve the commissioning of Nord Steam 2, an alternative supply channel of Russian gas to Europe. For Russia, Germany's reluctance to approve the usage of the of the pipeline (which cost c. USD11bn and lasted 2014 – 2021) is unjustifiable. On Germany's part, it is part of the series of sanctions against Russia's invasion of Ukraine.

However, this reluctance will have to be met by investments in either energy-saving technology or alternative energy source, especially as winter approaches. During winter, Europe generally consumes more gas as the demand for heating increases.

Is an End Yet in Sight to the Soaring Prices?

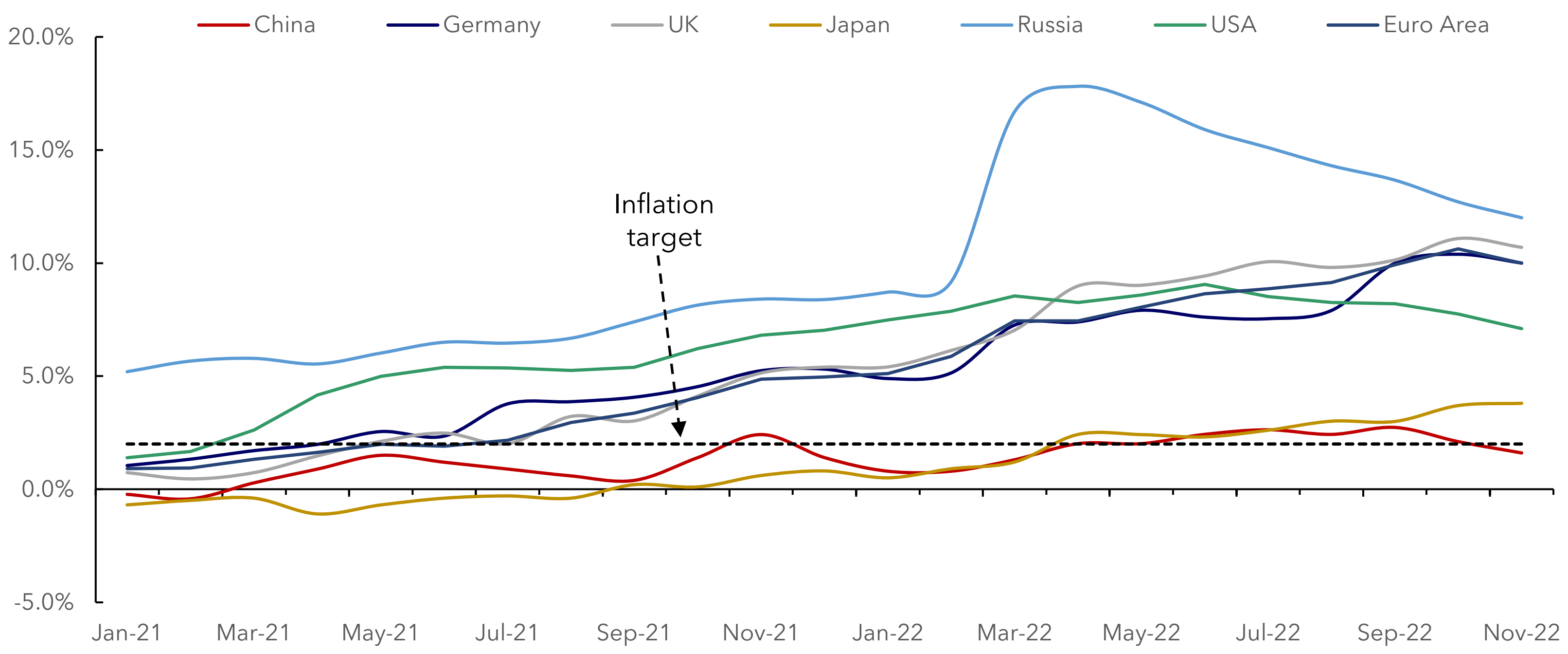
Between December 2021 and November 2022, rising commodities prices, coupled with other supply-chain bottlenecks resulted in decade-high inflation in different countries. For some advanced economies with an inflation target of 2.00%, inflation rose by more than 5x the target.

In U.S.A., inflation peaked at 9.06% in June 2022 before reversing (to 7.11% as of November 2022). In our view, the release of the strategic oil reserves in the U.S.A. was beneficial in easing inflationary pressure, in addition to the aggressive monetary stance. In the U.K. and Euro area, prices are still soaring (10.66% and 10.05% as of November 2022).

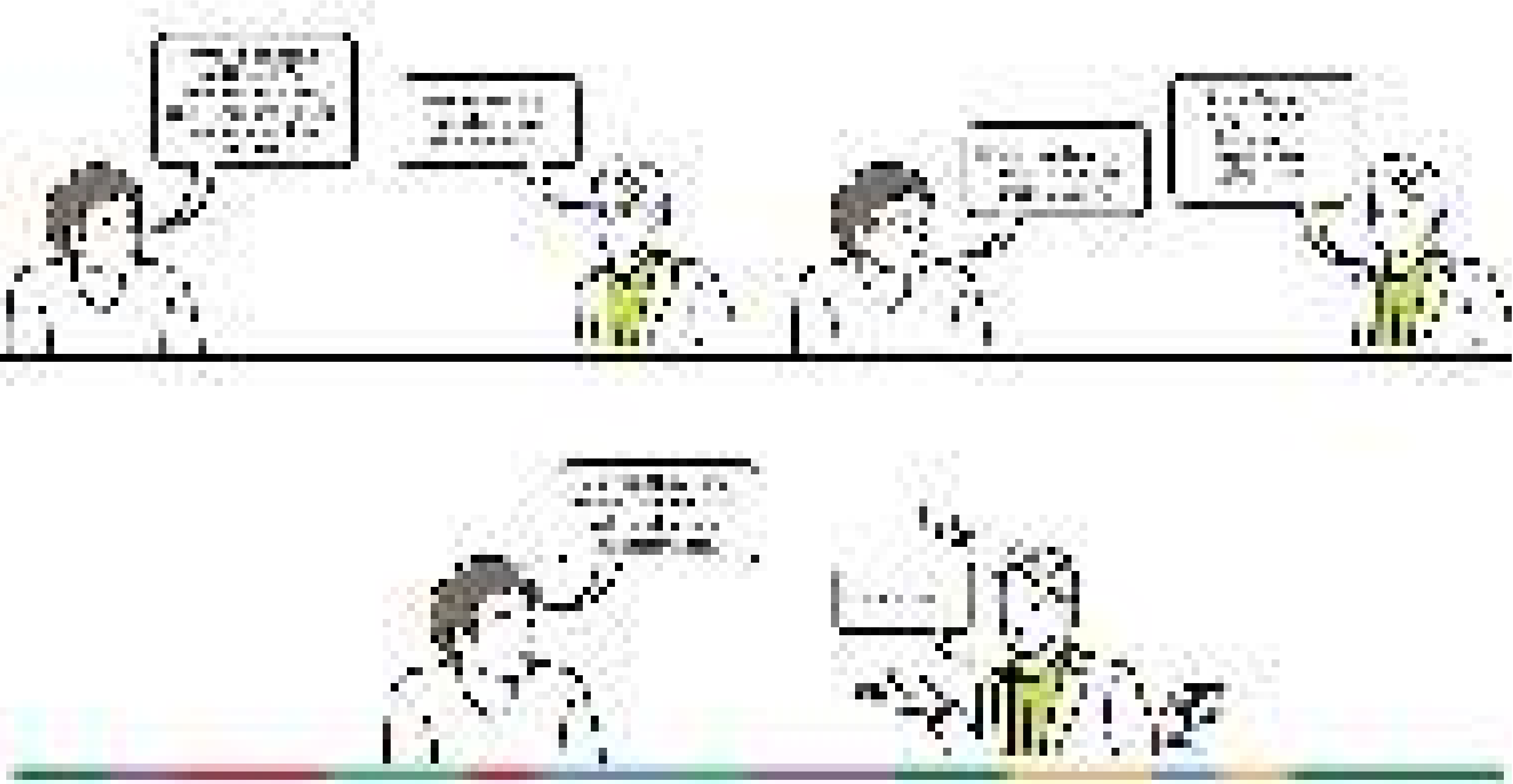
Getting a viable alternative to Russian gas is critical in cooling off inflation in Europe. However, we do not see inflation rescinding to the 2% policy target until at least 2024, even in the U.S.A. as the fight against inflation is only being won gradually. In 2023 however, we expect a continuous moderation in inflationary pressure, barring any new global shock.

Asia was less impacted by the global inflationary pressure in 2022. In Japan, although inflation is also rising, the increase has been minimal, and currently stands at 3.80% (from 0.81% in December 2021). China is also benefitting from a steady supply of crude oil and gas from Russia with its inflation rate at 1.60% as of November 2022.

Chart 8: Inflation Rate in Key Countries vs Target



Source: Bank for International Settlement (BIS), Bloomberg, Meristem Research



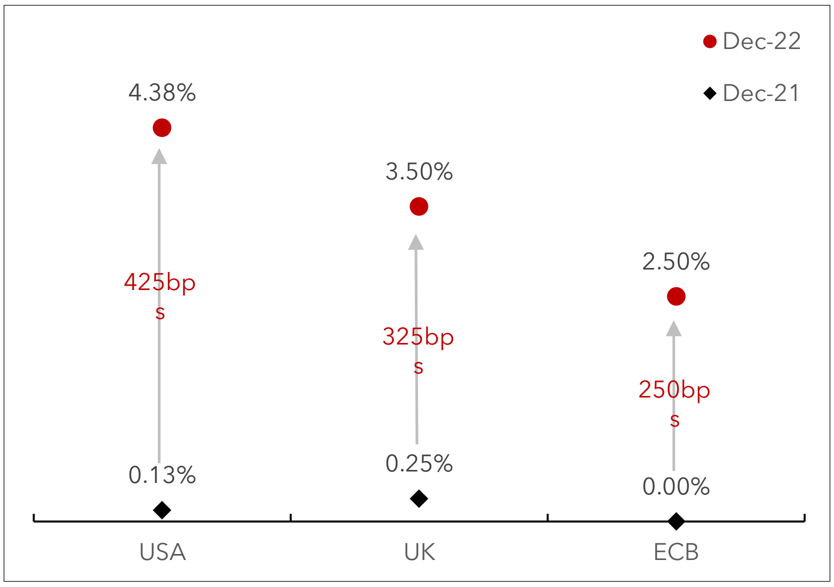
Monetary Policy Responses

Rounds of Monetary Tightening

2022 was a year of large shift in monetary policy stance from the massive injection and monetary accommodation in 2020. While liquidity mop-up started gradually in 2021, monetary authorities had been gearing up for a hawkish 2022.

However, the unexpected spike in price levels informed the unanimity of aggressive monetary policy decisions across the globe. Both in terms of size and frequency of rate hike, monetary policy has been successively tough on its campaign against rising inflation. Monetary policy rates were raised by, and to, levels not seen in a long time. In four successive meetings through November 2022, the US Fed hiked its federal funds rate by 75bps each. Other monetary authorities who have been on the rate hike cycle, include the Bank of England (BoE) and the European Central Bank (ECB).

Chart 9: Magnitude of Monetary Policy Rates Hike in 2022



NB: For USA, the midpoint of the Fed target fund rate has been used. Texts in Red represent magnitude of rate hike

Source: BIS, Central Banks' Policy Announcements, Meristem Research

Monetary Pivot Underway

While monetary policy authorities are not oblivious of the economic damage of continuous rounds of policy rate hikes, addressing inflation is an immediate priority. With inflation starting to moderate in some countries particularly in the U.S.A. – *which has recorded its fifth straight months of decline in inflation rate* – the rate hike cycle is gradually coming to an end.

At their respective meetings in December 2022, the U.S. Fed, the BoE, and the ECB all raised rate by 50bps, compared to 75bps in at least the last two meetings. The guidance from monetary policymakers also affirms that a gradual slowdown in the magnitude of rate hike has started.

"Thus, our view is that global monetary policymakers, particularly the U.S. Fed, will raise their policy rates by only about 50bps accumulatively in their meetings in Q1:2023, following which would be a hold on policy rates from Q2:2023. We do not anticipate an outright reduction in policy rates until at least Q4:2023, barring any unexpected new shock to the global economy."

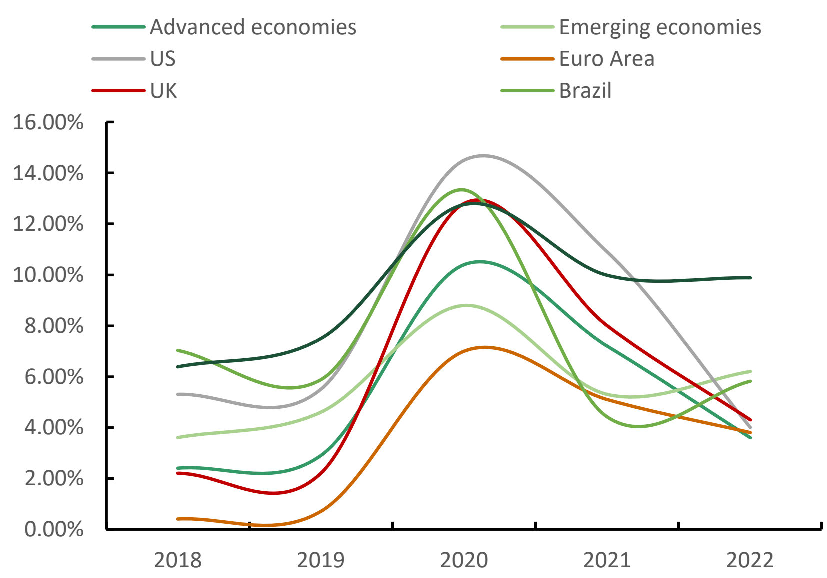
Global Fiscal Policy

Fiscal Deficit Poised to Rise

Developing and implementing suitable fiscal policies without conflicting the monetary authorities' efforts to tame inflation has proved to be a policy dilemma for many countries. The need to scale back on pandemic related fiscal support also impacted real disposable income for households in 2022.

Consequently, in 2022, the average fiscal deficit for advanced economies declined, owing to fiscal normalization. Emerging economies however experience marginal widening in their fiscal deficit balance.

Chart 10: Fiscal Deficit to GDP

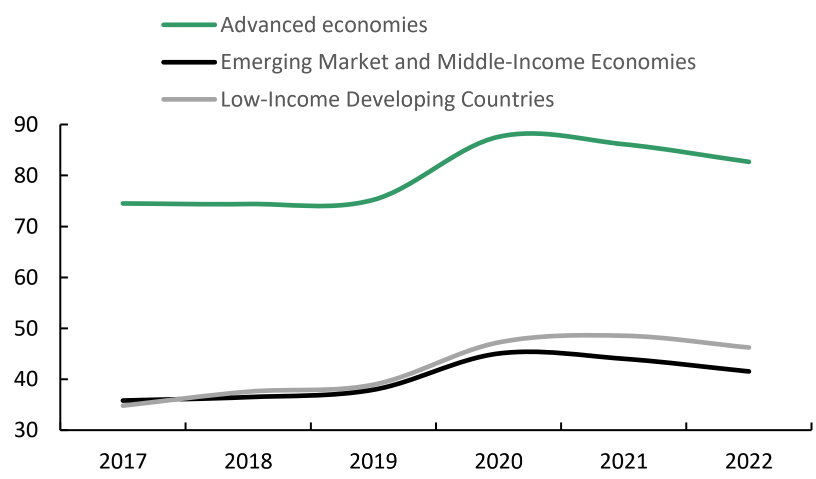


Source: IMF, Meristem Research

While the fiscal deficits in advanced countries mirrored lower spending relative to the pre-pandemic year, the low pace of revenue recovery impacted emerging economies.

For 2023, we expect fiscal deficits to widen in advanced economies to be driven by increased spending targeted at vulnerable groups. Also, monetary policy reversals and concerns about a looming recession (in some economies) would necessitate increased fiscal spending.

Chart 11: Trend in Net Debt (% of GDP)



Source: IMF, Meristem Research

Global Trade

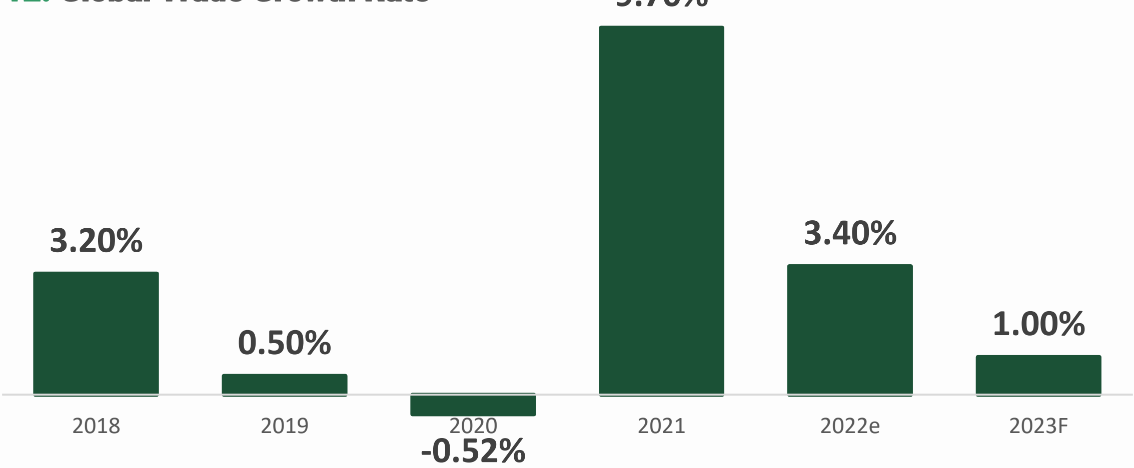
Global Headwinds to Slow Global Trade

While global trade experienced robust growth in the first half of 2022, it waned in the second half owing to the worsening economic conditions of countries. China's zero COVID-19 policy, the lingering Eastern Europe crisis, and the significant appreciation of the US dollar against other currencies have also largely influenced the direction of trade in 2022.

As concerns about a potential recession in major trade countries, monetary tightening, high inflation numbers, and debt sustainability persist, the slowdown in trade is expected to be sustained in 2023. Thus, the World Trade Organization estimates that the trade growth rate would decline in 2022 and 2023 to 3.40% and 1.00%, respectively, down from 9.70% in 2021.

" While the aforementioned negatives would significantly impact trade in 2023, improvement in the logistics condition brought on by the pandemic and recently ratified agreements (such as the African Continental Free Trade Area (AfCFTA) and the Regional Comprehensive Economic Partnership) should act as positive catalysts".

Chart 12: Global Trade Growth Rate



Source: World Trade Organization, Meristem Research

Global Equities

Negative Returns Across Board

Global equities markets closed out 2022 on a weak footing as investors priced in the monetary authorities' adoption of a tighter stance which increased the attractiveness of fixed-income instruments. Positive company performances also failed to spur optimism in the market, translating into negative performance of major equities indices. In addition, global recession fear triggered by the tension in Eastern Europe also waned investors' sentiment. The MSCI World Index, which tracks stocks across developed markets lost 19.46% in 2022 (its worst performance since 2018), with the MSCI indices for European, developed, emerging and frontier markets shedding 12.28%, 16.79%, 22.47%, and 20.80%, respectively.

Equities market in China also felt the brunt of the resurged Covid-19 cases as investors priced in the shutdown effect on company performance. Thus, the SHSN300 Index, China's major stock market index closed in negative territory, down by 21.63%.

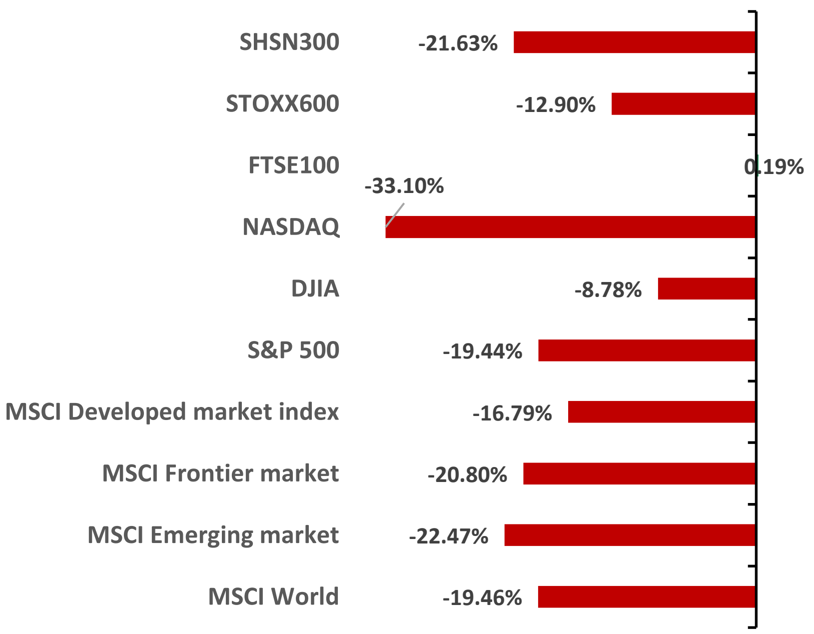
However, on the back of investors' anticipation of a possible slowdown in the hawkish monetary stance, optimism over China's reopening, and a gradually moderating inflation, there was a steady rebound in the global equities market in the last quarter of the year. Thus, in Q4:2022, the S&P500, DJIA, MSCI world index and MSCI European index recorded gains of 7.08%, 15.09%, 9.42%, and 9.25%, respectively.

Outlook

As referenced earlier, monetary authorities are expected to adopt a dovish tilt in their monetary policy actions which will build investors' optimism for global equities. Considering that P/E ratios have touched 2020 lows, we posit that this presents attractive points for investors with a long-term market focus.

A potential recessionary environment however constitutes a major risk to this outlook as this could lead to a further reduction in earnings expectations. We also expect fixed-income yields to remain elevated for at least the first part of 2023, further dimming the optimism for the equities market

Chart 13: 2022 Returns Across Global Equities Markets



Source: Bloomberg, Meristem Research

Global
Fixed Income

Rate Hikes and Tighter Financial Conditions Dictate Yield Levels

Yields in the global fixed-income market sustained their upward trajectory, just as we predicted in our 2022 outlook. Historic high and sticky inflation, leading to aggressive tightening campaigns by central banks across various economies dictated the direction of the global fixed-income market. This was a total reversal from the 2019-2021 era, where abundant liquidity and lower rates (accommodative policy stance) called the market direction. 2022 proved to be the reset year for liquidity; thus, bond yields rose sharply, delivering some of the worst total returns in the history of the fixed-income market. (See table below)

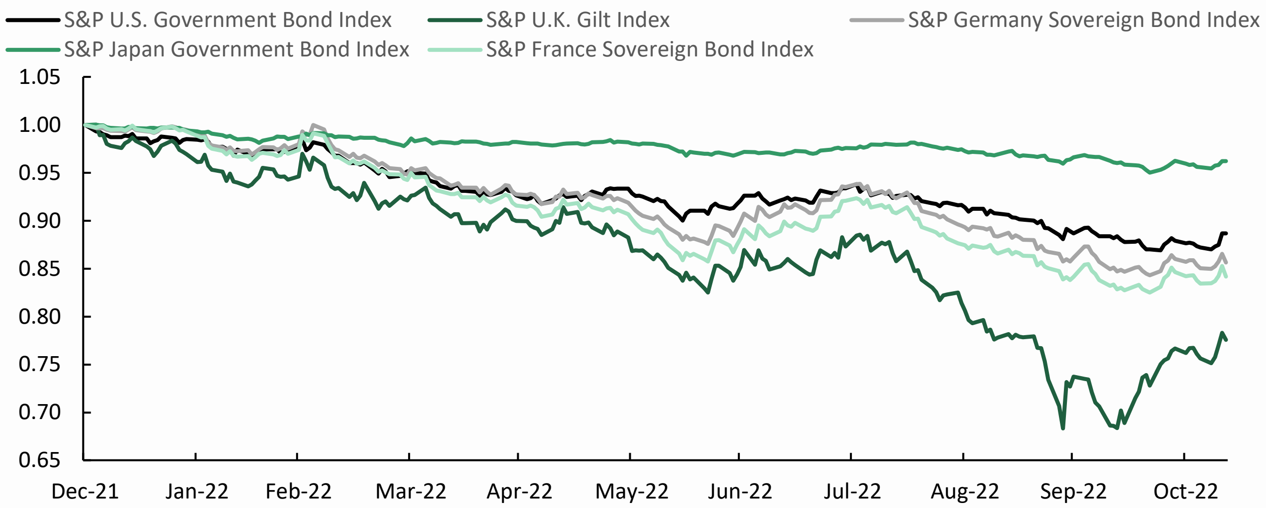
Particularly in the developed market, the rapidly rising yields in the U.S. was driven primarily by the aggressive U.S. Federal Reserve (Fed) (hiked its benchmark rate by 425bps in 2022), which has been forced to combat historically high inflationary pressures. Similarly, in the U.K., rate increases (with the Bank of England hiking rates by 325bps so far in 2022) have been the villain of the fixed-income market as the yield curve inverted. Consequently, average treasury yield in the U.S. and the U.K. rose by c. 295bps and c. 281bps to 4.18% and 3.75%, respectively, translating to lower prices. However, the steep rise in yields meant that investors could finally earn relatively attractive yields in the fixed-income market after enduring nearly 3-years of near-zero interest rates. Thus, rising yields and widening spreads created attractive entry points.

Table 2: Market Performance Across Global Fixed Income Markets

	Corporate Bonds				
Global Government Bonds	US	UK	Europe	HY	Emerging Market Bonds
Bloomberg Global Aggregate Treasuries (USD Hedged)	Bloomberg Global Aggregate USD Corporate (USD Hedged)	Bloomberg Global Aggregated GBP Corporate (USD Hedged)	Bloomberg Global Aggregate EUR Corporate (USD Hedged)	Bloomberg Global High Yield (USD Hedged)	JP Morgan Emerging Markets Bond Index EMBI Global Diversified (USD Hedged)
-17.47%	-14.34%	-15.26%	-16.31%	-11.05%	-17.78%

Source: Bloomberg, Meristem Research

Chart 14: S&P Global Bond Indices Across Advanced Economies



Source: S&P Global Index, Bloomberg, Meristem Research

"Given the expectation of a peak in interest rate, likely moderation in inflation, and most advanced economies set to enter recession, 2023 is projected to be a good year for debt markets. For context, the terminal federal funds rate (the rate at which the Fed is expected to stop raising rates) is currently estimated at around c. 5%, which implies that after hiking rates by 425bps in 2022, markets are only anticipating another 100bps increase in rate through half the year 2023. Thus, as economies hit the brakes and inflation crests, we expect yields to hover around current levels for most of the year. However, we anticipate a gradual reversal in yield levels from the third quarter of 2023 across developed markets."

Emerging Debt Market Suffers Huge Capital Outflow

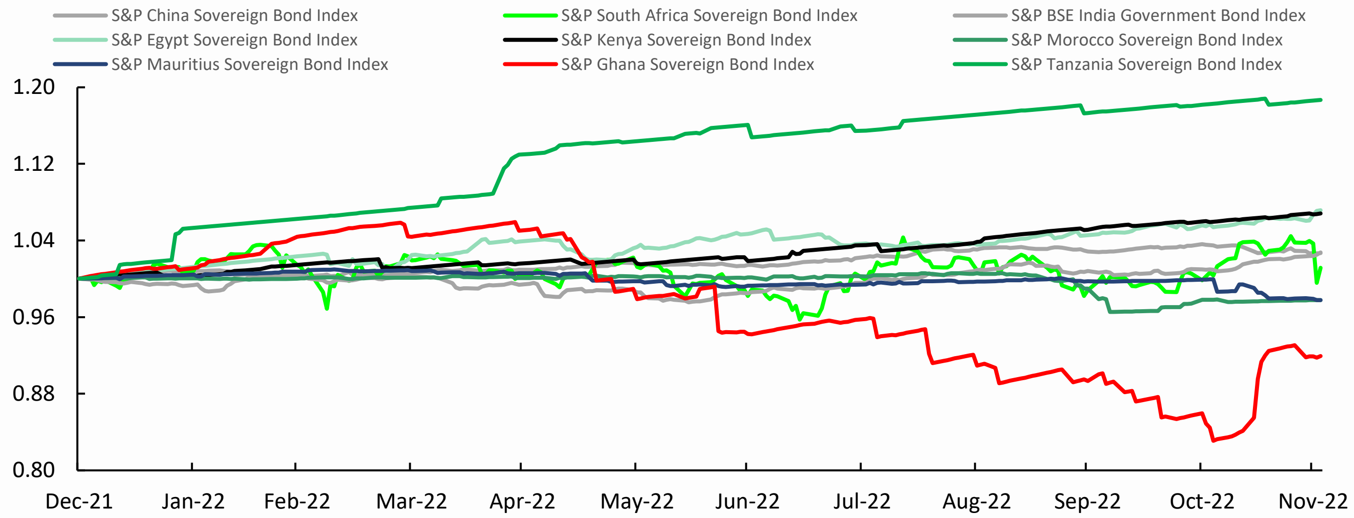
Unarguably, 2022 has been a bad year for emerging markets as the emerging market local currency debt (calculated by the JP Morgan GBI-EM Global Diversified Index) returned -17.78% (in U.S. dollar terms) as of December 05, 2022. While many emerging debt markets had a promising start to the year, pressure from the prolonged Eastern European Crisis, with the soaring U.S. dollar and rising global interest rates, led to huge capital outflow from emerging markets. Other themes that impacted the market include the trajectory of U.S. inflation, increased haven demand, a downgrade in sovereign credit rating across countries, and concerns about fiscal sustainability. Consequently, monetary policy authorities in emerging economies toed the line of their counterparts in developed markets by raising rates (in a bid also to improve the market's attractiveness) as inflation became a global phenomenon. As a result of hike in policy rates, some countries (Egypt, Tanzania, Kenya) in the region witness gradual moderation in yields, with most countries recording positive returns by year-end (see table below).

Table 3: Market Performance of Emerging Market Bond Indices

Emerging Market Bond Index	YtD Returns
S&P Ghana Sovereign Bond Index	-14.63%
S&P Egypt Sovereign Bond Index	8.33%
S&P Tanzania Sovereign Bond Index	18.79%
S&P Kenya Sovereign Bond Index	7.77%
S&P South Africa Sovereign Bond Index	4.32%
S&P China Government Bond Index	3.51%
S&P BSE India Sovereign Bond Index	4.93%
S&P Morocco Sovereign Bond Index	-2.99%
S&P Mauritius Sovereign Bond Index	-5.98%

Source: S&P Global Index, Bloomberg, Meristem Research

Chart 15: S&P Global Bond Indices Across Emerging Economies



Source: S&P Global Index, Bloomberg, Meristem Research

"The emerging fixed-income market may start to look more attractive in 2023, with the Fed's hiking cycle likely to end in the near term (Q3:2023), China is likely to gradually reopen, probable ease in the geopolitical tensions, and U.S. dollar strength likely to temper (around mid-2023). Thus, volatility of the global interest rate should begin to recede and provide opportunities for alpha generation in emerging market local debt in 2023. Particularly, the U.S. Fed monetary policy direction will be crucial in shaping the outlook for emerging market debt; however, recessionary conditions could see risk spread rise in some areas."

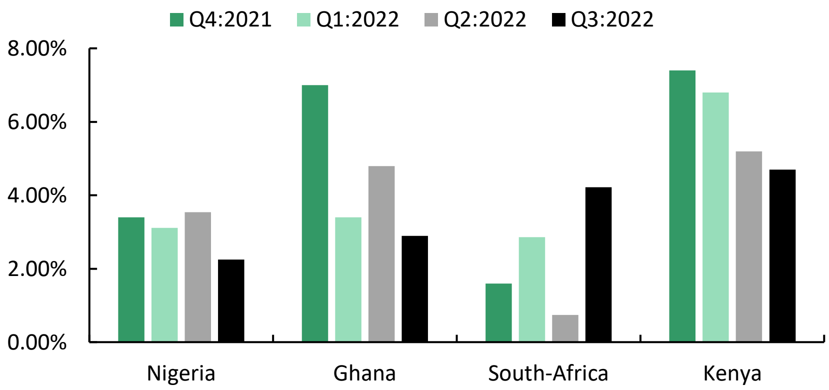
Sub-Saharan Africa

Economic Growth:
Positive But Weakening

Economic performance of countries across the sub-Saharan Africa (SSA) region in 2022 is expected to be slower than 2021. Several factors are responsible for this growth expectation, including the region's exposure to fluctuations in commodity prices on the global economy (given its import dependent nature), tighter monetary policy actions to curtain rising inflation and country specific issues (such as drought, adverse weather conditions, exchange rate volatility, debt-sustainability challenges and socio-political peculiarities).

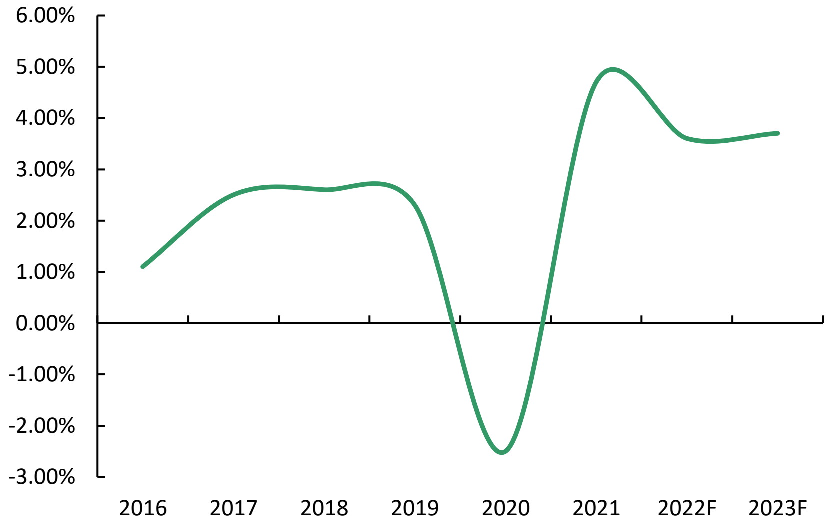
Kenya's GDP in Q3:2022 slowed to 4.70% YoY (vs. 5.20% YoY in Q2:2022). Ghana recorded a deterioration in Q3:2022 to 2.90% YoY (vs. 4.80% in Q2:2022). In South Africa, after contracting by 0.74% YoY in Q2:2022 (*due to flooding in KwaZulu-Natal (the second largest contributor to GDP), heightened political risks as well as labour protests and strike actions*), its Q3:2022 GDP performance recorded a 4.22% YoY growth rate mainly propelled by the Agricultural sector.

Chart 16: Economic Growth of Selected Countries in SSA



Source: Bloomberg, Meristem Research

Chart 17: SSA Historical and Forecast Growth Rate



Source: IMF, Meristem Research

While growth is expected to still be positive in SSA, the expectation is that it would continue to weaken. First, the rising likelihood of another variant of Covid-19 in China, the U.S.A, amongst other countries, could trickle down to SSA and cause a set back to productivity gains if not properly managed. Also, the slower growth of the region's trading partners, tighter monetary policies across the region as well as cost pressure from the adverse impact of currency devaluation/depreciation on the region's terms of trade are additional growth constraining elements. Consequently, the IMF revised its growth forecast for the region downwards to 3.60% and 3.70% (from 3.80% and 4.00%) for 2022 and 2023, respectively.

Inflation:

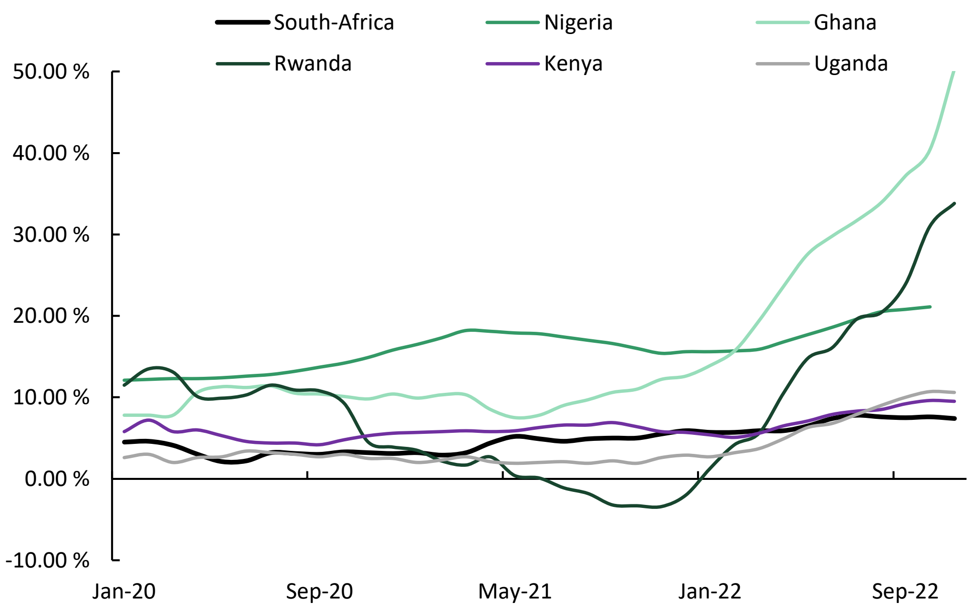
...Risks Tilted to the Upside

Price levels in the SSA region also increased significantly. As highlighted earlier, the pass-through effect of imported inflation, drought and adverse weather conditions (which disrupted agricultural activities) kept both food and non-food prices elevated. The IMF estimates the pass-through effect of global prices on domestic prices at c.30%.

Kenya recorded a 5-year high inflation of 9.50% YoY as of November 2022, while Ethiopia's inflation rate reached a 10-year high of 30.70% YoY in September 2022. In West-Africa, incidences of multi-decade high flooding adversely impacted food production and logistics which further stoked inflationary pressures. Ghana recorded a 21-year high inflation of 50.30% YoY in November 2022. Similarly in South-Africa, the ravaging flood and the power outages in the economy hampered production its inflation rates soared to a 5-year of 7.40% YoY in November.

While inflation is expected to remain elevated in 2023, the pace of increase is expected to decelerate. Moreover, imported inflation in SSA countries is expected to also moderate on the back of the expected slower inflation in trading partners' countries. Major risks to this outlook however include the evolution of the Russia-Ukraine war, the decision of OPEC+ on oil production and its effect on global crude oil price, as well as the avoidance of another global shock from the sprouting new wave of the pandemic that had been almost been left behind.

Chart 18: Trend of Inflation in Countries across sub-Saharan Africa



Source: Bloomberg, Meristem Research

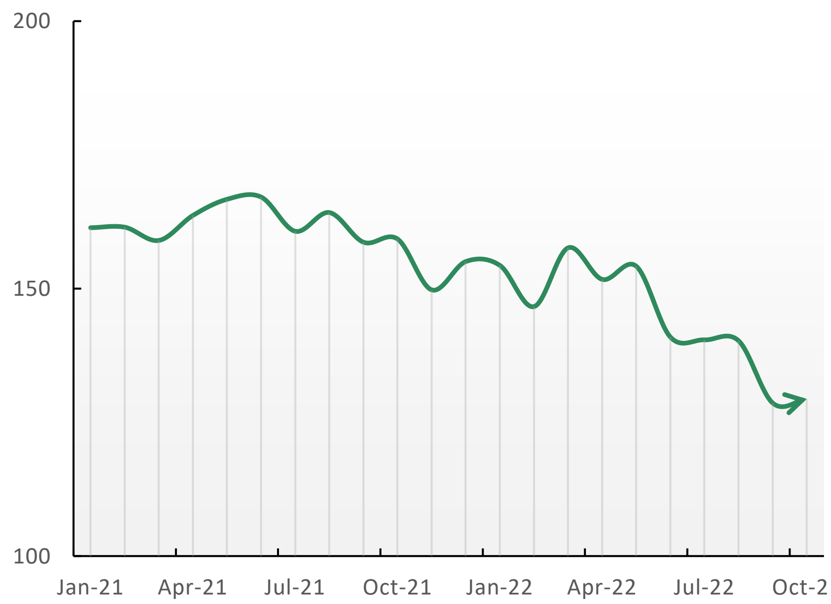
Monetary Policy

Confronted with Multiple Dilemmas

As a result of the heightened inflation, monetary policymakers have been confronted with multiple economic dilemmas. The decision lay between adopting a tighter monetary stance or retain focus on supporting fragile economic recovery. Given that high inflation elevates cost of living, monetary policymakers opted for the campaign against inflation, prompting a shift in policy direction to squeeze out excess liquidity and control the pace of price increases. Thus, most monetary authorities in SSA adopted a hawkish policy stance. Notably, Ghana, Mozambique, Uganda, South Africa, and Egypt have hiked their respective key interest rates by 1250bps, 400bps, 350bps, 675bps and 700bps respectively, in 2022.

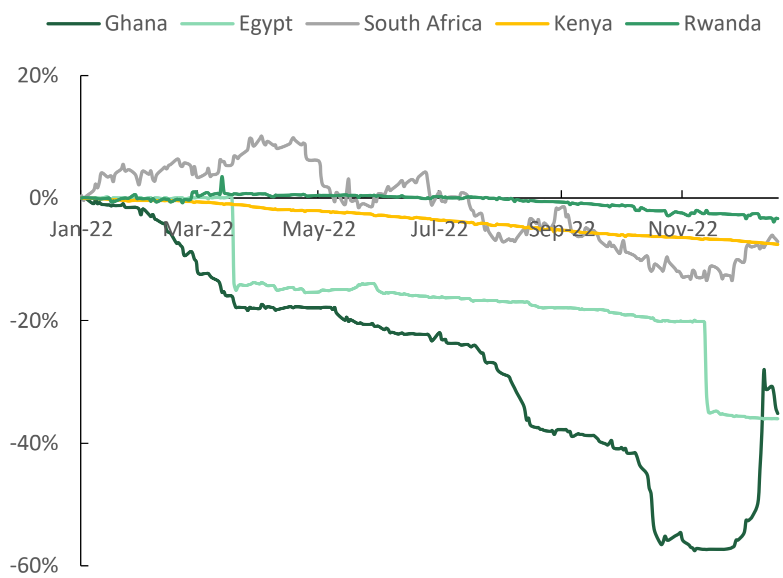
Furthermore, the uniform tightening of key policy rates across the global economy triggered capital outflow from the SSA, mounting pressure on the exchange rate. Some of the most notable currency depreciation was in Egypt (-54.22% Ytd) and Ghana (-56.30% Ytd). Although further policy interventions could support the strengthening of the exchange rate, the subpar foreign exchange reserve position remains a major constraint to any likely positive turnaround.

Chart 19: Bloomberg Emerging Market Capital Index



Source: Bloomberg. Meristem Research

Chart 20: Exchange Rate YtD Movement Per US Dollar



Source: Bloomberg. Meristem Research

Table 4: Selected SSA Countries Monetary Rate Movement

SSA Countries	Dec-21	Dec-22	Ytd
Kenya	7.00%	8.75%	+175bps
Ghana	13.50%	26.00%	+1250bps
Egypt	9.25%	16.25%	+700bps
Uganda	6.50%	10.00%	+350bps
South Africa	3.75%	10.50%	+675bps
Mozambique	13.25%	17.25%	+400bps
Rwanda	4.50%	6.50%	+200bps
Angola	20.00%	19.50%	-50bps

Source: S&P Global Index, Bloomberg, Meristem Research

"As the factors responsible for the soaring prices persist (constrained supply of commodities, demand pressure, exchange rate depreciation and weak foreign reserve), monetary authorities are expected to sustain the tightening approach in the near term. Thus, we expect the policymakers to closely monitor the near-term direction of the rising prices and the ripple effect on their respective domestic economies."

Fiscal Sustainability

Heightened Worries Rubbed off on Eurobonds Market

The already concerning fiscal position of most SSA countries after the Covid-19 incident was worsened in the face of the aforementioned macroeconomic issues both globally and in the region. While net commodity exporters like Angola recorded higher revenues due to the high commodities prices, others were mostly faced with lower revenue generating capacity.

These weakening macroeconomic fundamentals thus limited government's ability to support their respective economies. The fiscal deficit of countries in the SSA region widened (contrary to major advanced economies) as borrowing increased and debt level kept their uptrend (although debt-to-GDP slowed in some countries due to higher nominal GDP given rising price levels).

Notably, debt-to-GDP ratio is still above 70% (and in excess of the IMF's advised threshold of 55%) and fiscal deficit to GDP also remains elevated.

In light of these, issues concerning debt sustainability remained òn the front-burner. Unsurprisingly, some countries have turned to multilateral organizations like the IMF to reduce these vulnerabilities and support their ailing economies.

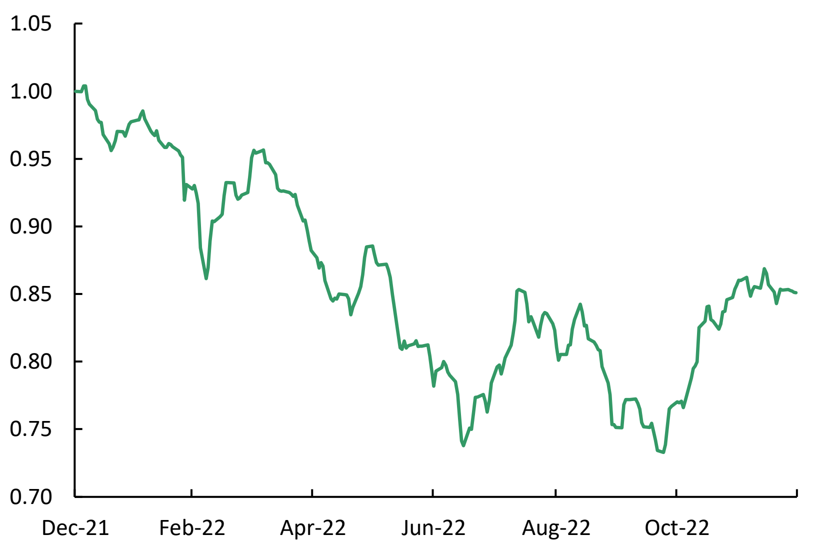
Egypt recently secured a c. USD3bn facility from the IMF while Ghana is currently at an advanced stage towards obtaining a similar facility.

As is typical of these facilities, conditionalities such as internal and external debt restructuring for Ghana as well as currency devaluation have been set for Egypt. Ghana also produced a debt restructuring plan for its external debt necessitating a 30% haircut for investor funds.

Credit rating for most SSA countries have also been downgraded, thereby leading to higher yield on SSA Eurobonds as prices declined. The Ghanaian Eurobonds recorded the steepest increase in yield given the heavy spotlight on its economic issues. Reflecting the low new Eurobonds issuances, the S&P Africa Hard Currency Sovereign Bond Index - which tracks Eurobonds issued by sovereign governments of 13 key African markets – declined by -14.91% in 2022.

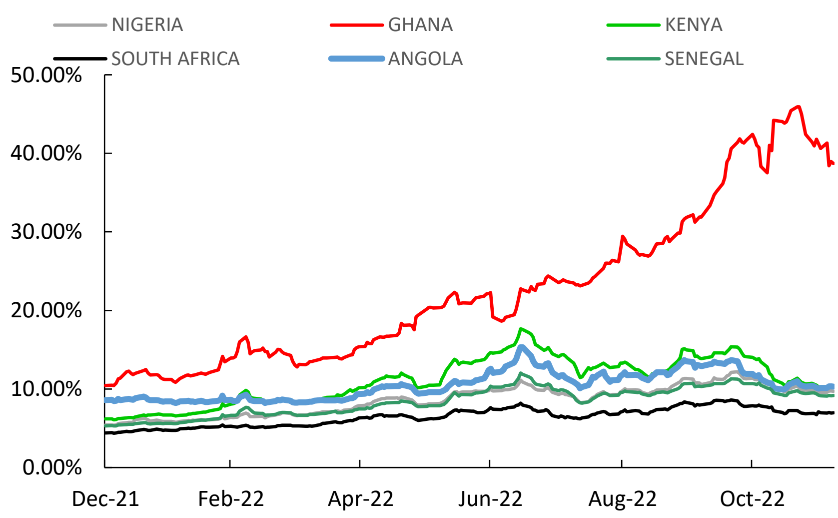
We see the possibility of more debt restructuring is underway in other SSA countries given the urgent need to reduce fiscal vulnerability in most countries. As such, there might be apathy towards SSA Eurobonds, and more capital outflows leading to yet higher borrowing cost.

Chart 21: S&P Africa Hard Currency Sovereign Bond Index



Source: S&P, Meristem Research

Chart 22: Average Eurobond Yields (YtD)



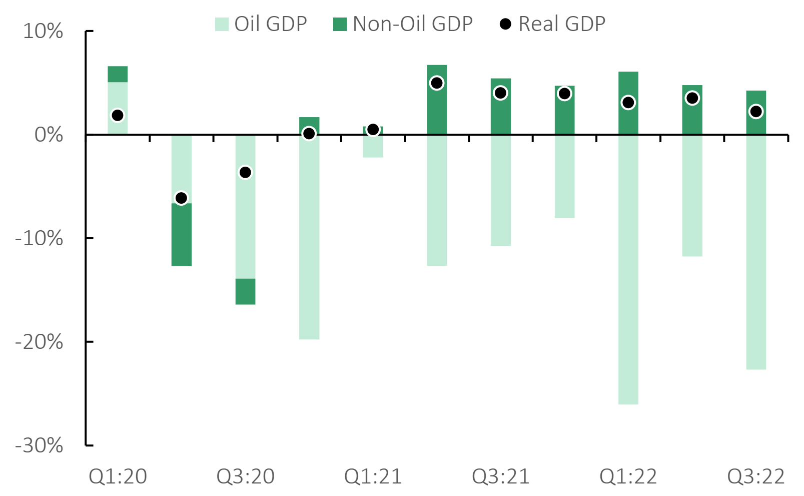
Source: Bloomberg, Meristem Research


Don't gamble with
their greatness.

Domestic Economy

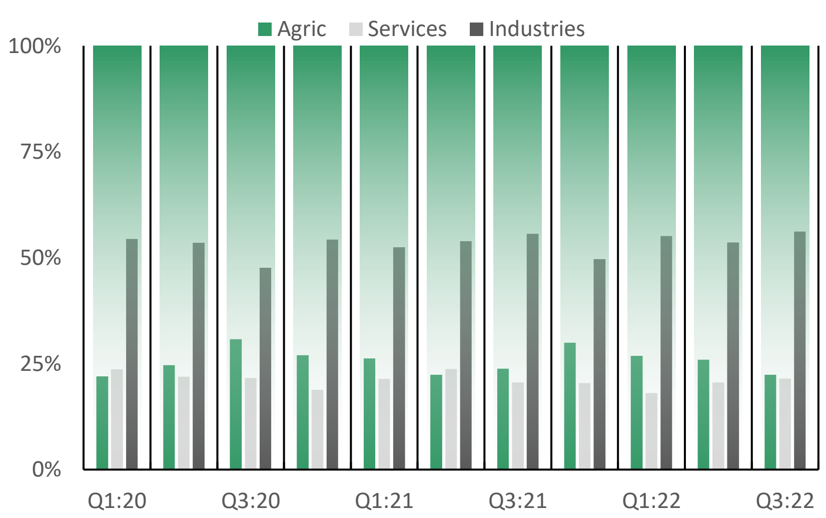
Gross Domestic Product:
Steady Growth Although Risk Lies Ahead

Chart 23: Historical Real GDP Growth Rate



Source: National Bureau of Statistics, Meristem Research

Chart 24: Sectoral Contribution to Real GDP



Source: National Bureau of Statistics, Meristem Research

The Nigerian economy has maintained its steady recovery that started in Q4:2020. Large fiscal and monetary stimulus in 2020 continue to provide support. While the low-base effect from 2020 might have waned, the expansion of the informal trade sector and the resilience of the services industry has also been growth-enhancing. In addition, the effect of the Apex Banks's continued monetary support for the real sector (including manufacturing, agriculture, and health sectors) cannot be ignored.

In the most recent report from the Nigerian Bureau of Statistics (NBS), Nigeria's real Gross Domestic Product (GDP) increased by 2.25% YoY in Q3:2022 to NGN18.96trn. For the nine months to September 2022, the country's (GDP) was up by 2.94% YoY. The resilience of the non-oil sector has been central to GDP growth. Moreover, the non-oil sector now contributes over 94% to Nigeria's GDP (amid the contraction of the oil sector) from an average of c. 91% a few years back.

Non-oil Sector:

Continues to Save the Day

The non-oil sector has been the growth enabler for the Nigerian economy. Key to this continuous growth is the services sector, which accounts for more than half of the total real GDP and has expanded by an average of c. 7.05% in 2022. Specific services sub-sectors that propped the growth includes the Information and Communication Technology (ICT) – *contributing 15.35% to real GDP and expanding by 10.53% YoY*. This advancement was due to a couple of factors: a higher number of telephone subscribers and a deepened teledensity; +7.62% YtD rise in the number of active internet subscriptions; addition to number of broadband subscriptions; and improved broadband penetration (+421bps YtD). Trade sub-sector also contributed 15.35% to total real GDP and expanded by 5.08% YoY

"In Q4:2022, we expect the ICT sector to maintain its resilience as the deployment of 5G network should engender further internet penetration and internet speed. Further increase in the number of active internet users and the higher call frequency that typically come with festive periods would support growth of the ICT sector, and by extension, the non-oil sector. In fact, historical data shows that the ICT sector records its highest real GDP in the fourth quarter of the year and preliminary data from the Nigerian Communications Commission (NCC) shows that broadband subscription, broadband penetration, and subscriber tele-density continue to trend upwards in October 2022.

Trailing the services sector is the agricultural sector which accounts for c. 25% of the total real GDP up to Q3:2022, and has also been growing steadily in line with its historical seasonality pattern. In Q3:2022, the sector expanded by 1.34% YoY. The lean harvest season within the period came in with higher crop produces.

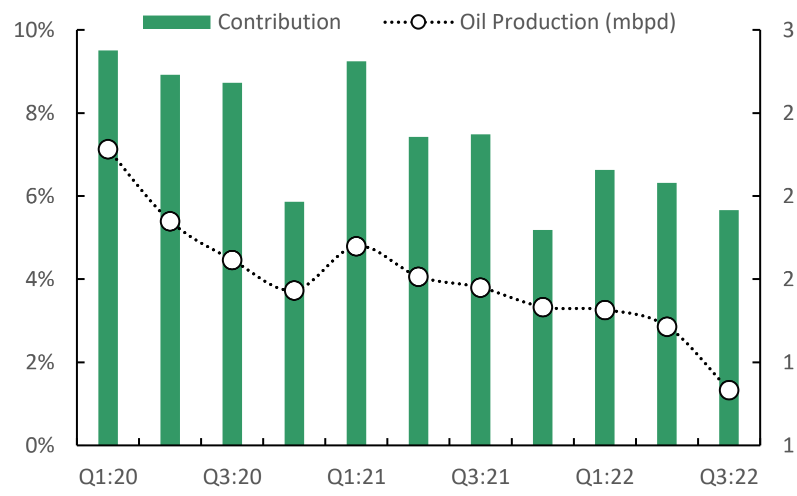
The flooding event of Q3:2022 poses a major threat to agriculture sector expansion in Q4:2022 and in the early parts of 2023. The flood had wiped out some crops from farmlands while also displacing some farmers. This is expected to put a strain on output.

Oil Sector:

Deep Contraction Persists

Throughout 2022, the performance of the crude oil sector was very unimpressive. Firstly, the contribution of the oil sector to real GDP has declined from over 9% in Q1:2020 to less than 6% in Q3:2022. This comes on the heel of continuous decline in oil production which has persisted for 6 consecutive quarters (since Q2:2021). Oil production volumes plunged to 1.20mbpd in Q3:2022 (vs. 1.57mbpd in Q3:2021), despite an OPEC+ quota of 1.82mbpd during the period. The major issues confronting the Nigerian oil sector remain lack of investment flows into the sector, pipeline vandalism, and oil theft. Other non-negligible issues during the period were the flooding, prolonged shut down of Trans Forcados and Trans Niger pipelines for maintenance purposes which affected exportation of crude oil.

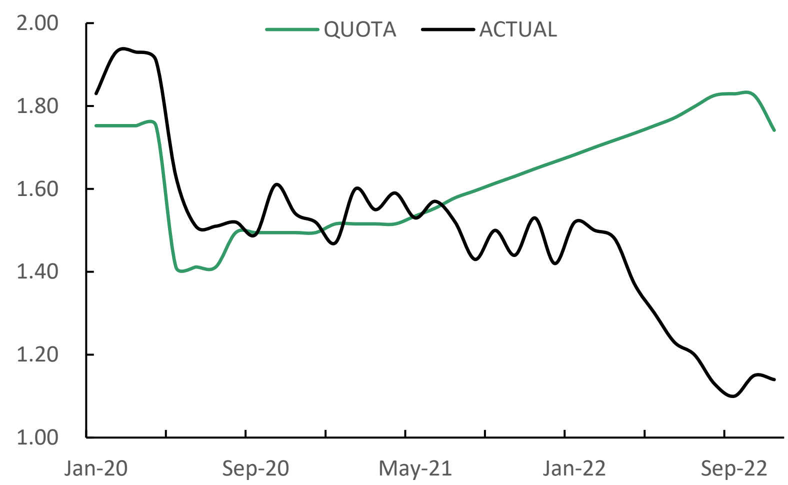
Chart 25: Oil sector Contribution to real GDP



Source: National Bureau of Statistics, Meristem Research

The decline in oil production has denied Nigeria the opportunity to benefit from the steady rise in crude oil price during the year. So far in 2022, oil price has averaged c. USD100/bbl gaining more than 40% over 2021 average price of USD70.85/bbl.

Chart 26: Nigeria's Actual Oil Production vs. OPEC Quota



Source: National Bureau of Statistics, Meristem Research

Outlook:

Gradual Oil Recovery, Stunted Non-Oil Prospect

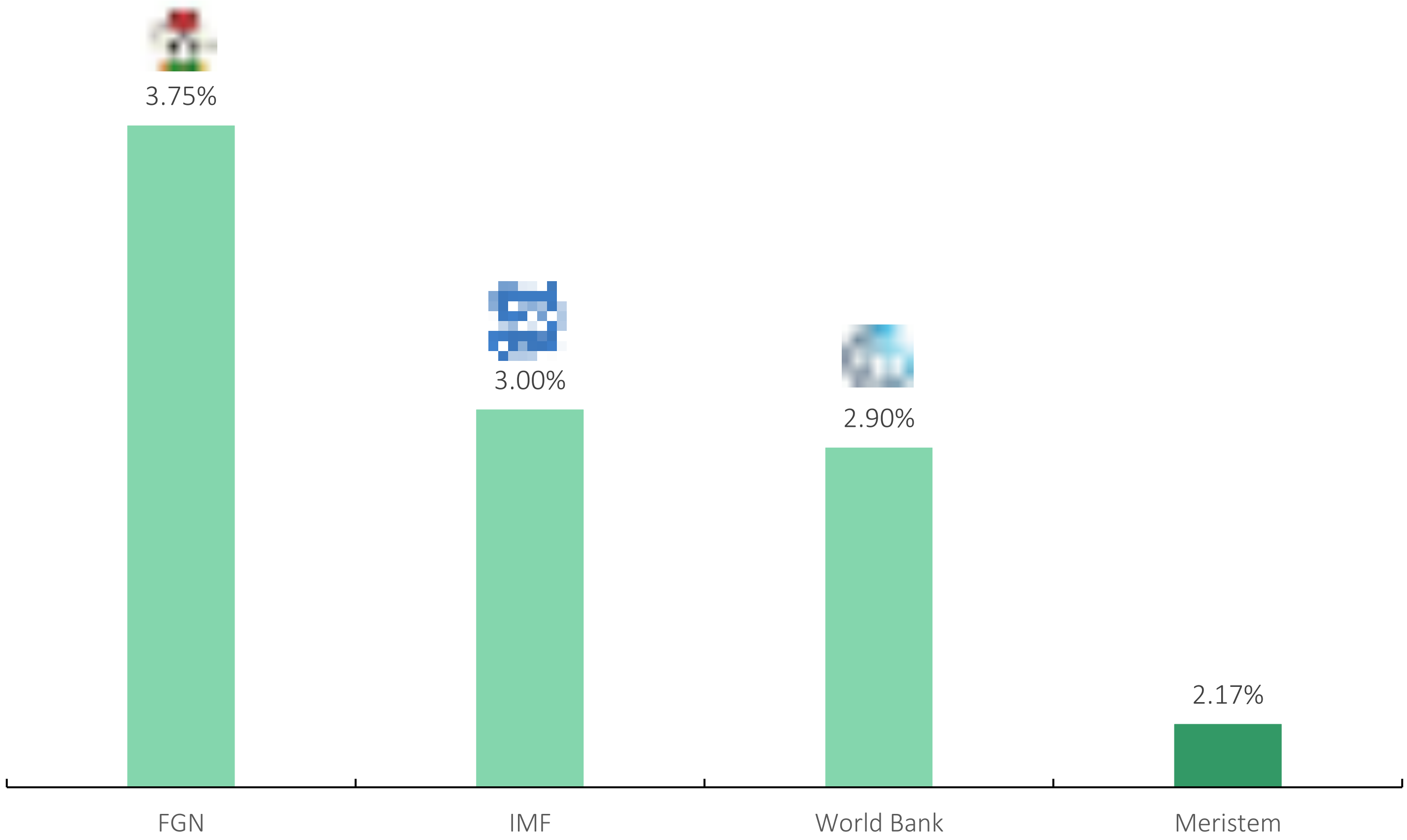
There is a general consensus of an expected slower growth for the Nigerian economy in 2023. The IMF recently revised its Nigerian real GDP growth forecast downwards to 3.00% (down from 3.20% earlier expected) while the World Bank also slashed the same to 2.90% from an earlier projection of 3.20%. Also, the rather bullish forecast of the Federal Government reduced to 3.75% from its initial estimate of 4.39%.

The reasons for the slower growth projections are similar: slowdown in agricultural output due to the flooding; the permeation of the hawkish monetary stance on the real sector, as well as the lingering FX issues. On the one hand, the prospect for the oil sector is positive in 2023 as the FGN's intensified efforts on combating oil theft and pipeline vandalism have began to yield good fruits in terms of higher crude oil production. We also posit that the coming on stream of the Dangote Refinery portends positives for recovery of the oil sector.

On the other, we think that the expected slowdown in the non-oil sector will outweigh the gradual recovery in the oil sector.

"Thus, our projected real GDP growth for Nigeria in 2023 is 2.17%".

Chart 27: Nigeria's 2023 Real GDP Growth Forecast



Source: FMoF, IMF Staff Update, World Bank's Nigeria Development Update , Meristem Research .

Money & Credit

Money Supply on the Rise

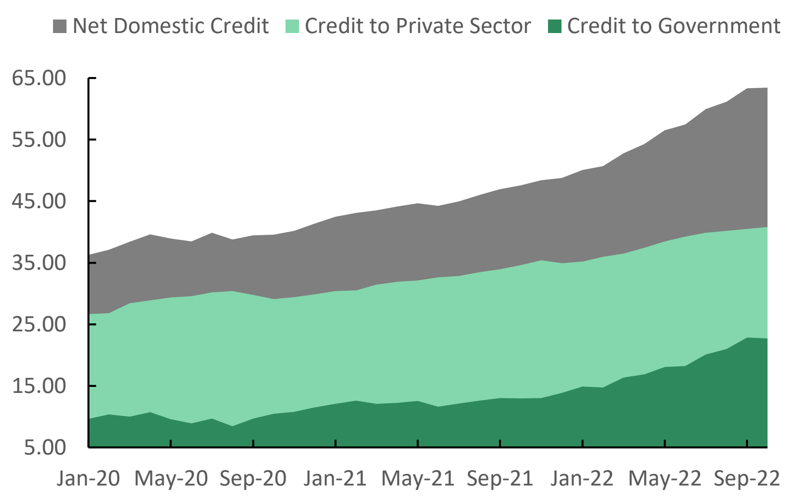
Broad money supply (M2) maintained an upward trend for most of 2022. Compared to 2021, M2 expanded by 16.52% YtD to NGN51.78trn as of November 2022 despite the shift to a contractionary monetary stance by the monetary authorities.

An assessment of the CBN's money and credit statistics also revealed that the net domestic credit (a component of broad money supply) (+31.71% YtD) expanded to NGN64.22trn as of November 2022. The expansion is mostly credited to higher credit to the government (+73.69% YoY). In our view, this is reflective of the FG's shift to more domestic borrowings as a result of the higher cost of borrowing in the international market.

On the other hand, credit to the private sector stood at 41.58trn as of November 2022. This represents an increase of 19.07% from the value recorded as of December 2021. We accredit this growth partly to the CBN intervention programs in the real sector.

According to the data from the CBN, the sectors that received a significant part of the credit include the industry and services sectors, with 37.15% and 37.79%, respectively, of the deposit money bank credit. These sectors contribute majorly to the aggregate output of the country.

Chart 28: Trend of Domestic Credit (NGN'trn)



Source: CBN, Meristem Research.