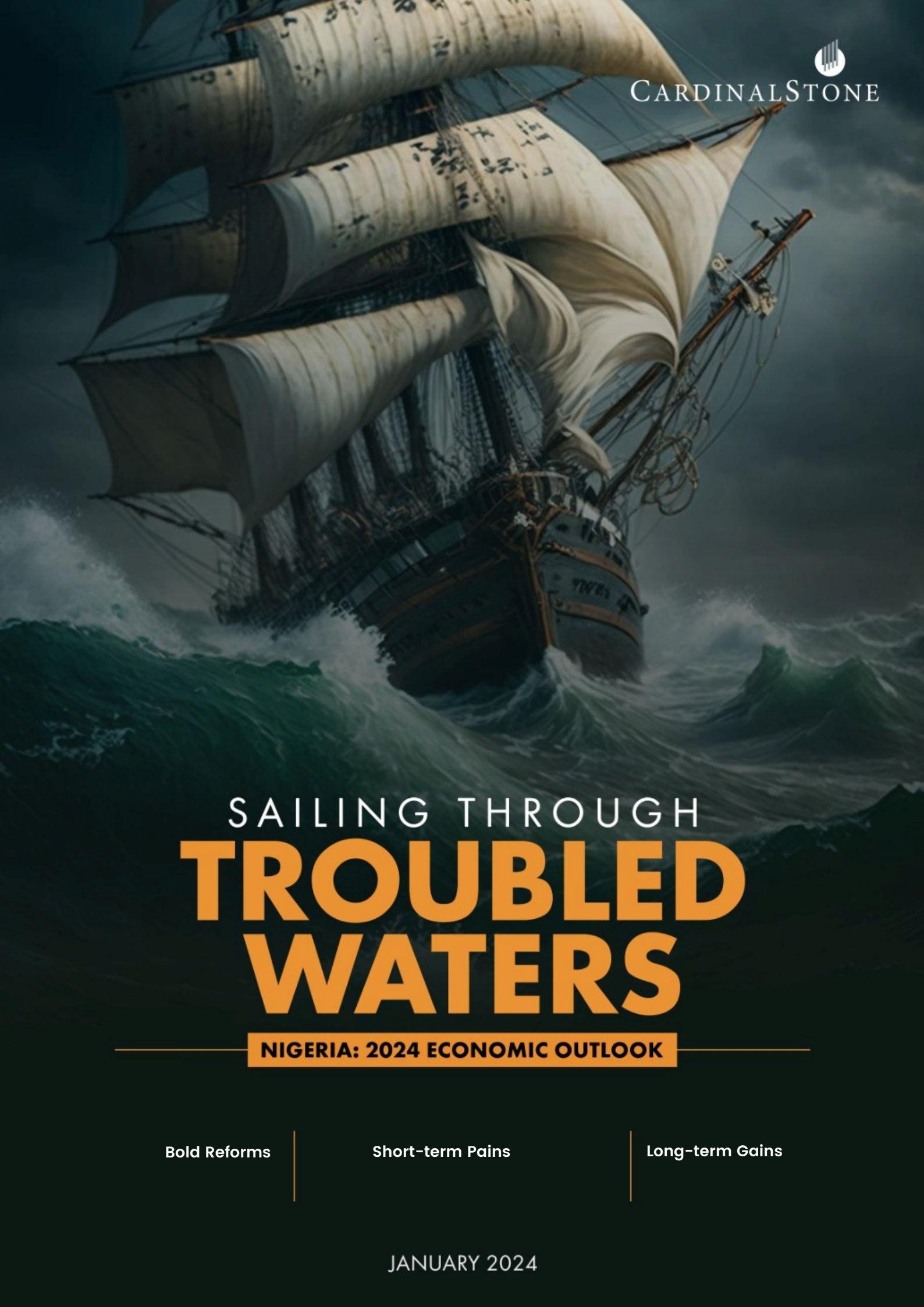




CARDINALSTONE



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NIGERIA: 2024 ECONOMIC OUTLOOK

Bold Reforms

Short-term Pains

Long-term Gains

JANUARY 2024

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Executive Summary

We begin our outlook conversations with context. Nigeria, a country with 37.0% of its population living on less than \$1.9 per day, is facing an inflation rate of over 28.0%, an inability to produce its most important economic resource optimally, and the threat of sustained departure of some of its finest human resources. The preceding gives a sense of the weight of burden ongoing reforms must have placed on the population and the level of responsibility on economic managers to carefully track and report execution to ensure the short-term pains someday yield sustainable long-term benefits.

Indeed, Nigeria was not alone in the revolutionary swing of new helmsmen, with Kenya and Argentina other examples of countries which saw new presidents withdraw fuel subsidies or implement other shock economic measures. While Kenya quickly backtracked on its subsidy removal following heavy backlash from its citizens, there appears to be lingering debate on whether Nigeria has retained the full subsidy removal it fervently declared in May 2023, especially given the relative stability of the price of PMS vis-à-vis the sharp increase in that of diesel between May and December. The debate subsist because both products are meant to be fully deregulated, dictated by forces of demand and

supply, and have similar drivers (i.e. exchange rate, crude oil prices, freight charges, and others).

Whatever the case (partial or full subsidy removal), this report acknowledges that the country appears to be taking the difficult but economically sustainable path, with efforts to unify the exchange rates, remove the cap on standing deposit facilities, and review of electricity meter prices among proactive decisions taken. The report also joins economic managers to do a review of developments since the introduction of the policies, delineate the outlook for the economy, as well as suggest potential opportunities these initiatives and expectations can throw out to investors. After all, even in the challenging 2023, a passive investor could still have earned a staggering 45.9% just by tracking the Nigerian All-Share Index (ASI), while those who played at the short end of the bond curve had intermittent opportunities to book implied yields in excess of 21.0% on 1-year instruments.

We hold the view that 2024 would also be slightly tough but filled with opportunities for those who proactively seek alpha. Thus, we adopt a top-down approach to help readers assess what potential macroeconomic gyrations could mean for investments and opportunities in 2024.

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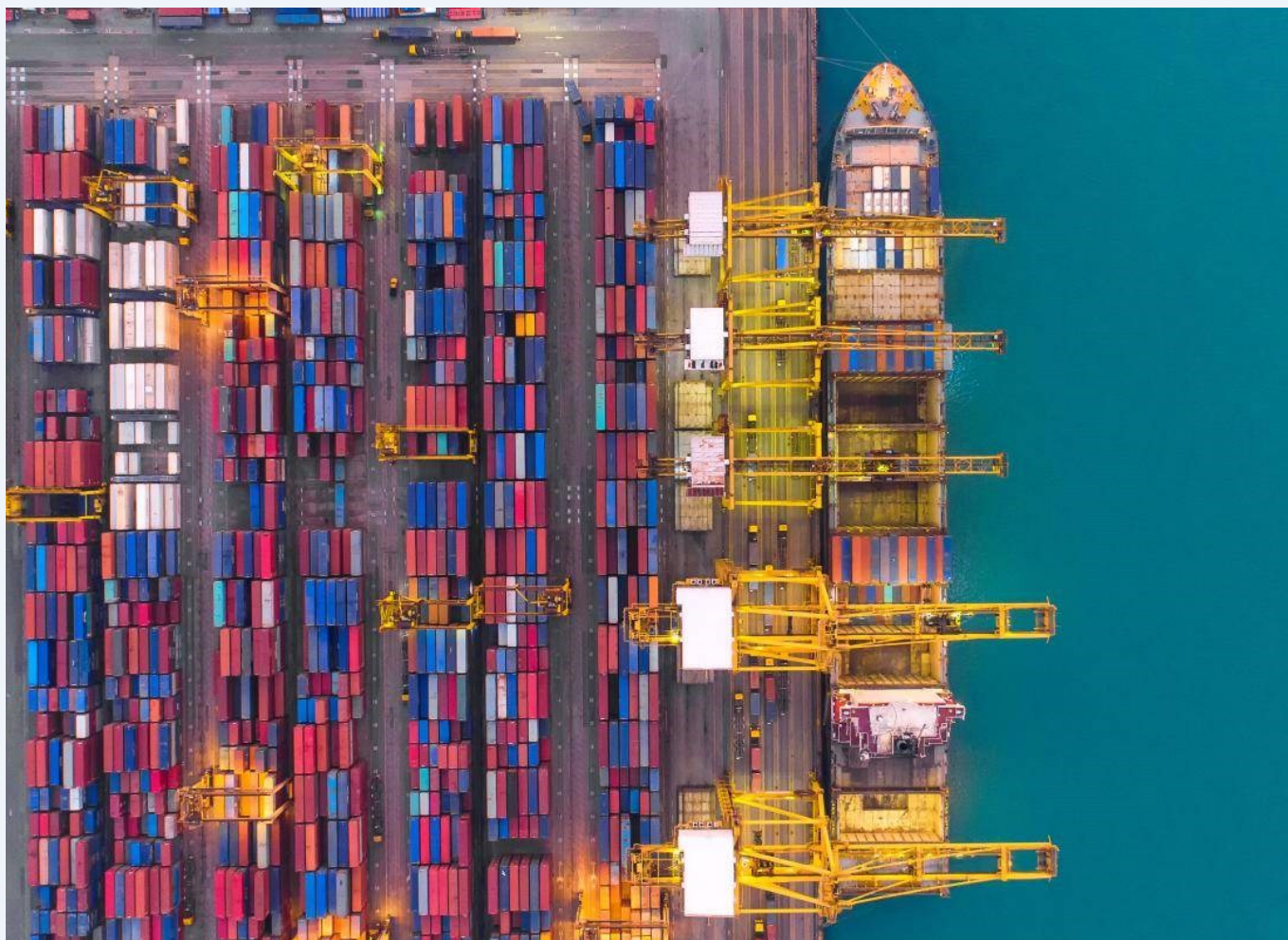
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Global Economy

Countdown to monetary policy reversal

The global economy outperformed analyst expectations in 2023, largely aided by the stronger-than-expected growth in the US due to a robust labour market and elevated private consumption. This resilience was despite the negative pass-through of a higher-for-longer interest rate environment, the banking crises in H1'23, US debt ceiling tensions, and sustained geopolitical concerns.

Nevertheless, global growth still trailed its pre-pandemic level, indicating that there were still inherent drags. These challenges included weaker-than-anticipated growth in the Euro Area due to high energy costs and low productivity, an effect of an ageing population. Elsewhere, the real estate crisis continued to weaken sentiments in China despite its economic re-opening and the stimulus from both the fiscal and monetary

authorities. In all, about 90.0% of economies were projected to record slower growth in 2023, with global growth set to settle at 3.0% for 2023 (vs 3.5% in 2022).

The global economic outlook appears even weaker in 2024, with advanced economies expected to shed 10bps of GDP growth vs 2023. The US is projected to have the biggest drag due to weaker domestic consumption (over 60.0% of the economy) as the momentum in the job market plateau with slowing payroll growth and modestly rising unemployment. There is also a concerning reduction in some of the savings accumulated during the coronavirus pandemic period. Elsewhere, the Chinese market is projected to suffer from a slowdown in consumption, sustained pressure in the property market, and rising local government debt.



Figure 1: Global growth to weaken in 2024

Real GDP Growth (%)	2018	2019	2020	2021	2022F	2023E	2024F
World	3.6	2.8	-2.8	6.3	3.5	3.0	2.9
Advanced Economies	2.3	1.7	-4.2	5.6	2.6	1.5	1.4
United States	2.9	2.3	-2.8	5.9	2.1	2.1	1.5
Euro Area	1.8	1.6	-6.1	5.2	3.1	0.5	1.2
Germany	1.0	1.1	-3.8	3.2	1.8	-0.5	0.9
France	1.8	1.9	-7.7	6.4	2.5	1.0	1.3
Italy	0.9	0.5	-9.0	7.0	3.7	0.7	0.7
Spain	2.3	2.0	-11.2	6.4	5.8	2.5	1.7
United Kingdom	1.7	1.6	-11.0	7.6	4.1	0.5	0.6
Japan	0.6	-0.4	-4.2	2.2	1.0	2.0	1.0
EM and Developing Economies	4.6	3.6	-1.8	6.9	4.1	4.0	4.0
Sub-Saharan Africa	3.3	3.2	-1.6	4.7	4.0	3.3	4.0

Source: IMF, CardinalStone Research

Moderating inflation could fuel monetary authorities' pivot

After reaching a four-decade high of 8.7% in 2022, global inflation was projected to moderate to 6.9% in 2023. We see legroom for further temperance in inflation in 2024, aided by declining commodity prices. On this wise, the US Fed and other global monetary authorities could either stand pat on interest rates or gradually reduce rates, especially in the second half of 2024. For context, 17 out of 19 Fed officials project that the policy rate will be lower than the current 5.25%-5.50% range by the end of 2024. This view is consistent with market consensus, which projects the rate to fall to 3.8% by the end of 2024.

Figure 2: Sustained moderation in inflation

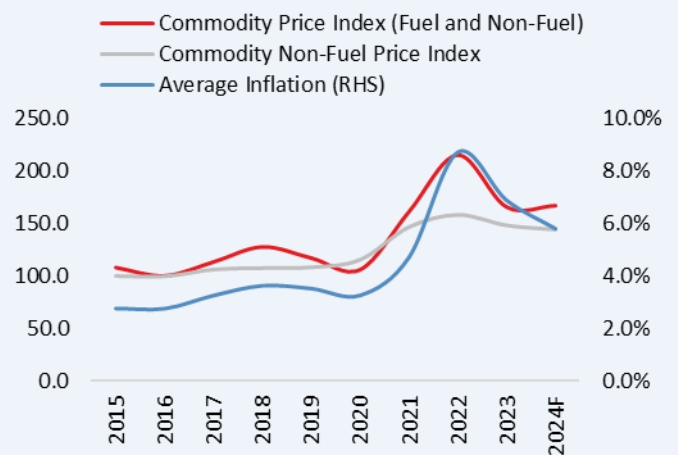
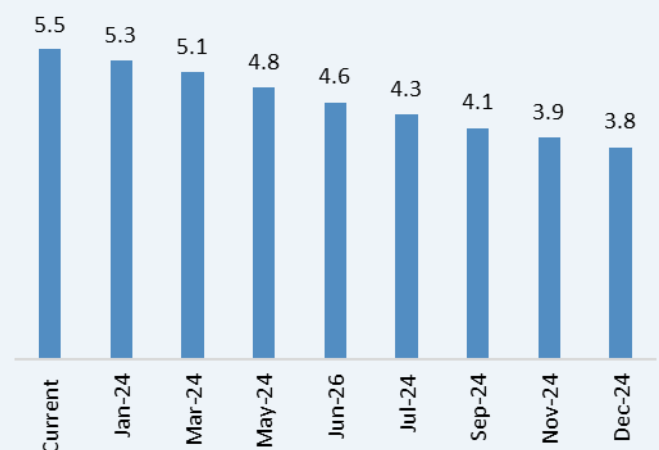


Figure 3: Consensus expects US Fed to cut rate (%) to 3.8% by end of 2024



Source: IMF, CardinalStone Research

3.8%

Consensus expects US Fed to cut rate in 2024



Domestic Economy

Reclaiming the lost economic momentum

The effects of economic reforms – subsidy removal, efforts to harmonise exchange rates and others – appear to have driven inflation to a 27-year high and, inadvertently, weakened economic activities in 2023. On the heels of the policies, domestic consumption (c.60.0% of the economy) declined by c.10.6% in 2023, materially weaker than the 2.0% and 5.3% contractions during the Covid period and 2016 recession, respectively. Despite the government's efforts to alleviate the impacts on the cost and standard of living of the populace, the country's poverty level worsened

in 2023. The sluggish economic growth also became more entrenched due to flat investments and low unemployment, which increased the burden of catering for dependents. Elsewhere, material currency devaluation cascaded to FX losses for exposed businesses, higher import duties for companies reliant on imported raw materials, and, consequently, weaker manufacturing growth. Even though the weaker currency appeared to have had a positive impact on exports, available data still suggested that overall 2023 growth averaged 2.5% (vs 3.1% for 2022).



Figure 4: Policy-induced drag on economic activities

Quarterly average growth (%)	Pre-recession	Slowdown	Recession	Early recovery	Recovery	Covid	Covid Recovery	Inflation-induced slowdown
	2011-2014	2015	2016	2017	2018-2019	2020	2021-2022	2023
Domestic consumption	5.5%	1.4%	-5.3%	0.0%	1.7%	-2.0%	12.9%	-10.6%
Government consumption	-2.3%	-11.4%	-14.5%	-12.2%	24.6%	66.6%	-19.2%	11.8%
Inventories	51.2%	-5.7%	-1.3%	21.2%	-10.9%	9.6%	8.2%	-23.7%
Investment	3.5%	-1.2%	-5.1%	-2.5%	9.2%	-14.2%	4.2%	0.1%
Export	7.8%	0.7%	12.4%	8.5%	8.0%	-31.1%	20.4%	72.6%
Import	-3.5%	-24.6%	-9.3%	6.2%	39.8%	-61.4%	52.0%	-29.1%
Aggregate GDP	5.2%	2.7%	-1.6%	0.7%	2.1%	-1.8%	3.4%	2.5%

Source: NBS, CardinalStone Research

In assessing the impact of reforms, we isolated 3 key indicators – growth, inflation and fiscal position. Initial evaluations suggest a material short-term burden on the economy.

Nevertheless, we remain optimistic that the pain is likely to translate into improved economic momentum in the medium-to-long term.

Figure 5: The gains and brunt from the government's economic reforms



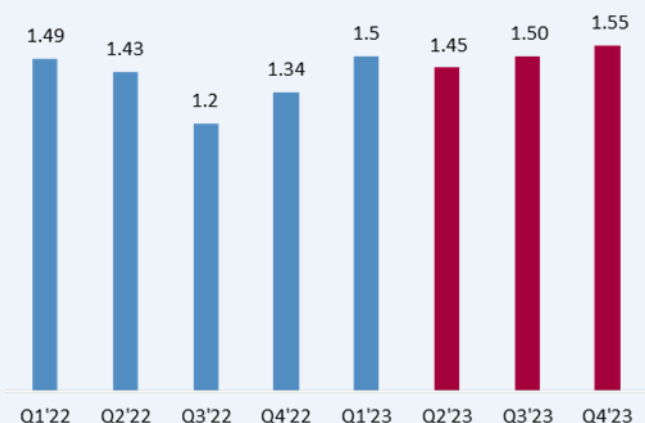
Source: World Bank, CardinalStone Research



Unlocking dormant oil fields could lift the oil sector out of recession

2024 will likely be an exciting year as the GDP growth rate could reach 3.5%. The oil sector is expected to be a key driver, with projected improvement in oil production set to propel the sector out of a 3-year recession. After a long oil output drag due to operational difficulties, incessant oil theft, and underinvestment, the recent impetus of the government to drive offshore exploration, which is less prone to oil theft, bodes well for oil production outlook. In addition, the government has approved a new marginal field round aimed at dormant oil fields abandoned by international oil companies (IOCs) for over a decade. These actions of government action could propel average oil production to 1.56mb/d, with associated GDP likely to rise by 7.6% YoY.

Figure 6: We see legroom for improved oil production (Mb/d) in 2024



Sources: NBS, CardinalStone Research

Tapping gains from digital society, emerging technologies, financial literacy, and increasing e-commerce activities

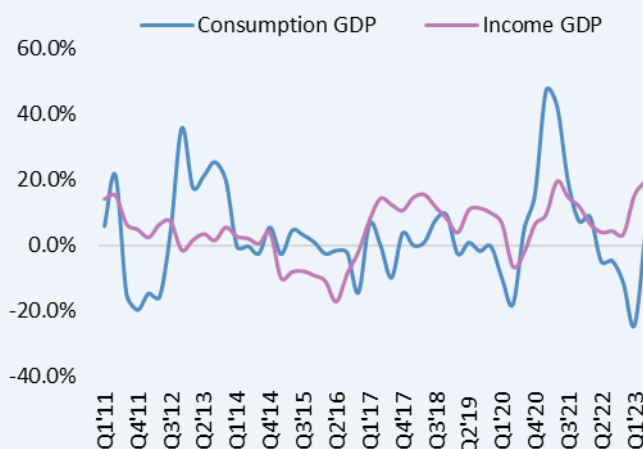
We are constructive on the services sector due to the sustained traction in ICT. We expect improved investments from telecom players, who remain aggressive in improving network coverage, technology, and service (mean post-Covid annual CAPEX of ₦957.2 billion).

In addition, we expect accretive benefits from higher subscribers as demand for data and voice continues to soar. We see legroom for additional gains from the growing e-commerce sector, aided by technological advancement, widespread internet accessibility, and a young, tech-savvy population. The e-commerce market was valued at \$6.8 billion in 2022, with an average growth of 11.0% over the last 3 years. The growing e-commerce segment is positive for the trade sector and FMCG sales options.

Rising wages could prop up domestic consumption

We see legroom for higher wages in 2024, with inflation forcing the private sector to push up salaries and the government set to initiate a new wage regime in April, 2024. While higher wages could increase inflationary risk if production does not keep pace, we expect the impact of the high base effects on some inflation buckets to cap the scope for a strong YoY increase in the broad CPI reading. In addition, wages have historically had a weak correlation with inflation (0.28 over the last 12 years), possibly due to Nigeria's inflation computation methodology. In any case, we are of the view that higher wages could support recovery in domestic consumption, with a positive pass-through to the economy.

Figure 7: Rising wages could support consumption



Sources: NBS, CardinalStone Research



The Growth outlook is biased to the upside

In summary, we see 2024 growth at a 3.5% level, split into 7.6% growth in the oil sector and 3.3% in the non-oil sector. Our 2024 growth expectation is higher than the 2.5% projected for 2023 and 3.0% average recorded over the last 3 years.

Figure 8: We project real GDP growth of 3.5% for 2024

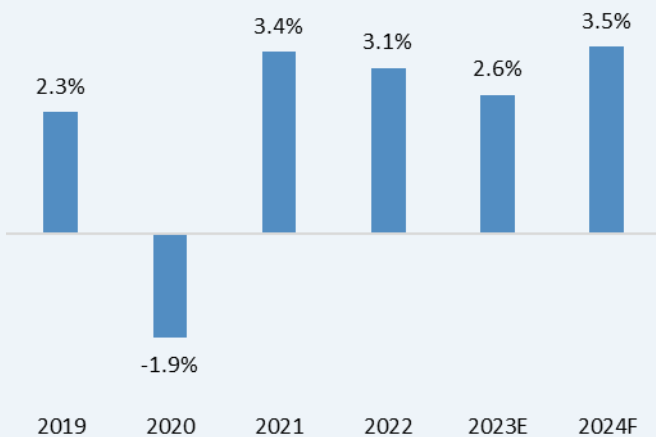
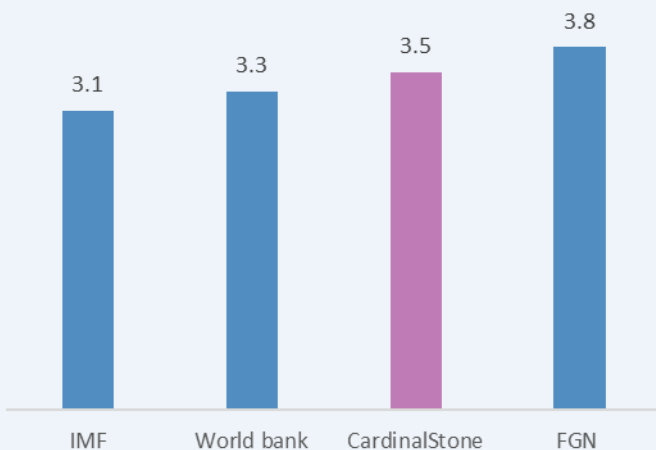


Figure 9: Our 2024 growth projection (%) compared to other forecasts

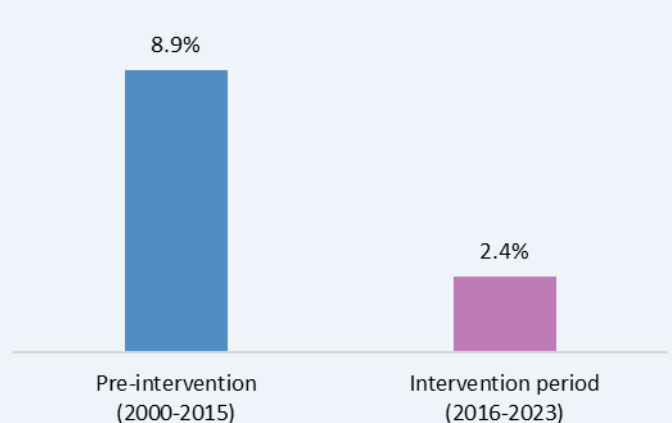


Sources: NBS, World Bank, IMF, CardinalStone Research

Can the CBN discontinuation of developmental finance further weaken the Agro output?

The CBN has pulled back from the development finance intervention initiated to support the real sector. About 34.7% of these interventions were skewed to the agricultural sector, wherein CBN disbursed single-digit loans of about ₦1.8 trillion to 4.6 million farmers for 679 agro projects since 2015. Despite the financing, agricultural GDP growth has weakened materially, averaging 2.4% between 2016 to 2023 versus the pre-intervention period outturn of 8.9%. We perceive that these interventions yielded little impact due to a lack of proper accountability on the use of funds and other exogenous setbacks such as insecurity and unfavourable weather conditions. Should security and weather improve, we opine that the discontinuation of the intervention will unlikely drag the sector's growth traction. We project agricultural sector GDP growth to improve to 1.6% in 2024 from 0.8% in 2023, aided by low base and likely favourable weather conditions, with improvement in security a material upside risk.

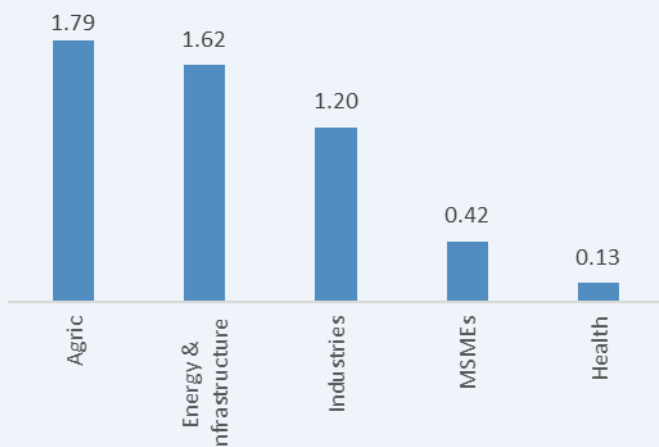
Figure 10: Agric sector average growth was weaker in the intervention period



Sources: NBS, CardinalStone Research



Figure 11: The cumulative CBN intervention (₦' trillion)



Source: CBN, CardinalStone Research

In pursuit of a \$1 trillion economy. Ambitious? Yes, realistic?

Nigeria has set an ambitious plan to join the trillion-dollar economies, targeting \$1.0 trillion in the next 7 years and \$3.0 trillion in the next 10 years. If the government's target is achieved, Nigeria could be among the top 25 largest economies globally. In our view, 3 factors are likely to be pivotal in achieving these targets. They include exchange rate level, inflation trajectory, and value creation. To start with, we assume that inflation will revert to its long-run average of 14.0% from current levels of over 27.0%, as most of the currency pressure points may have waned by 2025. On currency, we assume that the naira at the official window will touch ₦1000.0/\$ by 2024 before depreciating annually by 4.0% between 2026-2030. Assuming the assumptions above hold, Nigeria would still need to grow at an average annual GDP rate of 7.6% over the next 7 years to be able to achieve a \$1.0 trillion economy.

Turning attention to value creation, which is the crux of this section, we identify 5 factors that could aid economic value over the projected period.

- **Dangote refinery** — After a long delay, the Dangote refinery received its maiden one million barrels of Agbami crude grade in Dec 2023, while other supplies followed from the NNPC.

We project that the facility could add about 1.2% - 1.5% to GDP output, assuming a capacity utilisation of 80.0%-90.0%. On second-order impact, the refinery currently employs 33,000 individuals, both directly and indirectly, and this number is expected to rise to 100,000 once the facility reaches full capacity. Moreover, the refinery has the potential to result in FX inflows of about \$15.0 billion for Nigeria, equivalent to 45.8% of the current gross foreign exchange reserves. This substantial foreign exchange gain is expected to have a positive ripple effect on manufacturing companies by improving liquidity across various foreign exchange channels.

- **Lekki Free Trade Zone (LFTZ)** – The free zone area currently covers over 16,500 hectares, and it is projected to be a major economic hub in Nigeria in the next few years. The LFTZ is positive for businesses located there and is projected to result in more than 30,000 jobs over the next few years.
- **African Continental Free Trade Area (AfCFTA)** – The AfCFTA was designed to eliminate tariffs and reduce barriers to trade in services. According to the World Bank, the AfCFTA could increase Africa's income by \$450.0 billion by 2035, increase intra-African exports by more than 81.0% and reduce the number of people living in extreme poverty by 40 million. The outlook for AfCFTA is positive for Nigeria and long-term growth prospects.
- **Rebasing of the GDP** – A rebasing exercise could help narrow the informal sector through improved capturing. Also, better capturing could enhance the efficacy of policy and direct interventions, expand the tax net, and boost related revenues. We highlight that the GDP rebasing exercise of 2014 increased Nigeria's economic size by c.89.2% from ₦42.4 trillion (\$270.0 billion) to ₦80.2 trillion (\$510.0 billion), which resulted in the inclusion of sectors like telecommunication.
- **Strong commitment to economic reforms** – During the first decade of the 21st century, the Nigerian economy exhibited immense potential, with an average GDP growth rate of 8.2% and recognition by the World Bank as one of the top 15 fastest-growing economies worldwide. Effective implementation of reforms could draw the country steps closer to these glory days, aided by the expected improvement in foreign investors' appetite for Nigerian assets.



Fiscal Position: Rising debt level, any sustainability concerns?

FX gains propped up the federation account in 2023

The federation account materially improved in the second half of 2023, largely propped up by the positive pass-through from exchange rate gains. Specifically, windfall from FX gains accounted for c.17.4% of total distributed revenue across the 3 tiers of government. The second-order impact of the FX gains was also evident on the corporate taxes in H2'23, which was over 3.0x the CIT recorded in H1'23, as companies recorded revaluation gains, especially banks which had large positive net-FX exposures.

FX Subsidies yet to fully reflect on government earnings

Elsewhere, following the announcement of subsidy removal, we had predicted a net saving of about N4.0 trillion per annum, translating into a monthly gain of about N330.0 billion. So far, we have witnessed material jumps in petroleum profit taxes, royalties, interim yearly dividends, and FX gains. The monthly average FAAC inflows have improved since subsidy removal to N1.7 trillion vs N900.0 billion. To our minds, given that PMS prices have been relatively stable despite the fluctuations in the NAFEM rate and higher average crude oil prices, it could be that the government still made some small subsidy payments on PMS.

Figure 12: FX gains prop up government gross earnings (N' trillion)

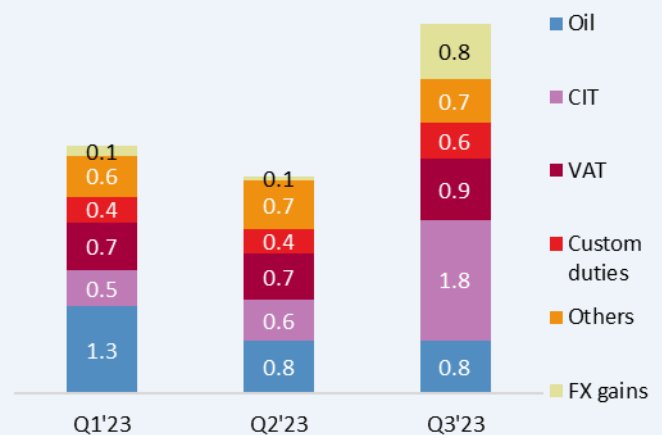
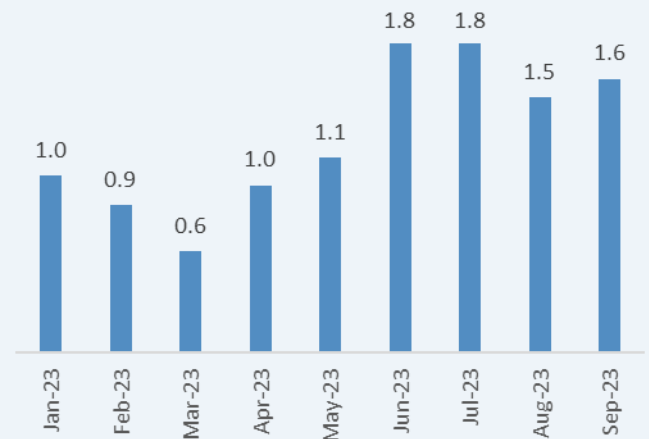


Figure 13: FAAC inflows (N' trillion) have improved since subsidy removal



Sources: OAGF, CBN, CardinalStone Research



FGN to drive efficiency in tax systems

Even though there are c.60 different taxes levied across federal and state governments, Nigeria has one of the lowest tax revenue to GDP ratio in the SSA region (c.10.0%). The uninspiring ratio is the result of low tax compliance, a narrow tax base, and large tax expenditures. Tax expenditures are government losses from tax exclusions, exemptions, deductions, credits, deferrals, preferential tax rates and cost of tax collection. According to the budget office, the revenue foregone due to tax expenditures has averaged ₦5.8 trillion annually (c.63.2% of the projected fiscal deficit for 2024) over the last 4 years.

According to the IMF, a survey conducted by McCulloch (2020) indicated that almost half of the respondents agreed with the statement "I would not pay my taxes if I would not be caught", while about 73.6% of the respondents didn't pay tax in the preceding year. Hence, low compliance is another critical issue to address to unlock low-hanging non-oil revenue.

Nigeria has plans to propel the tax-to-GDP ratio to 18.0% by 2026 from current levels of 10.0%. This objective can be achieved by clamping down on tax evasion, materially reducing tax expenditure, and enhancing transparency in the tax system.

Figure 15: Elevated tax expenditure limiting gov't's gross tax revenue

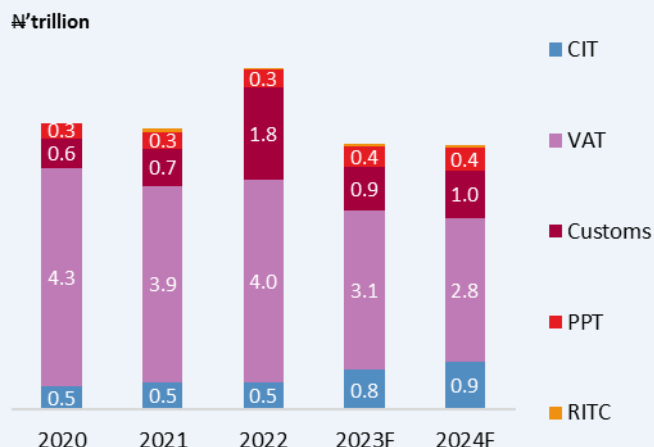
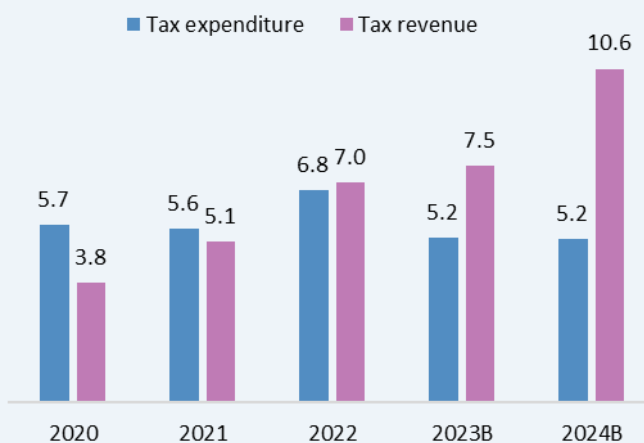


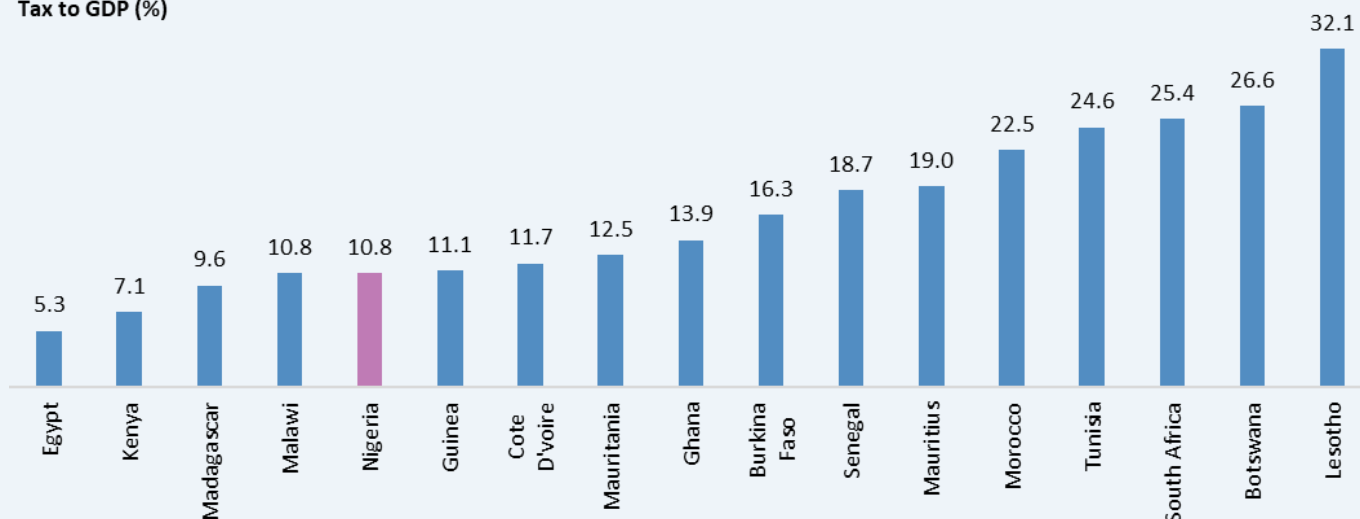
Figure 16: Trend of tax expenditure and revenue (₦ trillion)



Source: CBN, CardinalStone Research

Figure 14: Nigeria has low tax revenue mobilization

Tax to GDP (%)



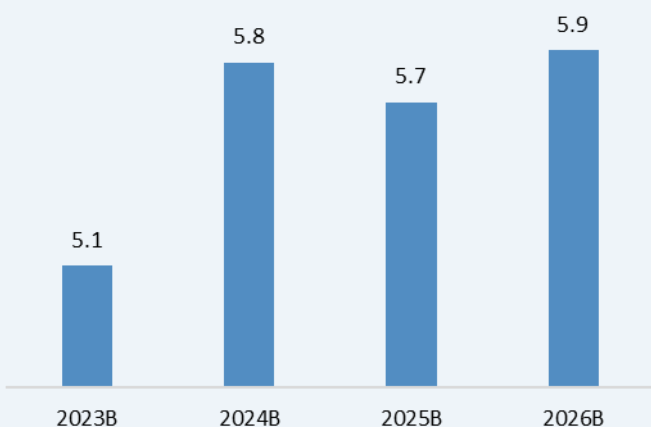
Source: CEIC, CardinalStone Research



Government to introduce new minimum wages in 2024

Elsewhere, after months of negotiations between the government and labour unions, a new minimum wage for workers is expected to begin in April 2024, marking Nigeria's first modification to the minimum wage structure since 2019. In light of the above, the government has planned to spend an average of ₦5.8 trillion over the next 3 years on personnel costs.

Figure 17: New minimum wage (₦' trillion) to fuel higher personnel cost



Source: Budget office, CardinalStone Research

Rising debt level: Any sustainability concerns

Debt sustainability remains a concern in the SSA region, as elevated spending and weak revenue mobilisation continue to fuel high risks of debt default. For context, according to the IMF, the average debt ratio to GDP in SSA has almost doubled from 30.0% in 2013 to c.60.0% as of the end of 2022. Repayments have also become costlier due to the elevated global yield environment.

For Nigeria, the debt level continues to rise, up by ₦41.7 trillion to ₦87.9 trillion as of 9M'23, reflecting the securitisation of Ways and Means and the negative pass-through of naira devaluation on foreign debt. For context, following the over 40.0% naira devaluation by the CBN, FX conversion added about ₦12.8 trillion to the total debt profile.

Despite the mounting debt level, sustainability worries have not gone over the roof, as Nigeria is projected to have a modest debt-to-GDP of 38.8% by the end of 2023, which is materially lower than the IMF benchmark of 50.0-55.0%.

The above analysis suggests that, from a broad perspective, the country's debt level is still within a manageable range. Additionally, analysing Nigeria's public debt (excluding loans from the CBN), we observe that the average debt maturity stands at a fairly long duration of 9.7 years, with a small proportion of debt instruments with less than five years of maturity. Thus, Nigeria appears to have a significant time frame to repay obligations and a low risk of default.

Figure 18: Moderate risk of debt distress

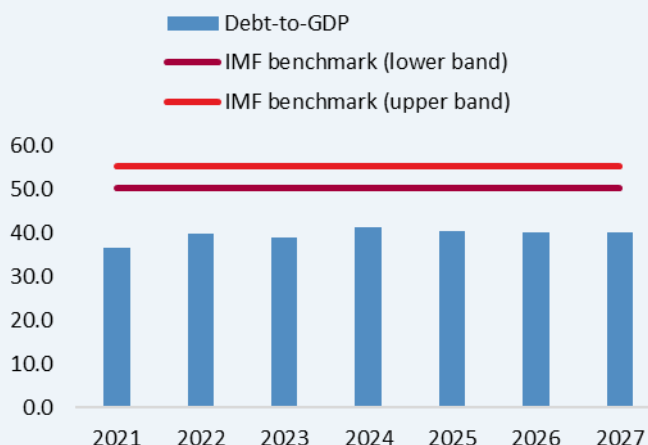
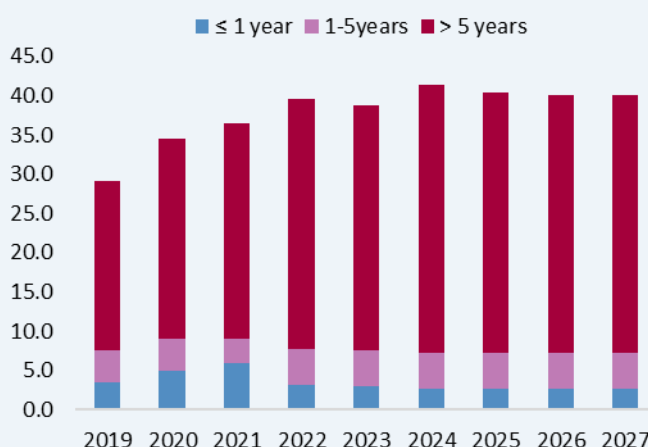


Figure 19: Moderate risk of debt distress



Source: Budget office, CardinalStone Research



Monetary Policy: In pursuit of price stability

Inflation closed 2023 at a 27-year high

For over 3 decades, Nigeria's inflation has largely stemmed from monetary and FX factors. For context, the IMF analysed Nigeria's inflation using a panel regression over 1970-2020 and discovered that about half of the average inflation is explained by money supply (M3) growth, while 25.0% stemmed from exchange rate depreciation, and the remainder by country-specific effects which may be interpreted as unidentifiable structural factors. Clearly, these drivers remain prevalent, with money supply (M3) scaling by an average of 28.8% in 2023, the highest growth level seen in over a decade. Aside from the M3, the largest inflationary drivers in 2023 were elevated PMS and AGO prices, material currency pressure, and below-average rainfall. These factors pushed inflation to par with 2005 levels of 28.2%, which is also the highest point since 1996.

28.3%

Nigeria's inflation ranks one of the highest in Africa

Figure 20: Inflation at the highest point since 1996

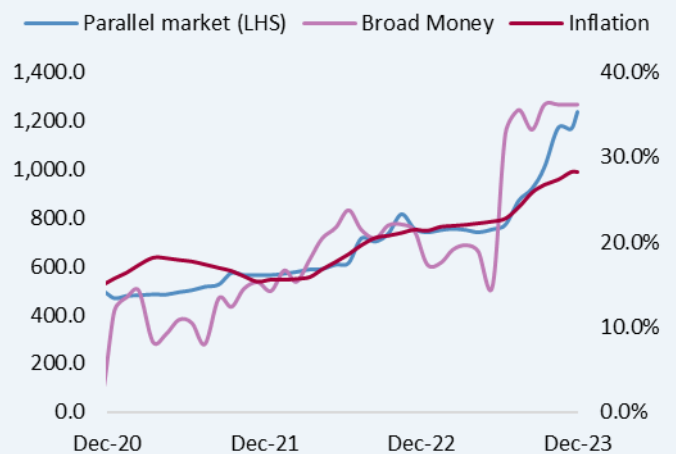
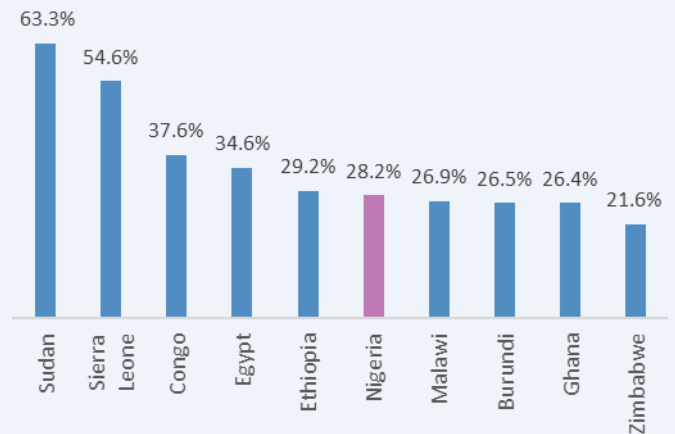


Figure 21: Nigeria's inflation ranks one of the highest in Africa



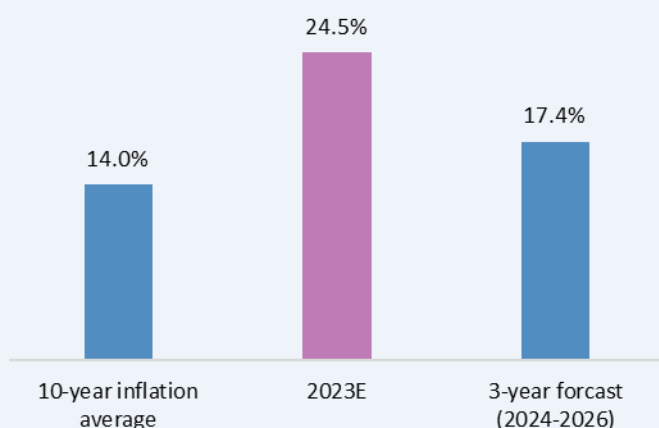
Source: NBS, CBN, CardinalStone Research



Base effect-induced moderation expected in 2024

Inflation is projected to peak in the first quarter of 2023, settling at c.29.5% by March 2024. From the second quarter of the year, we expect the base effect and the dissipating impact of the large gasoline price increases to propel a disinflation, helping 2024 inflation to average 22.0% from 24.5% expected in 2023. In addition, the sustained hawkish disposition of the CBN and reduced deficit financing to the government due to expected gains from subsidy removal could lower the broad money supply, which is positive for inflation. Despite the expected moderation, our projected inflation is well above the long-run average of 14.0% partly reflecting pressure points currency pressures.

Figure 22: Inflation trajectory



Source: NBS, IMF, CardinalStone Research

22.0%

Inflation projected to remain well above the long-run average of 14.0%

Monetary policy: Inflation targeting and improving MPR transmission

The CBN governor has communicated a few lines of action that could guide monetary direction over the next few years: the adoption of inflation targeting, price stability primacy, strengthening MPR transmission, discontinuation of development finance, and gradual return to orthodoxy.

To start with, the CBN has reiterated its commitment to adopting an inflation targeting (IT) framework as against the monetary targeting policy framework. In an IT regime, as defined by the IMF, the central bank uses its inflation forecast as the intermediate goal and short-term interest rates as the operating target. Under this regime, the central bank engages in day-to-day liquidity operations to align interbank rates with the policy rate. To our mind, an IT framework will help to prevent inflation blindness and ensure a proactive approach from the CBN to keep inflation in check. In the event of inflationary shocks that could deviate from the target, the policy rate is not adjusted in response to the shocks but based on the perceived impact of these shocks on the initial target.

On the weak MPR transmission, the IMF applied Taylor's rule¹, which revealed a significant interest rate smoothing over the last years. Interest rate smoothing implies that the CBN tightens monetary policy only when there are depreciation pressures on the naira and capital flight concerns, while inflation and output goals are associated with unorthodox monetary policies. This historical action might have contributed to the weakened MPR transmission over the years and undermined the CBN's ability to pursue its inflation control mandate. Nevertheless, the new CBN administration has started to improve MPR transmission by showing commitment to reducing the central bank financing of fiscal deficits through Ways and Means and removing the ₦2.0 billion daily limit at the SDF window, which allows the bottom of the MPR corridor to anchor short-term market rates since it provides banks with a remunerated option to place excess liquidity.

¹Taylor rule – explains how central banks set their interest rates in response to inflation and macroeconomic developments



Elsewhere, we have seen increased traction in the use of Open Market Operation (OMO) to curb excess liquidity, with the CBN conducting four (4) since the start of this current administration. However, it is unclear if the CBN's action is a de facto monetary policy, where OMO is deployed to mop up excess liquidity in the banking system without changing the MPR.

Importantly, policy communications by the CBN will be a key element of the monetary policy framework in 2024. These communications should unearth

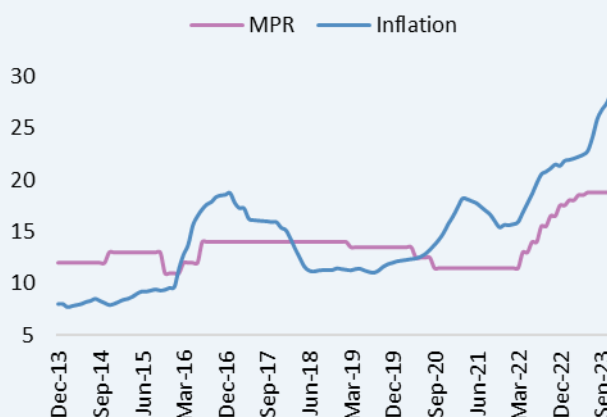
- the inflation target,
- the monetary policy strategy, and
- the expected future trajectory of the key policy rate and its relationship to the inflation target.

Consequently, the CBN is encouraged to use its regular MPC meeting communique to strengthen the forward guidance on monetary policy.

The CBN governor has guided that the current inflation trajectory requires a sustained tightening stance. We have projected that inflation will continue to rise in the early part of 2024, peaking by March 2023 before moderating due to the high base effect from the prior year. We estimate that the CBN will likely hike the policy rate by 100-150bps in H1'24 before standing pat in the second half of the year.

Elsewhere, given our expectations for a sustained hawkish stance from the CBN and a likely rate cut by the US Fed, we anticipate Nigeria's carry trade to improve, which is positive for foreign investor's confidence.

Figure 23: Policy rate tracking Inflation



Source: NBS, CardinalStone Research



Foreign Exchange: Risk of currency devaluation persist

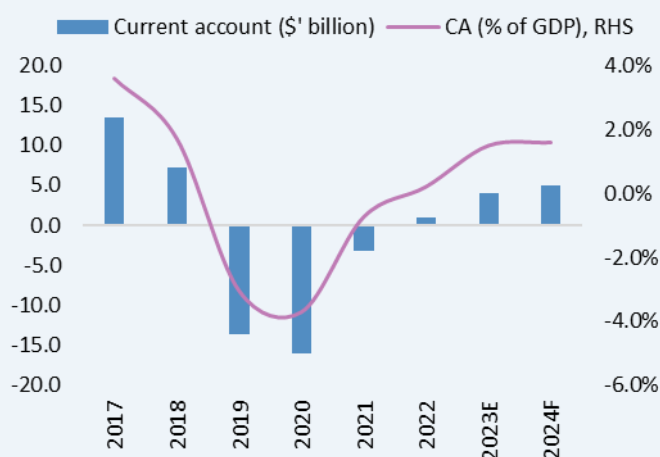
Improving external position

For the second consecutive year, the current account (9M'23 at \$3.6 billion or 1.1% of GDP) is projected to close in the surplus territory in 2023. Our optimism for a surplus close (1.5% of GDP) feeds off improvement in crude oil production and relatively high oil prices, both of which are supporting export earnings. In addition, we perceive that the removal of subsidies and the material devaluation of the naira seem to be weakening the import capacity of the economy.

In 2024, the current account will likely remain in the positive territory, with a projected surplus in trade balance likely to mask the deficit in services. This view is consistent with the government's quest to revive dormant oil fields and to drive higher exploration of offshore drilling bore wells for oil production. In addition, despite the weak global oil demand outlook, oil prices will likely remain elevated, aided by geopolitical tensions. IEA forecast prices to average \$84.4/bbl in 2024 (vs. the 2023 average of \$82.59/bbl). The improved oil price and production forecasts support our expectation for higher exports in 2024.

Elsewhere, with the Dangote refinery set to ramp up production and 'subsidy removal' set to continue lowering PMS consumption, we see legroom for lower oil-related imports. We expect the current account position to sit at \$5.0 billion (1.6% of the GDP) in 2024.

Figure 24: Current account (\$' billion) seems to be improving



Source: CBN, CardinalStone Research

Foreign investors remained on the sidelines

Although foreign investors acknowledged the growing economic reforms in the country, inflows into the current were still limited in 2023. The biggest impeding factor must have stemmed from the low FX liquidity in the system, with CBN intervention at the low ebb. For context, the total FX supply by the CBN settled at \$9.4 billion in 2023, the lowest since 2016.



However, we see legroom for improving FX liquidity in 2024, which could be instrumental in stimulating foreign inflows. This view is supported by the decision of the CBN to clear outstanding backlogs, the recent receipt of a \$2.25 billion FX support facility from AFREXIM, anticipated inflows from the World Bank, and proceeds from dividend securitization from the NLNG.

Consequently, with global interest expected to be lower in 2024, these house-cleaning efforts and other private initiatives, such as the Dangote Refinery, could result in improved dollar inflow and better FX liquidity.

Figure 25: Weak CBN FX supply a bane on liquidity

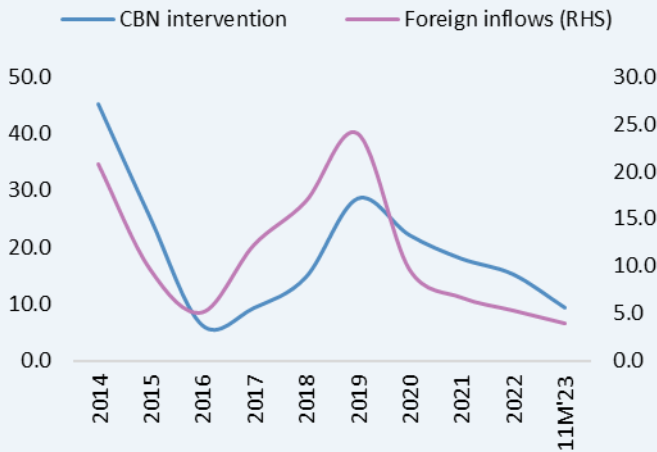
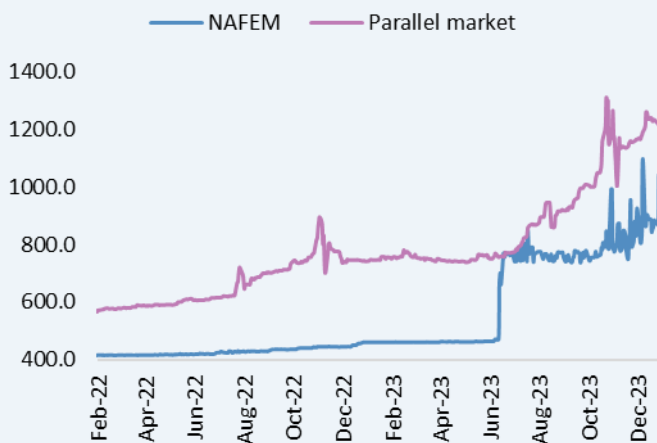
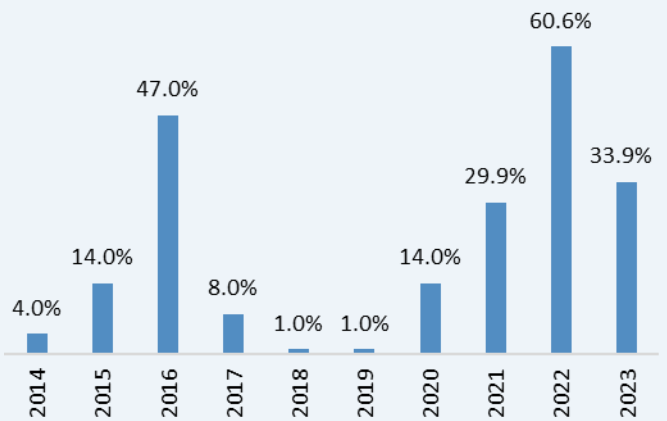


Figure 26: Parallel market premium closed the year at 33.9%



Source: CBN, CardinalStone Research

Figure 27: Parallel market premium closed the year at 33.9%

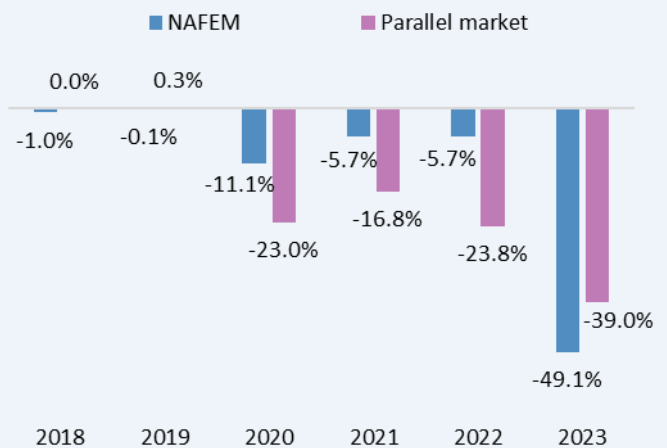


Source: CBN, CardinalStone Research

Official FX rate could cross ₦1000.0/\$ in 2024

Naira at the official window touched new lows in 2023, reflecting the over 40.0% currency devaluation by the CBN and weak FX inflows. Adopting a blend of uncovered interest rate parity and purchasing power parity, we expect the naira at the official window to cross ₦1000.0/\$ in 2024.

Figure 28: Parallel market premium closed the year at 33.9%



Source: CBN, CardinalStone Research



Asset Allocation Guide: What are the investment options for 2024?

Equities: Exploring return possibilities

In delineating potential options for equity investors in 2024, we highlight the following:

- **Dangote Refinery:** Likely to drive improved sentiments in the mid and downstream oil and gas sector, especially because it could make regulators more willing to accommodate demand and supply-driven PMS prices. This commencement may combine with the proposed listing of the refinery to drive positive sentiments in Nigerian assets in 2024, given the expected passthrough to FX liquidity.
- **Banking Sector Recapitalisation:** Likely to drive mergers and acquisitions within the banking industry. If the broad strategy for recapitalisation is inorganic, savvy investors will likely mop up shares in potential targets (e.g. Tier 2 and Tier 3 banks) in 2024. Conversely, if a more organic approach is favoured (i.e. private placements or public offerings), banks may work to reprice existing equities upwards so that they can raise the maximum from placements or public offerings. In this instance, it may be wise to pitch a tent with banks with the highest book values because they will have more legroom to reprice existing equities upward.
- **Other Corporate Actions:** Away from the banking sector, there are uncompleted corporate actions that are likely to play pivotal roles in shaping market sentiments in 2024. For instance, there is the DANGSUGA, NASCON, and Dangote Rice merger for which investors are still awaiting the scheme document. Investors could buy and hold ahead of the release of the document or play tactical trades with the spread between DANGSUGA and NASCON in the interim, given the available information. Similarly, SEPLAT, OANDO, GSK, and PZ also have uncompleted corporate actions. The first two are looking to conclude acquisitions that are likely to trigger a repricing of their equities, while the latter duo seek to exit the country in such a fashion that may throw up tactical opportunities given market volatility.



- Potential Return of FPIs:** While prior to the post-election rally of 2023 would have been better, early 2024 may still be a good time to enter into the markets in anticipation of the return of FPIs, especially if the CBN Governor goes ahead to tighten in the first two quarters (in line with his guidance) and, inadvertently, create some attractive entry opportunities into some securities. For context, foreign inflows into equity amounted to only ₦157.3 billion in 2023 vs ₦772.2 billion in 2017, the last time similar pro-market policies

were implemented. Should a small proportion of the implied difference re-enter the market, another major rally may materialise.

- Asset Sales:** Bureau of Public Enterprises intends to sell the remaining 40.0% of government holdings in electricity distribution companies in the capital market in 2024. It may also take 4 other assets to the market. These assets include Eleme Petrochemicals Company Limited, Nigeria Re-Insurance, Nikon Insurance, and Nigeria Machine Tools.

Figure 29: African equity index continues to trail Nigeria



Figure 31: NGXASI vs MSCI EFM index P/E ratios



Figure 30: The Nigeria equity index has outfoxed peers since 2020 (Index=100)

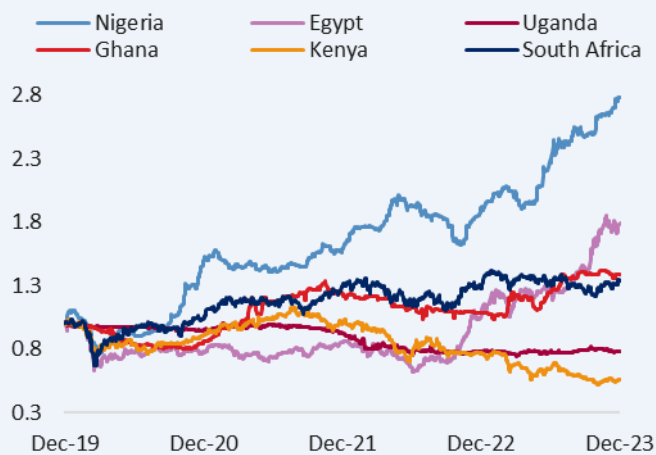
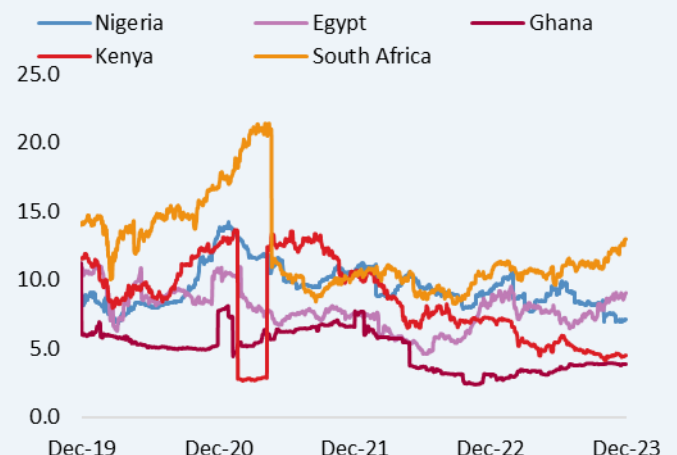


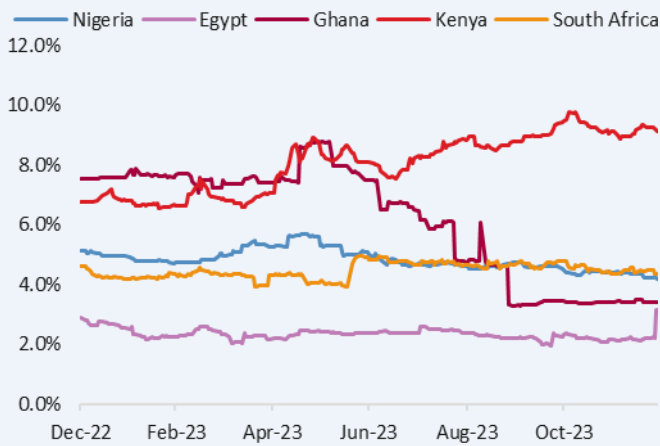
Figure 32: P/E ratios across select African markets



Source: Bloomberg, CardinalStone Research

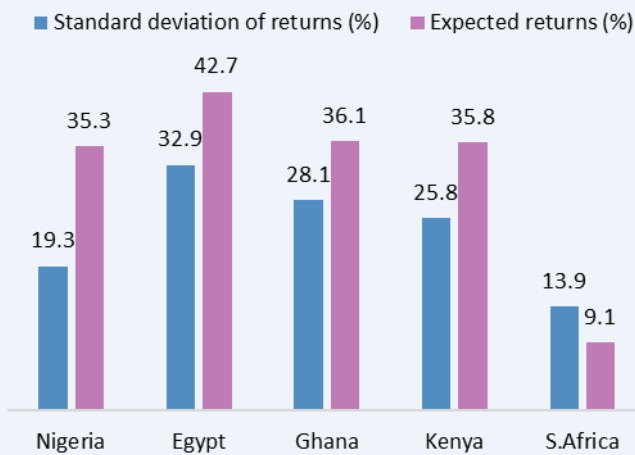


Figure 33: Dividend yields across select African markets



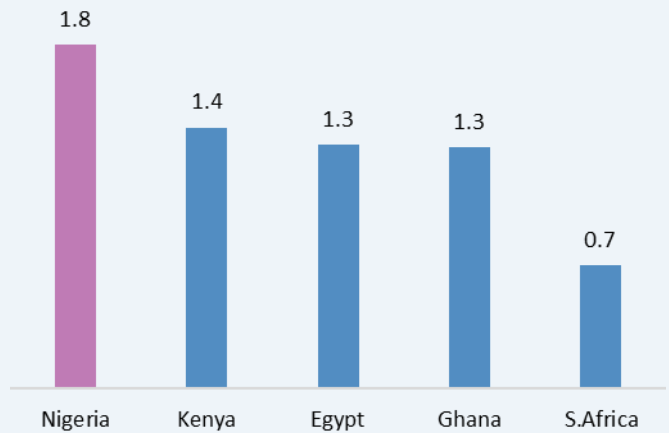
Source: CBN, CardinalStone Research

Figure 34: Forecasting equity market returns in 2024 using Grinold Kroner model



Source: CBN, CardinalStone Research

Figure 35: Expected return per risk (%) favours increased exposure to the Nigerian equities



Forecasting equity market returns for 2024

The Grinold-Kroner model states that the expected return of a stock is its dividend yield, plus the inflation rate, plus the real earnings growth rate, minus the change in stock outstanding, plus changes in the P/E ratio.

In our analysis, we assumed the following:

- Current dividend yield as provided by Bloomberg.
- Expected inflation as provided by the IMF.
- For the real earnings growth rate, we adopted the long-run mean GDP growth rate (10 years).
- For the changes in stock outstanding, we assumed zero % changes.
- % changes in PE: We assumed reversion to the historical level (5-year average) will occur over the next 5 years at the rate of 20.0% per annum.

Fixed Income: Playing uncertainties

Domestic Monetary Policy: The CBN governor guided to hawkishness in H1'24, even though there were some notable buy pressures in the fixed-income market in December 2023. Solely from a policy standpoint, investors may be inclined to hold a sizable portion of their fixed income portfolios in short-tenured instruments with a view to rotating into duration in the second half of the year or in the slightest hint of inflexion in 2024. However, should the CBN become slow to mop out huge maturities expected in Q1 or align with global monetary authorities

as they wind down on tightening, then the winning strategy could be long duration even from Q1.

Global Monetary Policy: Consensus favours the unwinding of tight monetary policy in the USA in 2024. Given the relatively strong monetary transmission in the country, 2024 may witness material rallies in US equities or dollar-denominated assets. In addition, we see scope for a rally in Eurobonds of countries not impeded by other internal incumbrances. Equity charts and insights



Figure 36: African local bond underperformed EM peers, reflecting fiscal concerns and other idiosyncratic risks

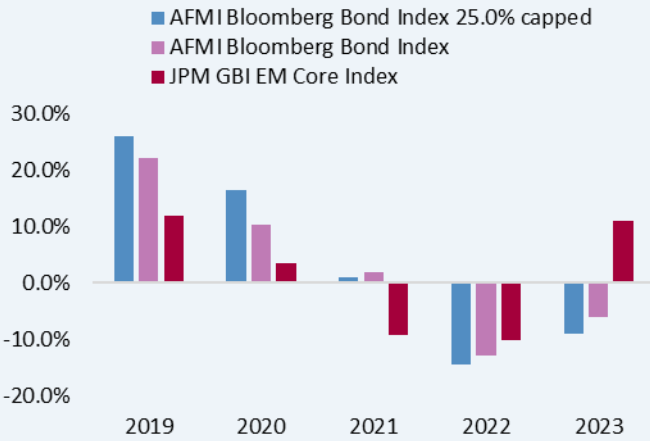


Figure 39: The cooling global inflation resulted in a 2.1% decline in the dollar, which provided some comfort for EM bonds

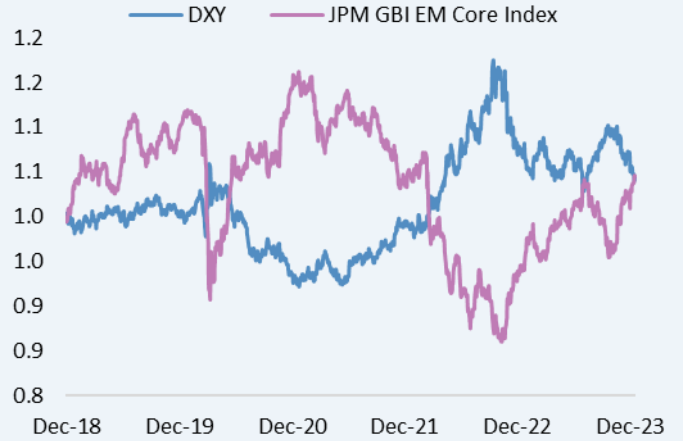


Figure 37: EM and African Eurobonds have closely tracked each other



Figure 40: SSA Debt Risk Status — number of countries with increasing risk of debt default

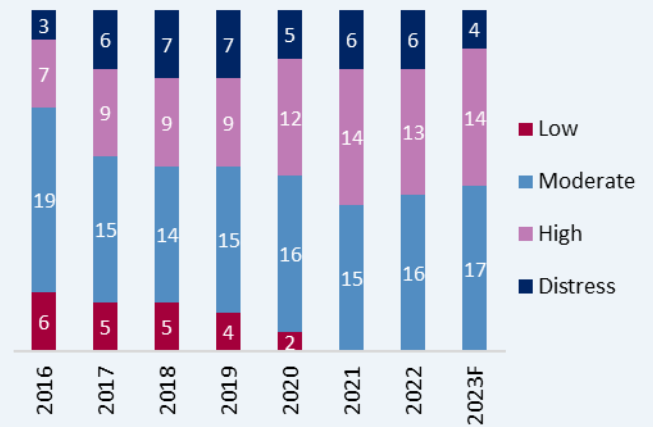
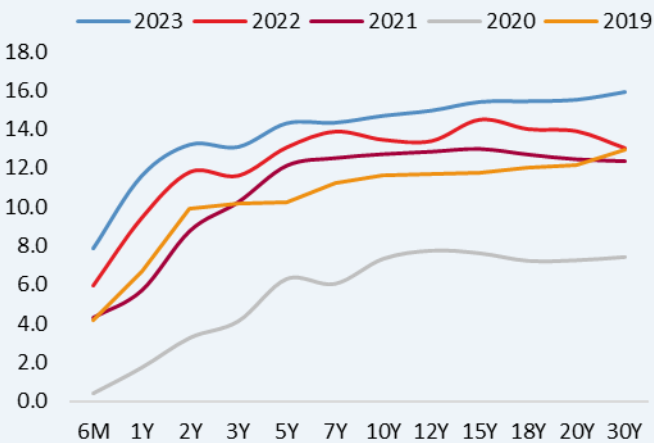


Figure 38: Nigeria yield curve trend (%)



Source: Bloomberg, IMF, CardinalStone Research



Figure 41: Analysis of some selected African Eurobonds

Selected Eurobonds	Ranking			Yield	Yield per duration	Spread vs UST	Upsides	Downsides
	Moody's	S&P	Fitch					
Angola	B3	B-	B-	11.3%	2.4%	712.4	<ul style="list-style-type: none"> Following the exit of Angola from the OPEC cartel, the country is no longer constrained by OPEC's quota, which could result in higher oil production in 2024. Our expectation of higher oil production bodes well for the current account (CA) in 2024. The IMF has projected the CA % of GDP to print 3.7% vs 3.0% expected in 2023. According to Fitch, Angola's reserve is enough to cover external payments for the next 5.7 months over 2024-2025 (vs 3.3 months for countries with similar ratings). The IMF projects Debt to GDP to moderate to 77.1% in 2024 from 84.9% in 2023, reflecting improved nominal GDP growth and primary budget surpluses. Despite a spark of protest due to the subsidy removal in 2023, the government has reiterated its commitment to removing all fuel subsidies by the end of 2025. Fitch projected a 50.0% reduction in gasoil subsidies in 2024 and a further 25.0% reduction in 2025. This action is positive for the fiscal space. 	<ul style="list-style-type: none"> Angolan Kwanza is projected to depreciate by 5.2% in 2024 due to FX liquidity challenges and a sustained FX backlog. Currently, the parallel market premium is estimated at c.16.0%. With 76.0% of Angola's total debt denominated in foreign currency, the expected depreciation of local currency poses a significant downside. The total external obligation is expected to average \$11.0 billion over the next 2 years.
Kenya	B2	B	B	11.4%	2.5%	728.4	<ul style="list-style-type: none"> Kenya continues to demonstrate economic resilience, despite policy tightening, higher inflation and external headwinds. The aggressive tightening stance of the CBK is expected to moderate inflation to 6.6% in 2024 from 7.7% in 2023. GDP is projected to improve to 5.3% in 2024 versus a 5-year average of 4.4%, profiting from improved traction in the agriculture and tourism sectors. 	<ul style="list-style-type: none"> External debt service will likely increase to \$4.3 billion in the financial year ending June 2024, up from \$2.8 billion in the preceding year. Foreign reserves is projected to decline to \$7.0 billion by the end of the 2024 fiscal year, reflecting financing constraints. Fitch estimates reserve coverage at 2.8 months of current external payments (vs 3.4 months for countries with similar ratings). Kenya's government debt is exposed to currency risk, as half is foreign currency denominated.

Source: Bloomberg, Fitch, S&P, Fitch, CardinalStone Research



Selected Eurobonds	Ranking			Yield	Yield per duration	Spread vs UST	Upsides	Downsides
	Moody's	S&P	Fitch					
Egypt	Caa1	B-	B-	16.6%	3.6%	1243.4	<ul style="list-style-type: none"> Egypt becoming part of BRICS is likely to increase international support, attract new foreign investments and improve trade. Furthermore, we understand that the New Development Bank (NDB), created by BRICS, has set up a \$100.0 billion currency reserve pool for its members to lend in local currencies by 2026. This bodes well for Egypt. The Central Bank of Egypt (CBE) has shown commitment to tackling the FX shortages in the economy. For context, after auctioning about \$850.0 million worth of denominated treasury bills in 2023, we see legroom for further dollar-dominated issuances in 2024. After the halt in liquefied natural gas (LNG) export in 2023 due to the Israel-Hamas tensions, export is expected to resume in 2024, which is positive for government earnings and foreign reserves. 	<ul style="list-style-type: none"> The government faces elevated external debt maturities of \$8.8 billion in the fiscal year ending June 2024 and \$9.2 billion in FY'25 versus \$4.3 billion in FY'23. The slow progress on reforms, including the delay in the transition to a more flexible FX regime, is negative for external financing. Growth is titled to the downside due to a weaker outturn in the tourism sector. IMF forecasted GDP to settle at 3.6% in 2024 from 4.2% in 2023. Egypt's Debt-to-GDP is projected to settle at 88.1% in 2024, higher than the 5-year mean of 87.5%. The current account deficit is projected to worsen to -2.4% in 2024 from -1.7% in 2023. The uninspiring outturn is expected to largely be influenced by weak dollar inflows from the tourism sector. Election-related risk, with presidential polls expected in 2024. Egypt's proximity to the Gaza conflict and the potential influx of refugees could intensify security risk, especially in the Sinai region.
Nigeria	Caa1	B-	B-	14.5%	1.8%	1035.4	<ul style="list-style-type: none"> Recovery in economic activities in 2024, aided by higher oil production. GDP could touch 3.5% from 2.6% in 2023. Current reforms bode well for long term growth, currency market, and future credit ratings. Recovery in oil production bodes well for FX earnings. Nigeria's public debt (excluding CBN loans) has a fairly long average maturity of 9.7 years, and 60.0% of it is local-currency denominated. Robust domestic market with sufficient capacity to compensate for tough external financing. We see legroom for improving FX liquidity in 2024, which could be instrumental in stimulating foreign inflows. This view is supported by the recent receipt of a \$2.25 billion FX support facility from AFREXIM, anticipated inflows from the World Bank, and proceeds from dividend securitization from the NLNG. Current account will likely remain in the positive territory in 2024, aided by improved oil production 	<ul style="list-style-type: none"> Deteriorating fiscal position, with debt-to-GDP set to rise to 41.3% in 2024 from 38.8% in 2023. Interest expense continues to take a significant portion of government revenue. Naira at the official window touched new lows in 2023, reflecting the over 40.0% currency devaluation by the CBN and weak FX inflows. Adopting a blend of uncovered interest rate parity and purchasing power parity, we expect the naira at the official window to cross 1000.0/\$ in 2024.

Source: Bloomberg, Fitch, S&P, Fitch, CardinalStone Research



Selected Eurobonds ¹	Ranking			Yield	Yield per duration	Spread vs UST	Upsides	Downsides
	Moody's	S&P	Fitch					
Mozambique	Caa2	CCC+	CCC+	14.5%	1.8%	1035.4	<ul style="list-style-type: none"> After a long hiatus due to insurgency, Mozambique plans to start its \$20.0 billion liquefied natural gas project in Q1'24. The Mozambican metical (FX) was largely been stable at MZN63.9/\$ in 2023, aided by the central bank's provision of FX to fuel importers and tight monetary policy. The government plans to create 413,000 jobs in 2024 	<ul style="list-style-type: none"> The persistent security concerns in Mozambique is likely to weaken economic activities in 2024. IMF projects growth to settle at 5.0% from 7.0% in 2023. Weak debt sustainability metrics, with public debt projected at print 92.4% in 2024 from 89.7% in 2023 The government's exposure to currency risk is substantial, with the share of FX-denominated debt amounting to 71.0% of total debt stock. The current account balance is poised to worsen to -39.3% of GDP in 2024 from -16.0% in 2023, driven by imports of liquefied natural gas.

Source: Bloomberg, Fitch, S&P, Fitch, CardinalStone Research



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