



Nigeria: 2023 Mid-Year Outlook

BITING THE BULLET



Bold Reforms

Short-term Pains

Long-term Gains

July 2023

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Executive Summary

Watchers may be tempted into a feeling of déjà vu as rapidly transforming monetary policies bring back the sensation of the 2017 pro-market win. Indeed, the Investors and Exporters (I&E) Window is reborn, and, with it, a breadth of fresh air for stranded investors as currency arbitrageurs face up to the reality of an end to the ‘easy money’ era. Yet, despite the similarities to 2017 initiatives, 2023 comes with a complete bouquet of pro-market initiatives this time out, commencing with the removal of subsidy on May 29, 2023, to the recent decision to allow the naira to trade more freely. The new government is also looking to tame the decade-long drag from weak labour productivity growth that has masked passthrough from a fast-rising labour force and left the nation underperforming peers from a trend growth rate perspective.

Despite the initial excitement and a surprising lack of resistance from a usually distrusting populace, there appears to be a consensus that initial pains must precede future gains. For one, the cost-of-living crisis seems set to worsen as the government pulls the plug on unsustainable subsidies and continues to demand tax charges despite dwindling incomes. Debt sustainability metrics may also deteriorate in the short run on the impact of devaluation and potential securitisation of ways and means.

A few producers would also have to resolve the difficult puzzle of trying to protect margins while preserving market share in the face of historically high-cost inflation and cut-throat competition in some instances. A resolution of this puzzle in no way insulates most of these businesses from the imminent foreign exchange losses on unhedged positions.

For us, the reality of rising costs puts a greater burden on asset managers to strategically seek alpha like never before. In the equity space, investors may monitor volatilities and seek to enter sound banking and downstream oil & gas counters, which appear in pole positions to benefit from the new policies. Investors may also chase traditional names that have, hitherto, been the toast of foreign investors who may now be inclined to re-evaluate the Nigerian story. Decision-making may be a tad difficult for domestic fixed-income investors, with fundamentals pointing to higher yields and political will seeking a low-interest rate environment. We, however, favour a laddered portfolio approach to mitigate the risk of locking in lower yields should interest rates become depressed and increase the chances of making good returns on re-investments should an upward swing in rates materialise.

Analysts

Olufisayo Ademilua
olufisayo.ademilua@cardinalstone.com

Kayode Eseyin
kayode.eseyin@cardinalstone.com

Ngozi Odum
ngozi.odum@cardinalstone.com

Adebayo Adebajo, ACA
adebayo.adebajo@cardinalstone.com

Olaolu Boboye
olaolu.boboye@cardinalstone.com

Jerry Nnebue, CFA
jerry.nnebue@cardinalstone.com

Philip Anegebe, CFA
philip.anegebe@cardinalstone.com

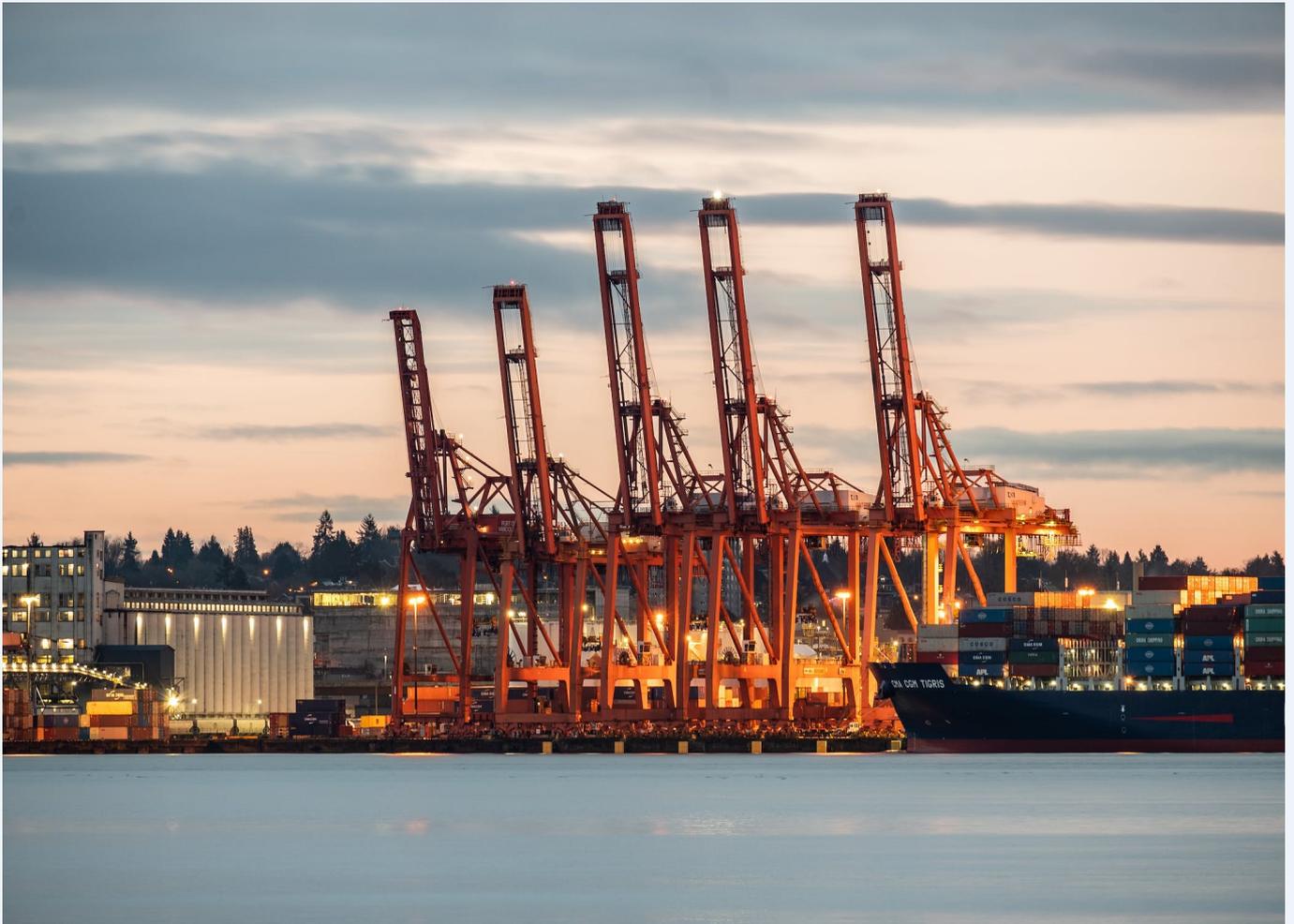
Investment Research

research@cardinalstone.com

Securities Trading

is@cardinalstone.com

(234) 7100 433



Global Economy

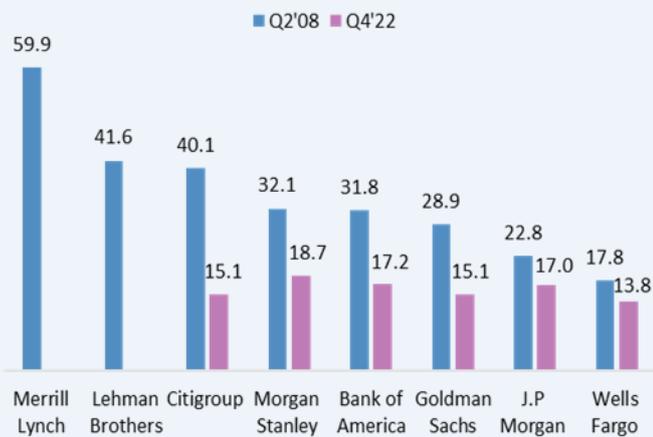
A long road to recovery

The global economy continues to face headwinds, with unprecedented rate hikes hampering growth prospects and casting doubts over expectations of quick recovery. With the conflict in Ukraine continuing into 2023, major investment and strategic decisions remain constrained by uncertainty. The regional bank challenges in the US and the Credit Suisse failure in Europe worsened uncertainties in March. However, the volatility was short-lived, as swift liquidity support by apex banks and UBS' takeover of Credit Suisse de-escalated the risks of a financial market

crisis and a potential contagion effect. The improved sentiment was also supported by the effective implementation of BASEL III regulations that distinguished the concerns from the conditions prevalent in the 2007/2008 global financial crisis. There were also re-assurances from the relatively more positive economic growth and the tamer unemployment rate of 3.7% (vs the 5.8% faced in 2008).

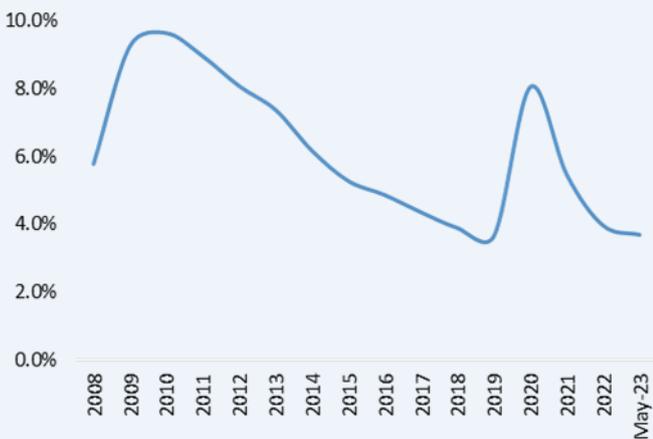


Figure 1: Recession risk and heightened market volatility



Source: Bloomberg, CardinalStone Research

Figure 2: US unemployment tamer than the level in 2008



Source: Bloomberg, CardinalStone Research

US debt ceiling worries highlighted the expanding debt sustainability crisis

According to the Institute of International Finance (IIF), the global debt level was estimated at \$305.0 trillion in Q1'23. The estimate represented the second highest point on record, as ageing populations, rising healthcare costs, and surging interest rates continue to pressure government finances. Notably, the debt sustainability worries, prominent in emerging and frontier markets, appear to be progressively extending into the developed world.

For instance, the United States found itself in a concerning situation after it breached its debt ceiling of \$31.4 trillion (120% of GDP) in January 2023. This development raised worries of a potential debt default, causing heightened financial market volatility that resulted in a materially wide credit default swap (CDS) spread in April. After months of nail-biting negotiations, the US Congress finally suspended the country's debt ceiling, averting what would have been a first-ever US default. Moody's had predicted that a default scenario would have led to a decline in US GDP and a loss of nearly 2 million jobs, pushing the unemployment rate from 3.7% to approximately 5.0%.

China may experience weaker growth

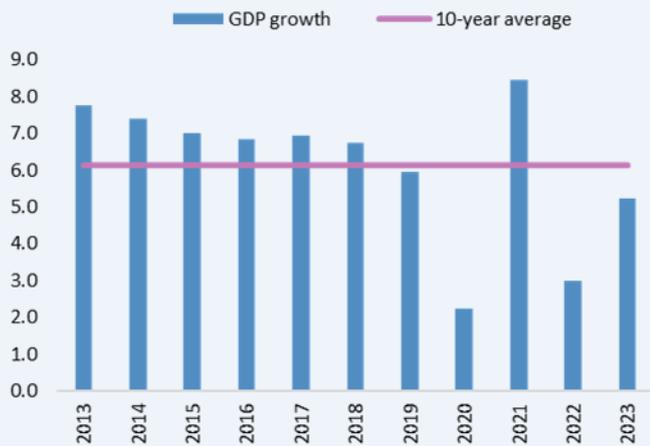
China's post-Covid recovery, which gained momentum after the unwinding of mobility restrictions and increased spending on services, appears to have run its course after economic activities waned in the second quarter. The weaker economic sentiment prompted China's central bank to lower its short-term lending rate to help prop up stalling growth. Consistent with this less optimistic outlook, the fiscal authorities in China have set a growth target of 5.0%, the weakest in a decade. IMF also projects its 2023 growth at 5.2%, materially lower than the 10-year average growth rate of 6.2%.

Despite the weaker growth expectation, China has a moderate debt level, providing adequate legroom for fiscal stimulus when required. Also, the lower inflation level in the country suggests that the People's Bank of China (PBOC) can further cut policy rates to support households.

China's economic slowdown could drag global growth



Figure 3: Weaker growth expectation in China

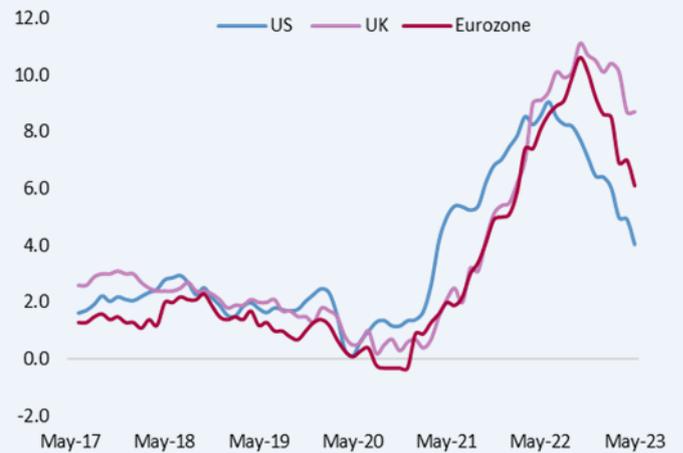


Source: IMF, CardinalStone Research

Figure 4: Core inflation is still elevated



Figure 5: Headline inflation has decelerated faster than core



Source: Bloomberg, CardinalStone

Global inflation to ease further in H2'23

Headline inflation is poised to moderate further in H2'23, aided by lower commodity prices and a favourable base. However, most of the deceleration will likely emanate from energy and food prices, as the tight labour market conditions and elevated consumer demand continue to pressure core inflation. Overall, the IMF project global headline inflation to moderate to 7.0% in 2023 from 8.7% in 2022.

Figure 6: Growth forecast for 2023

Real GDP Growth (%)	2018	2019	2020	2021	2022F	2023F
Advanced Economies	2.3	1.7	-4.4	5.2	3.6	0.3
United States	2.9	2.3	-3.4	5.7	2.1	1.6
Euro Area	1.8	1.6	-6.1	5.2	3.5	0.8
Germany	1.0	1.1	-3.7	2.6	1.8	-0.1
France	1.8	1.9	-7.9	6.8	2.6	0.7
Italy	0.9	0.5	-9.0	6.7	3.7	0.7
Spain	2.3	2.1	-10.8	5.1	5.5	1.5
United Kingdom	1.7	1.7	-9.3	7.4	4.0	-0.3
Japan	0.6	-0.4	-4.6	1.7	1.1	1.3
Sub-Saharan Africa	3.3	3.2	-1.6	4.7	3.9	3.6

Source: IMF, CardinalStone Research



Domestic Economy

Growth to remain robust despite unusual setback in the first quarter

The Naira liquidity crunch in the first quarter of 2023 shaved off about 80-100bps from growth, leading to a moderation in GDP to 2.3% (vs 3.5% in Q4'22.) The tamer growth was more evident in the non-oil sector, the key growth driver since the exit from the Covid-induced recession, which reached its lowest level in two years. We perceive the liquidity crunch had a far more reaching impact on the informal sector.

The informal sector, estimated at 50.0%-55.0% of the economy by the IMF, is predominantly concentrated in agriculture and mostly cash-driven. The close link between agriculture and the informal economy also explains why Nigeria experienced its first agriculture sector contraction in the quarter, characterised by the unusual headwind of the naira cash crunch.

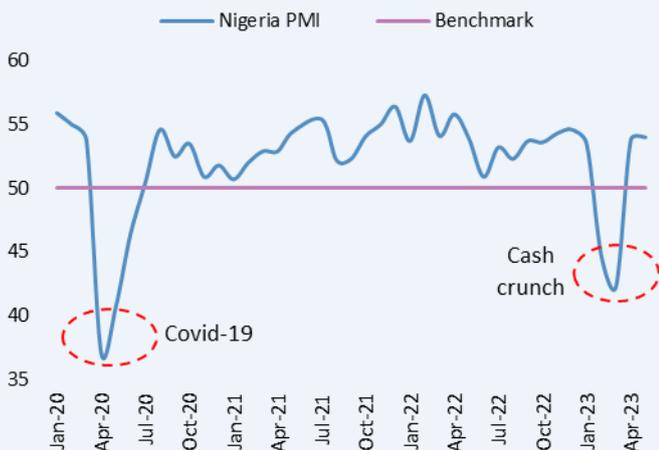


Figure 7: Agric recorded its first contraction on record in Q1'23



Source: NBS, CardinalStone Research

Figure 8: Naira scarcity led to PMI contraction in Q1'23, the first since Covid exit



Source: CBN, CardinalStone Research

Despite the blatant shock to outturn, the growth level in Q1'23 represented the second highest Q1 growth in 8 years. This glimmer of resistance indicates that the economy remains relatively strong at its core and is on course to record a 3.3% YoY expansion in 2023.

Figure 9: Q1'23 growth is the 2nd highest in eight years.



Source: NBS, CardinalStone Research

Dangote refinery: a growth propeller in the medium term

Following a construction period of 7 years, the inauguration of the Dangote refinery occurred on the 22nd of May, 2023. According to its owner, the facility is expected to produce its first set of refined products by the end of July 2023. As previously emphasised, if it does commence production in July, the Dangote refinery has the potential to contribute c.30-50bps to GDP growth, with most of the benefits accrue from the manufacturing sector. By our estimate, assuming a conservative capacity utilisation rate of 20.0% for H2'22, the refinery will likely enhance the manufacturing sector by c.45bps. This positive impact will partially offset the adverse effects of the CBN's hawkish stance.

Furthermore, the Dangote refinery currently employs 33,000 individuals, both directly and indirectly. This number is anticipated to rise to 100,000 once the refinery reaches full capacity. Moreover, the refinery has the potential to annually save Nigeria around \$15.0 billion, equivalent to 43.7% of the current gross foreign exchange reserves. These substantial foreign exchange savings is expected to have a positive ripple effect on manufacturing companies by improving liquidity across various foreign exchange channels. In our view, the passthrough effect of the refinery on the currency market is likely to be mostly felt in the medium to long term, with 2023 only likely to be a teething learning phase for the company if it commences production as expected.



Figure 10: Dangote refinery to fuel material growth in the manufacturing sector



Source: NBS, CardinalStone Research

Figure 11: Oil sector nears positive growth trajectory



Figure 12: oil production could reach 1.55mb/d by year-end



Sources: NBS, CardinalStone Research

The oil sector marches toward recovery

After crude oil production touched a 3-decade low in 2022, we saw a sharp rebound to 1.5mb/d in Q1'23, reflecting the effort of the government to tackle oil theft. Despite the strike action by some oil workers, which warranted the shutdown of production at some selected wells and the closure of the Forcados oil terminal in early Q2'23, we expect oil production to average 1.55mb/d in 2023, translating to 8.9% YoY growth in 2023. However, we expect some headwinds to the oil sector in 2024, with OPEC set to reduce Nigeria's 2024 oil production quota from 1.7mb/d to 1.4mb/d. This adjustment will likely cap the scope for material oil GDP growth in the coming year.

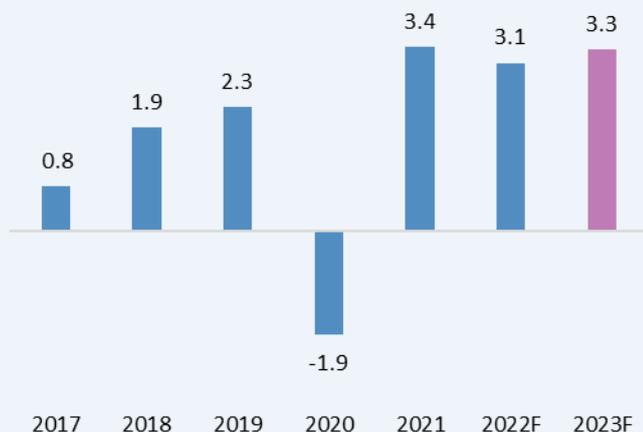
Oil sector exit from recession to keep economic growth above 3.0% levels

Growth to settle at 3.3% in 2023

We expect the positive outturn from the oil & gas sector and Dangote refinery to dovetail neatly with growth in 2023. Also, we remain optimistic about the services sector in the second half of 2023, midwived by data-led growth in ICT. Overall, we expect FY'23 growth of 3.3%.



Figure 13: Nigerian economy to expand by over 3.0% for third straight year



Source: NBS, CardinalStone Research

New policies may fuel Nigeria's long-run growth

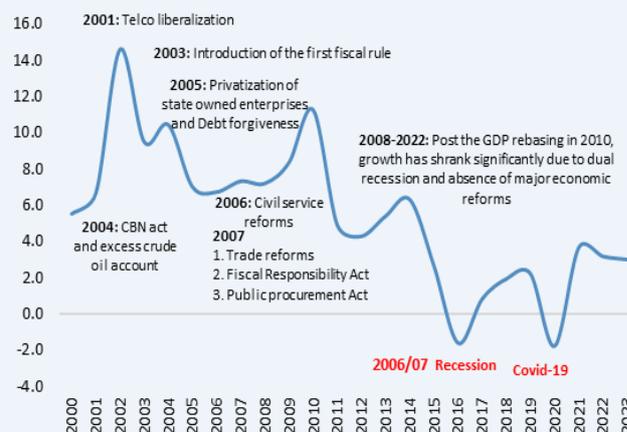
By our assessment, Nigeria has trailed African peers such as Egypt and Kenya, with the distinctive underperformance largely traceable to low labour productivity. For context, while Nigeria's long-run labour force growth rate is almost at par with that of Kenya and ahead of Egypt's, its labour productivity decline of -0.4% has resulted in a materially low long-trend growth relative to these nations over the last ten years. On this wise, we assess the new administration's economic policies, the bulk of which speaks to the efficient allocation of resources and greater labour productivity, as both suitable and timely. In particular, plans to increase budgetary allocations to education could enhance the human development index, while a targeted drive to address security will encourage more inclusive growth, given that agriculture is one of the largest employers of labour in the country.

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. However, the momentum started diminishing from 2011 onwards due to weak economic and structural reforms and global shocks.

With Nigeria largely back on track, steamrolling its biggest reforms in over a decade (i.e. subsidy removal on PMS, FX, and potentially, electricity), we believe that its GDP growth could once again reach the 6.0% mark over 5 to 10 years.

In addition, we note that the highest growth recorded by Nigeria coincided with periods when foreign investors' appetite was largely biased to the upside. As the country progresses towards a more market-driven economy, we expect foreign investors to commence a re-assessment of Nigeria's long-term investment prospects that may cascade to robust growth. Consequently, we see legroom for an increase in the FDI to GDP ratio to over 2.0% over the next few years (vs an average of 0.8% over the last 10 years).

Figure 14: Reforms and investor confidence have coincided with strong GDP growths (%) in Nigeria



Sources: World Bank, CardinalStone Research



Fiscal position: Hard decisions for expected future gains

Nigeria continues to face significant fiscal vulnerabilities, as evidenced by the persistent increase in public debt and elevated debt servicing, which has constrained room for vital social spending. Before the currency convergence to the I&E window rate, the IMF estimated Nigeria's Debt to GDP ratio at 35.0% in 2023 and projected an increase to 42.3% by 2027. However, the policy-induced naira weakness at the I&E looks set to worsen this ratio in the short run. We further highlight near to medium-term fiscal impacts of the pro-market FX policy in the points below:

- ◆ Based on the exchange rate of ₦753.0/\$ from the CBN and the latest debt numbers in Q1'23, Nigeria's total debt level is projected to increase by ₦11.8 trillion in 2023 due to the devaluation.
- ◆ The debt to GDP ratio may rise by 4.7ppts to 43.7% in 2023 and reach 45.1% in 2027
- ◆ Foreign debt servicing costs may amplify by about 67.0% in 2023.

Despite the mounting debt burden, Nigeria faces a moderate risk of debt distress. From assessment, Nigeria's Debt-to-GDP ratio remains below the IMF benchmark of 50.0-55.0%. This range of guidance suggests that, even with the devaluation-induced projections, the country's debt level will likely remain manageable in the near to medium term. 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. These observations indicate a significant time frame to repay obligations and a low risk of default.

Figure 15: Moderate risk of debt distress (data in %)

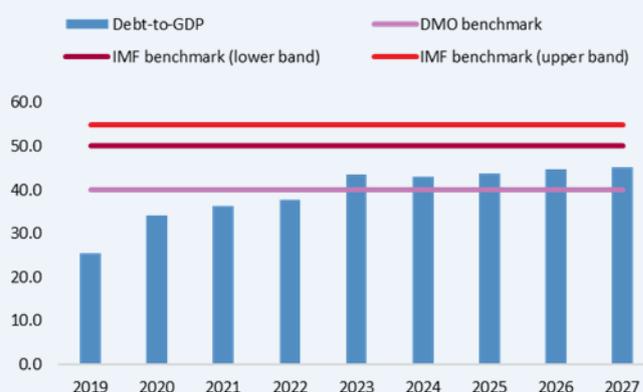
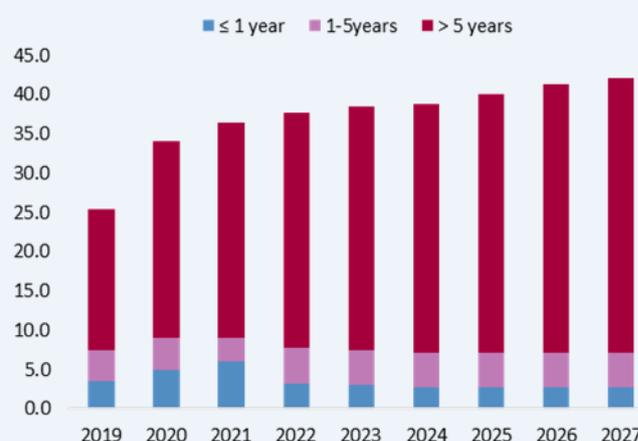


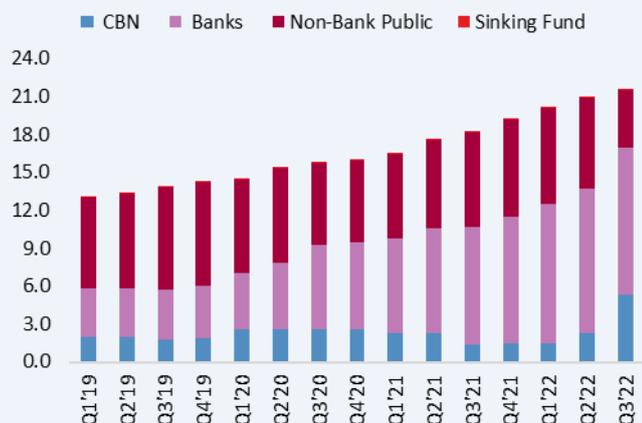
Figure 16: Nigeria's public debt by maturity (% of GDP)



Sources: IMF, CardinalStone Research



Figure 17: The banking sector has the greatest exposure to Nigeria’s domestic debt stock (₦ trillion)



Sources: CBN, CardinalStone Research

Figure 18: Debt service-to-revenue could reach 142.3% in 2023 and average 157.4% over the forecast period



Sources: IMF, DMO, CardinalStone Research

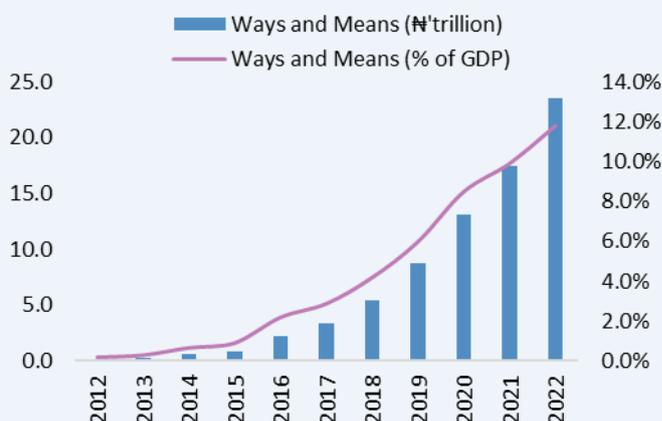
Nigeria to securitise stock of Ways and Means advance

After getting the national assembly's approval, the government announced plans to convert the ₦23.7 trillion Ways and Means advance to a 40-year bond at an interest rate of 9.0%. The bond is not open to the public but rather mostly an allowance granted to the CBN to apply a different accounting treatment to the stock of these advances extended to the Federal Government.

In our view, securitisation is a welcomed development, as it will enhance debt transparency in Nigeria. However, it should cause Nigeria's gross debt to jump from ₦46.3 trillion to c.₦70.0 trillion, leading to a rise in the debt-to-GDP ratio.

Elsewhere, the Senate has approved an upward adjustment of the Ways and Means loan accessible to the Federal Government from 5.0% of previous year's revenue to 15.0%. This move should provide the government with more wriggle room in negotiating the facility during periods of crisis or temporary dislocations without breaking the bounds of legality.

Figure 19: Ways and Means trajectory



Source: CBN, CardinalStone Research

Market-based PMS pricing to free fiscal space

The subsidy regime had constrained fiscal space, with the government expending over ₦7.5 trillion on PMS subsidies in the last 2 years. Given these statistics and dwindling revenues, the new administration wasted no time announcing its discontinuation. In our view, the decision to shock the nation with an inauguration day announcement was a masterstroke that spared the country the usually lengthy back and forth that have come to characterise this sort of negotiations over the years, with most of them resulting in inertia or only partial shifts.



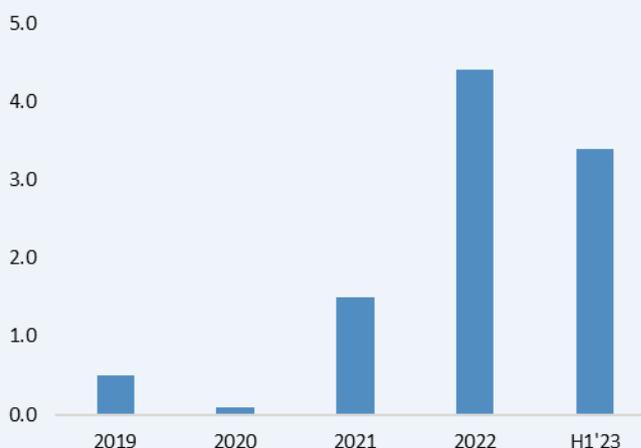
It was also expedient to bite the bullet now that the new government still has at least a third of the electorates on its side.

From a purely economic perspective, we believe the move could earn the government over ₦12.0 trillion (2.1% of GDP) in subsidy savings over the next three years. To alleviate the burden of this deregulation on consumers, which the IMF has estimated could result in a 1.2ppts increase in the headcount poverty rate and a 0.4 ppt rise in the poverty gap, the government has resorted to an \$800 million facility from the World Bank to offer as safety nets for the most vulnerable. There is also a collaborative effort between the government, labour unions and trade unions that led to the formation of a joint committee responsible for discussing a potential increase in the minimum wage. If approved, this adjustment would mark Nigeria's first modification to the minimum wage structure since 2019. Considering the previous upward adjustment in 2019, if a consensus is reached regarding a new minimum wage that follows a similar pattern, FGN's personnel costs could escalate soon.

In light of the increased PMS costs, certain states, such as Edo, have taken the initiative to raise the minimum wage to ₦40,000 to alleviate the impact. In the short term, there is legitimate concern regarding the ability of other states to meet the financial obligations associated with implementing a new minimum wage across the country. To provide some context, a survey conducted by BudgetIT in 2022 revealed that at least 12 states have accumulated unpaid salary arrears, while approximately 6 others are yet to enforce the ₦30,000 minimum wage that was legally established in 2019.

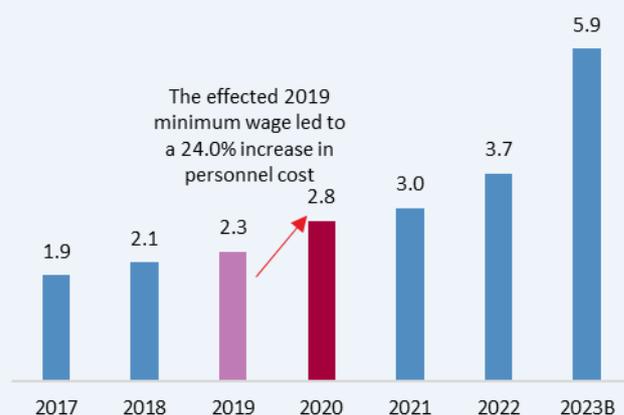
Yet, in this case, the point of difference is that the removal of the subsidy would create room for a 'bigger pie', capable of leaving each state in a relatively better position to meet its obligations compared to previous years. From our estimates, adopting the statutory allocation formula of 45.2%, 29.8% and 21.0% for Federal, State, and Local Governments, respectively, we expect about ₦1.2 trillion in annual flows to states. Assuming a flat distribution across the 36 states + FCT, we estimate c.₦31.8 billion annual inflows for each state.

Figure 20: Nigeria's subsidy payment (₦' trillion)



Source: NNPC, CardinalStone Research

Figure 21: Historical personnel cost (₦' trillion) of FGN



Source: NNPC, Budget office, CardinalStone Research



Inflation: Brace for more price increases

One of the main themes globally is elevated inflation, persistently driven by supply-side factors. In Nigeria, with consumer prices still hotbed and sitting comfortably at an 18-year high, the CBN has remained hawkish, hiking the policy rate in 2023 to 18.5%, the highest on record. Despite the negative passthrough of elevated inflation to the economy, guidance from the apex bank before the suspension of Emefiele indicates that policy tightening will remain on course in the months ahead.

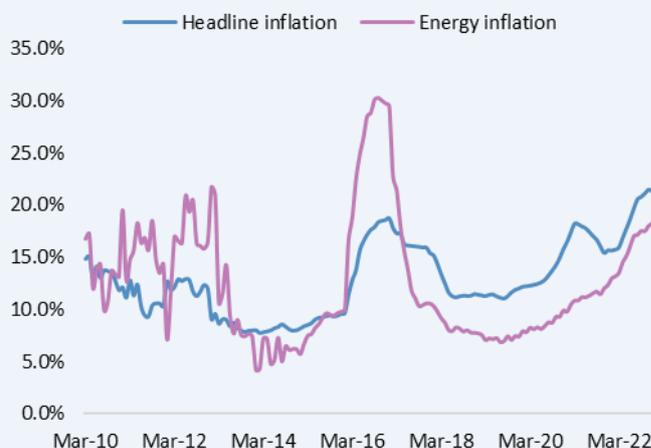
Inflation is unlikely to peak in H2'23, with pressures expected from the material jump in PMS prices. Following the president's announcement on discontinuing PMS subsidy, fuel prices adjusted upwards, selling for N500-N600/litre nationwide. With Nigeria's CPI composition being significantly sensitive to energy price changes, we expect the new PMS price to add about 490bps and 77bps to the MoM core and headline inflations in H2'23. Also, food inflation will not be insulated, as the basket will be affected by second-order effects through higher transport inflation. Consequently, we expect headline inflation to average 27.9% YoY in 2023, materially higher than our estimate of 23.8% without the passthrough from subsidy removal.

In addition, now that FX has been liberalised, NNPC and other PMS importers will get dollars at a higher rate, translating into a likely higher PMS pump price. The implied volatility in PMS prices will feed through to prices and make the cost of living worries a real concern for the populace in the near term.

Figure 22: Average PMS prices increased by 174.2% after subsidy removal



Figure 23: Energy and headline CPIs are strongly correlated



Source: Media sources, NBS, CardinalStone Research

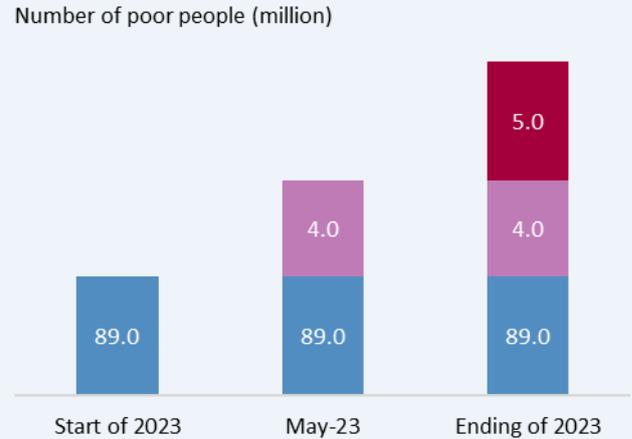


Figure 24: Inflation expectation is biased to the upside



Source: NBS, CardinalStone Research

Figure 25: Inflation pushed an additional 4 million Nigerians into poverty in the first four months of 2023



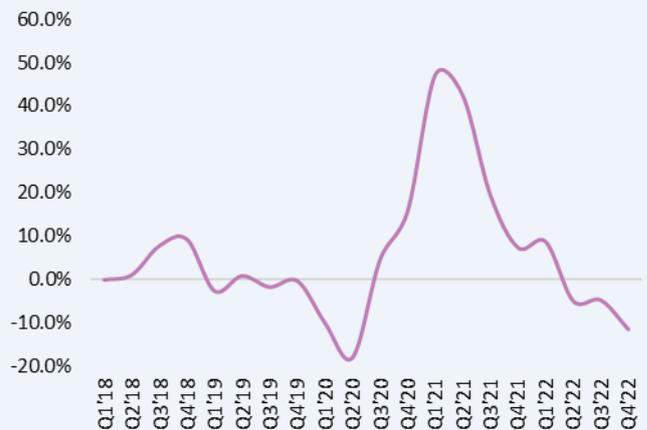
Source: World Bank, CardinalStone Research

Inflation may aggravate poverty

Currently, about 133 million Nigerians live below the poverty line, according to estimates from the World Bank. The inflationary pressures, reaching an 18-year high, have significantly constrained consumer spending power, leading to adverse effects on domestic demand. For context, consumption, which accounts for approximately 56.0% of the GDP, experienced a substantial decline of 3.5% in 2022, marking the second-largest contraction on record.

The World Bank has estimated that about 4 million Nigerians will be pushed into poverty in the first 4 months of 2023 due to the unprecedented inflation, which has eroded spending capacity across the country. With inflation projected to remain unabated, we expect an additional 5 million Nigerians to slump into poverty in H2'23. Nevertheless, we anticipate a gradual recovery in spending capacity in the medium term, fueled by the gains from net-subsidy savings, improved wage structure, and enhanced economic growth.

Figure 26: Consumption weakened materially in 2022 due to inflation shock



Source: NBS, CardinalStone Research



Monetary Policy: What to expect post unorthodoxy

Nigeria's monetary policy approach has been largely unconventional in recent years, but the recent changes to the leadership of the CBN have brought about some policy changes. To provide context, the CBN has eliminated the cap and floor rates previously imposed on the interbank market, which was limited to a range of +100/-700 basis points around the Monetary Policy Rate (MPR).

Furthermore, the CBN has indicated plans to normalise CRR maintenance processes and ensure equity in its implementation across the banking industry. In our view, this resolve implies strict compliance with regulatory requirements instead of the legacy issue of having banks' effective CRR higher than required. As per our last estimate, effective CRR is estimated at 45.0%-50.0%, materially more elevated than the statutory rate of 32.2% and highlighting the huge cost to banks in terms of lost revenue.

The next step may require the CBN to strengthen monetary policy transmission and switch to inflation targeting from monetary targeting. Nigeria presently implements a monetary targeting policy framework based on Friedman's theory that fluctuations in the money supply growth rate have greater explanatory power for economic changes and inflation than nominal interest rates.

Consequently, the country utilises broad money as a reference point to manage and stabilise inflation expectations. However, since the central bank does not have direct control over certain elements of broad money, it relies on reserve money as the operating target, intending to indirectly influence the broad money supply.

Considering the current situation where inflation in Nigeria has reached an 18-year high and is expected to rise further, it becomes evident that adopting an inflation targeting (IT) framework may be more suitable. 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. This framework helps to prevent inflation blindness and ensures a proactive approach 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' initial target.



Foreign exchange: Charting a new course

The Nigeria FX market has been starved of pro-market policies in the past few years, with the closest drive to a market-driven framework coming in 2017, following the creation of the I&E window. The recent change in CBN has been followed by the convergence of rates and the adoption of a managed floating exchange rate, which could partly de-risk Nigeria's current tough investing environment. As previously highlighted, the pro-market initiatives will materially improve the outlook for foreign capital providers. For example, in 2017, when the I&E window was introduced, FPI inflows surged by 304.3% YoY to \$7.3 billion, while the contraction in FDI slowed to -6.0% YoY (vs -68.9% YoY in the preceding year).

While the current policy reforms bode well for foreign providers of capital, additional investments into the country will also be partly dependent on the following: 1) the willingness of the CBN to clear existing backlogs, which is estimated at \$2.5 - \$3.0 billion; 2) the FX market reflects a genuine "willing buyers and willing sellers" structure and supply begins to improve notably. If the 2 highlighted points are achieved, we see legroom for a surge in foreign inflows from the multi-year lows of \$5.3 billion in 2022 to about c.\$12.0 billion over the next 1 year.

Figure 27: Capital inflows (\$' billion) have declined by CAGR of 15.6% in the last 15 years

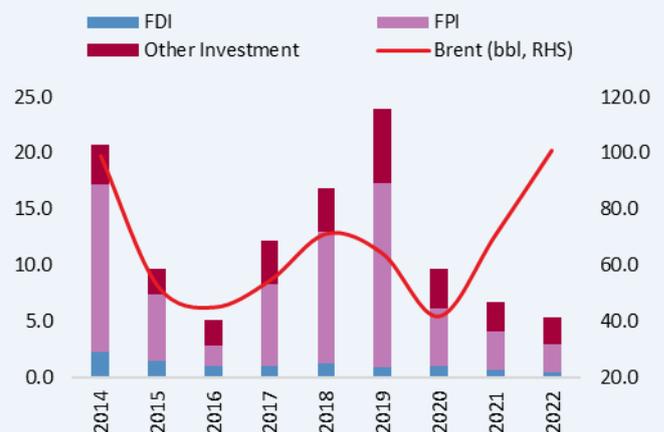
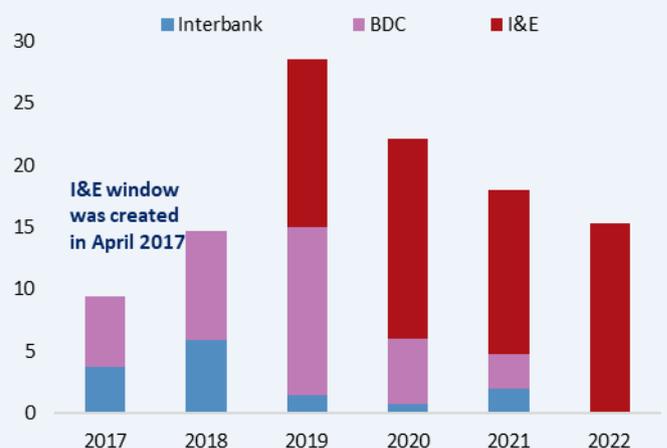


Figure 28: CBN supply data to the different FX markets (\$' billion) suggests that it didn't intervene in the I&E in its first 20 months of creation

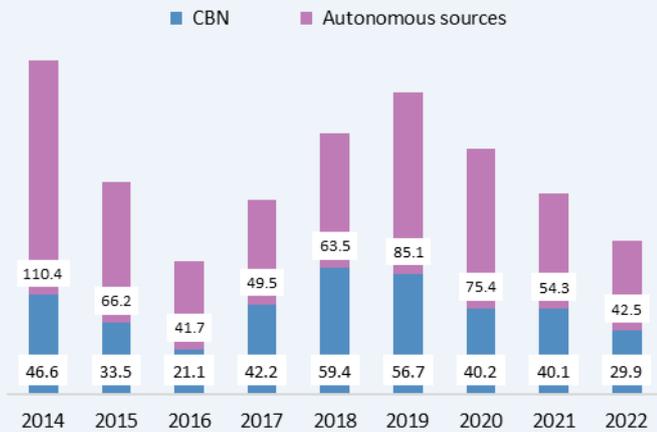


Source: CBN, Bloomberg, CardinalStone Research



Elsewhere, the parallel market premium significantly narrowed following the recent pro-market policies and the CBN's willingness to boost market confidence, demonstrated by removing restrictions on domiciliary accounts. Given these changes, we see legroom for improved capture of autonomous dollar inflows into the country in the near term. These autonomous sources account for about 58.0% of total dollar inflows into the country, most of which are not captured in the FX reserves.

Figure 29: Autonomous sources account for 58.0% of Nigeria's total inflows



Source: CBN, CardinalStone Research

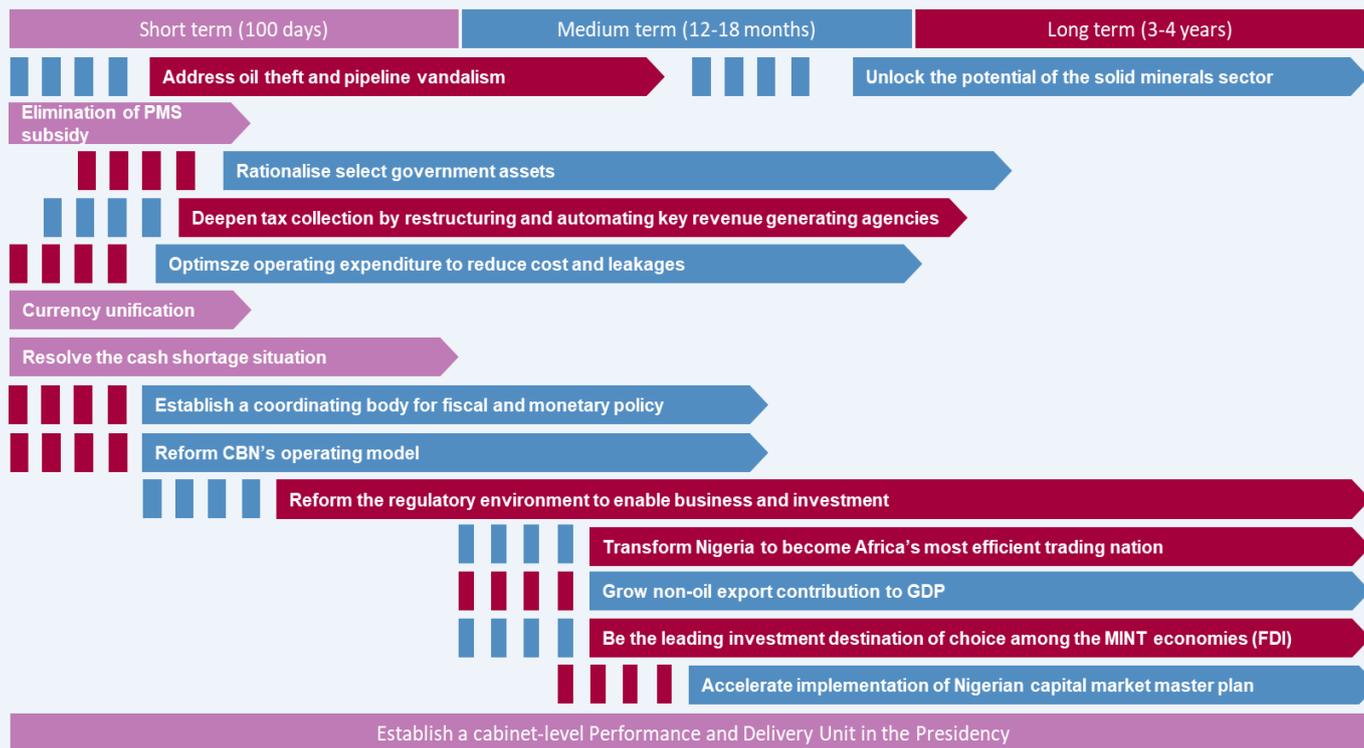
Figure 30: I&E and parallel market rates converge



Source: CBN, CardinalStone Research



Economic road map of the new administration



Source: Policy Advisory Council Report, CardinalStone Research

Market impact of new policies

Equities

The pro-market policy of the new administration will likely continue to cheer equity investors. The potential improvement in FX market liquidity and removal of fuel subsidies could re-ignite foreign participation in the equities market, especially inflows of new monies

We see scope for a positive re-rating of the equities market, which is currently trading at a 12.6% discount to its 13-year average level despite boasting higher ROE (22.9% vs a 13-year mean of 18.6%).

Fixed Income

Decision-making may be a tad difficult for domestic fixed-income investors, with fundamentals pointing to higher yields and political-will seeking a low-interest rate environment. To the latter, the administration's preference for lower interest rates (to promote investment) could combine with currently elevated liquidity to drive a yield downtrend in the near term.

In any case, the normalisation of CRR and departure from the arbitrary debits predominant under the suspended CBN Governor have already started cascading to robust daily system liquidity (N700.0 – N800.0 billion), and a full government backing may accentuate the pass-through to fixed-income markets.

However, the former likelihood is premised on the elevated fiscal deficit and the growing need to attract foreign inflows with better carry trade, particularly considering the sustained supply issues in the FX market despite the FX policy change. On the fiscal front, with the cumulative year-to-date bond issuance (estimated at N3.6 trillion) 48.6% lower than the domestic borrowing target of N7.0 trillion for 2023, we see latitude for an additional N3.4 trillion before year-end. These factors suggest that there is still a strong chance for yield increases in 2023.

Given the uncertainty implied by the above likelihoods, we favour a laddered portfolio approach to mitigate the risk of locking in lower yields should interest rates become depressed and increase the chances of making good returns on re-investments should an upward swing in rates materialise.



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Contact:

5 Okotie Eboh street,
Ikoyi, Lagos, Nigeria

4A, Misratah Street,
Wuse II, Abuja, Nigeria

+234-1 631 2225, +234-1 710 0433

research@cardinalstone.com

www.cardinalstone.com

