

SUBDUED GROWTH OUTLOOK AMID TIGHTENING FINANCIAL MARKET CONDITIONS

October 6, 2022



Economic Report

Global Market

Globally, the third quarter of 2022 was characterised by policy rate hike to multi-year highs, sticky consumer prices, weak manufacturing sentiments, gloomy economic outlook, and steep losses for equity investors. In the United States, Q2 2022 real GDP contracted for the second successive quarter to 0.90% year-on-year after a 1.60% year-on-year decline in Q1 2022 according to the US Bureau of Economic Analysis (BEA). The decrease in real GDP reflected decreases in private inventory investment, residential fixed investment, federal government spending, state and local government spending, and nonresidential fixed investment. We attribute the negative growth to persistently high inflation and an aggressive financial market conditions.

Inflation dropped for the second straight month to 8.30% year-on-year in August 2022 against 9.10% in the previous month. The ease in inflationary pressures to a four-month-low was largely driven by milder energy inflation of 23.80% year-on-year (July 2022: 32.90%). In addition, sustained job gains and improved unemployment rate (August: 3.70%) supported the case for extended aggressive tightening. Consequently, the Federal Open Markets Committee (FOMC) elected for a third consecutive policy rate hike in 2022 to starve inflation. The Fed Funds rate was raised in September 2022 by 75bps to a range of 3.00% - 3.25% - representing the fourth hike in 2022. The Fed also reiterated its commitment to driving inflation below the long-term ceiling of 2.00% level, signaling an unrelenting hawkish tilt until inflation reverses trend.

In the Euro area, the European Central Bank (ECB) implemented a 75bps hike in September to move its benchmark deposit rate to 0.75% alongside its main refinancing rate to 1.25%. Despite this, annual inflation rose to a new all-time high of 10.00% in September (August 2022: 9.10%) according to [Eurostat flash estimate](#). The surge in prices was propelled by soaring energy and food prices, and supply bottlenecks. Amid faltering industrial activities induced by the energy crisis, business confidence weakened for a third consecutive month - S&P Global Eurozone PMI fell to 48.40 points in September 2022 (Previous: 49.60 points). The Euro area's manufacturing sector fell deeper into contraction territory during September, due to further slides in both output and new orders. In some cases, production volumes were reduced in response to high energy prices, while many firms downwardly adjusted their operating schedules in line with lower order books. Also, demand for eurozone goods sank sharply in September as high inflation and economic uncertainty reportedly squeezed client appetite. Business confidence subsequently fell to its lowest level, leading firms to cut purchasing activity further in anticipation of more challenging conditions.

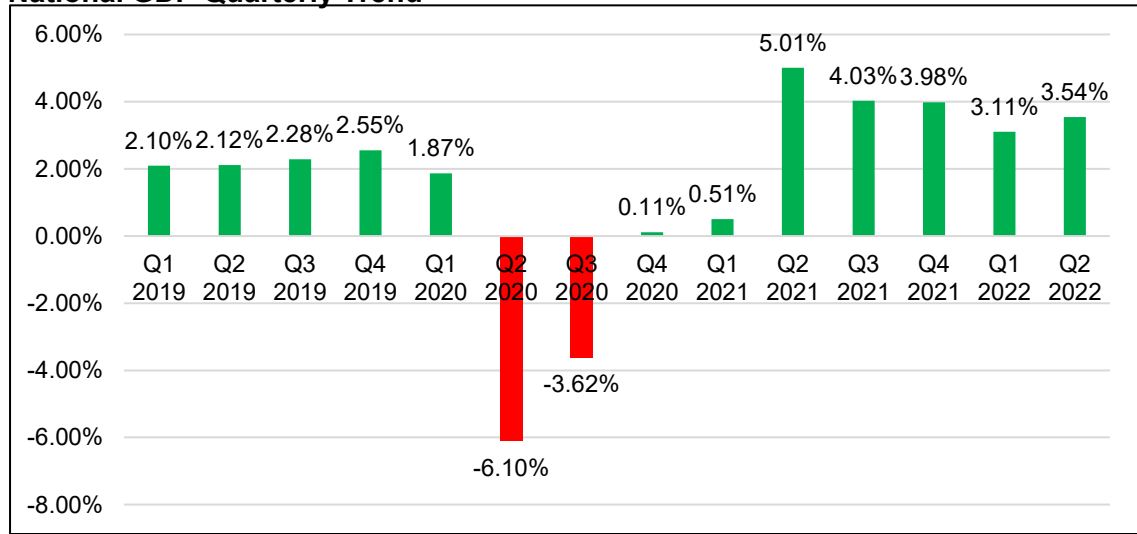


Domestic Economy

GDP

The National Bureau of Statistics released the Q2 2022 GDP numbers on August 26, 2022. According to the data, the Nigerian economy grew by 3.54% YoY in Q2 2022 (Q1 2022: 3.11% YoY). The growth was driven by a moderation in the decline of the Oil sector output rather than a broad-based output growth across the key sectors. Notably, the GDP growth in Q2 2022 was lower than the performance in Q1 2022.

National GDP Quarterly Trend



Sources: NBS, WSTC Research

Oil Sector

Occasioned by an 11.18% YoY daily oil production decline to an average of 1.43mbpd in Q2 2022, the Oil Sector dipped for the ninth consecutive quarter by 11.77% YoY. The decline in Q2 2022 was an improvement to Q1 2022 Oil sector's performance (-26.04% YoY). However, we attribute the Oil sector output decline to crude oil theft, pipeline vandalism, and weak investments due to unfavourable macroeconomic conditions. The problem of crude oil theft heightened in 2022 with reports suggesting an output loss of 80% - 90%. The Nigerian Upstream Petroleum Regulatory Commission (NUPRC) estimated the monthly value loss of crude oil at \$234mn.

Non-Oil Sector

The Non-Oil sector grew by 4.77% YoY in Q2 2022, about 131 basis points lower than the 6.08% YoY growth recorded in Q1 2022. Key sectors including Agriculture, Information & Communication, Manufacturing, Finance & Insurance, and Trade all recorded a slower output growth in Q2 2022. In our opinion, the slower growth was induced by the impact of rising inflationary pressures on aggregate demand, as household purchasing power eroded. In addition, global energy disruptions weighed on production capacity of some companies in the industrial sector.

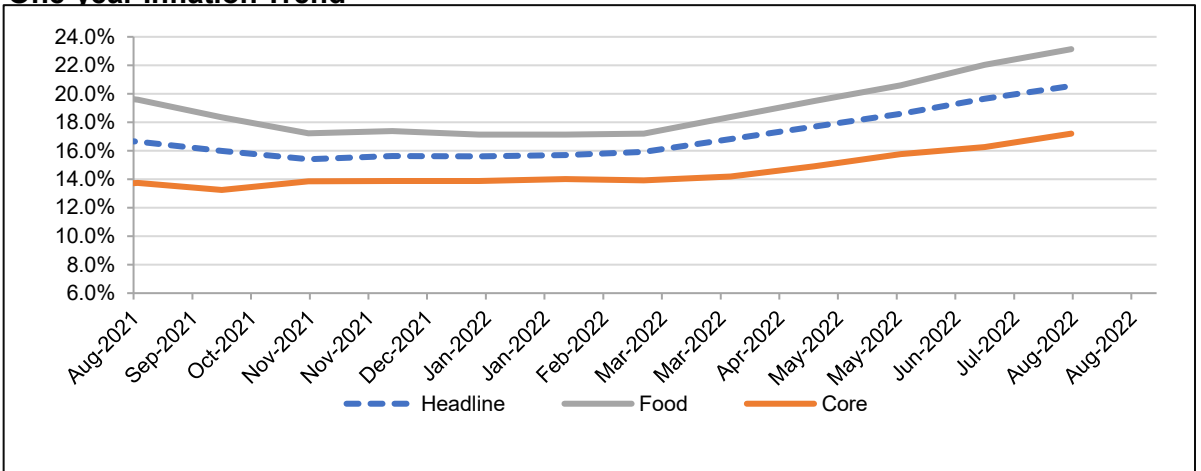


Inflation

Headline Inflation sustained its upward trend in Q3 2022, driven by higher energy prices and currency depreciation. Based on the most recent data by the NBS, the Headline Inflation was 20.52% as of August 2022, up from 18.60% as of Q3 2022 open. We estimate a 21.25% inflation rate in September 2022.

While inflation remained high, we note that the pressures are beginning to cool due to recent tapering of prices in the global commodities market (soft and hard commodities). Therefore, we see the pass-through effect of the global disruptions into the domestic economy moderating. Also, the monetary authorities have recently shifted the policy focus to price stability from the previous pro-growth stance. Hence, the hawkish moves of the monetary authorities are likely to combat the component of price stability pressure coming from the demand side.

One-year Inflation Trend



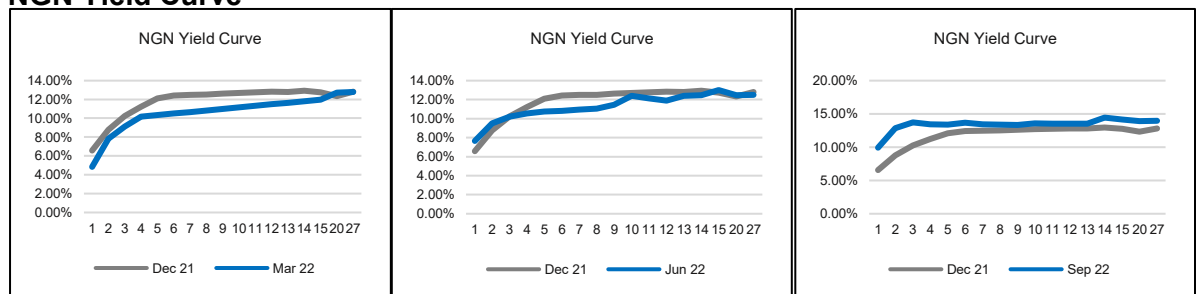
Sources: NBS, WSTC Research

Financial Markets

Fixed Income Market

On the back of a policy shift by the monetary authorities to a hawkish stance, yields in the fixed income rose significantly in Q3 2022, to above its year-open levels. We note that financial system liquidity initially resulted in lower yields in Q1 2022 and Q2 2022. However, rising inflationary pressures and tightening financial market conditions prompted the monetary authorities to react towards the end of Q2 2022. As shown on the chart below, average yields on the FGN 10-year benchmark bond rose to 13.57% as of Q3 2022 close (Q1 2022 close: 11.15%, Q2 2022 close: 12.39%).

NGN Yield Curve



Source: FMDQ, WSTC Research

Yields responded in a similar trend in the NTB Primary Market Auction (PMA). The trend of stop rates and yields in the NTB PMA at the close of the last four quarters are shown below:

	December 2021	March 2022	June 2022	September 2022
91-Day	2.49% (2.51%)	1.75% (1.78%)	2.40% (2.46%)	6.49% (6.94%)
82-Day	3.45% (3.51%)	3.00% (3.09%)	3.79% (3.94%)	7.50% (8.11%)
364-Day	4.90% (5.15%)	4.45% (4.66%)	6.07% (6.46%)	12.00% (13.64%)

Legend : stop rate (yield)

Source: DMO, WSTC Research

Equities market

The equities market closed the third quarter on a negative note (-5.40%) following positive closes in the previous two quarters (Q1 2022: +9.55%, Q2 2022: +10.33%). The weak market sentiment in Q3 2022 was hinged on weak macro conditions, specifically relating to inflation and foreign exchange management. Most relevantly, equity investors reacted to the reversal in the direction of fixed income yields. In May 2022, the monetary policy authorities announced a rate hike for the first time in two years. Consequent to the policy shift, yields across the fixed income market responded and that gave rise to higher opportunity costs of holding equities.

On a quarter-on-quarter basis, total volume declined by 77% to 12.24bn units, while value traded in Q3 2022 grossed N152.56bn, a 69% decline.

On a sectoral basis, only the Telco index closed positive in Q3 2022, driven by Airtel Africa (+15.46% to N2000.00). In our view, the positive performance was beyond fundamentals. We think that the fungible nature of the stock prompted increased buy-interest. That is, investors that needed to repatriate capital saw Airtel Africa stock as an exit option because of its cross-listing characteristics. Fungible stocks are stocks with a dual listing.

On the flip side, the industrial index suffered the worst decline, with a 17.61% price dip. We attribute the steep decline in the industrial sector to sell-offs in BUA Cement (Q3 2022 return: -24.96% to N52.00) and Dangote Cement (Q3 2022 return: -7.55% to N245.00). We believe that investors reacted to the two companies' Q2 2022 financial performances which were below expectations.

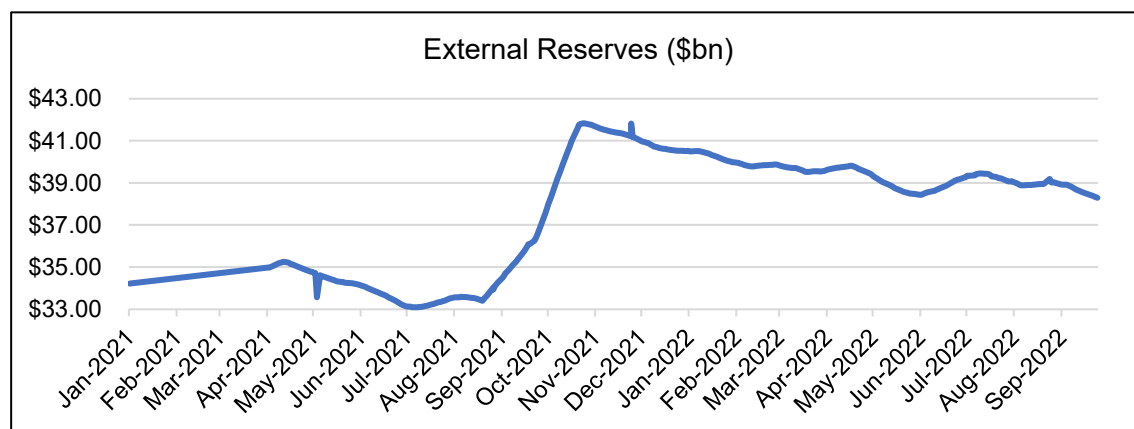
Sectors	Q3 2022 Return
Banking Index	-4.67%
Consumer Goods Index	-6.30%
Industrial Index	-17.61%
Insurance Index	-5.46%
Oil/Gas Index	-6.80%
Telco Index	+3.50%

Sources: NGX, WSTC Research

Foreign Exchange Market

The exchange rate at the I & E window worsened to N437.03 in Q3 2022 from N425.05 at the end of Q2 2022. An unending demand for the dollar, relative to weak supply, further widened the premium (68%) between the I & E window and the parallel market rate as black-market rate hit a new high of N740/\$.

The external reserve closed at \$38.25bn in Q3 2022, recording a 2.30% decline from \$39.16bn in Q2 2022. Inflows from major FX sources including crude oil proceeds, foreign capital inflows, and diaspora remittances remained weak in Q3 2022 due to sustained subsidy outflows, inconsistent FX policies, and tightening financial market conditions in the global economy.



Source: CBN, WSTC Research

Outlook

Fixed Income Market

In the continued efforts to rein-in inflationary pressure, we expect the committee to sustain its aggressive tightening. Therefore, we see yields trending upwards for the rest of the year.

Equities Market

We do not expect to see any change from the current trend. The bearish trend will most likely persist due to a high-interest-rate environment without a corresponding economic growth. Nonetheless, we believe that the market selloffs provide an entry opportunity for investors with a long investment horizon. These opportunities are fundamentally strong stocks with high (quality) earnings yield and dividend yields.

Foreign Exchange Market

The demand pressures in the foreign exchange market is expected to persist till the rest of the year, while dollar supply will likely remain weak due to underlying constraints including subsidy outflows, weak diaspora remittances, and weak foreign inflows. We also do not see any policy that could materially upturn the current trend in the Nigerian foreign exchange market.



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Investment Recommendation

WSTC uses a 3-tier recommendation system for stocks under coverage: Buy, Hold, and Sell.

- Buy Rating: estimated fair value is $\geq 15\%$ above current market price.
- Hold Rating: estimated change in price is between -10% and 15% of current market price.
- Sell Rating: estimated change in price is $\leq -10\%$ of current market price.

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