
Nigeria in 2023: At the Cliff's Edge



Executive Summary

The global economy was consolidating its recovery from the coronavirus pandemic that occurred in 2020 before it was faced with a fresh problem – the Russia – Ukraine war. The steady improvement was cast into significant doubt again as severe supply chain disruptions and inflationary pressures dominated the global economy. Both the advanced and emerging markets economies experienced historically high inflation levels which prompted a response by policymakers. In the United States, the Federal Reserve normalised policy rates. Therefore, the US Dollar strengthened, and the emerging market economies faced an additional downside – increased capital outflows leading to subdued economic growth.

The trend in the domestic economy was no different, as higher global commodity prices negatively impacted food supply and inflation rose to relatively high levels. The subsequent erosion of purchasing power resulted in subdued output growth as aggregate demand weakened. Meanwhile, financial system stability was threatened by high inflationary pressures and by implication, the foreign exchange market became volatile in 2022. In response, the monetary policy authorities raised rates to improve the negative real return in the economy.

In 2023, we expect global inflationary pressures to persist, but we see a moderation as the initial impact of the war in Ukraine appears to have normalised. We expect lower paces of rate hikes by the Fed in 2023. In the domestic scene, however, we may see elevated inflation levels due to other structural factors including misaligned policies – at least for the first half of 2023.

The exchange rate in the foreign exchange market is expected to depreciate further in 2023 driven by a combination of weak FX inflows amid tightened global financial market conditions. Based on our estimates, we expect the exchange rate in the I & E window to range between N430-N500 in 2023. However, we may see a decline in parallel market exchange rates in 2023 to N700 from the current N730 levels. We believe that the exchange rate in the parallel market overshot in 2022.

In the financial markets, we think that it will be a year of two halves. We expect yields in the fixed income market to decline in H1 2023 due to increased liquidity during the period amid fixed income maturities. In H2 2023, we see the trend a rising yield environment. Meanwhile, the losses of the fixed income market are the gain of equities market. We expect the equities market to benefit from the push-effect of increased liquidity in H1 2023 before the positive momentum reverses the trend in H2 2023.

Our expectations and outlooks were based on optimism that the economy could enjoy an upside and that 2023 could mark the U-turn of the country's fortunes. Given that 2023 is an election year, we believe that the three leading candidates are positively disposed to a market-driven economy. However, we think that what matters is the political will, courage, and conviction to implement the required changes.

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Global Economy

Global Economy

Events that shaped the global economy in 2022

The Russia-Ukraine war

A long-standing stand-off between the two Eastern European countries became an open-ended war just at the beginning of the year. Russia declared war on Ukraine on February 24, 2022, and the global economy – which was steadily recovering from the pandemic pressures – moved to a new dimension. The implication of the war translated to higher commodity prices including soft commodities (i.e., agricultural products). While the combined economies at war accounted for 2% of global GDP, they had an outsized impact in the global commodities market given that they are both top commodities exporting countries. Major commodities such as crude oil, wheat, palm oil, fertiliser etc. all rose sharply.

What the War Meant for the Global Economy

The war between Russia and Ukraine significantly impacted the global economy, particularly in the emerging markets. The pass-through impact was in the form of higher crude oil prices. While the net exporters of crude oil benefitted from this market situation, the net importers of oil suffered. Not many countries escaped the pass-through of heightened inflationary pressures as food prices rose astronomically. The global economic growth is expected to close 2022 at a 2.90% growth, lower than the 5.90% growth in 2021.

US Inflation and the Fed

The United States economy reported a record-high inflation at some point in 2022. In June 2022, inflation rose to 9.10% year-on-year – the highest level since the past 40 years. Higher energy costs induced by higher global crude oil prices and sustained global supply chain disruptions (semiconductor scarcity) were the major drivers. Meanwhile, the United States monetary policy authorities were hitherto faced with normalising the demand - supply distortion that was a consequence of quantitative easing. The twin impact of higher energy prices and excess liquidity in the financial system pushed inflation to record levels.

Rate Hikes, US Inflation, Emerging Markets Woes

In response, the United States Federal Reserves implemented rate hikes throughout 2022. Specifically, the Fed hiked rates seven times in 2022. The Fed Fund rate rose closed the year at 4.25% - 4.50% from 0.25% - 0.50% at the start of the year. Yields on the US 10-year Treasury advanced to 3.88% at the end of 2022 from 1.63% at year start. The follow-up events resulted to capital outflows from emerging markets and the currencies of these countries depreciated. The economic challenges of emerging market economies were pronounced by high debt levels (that rose sharply during the pandemic). Higher interest rates implied increased higher risk premiums. Thus, it became difficult to raise funds in the international markets, therefore, worsening the external accounts of emerging markets. Asset prices across the emerging markets dipped as a result.

2023 Outlook for the Global Economy

Global Output

The World Bank projects a **1.70%** global output growth in 2023, the third weakest global growth bested by the 2008 and 2020 global economic downturns. The weak global growth expectation was underpinned by tightened financial market conditions, effects of coronavirus pandemic, and continued impact of the Russia-Ukraine war.

Global Inflation

Global inflation is likely to remain high in 2023, however, we see the pressure moderating. Global commodity prices have moderated since they rose to record highs, but they are still above historical levels. On the back of a tightened financial conditions, global demand is expected to slowdown while supply chain disruptions are expected to ease, barring any future shocks. Therefore, the combination of weakened global demand and improved global supply should abate inflationary pressures in 2023.

United States Economy

In the United States, inflation rate moderated from its multi-year high of 9.10% in June 2022 to 6.50% in December 2022. We see the disinflation trend continuing into 2023 amid lower energy price pressures, subdued demand, and improved supply chain. Therefore, we expect the pace of the Federal Reserve's rate hike to moderate in 2023. However, the rate hike moderation should begin to take effect in H2 2023.

Crude Oil

We expect crude oil prices to range between **\$80-\$90** per barrel in 2023, on the back of our expected interactions between demand and supply. Subsequent to expectations of weak global demand, especially from China who is still faced with the coronavirus pandemic, the global oil demand is projected to slowdown. Meanwhile, we see a stable global oil supply in 2023.



Domestic Economy



Domestic Economy - *GDP*

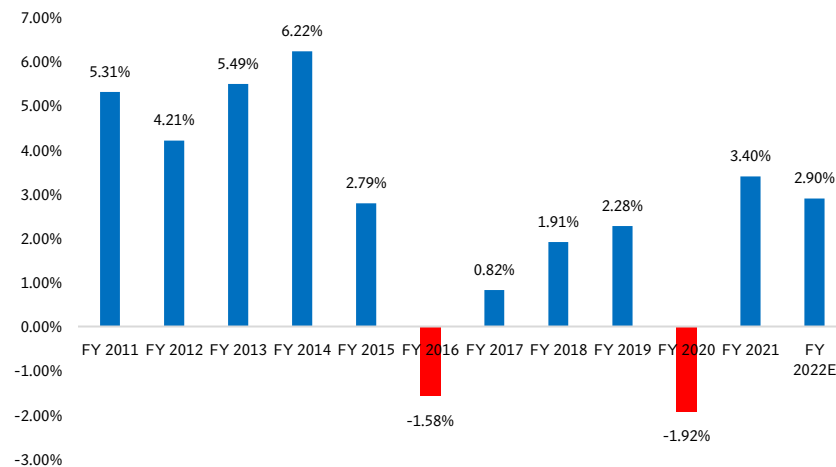
As of January 2022, to September 2022 (i.e., 9M 2022), the Nigerian economy grew by 2.94% year-on-year – led by the non-oil sector. The non-oil sector grew by 4.35% YoY while the oil sector declined by 15.67% YoY in 9M 2022. Resilient performances from the Agricultural, Trade, InfoComms, Transportation, and Manufacturing sectors drove the performance of the non-oil GDP.

We attribute the performance of the contributing non-oil sectors to technology and digitilisation (reflected in the InfoComms and Manufacturing sectors growth). In our view, output growth in the Manufacturing sector was aided by improved distribution channels via technology (e.g., e-commerce). Increased industrial activities due to capacity expansion in the cement subsector supported the growth of the Manufacturing sector.

Increased digital penetration of the Nigerian economy spurred the growth of the InfoComms sector, while the Trade sector grew on the back of sustained increase of economic activities since the economy moved on from the coronavirus pandemic in 2020.

Nonetheless the output growth in 9M 2022, we posit that the performance was heavily skewed to few sectors. The economy was characterised by FX illiquidity, high operating costs environment, weak foreign investments, and high household poverty levels.

Nigerian Real GDP Trend



Source: National Bureau of Statistics, WSTC Research

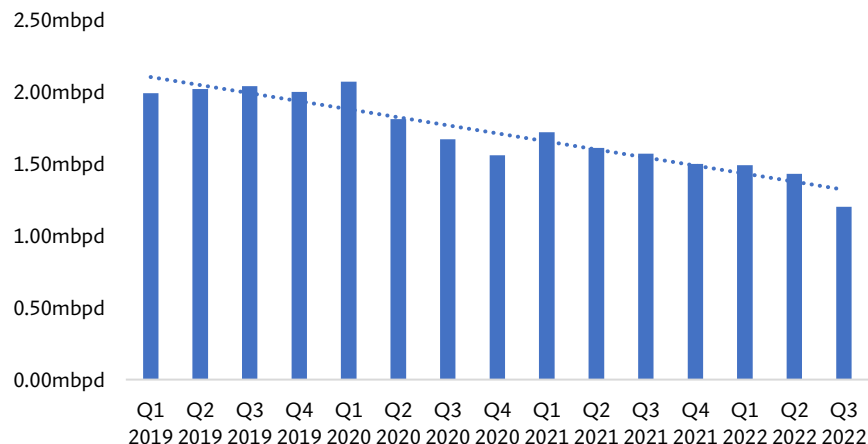
Performance of the Top Sectors of the Nigerian Economy

Sectors	Average Contribution to National GDP	Q3 2022 growth	Q2 2022 growth	Q1 2022 growth
Agriculture	25%	+1.34%	+1.20%	+3.16%
Trade	16%	+5.08%	+4.51%	+6.54%
InfoComms	16%	+10.53%	+6.55%	+12.07%
Manufacturing	9%	-1.91%	+3.00%	+5.89%
Real Estate	6%	+4.56%	+4.42%	+4.44%
Oil	6%	-22.67%	-11.77%	-26.04%
Finance & Insurance	4%	+12.70%	+18.48%	+23.24%
Combined Total	82%			

Source: National Bureau of Statistics, WSTC Research

Domestic Economy - GDP

Daily Oil Production



Source: National Bureau of Statistics, WSTC Research



Sectoral composition of GDP			
	2012	2017	2022E
Nominal			
Oil sector GDP	16%	9%	7%
Non-oil sector GDP	84%	91%	93%
Total GDP	100%	100%	100%
Agriculture	22%	21%	24%
Industry	27%	23%	32%
Services	51%	56%	44%
Total GDP	100%	100%	100%

	Real		
Oil sector GDP	14%	9%	6%
Non-oil sector GDP	86%	91%	94%
Total GDP	100%	100%	100%
Agriculture	24%	25%	25%
Industry	26%	22%	20%
Services	50%	53%	55%
Total GDP	100%	100%	100%

Source: National Bureau of Statistics, WSTC Research

The Persistent Challenges of the Oil Sector

Output in the oil sector was underwhelming. The average daily production declined to 1.37mn barrels per day as of 9M 2022 from a 1.60mn average as of FY 2021. High spate of crude oil theft and weak investment in the oil sector were the challenges of the oil sector in 2022. However, ongoing efforts to clamp down on oil thefts were put in place and early results showed progress.

Given the recent challenges of the oil sector, its contribution to the overall Nigerian economy is estimated to decline to 6% in 2022 from 9% in 2017.

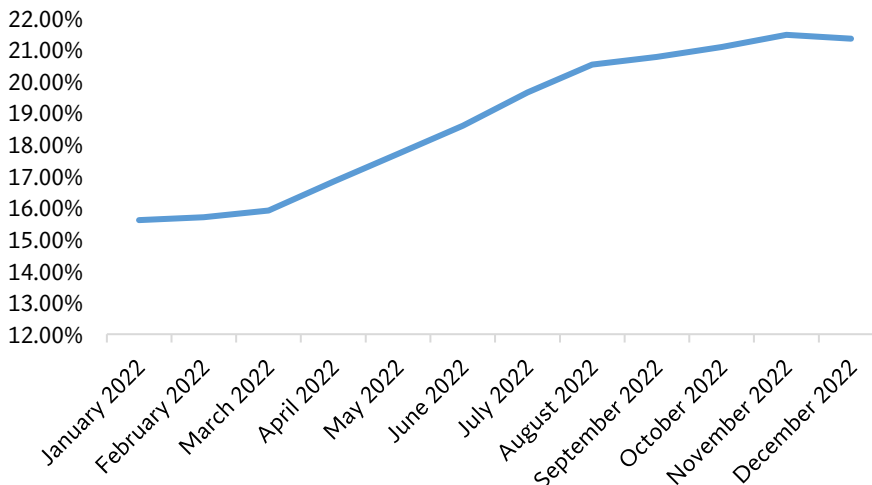
Domestic Economy - Inflation

Domestic prices closed the year 2022 at 21.34% year-on-year (year-open: 15.63%) – with food inflation rate closing at 23.75% (year-open: 17.13%) and core inflation closing at 18.49% (year-open: 13.87%).

The war in Eastern Europe cascaded into the domestic economy in the form of higher food and energy prices. For context, the prices of major food crops rose astronomically. The price of other commodities such as fertiliser (a key input used for local food production) rose significantly. In addition, higher diesel prices impacted haulage and transportation costs in 2022. Meanwhile, underlying legacy issues such as insecurity, weak macro policies, poor storage and farming techniques continued to strain food production.

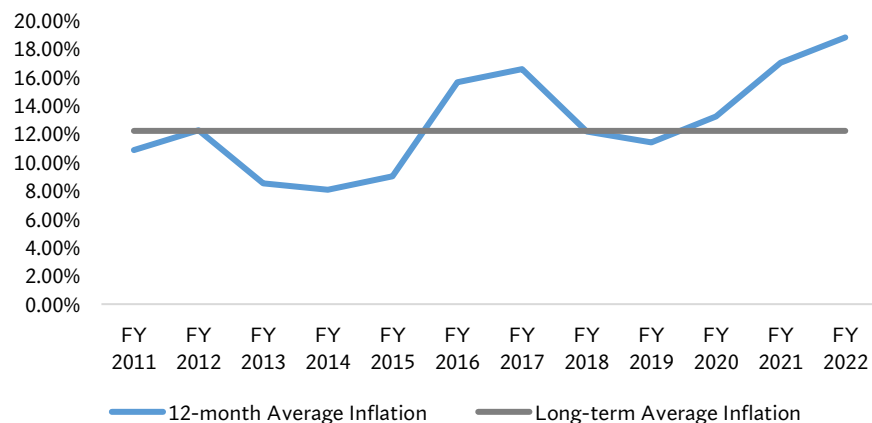
Notably, the 12-month average headline inflation rose to 18.76% in 2022, about 178 basis points higher than 16.98% average in 2021. It was the fourth consecutive year of annual inflation rise. Segmenting the past 12 years into three different periods, we observed that domestic inflation rose from a 10% average between 2011 – 2015 to 14% average between 2016 to 2020 and to 18% average between 2021-2022. We highlight the figures across the three periods were higher than the Central Bank of Nigeria's 9% inflation target. We also highlight that the rising inflationary trend reflected the weakening fundamentals of the Nigerian economy over the past decade.

Headline Inflation Trend



Source: National Bureau of Statistics, WSTC Research

Average Annual Inflation vs Long-term Average Inflation



Source: National Bureau of Statistics, WSTC Research

Domestic Economy – Fiscal Policy

FGN's Fiscal Trend

N'bn	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022E
Oil	1,980.36	1,218.22	697.80	1,125.05	1,960.85	1,373.18	1,521.44	1,111.84	755.35
Non-oil	779.06	769.27	818.51	956.67	1,124.84	1,582.58	1,276.09	3,266.21	2,278.08
Other revenue	482.89	1,252.85	1,431.20	575.95	780.80	1,164.33	1,139.82	265.46	4,055.28
Total revenue	3,242.31	3,240.34	2,947.51	2,657.67	3,866.49	4,120.09	3,937.35	4,643.51	7,088.71
Budgeted revenue		3,452	3,856	5,084	7,166	6,998	5,365	6,638	9,969
<i>Revenue performance</i>		94%	76%	52%	54%	59%	73%	70%	71%
Non-debt recurrent expenditure	2,216.78	2,550.07	2,411.63	2,765.33	3,238.10	4,251.11	4,645.21	4,457.97	5,462.45
Recurrent debt (debt service)	941.67	1,277.49	1,467.51	1,823.59	2,161.37	2,453.74	3,265.47	4,221.65	5,718.01
Capital expenditure	587.61	601.26	173.09	1,439.97	1,655.27	1,165.51	1,744.46	1,903.55	2,048.40
Statutory transfers	377.37	338.56	344.00	434.41	456.46	428.46	428.03	496.52	812.97
Other expenses	0.00	0.00	745.71	0.00	0.00	0.00	0.00	0.00	0.00
Expenditure	4,123.43	4,767.38	5,141.94	6,463.30	7,511.20	8,298.82	10,083.17	11,079.69	14,041.83
Deficit	(881.12)	(1,527.04)	(2,194.43)	(3,805.63)	(3,644.71)	(4,178.73)	(6,145.82)	(6,436.18)	(6,953.13)
Nominal GDP	89,043.65	95,177.76	102,575.45	114,899.26	129,086.96	145,639.10	152,324.09	173,527.66	193,983.27
Debt service ratio	29%	39%	50%	69%	56%	60%	83%	91%	81%
Fiscal deficit to GDP	-0.99%	-1.60%	-2.14%	-3.31%	-2.82%	-2.87%	-4.03%	-3.71%	-3.58%
Capex to borrowings	-67%	-39%	-8%	-38%	-45%	-28%	-28%	-30%	-29%
Govt spending to GDP	4.63%	5.01%	5.01%	5.63%	5.82%	5.70%	6.62%	6.38%	7.24%
Oil revenue contribution	61%	38%	24%	42%	51%	33%	39%	24%	11%
Non-oil revenue contribution	24%	24%	28%	36%	29%	38%	32%	70%	32%
Other revenue contribution	15%	39%	49%	22%	20%	28%	29%	6%	57%
Capex to total expenses	14%	13%	3%	22%	22%	14%	17%	17%	15%
Recurrent to total expenses	86%	87%	97%	78%	78%	86%	83%	83%	85%

Source: Ministry of Finance, Budget Office, WSTC Research

Domestic Economy – Fiscal Policy (Cont'd)

It was the same old story with the fiscal policy in 2022. As of November 2022, the FG recorded a N6.37trn fiscal deficit. We expected the full year figures of fiscal deficit to print at N7.00trn – approximately 4% of GDP, in line with the trend over the past two years.

Using annualised figures, the FG achieved 77% of what it planned to spend in 2022. However, the bulk of that spending was made on non-capex expenditures. Specifically, the FG spent 44% more than it planned on debt service. However, debt service to revenue declined to 81% in 2022 from 91% in 2021 as a result of improved revenue generation.

As a proxy to measure the effectiveness of the 2022 budget, we assessed the implementation of capex. Based on our findings, capex implementation rate stood at 33% - an underwhelming figure, in our view.

A concerning trend in the 2022 budget performance was the double decline of oil and non-oil revenue. Oil revenue declined by 32% while non-oil revenue declined by 30%. Although the decreases were fully offset by the 15x increase in other revenue (donors and grants, independent revenues, GOEs retained revenue etc.). Oil receipts were lower despite higher average realised prices in 2022. The consequence of lower oil production and fuel subsidy outflows resulted in the lower oil receipts.

FGN Debt stock

	FY	FY	FY	FY	FY	FY	FY	FY	FY
(N'bn)	2014	2015	2016	2017	2018	2019	2020	2021	2022E
Domestic debt (N'bn)	7,904	8,837	11,058	12,589	12,774	14,273	16,024	19,243	21,551
External debt (N'bn)	1,540	2,072	2,891	5,784	7,736	8,494	11,966	15,355	16,497
Total FGN debt stock	9,444	10,909	13,950	18,373	20,510	22,767	27,990	34,598	38,048

Source: Debt Management Office, Budget Office, WSTC Research

Debt Stock

The total FGN debt is expected to close at N38.05trn in 2022 (debt-to-GDP of 20%). Domestic debt rose by 12% to N21.55trn (\$51.81bn) while external debt rose by 7% to N16.49trn (\$39.66bn). In total, the FG's debt stock increased by 10% in 2022. A major conversation in public discourse in 2022 was the proposed securitisation of the outstanding Ways and Means dues to the Central Bank of Nigeria. The proposal to securitise Ways and Means obligation, if approved, would take the total debt stock to c.N60trn.

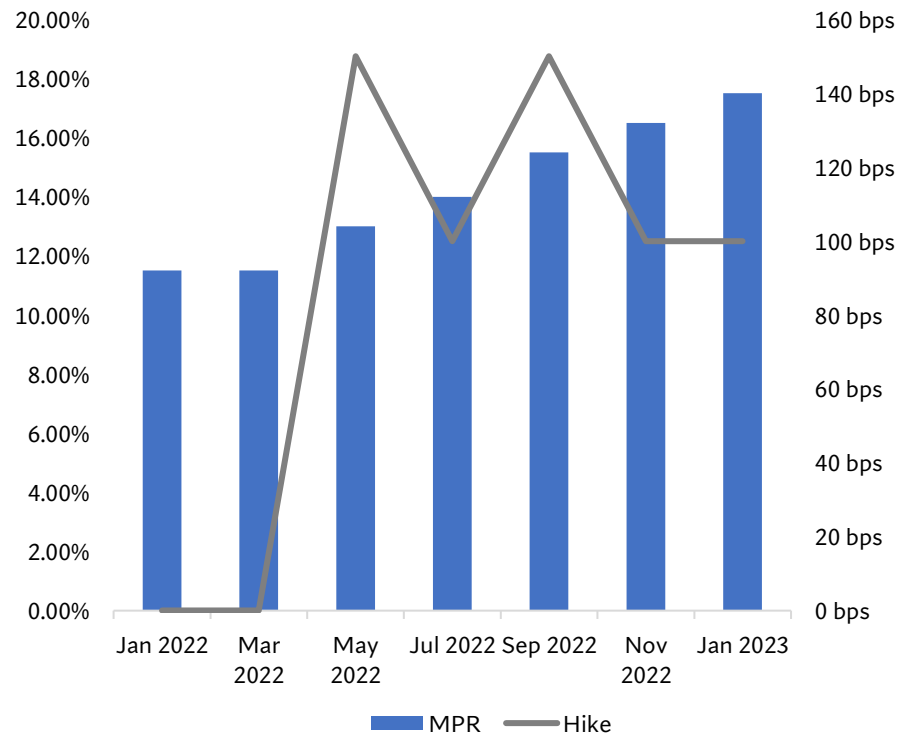
The emphasis on the FGN's debt stock is on the high debt service ratio and its implications for the country's risk premium. Over the last five years, two-thirds of government revenues were used to service debts. We believe that this trend is inimical for long-term economic growth.

Domestic Economy – *Monetary Policy*

The monetary authority policies were relatively hawkish in 2022, in efforts to combat inflationary pressures. Interest rates were, however, initially at low levels through Q1 2022. The stance changed during the MPC committee meeting held in May 2022, where the monetary policy rate (MPR) was hiked by 150 bps – the first of four hikes that was done in 2022. In total, the MPR was raised by 500 basis points to 16.50% by the end of 2022 from 11.50% by year open. In addition to raising benchmark rate, the MPC also increased the cash reserve requirements of banks (CRR) to 32.50% from 27.50% during the September 2022 meeting, although the effective CRR of deposit money banks had consistently been higher than the regulatory threshold.

Our opinion is that the impact of the monetary policy ranged between ineffective to unclear. Inflationary pressures continued to rise higher throughout the year at an increasing pace. Also, the exchange rate continued to depreciate in the I & E and parallel markets. This suggests to us interest managements had little correlation to the underlying drivers of inflationary pressures. In our view, we think that other (misaligned) policies undermined the impact of the rate increases.

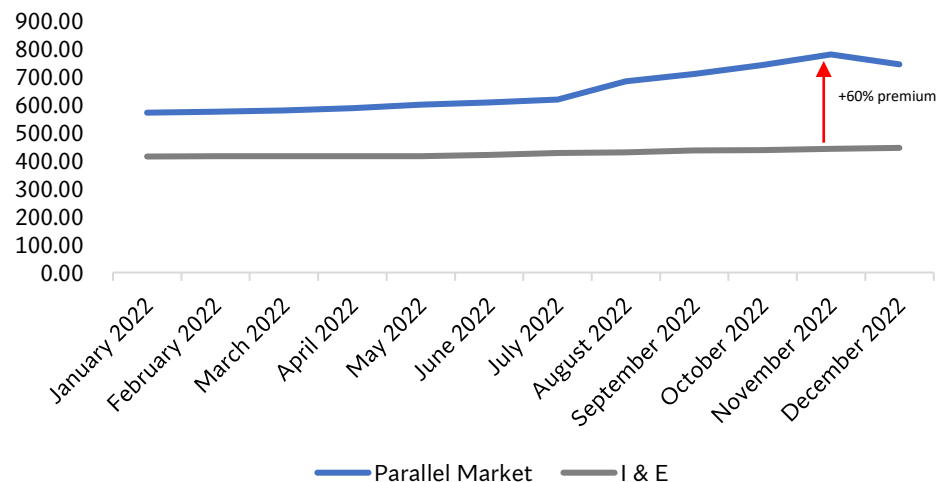
MPR Trend



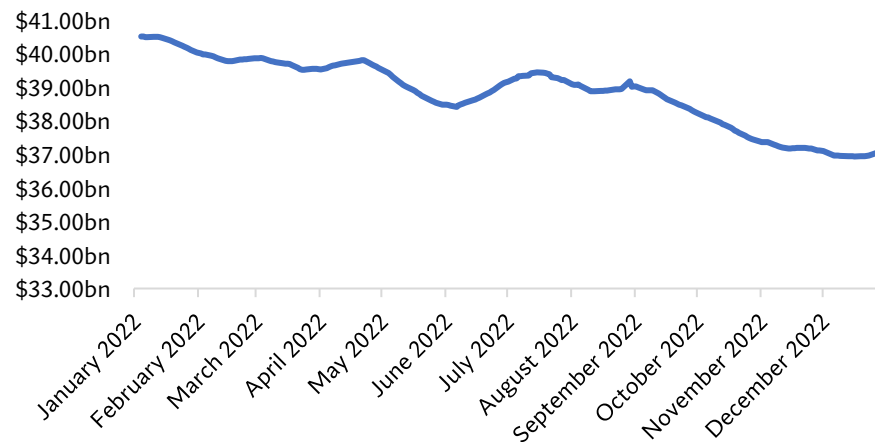
Source: Central Bank of Nigeria, WSTC Research

Domestic Economy – *External Accounts*

Average Exchange Rates



External Reserves (\$bn)



Sources: Central Bank of Nigeria, WSTC Research

External Accounts

Nigeria's balance of payments improved in 2022 (based on most recent data). An annualised trade surplus of \$18.40bn in 2022 is positive when compared to trade deficits of \$2.49bn and \$16.40bn in 2021 and 2020, respectively. Higher crude oil receipt was the catalyst of the trade surplus in 2022, as exports grew by 50% to an annualised \$70.99bn versus \$47.17bn in 2021. Despite improvements in current account balance, the external reserve was under pressure in 2022. The external reserves declined by 7% to \$37.80bn, due to the structure of the economy as a net importer of refined petrol.

The exchange rate in the I & E market depreciated by 6% to N449 by year end from N435 at the start of 2022. Meanwhile, the average rates in the parallel market depreciated by 30% to N736 from N565 at the start of 2022. Thus, the premium between the parallel market rate and I & E market rate widened to 64% in 2022 from 30% in 2021.

2023 Outlook for Domestic Economy

2023 Outlook for Domestic Economy

2023 Election: Nigeria will go to the polls to elect her leaders that will manage her affairs over the next four years. The presidential election in 2023 will be the first to hold since 2007 where neither of the contestants is an incumbent. Also, unlike the previous presidential elections, the 2023 election is more of a 3-man race. Based on the manifestoes and public discussions of their plans for the Nigerian economy, our deduction is that the three major candidates (Bola Tinubu of the All Progressive Congress, Atiku Abubakar of People's Democratic Party, and Peter Obi of the Labour Party) are all market friendly. The three candidates seem aligned (although with different approaches) on driving a private sector-led economy. We highlight three critical areas that require urgent attention namely:

- Tackling Insecurity
- Fuel Subsidy Removal
- Ensuring Fiscal Discipline
- Effective Foreign Exchange Policy

While the three major candidates all expressed their thoughts on addressing the listed issues above, we think that 'talk is cheap'. The conviction and political will are required to drive the needed reforms. Overall, we are optimistic that the economy could enjoy a significant upside and 2023 could mark the U-turn of the country's fortunes. Aided by stable oil prices, political changes could foster the implementation of economic reforms that would ensure macroeconomic stability and the better use of the country's vast resources.

GDP: We project a real GDP growth of 2.85% in 2023, lower than our FY 2022 estimate of 2.90%. Our growth expectations are anchored on weak aggregate demand growth due to inflationary pressures and shrinking purchasing power. We also see weak aggregate supply growth, on the back of tightened financial market conditions and slowdown of investments in the economy. In our view, political events will dominate governance for the most of H1 2023. Therefore, we see limited scope for effective policymaking to steer the economy during the period.



2023 Outlook for Domestic Economy – (Cont'd)

Domestic Inflation: We expect inflation to remain high in 2023 – our estimate is a 20.95% average headline inflation for 2023. The structural bottlenecks are expected to keep inflation at elevated level. Meanwhile, we expect the energy disruptions that pressured price levels in 2022 to normalise. We also see base effects panning out during the year. Hence, we see inflation rate closing at 20.66% in 2023 from 21.34% in 2022.

Fiscal Policy & Monetary Policy

Fiscal Policy

The FG's fiscal plan for 2023 is N21.83trn, broken down into N8.33trn for non-debt recurrent expenditure (38%), N6.56trn for debt financing (30%), N5.97trn for capital expenditure (12%), and N967.49bn for other statutory transfers (6%).

To finance the fiscal plan, the FG projects to earn N10.49trn, with N2.32trn (22%) expected to come from oil sources, N2.43trn (23%) to come from non-oil sources, and N5.74trn (55%) to come from other sources (including independent revenue and GOEs retained earnings).

According to the FG, only N3.6trn provision of subsidy was made, in view of phasing out the scheme mid-2023. The fiscal deficit for 2023, is therefore, estimated at N11.34trn for 2023 or 5% of GDP.4

While we note the ongoing efforts by the FG to boost revenues, we believe that only 57% of the planned revenue will be achieved.

The gap is based on expectations for lower oil revenue We do not think the FG will achieve her oil production target in 2023. Also, we are less optimistic about the expected inflows from government owned enterprises due to weak governance framework. We note that the FG consistently underperforms on this line.

On expenditure, we see a 75% implementation rate due to constrained revenues. While we expect a near full performance for recurrent expenditures, we only see 32% of capex performance. Therefore, we believe that the 2023 fiscal plan would do little to significantly revive the economy. Based on our budget performance expectations, we project a N10.26trn fiscal deficit in 2023 – to be mostly funded by domestic borrowings.

During our visit to Dangote Refinery in mid-2022, the management slated Q1 2023 as the period when the refinery is expected to commence production. The 650,000 barrels per day capacity refinery which is also the largest single train in the world, is expected to reduce the FX demand pressure and perhaps the prices of premium motor spirit (PMS). According to the FG, fuel subsidy removal will be easier implemented with the refinery in operation. In our view, we think that (i) the refinery won't begin operations fully till at least Q4 2023. We attribute this to potential delays related to change of government (ii) the dynamics that determine PMS prices are not straightforward and while FX savings are possible, we are less optimistic about the magnitude of price savings of PMS.

2023 Outlook for Domestic Economy – (Cont'd)

Monetary Policy

We expect the policy environment to remain hawkish in 2023, as inflationary pressures continue to discourage investors from holding Naira assets, thus distorting the exchange rate. Although we projected a relatively moderate inflationary pressure in 2023, the figure is significantly above the CBN's target of 9% and the long-term average of 12%.

The approach to tightening the financial system, is however unclear. It might be via the financial markets (bond and NTBills issuances) or via the banking system (CRR debits and Ways and Means). Overall, we expect interest rates to generally rise in 2023.

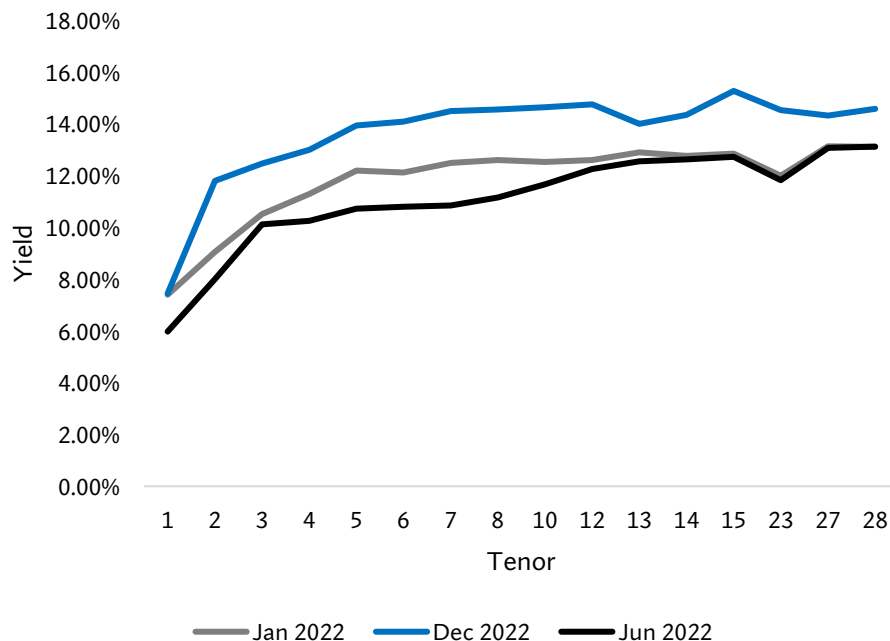


Financial Markets

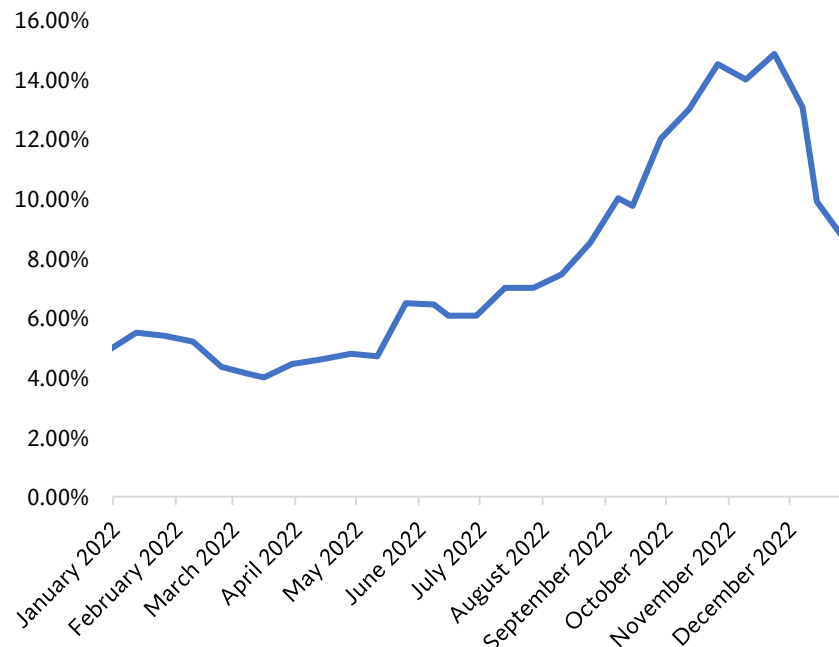


Financial Markets – *Fixed Income*

NGN Yield Curve



NTB One-Year Stop Rate



Sources: FMDQ, WSTC Research

Yields in the fixed income market traded sideways in 2022. In H1 2022, against the market consensus, yields remained low, but the trend reversed in H2 2022 following the change in the CBN's stance to policy tightening to combat inflationary pressures. We also believe that pressures in the foreign exchange market prompted the monetary policies to push for a higher interest rate environment. The closing yield on one-year treasury bills rose to 8.55% in December 2022 from 5.24% in December 2021. In the bond market, the closing yields on the FGN 10-year government bond also rose to 13.56% in December 2022 from 12.73% in December 2021.

Financial Markets – *Equities*

The equities market delivered a 19.98% return in 2022 – the third consecutive positive return – a feat last seen in 2007. The Oil & Gas, Industrials, and Telco sectors were the most performing sectors, led by Seplat (+69%), BUA Cement (+46%) and Airtel (+71%). In context, the performance of the equities market mirrored the fixed income market in a reverse mode. In H1 2022, the equities market delivered a double-digit growth of 21.91% while fixed income yields were low. In H2 2022, the prices tanked by 1.91% in response to higher fixed income yields.

Some of the factors that played out in the overall market rally are stated below:

i. **Oil Price Spike:** following the fallout between Russia (a major oil global power) and Ukraine, prices in the global crude oil market spiked. As a result, companies in the oil industry benefitted from the windfall in 2022. Notably, Seplat Energy Plc rallied by 69% to close at N1,100 in 2022.

ii. **Low-Interest Rates in H1 2022:** Between January 2022 to June 2022, a low-interest rate environment ‘pushed’ liquidity into the equities market. However, following a reverse of stance by the monetary policy authorities, interest rate gradually increased in H2 2022, and liquidity flowed out of equities. This was evident by the half year returns of the market. In H1 2022, the equities market delivered a +21.31% return while it declined by 1.91% in H2 2022. The earlier price gain in the market helped the market to close at a net positive position.

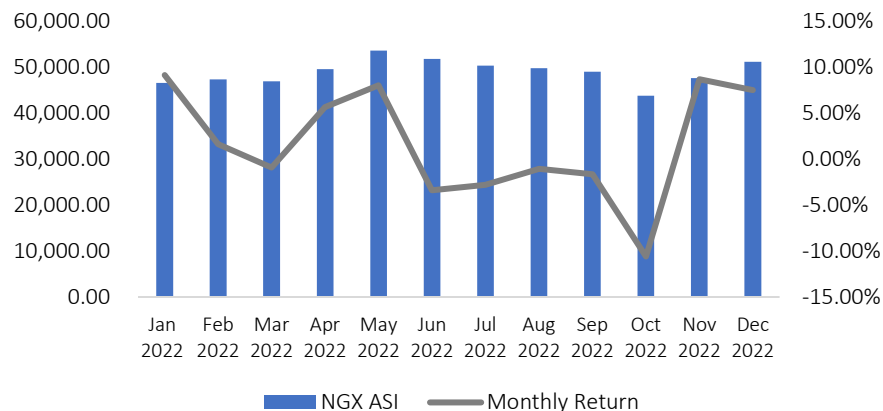
iii. **The ‘Airtel Factor’:** A price rally in Airtel Africa (the most capitalised stock on the Nigerian Exchange) gave the overall market a ‘positive pull’. We believe that illiquidity in the Nigerian foreign exchange market prompted investors to buy Airtel as a means to repatriate capital. We believe that this was possible due to the fungible nature (double listing in Nigeria and London) of the stock.

iv. **Sustained Demand Growth of Digital Services:** The telecommunications sector performed well during the year, on the back of strong revenue and profit growth that was driven by data demand. Increased digital penetration and innovation supported the demand for data during the period. Given the solid growth prospects of the telecommunications industry, increased buy-interest drove prices upwards.

v. **Corporate Actions:** new listings by BUA Foods Plc and Geregu Power Plc also contributed to the broad market positive performance.

Financial Markets – *Equities (Cont'd)*

NGX ASI Index



Sources: Nigerian Exchange, WSTC Research

Sector Drivers

Banking Index: a low interest environment coupled with high operating costs environment tanked profitability, as the banking players' margins shrunk. The situation, however, took a new dimension in H2 2022 with rising interest rates. Accordingly, investors renewed their buy interests on banking stocks in Q4 2022.

Consumer Goods Index: players in the consumer goods initially benefitted from higher effective pricing in the H1 2022. In our view, previous efforts on improved distribution and route to market also helped to deliver some volume growth. However, the fortunes of the consumer

Sectorial Trend

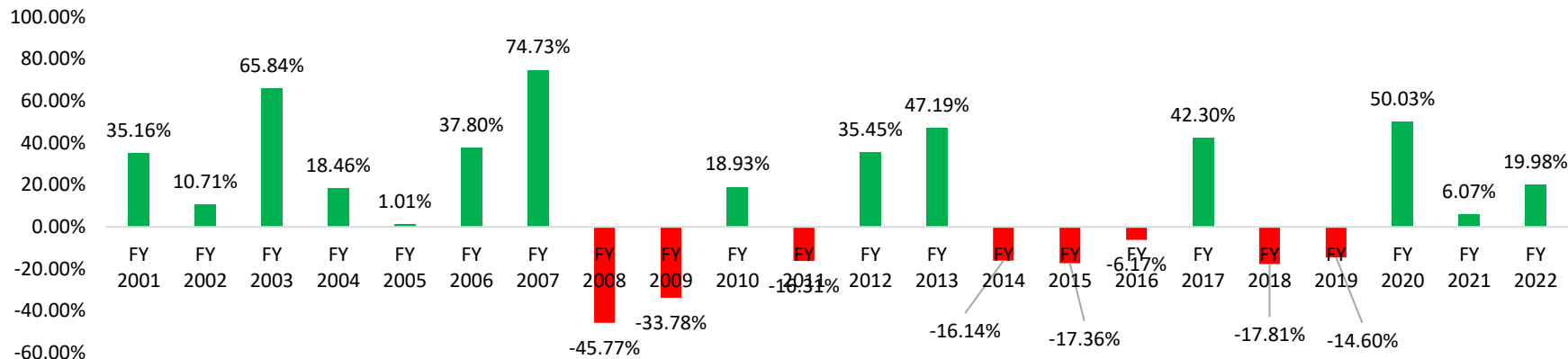
Description	Q1 2022	Q2 2022	Q3 2022	Q4 2022	FY 2022
NGX All-Share	+9.95%	+10.33%	-5.40%	+4.55%	+19.98%
Banking	+0.71%	-2.73%	-4.67%	+10.10%	+2.81%
Consumer Goods	-5.96%	+12.60%	-6.30%	+0.73%	-0.06%
Industrial	+5.39%	+1.69%	-17.61%	+35.53%	+19.67%
Insurance	-6.03%	-4.21%	-5.46%	+3.42%	-11.99%
Oil & Gas	+27.66%	+23.82%	-6.80%	-9.01%	+34.05%
Telco	+19.66%	+23.08%	+3.50%	-9.17%	+38.45%

goods players dwindled, as the spill-over effect of the Russian-Ukraine war hurt margins. Specifically, higher raw material costs and higher operating costs weighed negatively on margins. Also, an increase in raw material costs resulted in higher-than-average inventory build-up. This meant working capital pressures and increased funding needs. Meanwhile, interest rates began to rise towards the end of the year. Hence, investors distanced from consumer goods due to the combination of these factors.

Industrial Index: Although the industrial delivered a solid +19.67% return, it was below the overall market return. Also, a closer look reveals that the

Financial Markets – *Equities (Cont'd)*

22-Year NGX ASI Trend



Sources: Nigerian Exchange, WSTC Research

Sector performance was relatively weak until Q4 2022 when a specific rally on BUA Cement lifted the overall index. In line with global trends, the industrial players battled with heightened cost pressures due to energy disruptions and FX illiquidity. Notably, the combined profitability of the three major cement players (accounting for 35% of the overall market) declined by 50% in Q3 2022.

Insurance Index: On the back of a general investor apathy, the insurance sector significantly lagged the market in 2022. We attribute the insurance sector's weak interest to poor corporate governance and unconvincing growth prospects.

Oil & Gas Index: the war-induced spike in crude oil prices lifted the oil & gas sector. As noted above, Seplat led the rally in this sector.

Telecoms Index: two major stocks defined this index: MTN Nigeria Plc ('MTNN') and Airtel Africa Plc ('Airtel'). While MTNN's share price grew by 9%, Airtel's share price grew by 71%. The clear outperformance by Airtel, in our view, was due to the stock's fungibility. That is, it was not all about fundamentals. Our view is that owing to persistent FX illiquidity and backlogs, some investors devised an approach of buying Airtel stock listed on the Nigerian market, and selling them on the London market. Therefore, buy pressures in the Nigerian market drove prices upwards.

2023 Outlook for Financial Markets

2023 Outlook for the Financial Markets

Fixed Income: Similar to the pattern in the past two years, we expect yields in the fixed income to be mixed over the two halves of the year. Induced by increased financial system liquidity, as government instruments mature. We expect fixed income yields to decline across the first half of the year. Over the second half of the year, as liquidity gets absorbed, we see yields trending upwards.

Yields in the Eurobond market rose in 2022, in response to policy normalisation in the advanced economies. Based on our expectation of relatively less hawkish policy in the global financial market in 2023, we see Eurobond yields declining moderately.

We expect the FGN bond yield to average **12% - 14%** in 2023. In the Nigerian Treasury Bills (NTB) market, we expect the 364-day instrument to average **6%-8%** in 2023.

Equities Market: We also see a mixed performance of the equities market in 2023. On the back of push factor, we see some of the robust liquidity in Q1 2023 finding their way into equities, especially as corporates begin to declare their earnings performance and dividends. In H2 2023, we posit that funds would flow out of equities as interest rates rise. This is because we believe that foreign investors are likely to continue abstaining from Nigerian equities, which means that the domestic institutional investors will continue driving the market and with fixed income yields rising, it implies higher opportunity costs for holding equities.

However, our assumption is based on current market realities and the interplay of other global factors we mentioned above. We note that some other factors might influence the direction of the equities market. Some of these factors include some stocks' fungibility (e.g., Airtel Africa Plc and Seplat Energy Plc).

Sector Outlook

Agriculture: our focus here is on the oil palm producers – Okomu and Presco. We expect the two companies to record double-digit revenue and profit growth in 2023. Although palm oil prices are normalising, we yet believe that the unavailability of foreign exchange for importers, and smugglers puts a cap on market supply. Hence, we expect Okomu and Presco to keep enjoying increased market share in 2023. Valuation-wise, we see limited upside for the two stocks. We think that the market already priced-in their growth prospects.

Banking: a high interest rate environment is generally positive for the banking stocks. Hence, we expect improved profitability in the banking sector in 2023. However, we note some potential downsides including high impairments (as macro fundamentals weaken), difficulties in creating quality risk asset, high operating costs, and regulatory pressures. Meanwhile, we expect non-interest income as a portion of operating income to keep growing in 2023, as major banks double-down on their digital banking. Overall, valuation-wise, we are bullish about the fortunes of the banks in 2023.

2023 Outlook for the Financial Markets – (Cont'd)

Consumer Goods: we believe that the consumer goods sector is the most vulnerable to inflationary pressures and challenging macroeconomic environment. We posit that consumer goods players could struggle to grow volumes due to shrinking household consumption. Higher prices may drive revenue growth. Profitability could, however, remain flat or even decline as margins deteriorate. Higher direct costs due to supply chain bottlenecks, higher operating costs due to inflationary environment, and higher finance costs due to higher interest rates are all expected to weigh negatively on bottomline. Amid the ocean, we highlight Nestle Nigeria Plc and Dangote Sugar Plc as our top picks in the consumer goods sector. We believe that these two companies are currently undervalued relative to their fundamentals. High pricing power, strong brand name, market leadership, strong cash flow generation, and relatively high margins justify our preference for the two companies.

Industrial: we expect the cement players to rebound strongly from their Q3 2022 underwhelming performance, on the back of normalisation of higher energy pricing, stable product demand, and higher pricing. However, we think that the three major companies in the sector – Dangote Cement Plc, BUA Cement Plc, and Lafarge Africa Plc – are already richly priced at current market valuation.

Telcos: growth momentum of the telcos are expected to continue in 2023, driven by strong data demand. Some of the variables that would drive telcos performance in 2023 include full recovery from the NIN-SIM regulation, increased 4G coverage, enhanced rollout of the 5G, growth of payments business, and an overall growth of the digital economy. Our pick in this sector is MTN Nigeria Plc. We note Airtel's fundamentals, growth prospects, and competitive advantage. However, we think that the current share price of the stock incorporates factors that are not based on the fundamentals of the company. Based on our previous explanation on 'the Airtel factor', we do not think that market valuation is 'real'.

Oil & Gas: the upstream segment of the oil & gas sector is expected to continue benefitting from higher oil prices in 2023, although at a lesser level compared to 2022. The positive news is recovery of oil production to normalised levels, as the government intensifies efforts in clamping down on theft and pipeline damages. Meanwhile, in the downstream segment, prospects for higher pump price and even a potential subsidy removal could be very positive for players in the downstream segment.

2023 Outlook for the Financial Markets – (Cont'd)

Foreign Exchange Market: Supported by improved oil inflows in 2023, we expect the Central Bank of Nigeria to do more intervention in the foreign exchange market. However, we still see downside risks. First, a tightened global financial market condition places emerging markets currencies, including Nigeria, at risk. Secondly, policies around FX pricing could hinder inflows from other sources (e.g., diaspora remittances and other exports) from flowing through the official channels or even at all. In our view, these downside risks outweigh the positive impact of improved oil inflows. Hence, we believe that the exchange rate in the official market could rise further to N480-N500 in 2023. On the other hand, we expect the pressures in the parallel market to ease. Our thought is that a combination of tightened monetary policy, improved outlook for the economy associated with a new government, and improved liquidity in the official market would lower demand pressures in the parallel market. We estimate parallel market exchange rate to close at N700 – thus narrowing the parallel market premium to 40% in 2023 (2022: 60%).

Investment Recommendations

Based on our capital market expectations, we expect allocation to equities in the first half of the year to be optimal, especially with exposure to the banking sector and telecommunications sector. As expressed earlier, we expect increased liquidity to drive yields lower temporarily, which will also push funds into equities as investors hunt for yields.

Investors with very short-term horizon should position in shorter end of the fixed income market. Our opinion is to invest in 60-90 days maturities. In H2 2023, as yields rebound, we think that asset allocation should change in favour of fixed income assets. For investors with limited access to FG securities, an investment vehicle that could help deliver exposure to fixed income assets is mutual funds: specifically money market mutual funds or bond mutual funds.

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