MERCHANT BANK LTD

# Nigeria’s Macroeconomic Report

## *Calm in sight after the Storm*

April 2024

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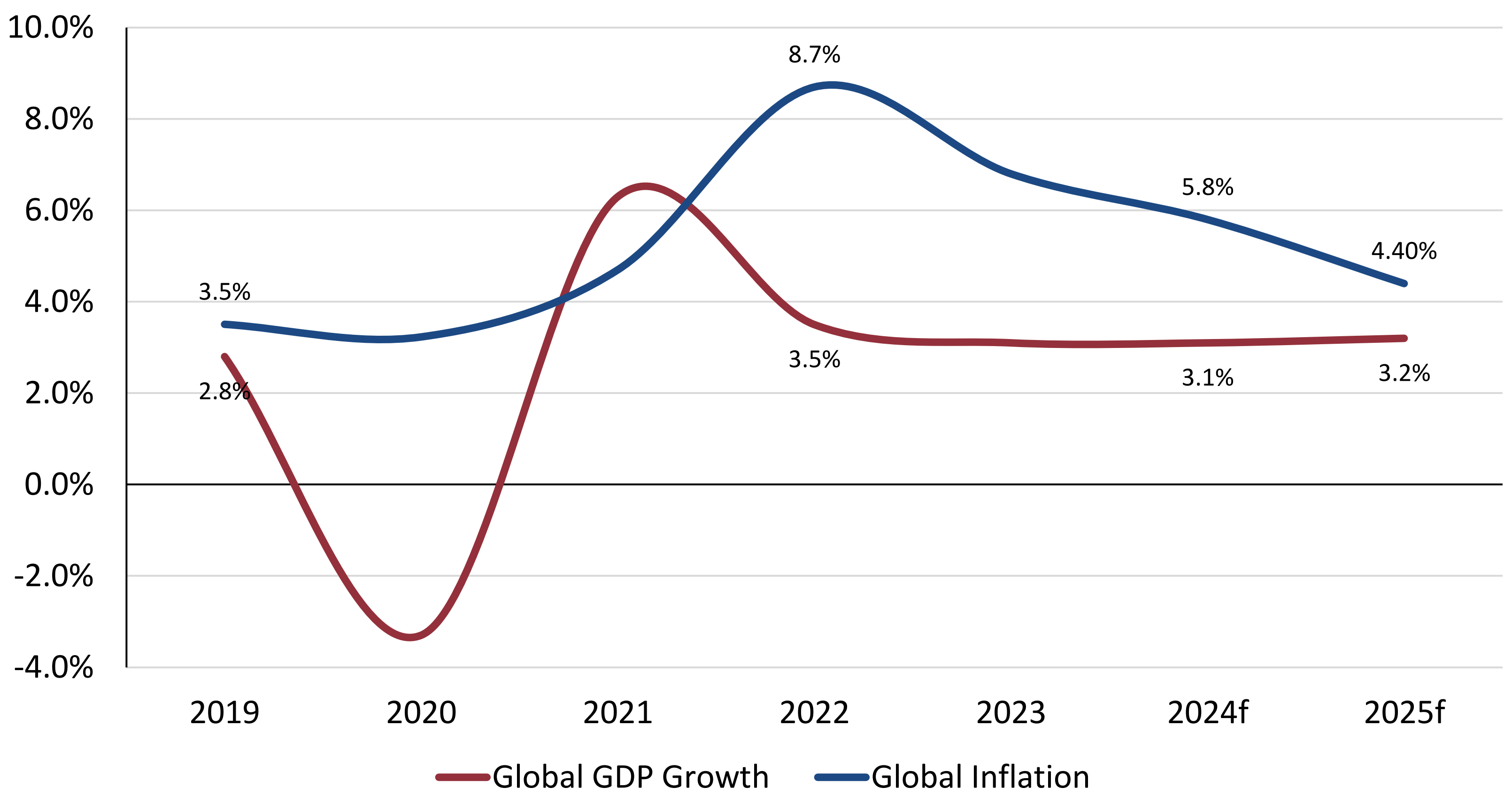
SECTION 01

# Review of the Global Economy

# Global growth projections remain flat for 2024 and 2025

Global GDP Growth and Global Inflation (%)

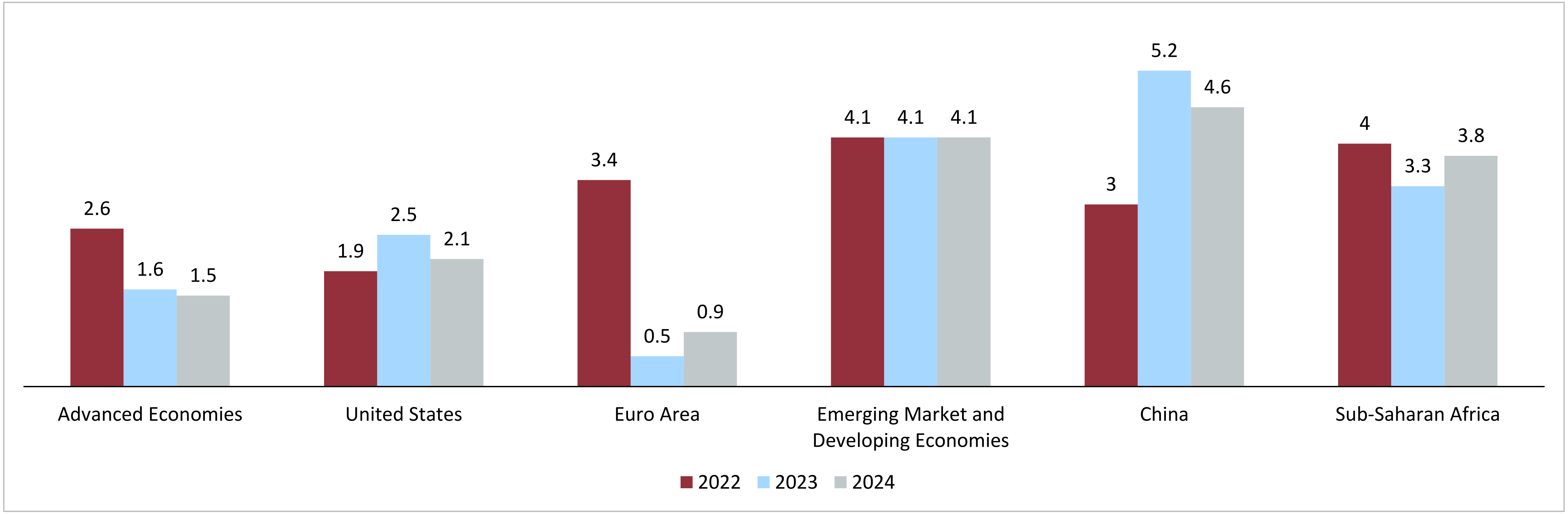



- Global GDP growth is projected to remain flat in the medium term. Growth in 2023 was estimated at 3.1%, which is also the projected growth for 2024.
- Although inflation is expected to fall in 2024 due to the tightening stance of Central Banks and the slow growth of fiscal spending, these actions are expected to weigh on growth in 2024.
- As noted by the International Monetary Fund (IMF), global growth in 2024 and 2025 is still below the historical annual average of 3.8% from 2000 – 2009.

*Data Source: IMF*

# Emerging and Developing Economies are a major driver of global growth

Real GDP Growth (%)




- Although advanced economies remain resilient, emerging and developing economies led by China contribute significantly to global growth. Growth is projected to remain steady at 4.1% in 2024 and 2025 driven by strong-but-lower growth in China.

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*Data Source: IMF*

# Risks to global economic growth remain elevated

*While global growth is expected at 3.1% in 2024 – the same growth recorded in 2023 – there are several downside risks to global growth.*

1

## Rising geo-political tensions

The war in Ukraine is still not over. Tensions are rising in the Middle East with attacks on vessels in the Red Sea, which could trigger energy and food crises via high shipping costs.

2

## Extreme weather events

Adverse weather conditions such as floods, drought, heavy rainfall, etc pose risks to food production in many parts of the world.

3

## Slowdown in China's Growth

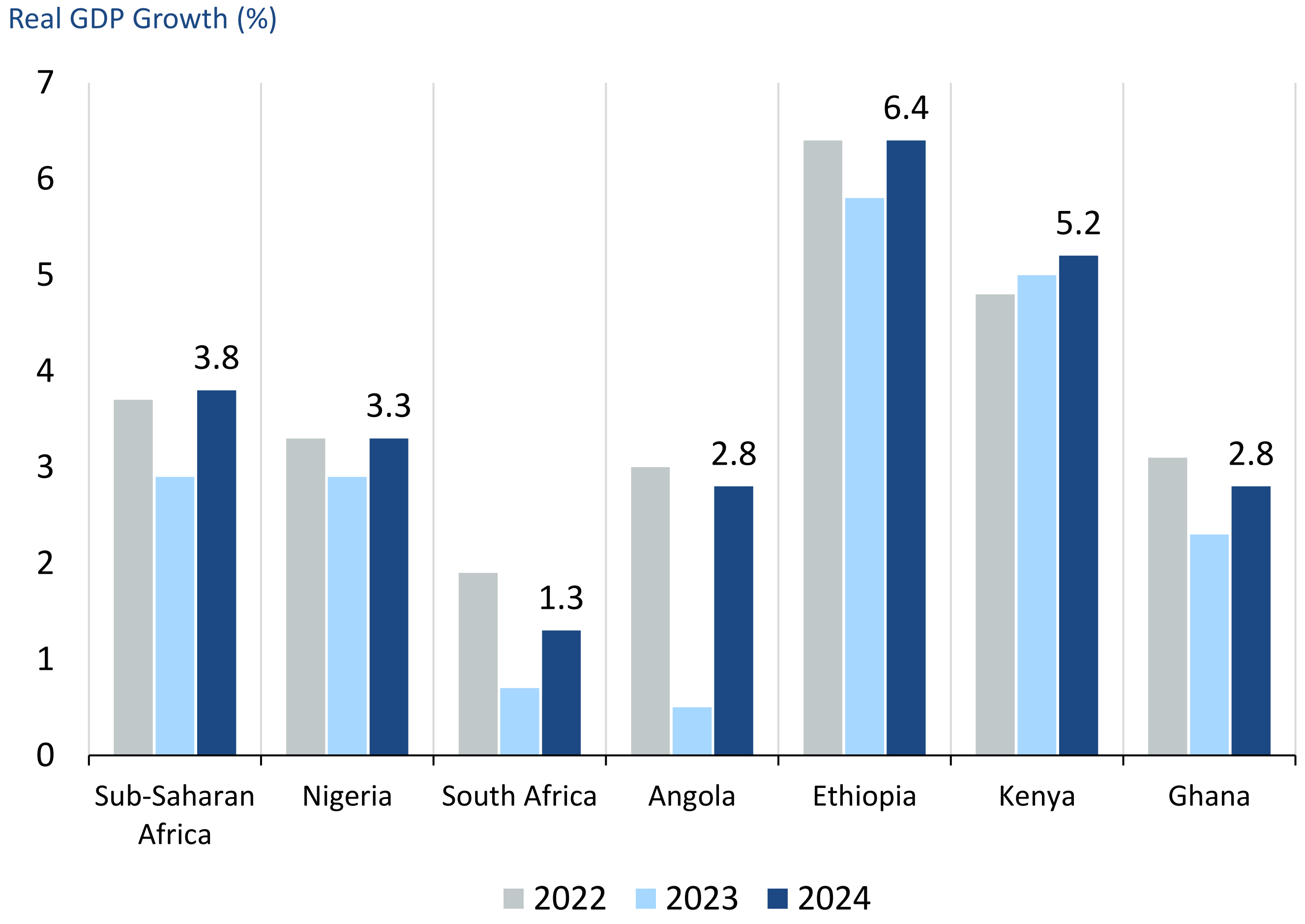
China's economy is expected to grow by 4.6% in 2024 from 5.2% in 2023. The slow growth is partly fueled by a downturn in the real estate market. Overall, a slowdown in China will affect global demand for goods.

4

## Global financial system – interest rate trend

Interest rates in advanced economies remain high and there is still uncertainty about their trajectory. High inflationary pressures could mean that rates may remain high for an extended period.

# Sub-Saharan Africa expected to grow by 3.8% in 2024




SSA economies will experience a rebound in GDP growth – from 2.9% in 2023 to 3.8% in 2024. The larger economies in the region, Nigeria and South Africa are expected to deliver high growth, though still below optimal growth level. A more positive outlook for commodity prices will play a major role in driving growth in 2024. Major risks to growth include political instability in the region, high debt burden and adverse weather conditions which could affect productivity in the agricultural sector.

*Data Source: World Bank*

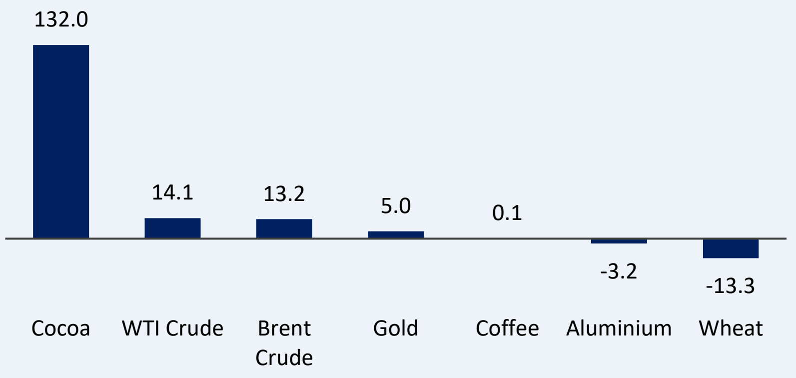
# Oil price is on the rise owing to tensions in the Middle East and production cuts


**In 2024, the price of crude trended upward, with a year-to-date (Mar 25) gain of 13%. Oil prices have risen on the back of escalating tensions in the Middle East, production cuts by OPEC+ countries and attacks on Russian energy infrastructure.**

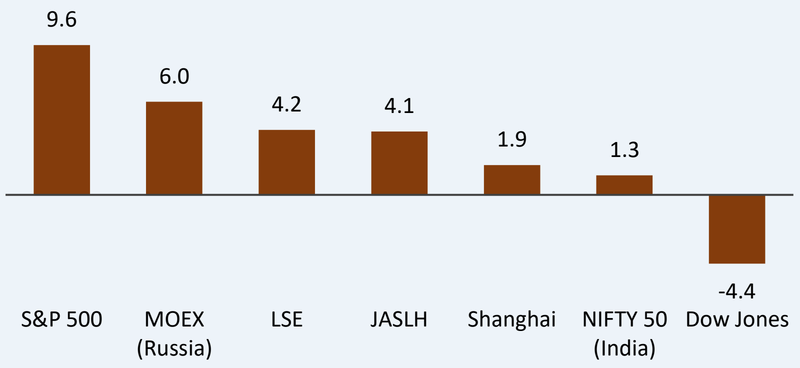
*Data Source: EIU*

# The US Dollar waxed strong against major currencies due to elevated interest rates

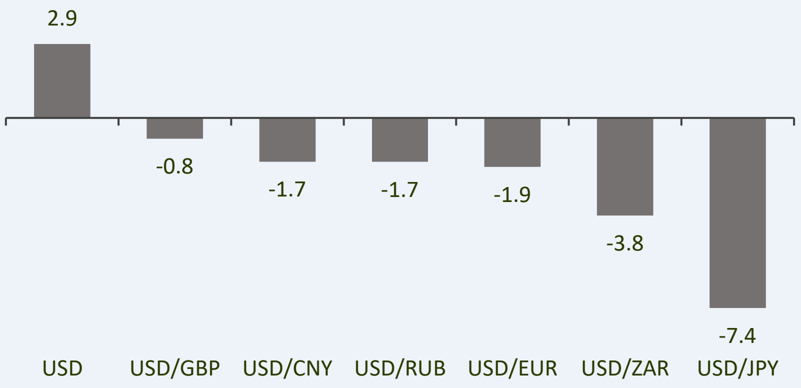
## Commodity Markets Performance (% Change) YTD



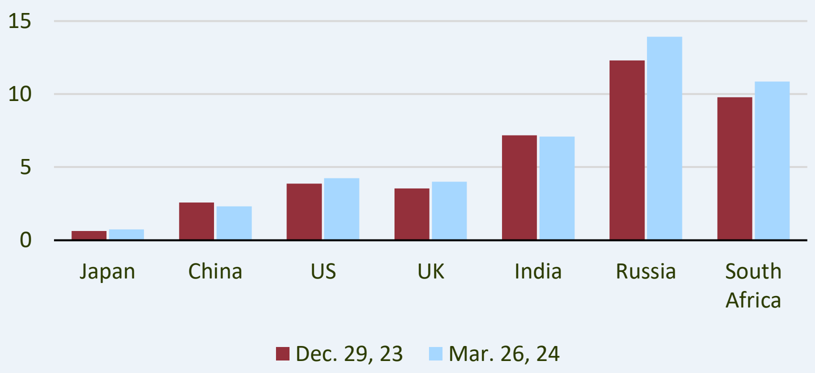

## Stock Markets Performance (% Change) YTD




## Global Currency (% Change) YTD




## Ten Year Government Bond Yield Performance (%)




*Data Source: Investing.com* *Note: End period for the data is March 26, 2024*

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# Analyst Views on the Global Economy

- **Global GDP growth remains fragile** with the tensions in the Middle East, the ongoing war in Ukraine, the slowdown of China's economy and a high interest rate environment which limits output expansion. These events raise uncertainties in the commodity markets and have negative implications on global trade. While emerging and developing economies are expected to post better growth outcomes, countries in the Euro Area will exhibit sluggish growth mainly due to low productivity and high interest rate.

- **The attack on vessels in the Red Sea following the Israel/Palestine conflict is having an impact on trade and shipping costs.** Already, global shipping companies are rerouting vessels from the Red Sea. This comes at an additional cost, which is borne by shipping and insurance companies. If such attacks persist, the impact will be severe across the world as these costs will be passed on to the consumers. The attacks could also trigger a food and energy crisis, especially in East African economies that rely on the Red Sea for imports and exports. Moreover, the budgets of many African countries are severely pressured as many countries are at risk of debt distress. Essentially, African countries and many countries elsewhere may not be prepared for another fiscal and social crisis as seen during the COVID-19 pandemic. Therefore, the international community will need to find a peaceful resolution to forestall the brewing crisis in the Middle East/Red Sea.

- **Monetary policy remains tight across advanced and developing economies.** Central Banks are observing the trend of inflation, which is still above target in many countries. In the US, the Federal Reserve kept rate unchanged at 5.25% to 5.5% in the two meetings held so far in 2024. Although inflation rate has started to fall, the Fed is expecting to see more positive data on inflation before reducing interest rates. The disruption in global trade could exacerbate inflationary pressure in advanced economies. Hence, Central Banks may keep interest rates high in the short term. This is expected to constrain capital flows into African economies unless the policymakers in these economies raise rates to encourage inflows. For the US in particular, the Fed indicated that it could reduce interest rates later in 2024. This will depend on the performance of inflation.

SECTION 02

# Nigeria’s Macroeconomic Environment: GDP Growth and Inflation

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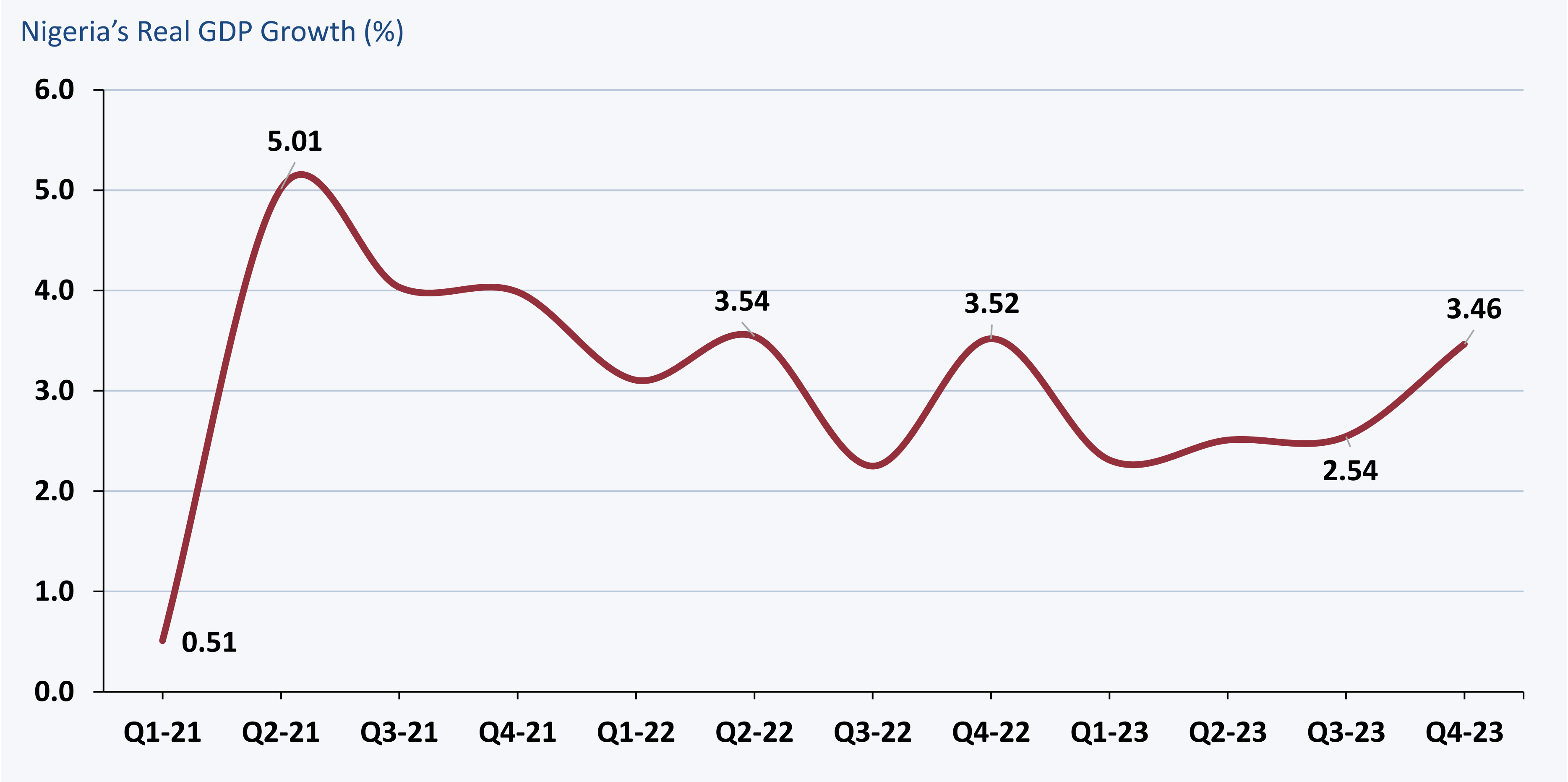
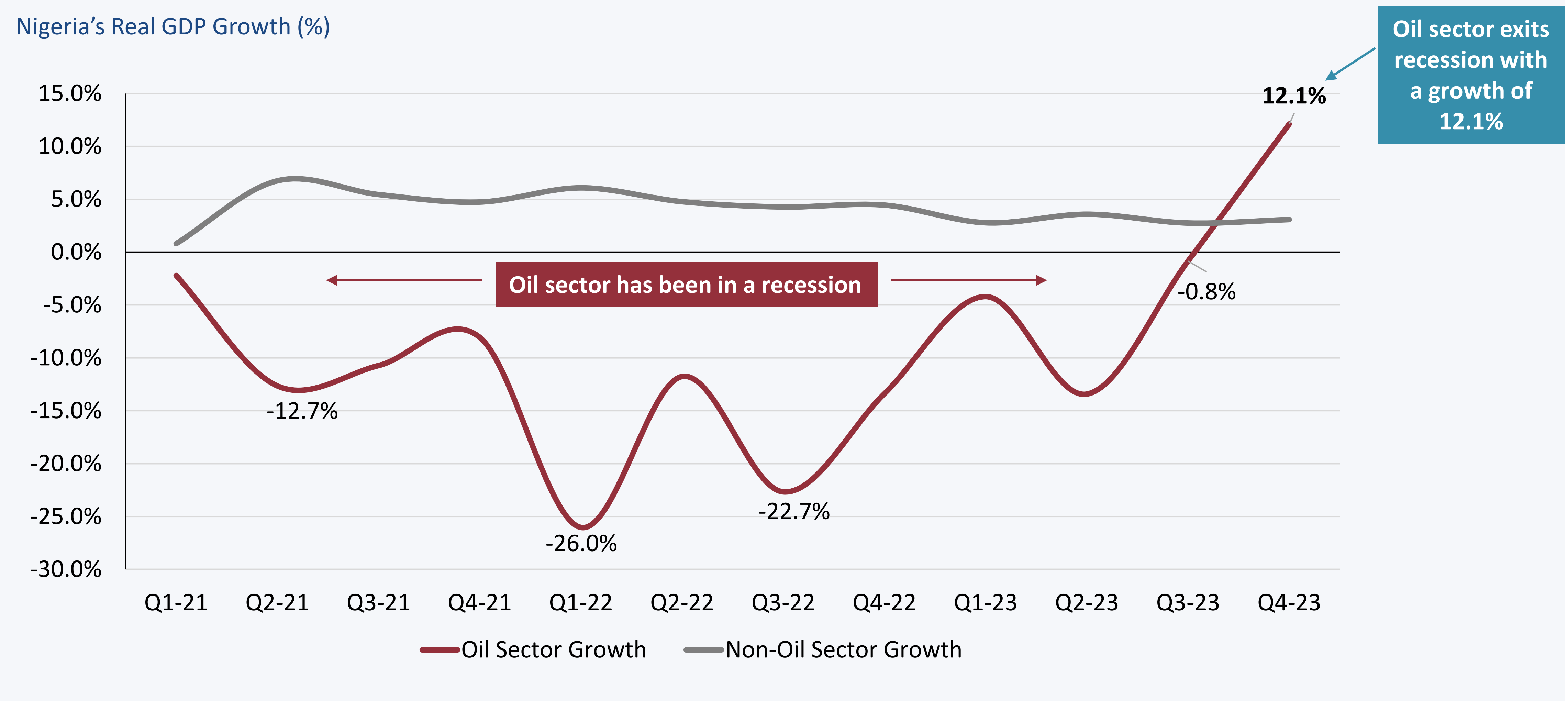
# Real GDP grew by 3.46% in 2023Q4, the highest quarterly growth since 2022Q4




- The 2023Q4 growth of 3.46% represents an improvement from 2.54% in the previous quarter.
- It is the highest growth rate in 2023.
- On an annual basis, GDP grew by 2.7%, lower than 3.1% in 2023.

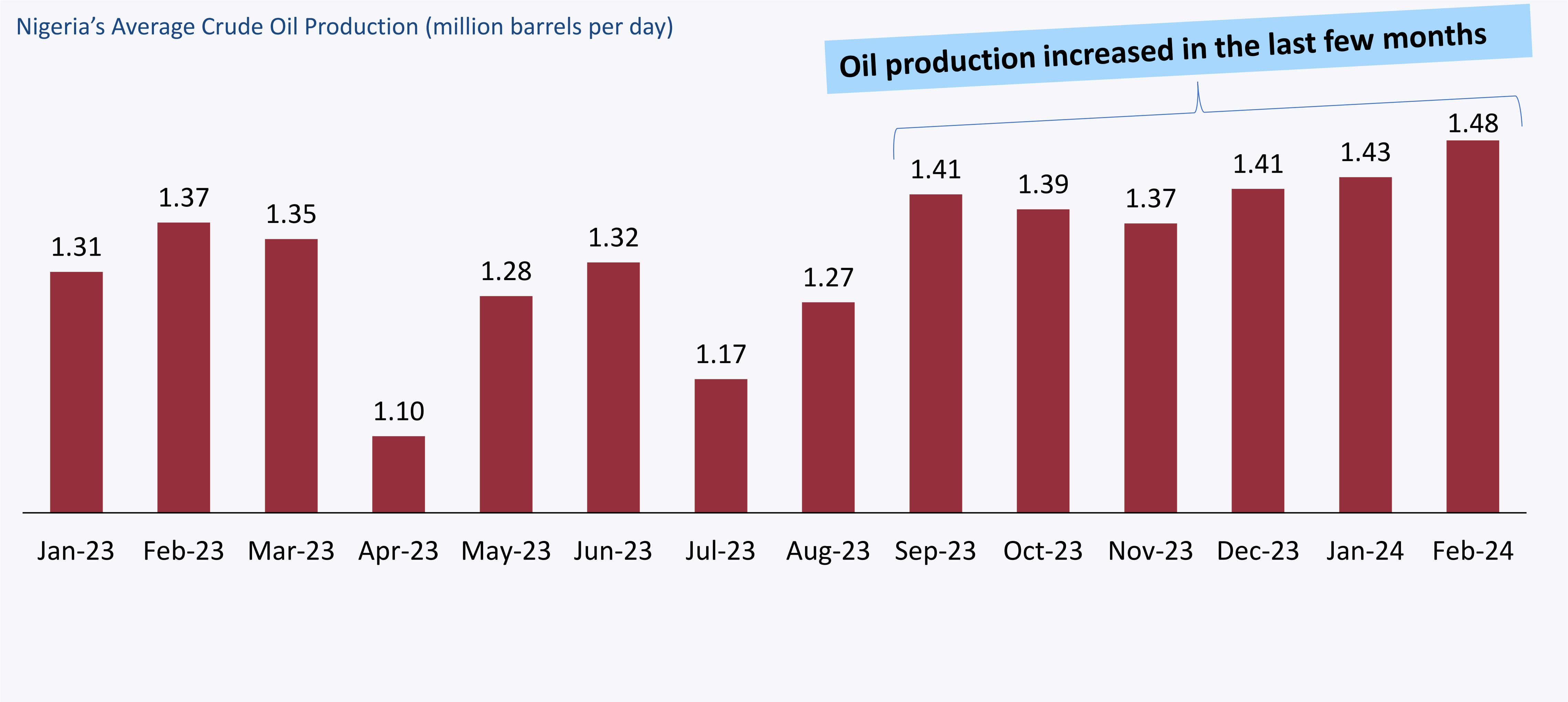
*Data Source: National Bureau of Statistics*

# For the first time since 2020Q1, the oil sector experienced growth in 2023Q4



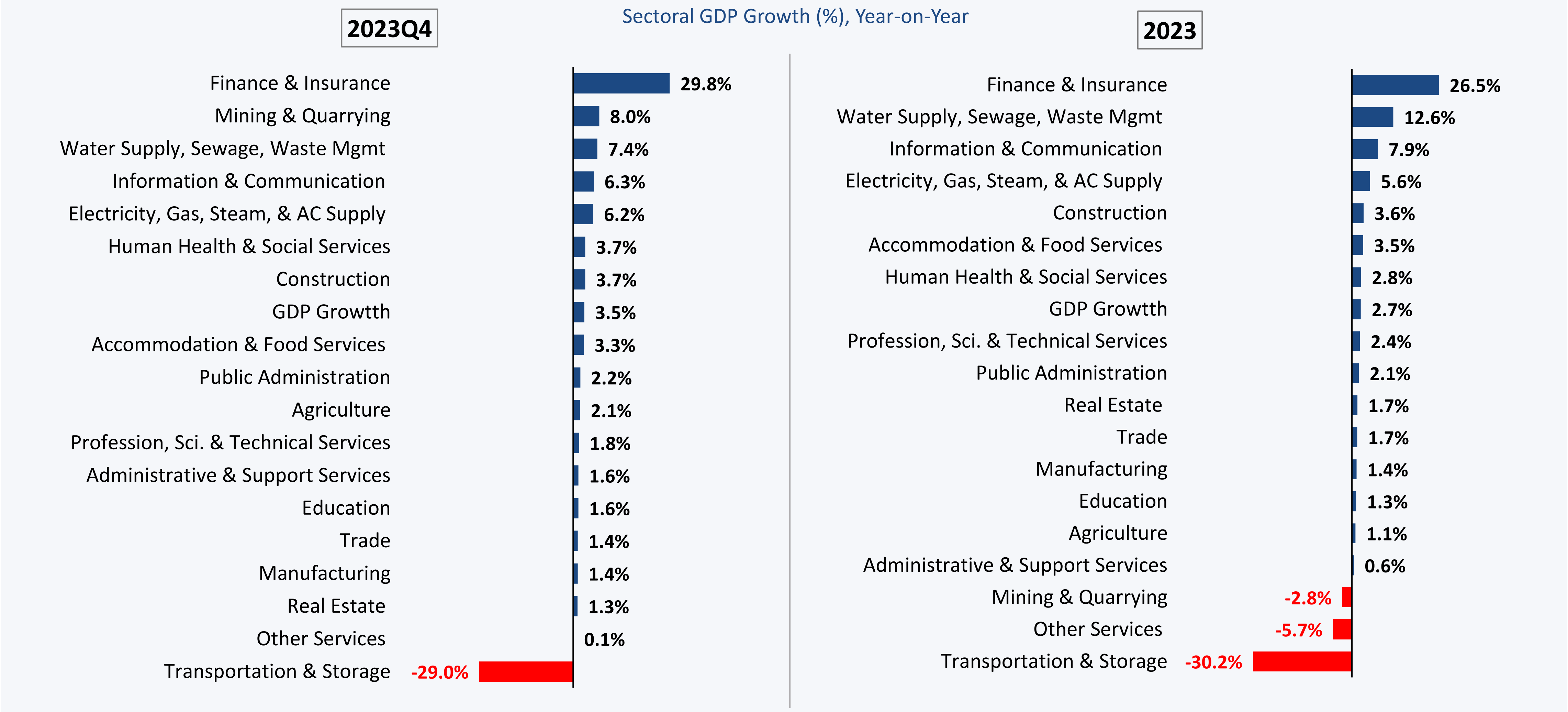

*Data Source: National Bureau of Statistics*

# The administration's efforts to curb oil theft are yielding positive results




*Data Source: OPEC*

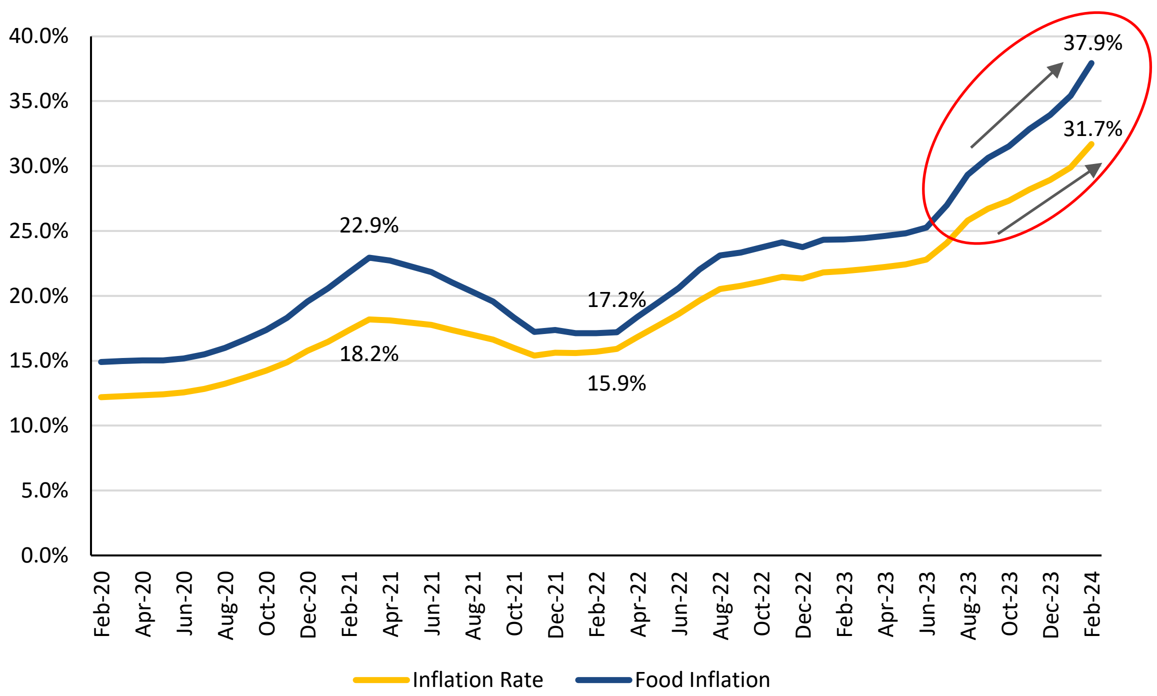
# In Q4 2023, only one sector (transportation & storage) showed a negative growth. Finance remained the fastest-growing sector with a growth of 29.8%



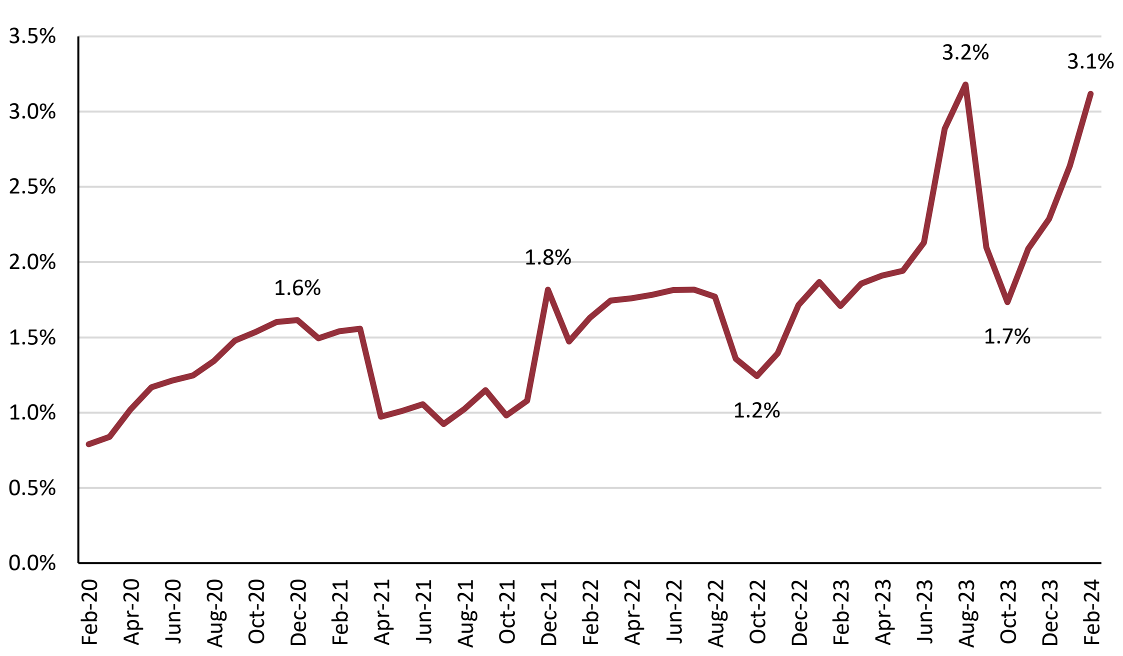

*Data Source: National Bureau of Statistics*

# Nigeria's Inflation rate reached a 27+ year high of 31.7% in February 2024

Inflation Rate (%), Year-on-Year




Inflation Rate (%), Month-on-Month

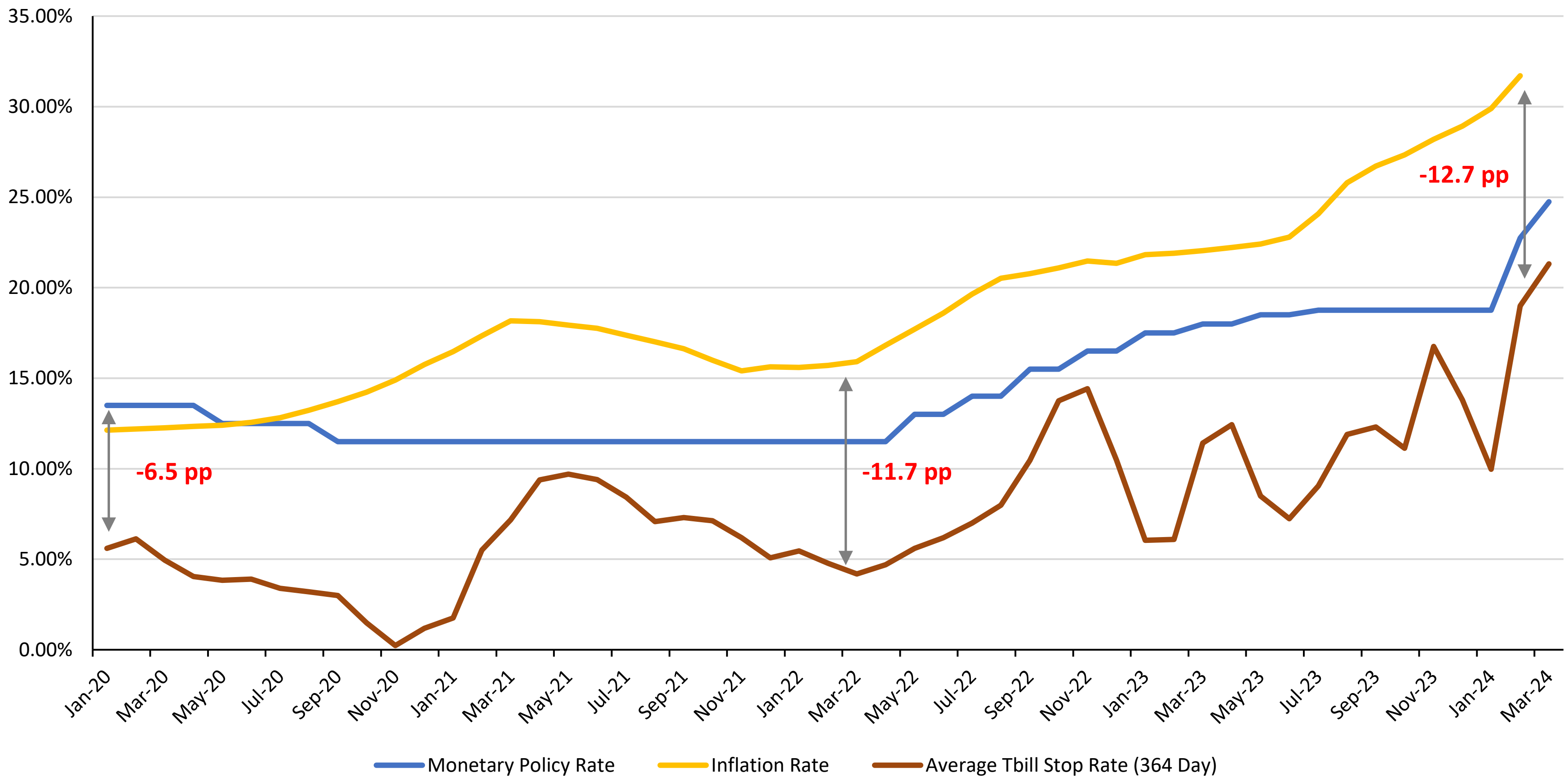



- Food inflation is the major driver of inflation. It continued its upward trend to reach 37.9% in February 2024. A combination of factors such as depreciating currency, low agricultural productivity, high transport costs following the fuel subsidy removal and insecurity in the food-producing region were responsible for the increase in prices. With these factors, it is clear that non-monetary factors play a major role in influencing inflation in Nigeria.

*Data Source: National Bureau of Statistics*

# Interest rates have increased significantly but yet to catch-up with inflation

**Real Interest Rate:** Monetary Policy Rate (MPR), 364-Day Treasury Bill Average Stop Rate vs Inflation Rate




- Real interest rates in Nigeria are still negative despite the increase in the Monetary Policy Rate and other interest rates.
- This is mainly due to an upward-trending inflation, which reached a 27+ year high in February.
- While raising rates is required to address the monetary factors that drive inflation, fiscal authorities will need to speedily implement reforms to address the long - standing issues of poor infrastructure, insecurity and low productivity.

*Data Source: National Bureau of Statistics & Central Bank of Nigeria*

pp - percentage points

# Analyst Views on Growth and Inflation

**GDP Growth**

- **In 2024, we expect a real GDP growth of 2.98%, higher than what was achieved in 2023.** Our optimism is based on the expectation that policymakers will continue to implement crucial reforms relating to foreign exchange, aimed at restoring investors' confidence. Improved performance of the oil sector will support growth while key sectors such as finance and information & communication will continue to post high growth figures in the year. Nevertheless, the tough operating environment will persist due to the slow pace of ease of doing business reforms. A major risk to growth is the falling consumer purchasing power and limited investment in the real sector, exacerbated by the challenge of insecurity in some parts of the country.

**Inflation**

- **We share an equally optimistic view regarding inflation. We expect that inflation rate will decline going into H2 2024 as households and businesses adjust to the FX and subsidy reforms.** We believe that efforts to ensure exchange rate stability are yielding results, especially with the reforms by the CBN and the increase in crude oil production. Furthermore, the implementation of the dry-season farming initiative and the supply of input to farmers will also contribute towards price stability in the medium term. Other factors such as infrastructure deficit, supply chain bottlenecks, port charges, etc are prevalent and are significant downside risks to our projection. **Overall, we expect inflation rate to average 27.1% in 2024.**

SECTION 02

# Nigeria’s Macroeconomic Environment: Foreign Exchange and External Reserves

# Since June 2023, the CBN has implemented several reforms aimed at restoring liquidity and confidence in the Naira

## Jun 2023

**Operational Changes to the Foreign Exchange Market**

The CBN abolished market segmentation and collapsed all into the Investors & Exporters window; re-introduced the Willing Buyer, Willing Seller framework, among other reforms.

## Aug 2023

**Operational Mechanism for Bureau De Change (BDC) Operations**

CBN resumed Forex sales to BDCs but limited the buying and selling spread by BDCs to +/-2.5% of the weighted average of transactions executed the previous day on the I&E window.

## Jan 2024

**Harmonisation of Reporting Requirements on Foreign Currency Exposure**

This sets the Net Open Position (NOP) of banks in Nigeria at a limit of 20 percent short or Zero percent long holding of foreign currency assets and liabilities.

## Jan 2024

**Reviewed guidelines for International Money Transfer Operators (IMTOs)**

IMTOs to quote an exchange rate for Naira payout to beneficiaries based on the prevailing market price.

## Feb 2024

**Removal of the spread on foreign exchange transaction**

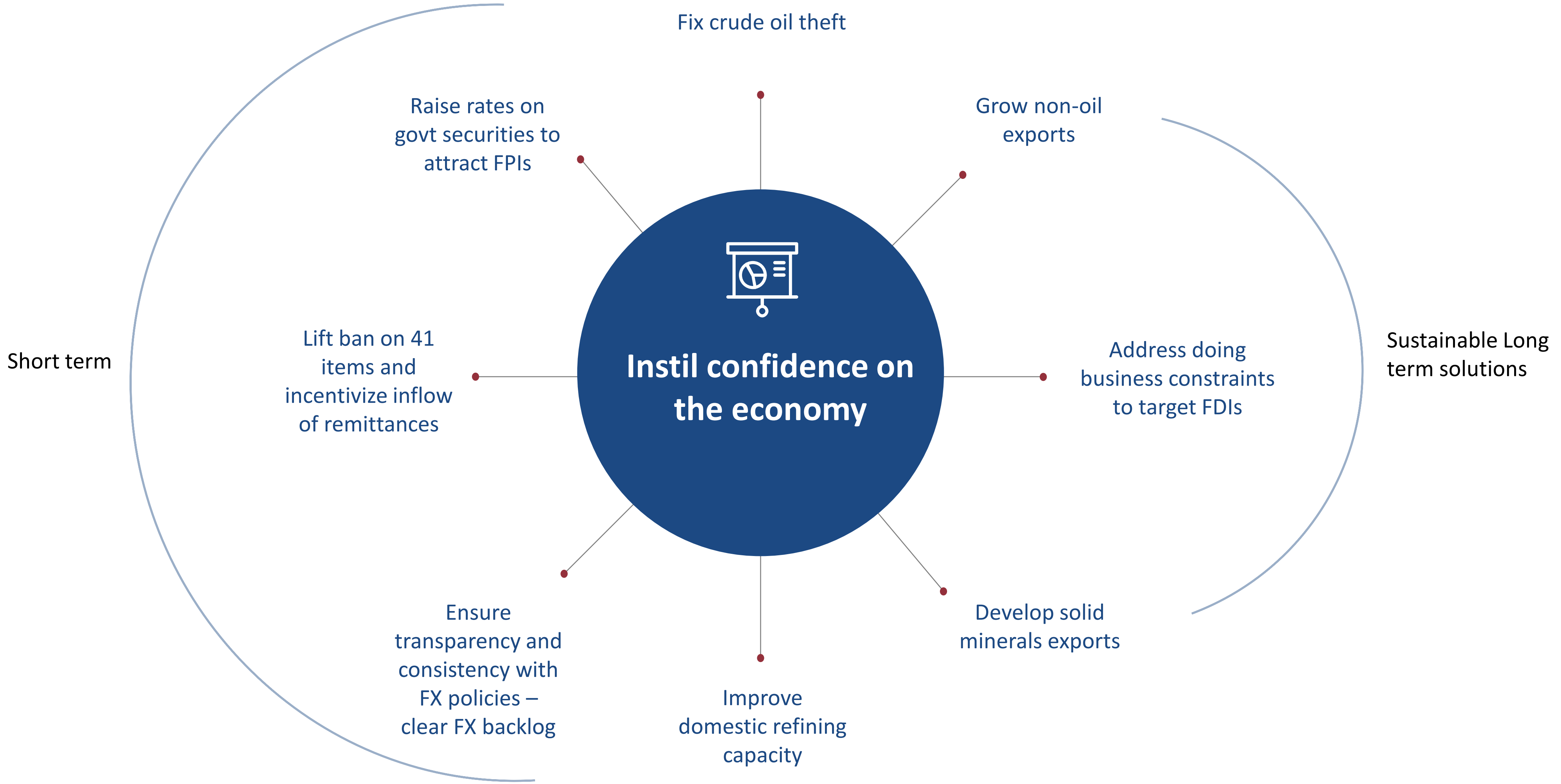
This discontinued any form of cap on the spread on interbank Forex transactions and restrictions on the sales of interbank proceeds.

## Feb 2024

**Allowable channel for payout of Personal/Business Travel Allowance**

The CBN limited the payout of PTA and BTA to electronic channels only.

# In September 2023, we outlined some required measures to instil confidence in the Nigerian FX market



# Most of the short-term measures we highlighted in September have been implemented by the Central Bank and Fiscal Authorities

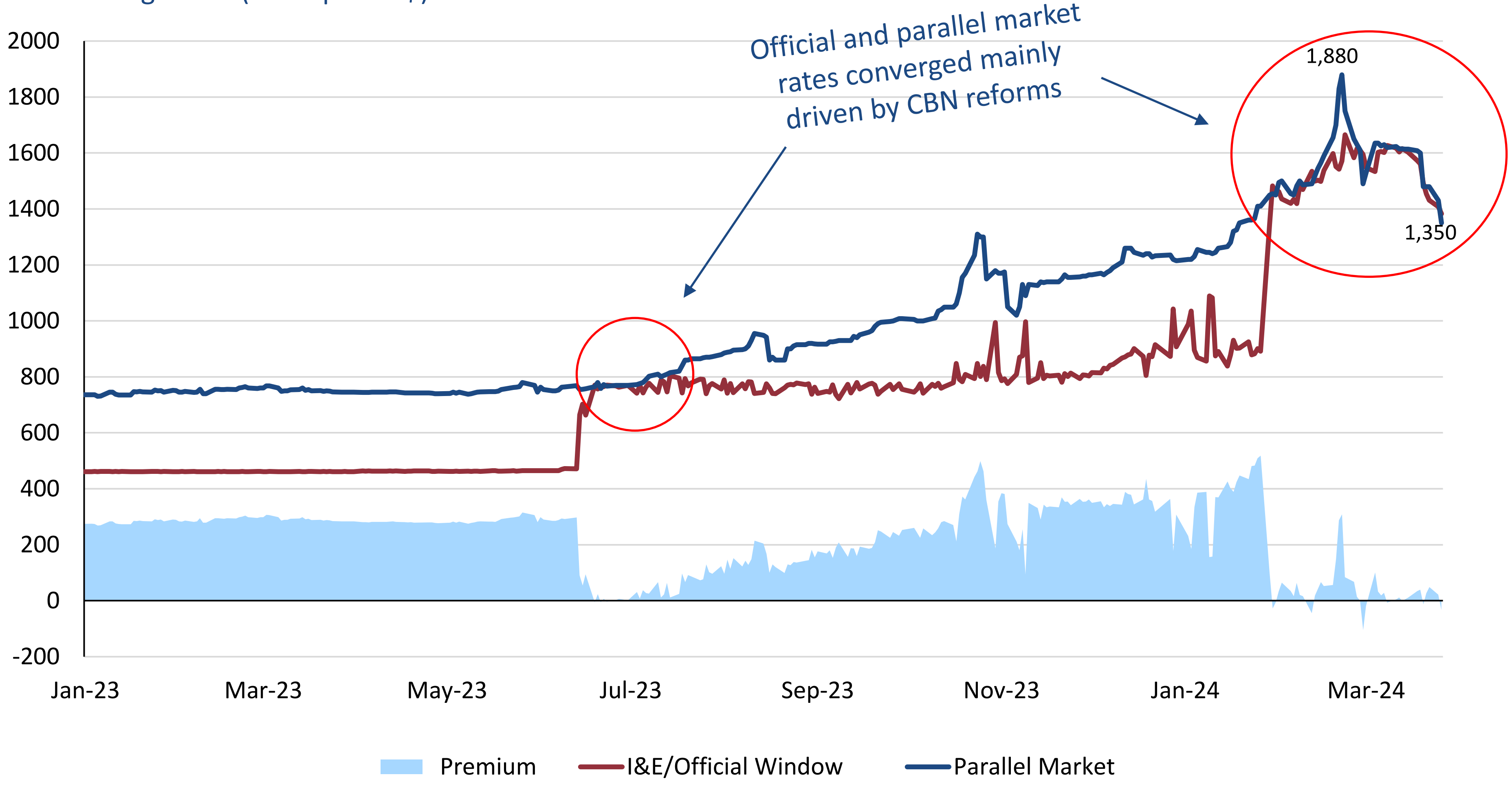
| | Major Policy Goal | Actionable steps |
|---|---|---|
| **1.** | Fix crude oil theft | • Crude oil production increased from 1.17 million barrels per day in July 2023 to 1.48mbpd in February 2024, according to data from OPEC. This was mainly as a result of efforts to contain crude oil theft. |
| **2.** | Raise rates on govt securities to attract FPIs | • Prior to the recent hike in Monetary Policy Rate (MPR) in February 2024, rates on government securities increased. Specifically, stop rate for 364-days NTB rose form 7.2% in June 2023 to 16.8% in November 2023. |
| **3.** | Lift ban on 41 items and incentivize inflow of remittances | • In October 2023, the Central Bank of Nigeria (CBN) announced the lifting of foreign exchange restrictions placed on the importation of 43 items. |
| **4.** | Ensure transparency and consistency with FX policies – clear FX backlog | • In March 2023, the CBN announced the successful clearing of valid foreign exchange backlogs, although this was disputed by some stakeholders in the aviation industry. The CBN noted that US$2.4bn of the over US$7bn forex backlog was invalid. |

**We note that the outstanding reforms fall within the remit of the fiscal authorities**

- Address doing business constraints to target FDIs
- Grow non-oil exports
- Improve domestic refining capacity
- Develop solid minerals exports

# The implementation of these measures has eased the volatility of the Naira

Exchange Rate (Naira per US$)

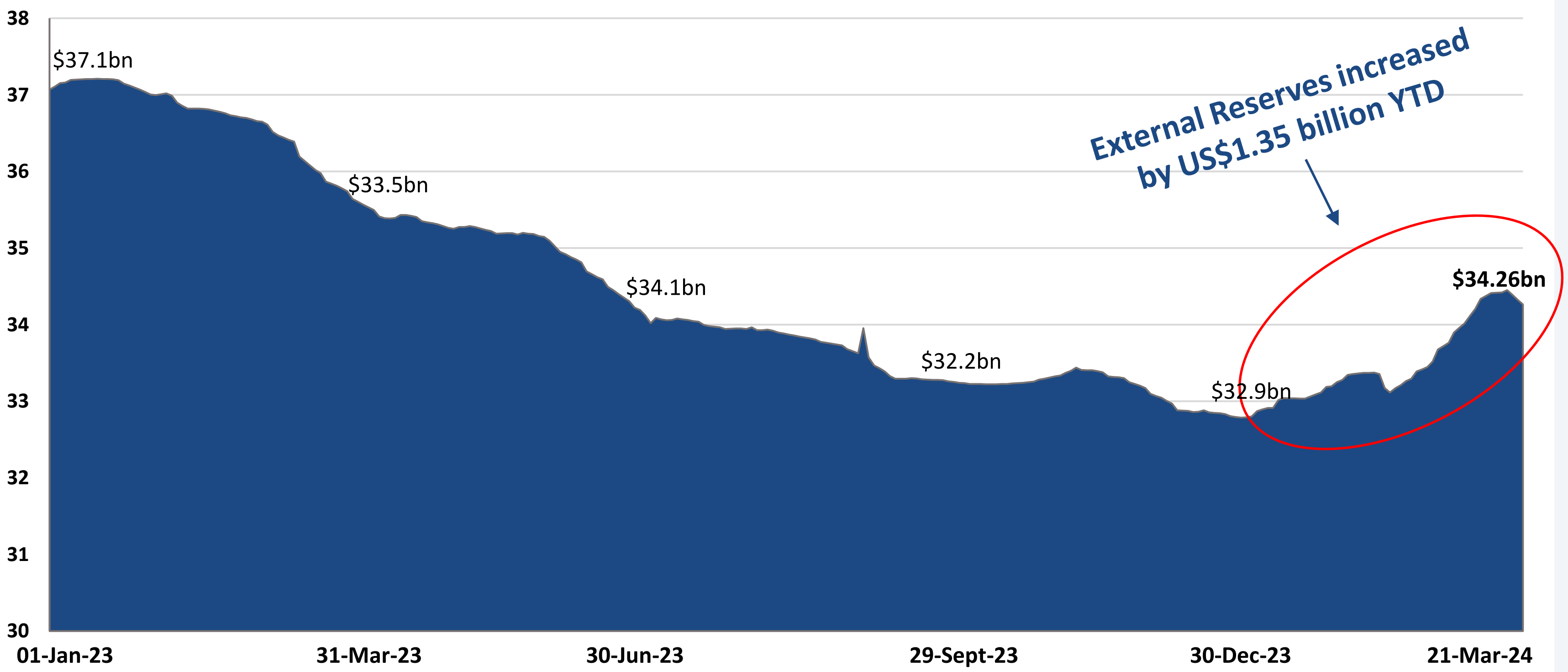



- In March 2024, the volatility of the Naira reduced following several reforms by the CBN to improve transparency and inflows into the FX market.
- On March 28, the NAFEM closing rate was ₦1309.4, a significant appreciation from a peak of ₦ 1,650 on February 26.
- We believe that the recent FX reforms coupled with high interest rate and improved oil production will bring stability to the FX market.

*Data Source: Central Bank of Nigeria and other sources*

# External Reserves improved to US$34.2bn. External reserve would have been much higher but for the clearance of valid FX backlog worth over US$4 billion

Gross External Reserves (Billion US$)




- In our Macroeconomic Outlook for September 2023, we noted that the CBN will need to allow for the depreciation of the currency while it focuses on growing the reserves.
- In line with this view, external reserves maintained an upward trend, gaining US$1.35 billion so far in 2024.
- We note that the increase in external reserves was constrained by the clearing of FX backlog, otherwise reserves would have increased significantly beyond US$34 billion.

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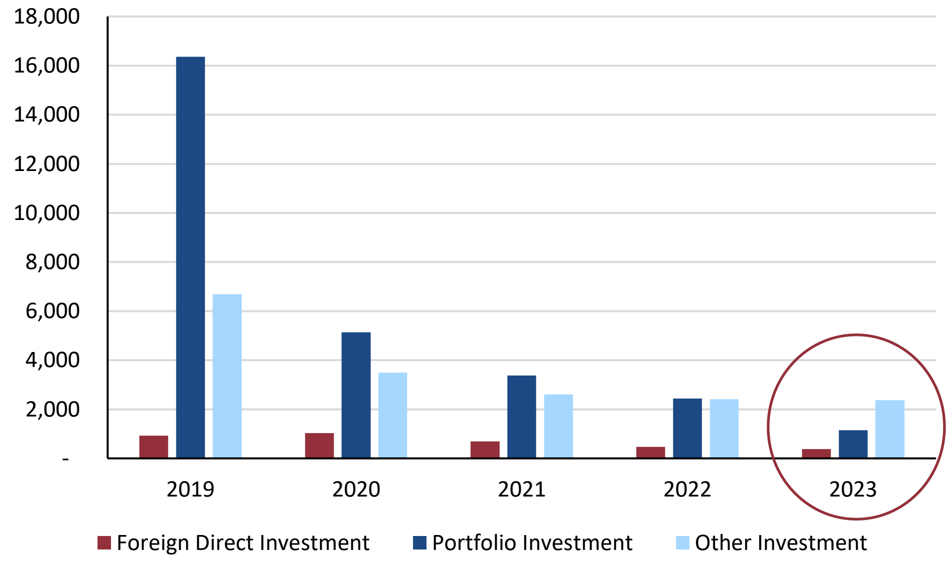
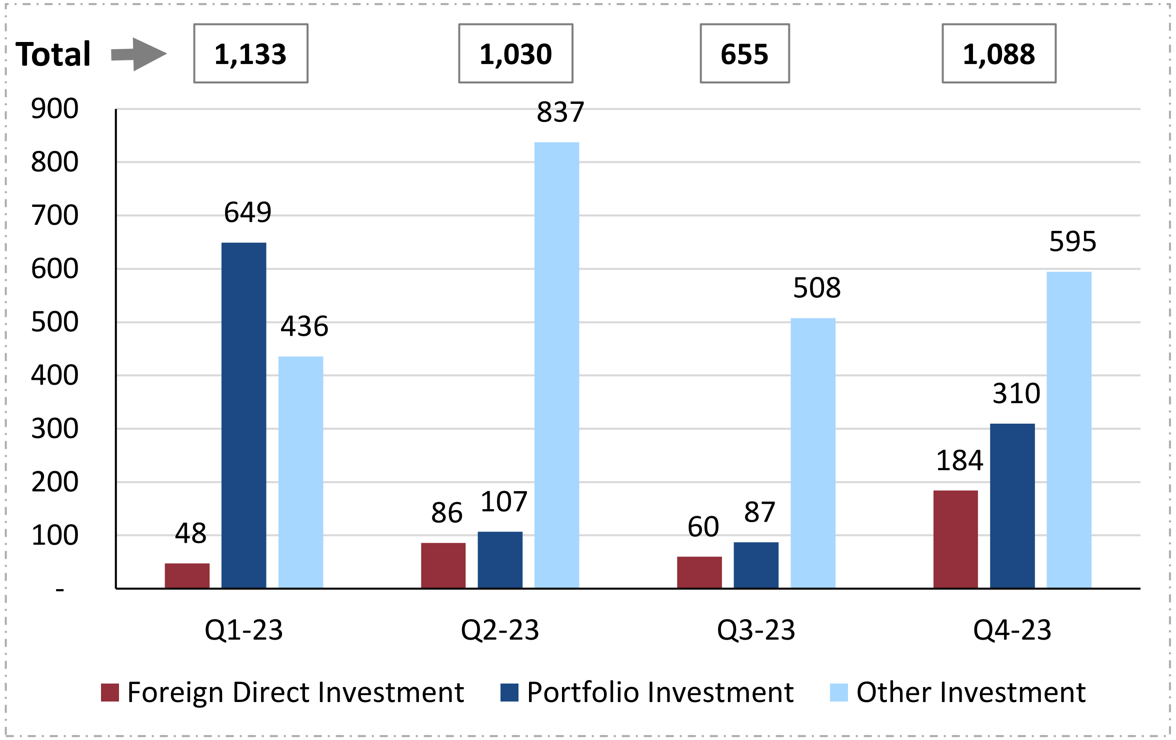
*Data Source: Central Bank of Nigeria (CBN)*

# Foreign Investment into Nigeria remains at low level but improvements were recorded in the Q4 2023

Foreign Investment Inflow into Nigeria (US$ Million) (2019– 2023)




Foreign Investment Inflow into Nigeria (US$ Million) in 2023




- There was marginal improvement in the inflow of foreign investment into Nigeria in Q4 2023. All three categories (FPIs, FDIs and Other Investments) improved in Q4 relative to Q3. With a high interest rate environment, we expect FPIs to increase significantly in Q2 and H2 2024 relative to 2023.

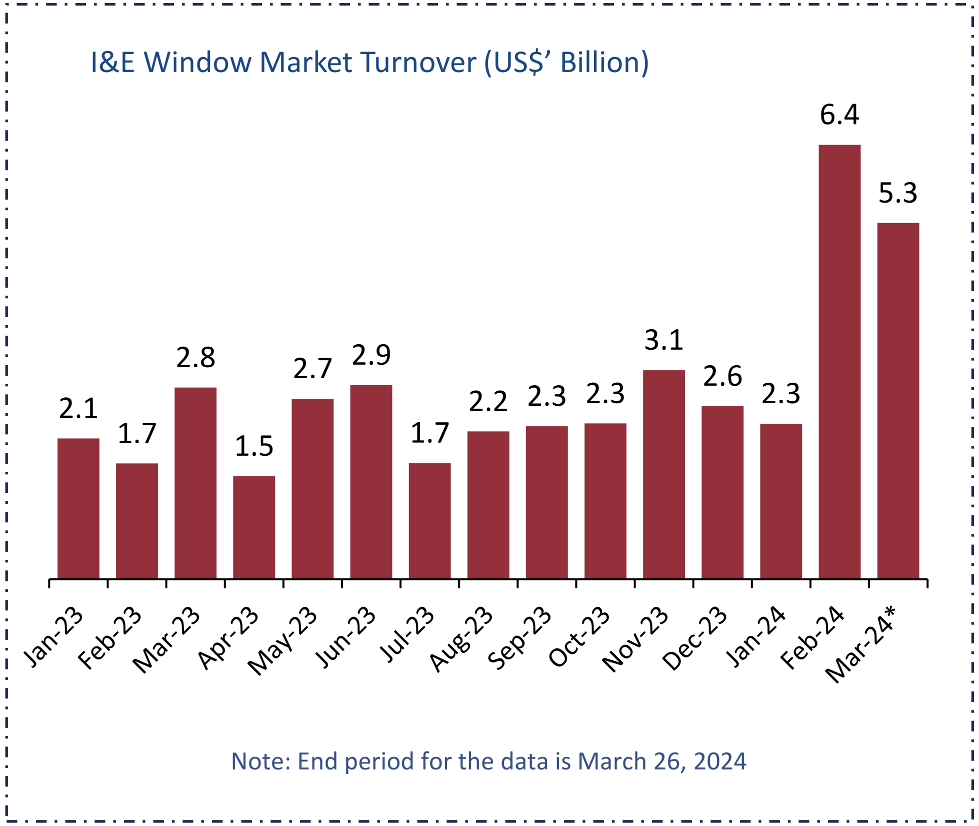
*Data Source: NBS*

# Analyst Views on FX and Reserves

- **Upon assuming office in September 2023, the governor of the Central Bank of Nigeria (CBN), Mr Olayemi Cardoso was met with a pressured exchange rate, declining external reserves and an FX backlog estimated at US$7 billion**. In responding to these challenges, the governor assured stakeholders of the Bank's commitment to achieve a single FX market. Some measures announced by the governor included lifting the ban on the 43 items, the review of the guidelines for International Money Transfer Operators (IMTOs) and Bureau de Change (BDC) operations and clearing the valid FX backlogs it inherited from the previous administration.

- **These measures, coupled with improving oil production, have resulted in significant gains in the FX market.** Exchange rate volatility has reduced; turnover in the FX market increased to US$6.4 billion in February 2024 and external reserves maintained an upward trend.

- **In light of these, we expect the CBN governor to continue efforts to win back investors' confidence.** The apex bank will need to contain the excessive growth of money supply and ensure transparency and clear communication on foreign exchange policy. The bank needs to temporarily halt Ways and Means and transfer its developmental lending activities to fiscal authorities.



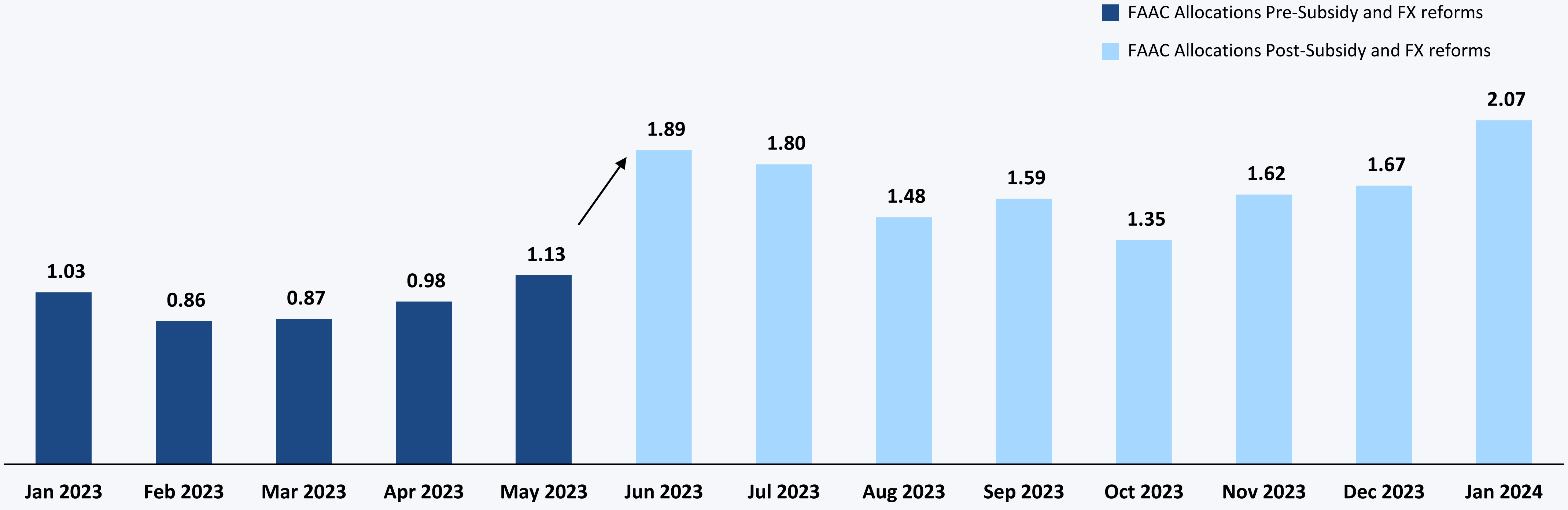

*Data Source: FMDQ*

SECTION 03

# Fiscal and Monetary Policy Update

# FAAC allocations rose to N16.28 trillion in 2023 from N12.367 trillion in 2022

Monthly FAAC Allocations (Billion Naira)

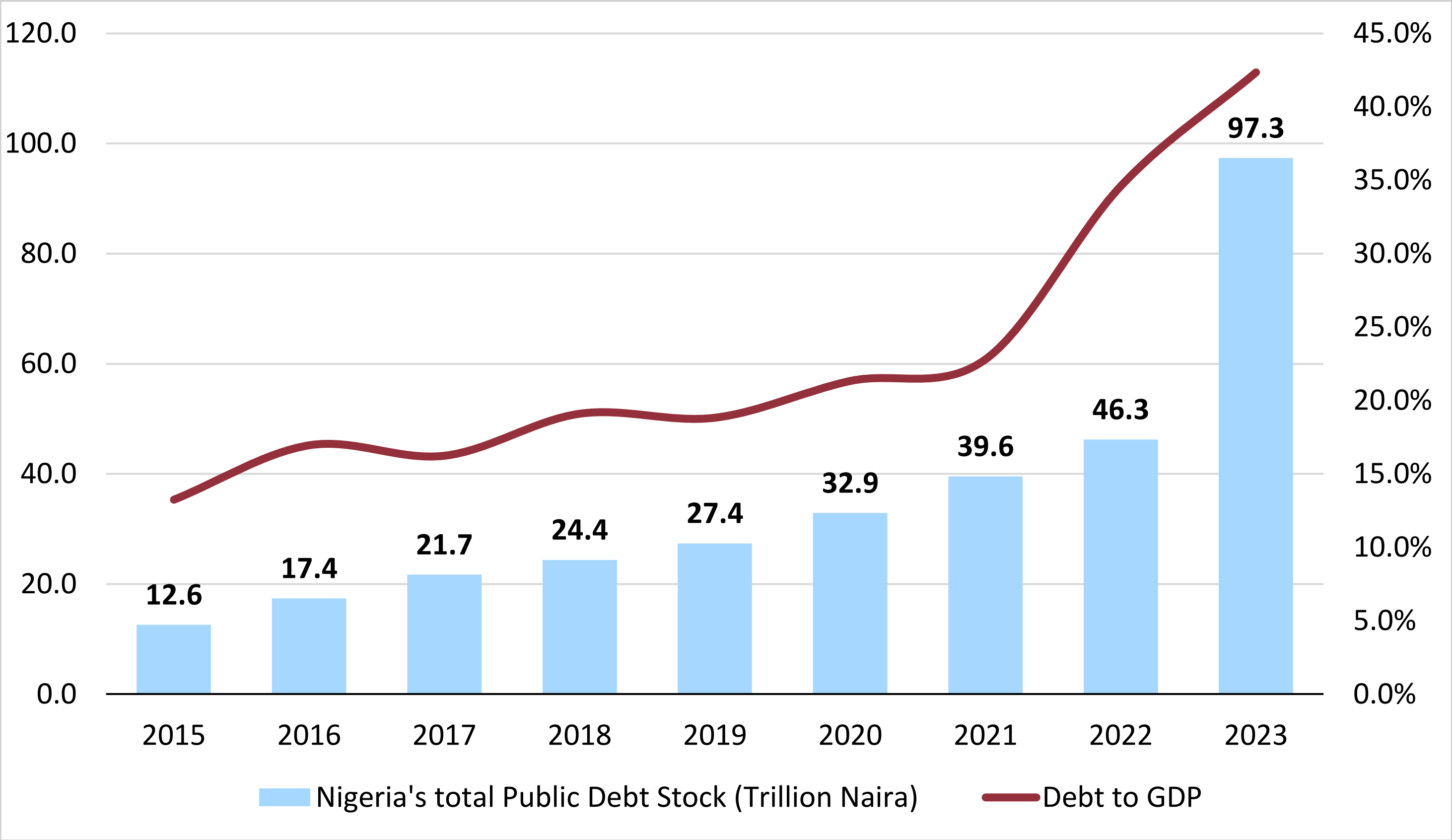



Data from the National Bureau of Statistics showed that FAAC allocations increased by 31.7% to N16.28 trillion in 2023. Significant increases in FAAC have been observed since June 2023 following the FX reforms and subsidy removal announcement on May 29 by the President.

*Data Source: National Bureau of Statistics*

# Public debt stock at N97.3 trillion (US$108.2 billion) as at December 2023

Nigeria's total Public Debt Stock (Trillion Naira) and Debt to GDP (%)

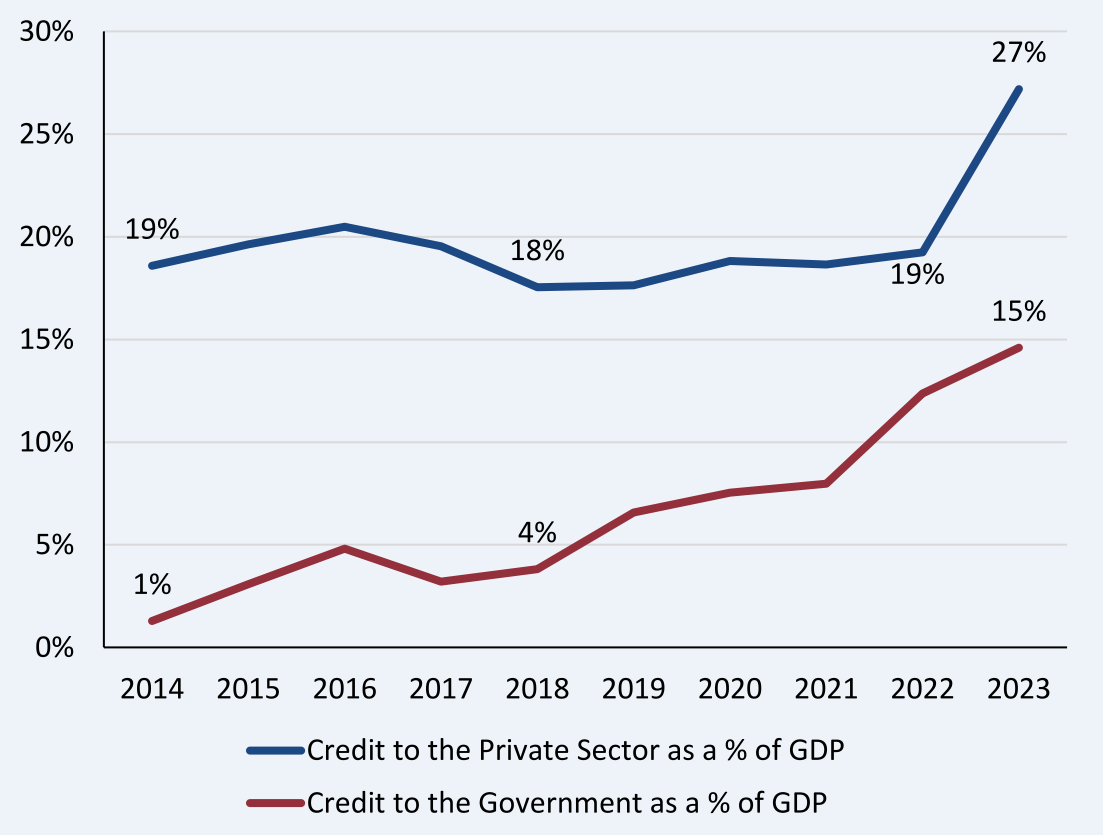



- Despite the increase in FAAC allocations, Nigeria's total public debt stock increased to N97.3 trillion in December 2023.
- This increase was driven mainly by domestic debts which stood at N59.1 trillion in 2023 from N27.55 trillion in 2022.
- Domestic debt now includes Ways and Means of N22.7 trillion and accounted for 60.74% of total debts in 2023.
- Debt to GDP rose to 42.3% in 2023.

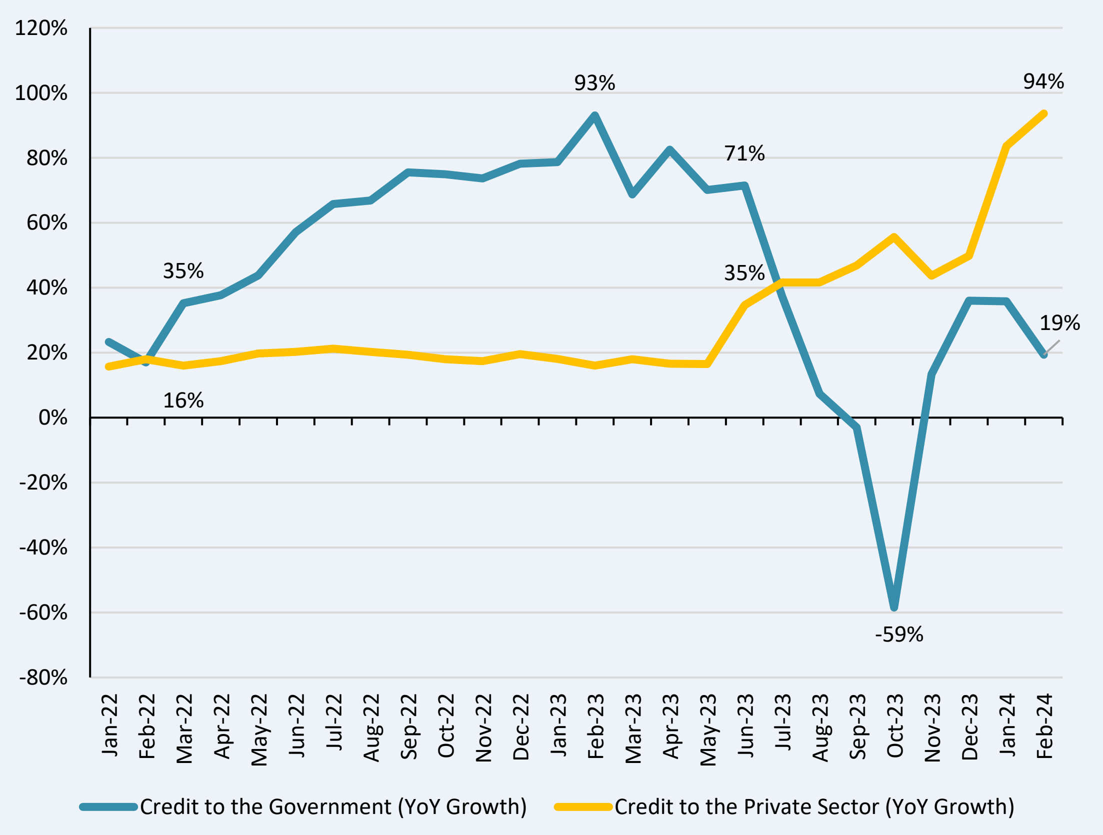
*Data Source: Debt Management Office, CBN*

# Key Monetary Policy Charts – Credit to the Government (CG) & Credit to the Private Sector (CPS)

## CG as a percentage of GDP has grown significantly since 2015



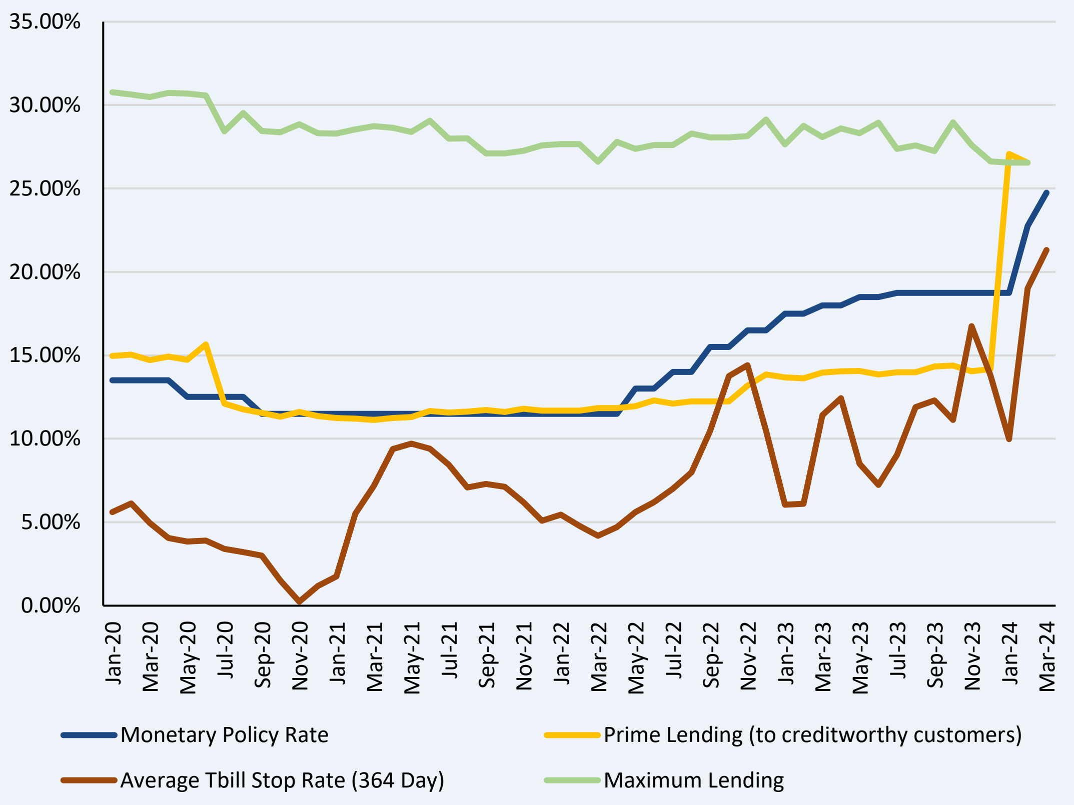

## CPS growth has been significant since the new administration



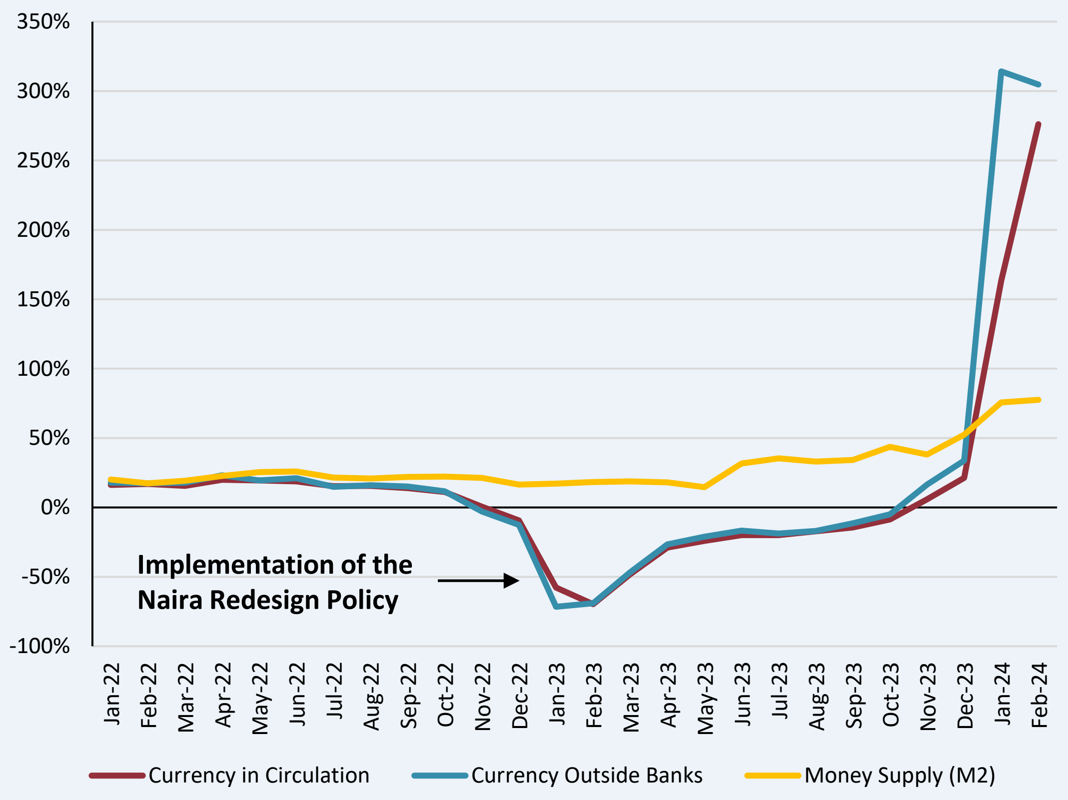

*Data Source: CBN, NBS*

# Key Monetary Policy Charts – Interest Rates and Money Supply

## Key Interest Rates have risen in the last few months




## Growth of Currency & Money Supply (YoY)




*Data Source: CBN*

# Key Monetary Policy Data

| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|
| **Currency/M2** | 8.6% | 8.5% | 7.7% | 7.5% | 5.8% | 4.6% |
| **Currency/GDP** | 1.8% | 1.7% | 1.9% | 1.9% | 1.5% | 1.6% |
| **M2/GDP** | 21.2% | 20.0% | 24.8% | 25.6% | 26.0% | 34.3% |
| **CPS/GDP** | 17.5% | 17.6% | 18.8% | 18.7% | 19.2% | 27.2% |
| **Stock Market Capitalization/GDP** | 9% | 9% | 26% | 25% | 14% | 18% |

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*Data Source: CBN, NGX*

# CBN MPC hiked the Monetary Policy Rate for the second time in 2024 to 24.75%

| CBN Monetary Policy Committee (MPC) Decision | | |
|---|---|---|
| **Instrument** | **Current** | **Previous (Feb 2024)** |
| Monetary Policy Rate | 24.75% | 22.75% |
| Asymmetric Corridor | +100/-300 | +100/-700 |
| Cash Reserve Ratio (DMBs) | 45% | 45% |
| Cash Reserve Ratio (Merchant Banks) | 14% | 10% |
| Liquidity Ratio | 30% | 30% |

In March 2024, the Monetary Policy Committee (MPC) held its second meeting of the year. The meeting was held at a time when inflation rate reached a 27-year+ high of 31.7%. Prior to the meeting, the Committee had raised the MPR by 4 percentage points to 22.75% and the CRR from 32.5% to 45% in February. The Committee also adjusted the asymmetric corridor from +100/-300 to +100/-700.

In March, the MPC further tightened, raising the MPR to 24.75% and CRR for Merchant Banks to 14%. The MPC also adjusted the asymmetric corridor back to +100/-300.

The Committee's decision was driven by the need to anchor inflation and ensure a stable currency. While the Committee acknowledged the role of non-monetary factors, they expressed the view that sustainable economic growth can only occur in an environment with stable and low inflation.

*Data Source: Central Bank of Nigeria*

# Banks' lending space is severely constrained following the increase in CRR

For every **N100** deposit in a commercial bank:

- **45%** is kept with the Central Bank as Cash Reserve
- **30%** is held in treasury bills, short-term instruments etc. i.e liquidity ratio
- Only **25%** is available for lending to businesses and individuals.

The Central Bank MPC has clearly demonstrated its stance on monetary policy – tightening stance – despite the risks to economic growth. Beyond the MPR, the Committee raised the CRR for both DMBs and Merchant Banks in the two MPC meetings of 2024 which will constrain the growth of credit.

But we also observed that the pace of the increase in the MPR slowed from 400 basis points in February to 200 basis points in March. In line with this trend, we believe the Committee will either hold or raise the MPR by 100 basis points in the next meeting. A raise is likely if inflation rate trends upward before the next MPC meeting.

# Implication of CRR increase for Merchant Banks

- In July 2023, the Central Bank reduced the Cash Reserve Requirement (CRR) for merchant banks from 32.5% to 10%, freeing up more funds for risk asset creation. This reduction in the CRR was an expansionary move, which provided room for increased allocation of funds towards development financing initiatives.

- At the Monetary Policy Committee meeting in March 2024, the CRR was raised by 400bps to 14% as part of broad efforts to tame growth in Money Supply. The hike in the CRR implies that merchant banks will have less cash to deploy towards the creation of risky assets. Thus, the hike in the CRR reduces their lending capacity as a higher percentage of deposits will be held as reserves with the Central Bank.

- **With reduced lending capacity, merchant banks could raise interest rates on new loans, thus making refinancing activities more expensive for project financiers and businesses.** On the other hand, merchant banks could allocate more funds to short-term government securities, especially as yields on risk-free instruments rise above 20%. Overall, we believe the hike in the CRR and the MPR could depress demand for credit. However, the effect of the CRR hike is expected to be milder on merchant banks than on commercial banks given the huge disparity between their respective CRRs.

- **In addition, it is important to note that the 400bps CRR hike could be a pointer to further tightening measures in the merchant banking space.** A surge in foreign exchange transactions could call for new policy directives like the Net Open Position (NOP) limits for commercial banks. Thus, merchant banks could remain under regulatory surveillance over the near term.

# Analyst Views and Outlook on Monetary and Fiscal Policy

- **The MPC's decision to raise the MPR and CRR reflects the intense focus on price stability in this new inflation-targeting regime**. Since the last MPC meeting in February 2024, inflation rate has increased by 1.8 percentage points to 31.7% in February 2024. The CBN MPC therefore raised rates further to contain this upward-trending inflation. There is also the potential benefit of attracting portfolio investments into the country, which if realized in large volumes, could positively impact the country's exchange rate. In the last few weeks, the exchange rate volatility has eased owing to several reforms including BDC regulations, clearing of FX backlogs and improving oil production. We believe that such stability in the exchange rate and appreciation in the currency will be important in bringing down inflation rate in the near term.

- **An aspect of concern is the Committee's back-and-forth decision regarding the asymmetric corridor.** In February 2024, the corridor was adjusted to +100/-700 from +100/-300. This decision was reversed in the meeting in March as the corridor was adjusted to +100/-300. While in both meetings the Committee expressed a tightening stance, the decision on the corridor in February reflected otherwise. We, therefore, reiterate our call for careful policy appraisals and perhaps, a specific explanation when such change is made. We hope that such reversals of the MPC decision (in another instance) will not result in substantial "unintended" costs to the economy.

- **On the CRR, a much higher CRR affects banks' ability to offer credit facilities to businesses.** Combining a CRR of 45% for commercial banks with a liquidity ratio of 30% and an MPR of 24.5% suggests slower growth of credit to businesses and may constrain the real sector. We note that this is a cost that the economy will have to face in the short term as the CBN seeks to achieve stable prices.

# Analyst Views and Outlook on Monetary and Fiscal Policy

- **Going forward, the fiscal authorities will need to step up in addressing non-monetary drivers of inflation**. The dry-season farming initiative is a good step in the right direction as it could increase the supply of agricultural products in the medium term. Infrastructure deficits, poor power supply and insecurity are critical issues for the fiscal authorities to address. The CBN will also need to temporarily halt Ways and Means – lending to the government. Raising rates and increasing lending to the government is counterintuitive and the cost will be borne by businesses in the form of higher borrowing costs and inflation. Fiscal authorities need to raise finance from non-CBN sources. Aggressively reducing oil theft, exploring solid mineral exports and curbing illegal mining are some options. We believe that having a positive real interest rate – where interest rates are higher than inflation rate – is ideal; and fiscal and monetary authorities must collaborate to address inflation, one of Nigeria's biggest economic problems.

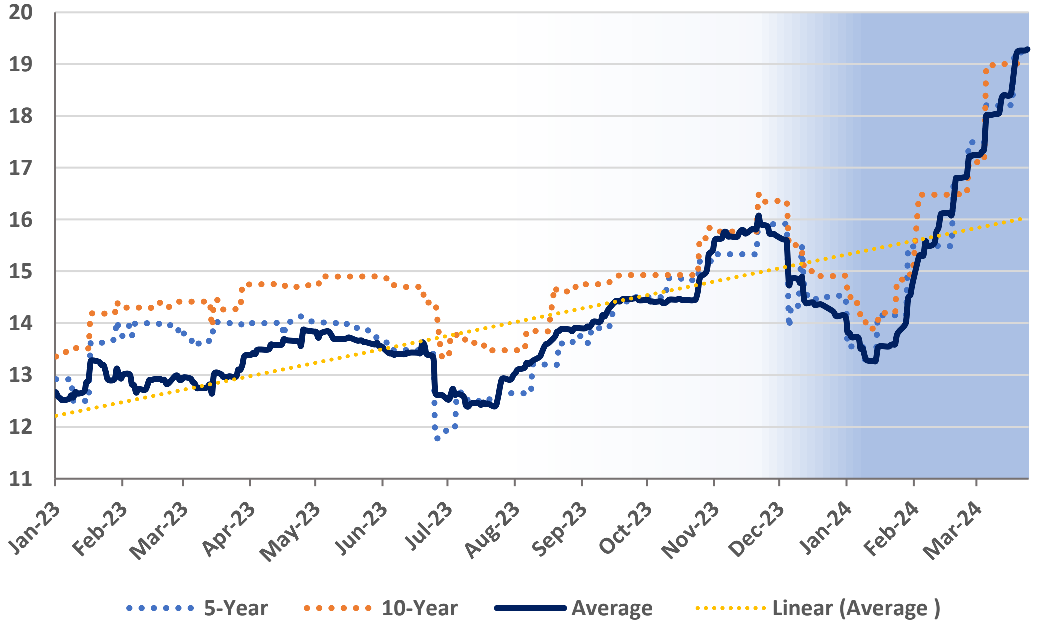
SECTION 04

# Nigeria’s Financial Market Update

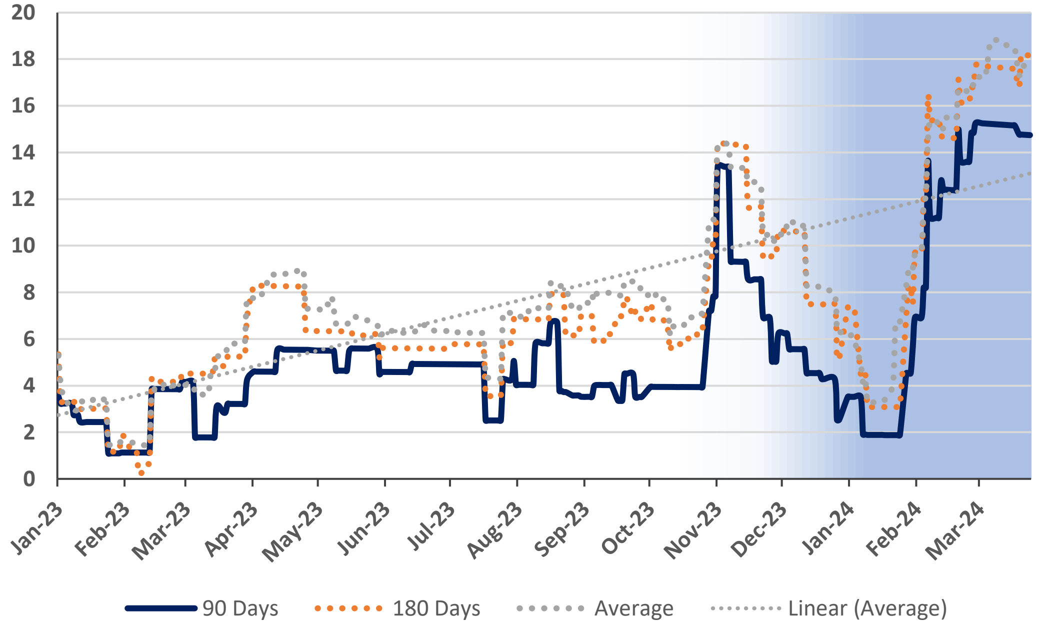
# Yields across government securities rise following MPC rate hikes

The FGN Bond and Treasury Bills markets experienced a significant rise in yields in 2024. The average yield in the FGN Bond market increased from 14.13% on the first trading day of the year to 19.29% (as at 26th March). Meanwhile, yields in the Treasury Bills market increased at a much higher rate to 17.67% (as at 26th March) from 6.29% at the beginning of the year. This follows the unprecedented rise in the monetary policy rate by 600 basis points so far in the year to 22.75%, thereby pushing up yields across markets.

Trend of FGN Bond Yields (%)




Trend of NT Bill Yields (%)




*Data Source: FMDQ; Investing.com*    *Note: End period for the data is March 26, 2024*

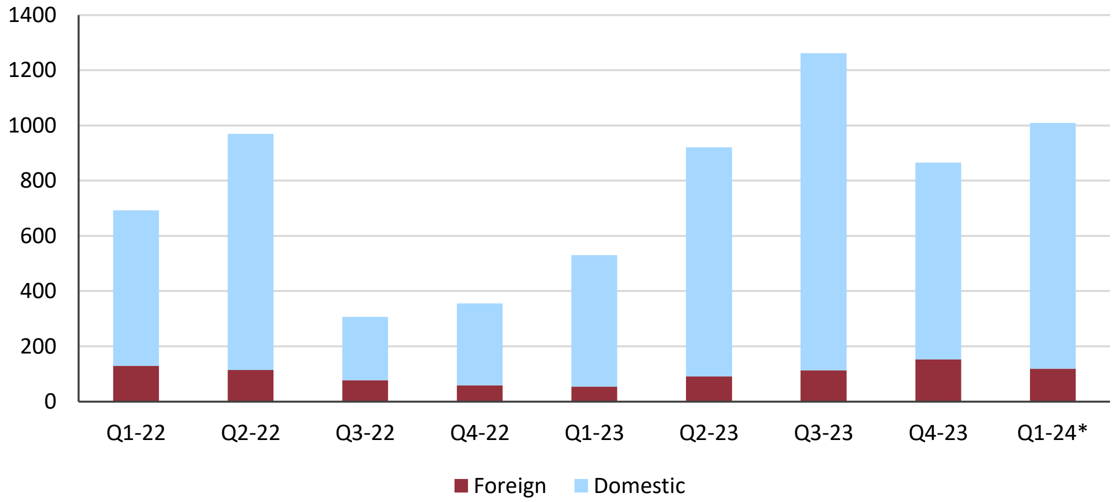
# Equity market was bullish in the first quarter of 2024 despite a hike in interest rate

***All Share Index closed rose by 39% year to date (March 26)***

Trend of ASI (Index Points)


***The market continues to be led by domestic players***

NGX Domestic & Foreign Participation (N' Billion)




Equity Market Performance

| NGX-ASI | 2023 | QTD |
|---|---|---|
| **Open (N'Bn)** | 51,251.06 | 74,773.85 |
| **Close (N'Bn)** | 74,773.85 | 103,952.47 |
| **% Change** | 45.90 | 39.02 |

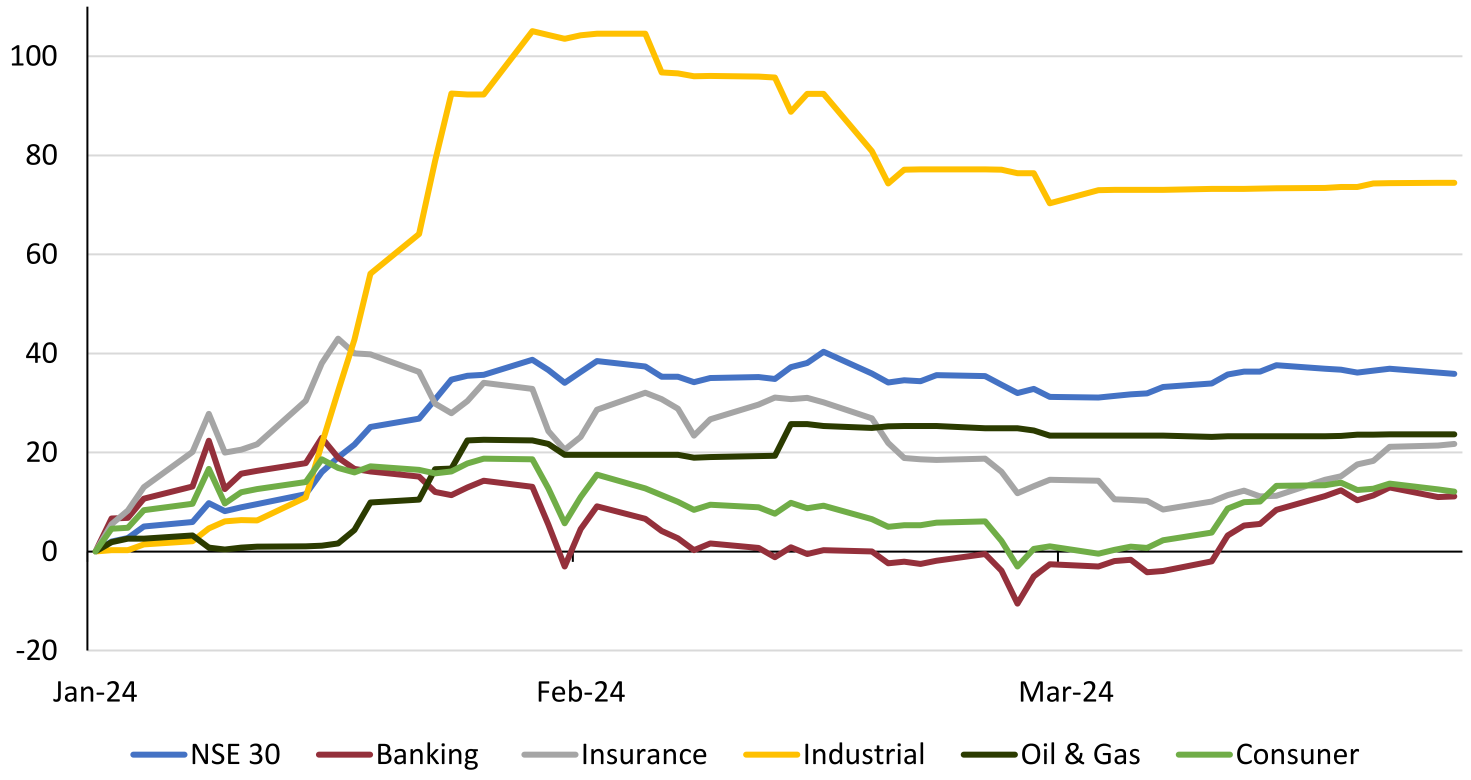
| MARKET CAP | 2023 | QTD |
|---|---|---|
| **Open (N'Bn)** | 27,186.00 | 40,918.00 |
| **Close (N'Bn)** | 40,918.00 | 58,780.00 |
| **% Change** | 50.51 | 43.65 |

*Source: NGX, CBN*

**Note: Data end on March 26, 2024*

# The bullish equity market has been propelled by strong performances of industrial stocks

Trend of Sectoral Performance (YTD, %)




Stock Market gains across select sectors (%)

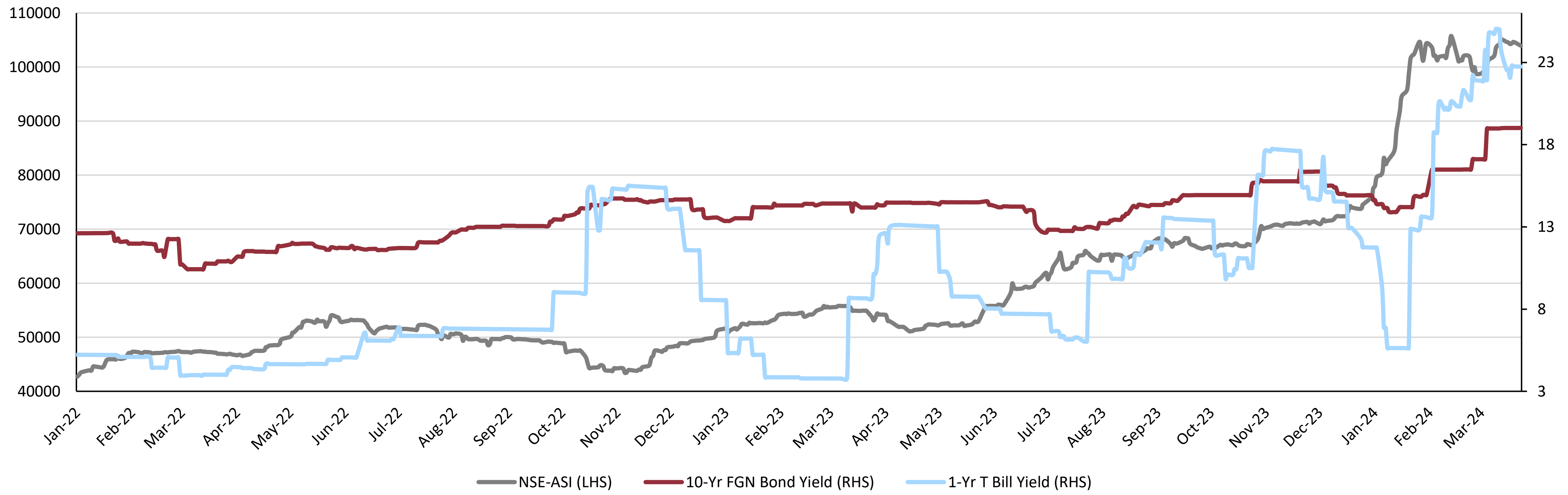
| SECTOR PERFORMANCE | 2023 (%) | 2024 QTD (%) |
|---|---|---|
| NSE ASI | 44.92 | 39.02 |
| NSE 30 | 50.48 | 38.21 |
| Banking | 109.46 | 10.73 |
| Insurance | 79.89 | 22.84 |
| Industrial | 12.86 | 78.16 |
| Oil & Gas | 125.59 | 24.09 |
| Consumer Goods | 71.25 | 12.56 |

| SECTOR PERFORMANCE | 2023 (%) | 2024 QTD (%) |
|---|---|---|
| DANGCEM | 22.57 | 93.22 |
| BUACEMENT | -0.77 | 33.81 |
| LAFARGE | 31.25 | 15.87 |

Source: NGX, Investing.com Note: data end on March 26, 2024

# Both equity and bond markets continue to move in the same direction despite rate hike

NGX-ASI Compared with 10-Year FGN Bond Yield (%) and 1-Year T-Bill Yield (%)




The bond market is expected to respond to the rate hike by the Monetary Policy Committee, which is in line with investors' expectations. However, despite the rising yields across bond markets, the equity market sustained an upward trend in the quarter. This is on the back of speculative positioning in the equity market. Also, investors are taking positions for dividend-paying stocks, especially in the banking sector, where there was an expansion in profit after tax for many banks following gains from exchange rate devaluation. Investors are also taking positions in the industrial sector, largely on stocks in the cement industry.

*Data Source: NGX /investing.com*  *Note: End period for the data is **March 26, 2024***

# Analyst Views and Outlook

## Fixed Income Market

- The fixed income market is adjusting to the increase in policy rate which reached unprecedented heights due to persistent inflationary pressures. The high policy rate is pressuring up yields across the fixed-income market as investors seek higher yields on their investments.
- With the CBN's inflation-targeting strategy, there could be more rate hikes in the coming months, depending on the trajectory of inflation rate. Therefore, the movement in policy rates will continue to modulate yields across the fixed income market.
- Meanwhile, the borrowing need of the government will constitute a major upward driver of yields as spot rates continue to rise in the primary auctions. Therefore, in the coming quarter, we anticipate a further rise in yields across the bond market.

## Equity Market

- In the face of rising yields, the equity market continues to post bullish performance. So far in the year, the market has recorded a 39% gain, driven mainly by the heavyweights - Dangote Cement alongside other stocks in the industrial, oil and gas and banking sectors.
- The market will continue to thrive on the inherent bullish sentiment that accompanied the new administration. Besides, with the policy rate outweighing rates and yields across different bond markets and the inflation rate still far off, the incentive to switch from equity to bond is still low.
- However, the performance of stocks on the NGX has rested on the speculative drive for capital contrary to the fundamentals of the listed companies. The past year has been challenging for most corporations in Nigeria due to the devastating impact of FX loss and amplified cost of operation, which shrunk their profit.
- Hence, the spiralling performance of the equity market raises concerns about the risk of asset bubbles, which could be accompanied by a burst in coming quarters. Aside from the banking sector, most listed businesses recorded losses or subdued profits in the past year. We also note that the banking recapitalisation will spur the stock market in the year and beyond.

# The Way Forward for the Economy: Fiscal and Monetary Authorities in Focus

# Key Reforms that need to be sustained by fiscal and monetary authorities

## Central Bank

- Ensure transparency in the management of foreign exchange
- Continue its inflation-targeting mandate to achieve low inflation in the medium term
- Continue efforts to increase FX inflows and ensure a stable exchange rate
- Increase surveillance on financial institutions
- Transfer developmental finance activities to fiscal authorities

## Fiscal Authorities

- Sustain efforts in curbing oil theft, which have led to an increase in oil production
- Hasten the completion of the Port Harcourt refinery to improve domestic refining capacity
- Continued implementation of the dry season farming initiative to boost food production
- Interventions by federal/state governments to provide palliatives – food, transport & health

# Key Reform Areas for fiscal authorities

Fiscal authorities must recognize their role in supporting growth, creating jobs and reducing inflation. Failure of the fiscal authorities to act will undermine efforts of the Central Bank in achieving macroeconomic stability.

More coordination is needed between fiscal authorities and the CBN.

## Budget & Tax Reforms

**To deliver economic growth**

Continuous scrutiny of the budget to remove frivolous items, contain fiscal deficits and stop unproductive spending is required. Transparency of government agencies such as NNPC, and Customs is important.

## Grow Non-Oil Export

**To create jobs and attract FX**

Fiscal authorities will need to incentivise the exportation of targeted non-oil items by leveraging the AfCFTA. Growth in non-oil exports is crucial for long-term exchange rate stability and job creation.

## Real Sector reforms

**To attract and sustain investments**

To attract both FDIs and increase local investment in key sectors, fiscal authorities will need to sanitize the tax environment, implement power sector reforms and improve critical infrastructure.

## Tackle Insecurity

**To ensure productivity and reduce inflation**

Insecurity remains a major concern for investors in the agricultural sector. Addressing insecurity will have a direct impact on food inflation.

# Key Reform Areas for the Central Bank

So far, the Central Bank under its new leadership has demonstrated the willingness to win back investors' confidence and ensure stability of the exchange rate. The Bank has implemented bold steps and must continue to reassure stakeholders.

The CBN must continue to act transparently and constantly engage stakeholders to win their trust.

## Recapitalization of Banks

On March 28, the CBN released a guideline on the minimum capital requirement of commercial, merchant and non-interest banks in Nigeria. We earlier noted that such recapitalization is due and will strengthen the banking industry. The CBN will need to engage stakeholders and follow through to ensure compliance with the guideline.

## Reform of the BDC Segment

On February 27th, the CBN issued a circular noting that $20,000 will be sold to each BDC at the rate of N1,301/$. BDCs are to sell at a margin not more than 1% above the purchase rate from CBN. We believe the CBN needs to constantly regulate the BDC space and review several issues such as the capitalisation of BDCs, sale of $20,000 and price regulation.

## Halt Ways and Means

The CBN will need to take a tough stance to temporarily halt ways and means – which is lending to the government. This will ensure consistency in its drive to anchor inflation.

## Increase surveillance on financial institutions

With high interest rate and a constrained space for lending, the Central Bank will need to intensify its risk-based supervision to limit non-performing loans and ensure a sound financial industry.

# CBN reviews the minimum capital requirements for banks

**On March 28, the CBN released a circular on the minimum capital requirement of commercial, merchant and non-interest banks in Nigeria. The rationale for the recapitalization of banks is to enhance the solvency, resilience and capacity of the banks to support the economy. Recall that the CBN governor in late 2023 noted that the Nigerian banking industry needs to be more resilient and stronger in supporting the realization of a US$1 trillion Nigerian economy.**

- With the new circular, Banks are required to increase their minimum paid-in common equity capital to the amount specified in the Table.
- According to the CBN, the capital requirements specified above shall be paid-in capital and share premium only.
- The following shall not be recognized to meet the new minimum capital requirements: Bonus issues, other reserves and Additional Tier 1 (AT1) Capital.
- The timeline to comply with the new requirement is 24 months from April 1, 2024.

| Type of Bank | Authorisation | Minimum Capital (N'Billion) |
|---|---|---|
| Commercial | International | 500 |
| | National | 200 |
| | Regional | 50 |
| Merchant | National | 50 |
| Non-Interest | National | 20 |
| | Regional | 10 |

*Source: CBN*

# Share Capital and Share Premium of select banks in Nigeria and amount to be raised

*Figures in Billion Naira*

| | Banks | Share Capital (A) | Share Premium (B) | Total C = (A+B) | Required Capital (D) | Amount to be raised E = (D-C) |
|---|---|---|---|---|---|---|
| **International Authorization** | Zenith | 15.7 | 255.0 | **270.7** | 500.0 | **229.3** |
| | Access Bank | 17.8 | 234.0 | **251.8** | 500.0 | **248.2** |
| | FBN | 17.9 | 233.4 | **251.3** | 500.0 | **248.7** |
| | Union Bank | 14.6 | 133.5 | **148.1** | 500.0 | **351.9** |
| | GTB | 14.7 | 123.5 | **138.2** | 500.0 | **361.8** |
| | Fidelity | 16.0 | 113.7 | **129.7** | 500.0 | **370.3** |
| | FCMB | 9.9 | 115.4 | **125.3** | 500.0 | **374.7** |
| | UBA | 17.1 | 98.7 | **115.8** | 500.0 | **384.2** |
| **National Authorization** | Ecobank Nigeria Plc | 13.7 | 179.3 | **193.0** | 200.0 | **7.0** |
| | Stanbic | 6.5 | 102.8 | **109.3** | 200.0 | **90.7** |
| | Sterling | 14.4 | 42.8 | **57.2** | 200.0 | **142.8** |
| **Regional Bank** | Providus Bank | 18.0 | 13.9 | **31.9** | 50.0 | **18.1** |
| | Globus | 20.3 | 4.8 | **25.1** | 50.0 | **24.9** |
| **Regional Non-Interest Bank** | Jaiz Bank | 17.3 | 1.3 | **18.6** | 10.0 | **-** |
| | Lotus Bank | 10.0 | 3.0 | **13.0** | 10.0 | **-** |
| **Merchant Bank** | FSDH | 2.1 | 0.2 | **2.4** | 50.0 | **47.6** |

*Data Source: Banks' 2022 Annual Accounts; Fidelity Bank Plc's Unaudited Financial Statement for the period ended 30 Sept. 2023 and CBN*

*NB: Figures on Share Capital and Share Premium were extracted from the Annual Accounts of the banks. Figures for Required Capital were derived from the CBN. Other figures reflect our calculations and analysis.*

*We used the categorisation of banks as published by the CBN in 2021. See https://www.cbn.gov.ng/Out/2021/FPRD/DMBs%20and%20HoldCos-Jun-30-2021.pdf*

# Possible Implications for the Banking Industry

The last banking recapitalization was executed in 2005 – banks were required to attain a minimum base of ₦25 billion (US$189 million). In dollar terms, this amounts to US$38.75 million as at 2023, an erosion of US$150.25 million in 18 years.

When we consider inflation alone, ₦25 billion has a real value of ₦2.62 billion* as at December 2023. Therefore, such a call for recapitalization is valid and Nigerian banks must be strengthened to support the economy.

## Key Implications for Banks

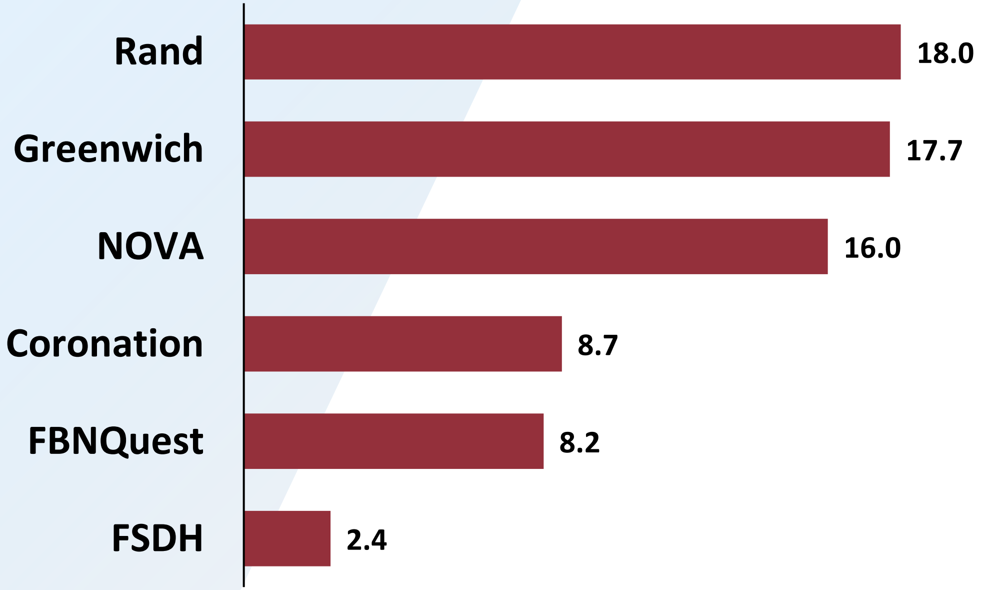
- The banks with international authorization have a huge task to meet the new requirements. Within this category, the least amount to be raised is N229 billion (Zenith) and the highest amount is N384.2 billion (UBA). We note that Access Holdings had announced plans to raise N365 billion through a rights issue. We believe that other banks will make such a move, implying an active capital market in the medium term.
- In addition to issuing ordinary shares to the public, many banks will target the inflow of foreign capital to leverage Nigeria's weaker currency. This could also serve as an avenue to increase foreign participation in the NGX. Banking stocks are expected to react positively to the review.
- We expect increased mergers and acquisitions in Nigeria's banking industry in 2024 - 2026. There will be fewer but stronger banks in Nigeria as some banks might be unable to independently meet the capital requirement.
- We believe that the timeline of 2 years is short and could add immense pressure on banks. The CBN will need to engage stakeholders to obtain their feedback going forward.

*NB: If a depositor placed N25 billion in a bank in 2005 with no interest, that amount is worth N2.62 billion today due to inflation. We used figures from Nigeria's Consumer Price Index to estimate the current value.

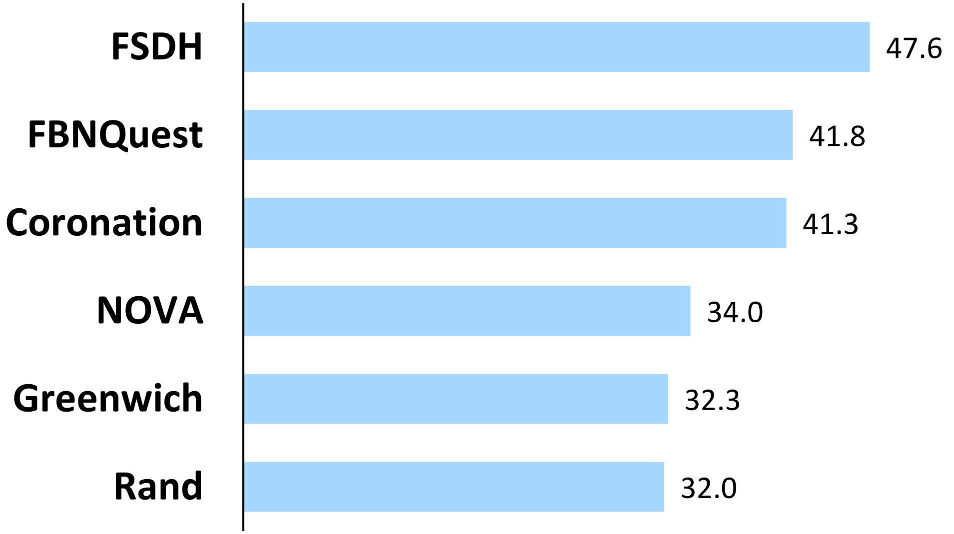
# Recapitalization and Merchant Banks in Nigeria

- From the onset, merchant banks were required to maintain a minimum paid-up share capital of ₦15 billion. The 2024 recapitalization guideline mandates that merchant banks should increase their current share capital and share premium to ₦50 billion.
- A review of the share capital and premium of all merchant banks shows an average share capital of ₦11 billion. According to available financials, there is an industry shortfall of ₦229 billion ($176 million at an exchange rate of ₦1,300/$).

Share Capital and Premium (₦ billion)




Funding gap (₦ billion)




*Data Source: 2022 Annual Report for FSDH, NOVA and FBNQuest; 2021 Annual Report for Coronation and Greenwich; Rand's 2021 Statement of Financial Position. Figures for Required Capital were derived from the CBN. Figures on funding gap reflect our calculations and analysis. We used the categorisation of banks as published by the CBN in 2021. See [https://www.cbn.gov.ng/Out/2021/FPRD/DMBs%20and%20HoldCos-Jun-30-2021.pdf](https://www.cbn.gov.ng/Out/2021/FPRD/DMBs%20and%20HoldCos-Jun-30-2021.pdf)*

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# Recapitalization and Merchant Banks in Nigeria

- With the restriction of the capital raising exercise to share capital and share premium, merchant banks, like their commercial bank counterparts, cannot rely on their robust retained earnings to plug the funding shortfall. With none of these banks listed on the Nigerian Exchange, the plausible source of funding could be equity injections via private placement or mergers and acquisitions. Banks that are affiliated with international firms such as Rand Merchant Bank*, could take advantage of capital injections from parent companies.

- Although merchant banks are much smaller compared to national commercial banks in Nigeria, the recapitalization exercise is necessary to deepen their contribution to trade facilitation and infrastructural development in the Nigerian economy.

- Overall, the recapitalization exercise seeks to strengthen the industry's balance sheet, and position these banks to plug key infrastructural financing deficits in the country.

**Rand Merchant Bank Nigeria is a member of FirstRand Group (its parent company) which is listed on the Johannesburg Stock Exchange (JSE) and the Namibian Stock Exchange (NSX).*

# Macroeconomic Projection for 2023 – 2024

# Macroeconomic Projection for 2024: Rationale for the Three Scenarios

| | |
|---|---|
| **Best Case** | The best case scenario assumes an oil price of US$95 per barrel for 2024. This assumption is driven by key factors such as the escalation of the crisis in the Middle East, the continued attack of vessels in the Red Sea, the continuation of the Russia-Ukraine war and oil production cuts by OPEC and OPEC+ to maintain high oil prices in the year. In the domestic economy, Nigeria's oil production improves to 2 million barrels per day following progress made in curbing oil theft. In addition, increased earnings from crude oil sales translate into higher government spending on capital projects with an injection of N7 trillion, which is 70% of the 2024 capital budget. |
| **Moderate Case** | Oil price averages US$85 per barrel following a moderation of tension in the Middle East and the increased supply of crude by the US to moderate prices. Events such as the slowing Chinese economy, and a moderation of the war in Ukraine place a cap on crude oil prices. Within Nigeria, there is continued progress in curbing oil theft and crude oil production averages 1.62 million barrels per day, below the budget benchmark of 1.78 mbpd. As such, spending on capital expenditure amounts to N4.7 trillion, which is 47.5% of capital expenditure in the 2024 budget. |
| **Worst Case** | This scenario assumes a bleak global outlook from the lens of an oil-exporting economy. Crude oil price averages US$52 per barrel as global demand drops. Oil theft in the Niger Delta intensifies and oil production falls to 1.1 million barrels per day. Consequently, government revenue declines leading to a spending of N1.4 trillion for capital expenditure in 2024. |

# Macroeconomic Scenario for 2023

| Scenario | Assumptions | Outcome |
|---|---|---|
| **Best Case** | • Oil price averages US$95 per barrel<br>• Demand for Nigerian crude improves - Nigeria produces 2 million barrels per day<br>• Government capital spending at N7 trillion | • GDP Growth at 4.2%<br>• Inflation Rate at 24.4%<br>• External Reserves at US$39.1bn<br>• Average Exchange Rate at N1100/US$ |
| **Moderate Case** | • Oil price averages US$85 per barrel<br>• Crude oil production at 1.62 million barrels per day<br>• Government capital spending at N4.7 trillion | • GDP Growth at 2.98%<br>• Inflation Rate at 27.1%<br>• External Reserves at US$36.8 billion<br>• Average Exchange Rate at N1,298/US$ |
| **Worst Case** | • Oil price averages US$52 pb<br>• Lower crude oil production- Nigeria produces 1.1 million barrels per day<br>• Government capital spending at 1.4 trillion | • GDP Growth at 1.2%<br>• Inflation Rate at 32%<br>• External Reserves at US$29.5 billion<br>• Average Exchange Rate at N1,923/US$ |

# Projection for 2024 – 2025 for Nigeria

| | 2022 | 2023 | 2024f* | 2025f* |
|---|---|---|---|---|
| Real GDP Growth | 3.1% | 2.74% | 2.98% | 3.4% |
| Inflation rate | 18.8% | 24.5% | 27.1% | 22.3% |
| Average Exchange rate (N/US$) | 423 | 645.18 | 1,298 | 1,281 |
| Monetary Policy Rate (End Period) | 16.5% | 18.75% | 25% | 17.5% |
| External Reserves (Average, US$ Billion) | 38.8 | 34.7 | 36.8 | 38.5 |
| Treasury Bill (91-Day) | 4.4% | 4.6% | 17.8% | 12.0% |
| Treasury Bill (182-Day) | 5.6% | 7.6% | 20.5% | 14.3% |
| Treasury Bill (270-Day) | 7.3% | 10.1% | 23.4% | 15.9% |
| Treasury Bill (360-Day) | 8.6% | 11.2% | 26.5% | 17.3% |

**Please note that there is still a high degree of uncertainty. Actual figures could exceed or fall below these forecasts.*

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