Coronation Research

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Coronation Breakfast Session

A Longer Investment Horizon in the Nigerian Market

19 February 2020

Our Corporate Philosophy

Vision

To be Africa's Premier Investment Bank

Mission

To be the Engine room for Africa's financial markets

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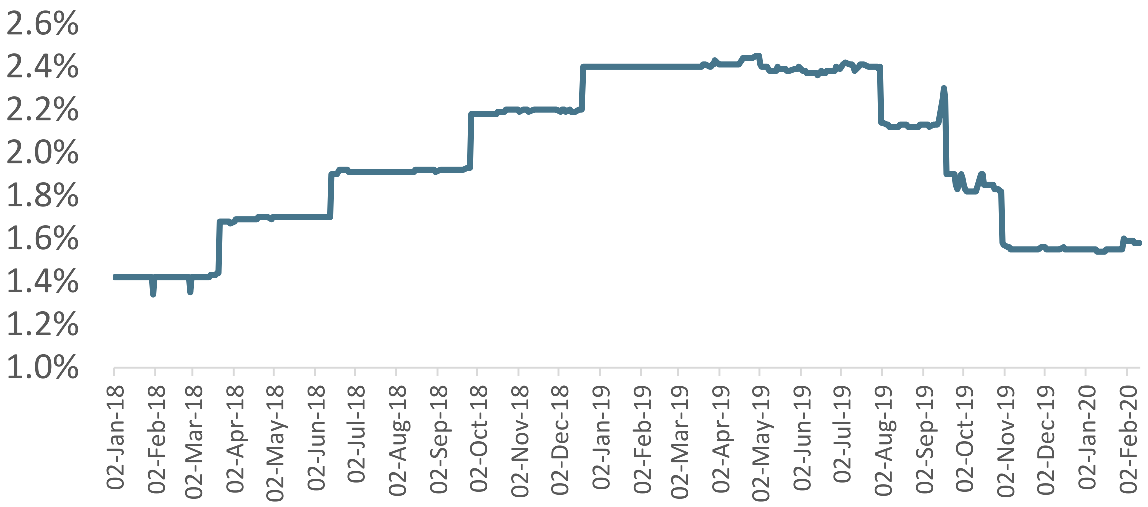
Global liquidity

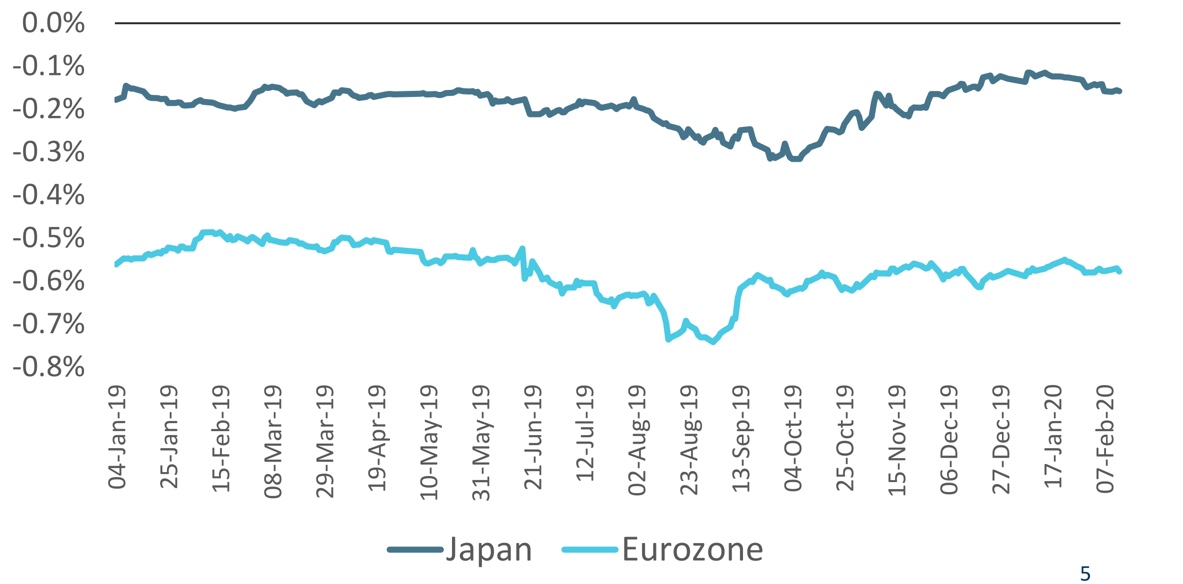
Global liquidity conditions are good

- Central banks are easing monetary conditions. The US Fed is reinforcing an easing cycle with fresh rounds of asset repurchases planned well into Q2 2020
- The People's Bank of China in November effected cuts to a spectrum of signal rates in reaction to a slowdown in the rate of GDP growth. Its medium-term lending rate, in particular, was cut for the first time since 2016
- The economic effects of the coronavirus outbreak therefore may be interpreted two ways:
  - Lowering of GDP expectations, therefore falls in commodity prices; copper, oil & gas
  - Further extension of liquidity by central banks
- We are inclined towards the second interpretation – in terms of the global liquidity outlook

Effective US Fed Funds rate



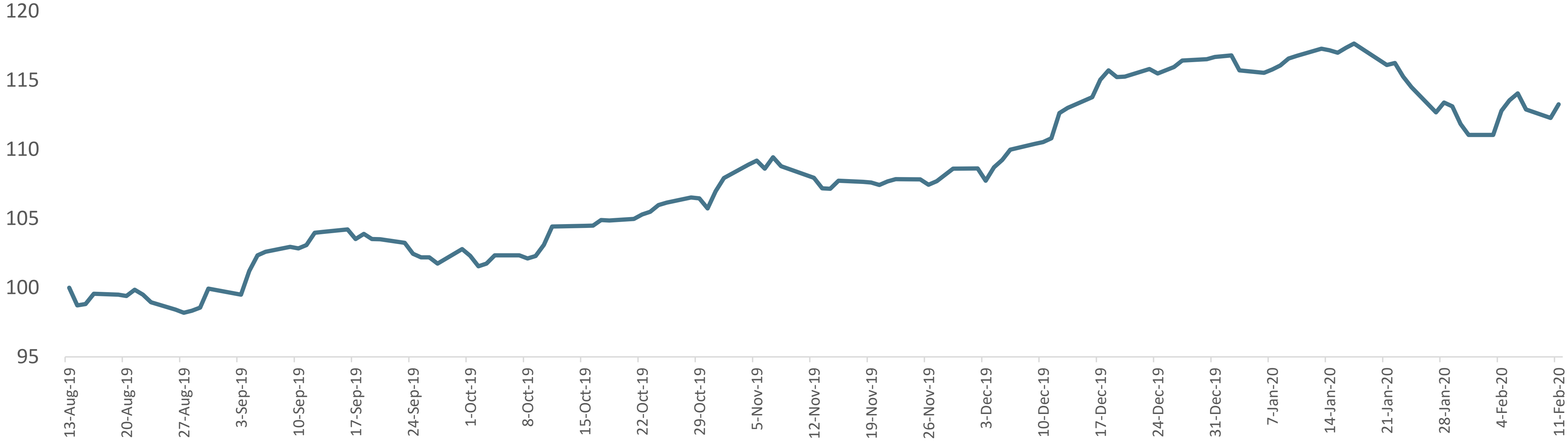
Eurozone and Japanese bonds, 1-year yields



Global investors are 'risk-on' in the search for yield

- Sub-zero yields in the Eurozone, Japan and other developed markets contrast with much higher yields on emerging market assets, pulling capital flows into emerging markets
- Gabon and Ghana have successfully raised US$4.obn in the international sovereign debt market this year, at the bottom end of indicative pricing. Ghana's 40-year issue is currently Africa's longest-duration eurobond
- Nigeria is on course to tap the eurobond market with an issue for approximately US$3.3bn

Bloomberg Index of Emerging Market Capital Flows, 31 Aug 2019=100

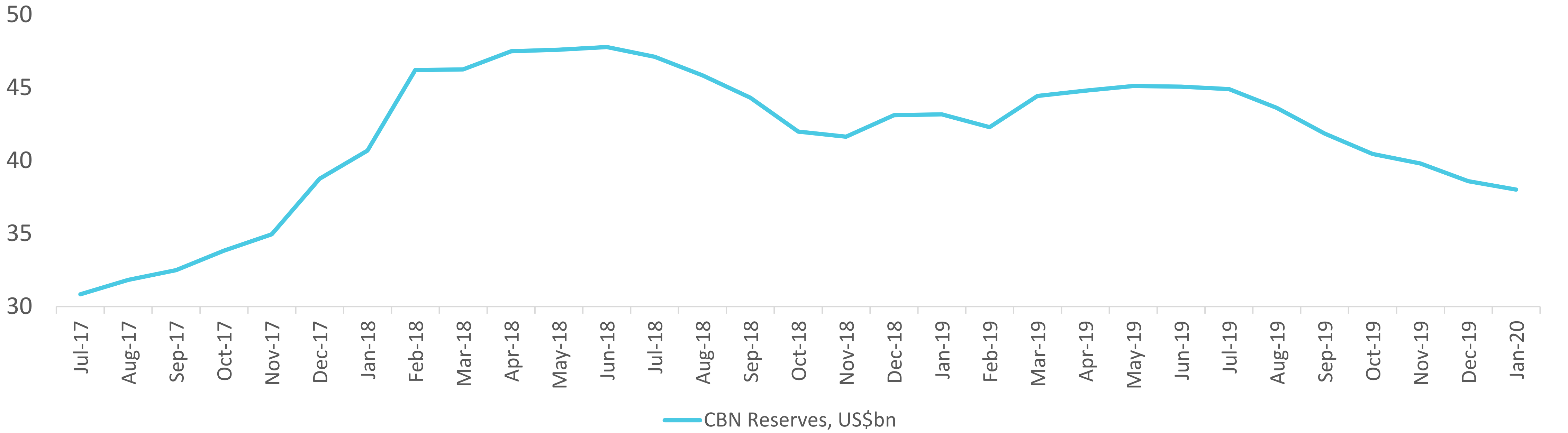


Foreign exchange

The CBN wants FX reserves at US$30bn+

- The CBN's FX reserves currently stand at US$37.3bn (one-month MA). It has three principal sources of US dollars:
  - Oil & gas earnings banked by the NNPC
  - Bilateral loans from institutions like the World Bank, and eurobonds
  - Foreign Portfolio Investment (FPI) in its open market operation (OMO) bills
- During H2 2019 the CBN lost reserves (largely providing US$ to the NAFEX market) at an average US$1.1bn per month. It has begun to arrest the slide. January's outflow was US$0.6bn. We await all Q1 data to be sure

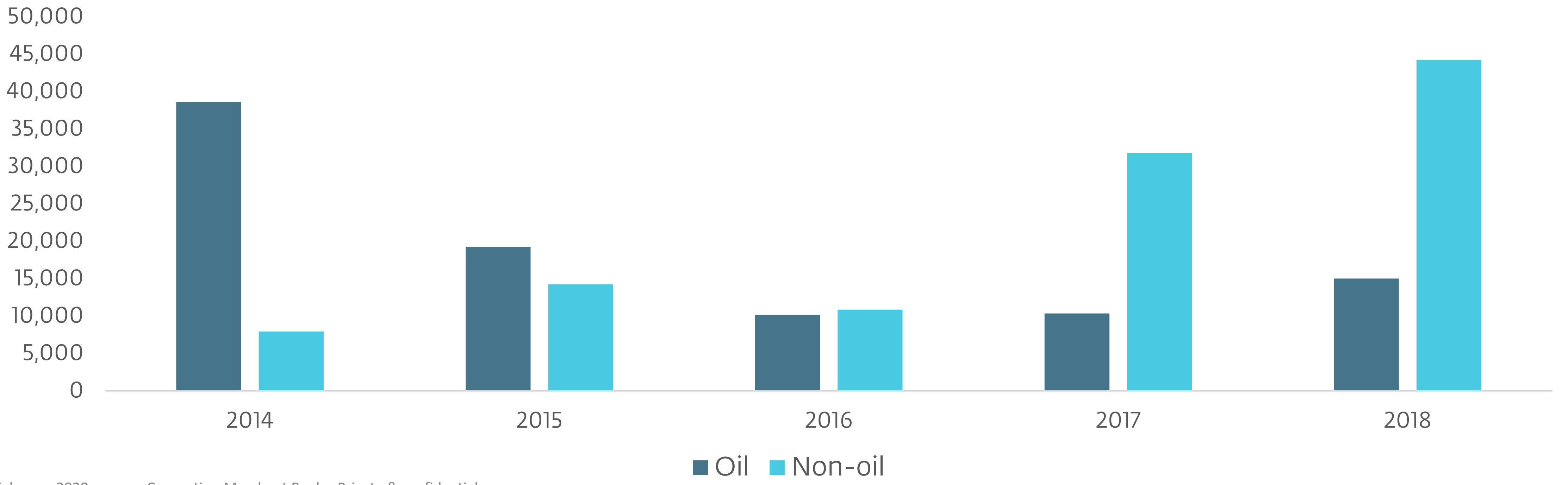
CBN FX reserves, US$bn (lhs)



Sources of US dollars for the CBN

- The bulk of the CBN's US dollar inflows are non-oil. Perhaps no more than US$10.0-15.0bn from oil in 2020
- The World Bank granted a US$3.0bn loan for infrastructure in 2019 and part of it will be drawn down in 2020. There may be money from China – from the US$29.69bn funding scheme announced in 2019
- An issue of US$3.3bn of Federal Government of Nigeria eurobonds has been announced
- Foreign (FPI) buying of the CBN's OMO bills is also critical to the success of CBN reserve management. Foreign holdings of OMO bills likely account for over US$5.0bn of the CBN FX reserves

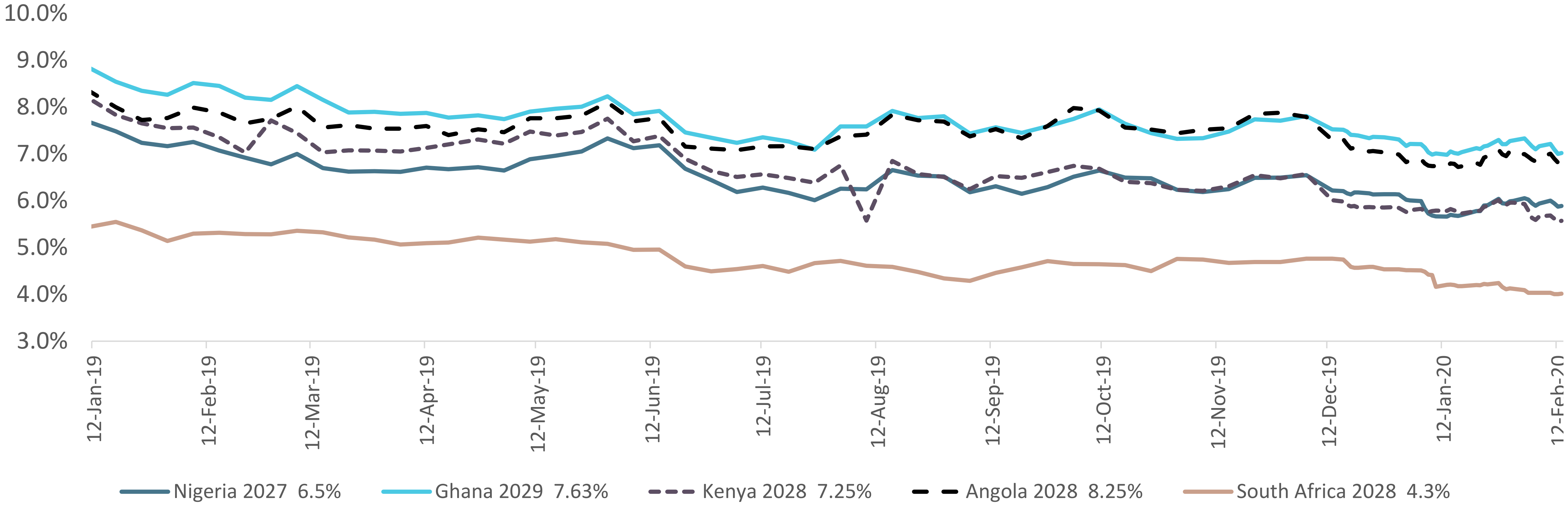
Sources of US dollars for the CBN, US$ millions



A sovereign eurobond of US$3.3bn

- In choosing to issue sovereign eurobonds of approximately US$3.3bn Nigeria is taking advantage of an environment of declining yields. And the fact that it stayed away from the eurobond market in 2019
- Last December's downgrade of Nigeria from stable to negative watch by Moody's has not adversely affected Nigeria's eurobond yields. However, it is important not to look at this just from the issuer's point of view

Yields on selected African sovereign bonds



FPI for OMO bills returned to Nigeria in January

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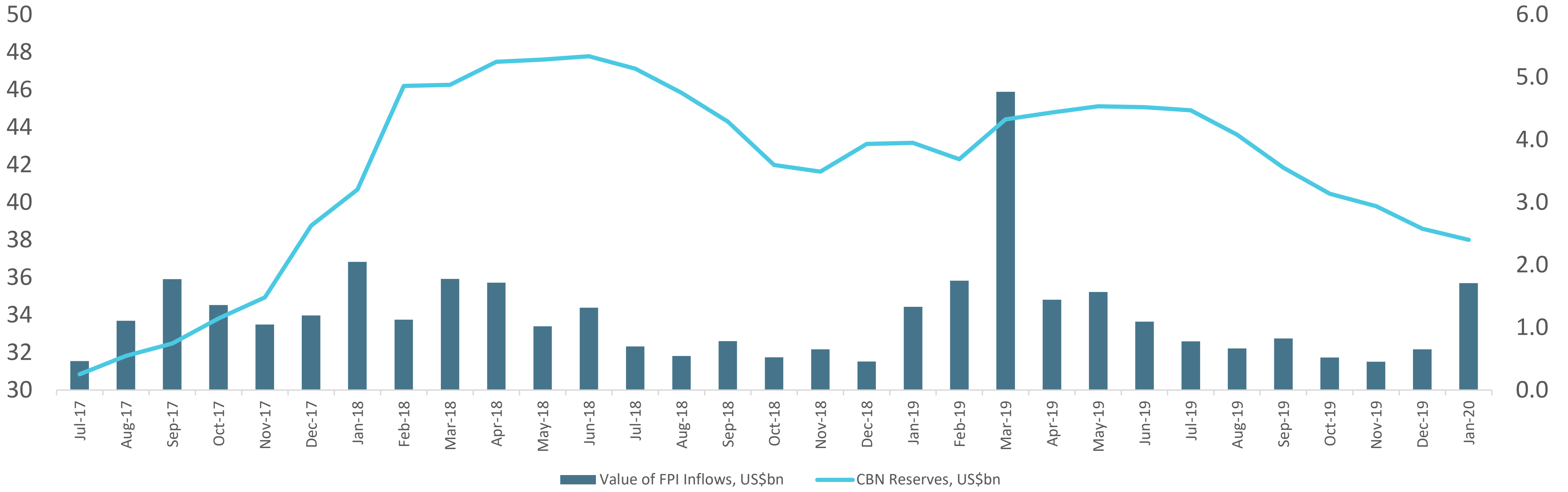
- In the OMO market the first key test of 2020 has been passed, namely US$1.71bn of Foreign Portfolio Investment entered via the NAFEX market in January, almost certainly destined for the OMO market
- A substantial part of the CBN's FX reserves can be attributed to the FPI, hence the need to maintain foreign interest in the OMO market in 2020
- The next test is February. Does FPI continue to enter the OMO market in spite of oil prices (Brent) at US$54.00/bbl and concerns over the global spread of the coronavirus?

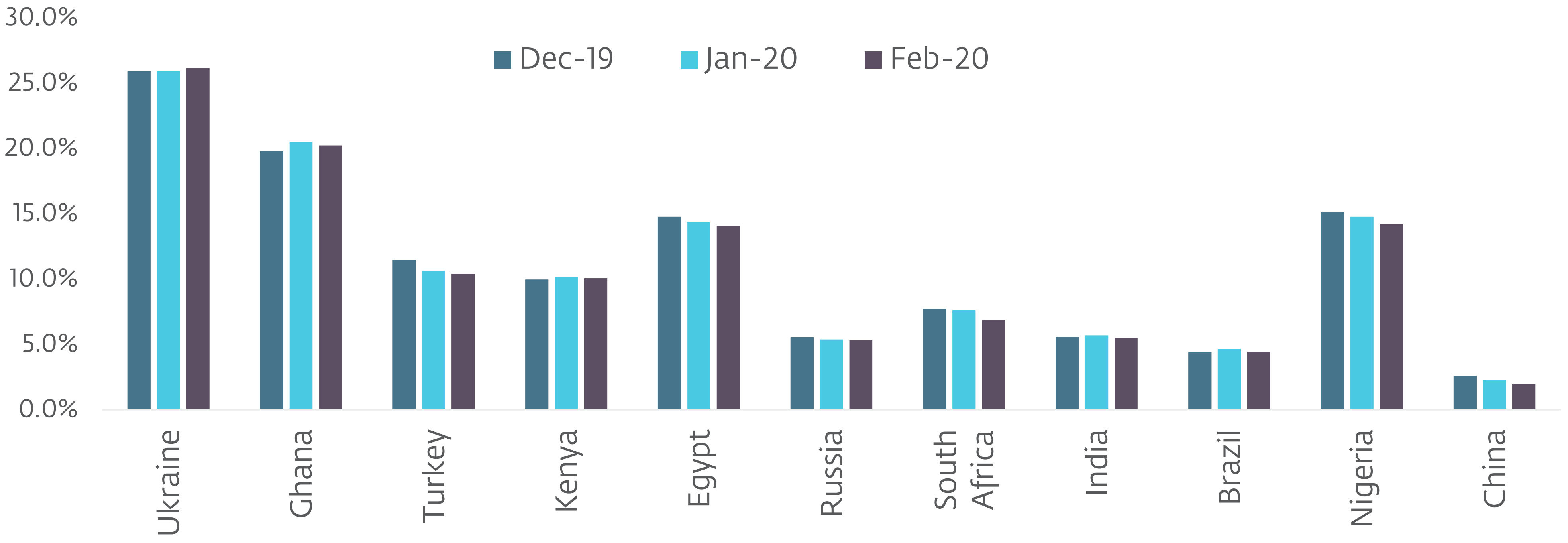
Gross inflows of FPI, US$bn (rhs) and CBN FX reserves, US$bn (lhs)



Key Emerging Market & Frontier Market risk-free rates

- Nigeria's OMO yields look comparable to risk-free yields of local currencies in other markets, notably Ghana and Egypt when it comes to competing for global local-currency capital flows
- Some investors look at the spread over inflation as an indication of currency security – though the Non-Deliverable Forward allays this fear to some extent (it hedges price, not liquidity)
- There is a cost to the CBN's policy of currency stabilization through lucrative carry trades for foreign portfolio investors – the costs mount up over time

International emerging and developing market local currency rates (one year)



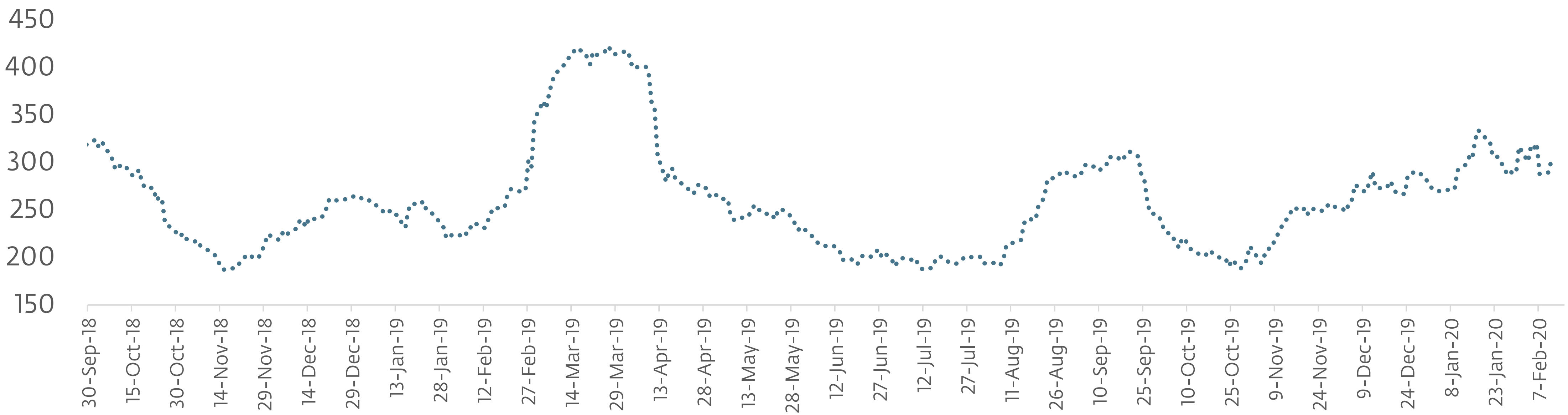
Foreign Exchange - conclusion

- Nigeria has a good chance of raising enough money to shore up its reserves in 2020. Sufficient to prevent a devaluation in 2020.

- Inflows from:
  - oil & gas
  - bilateral loans
  - eurobond issues
  - FPI for CBN OMO bills

- Outflows from:
  - foreign debt service – in the region of US$1.obn
  - roll-over in foreign-owned OMO bills with non-deliverable forwards
  - demand from the NAFEX market - Current Account deficit

Daily turnover in the NAFEX market, 30-day moving average, US$ millions

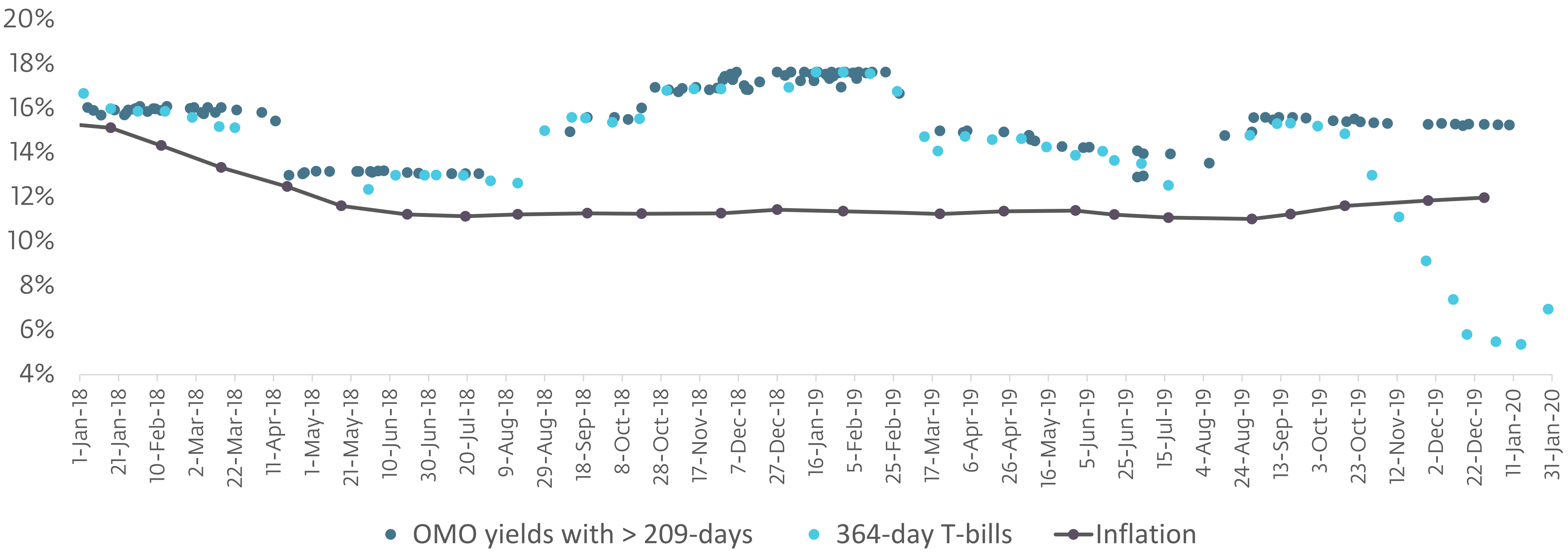


Naira interest rates

OMO interest rates at double – nearly treble – the rates on T-bills

- Since the de-coupling of the T-bill and OMO markets last October, T-bill yields continue to fall
- Foreign portfolio investors still receive OMO yields around 14%. T-bills sell at between 4.5% and 6.5%. Liquidity has been rotating out of the OMO market, via banks, into the T-bill market. Inflation remains at close to 12%

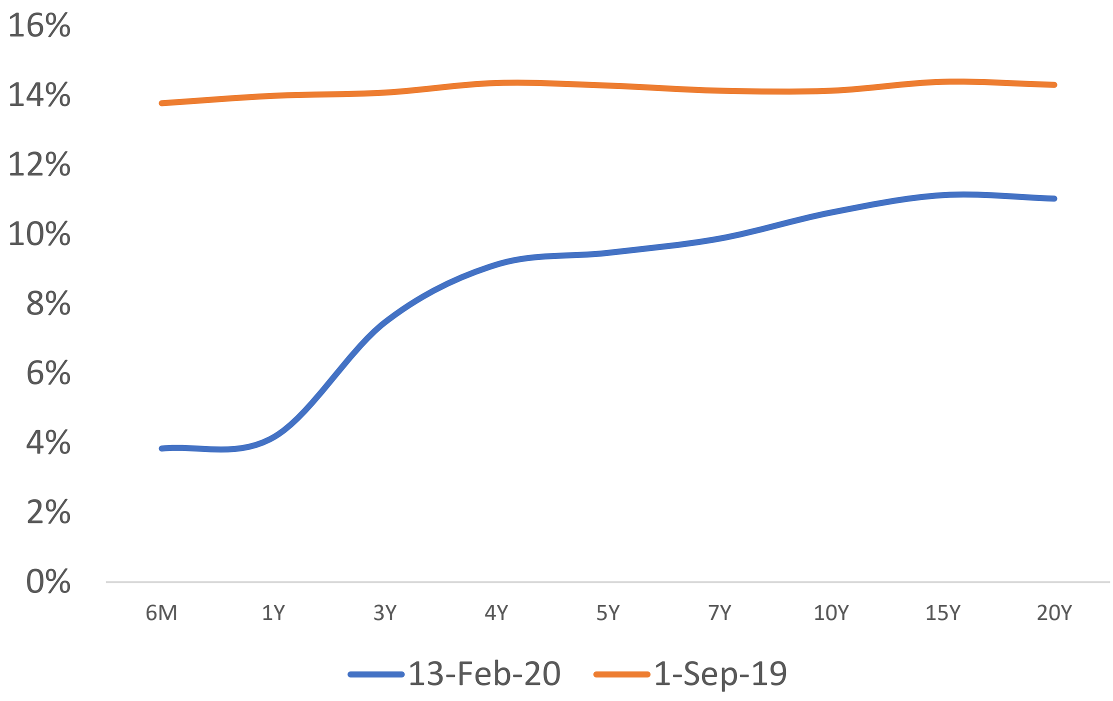
OMO primary market yields (dark blue does) and T-bill primary market yields (light blue dots), and inflation



For the first time in years, a Naira yield curve

- We are familiar with the flat, or gently upwardly-sloping but straight Naira yield curve. Now we have a yield curve that actually inflects
- The market does not think that low T-bill rates are here to stay. It is pricing in a steep rise in rates a year or two ahead. The question is, how do we get to that environment?

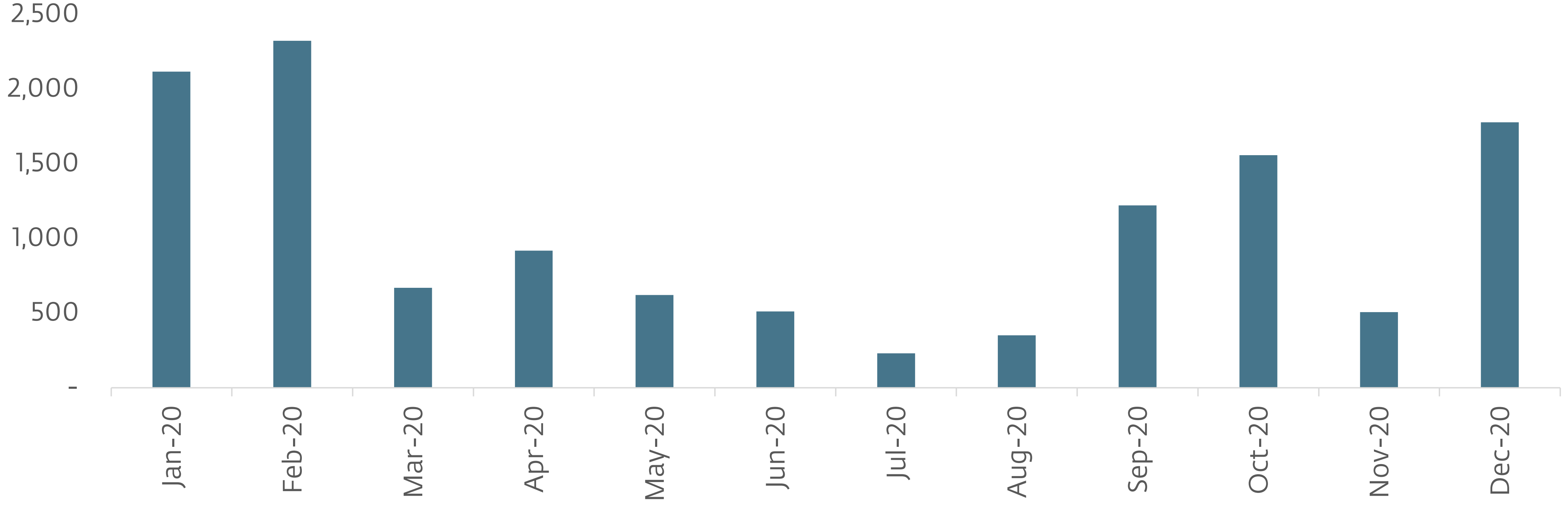
Yield Curve



OMO maturities imply increase in system liquidity

- The OMO market, at N6.0 trillion (US$16.5bn) in September 2019, was six times the size of the T-bill market. There are over N4.5 trillion in OMO bills to be redeemed in in the first quarter of 2020
- Clearly, pension fund, mutual fund and insurance companies have moved money from the OMO market into T-bills. Banks, as the conduit of this liquidity, have been very liquid with funds – until recently
- The Cash Reserve Requirement (CRR) of the banks was raised from 22.5% to 27.5% on 24 January

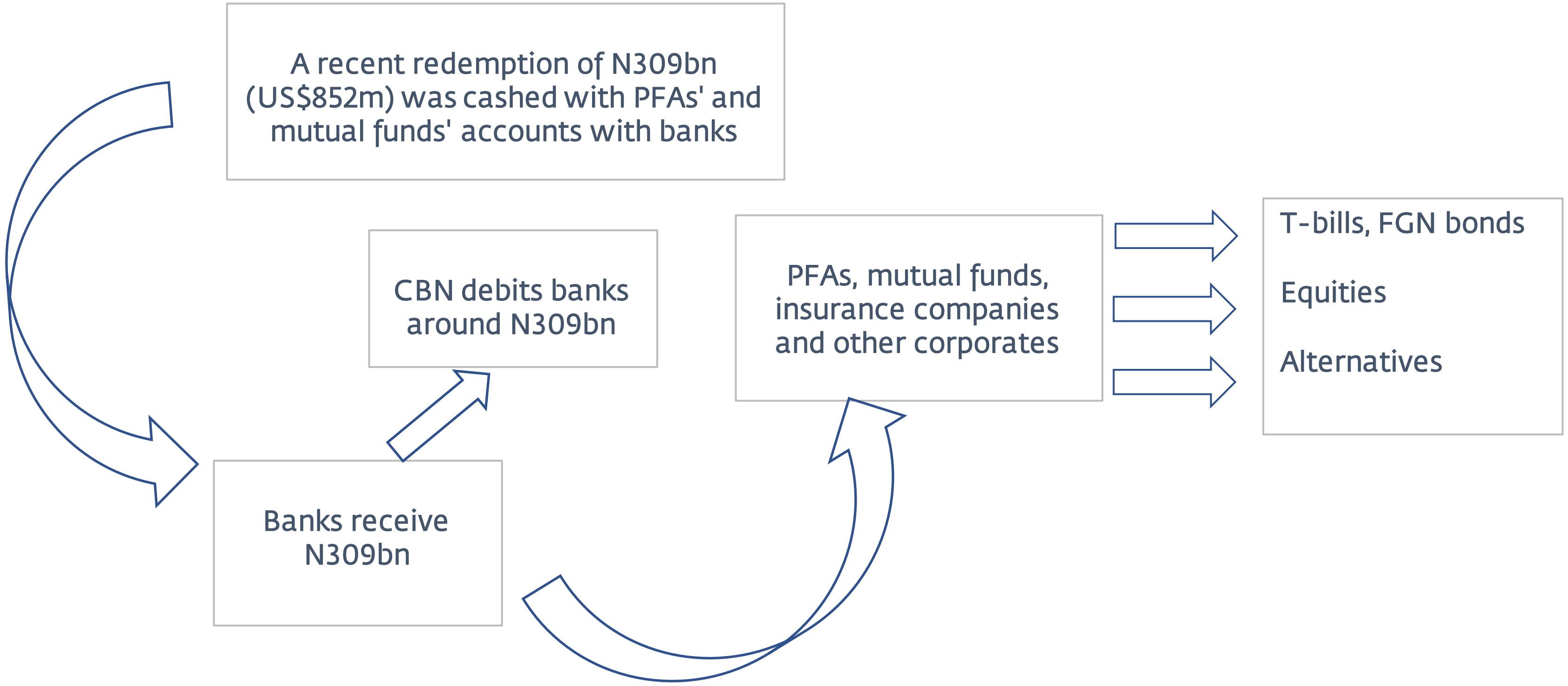
Monthly OMO redemptions in 2020, Naira billions



Sterilising liquidity in the banking system

- The CBN has pursued a policy of credit growth, requiring banks to lend 65.0% of customer deposits by 31 December 2019. The liquidity ratio remains at 30.0% and Cash Reserve Requirement is now 27.5%
- It appears that a recent N309.0bn OMO redemption was debited from banks by the CBN. Clearly the CBN is concerned about excess liquidity in the system, whether that drives down T-bill rates or bids for FX

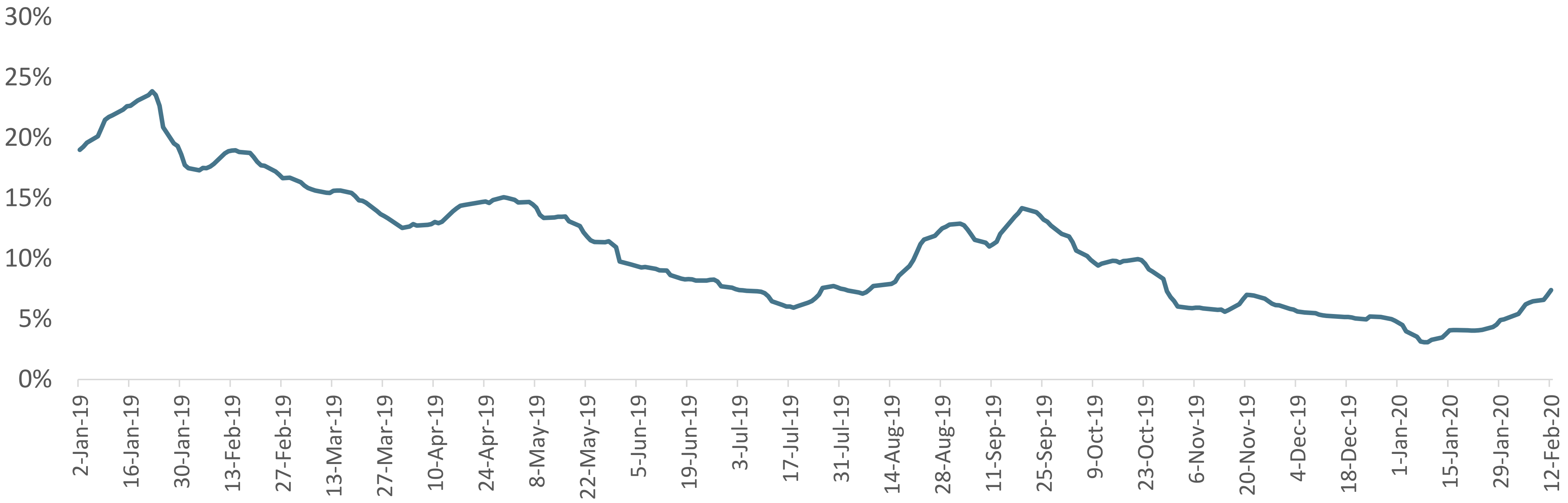
The destination of the N310bn OMO redemption during the week of 3 February 2020



Year-long easing in interbank rates is stabilising

- The CBN straddles several policy objectives when looking at commercial bank liquidity. The overall thrust of policy in H2 2019 was to stimulate loan growth
- This was followed in late October 2019 by the CBN acting to limit access to its OMO bills, banning pension funds, mutual fund and corporates from its auctions. Then in January 2020 the Cash Reserve Requirement of banks was raised 500bps to 27.5%
- A long period of declining interbank rates is coming to a halt, though bank liquidity is still good

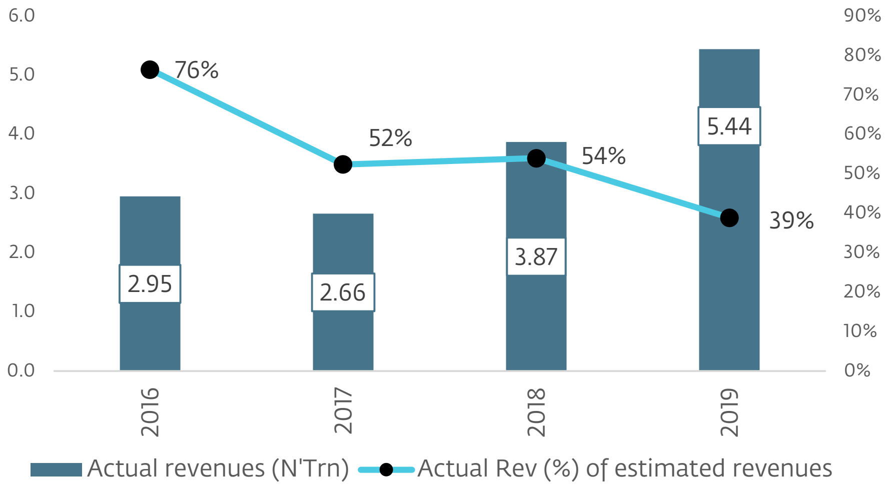
Nigeria interbank rate, 30-day Moving Average



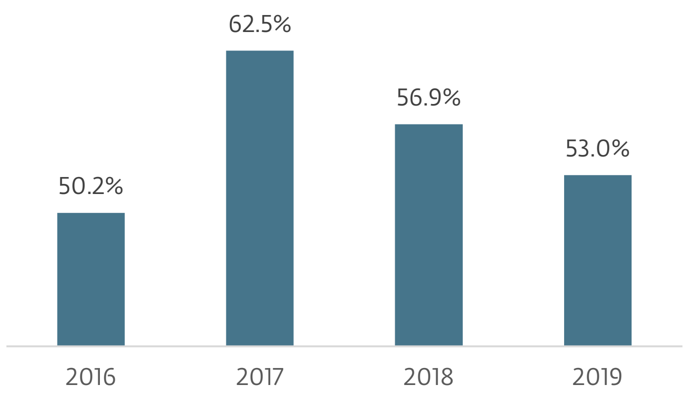
Government finances

Fiscal analysis

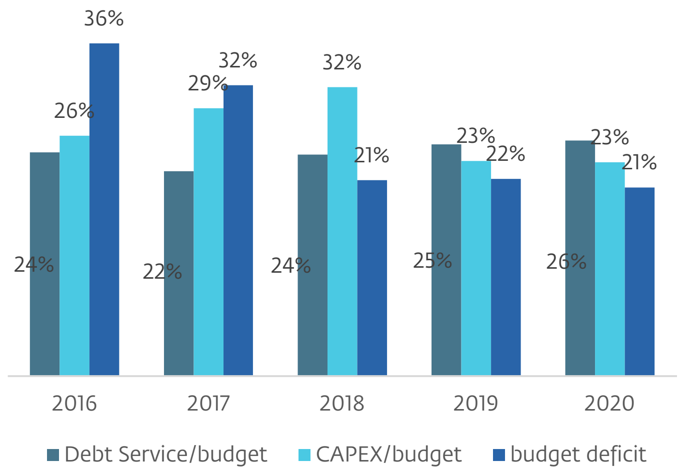
Actual FGN Revenue profile



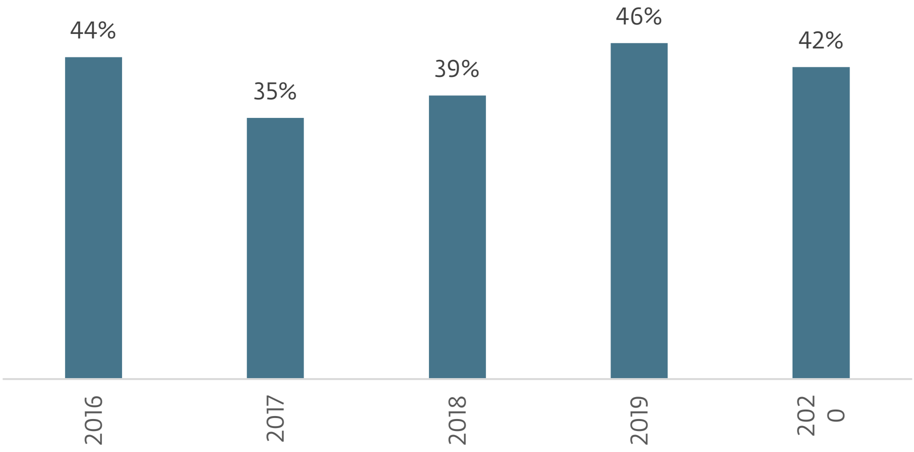
Debt Service (%) actual revenues



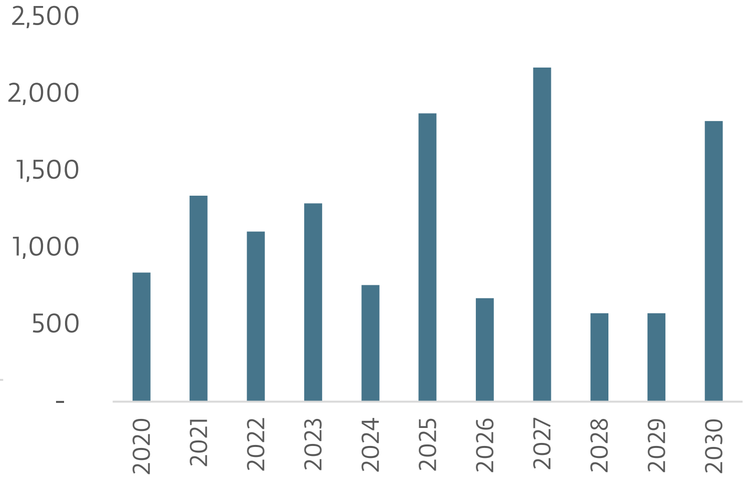
Expenditure heads and budget deficit



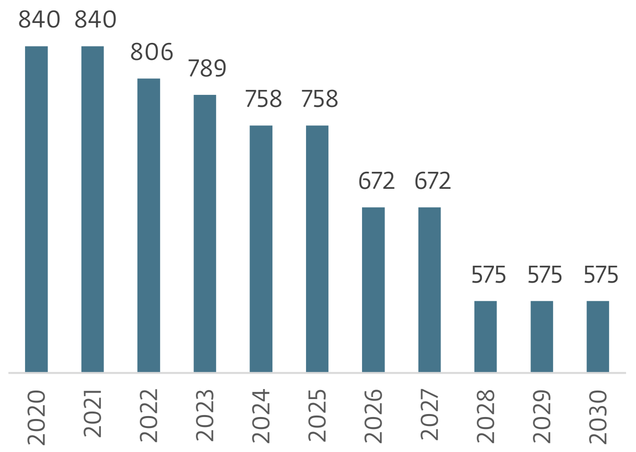
Recurrent Expenditure (%) of Budget estimates



Total sovereign debt obligation per year, US$m



Total sovereign debt interest obligation per year, US$m

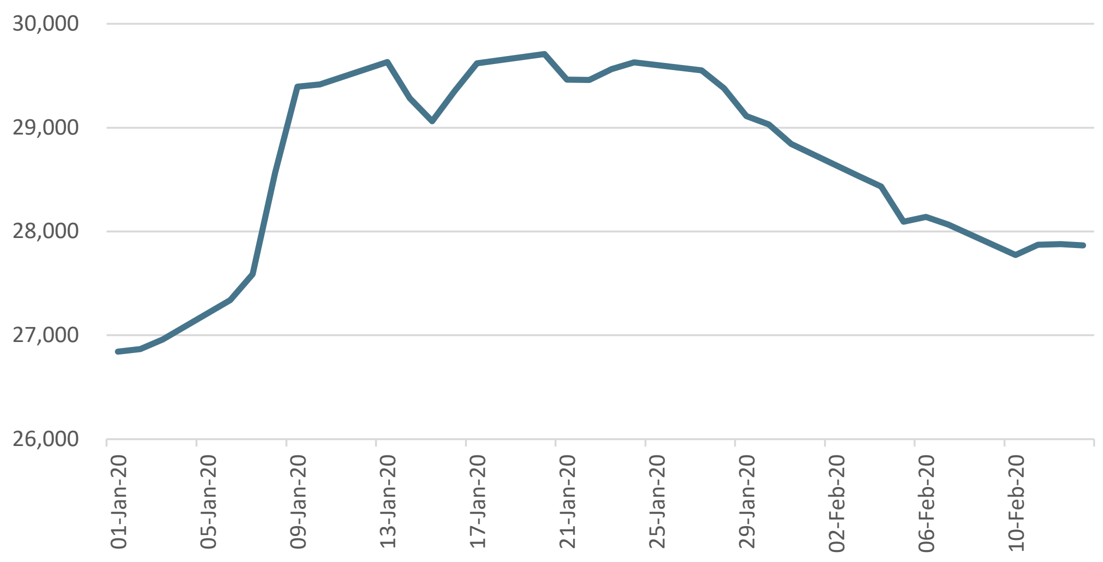


Equities

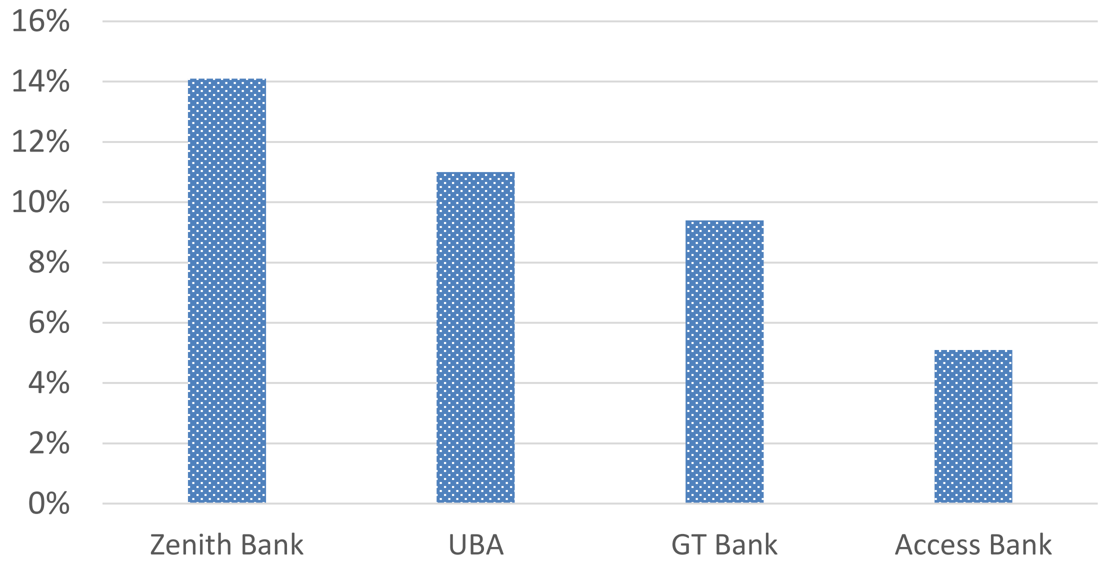
The equity market started off 2020 well

- At its best, in late January, the Nigerian Stock Exchange was the best performing in the world in 2020
- The correction in the market can be dated to a) the news of the coronavirus and, more specifically, b) the raising of the Cash Reserve Requirement from 22.5% to 27.5% on 24 January
- At the moment several bank stocks have gross dividend yields well in excess of the T-bill yield, and comparable if not higher than FGN bond yields

Nigerian Stock Exchange All-Share Index, 2020



Estimated Gross Dividend Yields of selected bank stocks



Historic dividend yields of bank stocks vs T-bill rates

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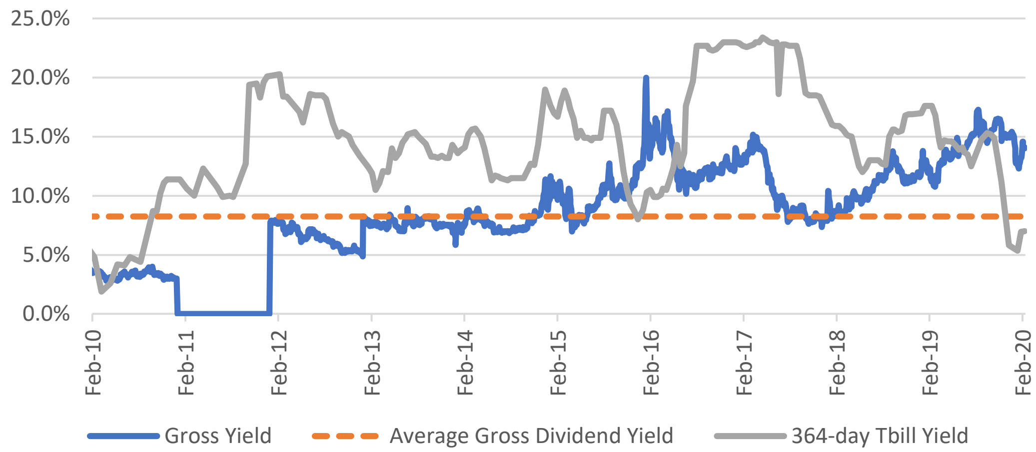
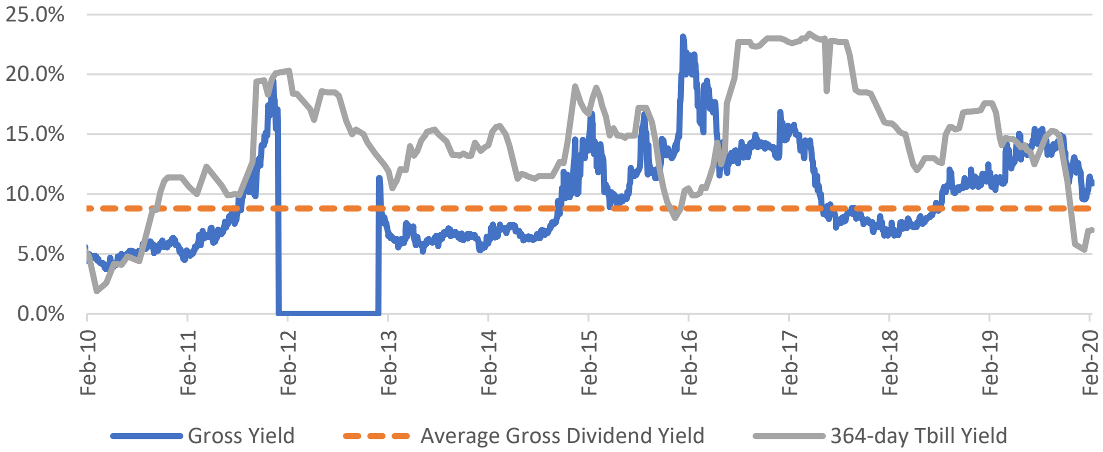
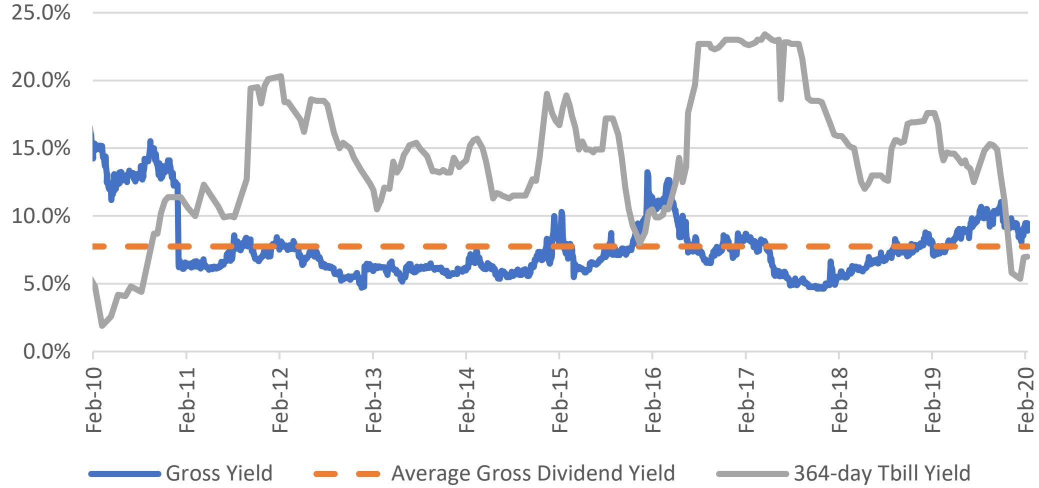
Zenith Bank



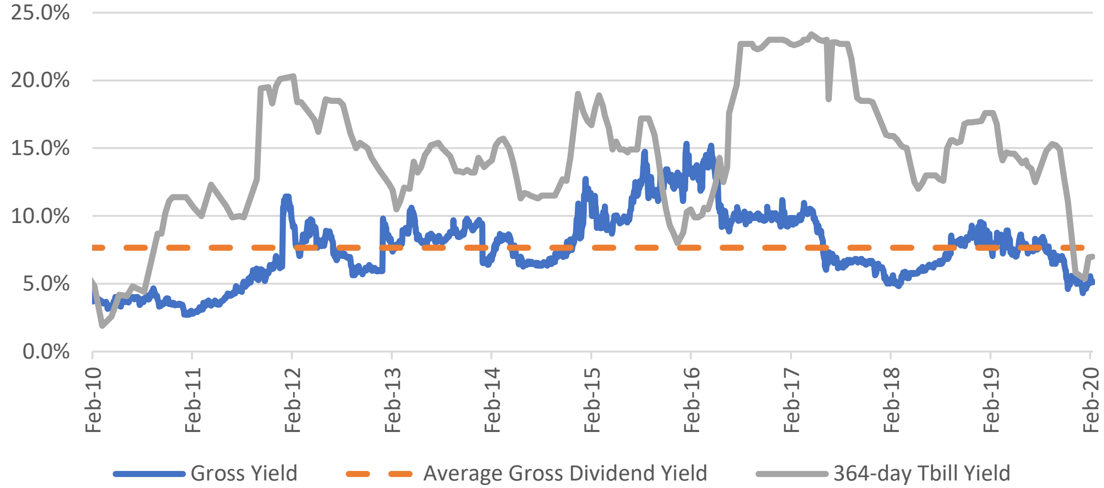
UBA



GT Bank



Access Bank



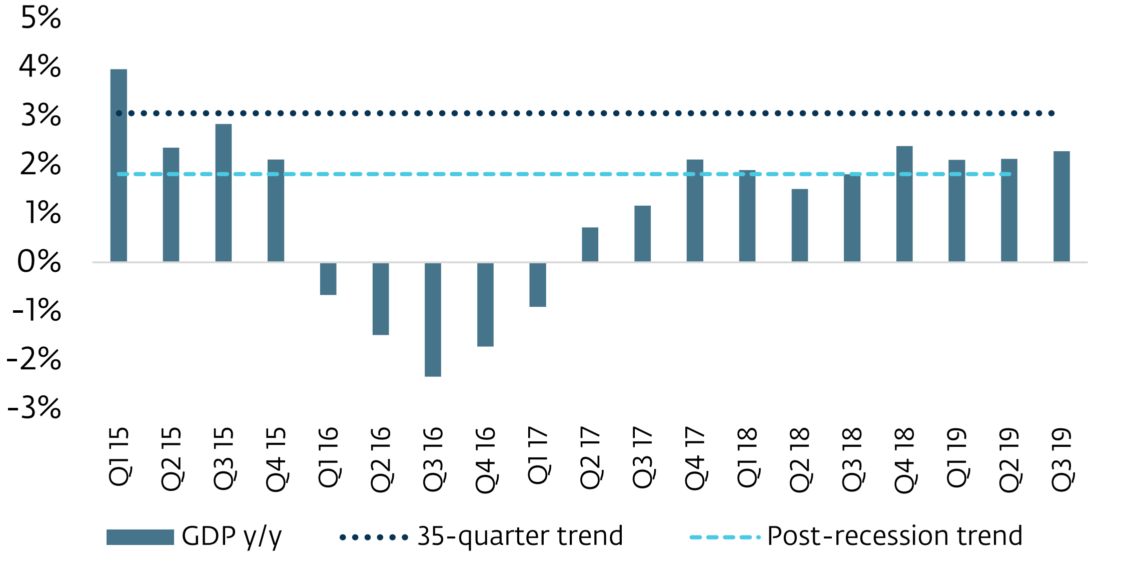
Thank you

GDP growth

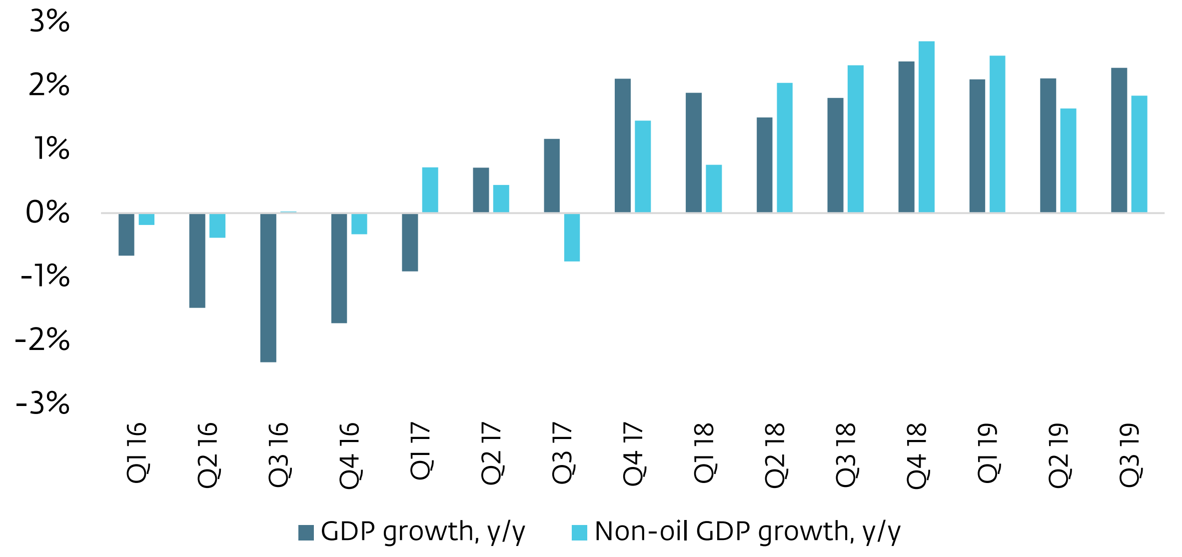
Q3 data suggests that Q4 economic growth is picking up - slightly

- The outlook for the Nigerian economy is a little brighter than when we last reported back in November
- Q3 2019 GDP rose by 2.28% y/y (Q2: +2.12%y/y) with non-oil GDP rising by 1.85% y/y (Q2: +1.64% y/y). In other words, the decline in the non-oil growth rate was reversed in Q3 and there are reasons to think this will continue
- Agriculture and Telecoms are the main growth drivers. When Q4 2019 data is published we may see positive effects on Agriculture from the closure of land borders towards the end of Q3 2019. We may see the growth rate pick up – the IMF, for example, sees 2.50% growth in 2020
- However, there are risks to this outlook if the CBN's policies change radically – see section on interest rates

GDP in real prices, year-on-year change



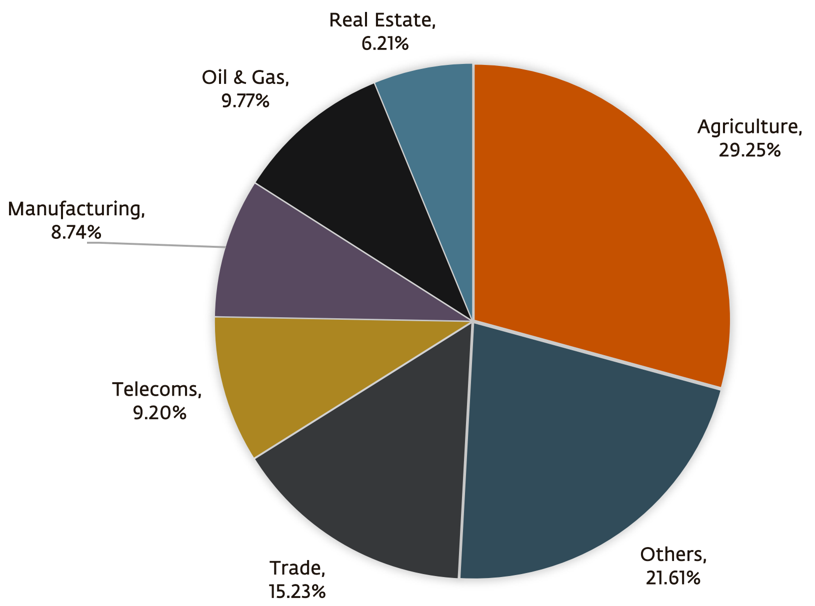
Headline GDP and Non-oil GDP in real prices, year-on-year change

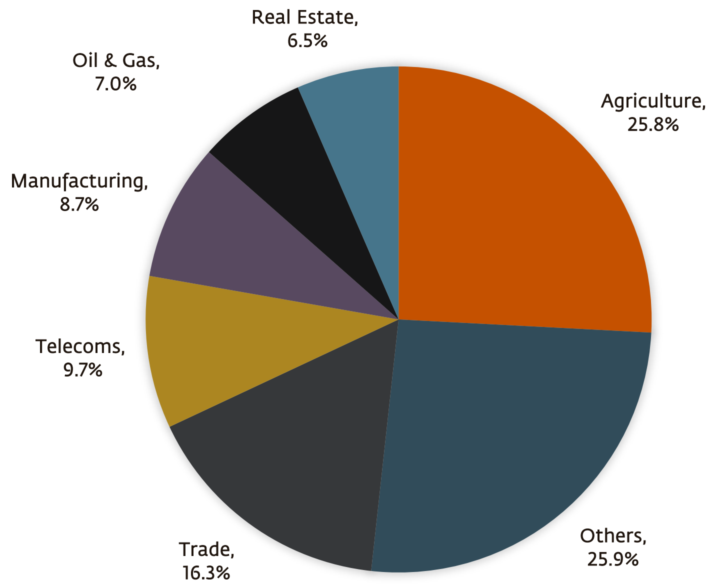


Composition of GDP remains weighted to Agric and Trade

- Agriculture is generally 25% of GDP though during the harvest seasons (Q3) this rises to almost 30%
- Trade is around 16% of GDP while Telecoms, Manufacturing and Oil & Gas account for roughly 9% each
- Together the top six sectors account for just over 75% of GDP

Sector contributions to GDP in Q3 2019 (left) and in FY 2018 (right)

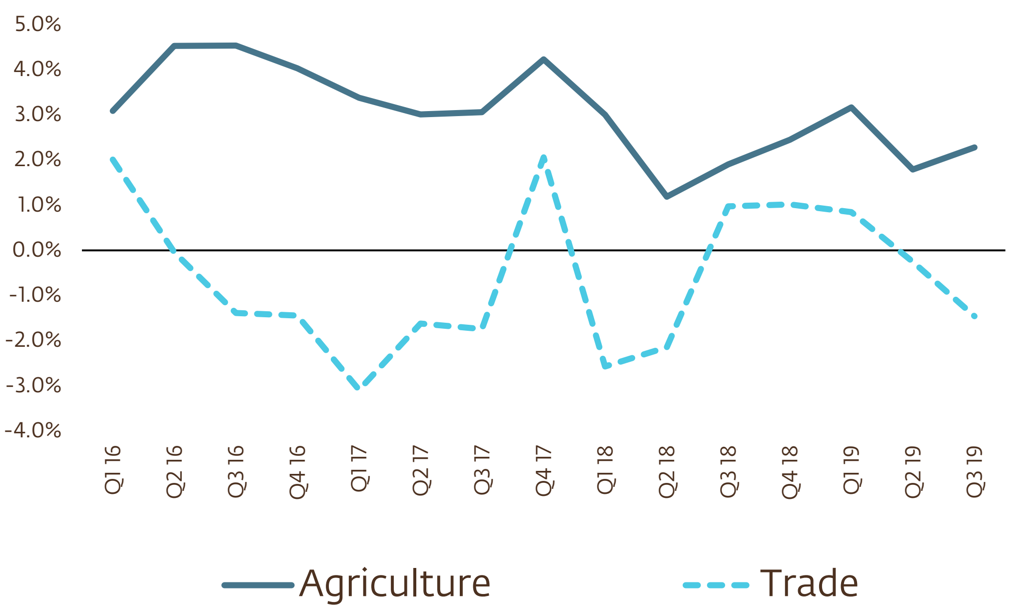




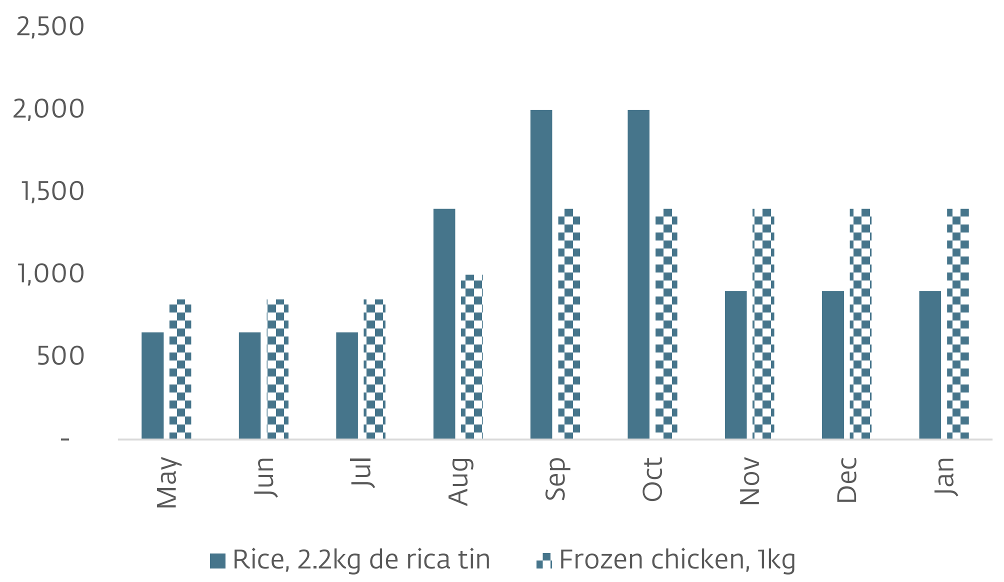
Closure of land borders has unequal effects on big sectors

- Q3 2019 Agriculture (29.25% of GDP) grew by 2.28% y/y. In the aftermath of the closure of land borders in August market prices of key foodstuffs rose. Rice is up 38% and chicken is up 65% since mid-year
- This may well stimulate domestic Agricultural production (though Q4 and Q1 are the wrong times of the year to stimulate un-irrigated rice production). Elevated Agricultural prices + border closures will likely help
- Q3 2019 Trade (15.23% of GDP) contracted by 1.45% y/y, and we expect this slowdown to continue into Q4 19 and Q1 20. However, implementation of loan-to-deposit ratio targets may bring a measure of stimulus

Nigeria Q3 2019 GDP, y/y growth in key sectors



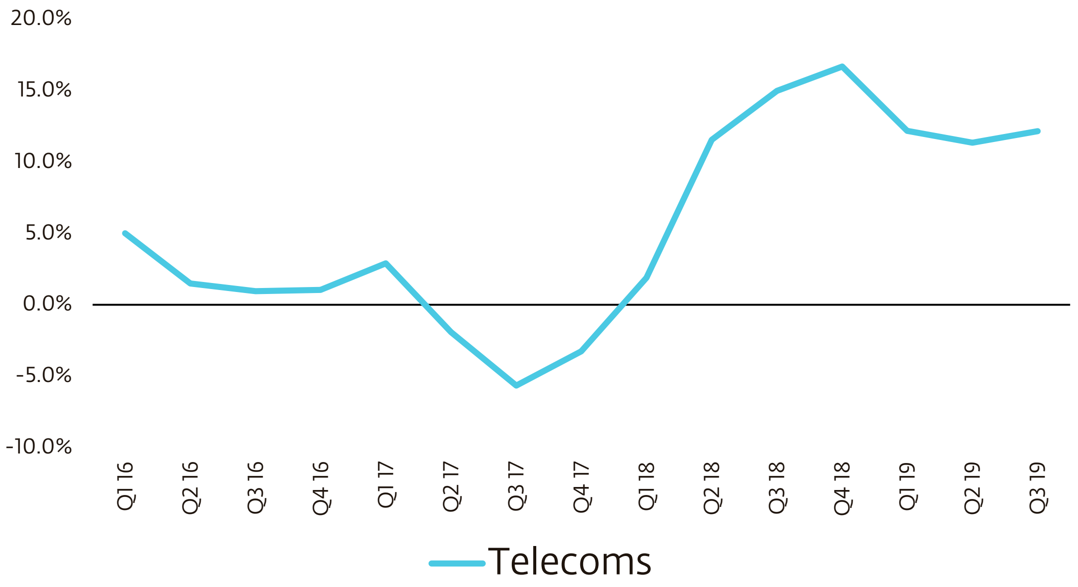
Prices of selected foodstuffs in Naira

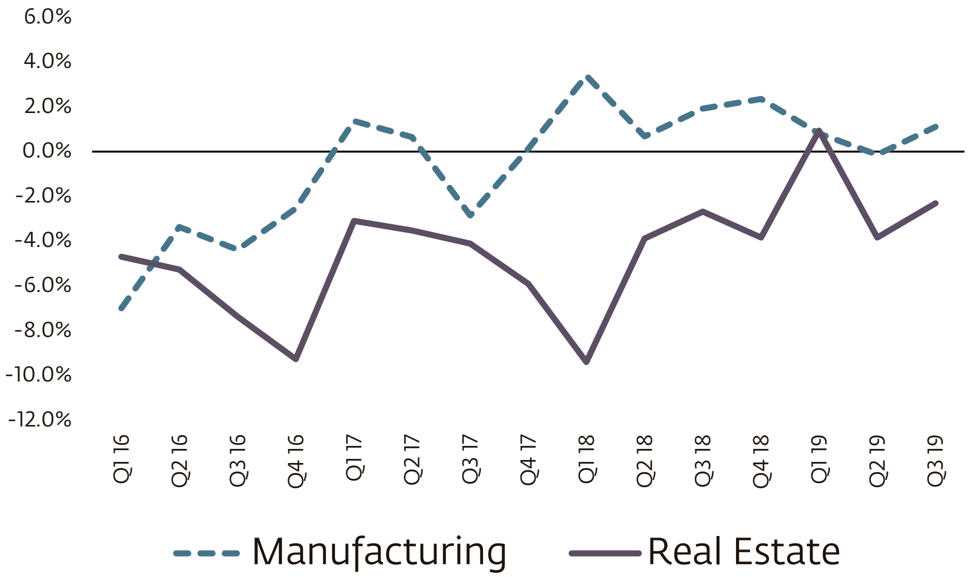


Telecom provides strong growth, Manufacturing has weak growth

- Q3 Telecoms (9.2% of GDP) grew by 12.16% y/y – on its own it provides 1.1 percentage points of growth for the economy as a whole. This is secular shift in activity (e.g. more online and mobile banking, more video on demand) and we think it will continue into Q4 and Q1
- Manufacturing (8.74% of GDP) grew by 1.10% y/y, a possible indication that easy credit is a stimulant, in which case we would expect continued growth in Q4 19 and Q1 20.
- Real Estate (6.21% of GDP) fell by 2.31% y/y in Q3 though construction itself grew in Q3 (2.37% y/y)

Nigeria Q3 2019 GDP, y/y growth in key sectors

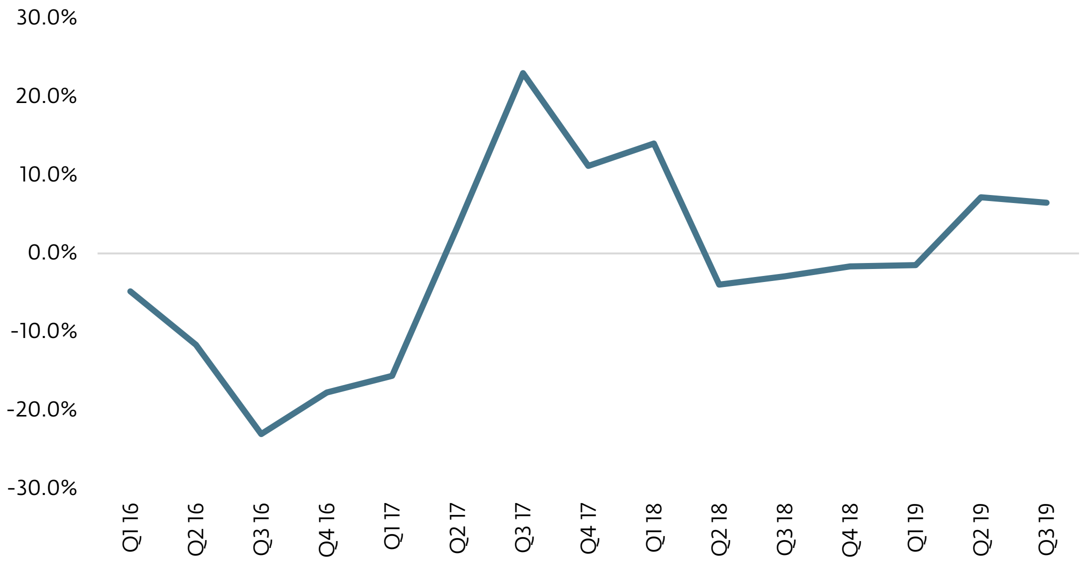




Oil & Gas

- Oil & Gas (9.77% of GDP) grew by 6.49% y/y in Q3 helped by steadily rising production levels (Q3 oil & gas production was up 2.15 y/y and 9.3% y/y)
- Oil prices averaged US$64/bbl in 2019 (and US$72/bbl in 2018). The forward curve has slumped by US$10.00/bbl in a month (to February) to US$54.00/bbl by mid-2020. This is likely coronavirus-related volatility and actual prices may rebound in a few months.
- On the other hand, strict compliance with OPEC quotas could mean a slight cut in Nigerian output during 2020. Note that Oil & Gas GDP is an inherently volatile data series – expect at least some reversals in 2020

Oil GDP growth, y/y

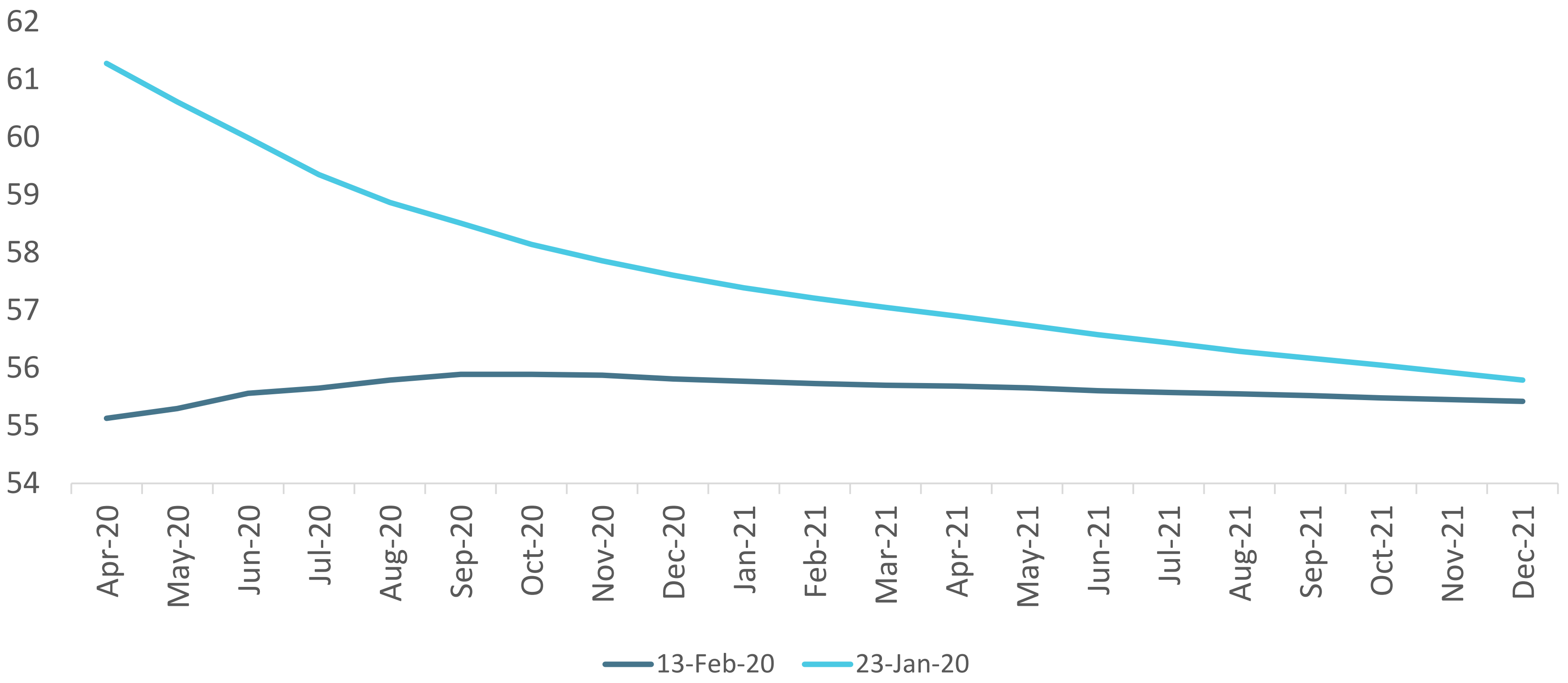


Oil

Oil futures

- The spot price of Brent has fallen by US$10.00/bbl in a month due to concerns over the coronavirus. Brent now trades around US$54.00/bbl. (Forcados usually trades between US$1.0-1.5/bbl above Brent.)
- Recently the forward curve in Brent futures has taken a slightly upward slope, suggesting a degree of support for Brent prices (i.e. off-takers paying a US$1.00/bbl premium for a six-month future)

Brent futures curve, US$/bbl



Thank you