



# Nigeria Weekly Update

## Inflation and interest rates

**Inflation continues to rise, with February inflation reported at 17.33% year-on-year after 16.47% y/y in January, and food inflation at 21.79% y/y. Policy makers believe that structural issues are the core problem, but we sense that they include market interest rates in the mix when it comes to considering all the drivers of inflation. This could mean that the current upward trend in market interest rates will be tolerated – to an extent. We are looking for 10.00% per annum 1-year T-bill rates by mid-year. See page 2 for details.**

### FX

Last week the exchange rate in the Investors and Exporters Window (I&E Window) appreciated by 0.24% to N410.00/US\$1. In the parallel, or street market the Naira weakened by 1.04% to close last week at N485.00/US\$1. There are arguments that the current level of Central Bank of Nigeria (CBN) foreign exchange reserves, at a gross US\$34.6bn, is no cause for alarm. The CBN is likely to build up buffers through inflows of oil receipts, now that Brent crude trades over US\$65.00/bbl again. And the Federal Government of Nigeria (FGN) may well return to the Eurobond market, now that domestic borrowing costs are again higher than external borrowing costs (at least in terms of coupon rates).

We believe that the CBN will be able to maintain its FX reserve position at close to the current level, though we doubt that it will be able to combine this goal with supplying US dollars to the FX markets in the same volumes which we saw prior to March 2020. Therefore, we think that there will be sustained pressure on the Naira in the foreign exchange markets. The CBN is also trying to harness foreign remittance flows from the Nigerian diaspora, and we note that the Naira for Dollar scheme has only just commenced. It will likely be several months before we learn the results of this initiative.

### Bonds & T-bills

Last week, the secondary market yield for an FGN Naira bond with 10 years to maturity declined by 6bps to 10.34% while the 7-year bond remained unchanged at 10.10% and the 3-year bond yield decreased by 54bps to 7.38%. The annualized yield on a 349-day T-bill increased by 216bps to 4.16% in the secondary market while the yield on a 354-day OMO bill fell by 95bps to 8.77%. Investors seeking yield focused on the CBN's Primary Market Auction that were held on Wednesday with a 1-year stop-rate of 6.50% (see page 2).

This week, we expect a pick-up in activity in the secondary market as T-bill and OMO maturities hit the system and money starts to look for a home again. It is possible that investors may react to recently-improved T-bill yields.

### Oil

The price of Brent crude fell by 0.20% last week, closing at US\$69.22/bbl, a 33.63% increase year-to-date. The average price to year-to-date is US\$60.42/bbl, 39.81% higher than the average of US\$43.22/bbl in 2020. There were many factors at work last week, one of them being the news that Iran has increased its exports of crude and is allowing discounts of between US\$3.00/bbl and US\$5.00/bbl for willing customers. Reuters reported that Saudi Arabia's voluntary output cut was 600,000 barrels per day month-on-month, rather than the 1.0mbpd earlier indicated. At the same time, the Organization of the Petroleum Exporting Countries (OPEC) downgraded its global demand forecast for the next two quarters with expected second quarter demand down by 690,000bpd.

The fact that oil prices have not weakened much, despite these three negative news items, is likely significant. We think that oil prices are likely to hold up at close to these levels for several weeks. However, if high prices encourage further output from the US shale industry, then we would expect price gains to be capped over the coming months.

### Equities

The Nigerian Stock Exchange All-Share Index (NSE-ASI) fell by 1.74% last week with a loss of 4.03% year-to-date. Oando (+11.32%), Flour Mills of Nigeria (+10.00%), and Ardova Oil (+10.00%) closed positive last week, while Zenith Bank (-15.61%), UBA (-10.06%) and MTN Nigeria (-7.06%) closed negative. The Equities market closed bearish last week with some sell-offs. We saw an appreciation in the insurance sector (with the insurance index gaining 2.84%, the highest performing sub-index in the week). Our view is that overall investor sentiment continues to be weak amid the improvements in bond yields. There is no Model Equity Portfolio page this week, but we will resume next week, in the meantime intending to further our sales of bank and industrial stocks to take the notional cash position from 25.0% to close to 30.0% of the portfolio.

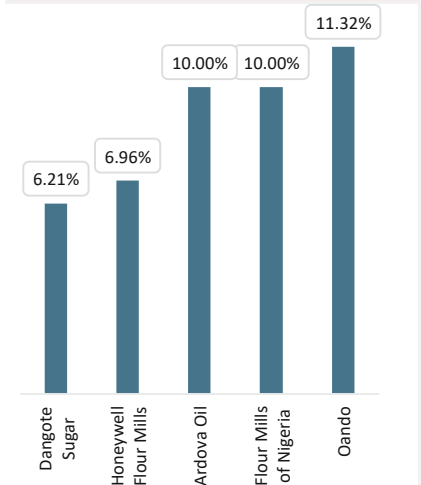
### ◆ Inflation and interest rates

#### Naira Sovereign Yields

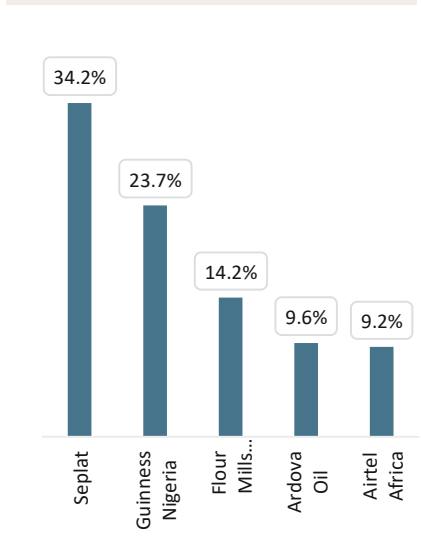
Spot	
354-day (OMO)	8.77%
349-day (T-bill)	4.16%
3 Year	7.38%
7 Year	10.10%
10 Year	10.34%
Inflation	17.33%

Quotes at 12 Mar 2021

#### WoW Performance of C-30



#### Best Performing in 2021, YTD



Source: NSE, FMDQ

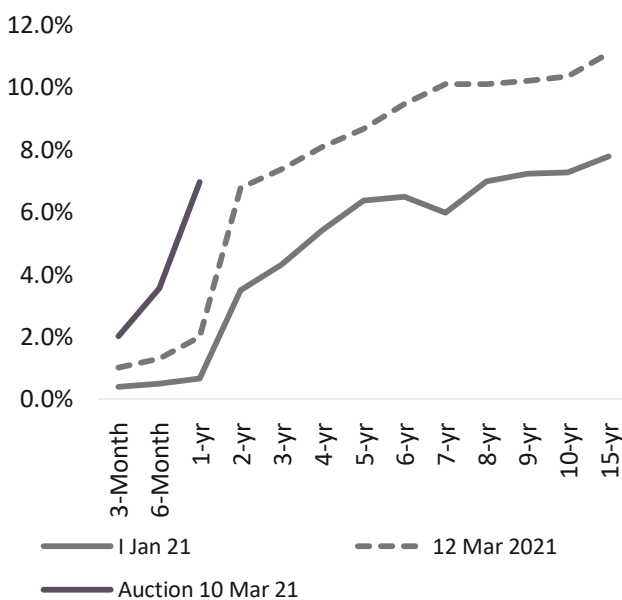


## Inflation and interest rates

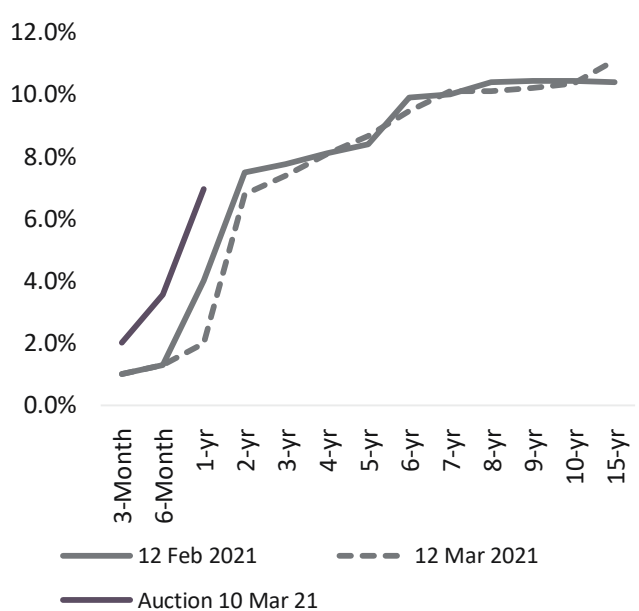
Where are interest rates headed? The National Bureau of Statistics (NBS) report for February puts inflation at 17.33% y/y, higher than the print for January at 16.47% y/y, with the critical component of food inflation running at 21.79% y/y. The upper end of the Central Bank of Nigeria's (CBN) target range for inflation is 9.00% y/y.

As the CBN argues, inflation is not just about interest rates: structural factors are the key determinant. Insecurity in agricultural supply lines is a critical issue. We believe the following are the main drivers of inflation: structural factors; foreign exchange rates; interest rates; credit growth; commodity prices. We think that CBN policy-makers include interest rates among the factors considered to influence inflation.

Nigeria Government T-bill and bond yield curve (1)



Nigeria Government T-bill and bond yield curve (2)



Source: Bloomberg, FMDQ, Coronation Research

After last year's remarkable decline in market interest rates (1-year T-bill rates fell from 5.40% in January 2020 to 0.15% in early December), rates have been rising this year. The rise in market interest rates since the beginning of January has been steep (see the chart on the left), with an average of 309 basis points added to the yields of Federal Government of Nigeria (FGN) bonds with durations of between two and 15 years.

However, over the past month (chart on the right), the yield curve in the secondary market for T-bills and FGN bonds has not changed much, the line waving like a flexed length of rope. Market participants relate that funds still have plenty of liquidity but nevertheless expect rates to continue going up. This is reflected in the results of the Primary Market Auctions (PMA) of T-bills. Last week the stop-rate for 1-year paper was 6.50% (a yield of 6.95% per annum): two weeks before that the stop rate had been 5.50%. The PMAs are considered more liquid and more representative of rates than secondary-market T-bills.

Is it desirable for market interest rates to trend higher? In terms of progress towards the rate of inflation, there is little argument. On the other hand, the CBN believes that the low interest rate regime of 2020 was important in alleviating the effects of recession (and indeed, 2020's recession was lighter than mid-year IMF and World Bank predictions). So, allowing market interest rates to rise now could put a brake on the recovery (the non-oil economy grew by 1.69% y/y in Q4 2020). For this reason, the CBN might tolerate rising rates, but only so far. Our view is that T-bill rates (in the PMAs) can get to 10.00% per annum by mid-year.

In the meantime, the setting of official rates by the Monetary Policy Council (MPC) of the CBN will continue to tread the delicate path between pro-growth policies and anti-inflationary policies. The current Monetary Policy Rate is 11.5% and the MPC is due to conclude its second meeting of 2020 this time next week. In view of inflation, a cut in the MPR seems unlikely. In the context of fragile growth, the MPC might retain the 11.5% MPR while allowing market interest rates to climb further. We only rate a small chance of the MPC raising the MPR.



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Flour Mills of Nigeria	G
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	Date	Recommendation	Date	Recommendation	Date	Recommendation	Current price, Naira/s	Target price, Naira/s
Zenith	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	21.80	27.50
GT Bank	02-Jan-19	Hold	08-May-19	Hold	08-Jan-20	Buy	31.25	37.50
Access	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	10.30	11.25
FBNH	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	6.50	12.50
UBA	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	8.85	11.50
Stanbic IBTC	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Buy	42.50	61.35
Fidelity	02-Jan-19	Buy	08-May-19	Buy	08-Jan-20	Hold	2.02	2.50
Sterling	02-Jan-19	Hold	08-May-19	Hold	08-Jan-20	Hold	2.00	1.90

	Date	Recommendation	Current Price, Naira/s	Target price, Naira/s
Nestle Nig.	17-May-19	Hold	1,300	1,213.89
Flour Mills of Nig.	17-May-19	Hold	13.50	18.29
Unilever Nig.	17-May-19	Hold	29.45	28.39
PZ Cussons Nig.	17-May-19	Hold	5.90	8.22

Coronation Research Investment Rating Distribution	
Buy	66.7%
Sell	0%
Hold	33.3%
Under Review	0%

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