

NIGERIA H2 2019 OUTLOOK

...a treasure
in the
mire?

JULY 2019

CONGRATULATIONS



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and members of our
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We did it!

Executive Summary

Global and SSA Overview: Protectionism or free trade?

Developments in the global economy remained bumpy in H1-19 with trade, monetary policy, and geopolitics being the key drivers. Trade spat between the US and China continued throughout the period as tariff threats and renegotiations went beyond China, to include the EU, Mexico, and India. For context, the World Trade Organization (WTO) reported that global trade restrictions – tariffs, import bans, and new custom procedures – are near record levels. Alongside the Venezuelan crisis, the US sanctions on Iran drove oil prices above \$70/b, before trending back to \$65/b on the possibility of a fresh showdown in the Middle East, especially as it relates to the very important choke point – Strait of Hormuz. While the never-ending process of UK's exit from the EU saw to the resignation of the Prime Minister, Theresa May in Jun-19, the global economy would have to come to terms with the crystallization of the new BREXIT deadline as the UK makes efforts to replace Theresa May. Against this backdrop, monetary policy authorities in the global space are increasingly taking an accommodative stance. Piecing these factors together, the outlook for global growth is muted, and risks that could upset markets abound.

As trade tensions, sanctions and BREXIT continue to gain ground, Africa is on the verge of piecing together a milestone trade agreement, the Africa Continental Free Trade Area (AfCFTA). The agreement, which took effect on May 30, 2019, following its ratification by the minimum 22-member states, is aimed at boosting intra-regional trade. While the AfCFTA is identified as a factor to bolster economic activities within the region in the medium to long term, faltering growth momentum in the largest economies on the continent - Nigeria, South Africa, and Angola – is expected to continue to subdue growth in the near term. On the other hand, Ethiopia, Ghana, Ivory Coast, and Kenya will remain the key growth markets in the region.

Nigeria: There and back again

Following his victory at the polls in Feb-19, President Buhari surprisingly re-appointed the CBN governor for another 5-year term, the first time a CBN governor would be re-appointed since 1999. In their 2nd term, both the President and the CBN governor must battle structural and policy challenges which have kept output growth at a sub-optimal level. To drive high single or double-digit GDP growth and check double-digit inflation rate, economic policies must address poor revenue mobilization, rising debt profile, petrol price subsidy, low foreign direct investment, booming population, high unemployment rate, power sector crisis, port congestion, corruption, and insecurity. In H2-19, we are of the view that Nigeria's short-term growth outlook will be driven by policy uncertainties, the sustenance of the current macroeconomic framework and the implementation of structural reforms, or otherwise. Overall, we expect economic activities to be slightly better than H1-19. Accordingly, we revise our expectation for FY-19 GDP growth from 2.1%/y to 2.2%/y.

We estimate headline inflation to be sticky between 11.0% and 11.5%, averaging 11.4% for the rest of the year. While the argument for a currency adjustment continues to gain momentum, we doubt the possibility of a devaluation before the end of the year. On interest rates, we see the potential for a further policy rate cut in H2-19.

Naira Assets: Will markets revert to fundamentals in H2-19?

While the stock market stayed bearish in H1-19, primary market activities, as well as corporate actions, supported returns for the period. Notably, MTN's massive listing, ACCESS Merger with DIAMOND, the proposed acquisition of Dangote Flour and the divestments in FO and WAPCO were some of the major events that shaped performance. Broadly speaking, secondary market sentiment remained bearish as FPIs continue to snub equities for fixed income securities. Driven by outsized demand by local and foreign investors, average yields on bills and bonds fell 215bps in H1-19. However, a more accommodative stance by the Apex Bank also resulted in the repricing of sovereign instruments. The above notwithstanding, demand for short-term bills outstripped other segments of the market. We note that weaker appetite for equities in H1-19 increased the spread between the market PE ratio which settled at 7.4x compared to its 5-year average of 13.1x. Again, the Nigerian market trades at a significant discount to the peer average of 11.1x, indicating that the market presents a huge opportunity for discerning investors. However, overall outlook for naira assets is skewed in favour of short-term bills, as sentiment for equities remain muted in the absence of a badly needed catalyst or clarity in the policy framework of the economy.

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Global Economy

Global Economy

Increasing drumbeats of a slowdown

At the start of the year, we highlighted three key events that the global economy and invariably markets, would have to come to terms with, namely: trade, monetary policy, and geopolitics. A rear-view glance at how these themes have metamorphosed shows a roller-coaster of twists and turns. On trade, optimism that earlier trailed the possibility of a successful resolution of the US-China trade talks has since dissipated on an escalation of tensions. On the other hand, monetary policy that was headed for a hiking spree, made a U-turn along the year as most central banks adopted a less aggressive stance in the face of recurring projections of a slowdown in global growth. Meanwhile, geopolitics did not fail to take the center stage. This ranges from the numerous BREXIT debates and votes that led to the exit of the UK's prime minister, to the outcomes of several elections that held during the year and more recently, fears of fresh war in the Middle East. Against this backdrop, markets were caught in a whirlwind of sentiments.

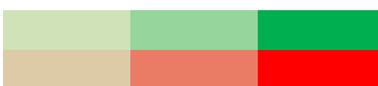
Trade, monetary policy and geopolitics continued to sway investors' sentiments in H1-19

Figure 1: Trend of Manufacturing PMIs across the globe

	Jan-19	Feb-19	Mar-19	Apr-19	May-19
Brazil	52.7	53.4	52.8	51.5	50.2
U.S.	54.9	53	52.4	52.6	50.5
France	51.2	51.5	49.7	50	50.6
Germany	49.7	47.6	44.1	44.4	44.3
Italy	47.8	47.7	47.4	49.1	49.7
Russia	50.9	50.1	52.8	51.8	49.8
U.K.	52.8	52.1	55.1	53.1	49.4
China	48.3	49.9	50.8	50.2	50.2
India	53.9	54.3	52.6	51.8	52.7
ASEAN	49.7	49.6	50.3	50.4	50.6
Emerging Markets	49.5	50.6	51	50.5	50.4
Eurozone	50.5	49.3	47.5	47.9	47.7
European Union	50.6	49.5	48.3	48.4	47.9
Global	50.8	50.6	50.5	50.4	49.8

Key

50 and above Expansionary region
 Below 50 Contractionary region



Source: Markit, Bloomberg, United Capital Research

Peering into potential outcomes for H2-19, there is a cause for caution as acceleration in global growth is muted, the bond market is flashing worrisome signs, and risks that could upset markets abound. Therefore, we acknowledge that these factors remain at the front burner of economic projections.

1) **Trade:** What started as a rancor between the two largest economies in the world has developed into multiple fronts. The US tariff threats and renegotiations have gone beyond China, to include the EU, Mexico and India. For context, the World Trade Organization (WTO) reported that global trade restrictions – tariffs, import bans and new custom procedures - are near record levels.

In the months ahead, chances of total resolution of trade disputes seem less likely, even if we get some agreement, the damage that the increased uncertainty has done on capital expenditure planning, corporate investment and trade growth, could leave lasting scars. Needless to say, the longer the tenure of trade tensions, the more precarious the recovery in global growth would be. Trade tensions will go through periods of escalation and easing, and a truce could be reached as the timing is more urgent for the US on fast approaching 2020 elections. However, in the longer term, issues more difficult than the ongoing trade dispute will come to fore. These include national security, technology transfer and, most importantly, the strive for global dominance which implies that these jitters are issues that would stay with us beyond 2019.

2) **Monetary policy:** In contrast to the start of the year, when fears that a hawkish global monetary policy was gaining ground, global monetary policy has metamorphosed into a somewhat dovish chorus. For the first time in years, speculations on the Federal Reserve's (the Fed) direction of monetary policy are about cutting rates rather than raising them. Meanwhile, the European Central Bank (ECB), with negative policy rates have guided on even more stimulus measures. Accordingly, while the change in tone of the central banks cannot offset the devastating impact of trade wars, it could provide support for economic growth and keep the major economies out of recession.

3) **Geopolitics:** In the months to end 2019, the global economy would have to come to terms with the crystallization of the new BREXIT deadline as the UK makes efforts to replace Theresa May. Outside of BREXIT, the US sanctions on Iran raises concerns on the possibility of a fresh showdown in the Middle East, especially as it relates to the very important choke point – Strait of Hormuz. Yet, in the light of the fast approaching US elections in 2020, the campaign against Iran is unlikely to trigger a major crisis this year.

United States

How long will Goldilocks stay?

In Q1-19, the US economy rose 3.1% y/y (vs 2.2% y/y in Q4-18). Inflation remained well anchored, settling at 1.8% in May-19, below the Fed's 2.0% target, and unemployment rate hinged at a near 50-year low of 3.6%. The economy, despite the government shutdown, enjoyed a near-goldilocks state. The question that comes to mind is how the economy would perform as we head into the second half of the year.

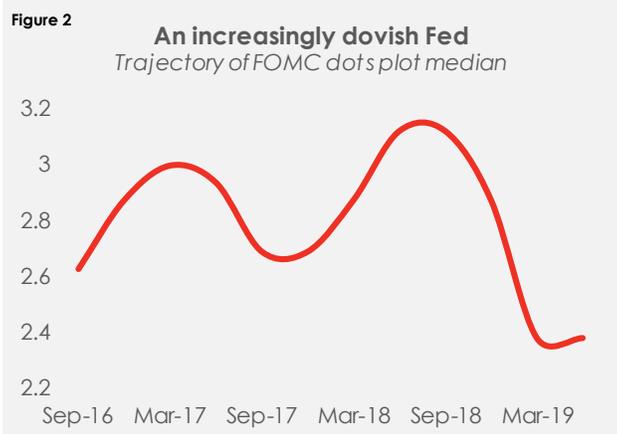
Increasing trade protectionism and disintegration will affect global growth trajectory

...global monetary policy has metamorphosed into a somewhat dovish chorus

Outside of BREXIT, the US sanctions on Iran amplifies geopolitical uncertainties

Already, the US economy is at a late cycle and the fading impact of fiscal stimulus would likely slow the economy relative to 2018. More so, leading indicators are flashing signs of worry. The PMI, both manufacturing and services, fell to a fresh multi-year low in Jun-19. The Manufacturing PMI fell to 50.1pts, its worst reading since Sep-09 while the services PMI fell to 50.7pts, its lowest since Mar-2019. Accordingly, the IMF downgraded its growth forecast to 2.3% in 2019 from 2.9% in 2018.

... leading indicators are flashing signs of worry



Source: Bloomberg, United Capital Research

Source: Bloomberg, United Capital Research

As for monetary policy, the Fed has pivoted from an excessively hawkish stance it adopted early in the year to an increasingly dovish tone. Commentaries from members of the Federal Open Market Committee (FOMC) suggests that the case for a more accommodative stance has strengthened in a bid to support economic growth momentum amid a spate of trade jitters. An observation of the latest Fed dot plot shows the possibility of at least one rate cut in H2-19. Overall, we expect between 25bps and 50bps cut in the Fed Funds rate by year-end.

United Kingdom

A race to the exit?

The UK economy grew 1.8% y/y in Q1-19 from 1.4% in Q4-18. As cheerful as this might have sounded in the face of geopolitical tensions, the fleeting nature of the rebound is seen in the dramatic growth of the manufacturing sector (from -0.5% to +1.6%).

Seemingly, this can be attributed to stockpiling ahead of the previous BREXIT deadline (March 31st). With BREXIT having metamorphosed into THREXIT (exit of Theresa May) and a new election, the outlook for the United Kingdom is hinged on the smoothness or otherwise of BREXIT in Oct-19. After Theresa May took a bow, the Conservative leadership race is sauntering into its final phase, clearing the way for a new prime minister to pick up the formidable challenge of delivering BREXIT. Jeremy Hunt and Boris Johnson emerged from the parliamentary votes and are heading into a run-off with results scheduled to be announced in late July. Both candidates have hinted on renegotiating BREXIT while the EU remains adamant on re-opening talks.

Whoever emerges as the new Prime Minister will have to deal with the Conservatives' lack of a parliamentary majority, an indecisive Parliament as well as an adamant EU. Come October 31st, the UK will have to decide between ratifying the exit treaty, opting for a no-deal Brexit, or canceling its departure. It is left to see how this will pan out after two extensions. The IMF and the Bank of England have revised lower their 2019 growth forecast for the UK's economy. The economic outlook will continue to depend significantly on the nature and timing of the exit. As for monetary policy, the combination of ongoing Brexit uncertainty and global trade tensions leaves the Bank of England in a tricky position. While we do not expect any change in policy from the Bank of England this year, a no-deal BREXIT could necessitate a rate cut.

European Economies

Near term moderation, will Draghi leave with a bang?

The Euro-area grew at an annualized 1.2% y/y in Q1-19 (vs 1.8% y/y in 2018), confirming the slowdown we had anticipated at the start of the year. This weakness was reflected in manufacturing PMI that breached the 50-points threshold in Feb-19 and has sustained a downward trend. Revision of auto emission standards weakened industrial production in Germany. Additionally, Italy's contraction in Q1-19 and political developments in France, all weighed on sentiments. In the medium term, the bloc stands the risk of Donald Trump extending his trade war to the European automotive sector. Also, a hard BREXIT remains one of the biggest and incalculable external risks for the Eurozone economy due to the strong economic relationships between the EU and the UK. Overall, the IMF expects 2019 growth in the bloc to settle at 1.3% (vs 1.8% in 2018).

In terms of monetary policy, at its latest meeting, the ECB left rates unchanged and signaled to maintain the status quo through H1-20. Yet, we have continued to see the ECB strike a more dovish chord with the floating of Target Long Term Refinancing Operations (TLTROs) and promise of even more stimulus as it aims to support economic growth. With Draghi's tenure as the president expiring in Oct-19 and the ECB's calendar indicating three monetary policy meetings before his tenure ends, Draghi could possibly deliver a rate cut on his way out. Additionally, Christine Lagarde, hinted to replace Mario Draghi, gives an even more dovish tilt to the outlook for ECB's monetary policy.

Emerging Markets

Caught in an external whirlwind

According to the IMF, global growth is also weighed down by emerging market and developing economies, where growth is expected to tick down to 4.4% in 2019 (from 4.5% in 2018). Overall, near-term prospects for emerging market and developing economies will continue to be shaped by increasing challenges in the external environment. This is marked by a slowdown in the advanced economies, trade tensions and a generally

The economic outlook for the UK will continue to depend significantly on the nature and timing of BREXIT

Eurozone's growth is expected to be supported by monetary policy easing

subdued outlook for commodity prices (including oil prices, which are projected to remain below their 2018 averages).

A glimpse at economies within the BRICS classification shows that the Brazilian economy continued its long recovery from the 2016 recession, growing 1.1% in FY-18. Yet, the economic prospect for the South-American nation is weakening, as growth in Q1-19 contracted to its lowest since early 2017. At the start of the year, optimism had trailed the swearing-in of the Jair Bolsonaro-led administration. However, the increase in confidence generated by the change in government and the hopes of adoption of major economic reforms have dwindled as slow implementation, structural rigidities and fiscal imbalances weigh on growth. The outlook is hinged on the delivery and implementation of reforms, especially in the fiscal space. Accordingly, Brazil's central bank slashed its 2019 economic growth forecast to 0.8% from 2.0% earlier predicted. With interest rates already at a record -low of 6.5%, barring further dramatic fall in economic activities to recession levels, we do not expect the monetary policy committee to make any change to interest rates.

As for Russia, growth in Q1-19 came in at a weak 0.5% y/y (vs 2.7% y/y in Q4-18), as a hike in the VAT rate and the OPEC+ agreement (which resulted in oil production cuts) weighed on domestic demand and exports. Hence, the IMF expects sluggish outcomes in 2019 at 1.6% (from 2.3% in 2018), weighed down by the modest outlook for oil production and prices as well as structural headwinds.

Meanwhile, India recorded 5.8%y/y growth in Q1-19, a 5-year low, due to a slowdown in investment and private consumption. Indeed, the first quarter of the current fiscal year was hampered by political uncertainty that trailed the conduct of its 2019 general election. In Q2-19, weaker growth experienced so far in the year may be worsened by trade spat with the US. Going forward, the re-election of Modi signals political stability and continued implementation of structural reforms. While the IMF expects the country to deliver a 7.3% growth in 2019, external factors remain a major source of concern for economic outcomes. Meanwhile, the Reserve Bank of India recently cut its policy rate for the second time in 2019, as it takes a more accommodative stance.

Finally, although China grew 6.4%y/y in Q1-19, largely supported by higher factory production, recent signs of a slowdown have started to emerge. Leading indicators point to weakness and long-term reforms could be put on hold to fire-fight and prevent a slowdown. For instance, the Caixin PMI fell into contraction level in Jun-19. Without the tariff war, China was on course for a gradual slowdown due to the shrinking working-age population, high debt level and reduced scope for additions to the capital stock. The reality of a prolonged tariff tit-tat puts further pressure on outcomes, as such, the IMF downgraded growth forecast to 6.3% (from 6.6% in 2018).

Brazil's growth is hinged on implementation of reforms, as Russia suffers from lower crude oil production

India continues to lead in terms of growth but threatened by fresh trade disputes

Further escalation and failure to resolve trade war with the U.S remains a primary concern for China

Oil Prices

Caught between two stools

Brent prices rose 21.2% YTD in H1-19, averaging \$66.2/b (vs \$71.7/b in 2018), supported by further reduction in supply by OPEC+ members in Jan-19. Beyond the production cut agreement, geopolitics played a significant role as a shortfall in supply due to sanctions on Iran and Venezuela also weighed.

Figure 4

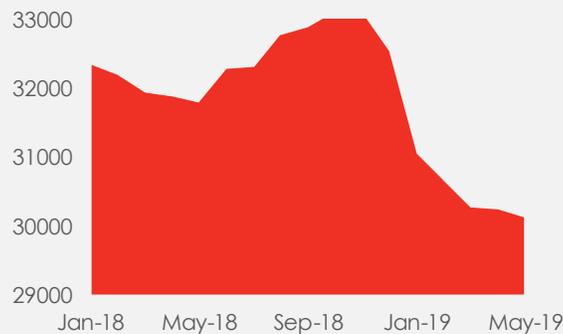
Rocky start to the year
Trajectory of Brent prices (\$'b)



Source: Bloomberg, United Capital Research

Figure 5

Brent crude: caught between two stools
Trajectory of OPEC production ('000 barrels)



Source: Bloomberg, EIG, United Capital Research

Heading into H2-19, factors that will influence the direction of oil prices remain the dynamics of demand and supply. In terms of demand, the expectation of a lackluster global growth raises dust on potential demand outcomes for the rest of the year. For context, in its latest Monthly Oil Market Report (MOMR), OPEC lowered its demand growth forecast for 2019 (by 70,000bpd to 1.14mbpd), citing trade tensions and geopolitics as threats to global output growth. While the medium-term off-take of the International Marine Organization's (IMO) rule for shippers to reduce the Sulphur content of their oil may mean more demand for crude oil derivatives, it would not necessarily be sufficient to offset an already weakening demand. As for supply, OPEC+ has extended its 1.2mbpd production cut agreement till Mar-20. This along with sanctions on Iran and Venezuela puts a cap on OPEC+'s supply growth. However, growth in non-OPEC supply remains a concern as the cartel and its allies continue to strive to balance the market. The IEA estimates that non-OPEC supply will grow to 2.3mbpd (from 1.9mbpd) in 2020.

Yet, in the medium to long term, the cartel faces the problem of weakening demand and relentless supply growth from non-OPEC countries. Additionally, geopolitics, especially with regards to the tension between the US and Iran also raises fear of supply disruption.

Overall, we retain our outlook for Brent crude to oscillate between the band of \$60-\$70/b as OPEC+ cuts and geopolitics create a support level for prices while weakening demand and non-OPEC supply growth put a lid on a potential rally. Downside risk factors would be a spiral in non-OPEC supply to the extent that it creates an oversupply and negates the balance OPEC+ is striving to achieve. An escalation of the US-China trade war and its knock-on effect on global growth outcomes and demand are also risk factors to watch.

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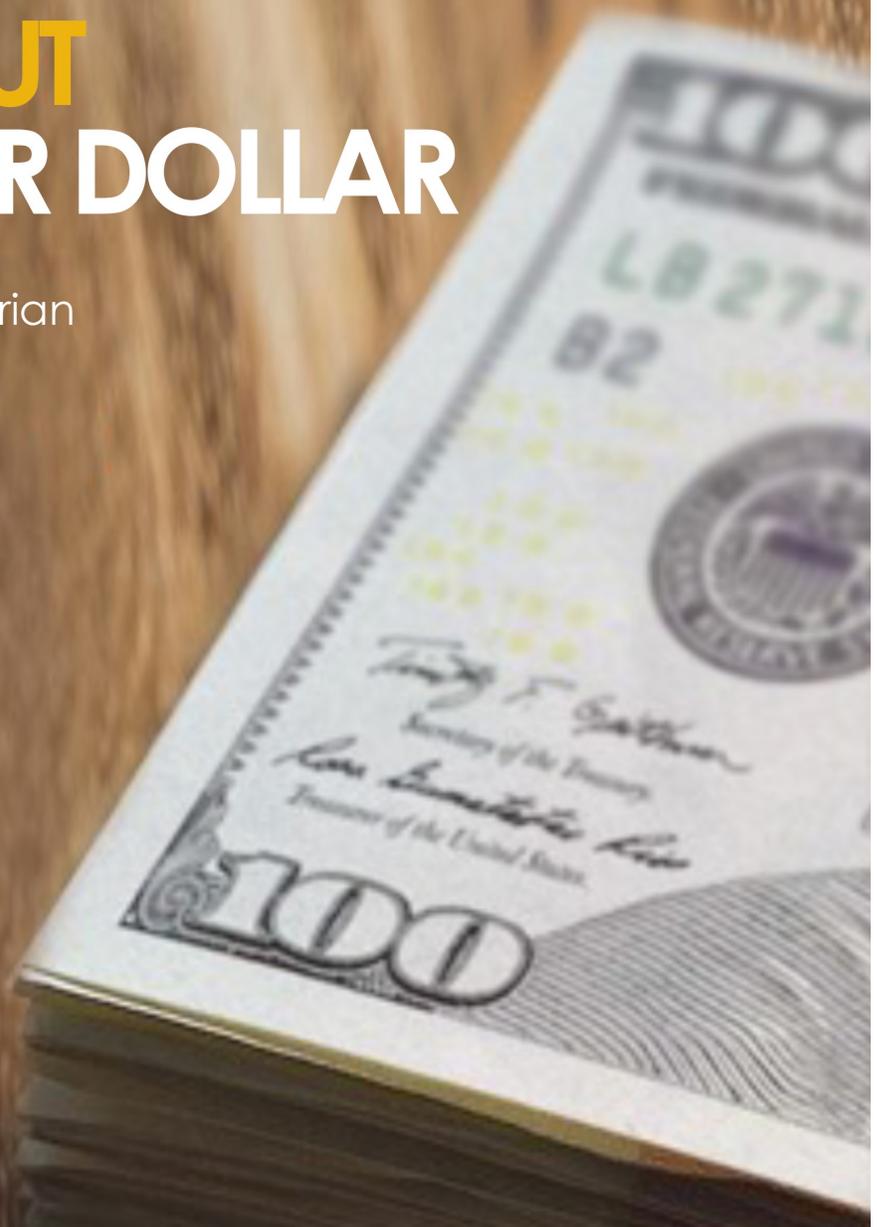
On the upside, the event of an actual war in the Middle East between the US and Iran implies supply disruption that could give oil bulls more leg to run.

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Sub-Saharan Africa

Sub-Saharan Africa

Macro Overview: Regional giants drag overall growth

The economic growth in Sub-Saharan Africa (SSA) region remained positive in H1-19, though, dragged by the weak growth posted by regional heavyweights -Nigeria, South Africa, and Angola. Economic recovery remained sluggish in Nigeria and Angola, as the deterioration in oil fortunes over H1-19, weighed on both countries' economic growth. Similarly, there was a decline in economic activities in South Africa as power cuts - load-shedding - levelled business sentiments. In Kenya, SSA's fourth largest economy, the spate of economic expansion decelerated slightly as a sustained delay in the rainy season led to a downturn in the country's all-important agriculture sector and further impacted electricity generation negatively. In all, global commodity price swings, extreme weather events, and domestic policy uncertainties clouded the broader economic growth.

Ethiopia, Ivory Coast, Ghana, and Rwanda remained among the region's fastest growing economies, supported by improved governance, policy stability, higher agriculture and services sector output. This buoyed the supply side activities; even as stronger household consumption and public investment bolstered the demand-side activities. Notably, Ghana recorded a slight slowdown in economic activities, as the country commenced life after the end of its 16th IMF bailout program in Apr-19. Also, large interest payments to foreign holders of government bonds kept Ghana's current account in the deficit, despite an improved trade balance which was bolstered by rising oil and gas exports. Additionally, significant volatility in the foreign exchange markets, coupled with elevated inflation, dampened investment sentiments in Ghana.

A few countries continue to deal with security challenges which mounted severe human and economic pressure on performance. Over H1-19, six countries within the region (Nigeria, South Africa, Senegal, Malawi, Benin, and Comoros) held their general elections, with all the countries remarkably re-electing their incumbent presidents for another tenure in the office. Save for a few cases of violence during the Nigerian and Comorian election, the voting process was generally peaceful across the board. Notably, elections were keenly contested in five of the six countries, as only Benin voted in an election with no opposition.

Macro and Policy Outlook

AfCFTA: On the cusp of glory

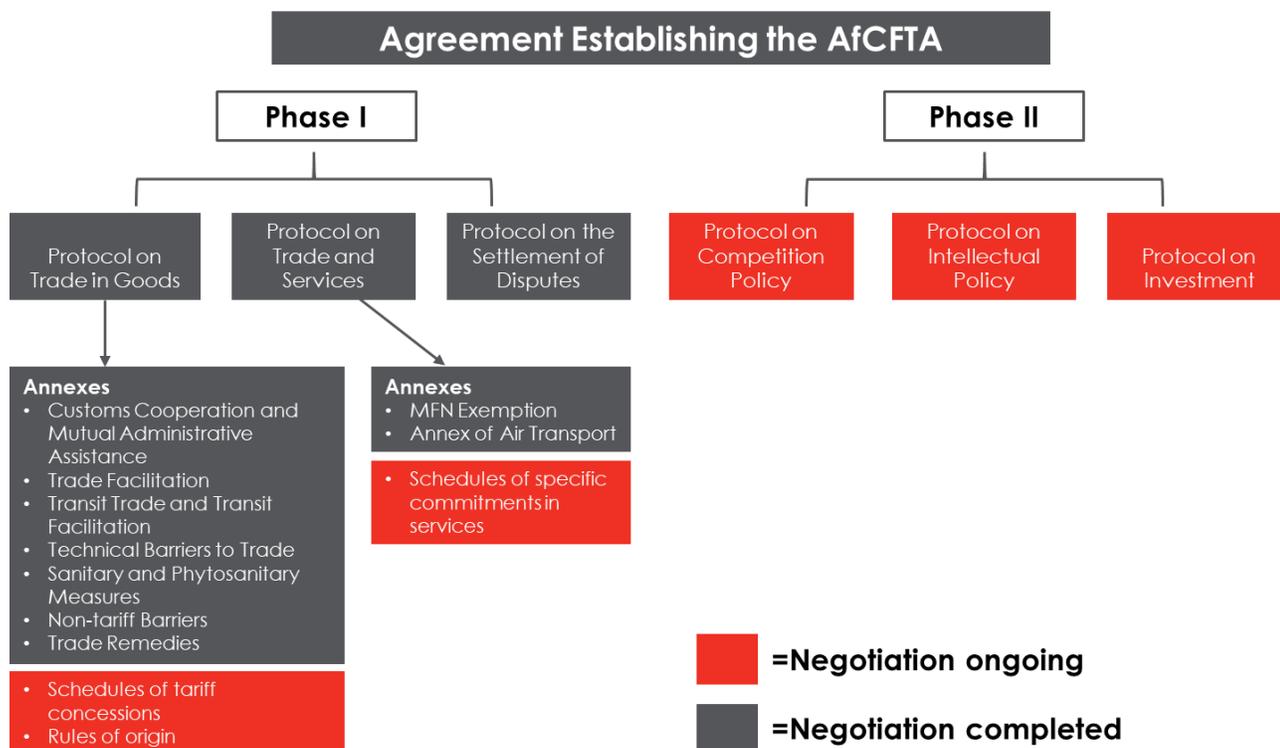
More than 25 years after the Abuja treaty, Africa is on the cusp of a historic step as it moves closer to finalizing negotiations for one of the milestones of regional integration envisaged by its pan-Africanist founding fathers. The Africa Continental Free Trade Area (AfCFTA) which is aimed at boosting intra-Africa trade, gained further grounds in H1-19 as the agreement went into effect on May 30, 2019. This was on the back of ratification by the minimum threshold of 22 African Union (AU) member states.

Overall, SSA growth was majorly affected by volatility in commodity prices

Economic performance was clouded by political uncertainties in SSA's largest economies

AfCFTA to kick off, despite increasing trade independence amongst developed nations

Figure 6: Understanding the AfCFTA



Source: UNCTAD, AU, United Capital Research

The AfCFTA, which is an umbrella instrument for the trade negotiations, is divided into two phases (Phase I and II). Each phase of the agreement requires ratification by AU member states. On March 21, 2018, following 10 negotiating rounds, 44 of 55 AU member states signed the agreement establishing the Phase I of AfCFTA. As at the time of writing this report, 54 out of the 55 AU states have signed the agreement (Phase I) while 27 states have ratified it. Eritrea is now the only state on the side-lines. The development means that Phase I of AfCFTA is now a binding legal instrument in the countries that have ratified the agreement.

Notably, a number of key issues in Phase I are yet to be negotiated, including schedules of tariff concessions, schedules of services commitments, and rules of origin. As long as these negotiations are pending, it remains unclear which products will be subjected to tariff cuts and which services sectors will be liberalized. Likewise, uncertainty remains regarding rules of origin, i.e., rules regarding the type of value addition that must occur within an AfCFTA State Party in order for a product to benefit from AfCFTA tariff rates. Additionally, all Phase II issues remain outstanding and negotiators are currently debating whether the AfCFTA should include a protocol on e-commerce in order to take full advantage of the Fourth Industrial Revolution. Phase II of AfCFTA requires its own instruments of ratification.

In Dec-18, a roadmap was adopted to finalize outstanding work on the AfCFTA negotiations. As at the time of writing, negotiation is ongoing among the member states on the rules of origin.

...as long as these negotiations are pending, it remains unclear which products will be subjected to tariff cuts

Also, AU members agreed on a Jan-20 deadline to submit their negotiated market access offers for goods and the five priority services sectors; transport, communications, financial services, tourism, and business services. Thus, Phase II negotiations are expected to be completed by Jun-20.

Output Growth Outlook

Faster growth ahead?

Looking ahead, IMF published a forecast for growth in the region to rise from 3.0% in 2018 to 3.5% in 2019 and this is largely buoyed by high growth from the relatively smaller economies. Our expectation is in line with that of IMF as we expect the smaller economies to continue to spur growth while the slow recoveries in the larger economies like Nigeria, South Africa, and Angola will continue to constrain the strength of the regional growth. We expect economic activity in South Africa to remain weak, as the economy continues to battle with a rolling blackout, high unemployment, land expropriation challenges and slow credit growth. Also, we expect a sustained but subdued recovery in Nigeria and Angola as both economies remain exposed to the vagaries of the oil market. On the other hand, we expect Ethiopia, Ghana, Ivory Coast, and Kenya to remain among the high flyers. Economic activity in the rest of the region is expected to continue to expand at a solid pace.

Elsewhere, election uncertainties are expected to dampen investment sentiments in eight countries (Mozambique, Botswana, Cameroon, Namibia, Mali, Guinea, Chad and Guinea-Bissau), scheduled to hold Presidential/Parliamentary elections in H2-19. However, given the relatively small size of these economies, we expect the uncertainties associated with the elections to have a minimal impact on the broader SSA outlook. Notably, save for Cameroon where cases of pre-election violence have been recorded, we expect the elections in the remaining economies to be relatively peaceful.

As the conclusion of Phase I of AfCFTA negotiations approaches, we believe Africa is on the verge of defining a new narrative for the continent. In practice, however, the devil lies in the details of negotiations and how Africa copes with challenges of implementation. Also, given that there are still a lot of grey areas that are yet to be coloured in the current agreement, we believe the economic impact of AfCFTA lies in the longer term.

Foreign Exchange

H2-19 to mirror H1-19

Analysis of SSA's foreign exchange condition showed that the performance was broadly divergent in H1-19. However, contrary to the broad base decline seen in 2018, the dovish global monetary policy stance provided support for some of the local units against the dollar in H1-19. Despite a weak macroeconomic condition in South Africa and Nigeria, the currency of both countries strengthened against the US dollar, thanks to a rise in Foreign Portfolio Investment (FPI) inflows during the period as investors sought alpha in

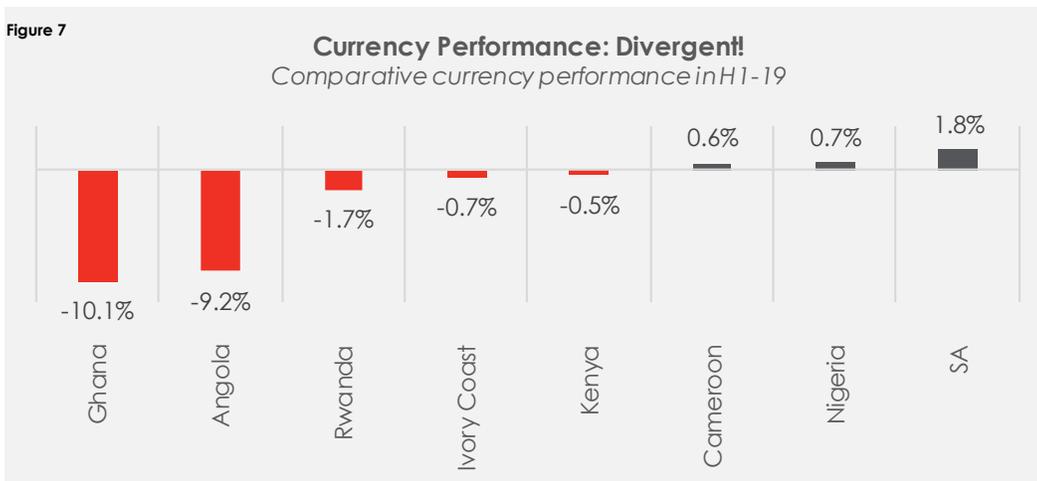
Push and pull on regional growth

In our view, economic impacts of AfCFTA will be seen in the longer term

high yielding Emerging Market (EM) assets. For Nigeria, a sustained FX intervention by the Apex bank provided further support for the local unit while in South Africa, the FPI inflows transcended the fixed income market, to the equities market.

On the other hand, among the list of currencies, we track, the Ghanaian cedi (GHC) was the worst performer as a surprise 100bps rate cut by the Bank of Ghana in Jan-19 and a further indication of policy easing sent the currency southwards. Additionally, weak economic conditions, rising trade deficits and lower commodity prices, pressured the local currencies of Angola, Rwanda and the West African CFA franc zone, lower.

Our overall outlook for currencies within the region remains similar to that of H1-19. In Nigeria and South Africa, barring any external shocks, we expect the naira and rand to stabilize in H2-19. This will be buoyed by a sustained FX intervention and continued FPI inflows. In the CFA franc zones (WEAMU and BCEAO), given that the currencies are pegged to the euro, we could see further weakening in the CFA franc as BREXIT uncertainty continues into H2-19. Similarly, we expect the Ghanaian cedi (GHC) and Kenyan shilling (KES) to weaken, relative to the US dollar (USD), due to current account deficits.



Source: Bloomberg, United Capital Research

Debt and Eurobond Market

A largely bullish H1-19 for Eurobonds

The fiscal narratives across SSA remained largely the same in H1-19 as pressures from rising recurrent expenditures continued to reduce the headroom to raise capital for investment in infrastructure. Thus, to cater for the rising recurrent needs and spur economic activities, public debt levels were elevated in H1-19.

The above notwithstanding, we saw a marked slowdown in Eurobond issuances compared to the prior year as only three of the region's frontier economies -Ghana (\$3.0bn), Benin (\$0.6bn), and Kenya (\$2.1bn)- tested the primary Eurobond market, issuing a total of c. \$5.7bn in H1-19 (vs. c. \$15.8bn in H1-18). This was due to rising external debt servicing cost and fragile domestic macroeconomic environment, even though monetary

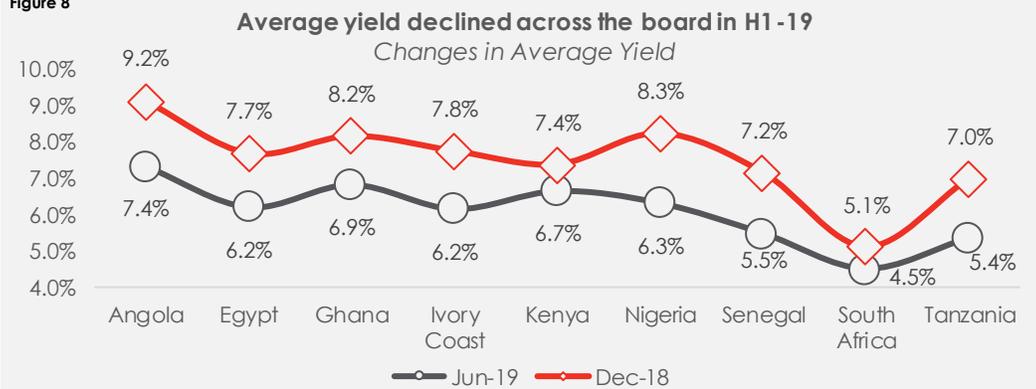
FPIs dominated the amount of capital inflows

Our overall outlook for currencies within the region is weak

Public debt levels were elevated in H1-19, however Eurobond issuances slowed y/y

policy in the global space became less hawkish. Notably, Benin was the “new kid on the block” in H1-19 as the West African country issued its debut Eurobond to fund its public infrastructure projects.

Figure 8



Source: Bloomberg, United Capital Research

Over H1-19, the overall narrative at the Eurobond market shifted from only issuances to repayments as South Africa (\$1.7bn) and Kenya (\$750.0mn) both repaid their Eurobonds that matured in May-19 and Jun-19, respectively.

Elsewhere, at the secondary market, SSA Eurobonds bounced back from a tough 2018 as the average yield on all the outstanding Eurobond instruments trended lower across the board. Only Zambia saw its performance deteriorate in Q2-19, as prices for its three Eurobonds saw large declines in Apr-19 and May-19 on the back of further rating downgrade by two of the three global credit rating agencies, Fitch and Moody's. This came after the across the board rating downgrades from all three agencies in 2018. In all, the renewed interest in SSA Eurobonds can be attributed to the complete reversal of the 2018 global hawkish stance, to a more dovish tone over H1-19.

With an outlook for a more accommodative monetary condition in the advanced economies, especially in the U.S, the outlook for SSA sovereign Eurobonds is likely to remain bullish in H2-19. Notably, we expect Togo to follow the footsteps of Benin, and leverage its recent credit ratings from S&P & Moody's to test the primary Eurobond market in H2-19.

Equity Market

Uninteresting macroeconomic environment scares FPIs

Over H1-19, equities in global, emerging and frontier markets bucked the 2018 bearish trend. This was as most indices ended in the green territory on the back of the global easing narratives. However, most equities in the SSA region underperformed their emerging and frontier market peers, as FPIs piled into high yielding debt instruments within the region. Of the six exchanges under our watch, only the South African and Kenyan bourses closed H1-19 in the positive territory. The performance in Kenya was buoyed by its strong economic growth while the depth of the South African market and the continued re-assurance by the President to commit to reforms, provided investors with some

Zambia's Eurobond performance divergent from SSA, as downgrade in credit ratings retracted demand

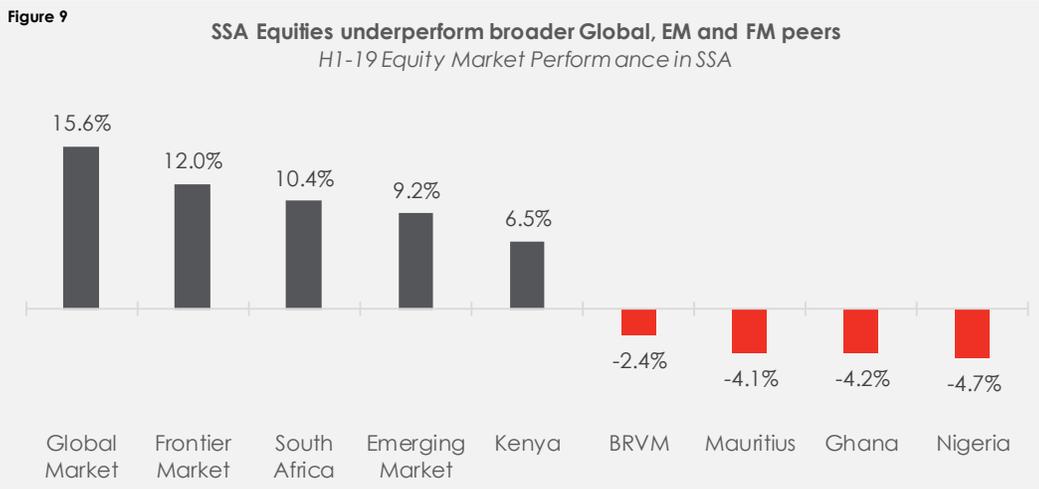
...equities in the SSA region underperformed peers

fundamental justifications for buying South African equities.

On the other hand, the benchmark indices in Ghana, Nigeria, the BRVM bloc and Mauritius, all closed H1-19 in the negative territory, largely due to risk-off sentiments by foreign investors.

Looking ahead, we believe the outlook for emerging and frontier market equities will remain positive through H2-19 on the back of the expectation for a more dovish global monetary policy. For SSA, we expect interest in equities to remain fundamentally driven as the heavy-weight market movers – FPI – continue to look for bold economic reforms as a fundamental reason for buying equities. Thus, in the absence of any new reforms in H2-19, we expect sentiments to remain similar to that of H1-19.

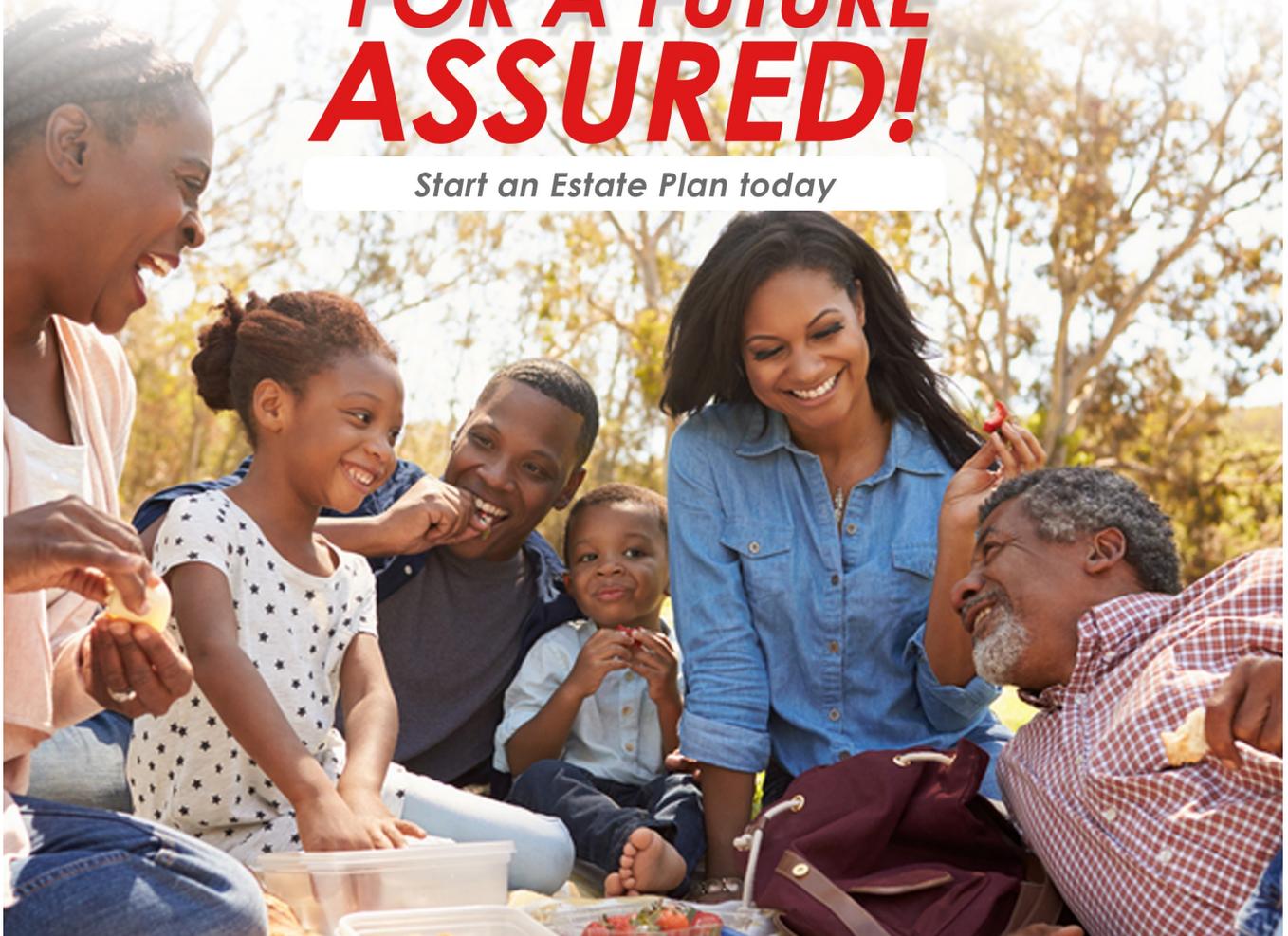
...we expect sentiments to remain similar to that of H1-19



Source: Bloomberg, United Capital Research

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Domestic Macro and Policies

Domestic Macroeconomic Overview

There and back again, President Buhari and Gov. Emeziele return for a 2nd leg

In our [2019 outlook report](#) published in January, we noted that the 2019 general election, a possible change in the leadership of the CBN and some structural changes in the economy, are the three key domestic factors to watch out for this year. As at Jun-19, two of these factors have materialized. Notably, Nigeria's 2019 general election did not pull any surprise, President Muhammadu Buhari defeated his major challenger, Alhaji Atiku Abubakar of the PDP by 15.1million votes to 11.3million votes. Following his victory at the polls, the President surprisingly re-appointed the CBN governor for another 5-year term, the first time a CBN governor would be returned for a second term since 1999. Additionally, the re-appointment was the first key strategic economic decision made by President Buhari following his re-election in Feb-19.

While political uncertainty may be out of the way, economic uncertainties remain elevated. Yes, continuity in government and an extension of the tenure of the CBN leadership suggests stability in the policy framework of the economy over the next 4 to 5 years. Nevertheless, concerns about the viability of the current macroeconomic framework are yet to be addressed. In our interaction with investors and stakeholders, the biggest question on their minds relates to whether the government's 2-fold subsidy program on foreign exchange and energy prices will continue despite sustained underperformance of government revenue against budget benchmarks, rising debt profile and fiscal crisis in most of the 36 States of the federation. Clearly, there is a need to strategically re-align fiscal policy to drive long term growth and development given that macroeconomic outcomes remain vulnerable to external and domestic shocks.

Agenda setting for President Buhari's 2nd term

In their 2nd term, both the President and the CBN governor must battle structural and policy challenges which have kept output growth at a sub-optimal level. More specifically, to drive high single or double-digit GDP growth and check double-digit inflation rate, economic policies must address poor revenue mobilization, rising debt profile, petrol price subsidy, low foreign direct investment, the inefficiency of the NNPC, booming population & job creation, power sector crisis & port congestion, as well as corruption & insecurity.

If the current policy framework is sustained, the outlook for the economy over the next 4 years will be muted. In his inauguration day speech, the President hinted his intention to lift 100million Nigerians out of poverty, but no clear guidance was given as to 'How?'. Give or take, we imagine that the administration will continue to invest in infrastructure, sustain its social welfare scheme, and retain its intervention programs across the Agriculture, Power and the SMEs space, by building on its Economic Recovery and Growth Plan (ERGP). As such, we expect the budget to remain large, dominated by recurrent spending and debt servicing while broadly financed by borrowings.

Despite political stability and continuity, key policy issues and revenue challenges are yet to be addressed

Social welfare, recurrent spending and debt servicing will continue to dominate fiscal expenditures

However, the role of the private sector may be limited by the absence of far-reaching liberal policies. This may keep investment low, and output growth soft. Accordingly, we expect GDP growth to sustain a gradual uptick over the next four years, rising from 2.0% to 3.5% over the period. Inflation rate will most probably remain at double-digit or high single-digit as high borrowing cost, increase in wages and power tariff adjustment may weigh on price level. Finally, the monetary policy rate should revert to its long term 12.0% over the period.

On monetary policy, Governors Emeziele's 5-year plan points to a broadly expansionary future, to double GDP growth, create jobs and lower inflation. However, foreign exchange (FX) is expected to remain supported by intervention for as long as it takes. Our belief is that Nigeria will hold the naira within the current band until forced to do so by external shocks, a framework that has allowed the naira to follow a 'step model' over time. Also, support programs in the Agriculture and SME Sectors such as the Anchor Borrowers' Program will be sustained. Overall, this means aggressive liquidity mop-up via persistent OMO issuances is likely to be retained considering that currency stability will broadly drive policy actions.

What to watch out for in H2-2019

In H2-19, we are of the view that Nigeria's short-term growth outlook will be dependent on:

1) **Policy Uncertainties:** Policy uncertainties will remain one of the biggest concerns for investors in H2-19. This position is buttressed by several factors. For instance, President Buhari is unlikely to form his cabinet until the end of Q3-19, if the experience from 2015 is anything to go by. This is because nomination must come from the 36 States in the name of the "Federal Character" clause, then go through Presidential consideration before a final screening by the Senate. This is likely to slow investment planning as important decision in the strategic sectors of the economy as well as policy formulation across the sectors, have to wait for the ministers to settle in.

2) **Weak macroeconomic framework:** In the last 4/5 years, the IMF and other stakeholders have insisted that the macroeconomic framework in Nigeria is too weak to spur the required growth. Majorly, this is captured in the multiple exchange rates regime, distortionary quasi-fiscal activities, inadequate fiscal consolidation efforts, and the reluctance to overhaul the 2-fold subsidy program in the currency and energy markets, despite low revenue mobilization. This concern is also reflected in the policy agenda of Governor Emeziele for the next 5 years. According to the governor, the overarching objective of his administration is to achieve a double-digit GDP growth, single digit inflation rate, lower unemployment rate, and a stable exchange rate.

While the target of the CBN is laudable, the Apex Bank lacks the capacity to drive this objective alone. For instance, to achieve a double-digit GDP growth, key economic

Inflation rate to remain at current levels, amid pending implementation of new minimum wage

Lag in key policy formulations will slow investment decisions

Policies are clear, capacity is lacking

agencies of the government such as the ministry of finance, trade & investment, oil & gas, agriculture, and national planning, must be drafted in.

Put differently, lack of coordination among economic policy-making organs of the government as well as economic leaning of the authorities, which is ‘increasingly Statist’ points to the continuation of the subsisting policy framework.

3) **Policy formulation & implementation:** The implementation of far-reaching policy reforms remains the bane of Nigeria's long-term growth. In his June-12th speech, President Buhari revealed his intention to lift 100million Nigerians out of poverty over the next 10-years. If the resolve of Mr. President is to be tested, investors must look out for efforts to push reforms in major sectors of the economy with the capacity to generate millions of jobs, as observed in the telecom and financial industries in the mid-2000s. Specifically, this effort will be reflected in the initiatives to fix the protracted problem of poor power supply and huge infrastructural deficits vis-a-vis sharp rising population growth. The passage and implementation of the Petroleum Industry Bill (PIB), the deregulation of electricity tariff and the metering of end-users are major issues that must also be watched.

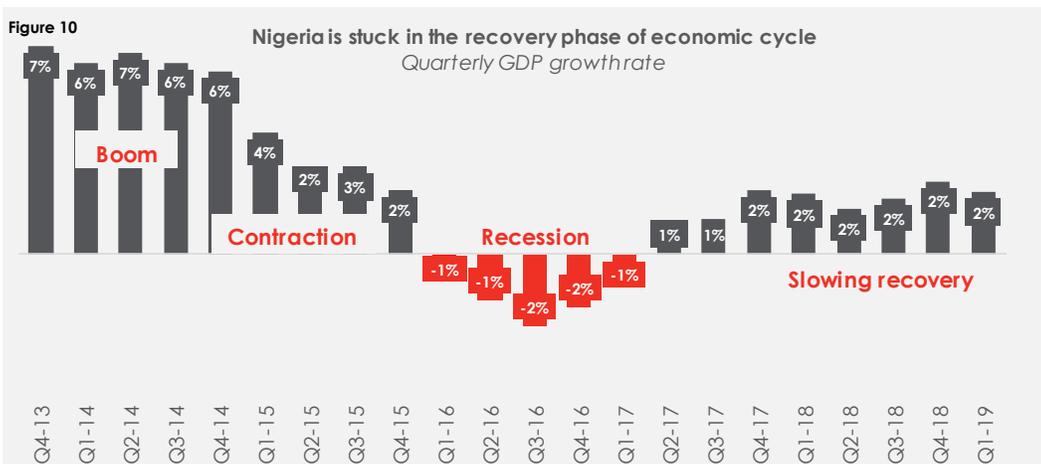
Domestic Output and Price Level

GDP Growth: Will GDP growth break out from the 2.0% threshold?

In Q1-19, Nigeria recorded an output growth of 2.0% y/y, a slight uptick from the 1.9% y/y growth recorded in Q1-18 and the strongest quarterly growth since 2015. This was despite the 2019 general elections and the attendant disruptions to normal business activity that followed the initial impromptu postponement of the February polls. Notably, growth was buoyed by a rebound in the Agriculture sector which recorded a 3.2% expansion as the crisis between herders and farmers, which had hitherto pressured output, begin to give way for peace. Also, growth in the Information & Communications (+9.5%), Transportation & Storage (+19.5%) and Trade (+0.9%) sub-sectors, supported performance.

...investors must look out for efforts to push reforms in major sectors of the economy

Q1-19 GDP growth was buoyed by a rebound in the Agriculture sector which expanded by 3.2%/y/y



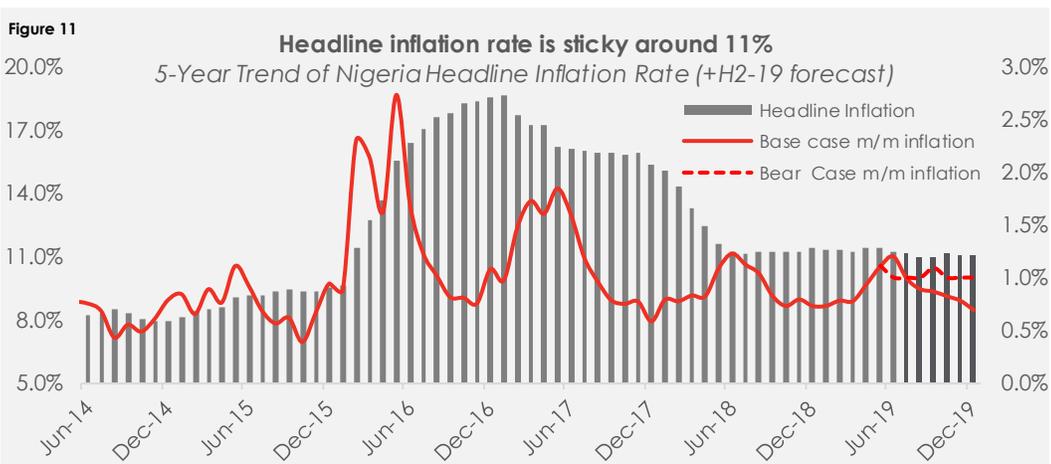
Source: NBS, United Capital Research

In Q2-19, we expect the momentum to improve with the possibility of breaking out of the 2.0% threshold amid increased political stability. The impact of seasonality on the Agriculture sector should be offset by the low base effect of 2018's performance which was dragged by insecurity, thus, we expect the Agriculture sector output growth to continue above 3.0% in Q2-19 as observed in Q1-19. For the Oil sector, the force majeure declared by two of the biggest oil exploration companies in the country (SHELL and TOTAL) during the latter part of April-19 may drag overall output growth and keep the sector growth in the negative territory in Q2-19. Lastly, the performance of the larger services sector, which continue to show signs of improvements, is also anticipated to gain momentum.

In H2-19, we expect economic activities to be slightly better than H1-19. This is predicated on stability in the Agriculture sector, majorly supported by faster growth in Crop production and Livestock. Meanwhile, growth in the manufacturing, retail and wholesale trade sectors should improve on the back of an increase in consumer spending which will be buoyed by higher wages following the recent minimum wage increase. We expect improvements in the services sector, which account for over 50.0% of GDP, to continue over H2-19. Additionally, the likely resumption of crude oil production in Ogoni by Oct-19 is positive for oil sector growth in Q4-19. Accordingly, we revise our expectation for FY-19 GDP growth at 2.2%/y.

Inflation rate: higher wage bill, low output growth, any impact on price?

From 12.8% in Dec-18, headline inflation rate moderated to a low of 11.25%/y in Mar-19. However, the scenario was different in Q2-19 as the headline rate bucked the southward trend, creeping back to 11.4%/y in May-19. Despite a slowdown in core inflation sub-index to 9.0%/y in May-19, renewed pressure on food inflation sub-index weighed on headline inflation. Evidently, the uptick in food inflation sub-index is traceable to seasonality and low output which often characterize the planting season, thus exerting pressure on food prices. However, the core inflation sub-component continues to moderate due to stability in the exchange rate market as well as the pegged price of PMS over the period.



Source: NBS, United Capital Research

Our overall outlook for FY-19 GDP growth is positive

Core inflation moderated over H1-19 while food inflation weighed on the headline number

In H2-19, we estimate headline inflation to be sticky between 11.0% and 11.5%, averaging 11.4%, which will be 80bps below the average inflation rate in 2018. Notably, the trend shows that m/m inflation rate is likely to moderate in H2-19 as observed over the last 5years, majorly due to seasonality which often drives cyclical movement in food prices, while a stable currency market environment will keep core inflation lower. Accordingly, m/m inflation may average 0.90% in H2-19 (compared to 0.93% in H1-19). Under this scenario, we expect the headline inflation rate to settle at 11.5% by Dec-19. However, there are structural issues that may sway this outlook in the opposite direction. Some of these include the sustained fiscal dominance which has kept the cost of capital high, thereby constraining credit to the private sector. Also, the increase in the minimum wage, depending on the aggressiveness of implementation, may be inflationary if the pace of output growth remains low. Finally, an adjustment in energy prices may mount fresh pressure on prices.

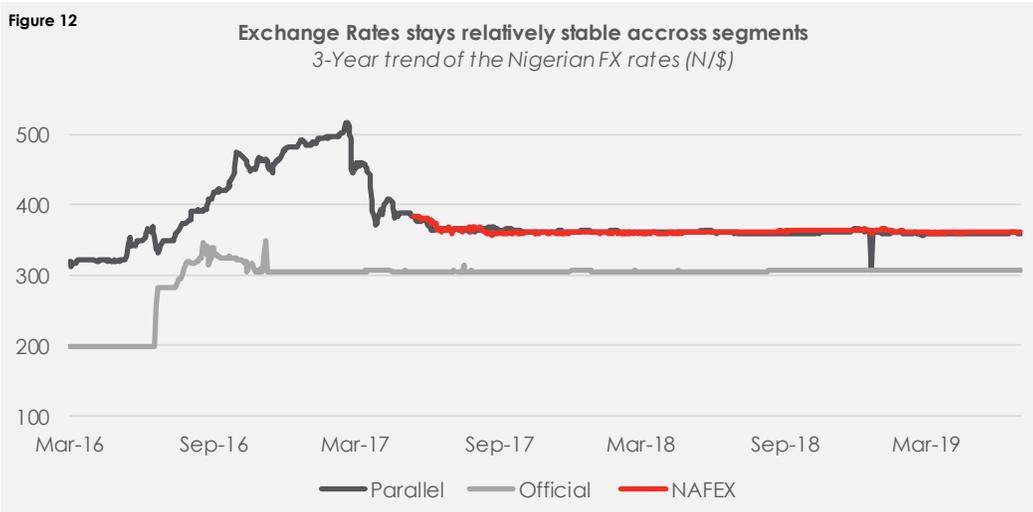
External Sector

Foreign exchange rate and reserves: Will the CBN harmonize Forex windows?

Currency market conditions were mostly stable in H1-19 as the Apex Bank stayed committed to defending the naira via frequent wholesale and retail FX intervention. This buoyed liquidity and kept the local currency relatively stable compared to widespread pressure on currencies among peers within Sub-Saharan Africa. Despite jitter of a rout during the general election in Q1-19, the local unit firmed against the greenback amid a sustained uptrend in oil prices, which bolstered Nigeria’s external reserves to \$45.0bn during the period. Notably, the external reserves improved 4.5%YTD in H1-19, driven by stronger than expected uptick in oil prices and increased foreign portfolio inflow during the period. Accordingly, the naira appreciated 0.9% and 0.3% over H1-19 at the I&E window and the parallel segment respectively, even as the official rate firmed at N306.1/ \$1.

We estimate headline inflation to be sticky between 11.0% and 11.5%, but there are structural issues that may change this

...the Apex Bank stayed committed to defending the naira



Source: CBN, FMDQ, United Capital Research

The above notwithstanding, concerns around the stability of the naira and the likelihood of a near term adjustment remained the biggest issues on the mind of investors interested in Nigeria. Our interaction with many investors revealed the three key concerns about the outlook of the naira. The first relates to the multiple exchange rates regime where the official rate trades at a wide margin to the I&E rate, alongside 2 to 3 other windows with rates trading at marginal spreads. The second concern borders on a possible harmonization of rates at the I&E and the official window or a collapse of all the rates across windows to the I & E rate (which is considered the market rate) as a strategy to boost government naira revenue and support allocations to States. The final concern is tied to the complexity and transparency of the current exchange rate regime and the need for simplification and more clarity. Again, while the list of 42 items excluded from FX sales was proposed to be a temporary fix, what we have observed is a subsequent increase in the number of items on the list.

With the above in mind, our view is that the Apex bank will maintain the status quo for now, especially with the reappointment of Governor Godwin Emefiele for a second term. As such, the foregoing points to a medium-term adjustment of the current policy framework of the CBN. Certainly, with the anticipated pressure on recurrent spending, following the recent approval of the minimum wage bill, collapsing the official rate from N305.5/\$1 to N360.0/\$1, may be a strategic move by the government to rebalance its revenue/expenditure profile in the medium term. While the decision of the authorities on this remain unclear, we maintain our view that the outlook for the naira is stable in the near term but not in the medium term.

Trade and Capital Flows: At the mercy of oil and fair-weather fans

In Q1-19, Nigeria's total export settled at N4.5tn, 3.9% lower compared to N4.7tn recorded in Q1-18 but 1.8% higher than the level in Q4-18. Oil exports (86.7%) remains the largest contributor to total exports. Meanwhile, total import settled at N3.7tn (up 3.4% and 25.8% relative to Q4-18 and Q1-18 respectively) with manufactured goods taking the largest share of 74.9%. Notably, while sustained improvement in export continued to support trade balance, at a favourable N1.0tn in Q1-19, import bill seems to be rising at a faster rate (up 25.8% y/y vs. export which declined 3.9% y/y). Evidently, weaker growth in export is tied to the vagaries of oil output, due to its outsized contribution as well as the impact of the output cap (1.76m/d) placed on Nigeria's export by OPEC in Dec-18. This is despite a sustained uptick in prices over the period.

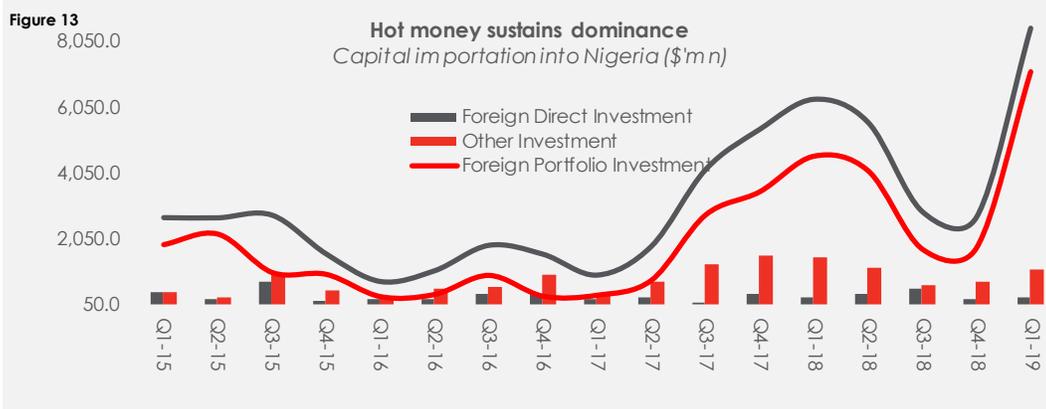
Despite the jitters that trailed the February general election and its eventual conduct in Q1-19, total capital imported into the country surged 34.6% y/y to settle \$8.5bn, the highest since Q3-13. Still, a deeper dive into the numbers shows that across the three components of capital imported, Foreign Portfolio Inflows (FPIs) accounted for the bulk of expansion observed, surging 56.5% y/y to \$7.1bn. Foreign Direct Investments (FDIs) and Other Investments remained subdued, sliding 1.3% y/y and 26.5% y/y to \$243.4mn and \$1.1bn respectively. With risk-off sentiment guiding decisions, foreign interests in money

The stability of the naira remained one of the biggest concern for investors

...the outlook for the naira is stable in the near term but not in the medium term.

Oil exports remained the largest contributor to total exports

market securities surged 67.9% y/y to \$5.9bn, with FPI flow into short term government bills single-handedly contributing 69.8% to total capital imported into the country, as carry traders continue to relish the mouth-watering return on government bills. Evidently, weaker FDI flows reflect the impact of waning confidence in the Nigerian economy by foreign investors amid concerns about macroeconomic fundamentals of the Nigerian economy.



Source: NBS, United Capital Research

Looking ahead, net funds flow into the Nigerian economy is not expected to improve significantly in H2-19 in the absence of clarity around measures to address structural vulnerabilities in the economy. To boost FDIs, Nigeria must review its macroeconomic framework to enable investors to clearly estimate the outlook of the naira and control fiscal deficit to stimulate private sector investment. More specifically, delayed policy formulation and cabinet selection by the President is another downside risk to capital inflow as guided by events following the 2015 inauguration ceremony of President Buhari. That said, in the absence of profound changes in the policy environment, FPIs in search of cheap naira assets will dominate capital importation into Nigeria while FDIs remain on the sidelines.

Monetary Policy

An agenda for Governor Emefiele's 2nd term

After keeping policy rates unchanged for more than 30 months, the Nigeria Monetary Policy Committee (MPC) reduced the MPR by 50bps in Mar-19 but left other variables such as; Cash Reserve Ratio (CRR) at 22.5%; Liquidity Ratio at 30%; and the Asymmetric Window around the MPR at +200/-500bps unchanged. In contrast to expectation, the Committee's decision was driven by improvement in the political environment following the conclusion of the 2019 general election. In line with the above, the average yield on fixed income instruments moderated 215bps to settle at 12.0% in Jun-19. Also, the CBN is getting increasingly accommodative as system liquidity continued to build, measured by OBB and OVN rates which eased, averaging 16.7% in Q1-19 compared to 11.4% in Q2-19.

In H2-19, monetary policy outlook depends on the overall policy framework of Governor

Hot money dominated capital imported, with heavy inflows into money market securities

FDIs will likely remain low in H2-19 amid weak macroeconomic framework

The CBN is getting increasingly accommodative

Emefiele following his reappointment. As Governor Emefiele head into his 2nd term, we expect him to begin to put the pieces of the 5-year plan together from H2-19. The Governor had hinted his intention to target double-digit GDP growth, single digit inflation rate and increased job creation while seeking to maintain stability in the exchange rate. To guarantee financial system stability, the CBN plans to recapitalize the banks to position Nigerian banks among the top 500 banks in the world. Also, CBN proposes to work on a framework to enable banks to securitize mortgage loans as well as spur consumer lending by working with large retail stores, automobile companies and so on. Lastly, the Governor intends to sustain intervention programs of the Apex Bank by extending same to Youth Corp members, activities in the Agric and manufacturing sector. As a follow up on the above plan, the CBN recently reviewed the minimum Loan/Deposit ratio for Banks to 60%, and then crashed minimum deposit for Standard Deposit Facility (SDF) to N2.0bn from N7.5bn. All in an effort to compel Banks to lend to the real sector.

The policy goals of the Governor are somewhat ambitious, given that achieving a double-digit GDP growth, lower unemployment rate and single digit inflation rate, will require something to give. Our immediate thought is that such an ambitious agenda can only pass on the back of some bold policy implementation across select sectors with the capacity to generate accelerated income growth. Clearly, this will require a well-coordinated contribution from the Fiscal authorities and the Presidency. However, we are more particular about the monetary policy implication of the Governor's speech going into H2-19. In our view, the statement points to a more accommodative stance from the monetary authority, as observed since Jan-19. Also, we note that this implies that the Apex bank will maintain its current exchange rate policy going forward. With global central banks becoming increasingly dovish, we imagine the possibility of a further 50bps reduction in the policy rate from 13.5% to 13.0%. The CRR of 22.5% may be held unchanged given "the 50% on liquid asset" penalty imposed on banks who fail to meet the minimum L/D ratio of 60% by Sept-19

Fiscal policy

Revenue mobilization remains challenged

Nigeria's fiscal operation is constrained by poor revenue mobilization despite efforts of the Government. In Q1-19, retained revenue of the government tumbled 28.8%q/q and 9.7% y/y to N798.8bn, no thanks to weaker oil revenue, which continued to fall short of the provisional budget estimate due to the vagaries of oil production and prices. Notably, shut-ins and shut-downs at some NNPC terminals relating to technical, leakages and maintenance were the identified factors cited by the authorities. On the other hand, all non-oil revenue sub-components underperformed due to lower collection compared to the provisional monthly budget estimate, amid shortfalls in Corporate Tax, VAT, FGN Independent Revenue and Education Tax. We observed that similar factors were cited for underperformance in the month of Apr-19. Over the last twelve months, the average monthly revenue and expenditure profile of the government has reported a shortfall of

With a faster growth objective, consumer lending is one of the main focus of Governor Emefiele's second term

...we imagine the possibility of a further 50bps reduction in the policy rate from 13.5% to 13.0%.

Fiscal deficit widened, due to lower revenue mobilization

54.1% and 72.2% respectively compared to provisional budget estimates. Accordingly, fiscal deficit has overshoot the monthly budgeted benchmark by 142.1% on the average.

Figure 14: FGN Fiscal Operation (Jul-18 to Apr-19)

FGN's Fiscal Operations	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	12mths Avrg	Mthly Est	Short fall
Retained Revenue (N'bn)	349.6	336.0	350.1	437.5	342.6	364.4	276.8	272.1	249.9	325.6	340.4	629.4	54.1%
Federation Account	279.7	269.8	274.9	263.4	284.4	280.9	255.2	232.8	221.0	208.4	256.8	381.0	67.4%
VAT Pool Account	12.3	11.5	16.5	11.4	15.1	13.3	14.5	15.0	13.9	13.3	13.5	18.5	72.7%
FGN Independent Revenue	34.6	37.7	13.3	31.9	38.1	20.0	6.6	19.7	12.5	67.8	33.1	70.7	46.8%
Excess oil revenue	0.0	5.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	35.8	3.6	0.0	na
Others /FX Gains/Recoveries	23.0	11.5	45.5	130.8	5.0	50.2	0.5	4.6	2.5	0.3	33.6	159.3	21.1%
Expenditure (N'bn)	575.7	555.3	808.9	758.0	669.0	590.6	303.2	496.1	397.8	636.8	571.8	792.3	72.2%
Recurrent	535.9	475.5	589.0	565.3	364.2	428.9	225.5	349.6	279.8	450.5	424.3	509.0	83.4%
Capital	18	418	1818	154.6	266.8	123.7	39.6	146.5	89.5	162.9	114.3	239.1	47.8%
Transfers	38.0	38.0	38.0	38.0	38.0	38.0	38.0	0.0	28.5	23.4	33.2	44.2	75.2%
Overall Balance: Deficit(-)	-226.1	-219.3	-458.7	-320.6	-326.4	-226.3	-26.4	-223.9	-147.9	-311.2	-231.4	-162.9	142.1%

Source: CBN, United Capital Research

According to the Debt Management Office (DMO), total debt stock rose 8.7% y/y to N24.0tn as at Dec-18. In H1-19, the DMO issued two new bonds, including the debut 30yr Bond (worth N50.0bn in two tranches) and the 2nd tranche of the Green Bond worth N15.0bn. Alongside the fresh issuances, over N500.0bn worth of debt was raised in the bond market in H1-19 alone, to fund government deficit.

In H2-19, the fiscal operation is expected to remain broadly the same, amid weak revenue framework. As such, the FG's cost of servicing debt should remain elevated even as non-debt recurrent spending continue to rise due to the new minimum wage implementation. For capital expenditure, the actual capital outlay will depend on policy formulation and the speed of cabinet formation.

Figure 15 Average monthly FAAC allocation is down 10% in 2019 relative to 2018
Monthly FAAC to Federal, States & Local Governments



Source: NBS, CBN, United Capital Research

On the revenue side, oil revenue will remain a function of the vagaries of domestic production and the dynamics of oil prices at the global market. With sustained stability in

The fiscal operation in H2-19 is expected to remain broadly the same

...efforts to ramp-up non-oil revenue will be sustained to cover up oil revenue shortfalls.

the Niger-Delta region, we do not expect a major decline in production. However, periodic shut-ins and shut-downs across terminals will remain a challenge. Our projection for oil prices is maintained at \$60-\$70/b as geopolitical issues continue to drive prices. As such, oil revenue will maintain the observed trend since Jan-19. Accordingly, we imagine that efforts to ramp-up non-oil revenue will be sustained to cover up oil revenue shortfalls.

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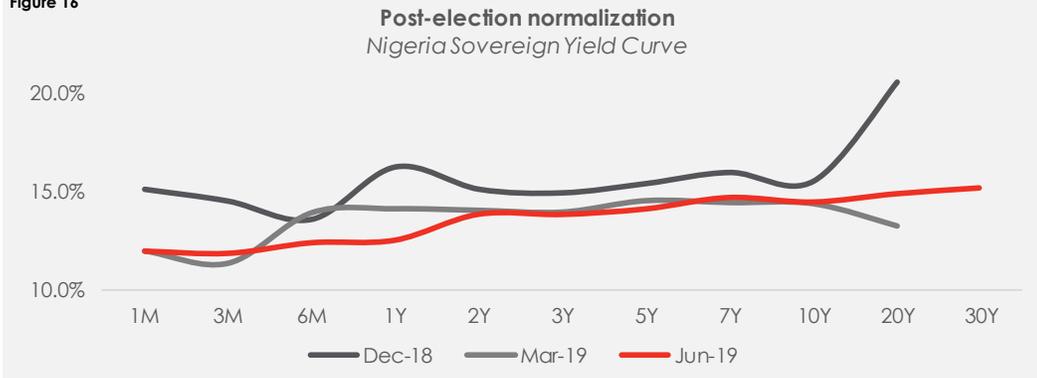
Financial Markets

Fixed Income

The naira yield curve normalizes

Contrary to the general market expectation for short-term yields to track higher, pre-2019 general elections, yields moderated on average as the dovish twist by the US Federal Reserve at its Jan-19 monetary policy meeting spurred strong foreign interest in emerging/frontier market assets (Nigeria inclusive). Also, the sustained dovish chorus by global central banks provided room for a more accommodative CBN that led to a further moderation in yields, post-election. Accordingly, the shape of the yield curve transited from being humped as at Dec-18 to normal as at the end of H1-19. Specifically, average yield on treasury bills and bonds which closed 2018 at 15.37% and 15.31%, moderated to 13.55% and 14.07% as at the end of Mar-19, despite election uncertainties that clouded the period and further declined to 12.13% and 13.92% respectively, at the end of H1-19.

Figure 16



Source: FMDQ, United Capital Research

Elsewhere, in the primary market segment, the CBN successfully rolled over all maturing Nigerian Treasury Bills (NTB) during the period, worth N1.4tn at an average stop rate of 12.2% (vs. 11.9% in H2-18). Additionally, given the high level of maturities and FAAC inflows of c. N10.3tn, the Apex bank mopped up a total of N9.4tn via OMO sales at 13.1% during H1-19, higher than N8.9tn and N8.8tn at 12.9% and 12.8% in H1-18 and H2-18 respectively. In the bond space, a total of N707.5bn were auctioned in the domestic sovereign bonds market at an average marginal rate of 14.5%, a 50bps decline from rates in H2-18. Notably, the Debt Management Office (DMO) during its Apr-19 bond auction elongated the Nigeria's yield curve by 10-year as it successfully issued its debut 30-year bond. Meanwhile, the moderation in interest rates was positive for short-term corporate borrowings during the period as we saw further activities at the commercial paper space. Also, Access Bank and North South Power-SPV followed the footsteps of the FG as they issued their debut Green bonds, totaling N23.5bn at an average rate of 15.6% (FG's: N15.0bn at 14.5%).

Dovish twist by the US Federal Reserve spurred strong foreign interest in emerging/frontier market assets

Overall, yields on fixed income securities moderated in H1-19

Figure 17

Global dovish chorus positive for naira bonds
S&P/FMDQ Nigeria Sovereign Bond Index (NGN) TR



Source: Bloomberg, United Capital Research

In the foreign space, the FG stayed off the Eurobond market as it pursued a strategy of accessing cheaper funding from concessional sources and raising any balance from commercial sources. At the secondary market segment, average yield on Nigerian sovereign Eurobonds declined, down by 210bps in H1-19 to 6.4%, as foreign investors seek alpha in high yielding Emerging Market (EM) assets. Similarly, interest in corporate Eurobonds was positive as average yield declined by 249bps in H1-19 to 7.5%. Notably, Zenith bank (\$500.0mn) and the defunct Diamond bank (\$200.0mn) repaid their maturing dollar notes while Access bank (\$400.0mn) successfully called its 2021 note during the period. Thus, the outstanding value of Nigeria's Corporate Eurobonds shrank to c. \$2.4bn in H1-19 from US\$3.5bn as at Dec-18 and it is anticipated to further shrink in H2-19 as First Bank of Nigeria Limited has indicated its willingness to recall its 2021 note (\$450.0mn) in Jul-19.

H2-19 Outlook: Caught between domestic and global policies

For us, H2-19 is anticipated to be a play of demand side-factors (global and domestic monetary policy actions) and supply-side factor (domestic financing needs).

Demand Side Factors

Global Monetary Policy: The fundamental backbone

Similar to H1-19, we expect that the tone of global central banks and the action of their monetary authorities will in a long way set the pace of the demand for EMs assets, in H2-19. Accordingly, our expectation for global monetary policy to remain dovish in H2-19 is a bull point for EMs assets. However, in Nigeria, we believe the lack of economic policy reforms will continue to scare the FPIs off equities while policy stability and a double-digit interest rate will promote further appetite for fixed income instruments.

...the FG stayed off the Eurobond market, as its strategy is to first access cheaper funding from concessional sources

Scarcity of corporate Eurobonds will drive yields down, as there are little or no signs of prospective issues from banks

The tone of global central banks to influence demand for EMs assets in H2-19

Figure 18

FPIs to continue to pile up at the fixed income market in H2-19
FPI flows in bonds and money market instruments



Source: NBS, United Capital Research

Domestic Monetary Policy: CBN to create the balance

Evidently, the dovish rhetoric from the global market is expected to create a more accommodative CBN in H2-19, especially as it aims to boost overall economic growth. Additionally, our outlook for oil, inflation and exchange rate in H2-19 supports a more accommodative monetary policy in H2-19. Yet, we expect the CBN to remain cautious in its easing process as it looks to maintain overall system stability by floating further OMO auctions at attractive rates compared to NTB in a bid to sustain the current FPI inflows.

Supply Side Factor

Fiscal Policy: Will government ramp up borrowing?

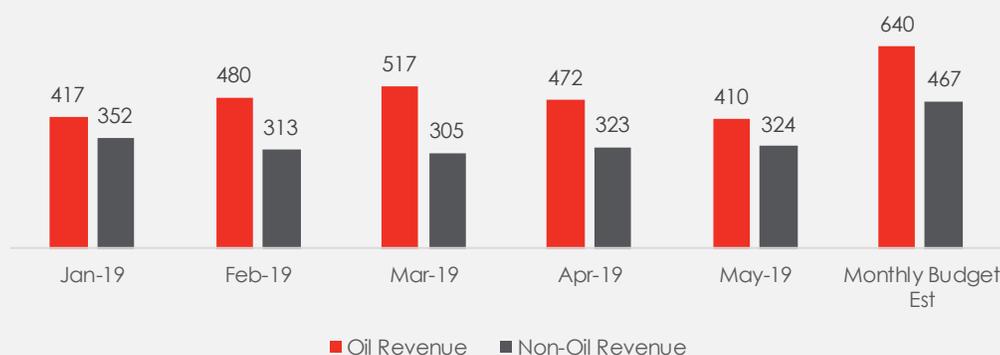
The 2019 budget which was approved in Jun-19, projects a fiscal deficit of N1.9tn (vs. N2.0tn in 2018), to be financed by a N1.6tn borrowing- split equally between domestic (N802.8bn) and foreign borrowing (N802.8bn or \$2.6bn at N306/\$). If historical trends are anything to go by, revenue mobilization is expected to continue to underperform budgeted estimate. Hence, overall fiscal deficit will widen going forward. Accordingly, we expect the government to maintain the current pace of borrowings (N100.0bn/auction) at the domestic bond market. Additionally, based on the DMO's strategy to explore concessional loan sources in 2019, the Federal Executive Council (FEC) approved FG's plan to borrow c. \$1.2bn from multilateral and bilateral sources in H1-19, leaving a wide shortfall of c. \$1.4bn to match up with the budgeted amount.

Global monetary policy setting is favourable for Nigeria's fixed income market and equities are not likely to steal the show

We expect the government to maintain the current pace of borrowings (N100.0bn/auction) at the domestic bond market

Figure 19

Revenue collection underperforming budget estimate
Components of gross federally-collected revenue (N'bn)



Source: CBN, United Capital Research

Looking at the above narratives, it is evident that the FG is likely to pace up both domestic and foreign borrowings to fill up the expected revenue gap. Thus, with the expectation for further FPI inflows in H2-19, we assume that the DMO will be willing to explore additional issuances at the local debt market which should cater for some of the budgeted revenue shortfalls. On the other hand, we do not rule out the possibility of issuing Eurobond, especially in Q4-19 when the reality of the currently large external shortfall is expected to kick-in.

Fixed income strategy for H2-19: Riding the yield curve

Aside from the development in the global monetary policy space, we believe that the major economic metric that investors will be watching, especially the Eurobond investors, will be the events in the oil market, as fortunes of the country remain dependent on oil. However, given the volatile nature of the oil market, a below \$60/bl price of global crude oil during H2-19 is likely to be trailed by sell-offs.

Looking into H2-19, we expect the yield curve to remain normal as fundamental factors highlighted above keep yields at the short-end of the curve low. Meanwhile, we expect the level of average yield to drop by c. 30-50bps from its level as at the end of H1-19. This is as the CBN is expected to continue on its path to drive down rates across the board to promote economic growth by encouraging private sector borrowings. Consequently, we believe that holders and managers of fixed-income portfolios will maximize returns by riding the yield curve through H2-19.

...we do not rule out the possibility of issuing Eurobond, especially in Q4-19

Looking into H2-19, we expect the yield curve to remain normal

Figure 20: Possible Triggers of Yield Movement in H2-19

	Probability	Yield Impact
Dovish global monetary policy tone and action	High	▼
Pro-growth CBN and MPC	High	▼
Higher FGN domestic borrowing	Moderate	▲
Below 13.0% inflation rate	High	▼
Higher FGN external borrowing	High	▼
CBN liquidity tightening via OMO sales	Moderate	▲
A further rotation away from equity to fixed income investments	Moderate	▼
A drop in monetary policy rate	High	▼

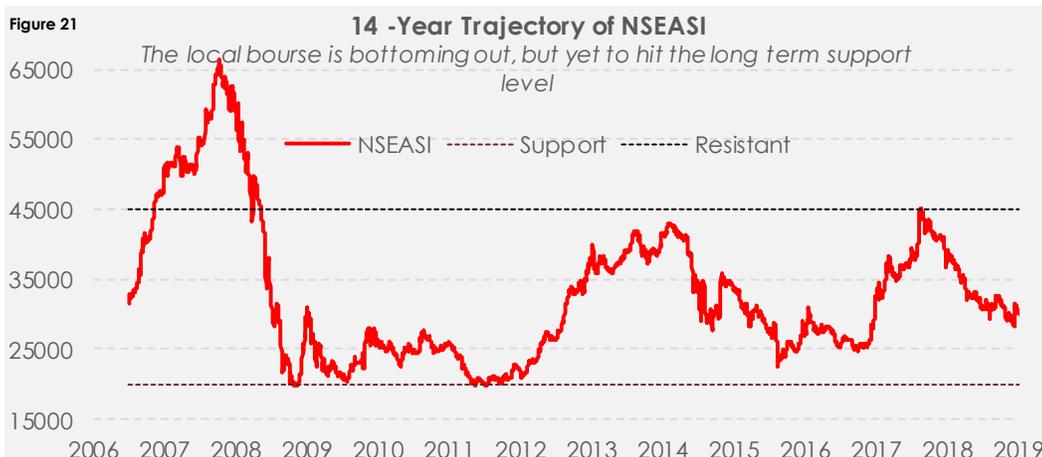
Source: United Capital Research

Equities

Will the local bourse reverse to fundamental?

In our [2019 outlook report](#), we noted that the market would be on a better balance of risk in 2019, given the general sell-off witnessed in the market in 2018. As such, it was expected to rebound based on the following factors: the cheap market valuation, the possibilities of a post-election repricing of Nigerian assets as well as an anticipated renewed foreign interest in Nigerian assets. On a balance of these highlighted factors, the local bourse was expected to revert to fundamentals, as the uncertainties that clogged sentiments in the previous year clear off.

Even though election uncertainties were out of the way and monetary policy in the global economy is increasingly looking dovish, investors continued to snub Nigerian equities despite attractive valuation, opting for short-dated money market bills. Evidently, activities at the local currency market witnessed a massive influx of foreign capital via the I & E window (with daily turnover touching a record high of \$1.9bn) immediately after the Presidential elections. Yet, activities on the local stock market stayed bearish as investors were clearly unimpressed by the outcome of the election. YTD return weakened from +3.6% before the election to -7.2% as at end of April, which marked the end of all electioneering processes (including the announcement of all gubernatorial polls). As at the end of H1-19, YTD return settled at -4.2%.



The above notwithstanding, the performance of the local bourse appeared to have been largely supported by a spree of corporate actions and primary markets activities across sectors over the period. Starting with the completion of the merger between DIAMOND and ACCESS in Mar-19 to the delisting of Diamond shares from the exchange, the market was treated to a cocktail of acquisitions, divestments and new listing as well as the announcement of Airtel's initial public offering (IPO).

In Apr-19, Olam International, a global food and agribusiness company, disclosed its interest to acquire Dangote Flour Mills Plc for an enterprise value consideration of

Despite the massive influx of foreign capital, investors continued to snub Nigerian equities

The market was treated to a cocktail of acquisitions, divestments and new listings in H1-19

N130.0bn. This news was welcomed on a cheery note by the market, spurring massive buying interest in DANGFLOUR's shares as the Stock surged 155.5% to N17.5 in H1-19.

After months of speculations, MTN Nigeria Communication Plc (MTNN), the biggest player in Nigeria's telecommunication sector, set the market on fire in May by listing a total of 20.4bn units of ordinary shares worth N1.8tn to become the second largest entity on the Nigerian bourse. The listing promptly reversed the downtrend observed in the market since January, as massive demand for the ticker which was listed at N90.0/share drove the market price to a high of N150.0/share before settling around N130.0/share. Also, in May-19, Forte Oil Plc announced the completion of the transfer of 75.0% direct and indirect shareholding of its erstwhile chairman's interest in the downstream segment of the business to Prudent Energy, through Ignite Investments and Commodities Limited. Ellah Lakes Plc, a fish farming business, also consummated a take-over deal with Telluria Ltd., via the issuance of 1.88bn units of ordinary shares.

Primary market activities also extended into Jun-19 as another giant player in the telecommunication sector, Airtel Africa Plc, announced its global IPO of ordinary shares worth \$780m (or N270.0bn). More specifically, the offer was listed on the floor of the London Stock Exchange (LSE) in Jun-19 and later on the Nigerian bourse. Lastly, Lafarge Africa Plc (WAPCO), rounded up corporate activities in H1-19, announcing the indirect sales of its South African operation to its parent company Lafarge Holcim in a bid to resolve its protracted challenges around financing, though subject to approval by its shareholders.

The above notwithstanding, all sector indices closed bearish for H1-19 save for MTNN which captures the telecom industry. The Consumer Goods Sector was the biggest loser, down 16.9% on the back of declines in INTBREW (-40.0%), GUINNESS (-33.8%), NB (-26.3%) and NESTLE (-6.4%). No thanks to the never-ending litigation on OANDO (-20.0%), the Oil & Gas Sector index fell 16.2%. Also, the Industrial Goods index followed with a 12.1% decline despite a late rebound in WAPCO (-3.6%). In the same vein, the Banking Sector index depreciated 8.0% for the period amid loses in GUARANTY (-4.5%), ZENITH (-14.1%), UBA (-19.5%), and ETI (-21.4%) while the Insurance Sector index pared 2.2%.

Outlook: Will equities rebound in H2-19?

While we had expected attractive market valuation will be one of the major factors to drive bullish performance this year, poor sentiment for equities extended into H1-19 despite increased stability in the polity, corporate actions and primary market activities in the post-election period. Notably, a weaker appetite for equities in H1-19 reduced the valuation of the Nigerian bourse, as the spread between the current market PE ratio of 7.4x against its 5-year average of 13.1x further expanded.

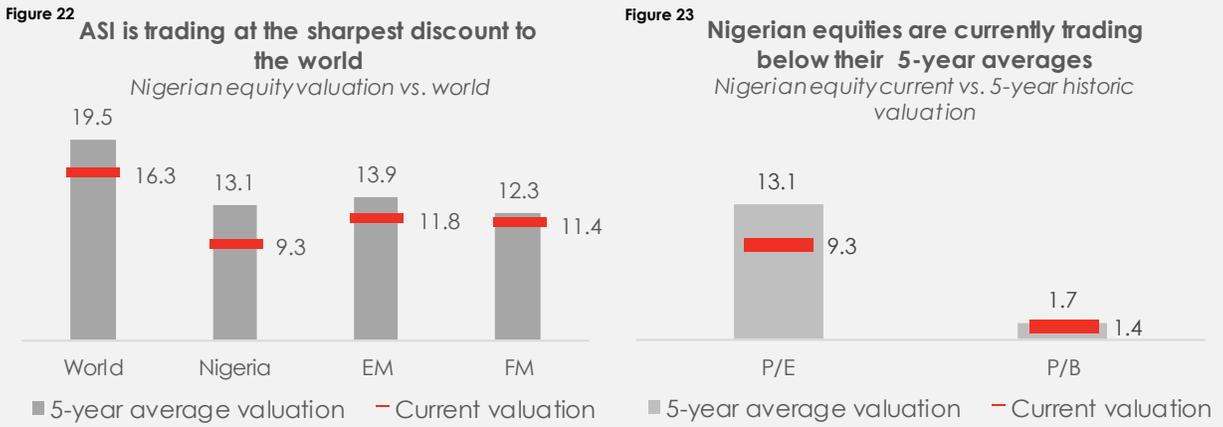
Comparatively, the Nigerian market now trades at a huge discount compared to the peer average of 11.1x, notwithstanding the MTN-effect. Accordingly, the current valuation in the market presents an opportunity for discerning investors to position for a

MTNN's listing triggered a momentary equity market rally in May-19

...poor sentiment for equities extended into H1-19 despite increased stability in the polity

medium to long-term return.

Will the market continue to ignore fundamentals?



Source: Bloomberg, NSE, United Capital Research

Source: Bloomberg, NSE, United Capital Research

In 2018, the historical strong positive correlation between the equity market and fundamentals, such as Oil prices and EPS, turned negative despite the increase in oil prices and the somewhat buoyant earnings performance in the year. We observed that the market ignored key fundamental metrics due to election uncertainties in the local economy and capital flow reversal in the global economy. Accordingly, we noted that the market should reverse to fundamentals once these concerns are out of the way. In H1-19, investors continued to disregard attractive valuation in the equities market despite improvement in the global and domestic environment. Notably, the correlation between the market and Brent prices for H1-19 stood at -35.9% compared to a 5-year average of +75.3%. Similarly, the level of correlation between the domestic bourse and EPS was -54.8% as against the 5-year historical average of +39.7%. While this analysis points to the increasing attractiveness of the Nigerian market and the need to take a long position in Nigeria, investors are likely to continue to snub equities due to deeper concerns about the policy framework of the government.

Bearish trend likely to continue in H2-19 amid an unfavourable economic environment

What does weak macroeconomic environment mean for equities?

While market valuations are seemingly compelling, the outlook for the broader macroeconomic environment suggests otherwise. GDP growth is expected to remain



Source: Bloomberg, United Capital Research

Source: Bloomberg, United Capital Research

muted or sluggish into 2020. In making a projection for market return for 2019 in our previous report, we established that a basis for a turnaround in the market from its bearish trend in 2018 after the election, would be the implementation of policy reforms and initiatives that would not only strengthen but hasten economic growth. However, the victory of the incumbent president, in contrast to a more liberal opposition, suggests that policy outlook for the Nigerian economy may remain largely the same. Clearly, this may keep investors' interest for equities soft amid expectation that growth will remain subdued by a weak policy framework and reluctance to execute bold policy reforms.

FPI Inflows in H2-19: Any possibility of a change in the narrative?

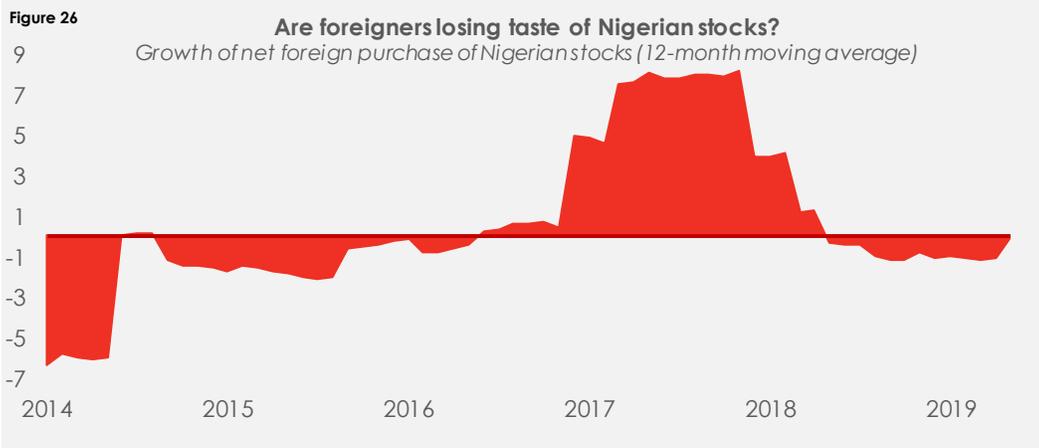
Despite the somewhat dovish tone across major central banks in the advanced economies since the beginning of H1-19, FPI flows into equities continued to taper amid increasing interest for short-dated debt securities in Nigeria. By the National Bureau of Statistics (NBS) reckoning, FPI flows continue to account for the bulk of capital imported into Nigeria. In Q1-19, it surged 56.5% y/y to \$7.1bn, however, interests in Money Market Instruments accounted for \$5.9bn or 69.8% of total capital imported into the country, as carry traders continue to relish the mouth-watering return on government bills. Evidently, the net foreign purchases gap on NSE became wider in H1-19. Clearly, to boost FPIs appetite for equities, uncertainties must be out of the way and the CBN must reduce the attractiveness of risk-free securities as monetary policy in the global economy becomes easier. Looking ahead, the possibility of a rate cut by the US Fed and the ECB points to a potential rebound in the local bourse, however, interest in Nigerian equities may be capped by the weak macroeconomic framework currently operational in the system.

Our Projection for H2-19

Putting the foregoing together, our overall outlook for equities is tepid in H2-19 despite positive monetary stance in the global space. Even though the argument for a rebound is increasingly compelling from a technical standpoint, uncertainties in the domestic policy environment linked to structural vulnerabilities are unlikely to change in the short term. Thus, risk-off sentiment will persist as carry traders continue to jump on easy money from the CBN. Yet, primary market activities may support the overall performance of the

Muted growth may persist in H2, limiting demand for local equities

Market is heavily dominated by short term investors with low risk appetite



Source: NSE, United Capital Research

broader index. This view is buttressed by the recent announcement by the CBN to recapitalize the Banks. Though the proposed recapitalization exercise in the banking sector is unlikely to have a far-reaching impact, we expect this to result in one or two consolidations, with the lower-tier banks mostly affected. Ultimately, we estimate a -0.1% y/y return for equities by the end of 2019, capping market uptrend at 31,399.1 points due to the absence of pro-market policy reforms which may continue to constrain momentum despite strong fundamentals.

Figure 27: Nigerian Equity Market: Scenario Analysis

Nigerian Equity Market: Scenario Analysis				
	Scenarios	Base Case	Bull Case	Bear Case
	Categories	Expectations	Expectations	Expectations
Global Economy	International Interest rate	US Fed maintain current status quo	US Fed actually delivers a rate cut	The Fed becomes hawkish with monetary policy
	Oil Prices (\$)	\$60/bbl - \$70/bbl reflecting global supply-demand balance	Above \$80/bbl should production tum weaker than expected	Below \$60
	Trade tensions	US-China trade truce continue to the end of 2019	Us and China reach an agreement and take back existing tariffs	US-China trade war continues with more economies joining the league
Domestic Economy	Corporate Action	Airtel completes its listing on NSE	MTN and more Companies embark on IPO	No more corporate action till the end of 2019
	Policy Rate (MPR)	maintain status quo at 13.5%	Reduce rate to 13.0%	Increase rate to 14%
	Market-friendly policies	No material policy change	Pro-market policies	Zero Reforms
Equity Market Outlook	Index level & YTD return	31,399.07 -0.1%	36,145.1 15.0%	25,710.15 -18.2%

Source: United Capital Research

Absence of pro-market policy reforms will constrain demand for equities, despite attractive valuations

Disclosure Appendix

Disclosure Appendix

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Hold: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at 31st December is greater zero but less than the Asymmetric Corridor around the MPR of the Central Bank of Nigeria (which is currently MPR – 500bps; i.e 9%).

Sell: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at December 31st is less than zero.

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Company	Disclosure
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