18 June 2021

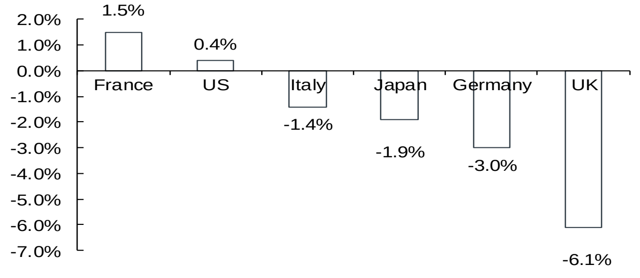
Weekly economic and market update.
Overview of markets in the week ended 18 June 2021

Global economy

In line with our expectation, the Federal Open Market Committee (FOMC) unanimously voted to (1) keep the key policy rate unchanged at 0.00%-0.25% and (2) sustain the pace of asset purchase at the current USD120.00 billion per month. Nonetheless, we highlight that the Committee's monetary policy expectations shifted as the forecasts released show that majority of the members expect to hike the interest rate at least once by the end of 2023, earlier than the initial market expectation of 2024. Besides, the Fed chairman stated that the Committee would begin a discussion about tapering its asset purchases amid the inflation concerns. **We think the Fed's decision to maintain the status-quo may be connected to the fact that the employment level is still far below pre-pandemic levels even though inflation has risen above the Fed's target. That said, we expect inflation to remain above the Fed's 2.0% target in the near term, given the low base in the prior year. Notwithstanding, we do not see a change in the policy decisions of the FOMC in 2021, given the Committee's short-term preference for supporting recovery in the labour market.**

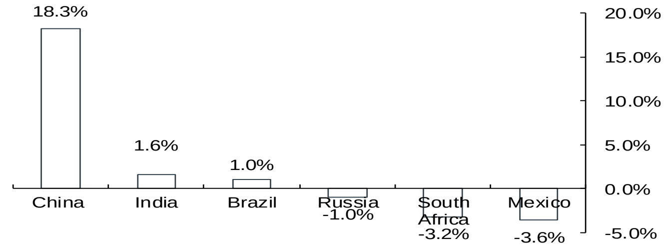
According to the Office for National Statistics (ONS), the inflation rate for the U.K increased above the Bank of England's (BOE) target of 2.0% for the first time since July 2019. Pertinently, the headline inflation increased by 60bps to 2.1% y/y in May (April: 1.5% y/y) – the highest since July 2019 (2.1% y/y). We believe the preceding stems from the impact of (1) the low base effect from the prior year and (2) rebound in consumer demand following the reopening of the economy reopens amidst higher energy prices. Accordingly, pressure were most significant in the prices of clothing (+2.1% y/y vs April: 0.0% y/y), transport (+6.5% y/y vs April: +5.0% y/y) and recreational goods (+1.9% y/y vs April: +0.7% y/y). On a month-on-month basis, the headline inflation increased printed 0.6%, the same as in April. **We expect the domestic prices to continue rising in the near term as post-lockdown demand continues to improve amidst higher energy prices and low base effects from the prior year.**

Fig 1: Annualized GDP growth rate Q1-2021 – DMs



Source: Bloomberg, Cordros Research

Fig 2: Annualized GDP growth rate Q1-2021 – EMs

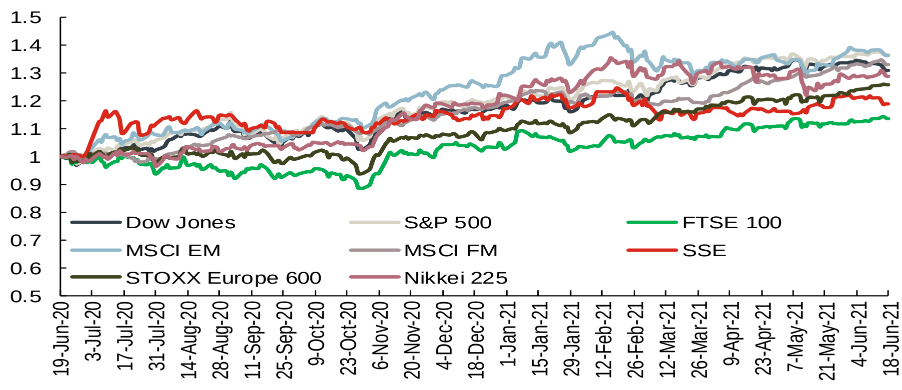


Source: Bloomberg, Cordros Research

Global markets

Global stocks posted bearish performances this week as investors' sentiments for risky assets waned in the wake of the Fed's decision which pointed towards interest rate raises in 2023, a year earlier than the market anticipated. Strong indications that the committee will soon start deliberating on tapering bond purchases further unsettled investors. In the U.S, the DJIA (-1.9%) and S&P (-0.6%) were on course to end the week in red as investors remained cautiously optimistic about reflation trade after digesting the U.S. Federal Reserve's shift to a hawkish stance. In Europe, the STOXX Europe (+0.3%) and FTSE 100 (+0.1%) were on track for a weekly gain as investors traded cautiously ahead of the BOE monetary policy decision amid relatively strong U.K economic data. In Asia, the Nikkei 225: (+0.1%) posted marginal gains amid Fed tightening concerns. Elsewhere, the SSE: (-1.8%) was on course for a weekly loss as sentiments dampened by the sell-off on Wall Street. Emerging (MSCI EM: -1.4%) stocks also mirrored the bearish trend across global equities consequent to the losses in China (-1.8%). Similarly, the Frontier (MSCI FM: -0.5%) market stocks declined, following weakness in Nigeria (-1.3%).

Fig 3: Global indices (index of 1)



Source: Bloomberg, Cordros Research

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Nigeria

Economy

According to the recent data published by the National Bureau of Statistics, Nigeria's headline inflation eased for the second consecutive month to 17.93% y/y (April: 18.12% y/y). We believe the preceding was driven by the favourable base effects from the prior year, given that the CPI increased by 1.01% m/m in May (April: 0.97% m/m). We attribute the month-on-month increase in the headline inflation to (1) limited supply of food produce to the market given the ongoing planting season, (2) pre-existing supply chain constraints and (3) increased demand for transport services. While the food inflation moderated by 44bps to 22.28% y/y, the core inflation rose by 42bps to 13.15% y/y (April: 12.73% y/y). **Given the (1) ongoing planting season across the country and (2) depreciation of the currency at the parallel market, we expect the headline inflation to increase by 12bps to 1.13% m/m in June, with the favourable base effect from the prior year translating to a y/y print of 17.83%.**

In its June 2021 Nigeria Development Update (NDU), the World Bank stated that the rising inflationary pressures, particularly on food items, is depressing economic activity and may have pushed an estimated seven million Nigerians into poverty in 2020FY alone. The Bank further expressed that the high inflation does not result primarily from supply constraints but also from policy decisions related to trade, exchange rate, fiscal and monetary factors. Accordingly, the Bank recommended that the Nigerian authorities address inflation sources through a mix of monetary, exchange rate, fiscal and trade policies, complemented by reforms that support job creation in the country. **The highlighted solutions to Nigeria's stubbornly high inflation have been suggested over time by the Bank and other global economic institutions. Unfortunately, these recommendations seem to have been neglected by policymakers. Considering the protracted delay on the part of the government in implementing structural reforms and the lack of coordination between monetary and fiscal actions, we struggle to see a notable improvement over the near term.**

Table 1: Macro indicators

Macro indicators (Nig)	Current	Year start	Forecast
Real GDP growth	0.51%	0.11%	3.37% (Q2-21)
MPR	11.50%	11.50%	11.50% (Next meeting)
CPI	17.93%	15.75%	17.83% (Jun-20)
Exchange rate (USD)	NGN410.21	NGN380.00	NGN410.21 (25th Jun)
Foreign reserve (USD billion)	33.82	35.37	33.63 (25th Jun)
Unemployment	33.28%	33.28%	*UR (Q1-21)
Brent crude oil price (USD)	73.66	51.80	65.00 (25th Jun)

Source: CBN, Bloomberg, NBS, Cordros Research estimates | UR.: Under Review

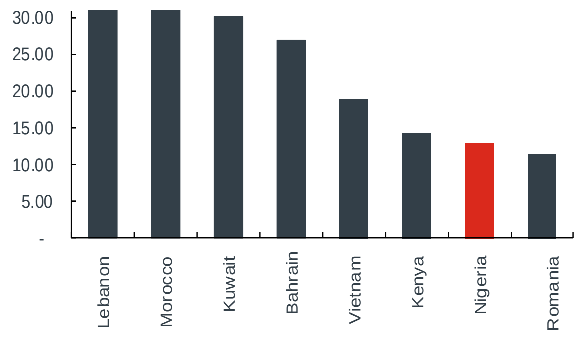
Capital markets

Equities

Although the market closed positive on three of the week's four trading sessions, the gains proved insufficient in pushing the market to a green close for the week. We observed that investors took full advantage of the gains recorded over the last two weeks in booking profit on bellwether stocks. Precisely, the NGX All-share Index shed 1.3% w/w to close at 38,648.91points. Specifically, foreign investors' sell-offs of AIRTELAF (-10.0%) and profit-taking in OKOMUOIL (-9.4%) and STANBIC (-4.9%) drove the weekly loss. Consequently, the MTD return decreased to 0.5%, while the YTD loss increased to -4.0%. Activity levels were mixed, as trading volume declined by 9.4% w/w, while trading value rose by 8.8% w/w. On the other hand, sectoral performance was broadly positive as the Banking (+1.1%), Oil and Gas (+1.0%), Insurance (+0.8%), and Consumer Goods (+0.2%) indices recorded gains. Elsewhere, the Industrial Goods index closed flat.

We expect market performance to remain mixed in the week ahead as investors rotate their portfolio towards dividend-paying stocks, which intermittent profit-taking activities would match. Notwithstanding, we advise investors to take positions in only fundamentally justified stocks as the weak macro story remains a significant headwind for corporate earnings.

Fig 4: Trailing 12M P/E ratios (frontier market)



Source: Bloomberg, Cordros Research

Table 2: Sectoral performance

	Previous week	Current week	w/w CHANGE	YtD Change
Banking	358.61	362.51	1.1%	-7.8%
Consumer Goods	566.96	568.35	0.2%	-0.9%
Industrial Goods	1952.38	1,951.41	0.0%	-4.9%
Insurance	199.42	200.93	0.8%	6.0%
Oil & Gas	310.95	314.21	1.0%	38.9%

Source: NSE, Cordros Research

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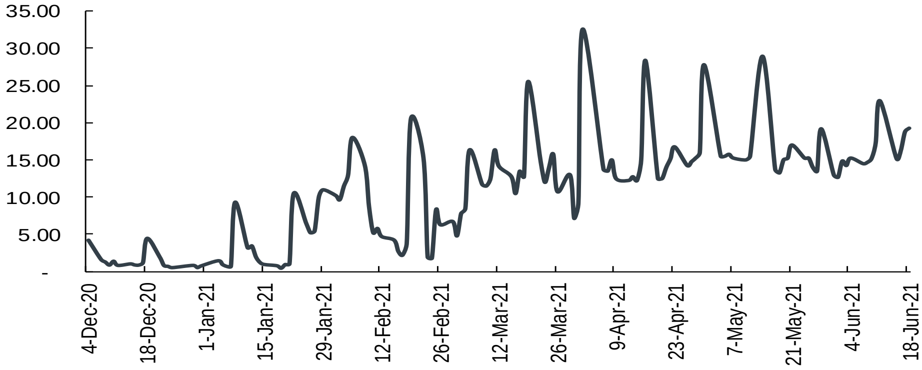
Money market and fixed income

Money market

The overnight rate contracted by 368bps w/w to 19.3%, as inflows from OMO maturities (NGN46.00 billion) saturated the system and limited the impact of outflows for NTB net issuances (NGN15.74 billion) and CBN's weekly OMO (NGN17.30 billion) and FX auctions.

We expect liquidity to remain tight in the coming week, as expected inflows from OMO maturities (NGN15.00 billion) may not be sufficient to offset the outflows from the system. Thus, we expect the OVN rate to trend higher.

Fig 5: Overnight money market rate (%)



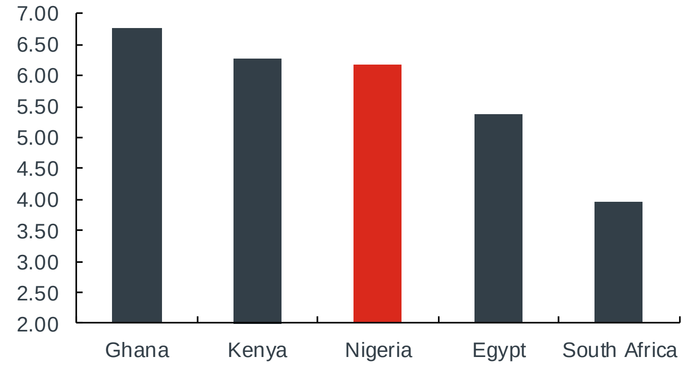
Source: FMDQ, Cordros Research

Treasury bills

The Treasury bills secondary market performance traded bearish this week, as market participants remained on the sidelines anticipating renewed supply from the mid-week auctions amid tight system liquidity. Consequently, average yields across all instruments expanded slightly by 1bp to 8.2%. Across the market segments, the average yield at the OMO segment inched higher by 2bps to 9.7% and similarly expanded by 14bps to 6.5% at the NTB segment. On Wednesday's NTB PMA, the CBN offered bills worth NGN14.84 billion with allotments of NGN1.61 billion of the 91D, NGN1.10 billion of the 182D and NGN27.87 billion of the 364D – at respective stop rates of 2.50% (previously 2.50%), 3.50% (previously 3.50%), and 9.40% (previously 9.64%). Also, the CBN sold NGN17.30 billion worth of bills to market participants at this week's OMO auction and maintained stop rates across the three tenors, as with previous auctions.

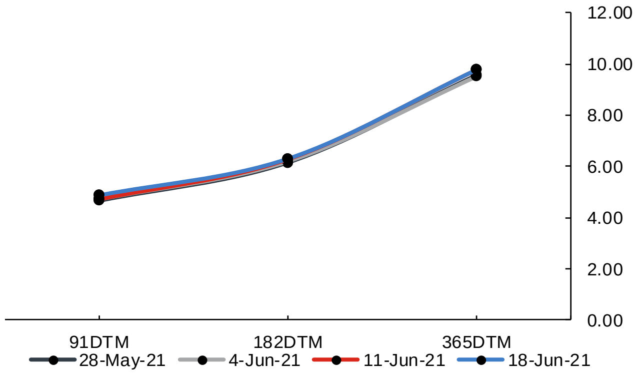
We expect yields to trend higher in the coming week as local investors sell-off positions to meet funding requirements amid the tight liquidity management posture of the CBN.

Fig 6: Yield on 10-year Eurobonds (Nigeria vs. African peers) (%)



Source: Bloomberg, Cordros Research

Fig 7: T-Bills yield curve (%)



Source: FMDQ, Cordros Research

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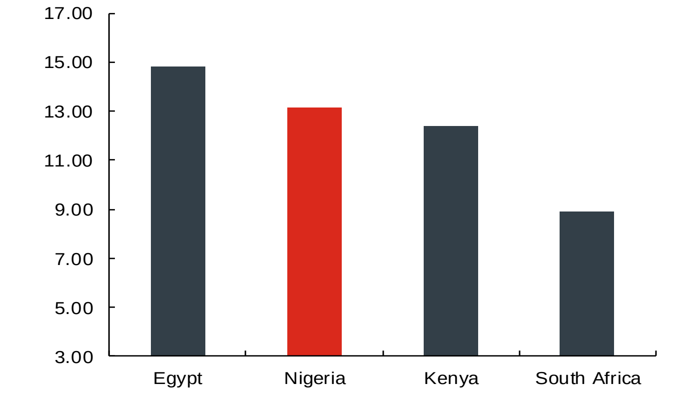
Bonds

The Treasury bonds secondary market turned bullish, as the average yield declined by 27bps to 12.0%. We attribute the drop to (1) improved demand following the improving macroeconomic conditions as signalled by the second consecutive month of decline in inflation (May 2021 CPI: 17.93% vs April: 18.12%), (2) reduced stop rates at the NTB auction albeit marginal, and (3) activities of short sellers rotating into long-dated bonds in anticipation of next week's auction. Across the curve, average yield at the mid (-37bps) and long (-45bps) segments contracted, as investors took positions in the JUL-2030 (-64bps) and JUL-2034 (-75bps) bonds, respectively. In contrast, investors continued to upwardly re-price short (+13bps) dated instruments, with major sell-offs recorded on the APR-2023 (+28bps) bond.

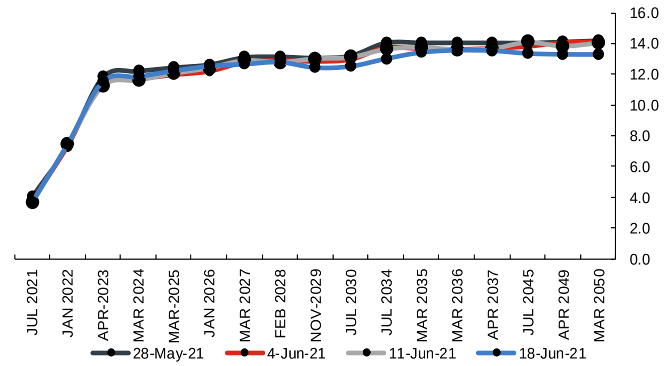
Next week, we expect the outcome of the bond auction to influence the direction of yields in the bonds secondary market. At the auction, the DMO will be offering instruments worth *c.* NGN150.00 billion through re-openings of the 16.2884% FGN MAR 2027, 12.50% FGN MAR 2035 and 12.98% FGN MAR 2050 bonds.

Fig 8: Yield on 10-year LCY bonds (Nigeria vs. African peers) (%)



Source: Bloomberg, Cordros Research

Fig 9: FGN bond yield curve (%)



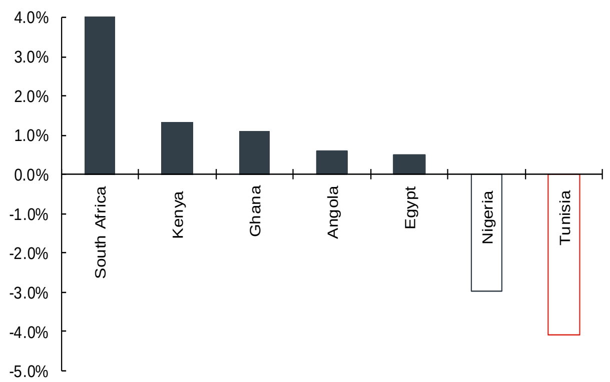
Source: FMDQ, Cordros Research

Foreign exchange

Nigeria's FX reserves sustained its decline, dipping USD182.93 million w/w to USD33.82 billion (16th June 2021) – the lowest since October 2017. Meanwhile, the naira depreciated by 0.1% to NGN411.00/USD at the I&E window (IEW) but appreciated by 0.8% to NGN498.00/USD at the parallel market. At the IEW, total turnover (as of 17th June 2021) decreased by 22.3% WTD to USD490.88 million, with trades consummated within the NGN400.00 – 412.00/USD band. In the Forwards market, the rate appreciated across the 1-month (+0.4% to NGN411.73/USD), 3-month (+0.9% to NGN415.68/USD), 6-month (+2.0% to NGN419.95/USD) and 1-year (+4.2% to NGN428.65/USD) contracts.

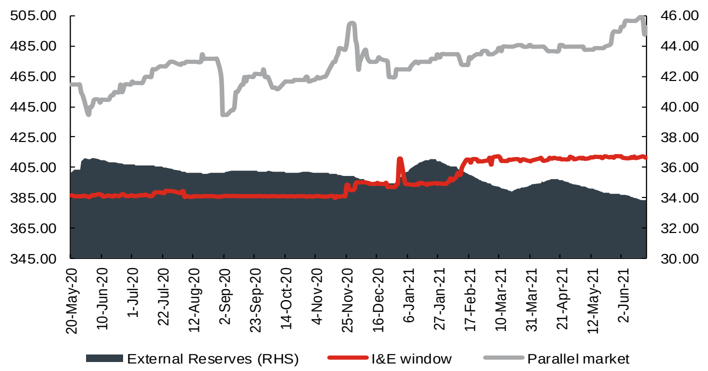
We expect improved liquidity in the IEW over the medium term, given our expectation of (1) increased oil inflows in line with the rise in crude oil prices, and (2) inflows from FCY borrowings. Accordingly, we expect the naira to remain relatively range-bound (NGN410.00/USD – NGN415.00/USD) at the IEW.

Fig 10: USD/NGN vs other African currencies (YtD returns)



Source: Bloomberg, Cordros Research

Fig 11: USD/NGN exchange rate vs. external reserves (USD'bn)



Source: FMDQ, CBN, aboki FX, Cordros Research

Top business headlines of the week

- Naira tumbles by 51.95% despite CBN's defence measures
- CBN may start printing Gambia's currency, says Emefiele
- External reserves drop by $1.4bn in two months
- Return of fuel subsidies disturbing, IMF tells FG