



Navigating the Tide

January 2022



Executive Summary

Recovery in the global economy is expected to be sustained albeit the pace of growth may be slower than 2021 given base effects; nonetheless, we see the return of economic activities and spending to levels seen prior to the pandemic, sometime in H2 2022. The U.S. economy remains poised for sustained economic recovery in 2022. Similarly, the Eurozone economy continues to recover with signs of improvement seen in the labour market. Elsewhere, the United Kingdom may continue to record a slowdown in the pace of recovery on the back of supply chain issues and labour shortages due to Brexit. The rapid economic recovery from successful vaccination rollout in Q2 2021 seems to be fading following rise in Covid cases, occasioned by the Omicron variant.

In Nigeria, the oil sector was ridden with continuous divestment in the upstream sector, pipeline vandalism and leakages, poor pipeline maintenance and oil theft. These factors may continue to impede the country's ability to improve its volume production in line with OPEC's output expansion in 2022. We opine that the resilience seen in the agricultural sector is not unconnected with the intervention efforts of the CBN. Hence, the sector could maintain its slow growth pattern in 2022 on the back of CBN's intervention effort. However, insecurity challenges, especially as election year approaches, remains key downside risk in that space. Overall, we expect GDP growth to register at around 2.50% in 2022 as base effects wanes in line with normalisation in economic activities. Major downside risk includes fuel subsidy removal, higher electricity prices, insecurity, continuous uncontrolled spread of coronavirus and FX volatility.

Given the tacit devaluation we saw on the last day of 2021 at the IEFX window to N435/\$, we highlight that the Naira will remain relatively stable at that level in 2022. As such, we opine that we are unlikely to see a major devaluation in the Naira beyond that level. At the parallel market, we expect rates to remain pressured given limited FX supply however, one factor to watch closely in 2022 will be the CBN's stance on revoking the ban on Bureau De Change Operators.

Furthermore, the commencement of Dangote refinery operations may provide some respite.

As most global central banks pursue restrictive monetary policies in 2022 coupled with the political uncertainty associated with the electioneering year, we believe that the CBN may raise the policy rate to attract investors, capital flows and prevent capital flight out of the country. Consequently, we posit that the monetary policy rate might increase by 50-100bps in H2 2022. Furthermore, we posit that the direction of yields will be determined by demand and supply dynamics, and we expect yields to increase from 2021 levels.

In the equities space, we expect earnings performance to attract investors especially in the first quarter, when full-year results will be released. With expectations of decent performances, we see investors buying into the market and taking positions in bellwether stocks specifically dividend-paying names.

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EQUITY

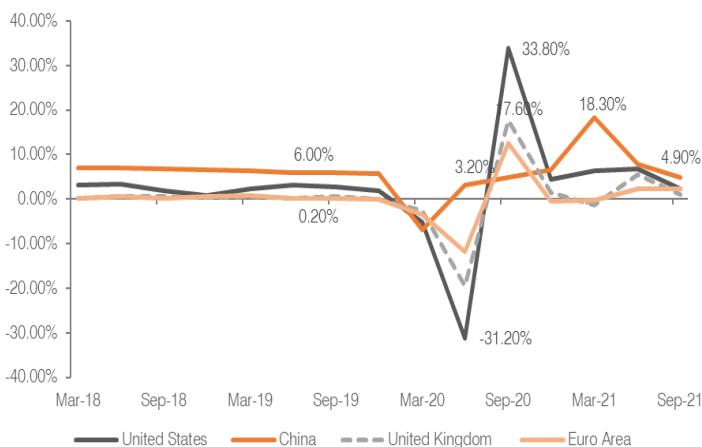
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Recovery to be Sustained

The road to recovery post Coronavirus outbreak has been bumpy although significant progress has been made with the virus, alongside its devastating variants, likely to be in the rear-view mirror by the end of 2022. We expect global economy recovery to be sustained albeit the pace of growth may be slower than 2021 given base effects; nonetheless, we see the return of economic activities and spending to levels seen prior to the pandemic sometime in H2 2022. Supportive fiscal and monetary policy environment will remain key alongside continued relaxation of COVID-19 related restrictions that will support industries such as Tourism and Travel. The worst is over for supply chain disruptions, although problems could resurface during peak periods such as the Lunar New Year in 2022 or during outbreak of new variants. Inevitably, we expect that supply chain bottlenecks will continue to ease.

GDP growth rates over the previous quarter (seasonally adjusted data)

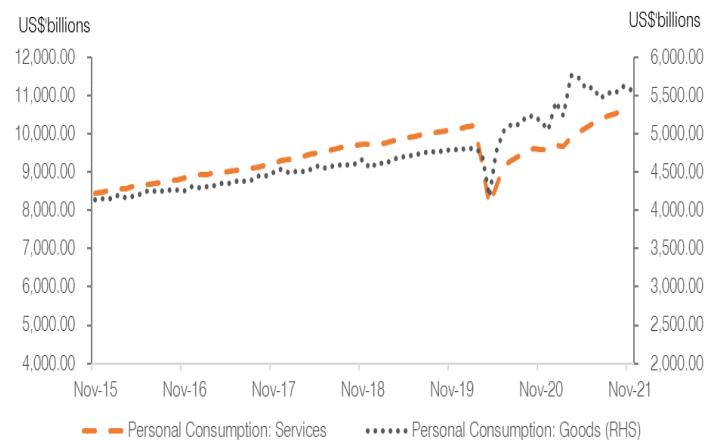


Source: Bloomberg, Investment One Research

The outbreak of new Coronavirus variants, more transmissible and deadly than existing variants, represents key downside risk to economic recovery in 2022. However, we hold some optimism on the back of rapid vaccination efforts around the world and vaccine efficiency thus far. This should help limit Covid related fears and disruptions. We see soft restrictions remaining dominant in affected regions like Europe during the first half of 2022; likewise, we also expect the pandemic to leave lasting impact on some day-to-day activities.

Work from Home (WFH) culture, Online Education and Virtual Reality are some of the areas we expect to see rapid acceptance and growth. The U.S. economy remains poised for sustained economic recovery in 2022. We expect recovery to be supported by increased consumer spending (a shift towards services consumption) on the back of robust household income and accumulated savings from robust wage growth.

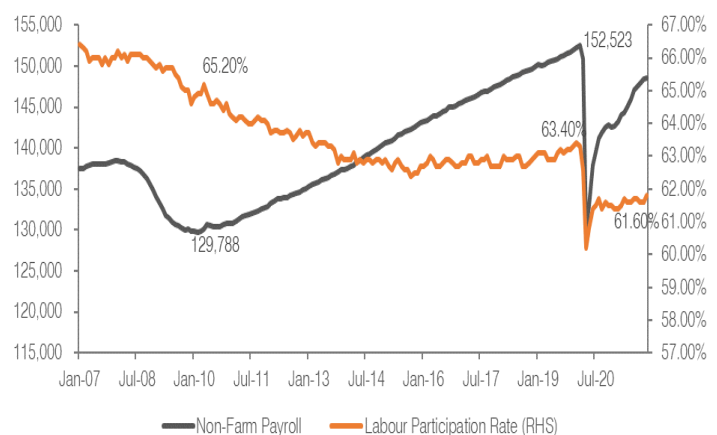
Spending on Services to catch up with Spending on Goods



Source: Bloomberg, Investment One Research

We have seen unemployment numbers decline (from 6.70% in December 2020 to 4.20% in November 2021) although labour participation remains weak at 61.80% due to reluctance of people to return to work in the face of the pandemic and early retirements among those above 50years of age. We opine that as more people become vaccinated and receive booster shots, confidence should gradually be restored to the labour force boding positively for labour participation rate.

GDP growth rates over the previous quarter (seasonally adjusted data)



Source: Bloomberg, Investment One Research



This may help stem wage inflation growth. We also see the drying up of pandemic savings and stimulus pushing people back to the labour market.

Nonetheless, we expect inflation to continue trending upwards in the earliest months of 2022 before slowing down for the rest of the year. We believe recent restrictions on movement across some developed economies as a result of the Omicron variant may constitute upward pressure on prices and further strain, albeit temporarily, supply chain disruptions.

The Eurozone economy continues to recover with signs of improvement seen in the labour market (more people having jobs and fewer in job retention schemes), this has been on the back of adequate policy support. Although the pace of recovery has slowed in the last quarter of 2021 as some countries re-introduced travel and activity restrictions, we expect growth to return strongly in 2022. Inflation in the euro area has been climbing as a result of jump in energy prices, and weaker supply unable to keep pace with consumer demand. As in the U.S., inflation is expected to remain elevated in the near term but should ease in the course of the year.

We believe the improvements in the labour market supports rising household income and consumption; this should translate to robust demand and spur economic recovery. However, recent restrictions would delay recovery in reopening sectors like Travel, Tourism and Hospitality. Likewise, rising energy price may pressure consumers wallets. Nonetheless, we expect energy prices to stabilise, consumption patterns to normalise, and price pressures from global supply bottlenecks to subside.

Elsewhere, the United Kingdom may continue to record a slowdown in the pace of recovery on the back of supply chain issues and labour shortages due to Brexit. The rapid economic recovery from successful vaccination rollout in Q2 2021 seems to be fading following rise in Covid cases, occasioned by the Omicron variant. We saw GDP growth slow to 1.30% in Q3 2021 from 5.50% in Q2 2021. Further decline in the pace of recovery remains likely as ongoing supply chain issues and skill shortages constrain production output.

Nonetheless, we expect consumer demand to continue strong recovery in line with the reopening of the economy and accumulated savings from the pandemic years.

Recovery in China's economy continued as it grew by 9.80% in the first nine months of 2021. However, signs of slowdown in growth were observed in its Q3 2021 GDP growth numbers which slowed to 4.90%, below 5.20% estimates based on analysts polled by Reuters. This was not unconnected with power shortages, regulatory uncertainty, property market woes and global supply chain bottlenecks. While we expect further recovery going into 2022, we see growth coming in at a slower pace on the back of high base effect. Furthermore, regulatory uncertainty in the Chinese Technology sector may pose downside risk to growth in 2022. Although the Chinese authorities have responded to risks in the real estate sector, the property market downturn remains a key factor that could drag economy growth as property investment growth is likely to further moderate in 2022. We opine that declining Chinese economic growth poses some level of uncertainty to other parts of emerging Asia.

Overall, we posit that sustained vaccination/booster shots administration, rising inflation, rising interest rates and moderate equity returns are likely to be major themes in global space in 2022.

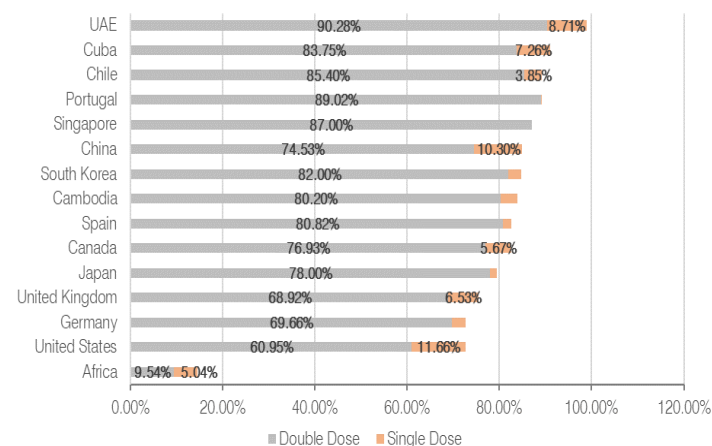
Vaccination Efforts to Continue Intensifying

At the onset of the coronavirus pandemic, it was largely mulled by experts and several global medical agencies around the world that coronavirus vaccine would not be available until 2022. However, today, the reality is much more favourable as about 58% of the total world population is vaccinated, at least by a dose (only about 8.8% of people in low-income countries have received at least one dose). This signifies the commendable progress the world has made against the pandemic and in ushering global economic recovery despite the virus mutation and outbreak of troublesome variants. Thankfully, existing vaccines have shown efficacy against new variants that have sprouted thus far. Although the public health crisis is still ongoing, many people have been vaccinated and booster campaigns have accelerated.



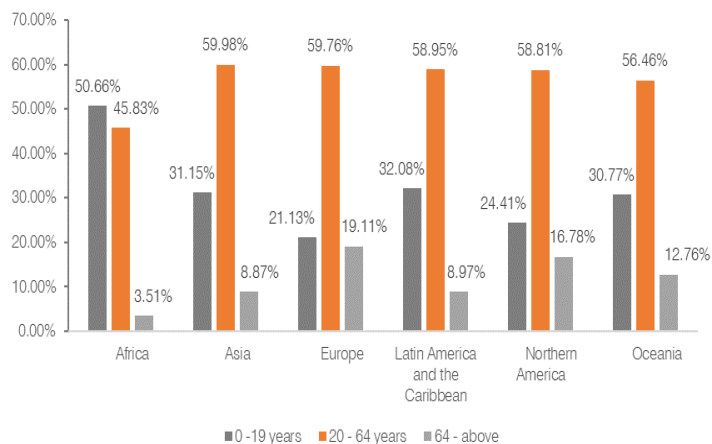
Overall, the global society has become better at coping with the pandemic waves and resulting constraints. This has and will continue to lessen the pandemic impact on the economy. We see continued economic recovery in 2022 as we expect vaccination efforts to improve around the world, especially in developing countries. The recent approval of new relatively cheaper vaccines (Novavax: US\$16 per dose vs Pfizer: US\$19.50 per dose vs Moderna: US\$37 per dose) by the World Health Organisation for developing countries should bode positively for vaccination efforts in those regions.

Rapid Vaccination in Developed Economies



Source: Our World in Data, Investment One Research

Africa Benefits from Relative Younger Population

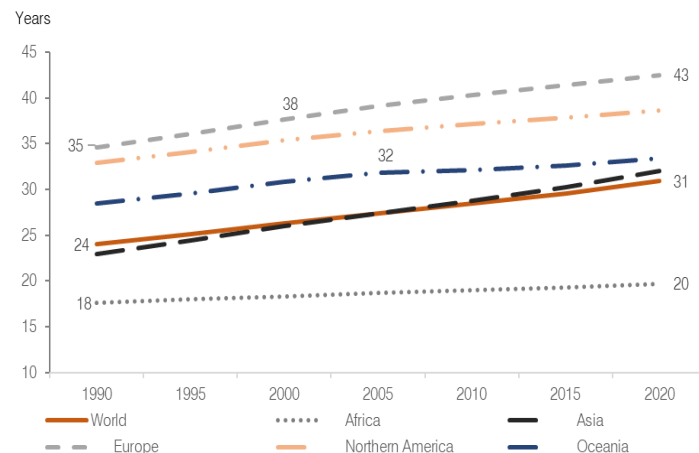


Source: United Nations, Investment One Research

In developed economies, we expect booster shots campaign to intensify especially as majority of the population belong to the older age group who are more susceptible to alarming cases from the virus.

We believe the young population in developing economies like Africa has proven favourable for the continent and improvement in vaccination program (single and double dose) should go a long way to limiting the spread of the virus.

Median Age of World Population



Source: United Nations, Investment One Research

Inflation: Prices to Rise, then Fall

“Transitory” was the term echoed by major central banks in describing the rise in price levels during 2021. This was largely due to a base effect that was expected to smoothen out quickly. For context, we highlight that at the onset of the COVID-19 crisis, reopening sectors had no pricing power. There was no demand due to government-mandated lockdowns and restrictions. However, with economies reopening and travel picking up in mid-2021, these sectors started to regain some pricing power from exceptionally low levels causing sharp increases in inflation.

As supply chain bottlenecks linger for longer than initially expected, we have seen inflation hit 6.20%, the highest in four decades in the United States. The Euro zone inflation rate hits a record 4.90% while the UK inflation touched 5.10%, representing a 10-year high. Major central banks are now tilting towards a more hawkish stance.

While major banks are being forced to hike interest rates sooner due to rising inflation, we do not see rate hikes as the sole solution in reversing the current upward trend in inflation because the sources of inflation are predominantly supply chain bottlenecks,

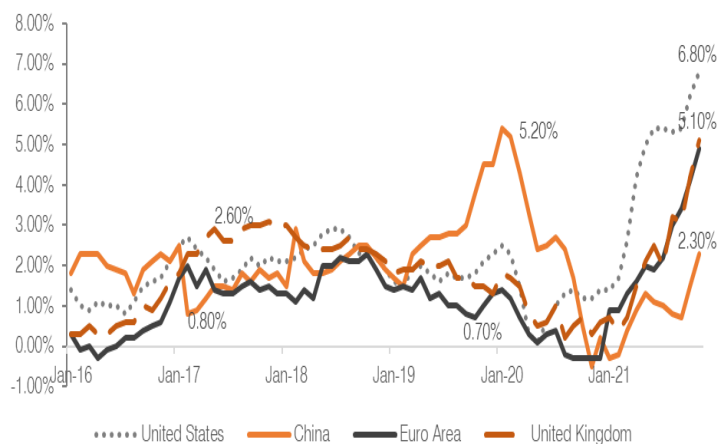


shortages in labour, materials & equipment and fiscal spending, which are areas that apex banks have no control.

Hence, we see production supply lagging speedy demand recovery in the near term occasioned by further disruptions from the Omicron variant exacerbating existing supply chain issues. Nonetheless, these issues are expected to ease further into the year. However, we spotlight that rise in interest rate could potentially slowdown consumers spending and demand capacity as cost of consumer loans inch higher.

It is likely that consumers face higher prices for earliest months of 2022 before an eventual slowdown begins on the back of easing in bottlenecks and pickup in industrial production. Furthermore, the continued slowdown in the pace of wage growth in the U.S. should bode positively for decline in consumer prices. We expect workers to continue returning to the labour market, which would help moderate wage growth.

Inflation Still on the Rise



Source: Bloomberg, Investment One Research

Doves vs Hawks: Rates to Rise

For most of 2021, we saw rapid recovery in consumer demand supported by fiscal stimulus and accommodative monetary policy stance across developed countries. Additionally, we saw major central banks show comfort in the face of the uptick in inflation as it was expected to linger for a short period before eventually phasing out.

However, the reality has been markedly different with inflation running hot and this has caused many major central banks to reconsider their accommodative stance.

Although some of the monetary supports are expected to continue into 2022, recent moves by global central banks suggest we may see most of these supports subside, perhaps completely, by mid-2022. Nonetheless, we note that there are indications that there will be a bit of divergence in central banks approach to economic recovery in 2022.

The European Central Bank (ECB) has taken a much more accommodating (dovish) approach relative to the U.S. Fed and Bank of England (BOE). The ECB is not projecting an increase in interest rate in 2022, however, in Q1 2022, the Governing Council expects to conduct net asset purchases under the Pandemic Emergency Purchase Programme (PEPP) at a slower pace than in Q4 2021. Furthermore, the ECB has affirmed that it will discontinue net asset purchases under the PEPP at the end of March 2022. The ECB's decision of its PEPP program is similar to the U.S. Fed's decision to end its bond buyback program by March 2022. However, unlike the ECB, the U.S. FED began tapering its bond buy back since its November meeting; it is expected that the Fed will be buying US\$60 billion of bonds each month starting in January 2022, from US\$30 billion in December 2021 and US\$15 billion in November 2021. Furthermore, the FOMC also projects three rates hike in 2022 in contrast with the ECB's plans but more in line with the BOE's plans in our opinion. With a surprise rate hike already in 2021, we opine that the BOE may further raise rates in 2022 owing to ongoing upside inflation risks.

In line with the ECB, the Bank of Japan at its latest monetary policy meeting scaled down emergency pandemic funding but maintained its dovish policy and extended financial relief for small firms. This indicates that the bank may likely remain among the most accommodative central banks in 2022.

It is unusual to see such a gap between central banks experiencing relatively similar economic conditions. However, we see the hawks taking this one.



Rise in interest rates in developed market would normally lead to increase in rates in emerging and frontier economies as emerging central banks look to stem portfolio capital outflow and currency depreciation against the US dollar and other major currencies. We see this playing out in 2022 especially as many emerging market economies have high debt levels. This would have been rather different if expected rise in interest rates is driven by favourable growth prospects where stronger developed economies would increase imports from trading partners and boost investor confidence.

Some emerging market currencies, including the Brazilian real, Turkish lira and South African rand, have already suffered sharp losses against a strengthening U.S. dollar in recent months. We are already seeing yields on emerging bonds increase and capital flows to the emerging markets drying up on the expectation of higher U.S. interest rates in 2022. This could push banks in developing economy to act to stem outflows and currency depreciation.

Developing Economies Currency Weaken Against the Dollar*



Source: Bloomberg, Investment One Research
 *Data is Factored to 100

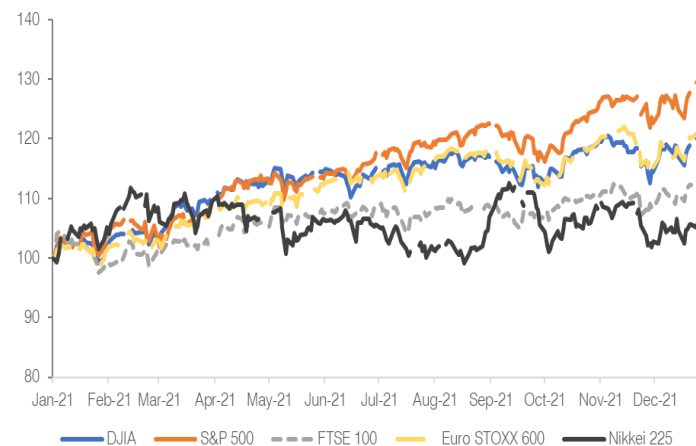
Moderate Equity Returns Expected

Equity returns in 2022 are likely to be modest relative to the large gains seen in 2021. The shift to hawkish tone from major apex banks, expected normalisation in economic growth and potential moderation in earnings growth (as base effect and fiscal stimulus thins out in the face of rising input cost) support our view. We see steeper yield curves favouring cyclical value stocks over technology and growth stocks.

We opine that the sectors (Travel, Tourism, Hospitality, Leisure etc) tied to the reopening of the economy may present rewarding opportunities to investors, however, outbreak of Covid-19 variants continue remains a major headwind risk in that space. Furthermore, given the potential increase in interest rates across major economies, Financials (especially banks) should be among the key beneficiaries. Increased distributions to shareholders through dividends and buybacks should bode positively for financials. Likewise, we expect the global supply chain pressures to moderate in 2022 and the Industrial sector stands to benefit from the pick-up in global industrial production momentum. While the energy sector may benefit from a full recovery from the pandemic, transition to green energy and environmental, social and governance (ESG) concerns remain.

UK equities have lagged the worldwide rally in 2021. Sector composition remains a major drawback, given the low technology exposure of the FTSE 100 Index. The index remains one of the cheapest among major advanced markets and it has the capacity to outperform in a global cyclical rally as economic activity pick up and COVID-19 fear ease. Furthermore, with the FTSE 100 offering an average dividend yield of about 3.90%, which is the best among major indices, this should serve as a catalyst in attracting income-seeking investors.

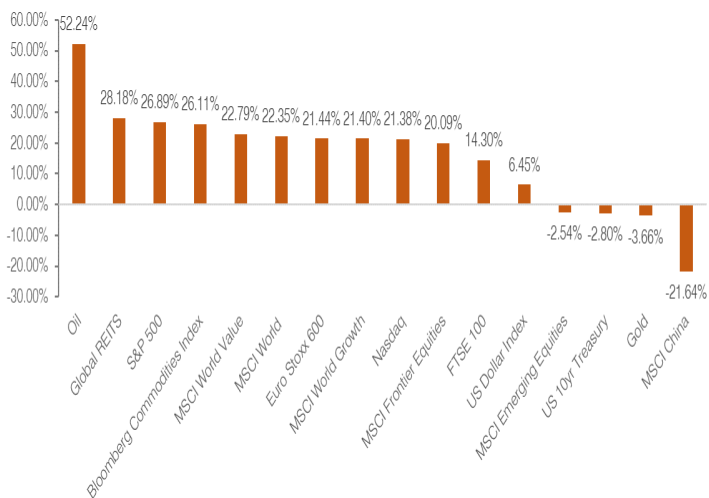
Equities Market in 2021*



Source: Bloomberg, Investment One Research
 *Data Factored to 100



Asset Performance in 2021



Source: Bloomberg, Investment One Research

Key Market Indices

Africa	P/E (x)	P/BV (x)	D.Y
NGX INDEX	9.82	2.02	4.65%
JALSH INDEX	12.44	2.14	4.15%
NSEASI INDEX	11.49	1.87	3.35%
EGX 30 INDEX	9.14	1.62	1.43%
MAURITIUS	N/A	0.64	3.00%
MOROCCO	23.14	3.45	2.74%
MSCI FM	14.48	2.27	2.71%
Emerging	P/E (x)	P/BV (x)	D.Y
SHANGHAI SE	15.30	1.65	2.01%
S&P BSE SENSEX	28.05	3.66	0.95%
KARACHI 100	5.24	1.01	7.55%
IBOV INDEX	6.55	1.69	8.52%
MOEX RUSSIA	7.16	1.13	5.76%
MSCI EM	13.81	1.79	2.42%
Developed	P/E (x)	P/BV (x)	D.Y
DOW JONES	20.09	4.92	1.74%
NASDAQ	124.84	6.52	0.64%
S&P 500 INDEX	25.81	4.83	1.29%
FTSE 100 INDEX	17.87	1.87	3.82%
CAC 40 INDEX	21.98	2.05	2.07%
DAX INDEX	15.50	1.95	2.07%
NIKKEI 225	16.22	1.89	1.67%
HANG SENG	9.37	0.98	2.53%
FTSE STR TIMES	22.63	1.07	4.35%
MSCI U.S	26.61	4.87	1.27%

Source: Bloomberg, Investment One Research

Oil Price: Supply to Match Demand

The strong recovery in oil demand during 2021 pushed oil price to year highs. This was supported by rapid vaccination programs in most developed economies, which helped faster reopening of the economy, and slower pace of ramp up in oil production – due to OPEC+ production cap. However, oil price faced some volatility over the outbreak of new COVID variants which tampered with the pace of global oil demand recovery.

In 2022, we expect oil demand recovery to continue albeit at a slower pace. As fears of Omicron variant simmer, we see sustained return of oil demand.

For context, recent data from International Energy Agency (IEA) shows that global demand reached 97.69mbpd in 2021, compared to 94.10mbpd in 2020 and 99.50mbpd in 2019 (pre-covid). This is a pointer as to what to expect in 2022. However, we posit that soft travel bans and restriction in Europe and other regions impacted by pandemic may continue to slow demand recovery (especially Jet fuel) in the earliest parts of 2022.

On the supply side, we see OPEC+ sticking to their current oil production plan of expanding oil production by 400,000bpd until mid-2022. This should push global supply to an equilibrium with demand. However, we note that capacity-led shortfalls among some OPEC+ countries may impede the cartels plan to significantly increase supply during the earliest months of 2022. We recall that OPEC+ members such as Nigeria, Angola and Kazakhstan have struggled in recent months to raise output due to years of under-investment (investment now flow to the renewables sector) or large maintenance work that has been delayed by the COVID -19 pandemic. This is markedly different from the norm where member nations produce above agreed targets.

One key event to watch going forward is the US-Iran Nuclear deal negotiations. Successful negotiation between the United States and Iran and restoration of the nuclear deal could potentially free up to over 1mbpd of Iranian supply to re-enter the global market. An increase of that size could put downward pressure on benchmark global oil prices.

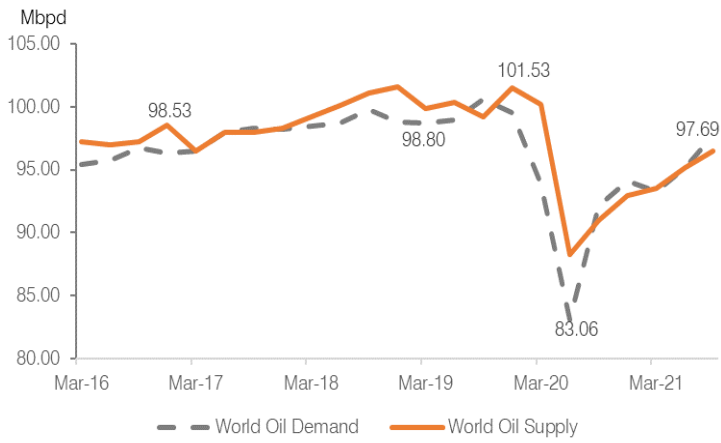
Oil Price Trend in 2021



Source: Bloomberg, Investment One Research



World Oil Supply vs. Demand



Source: IEA, OPEC, Bloomberg, Investment One Research



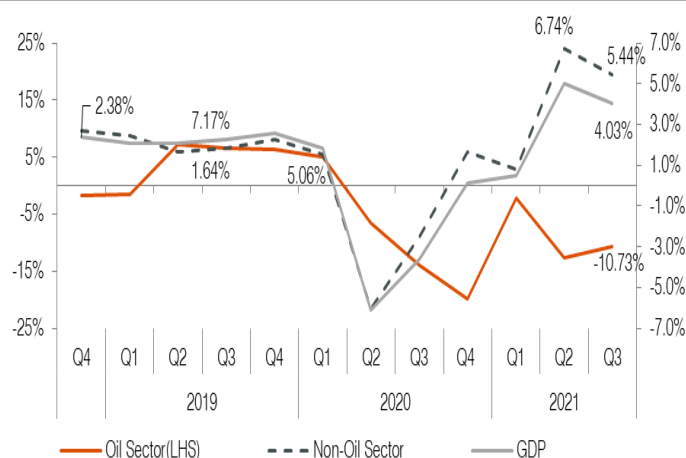
A Steady Progression

In 2021, the Nigerian economy continued to build on recovery first observed in Q4 2020. However, recovery remained fragile but supported by low base effect from 2020. GDP growth for Q3 2021 registered at 4.03%, this was largely supported by rebound in the non-oil sector (majorly Services sector) as the oil sector faced several production and operational challenges which limited output.

Despite the easing of production supply curbs by OPEC and its allied members, oil production in Nigeria continued to lag pre-pandemic levels and OPEC supply levels. Average daily production volume registered at 1.57mbpd (from 1.67mbpd in Q3 2020 and 1.61mbpd in Q2 2021). The sector (contracted by 10.73% y/y in Q3 2021) was ridden with continuous divestment in the upstream sector, pipeline vandalism and leakages, poor pipeline maintenance and oil theft. These factors may continue to impede the country's ability to improve its volume production in line with OPEC's output expansion in 2022. While the implementation of the Petroleum Industry Act should be positive, the current global energy transition may limit potential gains.

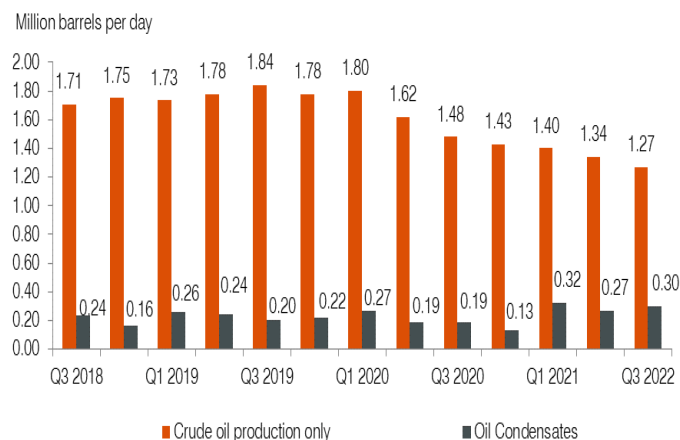
We believe farmer-herder crisis and banditry activities in key food-producing states continued to discourage farming activities, making the sector highly vulnerable to insecurity. We opine that the resilience seen in the agricultural sector is not unconnected with the intervention efforts of the CBN. Hence, the sector could maintain its slow growth pattern in 2022 on the back of CBN's intervention effort. However, insecurity challenges, especially as election year approaches, remains key downside risk in that space.

Growth Supported by Lower Base



Source: NBS, Investment One Research

Nigeria's Oil Production Under Pressure



Source: NBS, Investment One Research

The agricultural sector continued to recover during the year although we observed that growth slowed from one quarter to another signifying that the sector remained under pressure. The sector recorded a growth of 1.22% in Q3 2021, compared to 1.39% in the same quarter last year.

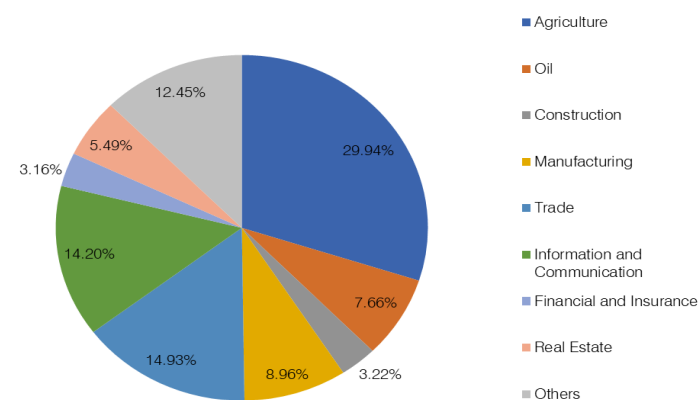
In the manufacturing space, we saw sustained recovery with a growth of 4.29% in Q3 2021, representing the third quarter of increasing growth. While the sector was supported by base effect, we opine that improved FX liquidity (relative to 2020) and absence of strict restrictions may have supported recovery during the year. Going forward, we expect recovery to be sustained and supported by continued recovery in the cement sector, stability in the FX space, CBN interventions in various sub-sectors and inelasticity on demand in the Food and Beverage and Tobacco sub-sectors. However, fuel subsidy removal could raise input costs and wane consumer spending abilities. Elsewhere, oil refining sub-sector, which has contracted for 11 consecutive quarters, may see some respite considering potential commencement of operations at Dangote refinery.

In the Construction sector, we expect that the pace of recovery seen so far may be sustained in 2022 although major activities could come from the private sector as the present administration prioritizes social



spending ahead of capital expenditure ahead of 2023 presidential elections. Nonetheless, election spending activities towards the end of 2022 may bode positively for economic activities as campaigning, travel, goods, and cash given out to voters all add to the spending in the economy.

GDP Sectoral Contribution



Source: NBS, Investment One Research

Although growth in the Information and Communication sector slowed to single digit in 2021 following the FGs enforcement of a compulsory registration and linkage of Subscriber Identity Module (SIM) cards with National Identification Number (NIN), this led to blockage of SIMs and loss of subscribers for major telecom providers. According to data from Nigerian Communications Commission (NCC), MTN, Airtel, Glo, and 9mobile lost over 14 million data subscribers between November 2020 and October 2021. However, with the ban on new sim registration lifted and extension of deadline on SIM-NIN linkage, we may see the sector post relatively stronger growth in 2022. Furthermore, the newly issued Payment Service Bank License (PSB) to major service providers may be positive for financial inclusion, capturing of the informal sector and GDP growth in the medium to long term.

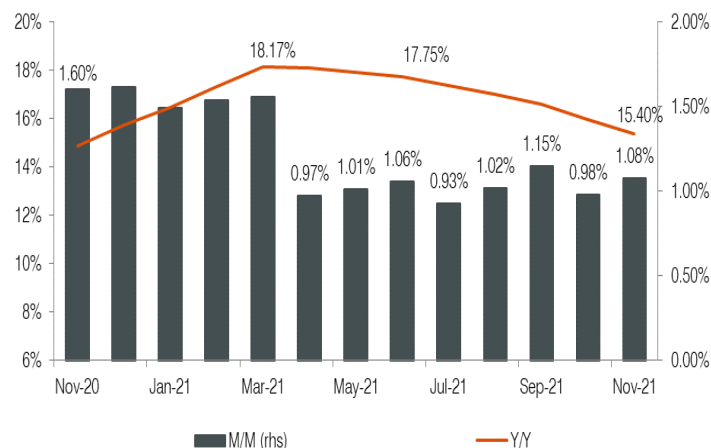
Overall, we expect GDP growth to register at around 2.50% in 2022 as base effects wanes in line with normalisation in economic activities. Major downside risk includes fuel subsidy removal, higher electricity prices, insecurity, continuous uncontrolled spread of coronavirus and FX volatility.

Nigeria Inflation Review

During the first three months of 2021, headline inflation trended upwards before moderating for the rest of the year. We observed that food prices were pressured by shortages in food supply fostered by security concerns in the middle-belt and northern region of the country, which has seen farm owners lose their farmlands to bandits and terrorists. Nonetheless, the disinflation witnessed from April was as a result of the high base effect of 2020. Unlike in 2020, where nationwide lockdown was imposed to curb the spread of Coronavirus, most of these restrictions were either removed or softened in 2021 allowing for increased economic activities.

The year started with inflation rising to 18.17% y/y in March, from 15.75% in December 2020. The rise in consumer prices in March represented the nineteen-month consecutive rise in headline numbers. By November, inflation decelerated for 8 months to 15.40% y/y as base effect kicked in.

Headline Inflation Trend



Source: NBS, Investment One Research

Going into 2022, we expect the movement in price levels to continue to be driven by base effect from 2021, developments on the removal of fuel subsidy, election spending, insecurity, and electricity tariffs.

Base Effect: Benefits to Linger in the Near Term

In analysing changes in inflation rates, it is necessary to understand the extent to which they reflect index movements that took place in the comparable period through base effects and the extent to which inflation numbers reflect current price developments.



Base effects occur when variations in the movement in y/y inflation numbers are attributable to an abnormal movement in the index in the base period. In other words, base effect is when the percentage change in price appears smaller (higher) due to impact of higher (lower) base in the comparing period.

Judging from Nigeria's inflation data, we observed stronger movements in m/m rate of change following the outbreak of the Coronavirus pandemic relative to periods preceding March 2020. This m/m change remained strong until April 2021 before a slowdown and consequent base effect benefits filtered into y/y headline inflation numbers. As such, we expect to see continued slowdown in the pace of inflation for Q1 2022 largely on the back of high base effect as m/m movements in Q1 2021 were somewhat atypical. Month-on-Month headline inflation reading averaged 1.53% in Q1 2021 but averaged 1.03% from April to November which is much more in line with an average of 0.97% m/m change between 2010 and 2021. Nonetheless, we spotlight that various pressure points such as FX shortages and removal of subsidy may be significant enough to outweigh base effect.

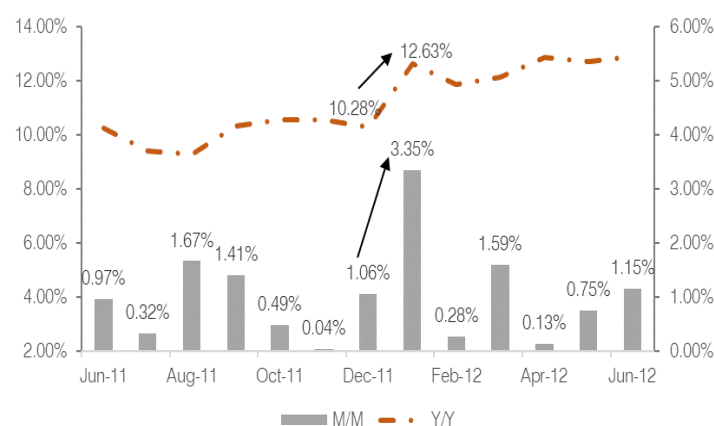
Fuel Subsidy: Key Upside Risk

The Federal Government recently announced that it is set to remove fuel subsidy in 2022. While we doubt that the administration will go through with its plan as similar announcements have been made in the past without coming into fruition, we could learn from the fuel subsidy removal in January 2012.

Former President Goodluck Jonathan announced the removal of fuel subsidy on the 1st of January 2012 and what followed was a leap in PMS prices from N65/litre to N141/litre. Cost of transportation doubled resulting to jump in prices of goods that were transported by road. Furthermore, during January 2012, headline inflation also rose to 12.63% y/y from 10.28% y/y in December 2011. In addition, inflation rose to 3.35% m/m, from 1.06% m/m in the preceding month. While this may serve as a pointer as to what to expect, we note that there was a nationwide protest during that month and that could have also impacted the inflation numbers.

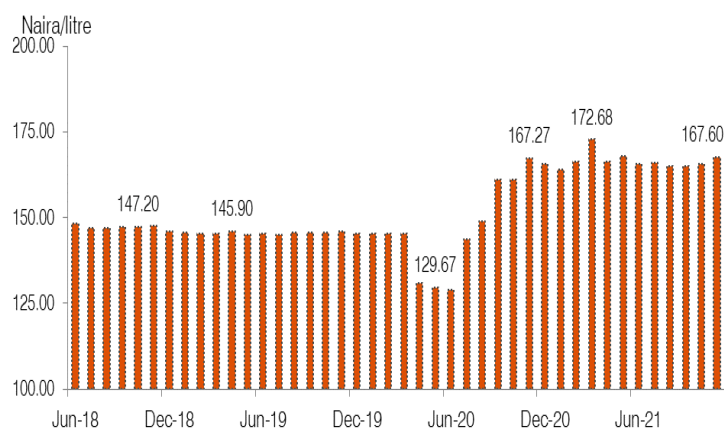
We opine that fuel subsidy removal will be a key upside risk to headline inflation in 2022 given that higher transport cost will likely filter into cost of other goods and services. Currently, PMS trades at about N165/litre however, landing cost is estimated to be around N256/litre (assuming Brent Crude oil trades at US\$74/bbl) according to Nigerian National Petroleum Corporation (NNPC). This implies that we could see up to a 55% upward adjustment in PMS price country especially as outlook for Brent Crude oil in the global space remains positive. However, we note that the upward adjustment in PMS price may be slimmer when Dangote refinery begins operation as we expect some landing cost savings (e.g Freight).

Inflation Spiked During 2012 Fuel Subsidy Removal



Source: NBS, Investment One Research

PMS Price Trend



Source: NBS, Investment One Research



Election Activities and Spending

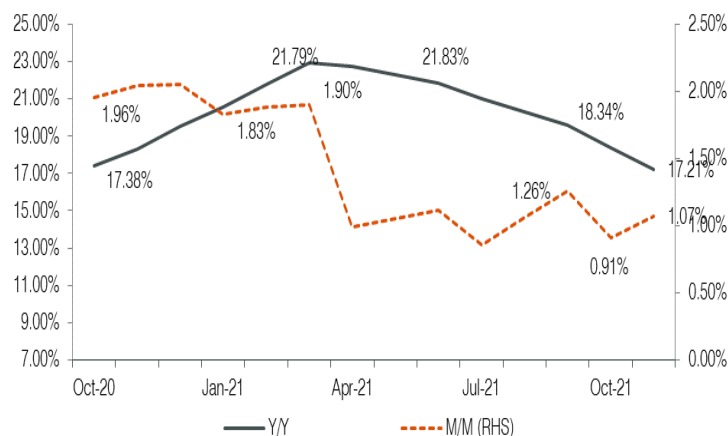
The Nigerian Presidential election is set to take place during the first quarter of 2023, consequently, we expect election spending and several campaign moves in H2 2022. It is likely that the present administration prioritises social spending over capital expenditure in a run up to the 2023 elections. This could include cash benefits and direct provision of goods targeted at low-income households, the elderly, unemployed, and youths. We opine that this may mount pressure on inflation levels during the year as more money in circulation chase goods. Furthermore, political instability and security challenges resulting from election activities will be key factors to watch especially in food producing states as this may negatively impact farming activities and lead to higher food prices.

Insecurity and Food Supply

We continue to watch the menace of bandits and terrorists and the impact of their activities on planting and food supply in the Middle Belt and Northern region of the nation. If unchecked, this may hinder food supply thereby aggravating the pressure on food prices in 2022. We may continue to see a pick-up in the rate of increase in the Food sub index, consequently driving the upward movement in inflation. Our opinion is backed by inflationary prospects driven by the conflicts in the Northern region disrupting food supply. This then lays more emphasis on the need to find a lasting solution to herdsmen attack and insecurity in the North.

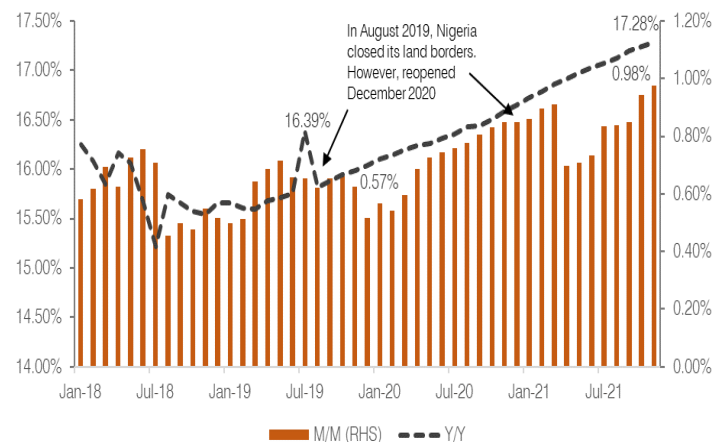
Elsewhere, we have seen sustained increase in imported food inflation since August 2019 which coincided with the closure of the Nigerian borders (later opened December 2020). In November 2021, imported food inflation printed at 17.28% y/y marking the twenty seventh month of consecutive increase. This is not unconnected with FX illiquidity issues faced by manufacturers and importers. Incessant naira devaluation and increase in the exchange rate for cargo clearance (increased from N381 per dollar to N404.97 per dollar by the CBN in June 2021) further supported the rise in imported food prices. Going into 2022, we believe the aforementioned factors might still be prevalent.

Food Sub-Index Trend



Source: NBS, Investment One Research

Imported Food Prices Running High



Source: NBS, Investment One Research

Electricity Tariff:

The increase in electricity tariffs has been subject to series of back and forth over the last year. In September 2020, electricity distribution companies (DisCos) increase tariff after negotiations with the Federal government. This increase was however suspended following the threat by the Nigerian Labour Congress (NLC) to embark on a nationwide strike. It is worthy to note that this was also a period where Nigerians and the economy were facing challenges of the pandemic. Nonetheless, the introduction of the Service-Based Tariffs saw the implementation of increased tariffs in November 2020 and January 2021.



A third tariff increase was slated to be implemented in September 2021; however, this was suspended as the NLC warned the federal government against flouting their agreement on electricity tariff increase.

Given continued weakness in the fiscal front, we do not rule out the possibility of the FG suspending electricity subsidy payments. Furthermore, an increase in electricity tariffs will positively support DisCos ability meet operational costs and engage in necessary capital investment programmes. However, rising electricity tariffs may pressure core inflation sub-index. We opine that the present administration might be constrained in this regard as re-election objective becomes top priority in 2022.

Our Scenarios

Our base-case scenario is premised on the assumption that the status quo as per government policies remains unchanged, fuel and energy prices are kept as is and no escalations to the tensions and insecurity in the North are recorded. As such, in this case, we envisage inflation averaging 14.00% y/y for 2022.

Our best-case scenario is premised on the assumption of calm returning to troubled regions and bountiful harvest not negatively affected by security issues. Subsidy (fuel and electricity) removal is suspended, with no significant increase in energy prices, as well as peaceful election activities. Consequently, we project an 11.50% y/y average growth in inflation for the year.

Major upside risks we foresee are factors that may negatively affect food supply directly or indirectly; increase in the seemingly insurmountable conflicts in the Northern region and/or flooding resulting to poor harvest. Similarly, the previously mentioned subsidy removal, energy price hikes and FX illiquidity/currency depreciation pose significant threats to inflation. Hence, our 18.50% y/y average inflation under our worst-case scenario.



The 2021 Budget

The 2021 Appropriation Bill was presented to the legislative chambers in October of the preceding year and signed into law two months after by the President; this displayed the unwavering commitment of the present administration to maintaining the January-December budget cycle which it began in 2020. The budget was themed “Budget of Economic Recovery and Resilience” with the expectation to accelerate the pace of economic recovery from the negative effect of the COVID-19 pandemic. Like we have seen in previous years, the budget was reviewed upwards by the National Assembly before passage into law. The budget which initially constituted an estimated expenditure size of N13.08trillion was increased by 4.00% (N505.61billion), while the expected revenue of N7.88trillion and other key assumptions were left unchanged. The upward review was largely on the back of a 7.27% increase in capital expenditure from N3.85trillion to N4.13trillion. However, with regards to budget implementation we saw an abysmal performance in the year similar to that of the previous year despite full reopening of the economy from the pandemic-induced lockdown in 2020. According to the H1 2021 budget implementation report, a total revenue of N2.31trillion (69% of the projected sum of N3.31trillion) was generated for the first half of the year. This indicated a revenue shortfall of about 30.36% in the period, which was largely attributed to the underperformance of oil revenue. In particular, the budget was anchored on an oil revenue projection of N1.01trillion for H1 2021 but only a sum of N538.31billion was actualised. This was despite average oil price for the period registering at US\$64/bbl (US\$24 higher than the benchmark price for the budget). This shortfall of 46.46% in oil revenue was majorly on the back of oil production levels being persistently below benchmark production(1.86mbpd) as only an average of 1.67mbpd was produced in the period under review.

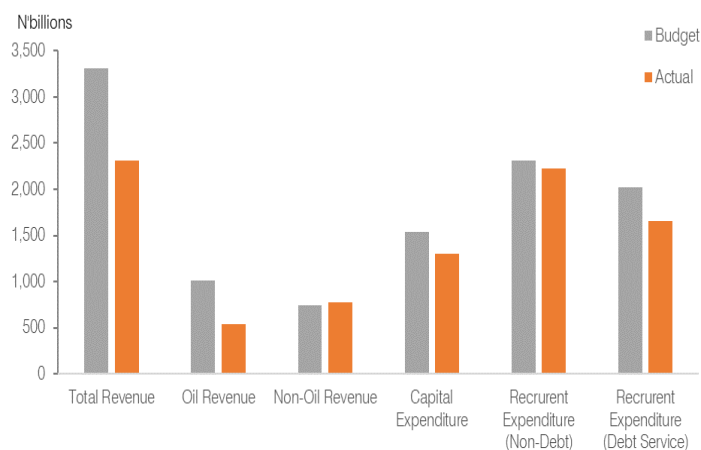
On the other hand, a good performance was recorded in terms of non-oil revenues, as actual inflows stood at N778.18billion, 104.53% over the projected figure of N744.46billion for H1 2021.

The outperformance of the prorated target for non-oil revenues was hinged on the Companies Income Tax (CIT) and Value Added Tax (VAT) collections being ahead of the budget targets by 16.50% and 8.20% respectively.

Despite weak oil revenue outcomes, expenditure levels were intact as a total of N5.81trillion was spent in H1, this represented a 100.86% of the N5.76trillion pro-rated half-year budget. As stated by the Budget office of the federation, N1.03trillion was spent on Capital expenditure, N2.02trillion was expended on debt service, N2.23trillion was spent on non-debt recurrent expenditure and N248.26billion was spent on statutory transfers. The figures showed that 22.42% of total expenditure was capital expenditure while 34.84% and 38.46% of total expenditure was expended on debt servicing and non-debt recurrent expenditure respectively. This implied that more funds were channelled towards debt service, payment of salaries, pension and overheads compared to CAPEX.

In addition, we saw that a budget deficit figure of N3.58trillion (55.65% above the prorated figure of N2.30trillion) was already incurred as at half year.

Budget Implementation H1 2021



Source: Budget Office of the Federation, Investment One Research



Sticking to the January-December Cycle

In a bid to maintain the January-December budget cycle the 2022 Budget titled “Budget of Economic Growth and Sustainability” was presented to the Joint session of the National Assembly by the President in October. The Appropriation bill had an aggregate expenditure and revenue target of N16.39trillion and N10.13trillion respectively which were c.28.00% and 25.00% higher than the 2021 budget. Consequently, budget deficit amounted to N6.26trillion (11.73% higher than the 2021 budget) which represented 3.39% of estimated GDP, slightly above the 3% threshold set by the Fiscal Responsibility Act 2007. The deficit is expected to be financed by new borrowings, privatisation proceeds and drawdown on loans secured for specific projects. The proposed budget was designed on the assumption of US\$57/bbl average price for oil, oil production of 1.88mbpd (inclusive of Condensates of 300,000 to 400,000 barrels per day), Exchange rate of N410.15/\$, GDP growth projected at 4.2% and inflation rate pegged at 13.00%.

However, barely two months after, the National Assembly revised the budget size upwards to N17.12trillion, from the N16.39trillion proposed by the President. This was predicated on the increase in oil price benchmark by 8.77% to US\$62/bbl largely reflecting the current value in the international oil market, while other assumptions were left unchanged. We highlight that the oil price benchmark of \$62/bbl is quite conservative given the outlook for improved global oil demand in 2022.

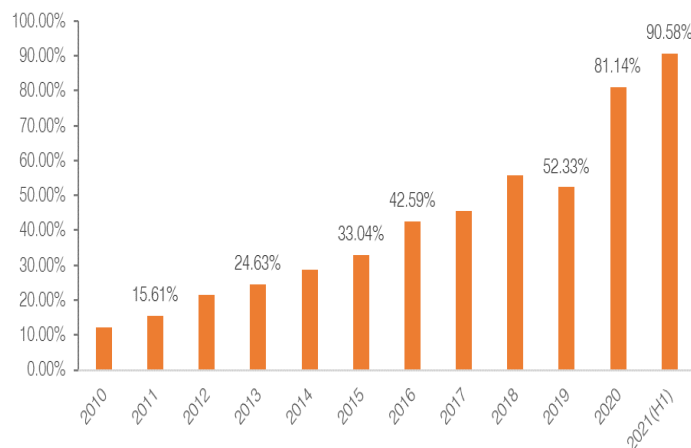
However, we are concerned about the ability of the government to meet up with the oil production quota target for the year as oil revenues continue to be a major determining factor for budget implementation. We opine that focus should be on diversification of earnings from oil proceeds to boost revenue. Furthermore, the burgeoning debt is worrisome as debt service to revenue ratio has grown from 12.30% in 2010 to 90.58% as at H1 2021. Similarly, we have seen the nation’s debt profile surge by 625.00% from N5.24trillion (in 2010) to N38.00trillion as at Q3 2021. We opine that the trend of high debt servicing is likely to continue in 2022, given the trend of budget deficit on the rise in recent years.

Nigeria’s Debt Profile



Source: DMO, Investment One Research

Debt-Service to Revenue Ratio

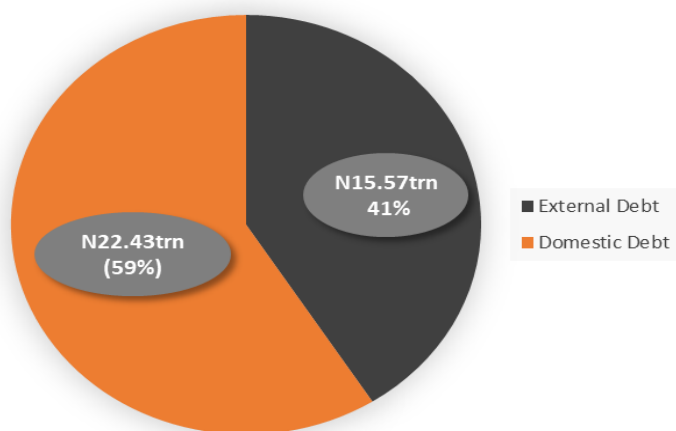


Source: DMO, Investment One Research



2022 BUDGET/KEY ASSUMPTIONS IN PERSPECTIVE		(NGN Trillion)		
Details	2020	2021	2022 Approved	
Budget (Expenditure)	10.33	13.08	17.12	
Total Revenue	8.16	7.89	10.74	
Capital Expenditure	2.14	4.37	5.46	
Recurrent Expenditure (Non-Debt)	4.88	5.65	6.90	
Oil Revenue	2.64	2.01	5.52	
Non-oil Revenue	5.51	1.49	2.21	
Budget Deficit	2.17	5.60	6.26	
Debt Service	2.45	3.32	3.80	
Oil Production (mbpd)	1.90	1.86	1.88	
Exchange Rate (N/US\$)	360.00	379.00	410.15	
Oil Price Benchmark (US\$/bbl.)	28.00	40.00	62.00	
GDP Growth Rate (%)	2.93%	3.00%	4.20%	

External vs Domestic Debt Stock



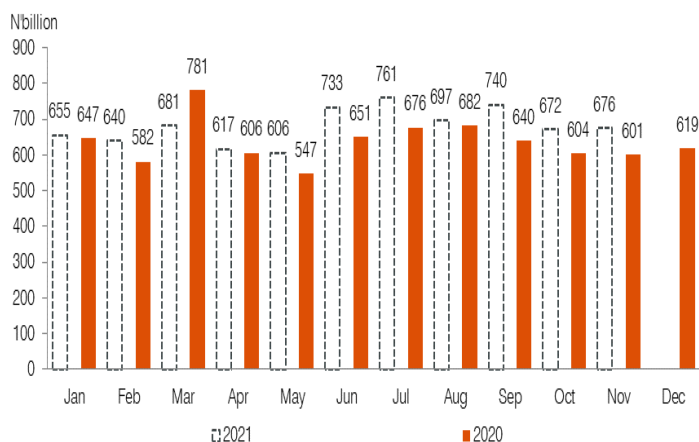
Source: DMO, Investment One Research



Fuel Subsidy Removal

The dwindling trend of remittances to the Federal Accounts Allocation Committee (FAAC) continued in 2021 but not as bad as the figures printed in the pandemic year (2020). The improvements seen in FAAC disbursements for 2021 compared to the prior year was majorly on the back of improved oil receipts, a major constituent of the monthly allocation, as well as improvements in tax revenues, particularly Company Income Tax (CIT) and Value Added Tax (VAT). Comparing figures, average monthly allocation increased by 6.55% from N638.00billion in 2020 to N680.00billion in 2021 with highest allocation of N740.00billion recorded in the month of September.

FAAC Allocations



Source: DMO, Investment One Research

However, we opine that the monthly disbursements would have been higher than actual figures save for the sums spent on subsidising the importation of Premium Motor Spirit which the Nigerian National Petroleum Company Limited deducts in form of value shortfall/under-recovery from its monthly remittance to the Federation account. We recall that while petrol subsidy was not accounted for in the 2021 budget, the latest data from the national oil company revealed that between January and October 2021 a total net revenue of N2.09trillion should have been remitted but just a paltry sum of N511.67 billion was remitted, representing a shortfall of N1.58trillion.

FAAC disbursements are projected to trend upwards particularly in the second half of 2022, if the plans of the federal government to eliminate subsidy by June next year is indeed implemented. This means the sums spent on subsidy will no longer be deducted and this will make a significant difference to the monthly pay-outs. While we see the potential economic benefits, a major impediment is the likely absence of political will to carry out the action of subsidy removal with the 2023 general elections just few months ahead.

Furthermore, we opine that the proposed plan to replace petrol subsidy with the doling out of N5,000 cash transfers to about 40million poorest Nigerians monthly in order to cushion the negative effect of the imminent halt to petrol subsidy could be channel for funds mismanagement and corruption.

Petroleum Industry Act: A Step in the Right Direction

In 2021, we finally saw the enactment and passage of the Petroleum Industry Act (PIA) after many years of delays and deliberations as previous attempts at passing the PIA in 2009, 2012 and 2018 failed because of factors such as perceived erosion of ministerial powers, lack of ownership, misalignment of interests between the National Assembly and the Executive, stiff opposition by the petroleum host communities and push back by investors on the perceived uncompetitive provisions in previous versions of the bill. While the bill could potentially bode positively for the oil sector, we are worried about the timing of passage as the world transitions to cleaner energy.

The oil and gas sector, though contributes less than 10% to the country's GDP, still continues to contribute about 90% and 60% to Nigeria's foreign exchange earnings and total revenue respectively. This makes the industry a significant one and a major determinant of the economic health of the nation. However, Nigeria has remained an unattractive destination to global oil and gas investors; according to the National Bureau Statistics, only US\$1.8billion (1.7%) of total Foreign Direct Investment inflows of US\$97.2billion between 2014 and 2020 was channelled to the sector.



We are cautiously positive about this new piece of legislation as it aims to address vital issues around the regulation and governance, gas flaring, environmental degradation and host community development. We point out the PIA is broken down into four parts to address Governance & Institutions, Fiscal framework, Host community development and Administration & Management of petroleum resources.

Governance & Institutions: To drive an efficient governance system in the industry, the PIA proposed the formal segmentation of the petroleum industry into two sectors: the Upstream sector (to be managed by the Nigerian Upstream Commission) and the Midstream & Downstream sectors (to be managed by the Midstream & Downstream Authority). The Upstream Commission is expected to drive efficient governance by enforcing, administering, and implementing all relevant laws in the upstream segment. On the other hand, the Midstream & Downstream authority is expected to regulate petroleum liquid operations, domestic natural gas operations, and the export of natural gas. This is a major shift from the previous governance settings with conflicting responsibilities among several agencies under the petroleum ministry. Hence, we expect this clear segmentation to reduce the bureaucratic process in the industry.

In addition, a provision of the PIA includes the privatization of the NNPC within 6-months of commencement of the PIA (to birth NNPC Ltd), with ownership of all shares vested in the government and held by the Ministry of Finance and Ministry of Petroleum. The new NNPC Ltd and any of its subsidiaries will conduct their affairs on a commercial basis profitably and efficiently without recourse to a government fund. We believe this development is laudable as it will eliminate recurrent expenditure and contingencies provisions for the NNPC or any of its subsidiaries in the national budget and enhance efficiency and transparency of the business.

We view these structural reforms as a step in the right direction as it creates a clear separation between NNPC's operations as a commercial entity and regulatory roles to be exercised by the regulatory authorities, allowing for oversight that is more transparent.

We also opine that the separation of regulation of the upstream and midstream/downstream sectors, though expensive, could help clarify roles of regulators fostering efficient and effective dispensation of required duties.

Administration: The administration segment of the PIA is aimed at promoting the exploration of petroleum products for the benefit of the Nigerian people. To achieve this objective, the Act empowers the Upstream Commission to make recommendation on the issuance/withdrawal of oil leases or licenses to the minister of petroleum for consideration. This is a deviation from the previous system of administration in the industry where the petroleum minister enjoys the exclusive power of granting/withdrawing oil lease/licenses. Elsewhere, the Act empowers the Commission to drive environmental sustainability objective by ensuring that upstream operators have and are implementing environmental management plans.

Also, the PIA empowers the management of the Midstream & Downstream authority to grant, renew, modify and extend licenses and permits to operators in the mid- and downstream, excluding license relating to the operation of a refinery which remains delegated to the petroleum minister. This is expected to significantly reduce the bureaucratic process and political bias that have characterized mid- and downstream license renewal for many years.

Host Community Development: To drive the objective of improving the socio-economic welfare of the host community, the PIA created a Host Community Development Trust (HCDDT) Fund. This will see operators in the upstream and mid- and downstream operators contribute 3.0% and 2.0% of actual annual operating expenses respectively to the fund. This is in addition to the existing contribution of 3.0% to the Niger-Delta Development Commission (NDDC). We believe this development will increase resources available to cater to the host community's needs if efficiently utilized. Nonetheless, we are cautiously optimistic about the sufficiency of this allocation to satisfy the required developments in oil producing states.



Fiscal Provision Framework: The Act is to establish a progressive fiscal framework that will encourage investment in the oil & gas industry and expand the revenue base of the government while ensuring a fair return to investors. To drive this, the PIA replaced the Petroleum Profit Tax (PPT) with Hydrocarbon Tax (HT) and Company Income Tax (CIT) respectively. Thus, players in the Upstream segment will be subjected to both HT (range: 10.0% and 22.5%) and CIT (30.0%).

Overall, we opine that the new bill could offer progressive departure from past norms as it addresses some of the present challenges in the sector. Nonetheless, we remain concerned about some aspects of the bill such as introduction of multiple taxes and royalties, limits on tax-deductible expenses and inadequate details on deregulation of gas pricing, which could limit investors' attraction to the sector. However, we posit that signing the bill into law while addressing the issues raised should lead to value addition and make the petroleum industry more attractive to potential investors while ensuring efficiency and effectiveness through its governing institutions making the industry conform to international standards.

Finance Bill 2021: Knee-Jerk Solution to Dwindling Revenues

The 2021 Finance bill has a major objective of giving support to the implementation of the 2022 Federal Government budget by proposing key reforms to specific taxation, customs, excise, fiscal and other relevant laws. It would also enhance domestic revenue mobilisation efforts to increase tax and non-tax revenues, tax administration and legislative drafting reforms, particularly to support the ongoing automation reforms by the Federal Inland Revenue Service.

Also, the bill seeks to amend the provisions of some laws which include: Capital Gains Tax Act, Companies Income Tax Act, Federal Inland Revenue Service (Establishment) Act [FIRSEA], Personal Income Tax Act, Stamp Duties Act, Tertiary Education Trust Fund (Establishment) Act and Value Added Tax Act.

We highlight 5 major proposed changes:

- A Capital gains tax at the rate of 5% will be charged on disposal of shares in a Nigerian company worth N500m or more in any 12 consecutive months except where the proceed is reinvested in the shares of any Nigerian company within the same year of assessment. Meanwhile Partial re-investment will attract tax proportionately and transfer of shares under the regulated Security Lending Transaction is exempted.
- Lottery and Gaming business will now be subject to Companies Income Tax.
- FIRS to be empowered to assess CIT on the turnover of foreign digital companies involved in transmitting, emitting, or receiving signals, sounds, messages, images or data of any kind including e-commerce, app stores, and online adverts.
- FIRS to be the primary agency of the Federal Government responsible for the administration, assessment, collection, accounting and enforcement of taxes and levies due to the Federation, the Federal Government and any of its agencies except otherwise authorized by the finance minister.
- The amendment of the Fiscal Responsibility Act would enable government to borrow for "critical reforms of significant national impact". Currently, government at all tiers are only empowered to borrow for capital expenditure and human development. Capital expenditure is defined as spending on an asset that lasts for more than one financial year. Human development and critical reforms are not defined.

We are of the view that this legislation is a positive one for the economy especially with regards implementation of the 2022 Budget, giving support to the reduction in budget deficit as well curbing the rate of borrowings. However, we think this should not be the sole strategy of the government to foot its bill for the year, rather attention should be given to trimming down on recurrent expenditures especially cost of governance. On the other hand, a lot more clarity still needs to be made by the government on some of these changes such as the taxing of foreign digital companies rendering services in the country.



Medium-Term National Development Plan 2021-2025: Same Old Story, Imminent Poor Implementation

The Federal Government recently launched the Medium-term National Development Plan, which is to replace the Economic Recovery and Growth Plan (ERGP 2017-2020). The plan provides details on the focus and goals of the Federal Government for the next five years.

The development plan has the following set goals:

- Projected average annual GDP Growth rate of 3.8%
- Reduction in the number of Nigerians in poverty by 35 million as well as reduction of poverty rate to 31% by 2025
- Increased total employment generation with the creation of 25million jobs within the period
- Expected annual foreign direct investment flow of N1.3trillion by 2025.
- Projected total Federal Expenditure and revenue of N16.30trillion and 8.80trillion respectively by 2025.

According to the Federal Government, the plan requires an investment size of about N348.70trillion, with expectations that the public sector will contribute about N49.70trillion (14.30%), while the private sector will provide the balance of N298.30trillion (85.70%). Funding strategies proposed for the plan include broadening the tax base, enhancing the capacity of the private sector through creating investment opportunities and deliberate policy incentives and engagements.

We opine that this new development plan, which builds on some recent development plans such as the Vision 2020, Economic Recovery and Growth Plan (ERGP) and Economic Sustainability Plan (ESP), may likely underperform expectations given the historical trend of poor policy implementations. More so, that 2022 is a pre-election year and the focus of the government will be skewed towards the 2023 general elections. Also, the required funding of N348.70trillion is quite unrealistic given foreign investment downturn coupled with the tough business environment and security challenges currently bewildering the nation.



A Look Ahead

Although FX reserves at current levels may support the CBN's ability to defend the Naira in the near term as it continues to clear FX backlogs; pressure on crude oil prices in the global market, due to concerns about the emergence of Omicron and other variant of the virus on demand outlook, may cast a doubt on the sustainability of the Apex bank's ability to continue to defend the Naira. Furthermore, the country's inability to meet up with its oil production quota of 1.86mbpd will continue to lower oil export earnings and reserves accretion.

In addition, we see foreign inflows in the market subdued as U.S. FED braces up to raise rates in 2022 coupled with the Bank of England (BOE) rate hike to 0.25% from 0.10%. We may see foreign investors further exit the nation's capital and OMO market to take advantage of opportunities in developed markets, which may further pressure the Naira albeit this may not be a significant pressure point as current FPIs investment size is relatively low compared to pre-pandemic era. Nonetheless, the political uncertainty around pre-election year and insecurity challenges may further discourage foreign inflows into the economy. The FX structure and multiple exchange rate continues to be a turnoff for inflows.

Given the tacit devaluation we saw on the last day of 2021 at the IEFX window to N435/\$, we highlight that the Naira will remain relatively stable at that level in 2022. As such, we opine that we are unlikely to see a major devaluation in the Naira beyond that level. Accordingly, we believe that this may encourage increased foreign participation in the market as well as stem pressures on the nation's FX reserves.

Despite the Naira for dollar incentive, remittances are unlikely to move needle as more inflows are now channeled through unofficial means.

Meanwhile, one factor to watch closely in 2022 will be the CBN's stance on revoking the ban on Bureau De Change Operators. While this may be unlikely given the stability of naira at the IEFX window and use of DMBs to settle PTA and BTA transactions, we posit that the return of FX sales to BDC could help rates improve in the parallel market boding positively for the banks convergence goals. For the parallel market, we spotlight that the Naira would remain pressured as demand continues to outweigh supply.

On the other hand, the commencement of operations at Dangote Refinery, slated for 2022, may bode positively for the economy given potential FX savings and inflows. This, combined with the possibility of a Eurobond issuance to finance the 2022 budget may bode well for the nation's FX reserves and by extension, support the CBN's ability to defend the domestic currency.

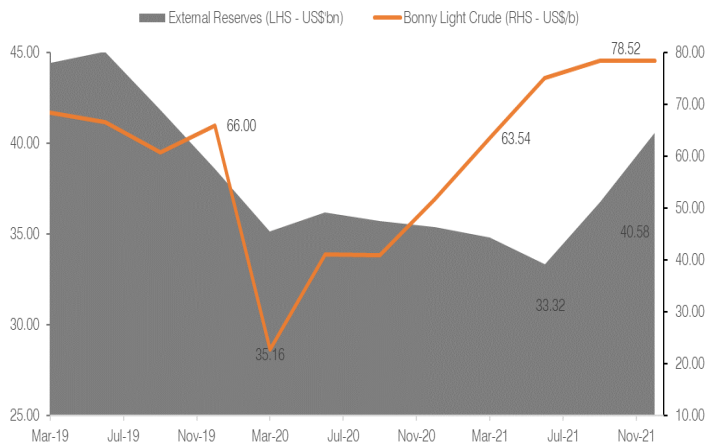
2021 Review: Safeguarding the Value of the Naira with Unorthodox Policies

The Naira was pressured at both the IEFX window and parallel market in H1 2021 until grants and loans increased reserves, thus, stabilizing the naira at the IEFX window. However, the parallel market remained pressured amid low supply and high demand; Naira rose to a high of about N575/\$ during the year.

At the start of the year, we saw the CBN express its displeasure for International Money Transfer Operators (IMTOs) and unlicensed companies that continue to operate contrary to its directives. We recall that in December 2020, the CBN directed that all remittances sent into the country should be paid to beneficiaries in dollars/foreign currencies. This move was aimed at increasing dollar liquidity in the parallel market as demand pressure continues to mount in that space. In a bid to further improve dollar inflow into the parallel market, the CBN introduced the "Naira 4 Dollar scheme" which rewards diaspora remittance recipients with an extra N5 for every dollar wired through the official routes. The scheme, which was meant to end on May 8, 2021, was extended indefinitely by the CBN. We believe this scheme was introduced due to weak success recorded following the issuance of the directive that effectively allowed beneficiaries receive remittances in foreign currencies. Nonetheless, the benefits of the incentive program are yet to be seen in the market given the lower remittances recorded in the year. This is a negative surprise as diaspora remittances dropped by 62.38% (10M:2021) to \$1.96 billion, lower than US\$5.21billion recorded in 10M:2020 despite the economic recovery seen in developed economies. We opine that the previous restrictive foreign exchange policies by the CBN may have prompted the use of alternative channels such as peer-to-peer transfer and blockchain technology.

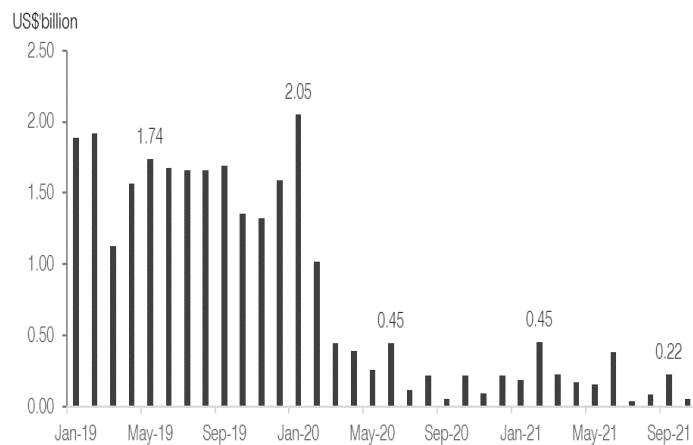


External Reserves Position and Crude Oil Prices



Source: CBN, Bloomberg, Investment One Research

Underwhelming Direct Remittances



Source: CBN, Investment One Research

The Journey Towards Exchange Rates Convergence

To access the US\$1.5billion loan approved by the World Bank to strengthen the recovery of the economy Post Covid-19, one of the conditions laid down was the unification of the multiple exchange rates. In a move towards convergence, the CBN scrapped the official rate and adopted the Investors and Exporters (IEFX) window as the official rate of conversion for all official and legitimate government transactions. The IEFX rate is the closest to a market-driven exchange rate and is referenced by both the private and public sector for official transactions.

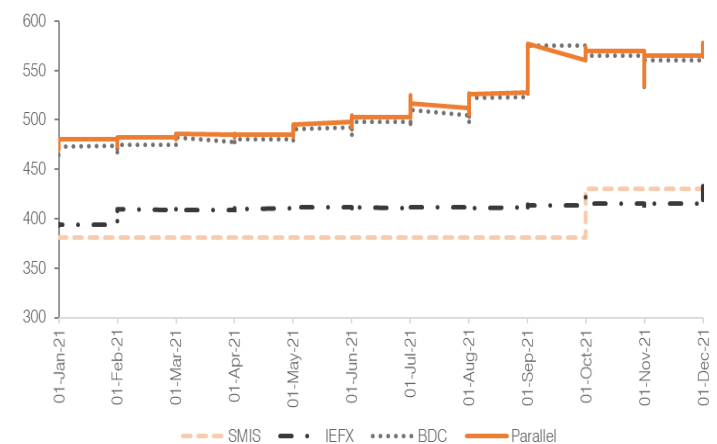
In a move that took the financial market by surprise, the CBN discontinued the sale of foreign exchange currencies to Bureau De Change Operators (BDCs)

and processing of new licenses citing the flouting of stipulated regulations as its chief reason. The weekly forex allocations are now channeled to the commercial banks to meet legitimate foreign exchange needs. A day after this policy was introduced, the Naira fell sharply to N525/\$ in the parallel market compared to N504/\$ which it traded the previous day. Investors were skeptical of the sustainability of this decision because a similar policy was made in 2016 and the Naira suffered its worst fall in the black market thus, forcing the CBN to reverse the policy in 2017. It is interesting to note that the CBN is firm on this policy due to healthy external reserves and the sustained rise in crude oil prices.

The CBN continued its unorthodox policy path as it questioned the activities of Abokifx, an exchange rate and news publishing company, for allegedly engaging in illegal foreign exchange transactions, and manipulating the currency. This shrouded the activities in that space in secrecy as Naira trades within the range of N560/\$ - N575/\$; a premium of N135 to the official market.

At the IEFX window, Naira remained relatively stable as it traded around N410/\$ - N415/\$ during the second half of the year ; however, on the last day of the year, it depreciated by 4.60% to N435/\$.

Convergence Here, Divergence There



Source: CBN, FMDQ, Investment One Research



Eurobond Issuance and Allocation from the IMF Boost Reserves

The country's reserve was pressured in the first half of the year even as the CBN rationed dollar resources and focused on the expenses that favored the local economy. As of June 2021, the reserves stood at US\$33.32billion.

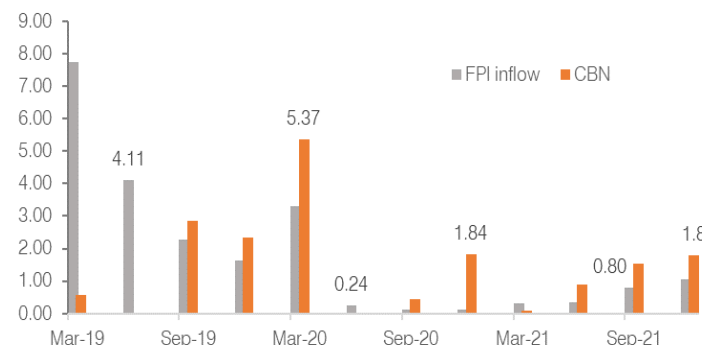
In H2 2021, we saw accretion in reserves as the IMF approved the allocation of US\$3.35 billion to Nigeria, as part of a historic general allocation of Special Drawing Rights (SDRs) from the International Multilateral Institution.

Furthermore, the US\$4.00billion Eurobond issuance further increased reserves as the CBN had the war chest to defend the Naira. At the end of the year, the reserves settled at US\$40.52 billion y/y, 14.56% higher than \$35.37 billion as of December 31st, 2020.

Underwhelming Foreign Portfolio Flows

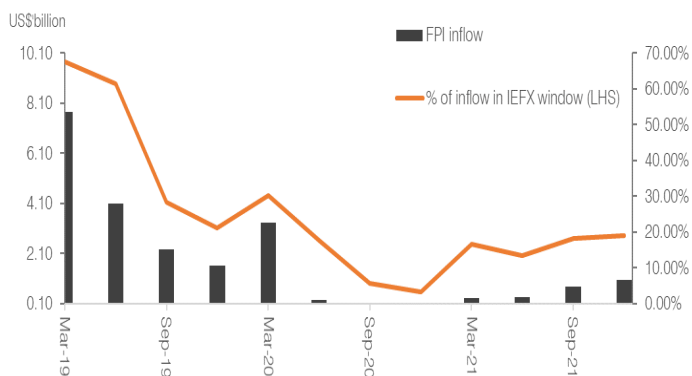
In the year under review, data from FMDQ indicated that foreign portfolio inflows declined by 30.00% y/y to \$2.66billion as the instability of the foreign exchange market, insecurity issues and concerns about the inability to repatriate funds continued to discourage foreign capital investments. It is important to note that FPI figures is yet to return to pre-pandemic levels which is around US\$15.00billion. Similarly, CBN's intervention in that space dropped by 42.61% y/y to \$4.39billion. Meanwhile, we saw an increase in outflows as the CBN cleared some of its FX backlogs when the reserve was at a healthy balance; hence FPI outflows rose by 52.82% y/y to \$2.98billion.

FPI Inflow vs CBN Intervention



Source: CBN, Investment One Research

External Reserves Position and Crude Oil Prices



Source: CBN, Bloomberg, Investment One Research

Supporting the Fragile Economy

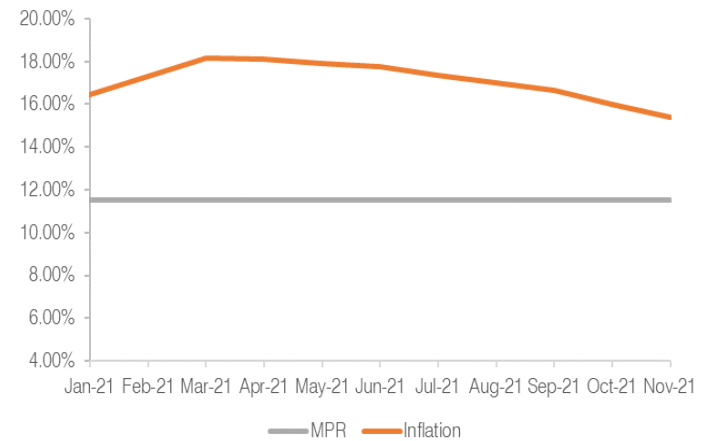
Economic growth was the primary consideration that influenced monetary policies and directives at major policy fronts across the globe in 2021. From the Americas and Europe to Asia and Africa, central banks across various countries maintained a dovish stance as the global economy recovered from the pandemic induced recession.

In the local scene, the apex bank kept Monetary Policy Rate (MPR) accommodative at 11.50% throughout the year. In addition, other monetary policy parameters remained unchanged: liquidity ratio at 30%, cash reserve ratio at 27.50% and asymmetric window at -700/+100 bps around the MPR. While the primary duty of the apex bank is to maintain price stability in the country especially as inflation ran above the CBN's target of 6-9%, the CBN believed that the inflationary pressures in the country stemmed from heightened security tensions in the country, deteriorating public infrastructure and other structural issues which are outside its purview. Accordingly, the CBN maintained its policy stance in 2021 to enable the continued permeation of current policy measures to support growth recovery and macro-economic stability.

We noted that the MPC was faced with the decision of either loosening or tightening rates. Specifically, the alternative of loosening rates might have worsened inflation and further widen negative real interest rate, thereby exacerbating capital flows. On the other hand, tightening rates would have subdued the inflationary pressures but the cost of credit to the real sectors of the economy would consequently rise thereby hampering output growth.

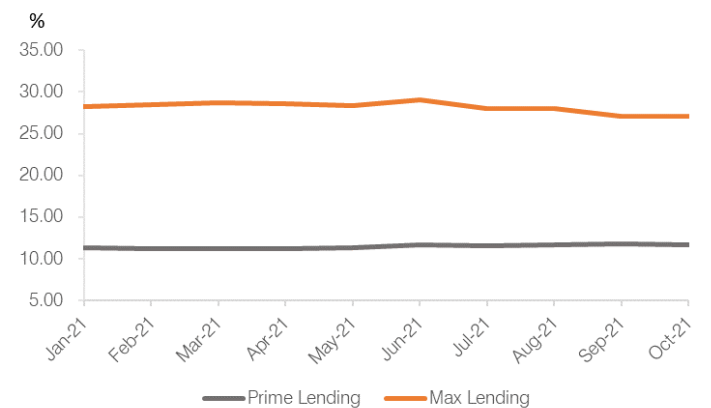
At one of its meetings during the year, the CBN suspended the sale of dollars to Bureau De Change operators and at the subsequent meeting, they questioned the activities of Abokifx – an exchange rate and news publishing company for allegedly engaging in illegal foreign exchange transactions and currency manipulation. The CBN stated the need to maintain transparency and stability in the FX space by restricting the activities of unauthorised and illegal foreign dealers; hence, ensuring that all foreign exchange activities are conducted at the I & E window and DMBs.

MPR vs Inflation



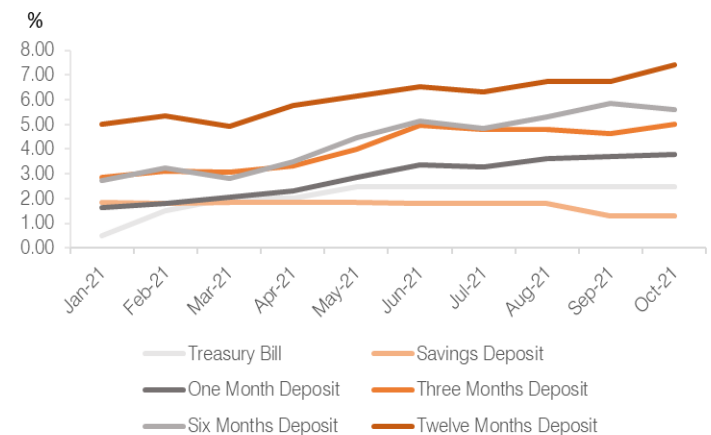
Source: CBN, NBS, Investment One Research

Lending Rates



Source: CBN, Investment One Research

Money Market Indicators



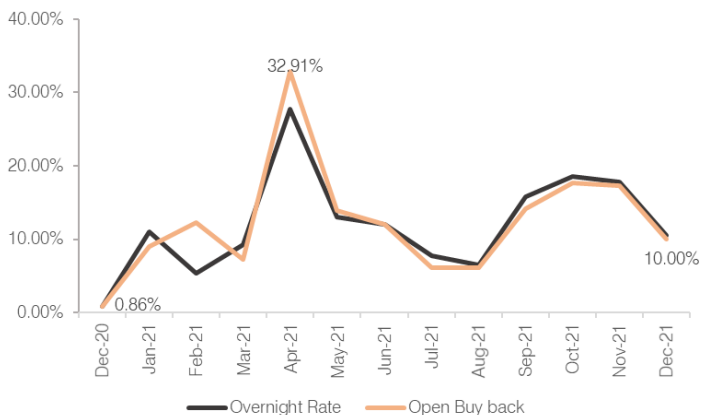
Source: CBN, Investment One Research



Strain in Financial System Liquidity

Despite retaining monetary policy rate, the CBN tightened liquidity in the market with its CRR debits as evidenced by heightened activities in the Standing Lending Facility (SLF) window, interbank and repo market. At the SLF window, transactions ballooned by 147.67% to N13.00trillion given the liquidity challenges faced by the banks. Similarly, at the repo market, activity level spiked by 1,617.53% to N14.07trillion as banks hedged their fixed income positions given the increase in rates in this space. Furthermore, Open buy back and Overnight rate averaged 12.11% y/y and 12.66% y/y respectively for the year (higher than 5.80% and 6.54% in 2020) amid strain in the financial system liquidity.

Interbank Rates

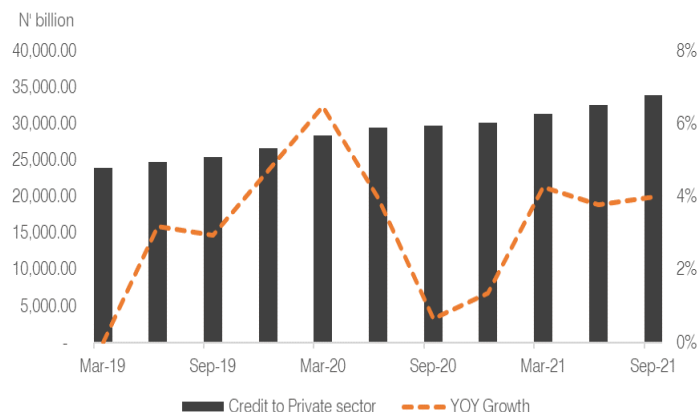


Source: CBN, Investment One Research

Credit to the Private Sector

Data on money supply from the CBN indicated that broad Money supply (M3) rose by 9.79% (11M: 2021) to N41.37trillion, faster than 8.29% rise recorded in 11M:2020. Additionally, we saw net domestic credit rise by 12.55% (11M: 2021) to N48.34trillion. Further breakdown of the net domestic credit revealed that Credit to the private sector increased by 15.22% (11M: 2021) to N35.31trillion as lending to the real sector continued to rise. In addition, credit to the government grew by 5.91% (11M: 2021) to N13.03trillion as the government borrowed to finance its budget deficit.

Credit to the Private Sector (2019 –2021)



Source: CBN, Investment One Research

To See Hawkish Moves?

Apex banks remained dovish in 2021 as supporting growth was the prime focus even amid burgeoning inflation data. As such, the U.S. FED (0.25%), BOE (0.1%), BOJ (-0.1%), ECB (0.0%) all maintained their respective low interest rates. However, there has been changes in sentiments as inflation is now of paramount concern. In its December meeting, the FED announced that it will speed up the tapering of its quantitative easing program while forecasting three possible rates hike in 2022. Similarly, the Bank of England hiked rates for the first time since the pandemic started by 15bps to 0.25% in its December meeting.

We see economic growth remaining of paramount importance to the CBN as they look to consolidate output growth. We expect the GDP numbers to maintain its positive trajectory albeit at a slower pace. Elsewhere, we expect the CPI to continue decelerating on the back of high base effect even as structural issues persist. Nonetheless, we see inflation pressures increasing at the later part of the year as election spending spurs consumer spending in the economy. As such, we expect monetary policy parameters to remain unchanged for most of H1 2022.

However, with most global central banks pursuing restrictive monetary policies, we believe that the CBN may raise the policy rate to attract investors, capital flows and limit the pressure of capital flight on the Naira. Consequently, we posit that the monetary policy rate might increase by around 50-100bps in H2 2022.

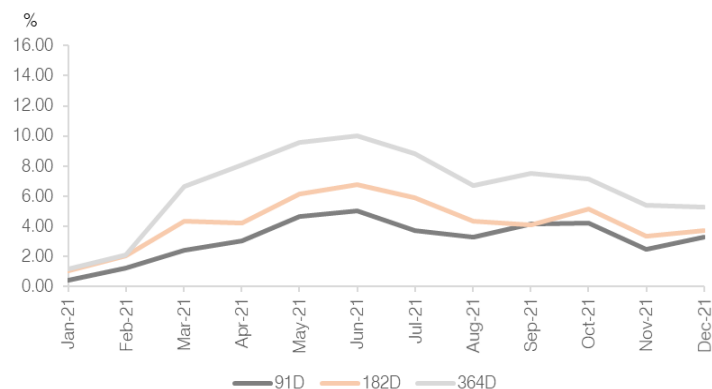


A Tale of Two Halves

At the beginning of 2021, yields in the fixed income space were at its lowest. However, we witnessed a reversal in the direction of yields as investors became worried and uncomfortable with negative real return, and this played out in lower subscription levels and aggressive bid for higher rates. Consequently, in February 2021, stop rates at the treasury bill, OMO and bond markets climbed, and this continued until H2 2021 when yields reversed downwards as government sourced for funding from external market.

Bid to cover ratios for the Nigerian Treasury bills declined to 2.32x y/y in 2021 (from 2.46x y/y) as stop rate for the 364-day bill hit 9.75% in May 2021. On a y/y basis, yields for the 91-day, 182-day and 364-day treasury bill increased to 3.82%, 4.32% and 5.24% respectively in December 2021 (higher than 0.35%, 0.38% and 1.72% respectively in December 2020).

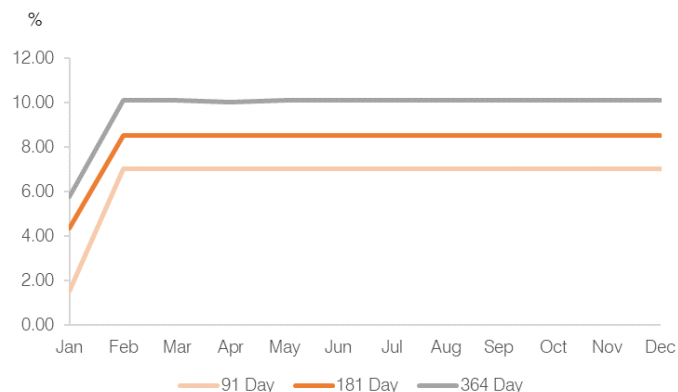
Treasury Bill Yield Curve



Source: FMDQ, Investment One Research

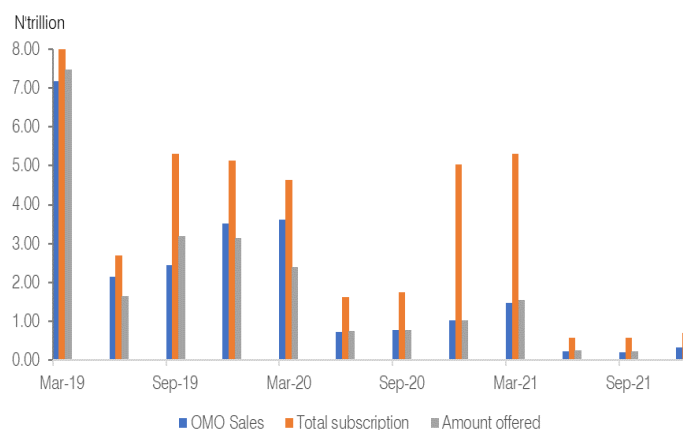
However, bid to cover ratios at the OMO space rose to 2.96x y/y in 2021 (from 2.43x y/y) due to the lower OMO sale offered in that space. During the year, we saw the CBN being less aggressive to take money as they drastically reduced OMO holdings in their balance sheet. However, we saw stop rates inch upwards to 7.00%, 8.50% and 10.10% for the short, medium and long tenures respectively; higher than 1.56%, 4.39% and 5.80% respectively printed in December 2020.

OMO Stop Rates in 2021



Source: CBN, Investment One Research

Trend in OMO Sales



Source: FMDQ, Investment One Research

The bond market also witnessed upward retraction as yields settled at 11.27%, 12.60% and 13.28% y/y respectively (higher than 3.54%, 7.26% and 7.42% y/y as of December 2020) for the 5year, 10year and 30years benchmark bonds. We saw bid to cover ratio contract to 1.92x y/y (from 3.72x in 2020) even as the DMO issued bonds worth N2.71trillion in 2021 (higher than N1.88 trillion in 2020).

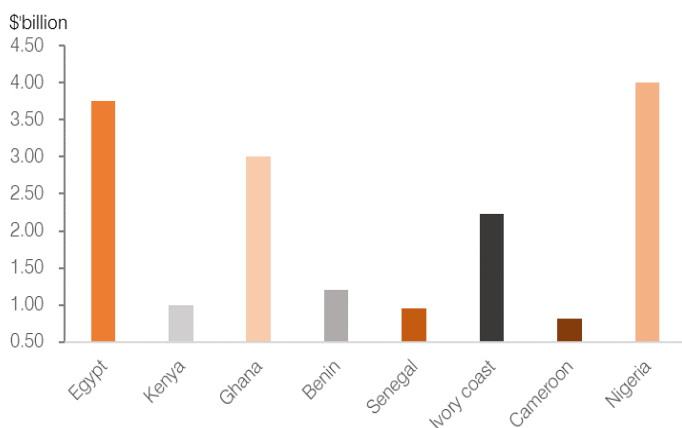
Eurobond Issuances

On the back of continued fiscal and monetary stimulus support by governments in developed economies in the previous year which led to elevated global liquidity, we saw most Sub-Saharan Africa (SSA) countries tap into the Eurobond market to meet their financing needs.



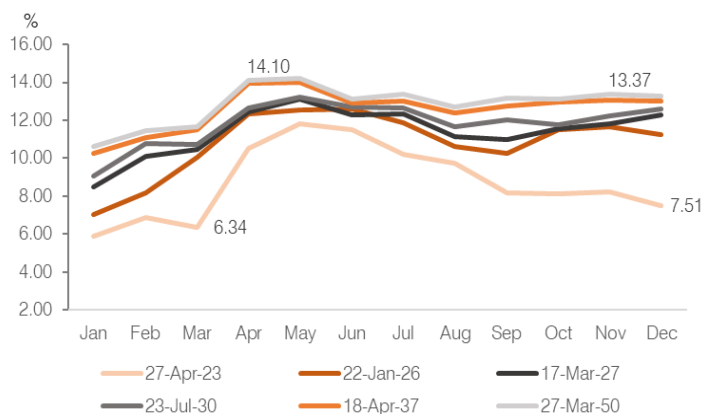
Countries like Egypt (\$3.75 billion), Kenya (\$1.00 billion), Ghana (\$3.00 billion), Benin (€1.00 billion), Senegal (€0.80 billion), Ivory Coast (€0.85 billion), and Cameroon (€0.7 billion) engaged in issuances in 2021 which were duly oversubscribed. Similarly, Nigeria was not left out as it accessed the International Capital Market to finance its budget deficit for the year. The Debt Management Organization (DMO) successfully raised \$4billion at its auction (higher than \$3billion that was offered), which was about 3x oversubscribed. The debt was issued in tranches of three tenors: \$1.25billion at a yield of 6.13%, \$1.50billion at a yield of 7.375% and \$1.25 billion at a yield of 8.25% for the 7-year, 12-year and 30-year tranche respectively. We highlight that this borrowing was relatively cheap for the country considering that the \$2.86billion Eurobond raised in 2018 for the 7-year, 12-year and 30-year tranche had a yield of 7.63%, 8.75% and 9.25% respectively.

Eurobond Issuances of African Countries



Source: Bloomberg, Investment One Research

Bond Yield Curve



Source: FMDQ, Investment One Research

Decline in activity level in State and Corporate Issuances

Unlike 2020, where corporates flocked to the debt market to borrow cheap funds given the ultra-low cost of borrowing, we saw less transactions in 2021. As cost of fund rose, we saw corporates switch to commercial papers to protect against interest rate risk. Consequently, corporate issuances for the year declined by 37.14% to N227.46 billion. For the states bond, we highlight that none of the states accessed the debt market in 2021. However, at the tail end of 2021, the Federal Government offered a N250 billion 10-year Sukuk bond for the construction and rehabilitation of road projects.

Outlook: Northwards Direction in Yields

Going into 2022, we posit that the direction of yields will be determined by demand and supply dynamics albeit, our base case for next year is a bias for an elevated interest rate. From the demand side, we see more foreign outflows than inflows given the hawkish moves by apex banks in developed market. We see more of risk off sentiment in 2022 as foreign investors will rather move their money to countries that are relatively safe and will only be tempted to come back if the carry trade is very attractive. To sustain inflows in the country, we see the CBN repricing yields upwards. Hence, we should see higher rates at the OMO space to lock in investors. Furthermore, the uncertainty regarding the pre-election year will keep FPIs wary and cautious of bringing in funds which should pressure FX reserves and subsequently induce the CBN to move rates northwards.

From the local demand perspective, we opine that dollar denominated asset such as Eurobonds and other liquid/safe assets such as placements might be more attractive to investors against Naira depreciation and capital preservation. Furthermore, global higher interest rate might trigger capital flights out of the country as local investors switch to foreign assets. we expect treasury bills and OMO maturities to be refinanced by the government. We highlight that FGN bond of c. N605.31billion will mature in January.



From the supply side, the Federal Government has proposed a budget spending plan with a deficit of ₦6.25 trillion, with crude benchmark of \$57/bbl and an exchange rate of ₦410.15/\$1 for 2022. The deficit will be financed from both local and external sources. From precedents, if non-oil and oil revenues continue to lag projections given the targets set in the 2022 budget, we opine that borrowing will be greater than the amount projected. As the government prepare to borrow for the new year, we see the DMO front loading most of his borrowings early in the year which will exert upward pressure on rates to attract investors buy in.

The downside risk to the elevated interest rate environment is the high debt service/ revenue ratio of the government at 90.58% as at H1 2021 and the expanding public debt profile of the government at N38.00 trillion as of September 2021. The DMO has stated the Ways and Means offered to the government by the CBN will be securitized and the process might be concluded in 2022. Given the high debt profile in 2022 and subdued government revenue, we spotlight that the DMO might ensure that the debt service ratio does not overshoot, thus, putting a lid on rise in yields.

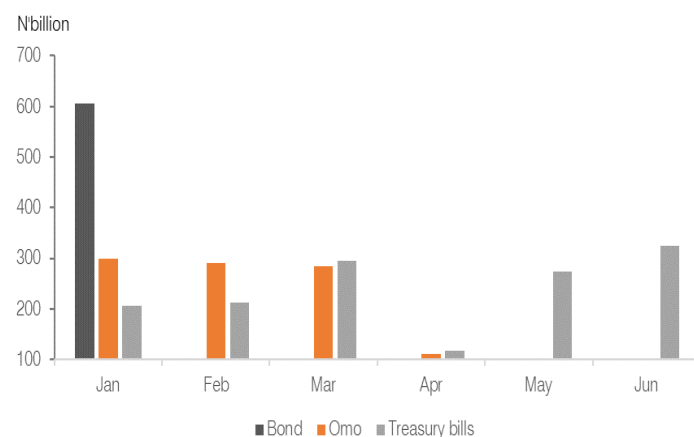
Return to the Eurobond Market

To meet its financing needs, we spotlight that the government might return to the market in Q1 2022 to take advantage of the low cost of borrowing before the upward reversal in interest rates in US and other global economies. Furthermore, Eurobond maturity of about \$300 million in June 2022 should further pressure the authorities to tap into the Eurobond market. We opine that if the government is unable to return at the early part of the year 2021, the higher interest rates in global space and pre-election year uncertainty will cause borrowing cost to increase and in extension, debt servicing for the authorities. This could further expose the economy to exchange rate fluctuations which could arise due to volatility in the global currency market and possible devaluation in Naira.

Short Dated Instruments Play by Corporates

For the corporate space, we spotlight that companies will rather issue short term dated securities i.e. commercial papers rather than bonds. We spotlight that the current low rates at the treasury space presents an opportunity for corporates to lock in their borrowings at low interest rates in H1 2022 before yields start going up. If we opine that bond interest rates will be elevated next year, then private investment will be crowded out because the cost of borrowing will be too high for them; hence, we see less of corporate bond issuances next year.

Maturity Profile in H1 2022



Source: Bloomberg, Investment One Research



Circling Back

Following the stellar performance of the equities market in 2020 (+50.03%), the Nigerian equities market began 2021 on a positive note with a gain of 5.32% in the first month, making January the best month in terms of returns during the year. This was largely on the back of increased demand for equities by local investors with expectations of continued bullish rally from the prior year. However, market failed to sustain the bullish momentum through the year on the back of a myriad of factors such as reduction in foreign investors participation and tepid economic growth. The rise in yields on fixed income securities during the first half of the year also negatively impacted the equities market.

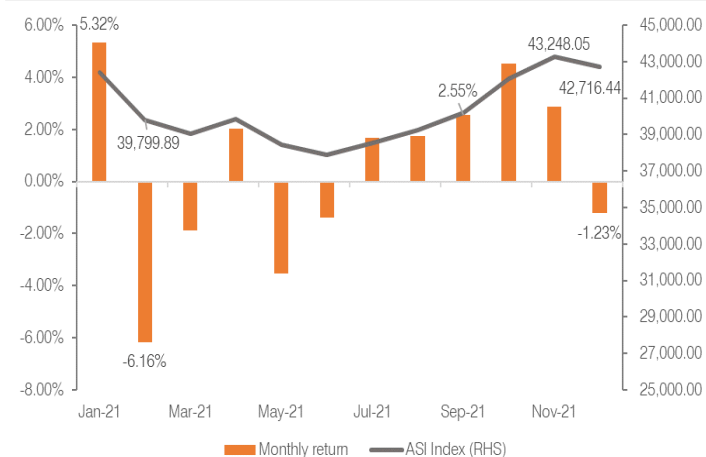
In the second half of the year, market activities were bolstered by decline in yields in the fixed income space, corporate actions (declaration and payment of interim dividends) and a number of events such as the tussle for control on FBNH shares which saw market participants take speculative buy-positions in the stock. In addition, the approval in principle granted to listed telecommunication companies to operate Payment Service Banks sent positive sentiments towards MTNN and AIRTELAFRI and the stock exchange market. Overall, we saw improved investors participation as investors searched for positive real returns given high inflation level.

Regarding foreign and domestic portfolio investors participation, it was observed that in the first half of the year participation on both ends declined significantly. Transactions from FPIs dipped by 48.61% from about N47.52billion in January to N23.42billion in June. Similarly, transactions of domestic portfolio investors also declined by 58.18% from N184.94billion in January to N77.35billion in June.

However, in the second half of the year, participation in the market surged, as transactions carried out by FPIs inched up by 347.91% from N15.53billion in July to N69.56billion as of November 2021. In the same vein, domestic participation grew by 70.50% from N74.24billion in July to N126.58billion. Elsewhere, foreign outflows as of November stood at N209.76billion, c.10.00% greater the foreign inflows of N189.42billion.

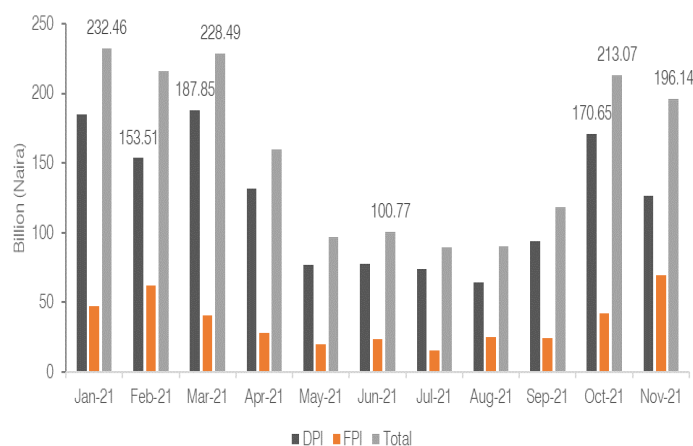
Overall, the equities market maintained upward trajectory during H2 2021 closing the year with a YTD gain of 6.07%, making this the first time since 2013 the market closed up for a second consecutive year.

Equities Market Monthly Return



Source: NGX, Bloomberg, Investment One Research

Foreign & Domestic Investors Participation In 2021



Source: NGX, Bloomberg, Investment One Research



Outlook

Going forward, we expect low participation to persist, given rise in yields in the global space and 2022 being a pre-election year. In periods close to the election, we tend to see relatively high levels of capital flight as investors become weary of the political and economic climate, hence, losing interest in investing in the economy until the post-election period where the degree of uncertainty has declined and investors are clear on policy directions of the new administration. However, we spotlight that capital flight is unlikely to significantly impact the market given already low participation from FPIs.

In our view, we expect earnings performance to attract the attention of investors especially in the first quarter, when full-year results of 2021 will be released. With expectations of impressive performances, we see investors taking positions in bellwether stocks; specifically dividend-paying names. This should bode positively for market performance during the earliest months of the year. In the near term, we expect banking names to benefit from the imminent increase in interest rate which would positively affect interest income across board. Furthermore, in the light of usual ostentatious election spending and cash dole that comes with campaigns, consumer spending could be positively impacted later in the year bolstering revenue growth for fast moving consumer goods companies.

We are likely to see a relatively quiet market for a major part of the year especially when election activities begin, and investors adopt the wait and see approach. Furthermore, the potential rise in yields in the global and local economy as well as possible increase in benchmark interest rate by the CBN could see investors favour fixed income instruments (less risky assets) over equities in a bid to reduce risk exposures.

Top Gainers and Losers in 2021 (by Index movement)				
1	MTNN	1,453.15	BUACEMENT	-669.38
2	DANGCEM	910.08	GTCCO	-127.14
3	AIRTELAFRI	874.32	NB	-79.33
4	SEPLAT	335.23	GTCCO	-67.98
5	FBNH	322.10	INTBREW	-51.39
6	ZENITHBANK	196.68	MANSARD	-28.33
7	NESTLE ACCESS	170.78	STERLNBANK	-26.29
8	WAPCO	149.28	FCMB	-7.30
9	ACCESS	115.69	CWG	-6.87
10	OKOMUOIL	105.97	ETRANZACT	-5.22

Source: NGX, Bloomberg, Investment One Research

Top Gainers and Losers in 2021 (by percentage change)				
1	MORISON	306.12%	SCOA	-64.51%
2	ROYALEX	238.46%	CWG	-55.91%
3	VITAFOAM	211.94%	SUNUASSUR	-55.00%
4	HONYFLOUR	188.80%	MANSARD	-41.21%
5	CHAMPION	173.26%	FTNCOCOA	40.91%
6	CHIPLC	156.56%	JAPAUFGOLD	-37.10%
7	UPLC	139.59%	VANLEER	-33.54%
8	UCAP	139.50%	DAAR	-33.33%
9	CUTIX	135.88%	ENAMELWA	-26.70%
10	REGALINS	131.82%	STERLNBANK	-23.39%

Source: NGX, Bloomberg, Investment One Research



Equities Market Monthly Return Since 2000

	January	February	March	April	May	June	July	August	September	October	November	December
2000	9.24%	3.53%	0.18%	-1.23%	3.44%	6.09%	6.71%	7.15%	-1.29%	1.60%	-3.69%	13.58%
2001	8.42%	4.39%	-0.23%	4.71%	5.86%	7.72%	-3.30%	-2.34%	-0.53%	7.95%	0.70%	-1.85%
2002	-2.86%	-0.64%	5.98%	1.65%	0.76%	8.31%	0.14%	-1.05%	-4.19%	-4.00%	2.50%	4.43%
2003	9.57%	2.78%	-0.46%	-0.86%	4.44%	3.14%	-3.90%	10.49%	6.17%	14.44%	3.07%	4.02%
2004	13.03%	9.18%	-7.67%	13.27%	6.92%	4.17%	-6.32%	-12.15%	-4.55%	2.73%	3.07%	0.10%
2005	-0.94%	-4.86%	-5.79%	6.19%	-2.59%	0.80%	1.61%	2.12%	10.10%	5.02%	-5.87%	-1.78%
2006	-1.01%	1.16%	-2.58%	-0.15%	6.20%	5.72%	6.57%	18.71%	-1.64%	0.27%	-3.10%	4.92%
2007	10.83%	10.73%	6.69%	8.44%	4.32%	4.42%	3.29%	-6.15%	0.94%	-0.05%	7.94%	7.01%
2008	1.00%	11.11%	-2.96%	-5.87%	-0.86%	-5.06%	-3.67%	-10.02%	-3.29%	-21.40%	-9.08%	-4.78%
2009	-30.63%	7.17%	-15.08%	7.56%	39.09%	-11.62%	-3.67%	-9.01%	-4.10%	-1.18%	-3.64%	-0.87%
2010	8.49%	1.73%	-5.36%	1.88%	-1.02%	-2.96%	1.86%	-6.17%	-5.07%	8.64%	-1.11%	0.02%
2011	8.32%	-3.03%	-5.36%	1.71%	3.29%	-3.43%	-4.62%	-9.78%	-5.23%	2.76%	-4.45%	3.64%
2012	0.70%	-3.60%	2.63%	7.06%	-0.20%	-2.12%	6.77%	2.99%	9.52%	1.61%	0.24%	5.98%
2013	13.44%	3.84%	1.39%	-0.29%	13.02%	-4.31%	4.84%	-4.39%	0.93%	2.84%	3.45%	6.19%
2014	-1.83%	-2.50%	-2.05%	-0.68%	7.77%	2.43%	-0.91%	-1.34%	-0.78%	-8.88%	-8.01%	0.33%
2015	-14.70%	1.83%	5.48%	9.31%	-1.15%	-2.49%	-9.79%	-1.64%	5.16%	-6.49%	-6.18%	4.59%
2016	-16.50%	2.74%	2.99%	-0.96%	10.41%	6.96%	-5.36%	-1.47%	2.67%	-3.94%	-7.27%	6.47%
2017	-3.12%	-2.72%	0.74%	0.98%	14.48%	12.27%	8.24%	-0.96%	-0.18%	3.50%	3.45%	0.79%
2018	15.95%	-2.28%	-4.21%	-0.57%	-7.67%	0.46%	-3.29%	-5.86%	-5.97%	-0.92%	-4.90%	1.80%
2019	-2.78%	3.81%	-2.14%	-6.06%	6.55%	-3.55%	-7.50%	-0.69%	0.38%	-4.60%	2.44%	-0.59%
2020	7.46%	-9.11%	-18.75%	8.08%	9.76%	-3.12%	0.88%	2.57%	5.96%	13.76%	14.78%	14.92%
2021	5.32%	-6.16%	-1.90%	2.04%	-3.52%	-1.38%	1.69%	1.74%	2.55%	4.52%	2.88%	-1.23%

Source: NGX, Bloomberg, Investment One Research



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