

Economic recovery to slow in H2

Except for our outlook on inflation, our main views on the macroeconomy from the start of the year have played out. In our 2022 outlook, we argued that the risk of FX depreciation will likely persist due to capital reversal from emerging markets (EMs) and frontier markets (FMs), necessitating a rate hike by the CBN to reduce the risk of capital flight. This has largely played out, with the CBN increasing rates by 150bps at its May MPC meeting, albeit higher and earlier than we expected. We forecast another 100bps rate hike before year end as inflation continues to rise. Average treasury bill yields were down in Q1 2022 but began to rise in Q2 2022 as investors priced in inflationary pressure. We expect a modest expansion in yields in H2 and forecast yield on 365-day Treasury bills to reach 9.5% by the end of the year.

Looking ahead, we are increasingly skeptical that the CBN will allow the rate at the I&E window to depreciate towards our initial NGN455.00/US\$ target for the end of the year. We have therefore altered our end-2022 forecast to NGN435/US\$, implying relative stability. Fundamental market pressures are clearly turning depreciatory and are likely to remain so over the remainder of the year amid declining investment inflows and fiscal expansion. However, the rate is clearly being heavily managed by the CBN. As such, the rate for the rest of the year depends more on the CBN's willingness and ability to maintain it at its current level than on fundamental or valuation pressures.

We retain our 2022e real GDP growth forecast at 2.8%, despite a better than expected turn out in Q1 2022. Nigeria's Gross Domestic Product (GDP) grew by 3.11% y/y in real terms in the first quarter of 2022 (Q1 2022), sustaining growth for the sixth consecutive quarter since the recession in 2020. However, looking ahead, we expect decreasing oil production due to previous underinvestment and theft to continue to cap export growth. Security concerns affecting food production, rising inflation, and increasing funding cost and a focus on election activities, are also expected to restrict output growth in H2. Global oil prices have remained elevated due to supply constraints in the market amidst below quota production by OPEC+. We forecast oil prices will average US\$90/bbl. in H2.

Inflation has grown more rapidly than we were expecting since the outbreak of the conflict between Russia and Ukraine and its impact on commodity prices such as oil and gas, fertilizer, wheat, corn, and barley. In June 2022, the headline inflation rate increased to 18.6% y/y, the highest since February 2017. We expect inflation to continue to rise in H2 2022 as the major drivers of food and core inflation remain. Overall, we expect headline inflation to average 20.67% in H2 compared with 16.72% in H1 and we expect headline inflation to close the year at 20.97% in December 2022.

The revised government expenditure for 2022 was estimated at an all-time high of N17.31 trillion. Revenue projected at N9.96 trillion will likely underperform estimate. The fiscal deficit has surpassed the target by an average of c.65% over the last 5 years due to ambitious revenue estimates and volatile crude oil prices. We project oil revenue will significantly fall short of target. We expect increased borrowings on the domestic market either through additional bonds or Ways and Means to finance the larger shortfall.

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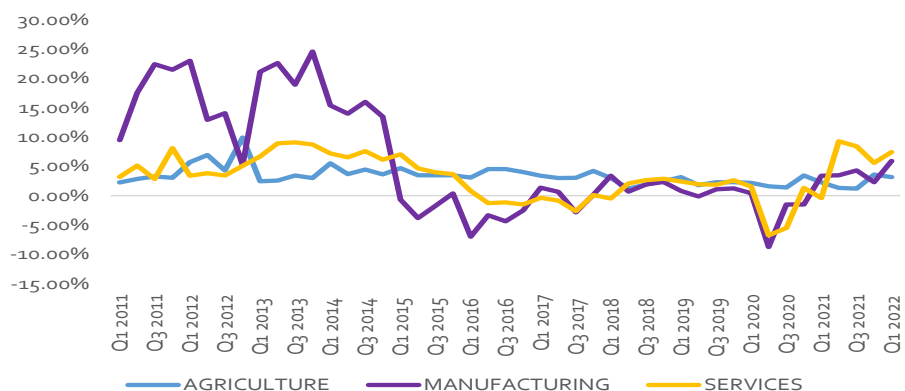
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Real GDP: Economy to grow at 2.8% in 2022

We retain our 2022e real GDP growth forecast at 2.8%, despite a better than expected turn out in Q1 2022. Nigeria’s Gross Domestic Product (GDP) grew by 3.11% y/y in real terms in the first quarter of 2022 (Q1 2022), sustaining growth for the sixth consecutive quarter since the recession in 2020 when output contracted by 6.10% and 3.62% in Q2 and Q3 respectively, at the heat of the Covid-19 pandemic. Q1 growth was driven by the non-oil sector (+6.08% y/y), while the oil sector remained uninspiring (-26.04% y/y). The growth in the non-oil sector outperformed expectations driven mainly by growth in services sector, while the manufacturing and Agricultural sectors remained resilient. Heavy-weight sub-sectors like trade (+6.54% y/y) and ICT (+12.07% y/y) were the main drivers of the growth in the services sector. While the growth in the trade sector could reflect improved domestic demand arising from complete removal of movement restrictions, it also benefitted from a low base in the prior year (Q1 2021: -2.43% y/y). Also, the ICT sector growth of 12.07% was mainly supported by the telecommunications sector (+14.50% y/y) given the continued demand for data and digital services. The non-oil sector contributed 93.37% to the nation’s GDP in Q1 2022 in real terms. Growth in the agricultural sector settled at 3.16% in Q1 2022 compared to 3.58% in Q4 2021. The subdued output continues to reflect the persistent security challenges and its effect on food production in the country despite CBN’s monetary interventions. That said, we expect the sector to remain resilient through the year, receiving respite from CBN Agro interventions. Likewise, the Manufacturing sector remained resilient, rising by 5.89% in Q1 2022 compared with 2.28% in Q4 2021 and 3.40% in Q1 2021 even as the negative impact of the oil refining subsector has continued to drag performance.

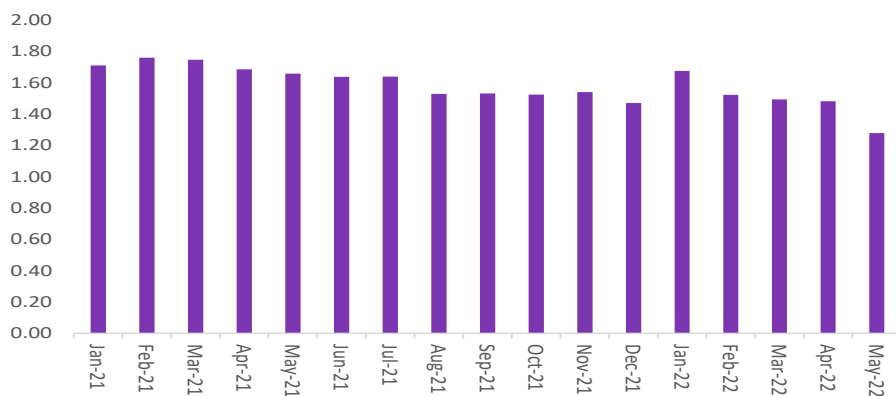
Y/y growth across major sectors of the economy



Source: NBS, CSL Research

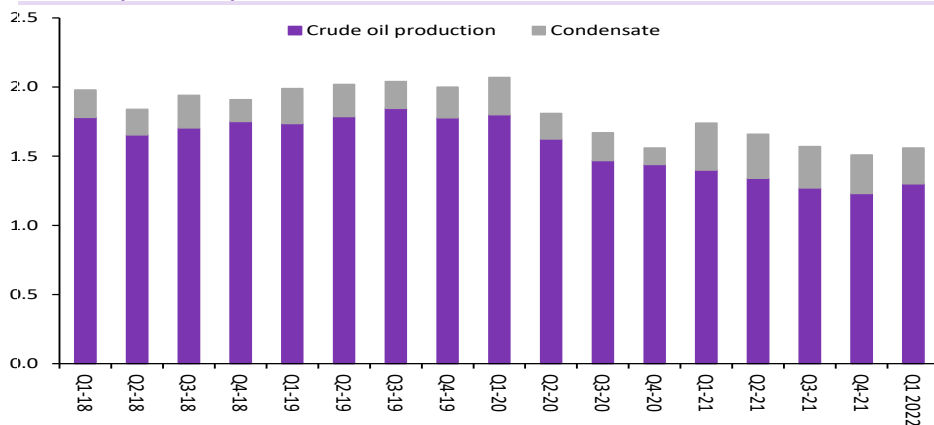
The oil sector contracted deeply by 26.04% y/y (despite a better average price of Brent crude in Q1 2022 compared to Q4 2021 and Q1 2021), due to low production. Brent crude averaged US\$97.86/bbl. in Q1 2022, compared with US\$79.66/bbl in Q4 2021 and an average price of US\$61.32/bbl in Q1 2021. Meanwhile, average daily oil production for Q1 2022 at 1.56mbpd (including condensates), was lower than 1.74mbpd in Q1 2021. The uninspiring output was largely due to crude oil terminal maintenance, shutdowns, theft, and reduced investments. With the perennial issues affecting oil production in the country. Crude oil production reached a low of 1.28mbd. (Including condensates) in May 2022. We do not anticipate any significant recovery in the near term. The passage of the PIB that should have incentivized investments into the sector appears ineffective).

Monthly crude oil production including condensates



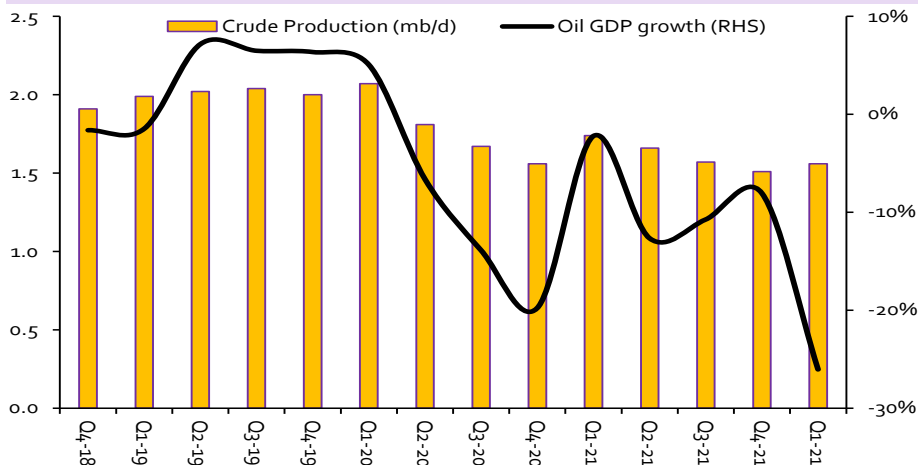
Source: NUPRC, CSL Research

Quarterly crude oil production



Source: NBS, CSL Research

Crude oil production and oil sector growth



Source: NBS, CSL Research

We expect GDP growth to soften in the second half of 2022 based on the following assumptions.

- The oil sector is forecast to continue to contract. Production has been declining steadily since the beginning of the year. Nigeria has been unable to maximize the surge in oil prices, as crude oil production has remained perpetually below the OPEC benchmark due to terminal shutdowns resulting from dilapidating infrastructure, oil theft and we do not expect an improvement to the current situation in H2. New production from new fields will not do much to reduce the overall drop in output in our view. We project average crude oil production (including condensates) of 1.38mbpd in H2 compared with 1.48mbpd in H1.
- Elsewhere, we had expected the completion of Dangote's refinery to boost refined petroleum exports while simultaneously offering structural tailwinds to FX liquidity but that is looking impossible to happen before year end.
- Increasing focus on the elections, will likely dampen growth in the non-oil sectors. The rising cost of diesel, FX illiquidity and increased borrowing cost is expected to put further pressure on the manufacturing and services sectors. Also, the continuous decline in consumer purchasing power will most likely dampen output growth.
- We also expect growth in the agricultural sector to remain subdued due to the escalating insecurity in the food producing regions.

Inflation: Sticky all the way!

Nigeria's inflation rate began to increase rapidly following the Russian-Ukraine war, reaching 18.6% y/y in June, the highest since February 2017. The ongoing dollar shortage and increasing diesel prices will also keep price pressures strong over the coming months. In June 2022, the headline inflation rate increased to 18.6% y/y, 0.86% higher than 17.72% recorded in May 2022 and 0.84ppts higher compared to 17.75% recorded in June 2021. Increases were recorded in all COICOP divisions that yielded the Headline index. Month-on-month, the Headline inflation rate increased to 1.82% in June 2022, also 0.03ppts higher than the 1.78% recorded in May 2022. The authorities raised the Monetary Policy Rate (MPR) from 11.5% to 13.0%, in a surprising move in May. This, according to the committee, was to moderate inflationary pressure, among other reasons.

Amidst the continued rise in food prices, the food index rose to 20.6% in June 2022 compared with 19.50% y/y in May 2022, but 1.23% lower compared to 21.83% in June 2021. The rise in the food index according to the bureau was driven by increases in prices of bread and cereals, food products, potatoes, yam, and other tubers, meat, fish, oil and fat, and wine. Month-on-month, the food sub-index increased to 2.05% in June 2022, up by 0.03 percent points from 2.01 percent recorded in May 2022. We anticipate a mild respite to increasing food prices when the harvest season begins in September. However, the impact of the Russian-Ukraine war on the prices of commodities like wheat and oil will continue to pressure food inflation and pass-through effect from rising transport cost will continue to add another layer of pressure. Also, the worsening insecurity situation will also continue to limit food production. Based on these factors, we have revised our forecast for average food inflation for the year to 18.92% from 15.01% previously. Overall, we expect food inflation to average 20.1% in H2 compared with an average of 18.3% in H1.

Core inflation of 15.75% y/y was reported in June 2022; 0.72% higher than 14.90% recorded in May 2022 and 2.66% higher than 13.09% recorded in June 2021. Month-

on-month, the core sub-index increased to 1.56% in June 2022, down 0.31% compared to 1.87% recorded in May 2022. The highest increases were recorded in prices of Gas, Liquid fuel, Solid fuel, Garments, Passenger transport by road, Cleaning, Repair and Hire of clothing, Passenger travel by Air. The growth in the core index continues to reflect the impact of the increased cost of diesel and gas, which we believe will continue to pressure core inflation in the second half of the year. In February, a few discos were allowed to review tariffs. There is a chance that another review will happen before the end of the year, and this will increase the pressure on core inflation. Again, with agitations from various petroleum stakeholder unions rising, there may be an increase in pump price of petrol from the current N165/litre, though we rule out a complete deregulation. Overall, we forecast core inflation will average 17.63% in H2 2022 compared with an average of 14.4% in H1.

Finally, election spending, which is likely to result in huge liquidity injections into the economy for the rest of the year, continues to pose a threat to price stability. Overall, we expect headline inflation to average 20.67% in H2 compared with 16.72% in H1 and we expect headline inflation to close the year at 20.97% in December 2022.

Inflation rate (July – December are forecasts)



Source: NBS, CSL Research

Exchange Rate

The Naira has fallen to low levels in the past week, as traders adjusted prices to reflect the rate the Central Bank of Nigeria (CBN) sold the currency amidst the ongoing dollar scarcity. Nigeria is experiencing one of its worst FX crises in history due to increasing demand for FX amidst low supply. According to bank treasurers, the CBN has stopped its bi-weekly sale of FX to Foreign Portfolio Investors (FPIs) for the third consecutive week. This, many believe, is to clear the outstanding backlog of contractual obligations to supply FX to FPIs through the banks that have not been met.

CBN is unlikely to ramp up intervention levels at the I&E window in the near term as inflows remain tepid. We project the FX reserves to deplete to US\$35.00 billion by the end of 2022, Meanwhile, the current parallel market premium of c.45% continues to fuel arbitrage opportunities while FX rationing at the IEW has magnified the demand pressure at the parallel market. Our prognosis is for the premium to remain widened, as the CBN is yet to resume FX sales to the BDCs, and importers of many items remain barred from sourcing FX from the official window. Also, there has been a

surge in demand for FX from an increasing number of Nigerians migrating to the UK, taking advantage of the new immigration laws.

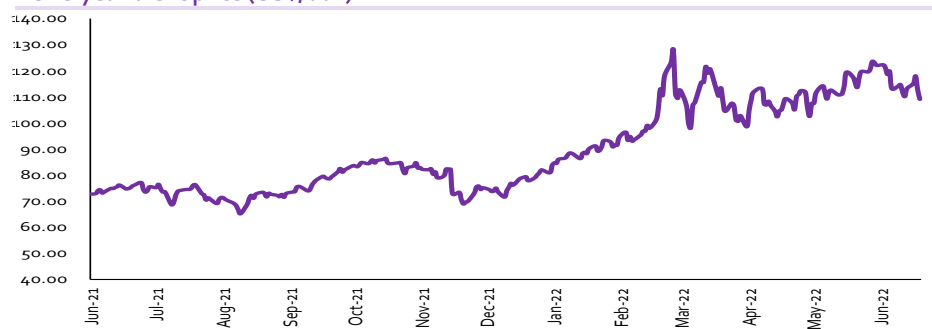
Looking ahead, we are increasingly skeptical that the CBN will allow the rate on the I&E window (quoted as the Nigerian Autonomous Exchange Rate Fixing or NAFEX) to depreciate towards our NGN455.00/US\$ target for the end of the year. We have therefore altered our end-2022 forecast to NGN435/US\$, implying continued relatively stability. Fundamental market pressures are clearly turning depreciatory and are likely to remain so over the remainder of the year amidst declining investment inflows and fiscal policy expansion. We also note that the currency is increasingly overvalued. However, the rate is clearly being heavily managed by the CBN. As such, the rate for the remainder of the year depends more on the CBN's willingness and ability to maintain it at its current level than on fundamental or valuation pressures.

From a willingness perspective, we believe that the CBN has always been and is very keen to prevent further depreciation especially not during the run up to the elections, when depreciation of the currency will be an unpopular decision. As for the CBN's ability to maintain the rate at its current level, we note that despite the high oil price, occasioned by the Russia-Ukraine war, Nigeria has failed to benefit from it due to limited production and the maintenance of a subsidy regime, which is estimated to cost the country at least N4trn this year. High oil prices imply increased cost of refined products and Nigeria continues to spend a huge part of its FX earnings on the importation of Petroleum Motor Spirit (PMS) and other refined products due to the complete absence of local refining capacity. The country has also failed to significantly increase its non-oil exports. Crude oil with decreasing production capacity continues to dominate the export earnings with a total value of N5.62trn representing 79.16% of total exports as of Q1 2022. Understandably, the reserves are being pressured. Based on CBN data, foreign reserves are down 2.9% compared to the position as of December 31, 2021. That said, we believe CBN will still apply many unorthodox measures to keep the rate at the I&E window relatively stable, making us forecast only a mild depreciation to c. N435/US\$ at the end of the year.

Global oil prices: Global oil prices have remained high due to supply constraints in the market and falling Russian oil exports amidst an inability of OPEC+ members to meet their production quota. We forecast oil prices will average **US\$90/bbl.** in H2 due to a combination of various factors.

- Expectations of a further restrictions on Russian imports by the EU.
- Slowdown in demand growth due to expectations of slowing global economic growth and a recession in the US should prevent a severe supply deficit.
- Except for Russia, output from the rest of the world is set to rise in the second half.
- Increase in energy demand associated with summer travels.

One-year brent price (US\$/bbl.)



Source: Bloomberg, CSL Research

Monetary Policy

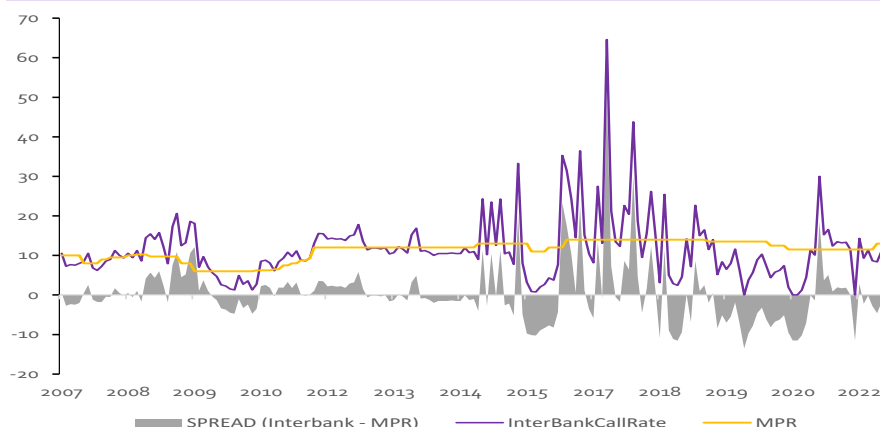
The authorities raised the Monetary Policy Rate (MPR) from 11.5% to 13.0% in a surprising move in May, for the first time in almost six years. This, according to the committee was to moderate inflationary pressure, restrain the speed of capital flow reversal, provide incentives for foreign capital inflows, and sustain remittances. Though we had anticipated a rate hike, we didn't anticipate a single steep hike.

The Committee expressed great concern around the headline inflation rate, which they believe may be inimical to growth and expressed their belief that tightening would moderate inflationary pressure pass-through to exchange rate depreciation. They also expressed concerns around capital reversals. As part of measures to address the supply constraint in the foreign exchange market, yields on domestic instruments must be competitive to moderate the speed of capital flow reversal. Lastly, the committee noted that tightening could moderate government domestic borrowing.

Inflation is at a faster pace and was not ignored. While the MPC agreed that several supply-side factors, which cannot be abated by a rate hike, were responsible for the inflationary pressure, they also noted that emerging evidence showed that money demand pressure was on the rise. The committee noted that election spending is likely to result in huge liquidity injections into the economy for the rest of the year and, as such, pose a threat to price stability.

The risk of FX depreciation will likely persist in H2 due to capital reversal from emerging markets (EMs) and frontier markets (FMs) as inflation continues to bite harder in developed markets. As such, to reduce the risk of capital flight, the CBN may need to increase the rate, albeit more moderately, to keep borrowing costs low. Yields at the Eurobond market are at record highs and the government may need to rely more on local borrowings to fund its budget deficit. Consequently, we expect the authorities to keep an eye on rates. Going into H2 2022, we acknowledge the continued threat of more money supply through increased election spending. In our view, the shift in policy will likely constrain the country's fragile growth while achieving very little in terms of combating inflation and attracting foreign inflows and we believe the authorities have seen this already playing out with the last increase. We anticipate at most, only a further 100bps hike in MPR. Alongside the use of the MPR, we are likely to see continuous ad hoc measures to manage liquidity and address the FX imbalances.

Interbank versus MPR



Source: CBN, CSL Research

External imbalances to moderate

External imbalances improved in 2021 and the current account is in surplus in Q1 2022 based on CBN provisional data. The outturn was supported by both higher crude oil prices and improved remittance inflows. Nonetheless, Nigeria could not maximize the surge in oil prices, as oil crude production remained perpetually below the OPEC benchmark due to terminal shutdowns and low investment. The current account will likely remain in deficit in H2 2022. We project import to grow, driven by improving domestic consumption and higher prices of refined petroleum products. Elsewhere, we expect export to grow slower, as our projected crude oil price of US\$90 per barrel is lower than current levels of US\$104.69/bbl. (average for H1 2022). Nonetheless, we think that improved remittance inflow will help narrow the current account deficit.

Based on the data released by the National Bureau of Statistics, Nigeria’s foreign trade position in Q1 2022 returned to a surplus position of N1.2tn as exports (N7.1tn) significantly exceeded the value of the country’s imports (N5.90tn) in the period. Relative to Q1 2021, total exports of N7.10trn were 137.9% y/y higher in Q1 2022 than the value of N2.98trn reported in Q1 2021 while total imports of 5.90trn were 21.0% y/y higher in Q1 2022 than the N4.88trn recorded in Q1 2021. The total trade value of N13.0tn in Q1 2022 when compared to the value of N7.86tn in Q1 2021 is a testament to the continued global economic recovery. Likewise, the rally in crude oil price in Q1 2022 also played a significant role in exports since Africa’s biggest economy’s export is skewed to crude oil (79.2% of total exports in Q1 2022).

Fiscal space to remain constrained in 2022

The revised government expenditure for 2022 was estimated at an all-time high of N17.31 trillion. Revenue projection of N9.96trn will likely underperform estimate, however, we expect the continued economic recovery to support tax revenue. We forecast that the budget deficit will come in at N9.7tn, above the government's deficit target of N7.35tn. Recurrent spending will likely overshoot targets while capital spending will be lower than planned, in our view, oil revenue will significantly fall short of target, but non-oil revenue will outperform budget estimates. We expect increased borrowings on the domestic market either through additional bonds or Ways and Means to finance the larger shortfall. The fiscal deficit has surpassed the target by an average of c.65% over the last 5 years due to ambitious revenue estimates and volatile crude oil prices.

We highlight several factors underpinning our assumptions of a wider budget deficit below.

First, we believe recurrent spending will come in at N7.5trn above the N7.0trn targeted in the budget. With election activities lined up, spending will likely intensify over the course of the year. Furthermore, with inflation set to remain high, nominal spending will have to increase robustly if it is to remain positive in real terms. Capital spending historically has come in below target and we believe that it will do so once again in 2022 – we are forecasting total capital expenditure of NGN3.6trn, below the authorities' target of NGN5.4trn. Also, the government plans to spend N4tn on subsidy in the year. As of May 2022, the government had already expended N1.27tn on petrol subsidy. Data from the Nigerian National Petroleum Company Limited (NNPC) showed that N210.38bn, N219.78bn, N245.77bn, N271.59bn and N327.1bn were spent on subsidies in January, February, March, April, and May 2022, respectively. Going by the monthly progressive increase in subsidy so far in the past 5 months, we expect the government to spend not less than N3.5tn on petrol subsidy in 2022.

On the revenue side, we believe that the authorities' non-oil revenue targets particularly on VAT and CIT collections are achievable. Even as of Q1 2022, we had seen improvements in both CIT (+35.6% y/y) and VAT collections (+18.6%). Given the expectations of continued inflationary pressures, we expect VAT revenue to maintain the growth momentum since VAT is deducted by applying VAT rate on the value of transactions. An increase in prices of goods and services will necessarily imply growth in VAT collections. Likewise, we are also optimistic on the revenue from CIT payments given our positive outlook for improved companies' profitability in the year, which translates to higher tax payment. Hence, just like we saw in 2021, we believe the non-oil revenue in 2022 arising from VAT and CIT collections will likely outperform 2022 budget estimates, which is positive, especially at a time when high subsidy payments and low oil production keep throwing a spanner in the works of oil revenue.

Beyond that, taxes from new sources such as the N10 per litre tax placed on carbonated drinks, tax on phone calls to fund healthcare, and 10% on disposal of shares worth N100 million and above, should support accretion to non-oil revenue. On the other hand, we think the target oil revenue is ambitious in our view. While we think the oil prices will end up being higher than the government's revised expectation of US\$73/bbl from the initial US\$62/bbl, we do not think that the revised target oil production of 1.6mbpd from 1.88mbpd is achievable. Going by the latest data released by the Nigerian Upstream Petroleum Regulatory Commission (NUPRC), average daily oil production (including condensates) for the first half of the year was 1.48mpd, also lower than the OPEC benchmark of 1.68mbpd in the review period. The perennial

issues of pipeline vandalism, theft, and terminal shutdowns have continued to constitute clogs. With no lasting solution in sight to curb this menace in the year, oil production will most likely remain at sub-optimal levels for the rest of the year.

Debt on the rise and could reach IMF benchmark in near term

The Debt Management Office (DMO) in its last report, said that Nigeria's total public debt stock increased to N41.60tn in the first quarter of 2022 from N39.56tn as of December 2021. The public debt stock covers the total domestic and external borrowings of the Federal Government and state governments, including the Federal Capital Territory. According to the DMO, the increase in total public debt stock includes new domestic borrowing by the FGN to partly finance the 2022 budget deficit and the US\$1.25bn Eurobond issued in March 2022 as well as disbursements by multilateral and bilateral lenders. It added that there were also increases in the debt stock of the state governments and the FCT.

Based on FY 2021 GDP data at current prices, the debt to GDP ratio comes to about 24.0%, below Nigeria's self-imposed limit and IMF benchmark of 40% and still significantly below those of African peers like Ghana and Kenya. However, with the inclusion of borrowings from the CBN (Ways and means- estimated at 19.01trn as of April 2022) and the stock of AMCON debt (estimated at about N4.4trn), the debt profile would be about N65.01trn, and debt to GDP ratio comes to c.36.9%. This raises strong debt sustainability concerns. The relatively moderate debt level of the country has increasingly become vulnerable due to high-interest payments, which continue to absorb a significant portion of federal government revenues. Debt service to revenue was estimated at 76.1% as of November 2021. The moderate debt level of the country has increasingly become vulnerable due to high-interest payments which continue to absorb a significant portion of federal government revenues.

Total Public Debt (Q1 2022)

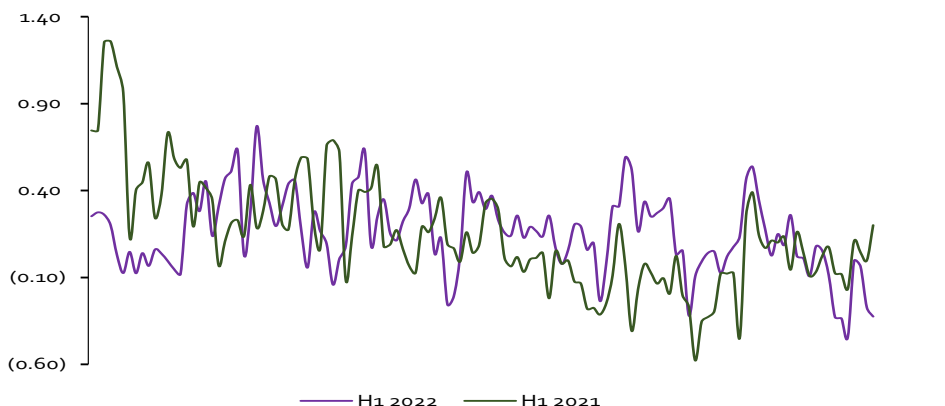
Debt Category	Amount Outstanding (US\$m)	Amount Outstanding (Nm)
Total External Debt	39,969.19	16,617,190.74
Total Domestic Debt	60,100.70	24,986,866.71
FGN Only	48,452.26	20,144,027.72
States & FCT	11,648.44	4,842,838.99
Total Public Debt(A+B)	100,069.89	41,604,057.45

Source: DMO, CSL Research. Note: I&E window exchange rate of N415.75/US\$ as of 31 March 2022 applied

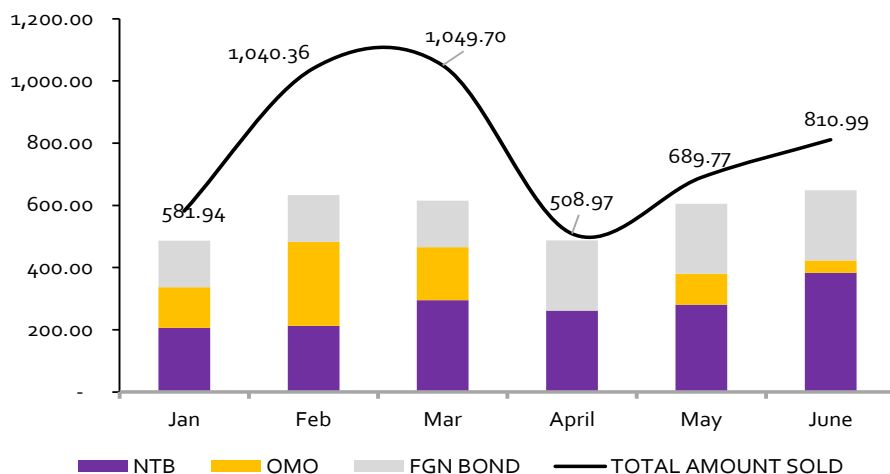
Fixed Income Outlook: Modest expansion in H2

System liquidity remained under control as CBN intensified mop up through N800bn OMO sales, in addition to N2.48trn treasury bills auction in H1 2022. Auctions were oversubscribed particularly at the longer end of the yield curve. While a total of N1.64 trillion, N710 bn and N1.13 trillion were respectively offered for NTB, OMO and FGN Bonds respectively, a total of N2.48 trillion, N800bn and N1.4trn were sold in that order.

System liquidity

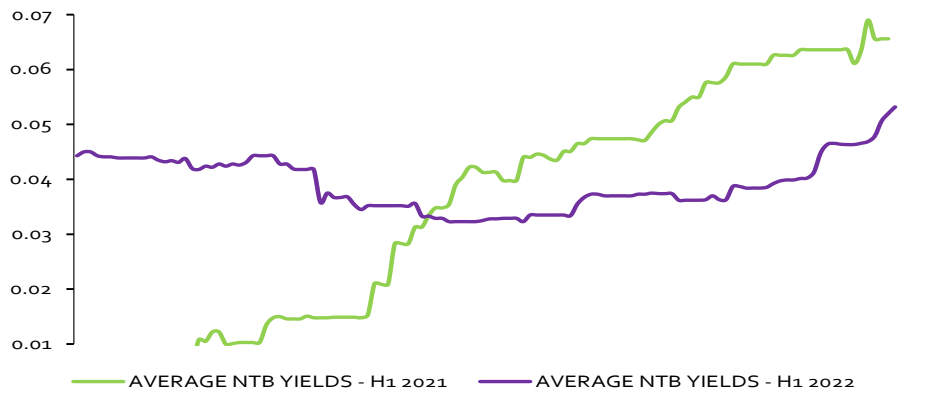


FGN Fixed Income Issuances (offer versus sold)

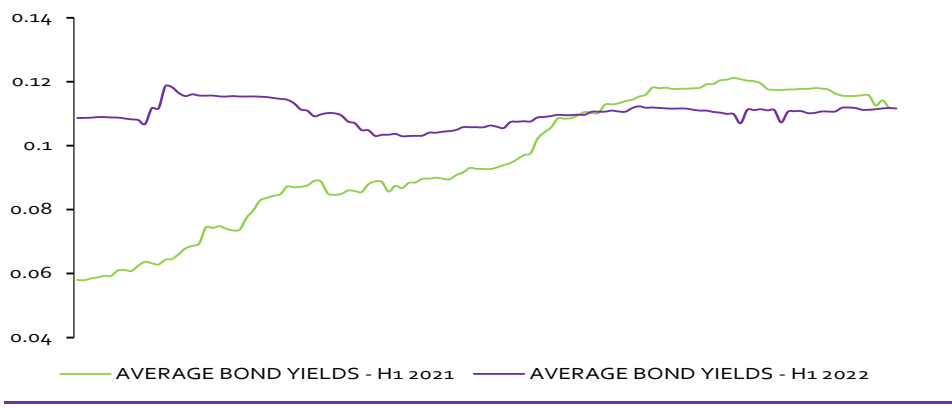


Negative Real Return on average fixed income yields widened as Consumer Price Index trended higher. Yields on Treasury Bills contracted in Q1 2022, in line with our expectation upon bond maturities and coupon payments (N605 billion and N200 billion respectively) even as the Central Bank struggled to minimize funding costs particularly at the shorter end of the tenor buckets. While average treasury bill yields maintained a steady upbeat in H1 2021, it assumed a downward spiral in Q1 2022. However, Q2 2022 witnessed a gradual reversal as investors began to price in inflationary pressure. Yields on FGN Naira Bonds in H1 2022 converged with H1 2021 levels despite increased inflationary pressure revealing DMO's unwillingness to borrow at higher costs.

Average treasury bills yield



Average bond yield



Outlook

We expect the short end of the curve to continue to rise in H2 as liquidity is squeezed out of the system. One-year Treasury bills rate may reach 9.5% if inflation continues to rise and the CBN continues to tighten. While we expect the yields on the long duration to eventually readjust, we expect that will take a longer time. However, we still retain our view that given the country’s very poor fiscal state, funding any marginal cost of debt will be difficult. Hence, we expect the authorities to keep an eye on rates, implying real return will remain negative and possibly widen further. For 3-year and below maturity bonds, we expect average yield to reach about 13.0% while for 10-30 years government bonds, we expect average yield to reach about 14.5% by year end.

Equities: Activities around bellwether stocks will likely lead to a positive close

We began 2022 noting that save for expectations of corporate actions and positive news around the heavy weighted stocks on the exchange, which could drive activities in the stock market, the narrative for 2022, appeared largely negative. This has played out in the first half of the year, as the current positive ytd return has been driven mainly by corporate actions and announcements around bellwether stocks and we believe these will continue to drive activities in the second half of the year.

Foreign investors remained apathetic towards Nigerian equities in H₁, and we believe this sentiment will worsen in H₂ given more uncertainties as the election draws closer and the worsening FX liquidity situation. Repatriation of funds has been difficult for FPIs in the last two years and the situation appears set to worsen in H₂. We believe favourable FX outlook and clarity on FX repatriation policy, both of which appear far-fetched in 2022 remain major catalysts for FPIs to return to the market.

We however remain optimistic about the performance of some of the players in the sectors we cover. Current P/BV valuations of the banks remain at historic lows and in many cases, price in the loss of all profits and of a substantial portion of equity in 2022e. By contrast, we estimate that a COR of 1.7% (forecasted average for the tier 1 banks in 2022e) will not result in any significant dent to profit in 2022e. We also expect the increasing rate environment to support Net Interest Income growth as we expect funding cost growth to lag yield growth for the big banks.

Since the emergence of the geo-political tensions amidst the exiting supply chain disruptions, commodity prices have risen further. Hence, prices adjustments have been and will be needed to save margins. While we expect consumers to remain price-sensitive, we believe consumer businesses with a wide product portfolio to cater for all income categories, can sustain a positive performance in 2022.

The Nigerian cement players have also faced challenging times, ranging from energy pressures to the cost impact of FX depreciation and to inflationary pressures. However, they have remained resilient, benefiting from major price increments in the first half of the year (H₁ 2022). Though, we believe the challenges are far from over, demand remains strong and should support revenue growth. That said, downside risk to our outlook is the impact of torrential rainfall which may dampen cement demand if it persists.

The pandemic had adverse effects on many sectors, yet it was positive for the telecoms sector, and since then, the sector has remained the bright spot in the Nigerian economy. Despite the regulatory policy barring outgoing calls for unlinked SIMs, we expect increased adoption of communication via Voice over the Internet Protocol (VoIP), to support growth in data usage. Meanwhile, both MTNN and Airtel Africa have commenced their PSB operations in Q2 2022, and we expect a boost to Fintech Revenue for the players.

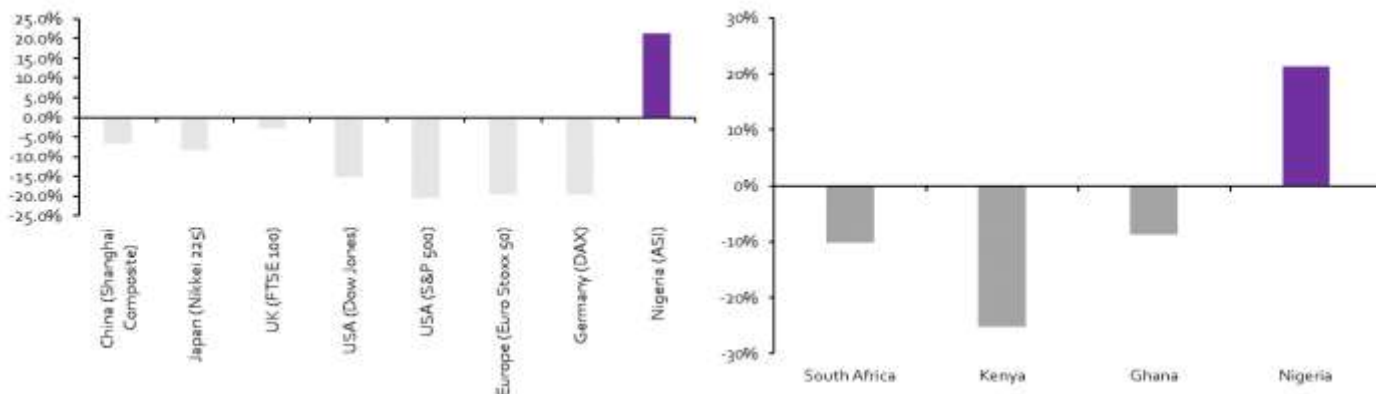
We believe the valuations of many stocks remain very attractive. Within our coverage universe, we have Buy ratings on UBA, Access, Zenith, Guaranty Trust Bank, Lafarge Africa, MTNN, and Nigerian Breweries. Essentially, we believe current valuations present attractive entry opportunities.

Equities Review

In contrast to the bearish sentiments that pervaded the global equities market and its peers in the African market, the domestic equities market started the year on a positive note with the bulls wielding the upper hand till the NSE All-Share Index peaked at 54,085.30pts (the highest ever recorded) on 27 May 2022. At the end of H1, the local bourse posted ytd return of 21.3% as of June 30, 2022, in a not too bright yield environment. Unsurprisingly, activities in H1 2022 mirrored those of H2 2021, as the factors which supported gains in the last half of 2021 played out (even stronger) over the first half of 2022 (H1 2022).

Frontier markets vs Nigeria

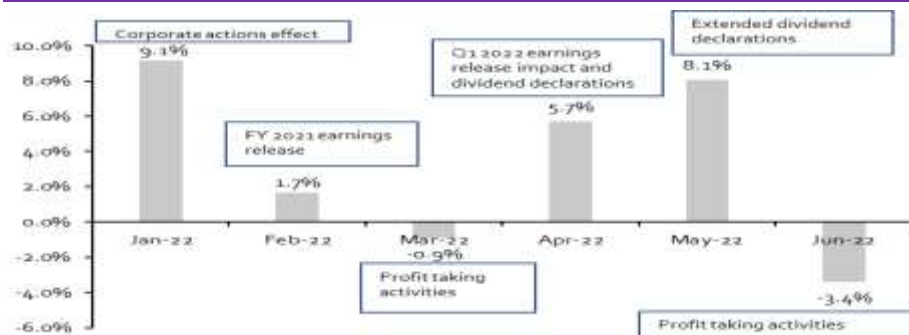
African peers vs Nigeria



Source: Bloomberg, NGX, CSL Research

In our 2022 Economic and Financial Markets Outlook 'In Dribs and Drabs', we posited that we could not overemphasize the weighty impact of corporate announcements and actions on the market's direction. Rightly so, the listing of BUA Foods Plc's shares in January helped the market begin the year on a positive note. Likewise, the sustained increase in crude oil prices renewed investors' interest in Seplat Plc. Again, Dangote Cement conducted the second tranche of its share buyback programme. Similarly, the inclusion of Airtel Africa Plc on the FTSE 100's index, resulted in increased activity on the stock due to its dual listing status, making it the most capitalized stock on the exchange. Solely in January, the market returned a m/m gain of 9.1%, which even outperformed prior year's gain of 6.1% and was the highest monthly return so far in the first half of the year (H1 2022).

m/m return (%)

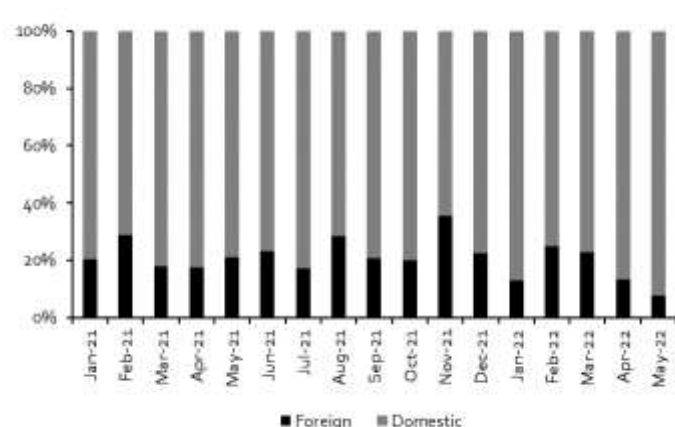
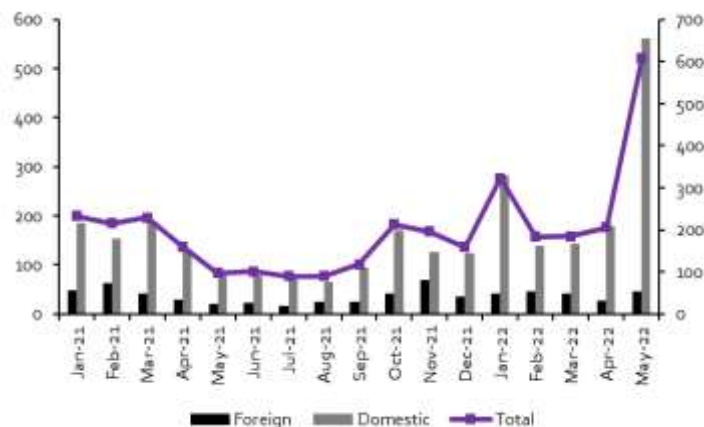


Source: NGX, CSL Research

Interestingly, the low foreign investors' participation on the local bourse made the equities market less vulnerable to external shocks despite the relatively unstable currency environment in the first half of the year. Reflecting the slowdown in the participation of foreign investors in the local bourse, data from the Nigerian Stock Exchange (NGX) showed that ytd, foreign investors share of transactions declined to an all-time low of 13.4% in May 2022 from 21.3% in the corresponding period of 2021. Although, ytd, foreign transactions increased by 1.4% to N201.3bn in May 2022 from N198.5bn in the corresponding period of 2021. However, FIs remained net sellers of domestic equities with a ytd net outflow position of Ng.5bn at the end of May 2022.

Foreign vs domestic investors activity level

foreign vs domestic investors share of transactions



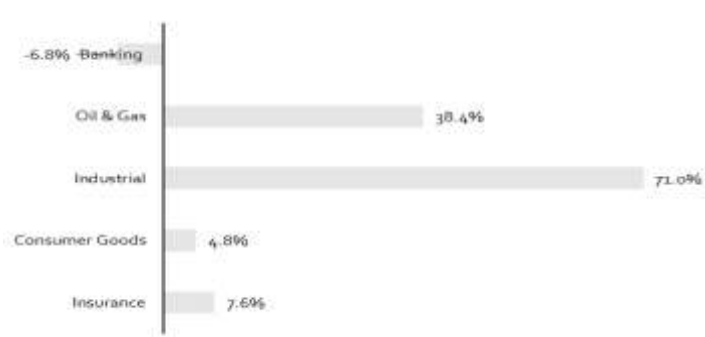
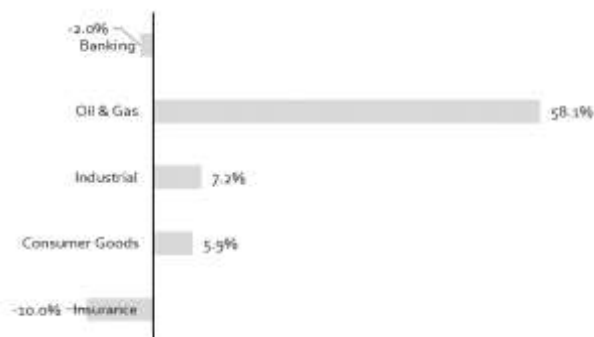
Source: NGX, CSL Research

Mixed sectoral performances in H1 2022

Performances across sectors were mixed in the period. While the Oil and Gas Industrial and Consumer Goods sectors grew respectively by 58.1%, 7.2%, and 5.9% in H1, the Banking, and Insurance sectors lost 2.0%, and 10.0%, respectively. The strong positive performance recorded in the Oil & Gas sector can be closely linked to the high oil prices which was good for the upstream players like SEPLAT (+100.0% ytd). Impressive earnings, alongside dividend announcements from the building materials companies sustained investors' attention on the Industrial goods space. Also, seeing good numbers from the Consumer Goods segment, particularly a turnaround in the performance of the brewers (GUINNESS: +132.1% ytd; INTBREW: +27.3% ytd and NB: +17.6% ytd) renewed investors' interest in the sector.

Sectoral performance in H1 2022

Sectoral performance in H1 2021



Source: NGX, CSL Research





Equities market outlook: The third time won't be a charm

The domestic equities market is currently witnessing the lowest level of foreign investors' participation in the local bourse (foreign investors' share: 13.4% ytd). Going by the sustained foreign investors' apathy towards Naira assets and with no expectations of any significant comeback, the direction of the equities market for the rest of the year will likely depend on internal factors and less of external triggers. Internal factors, such as corporate actions and announcements, the direction fixed income yields, and earnings performance. While we expect overall low liquidity in the market, we believe the market will close on a positive note, driven by.

- Corporate actions and announcements:** Similar to what played out at the twilight of 2021 (announcement of Honeywell's acquisition by Flourmills, notification of approval in principle for PSB license on MTNN's MOMO and Airtel Africa's Smart Cash, etc), the year started with the listing of BUA Foods Plc's shares (January 5), which was met with strong enthusiasm, causing a significant gain in the share price, up as much as 61%.0% as of the end of the month (January). We cannot overemphasize the impact of corporate actions & announcements on market's direction. Hence, positive announcements such as strategic investments, particularly around the heavy weighted stocks will have a major impact on the direction of the market.
- Strong earnings corporate growth:** The resilient consumer demand specifically in the consumer goods and industrial sectors, despite the increase in prices is a testament that the companies can get away with price increases, with little impact on volumes. As of March 2022, the average net earnings of the cement, consumer goods, and agriculture companies under our coverage were higher by 54.6%, 202.6%, and 66.7%, respectively compared with the same period of 2021. This impressive run rate makes us believe that corporate earnings will surpass 2021 earnings.
- Modest expansion of fixed income yields:** Going by the latest data on government borrowings, the government has already achieved 53% of its domestic borrowings as of June 2022 (Net issuance of N1.91tn from NT-Bills and Bonds over budgeted domestic borrowings of N3.6tn (inclusive of supplementary budget)). Consequently, we do not expect significant expansion in fixed income yields. That said, given the rising yields in the Eurobond market, we expect the government to resort to more domestic borrowing. However, this will likely be supported by its usual Ways and Means. As of April 2022, the Federal Government's total borrowing from the Central Bank of Nigeria through Ways and Means Advances increased by N1.6tn from N17.46tn as of December 2021 to N19.01tn. We believe the CBN will continue to pursue its unorthodox approaches especially at a time when it feels election spending is rife and tightening liquidity is imperative.

Upside risks to our positive close forecast include 1) higher than anticipated inflation which may ignite a more hawkish approach and higher than expected yields in the fixed income market, 2) subdued earnings performance, and 3) Negative corporate actions and announcements.

Equity Views by Sector

Sector	Industry	Positive	Negative	Outlook
ICT	Telecommunications	<ul style="list-style-type: none"> Improving mobile penetration Commencement of PSB operations to boost earnings Convenience with Voice over Internet Protocol (VoIP) provides a compelling case for strong growth in Data revenue Market demographics in favour of Telcos 	<ul style="list-style-type: none"> Regulatory Uncertainties Pressured purchasing power Competition among players 	
	Brewery	<ul style="list-style-type: none"> Capacity expansion Leveraging Premium brands The growing market for energy drinks 	<ul style="list-style-type: none"> Supply chain bottlenecks More tilt towards essential spending Competition among players 	
Consumer Goods	Food and Household & Personal Products	<ul style="list-style-type: none"> Opportunities for Price Increase by food processors Low valuation Ban of FX intervention for the importation of Sugar 	<ul style="list-style-type: none"> Pressured purchasing power Intense competition amid border re-opening 	
	Financial Services	Banks	<ul style="list-style-type: none"> Low cost of fund Low valuation Improving yield environment 	<ul style="list-style-type: none"> Regulatory uncertainty CRR debits
Industrial Goods	Cement	<ul style="list-style-type: none"> Unrelenting demand for real estate investments Price increment is an upside potential 	<ul style="list-style-type: none"> Sustained inflationary pressure and FX depreciation to throw a spanner in the works Torrential rainfall. 	

Optimism  Neutral  Pessimism 

Top Recommendations:

Zenith Bank: The valuation of the bank remains attractive at a PBV of 0.53x and PE of 2.8x while dividend yield stood at 13.9% for FY 2021. The bank still rates well based on capital adequacy (Q1 CAR 22.1% up from 21.1% in December 2021), sustainable long-term dividend yield, and stable asset quality (Q1 2022 annualised Cost of Risk of 0.8%, NPL ratio of 4.2% and coverage ratio of 97.3%).

Access Bank: The bank's decision to adopt a Holdco structure is broadly positive for earnings as it implies diversification from a strained commercial banking income. Capital adequacy remains strong at 23.5% for the group. Asset quality ratios minimal (Q1 2022 annualised Cost of Risk (COR) of 1.3%, NPL ratio 4%). Valuations are attractive (PBV 0.32 and PE of 2.06x). We have a target price of N19.14/s, a 106.9% upside potential when compared to the last closing price of N9.25/s.

UBA: The bank reports healthy asset quality ratios with annualized Cost of Risk of 0.6% for Q1 2022. We expect impairment to remain moderate in 2022 and we model FY 2022e COR of 0.7%. Growing contribution from its Pan African subsidiaries gives some versatility to the business and helps protect margins. Valuation remains attractive (PBV of 0.33x and PE of 2.18x). We have a buy rating on the stock with a target price of N19.40/s, current price: N7.45/s as of 18 July 2022.

GTCO: The current price of GTCO at N20.95/s offers huge upside potential compared to our revised target price of N35.00/s. The Holdco ranks among the top in terms of dividend yield (13.8% for FY 2021) while valuation remains attractive (PBV of 0.70x and PE of 3.47x compared to the sector PE of 8.2x). Though Profit has been pressured by declining yields on its investment securities portfolio, we believe the companies operating performance is set to improve. The bank also rates well based on capital adequacy (Basel 2 CAR of 23.8%) and stable asset quality (Q1 2022 annualised cost of risk of 0.3%).

WAPCO: Our price target of N43.88/s implies a 69.7% upside potential from the last closing price of N25.85/s. We still believe the market is yet to fully price in the firm's improved operating performance, and we maintain our Buy recommendation. Lafarge is currently trading at a FY 2022E EV/EBITDA of 7.1x, a discount to its EM peer average of 10.2x.

MTNN: In its Q1 2022 results, MTN Nigeria once again demonstrated the resilience of its revenue generation capacity despite the industry-wide NIN-SIM exercise that has slowed down activities in the sector. While the impact of the recent policy on barring outgoing calls may reflect on its Voice Revenue in the year, we believe revenue from its new PSB operation will provide respite. Moreso, Data revenue remains the goldmine, expected to grow at a significant double-digit rate. Hence, we sustain our Buy recommendation on MTNN with a target price of N270.40/s with an upside potential of 17.6% compared to the last closing price of N230.00/s.

Nigerian Breweries: The turnaround in the performance of brewers renewed investors' interest in the brewery space. Specifically, NB recorded its highest first quarter earnings growth in the past 18 years in Q1 2022 (+30.4% y/y). Looking ahead, we are positive on the firm's ability to sustain the momentum. One, the ability to offer a wide range of products that cater for all the income classes in its focus market, particularly the premium segment, makes demand resilient. Also, expected volume arising from the expansion of its Ama factory will prove supportive. Although, the market has already factored in the Q1 run rate, we still maintain our Buy recommendation on the stock with a target price of N68.55/s.

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