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# A BRIGHT SPOT IN SIGHT?

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NIGERIA STRATEGY REPORT  
H2:2023

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## Executive Summary

The year so far has been clogged with setbacks in the global economy. Over in the US, we witnessed an historic banking failure following the incessant rate hikes by the US Fed<sup>1</sup>. Consequently, the fear of contagion slowed down the global equities market, especially the banking sector. However, in the later parts of H1:2023, we witnessed a bullish run in the market, buoyed by positive sentiments in the tech space. Elsewhere, the Euro area continued to grapple with the impact of the Russia-Ukraine conflict on its economy in H1:2023, with a looming recession in sight.

In the domestic economy, structural issues such as insecurity and infrastructural deficit continues to affect food inflation and consumer price levels in the period. Economic growth was further hampered by monetary policy tightening, electioneering activities, and the cash constraint in Q1:2023. Hence, GDP<sup>2</sup> slowed to 2.31% in Q1:2023 (vs. 3.52% in Q4:2022).

For the rest of the year, we foresee a rebound in economic growth. Our outlook for the oil sector is positive, as we foresee the sector exiting the negative territory. We see the non-oil sector recover from the slow-down in economic activities, induced by the cash constraint earlier in the year.

In the Capital market, the equities market fared quite well, despite the banking crisis that permeated major economies in H1:2023. A prolonged January rally amid lower yields in the Fixed income market and more recently, the pro-market policy statement by the new administration, pushed the YtD<sup>3</sup> performance of the Nigerian equities market to 18.96% as of 30th June 2023.

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<sup>1</sup> U.S. Federal Reserve

<sup>2</sup> Gross Domestic Product

<sup>3</sup> Year-to-date



(23.00% as of 7th of July 2023). Furthermore, we expect an increase in foreign participation in the stock market as a result of the unification of the foreign exchange system which is expected to facilitate seamless repatriation of funds. We have already witnessed this trend in the Banking sector, which managed to achieve a positive performance (+54.59% YtD as of June 2023). This trend is expected to persist in H2:2023 given that foreign inflows are expected to join the fray.

Although in H2:2023, maturity profile lies below that of H1:2023, we believe the market will be awash with liquidity, given CBN's CRR<sup>4</sup> normalization and anticipated increase in FAAC allocations following the effect of the new exchange rate on foreign exchange proceeds. On the supply side, we expect the government to issue more debt in H2:2023, although we do not rule out the possibility of the use of the Ways and Means following the revised limit approved by the legislative houses to 15% of the prior year's Government revenue. Overall, we expect fixed income yields to taper further in H2:2023.

In the equities market, we believe the positive sentiment we have witnessed would persist as domestic investors take more position in the market, in anticipation of increased foreign participation. Half-year earnings release as well as dividend declaration would also influence the market in H2:2023. We believe fundamentally sound stocks in the **banking, oil and gas, and industrials sector** still have an upside potential. Barring any major policy changes that could be detrimental to the equities space, we expect the All-share Index to close positive for 2023FY.

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<sup>4</sup> Cash Reserve Ratio



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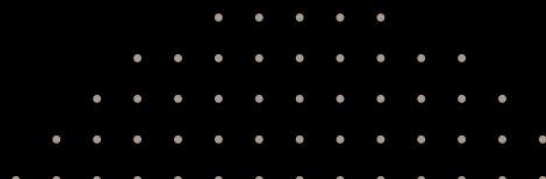
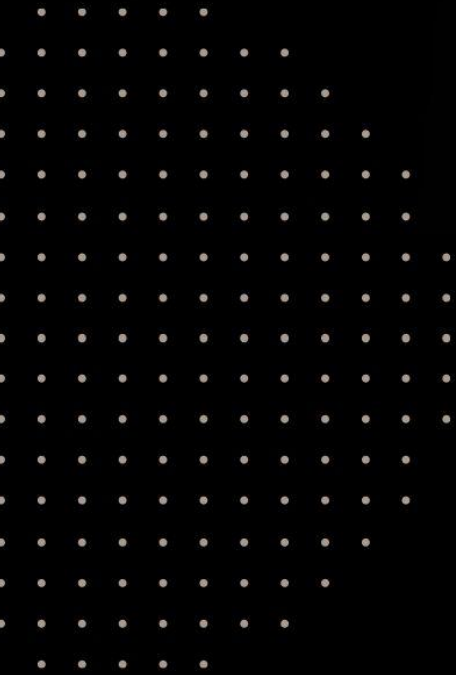
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GLOBAL



## HI:2023 Review: 2008 all over again? The U.S. Fed to the rescue, Monetary Policy Lifelines

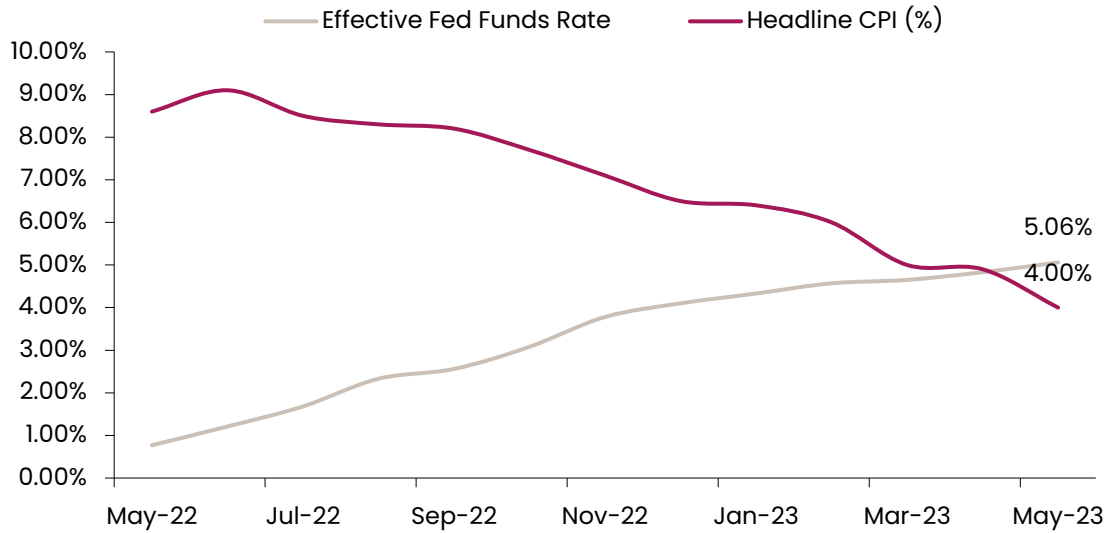
### The United States: Banking Crisis: The Fed's Watchful Eye

Earlier in the year, many investors, and capital markets participants alike, held their breath in fears of a possible global financial crisis contagion, while observing the impact of successive rate hikes by the US Fed, on certain mid- to smaller-sized banks. As of March 2023, the Fed had raised its benchmark rate, eight (8) consecutive times, bringing interest rates to its highest levels since July 2007 to a range of 4.75% to 5.00%. This development led to the failure of the 16<sup>th</sup> largest U.S. bank at the time, Silicon Valley Bank (SVB). SVB provided banking services to nearly half of U.S. venture-backed technology and life science companies, benefitting from an influx of cash, through venture funding during the low-interest rate era of the Covid-19 Pandemic. These funds were then invested in safe assets such as low-yielding U.S. Government Treasuries. This decision backfired as the Fed began to hike interest rates. Huge demand for cash balances ensued following a liquidity squeeze in the Venture-Capital space as cash burn accelerated, and investor funding dried up. SVB's collapse was underpinned by a classic bank run on the bank's assets following the losses crystallized from the sale of government bonds at steep discounts, as interest rates climbed higher, to meet customer liquidity needs. After the collapse of SVB, a crisis of confidence ensued as it was the second-largest bank failure at the time with assets of USD212bn. Similar trends were observed thereafter with the failure of Signature Bank and First Republic Bank, which both had assets of USD110bn and USD219bn, respectively as customer trust in the banking system faltered. However, the U.S. government's prompt intervention and coordinated



efforts with the nation's largest financial institutions helped to restore market trust as customer funds were fully secured.

Chart 1: Analysis of US Fed Funds Rate and Headline CPI



Source: US Federal Reserve, ARM Research

### A Close Call: The Threat of Fiscal Deficit

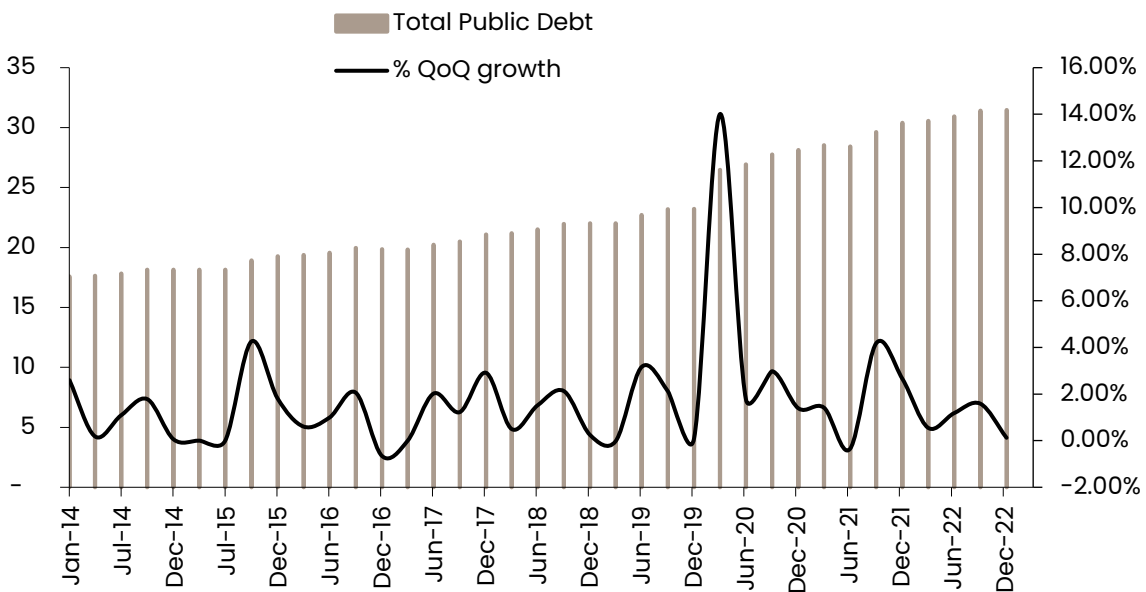
In April 2023, the U.S. Treasury Secretary, Janet Yellen, warned as the U.S. approached its debt ceiling, that the failure to raise its debt ceiling would be catastrophic and cause a “steep economic downturn”. The debt ceiling (sometimes known as the debt limit) is a statutory limit on the total amount of funds the government may borrow to cover its obligations. There are formal debt ceiling statutes in just one other Western economy besides the U.S., Denmark. The U.S. obligations includes paying for federal employees, the military, Social Security and Medicare, as well as debt servicing and tax rebates. The US Congress votes to increase or suspend the ceiling periodically so that it can borrow more money. Historically, the Congress has always raised the ceiling as needed, but as political parties have grown more divisive, they have





consistently battled to come to decisive agreements. Currently, the debt limit stands at nearly USD31.40trn, which was breached in January 2023, but the Treasury Department took "extraordinary measures" to provide the government access to more funds while it considered its options. These fears were allayed when the U.S. President, Joe Biden signed legislation in June 2023 into law that suspended the debt ceiling. The bill, now the Fiscal Responsibility Act of 2023 ("FRA"), which includes tens of billions in spending cuts, will allow the government to borrow whatever it wants until the end of 2024, when the debt ceiling suspension ends. Along with future spending constraints, the debt ceiling would be suspended through January 1, 2025, and it would automatically be reinstated to the amount of debt outstanding on January 2, 2025, in addition to spending cuts and the rescinding of unused federal funds.

Chart 2: Analysis of US Total Public Debt Stock (in USD'trn) and the QoQ growth (%)



Source: U.S. FRED, ARM Research



### Finding a Soft Landing: A Peak in Sight?

In June 2023, the U.S. Bureau of Labor Statistics released Consumer Price Index (CPI) data for May 2023. According to the release, the Headline CPI was higher by 0.10% MoM<sup>5</sup> in May 2023 (vs. 0.40% MoM in April 2023). On a YoY<sup>6</sup> basis, the Headline CPI increased by 4.00% YoY in May 2023 (vs. 4.90% YoY in April 2023), and this was the smallest YoY increase since March 2021. Similarly, the core CPI rose 5.30% YoY in May 2023 (vs. 5.50% YoY in April 2023). Closely following the release of CPI data, the Fed announced a pause in benchmark rate hikes in its just-concluded policy meeting, signalling a possible end to its hawkish policy regime. Furthermore, supported by the slower growth in prices as recorded by the May 2023 CPI, the Fed's decision to keep interest rates at 5.00% to 5.25% in May 2023 may have given an indication that U.S. inflation has peaked. Looking at employment data alongside real GDP data in [Chart 3](#) below, provides insight to the effect of rate hikes on the economy. Initial jobless claims, which are a gauge of the rate of layoffs over time, have risen steadily since the Fed's hawkish campaign began in March 2022, reaching its highest QoQ<sup>7</sup> growth during the period in view of 5.84% in Q1:2023 (vs. -8.85% QoQ in Q1:2022). Similarly, we see a fall in total nonfarm payrolls, a key indicator of employment, to 0.97mn in Q1:2023 (down from 1.67mn or -42.81% YoY in Q1:2022), further suggesting a weaker labour market. However, the Fed kept rates unchanged as inflation cooled in May 2023, retaining a hawkish pause, and stressing the need for ongoing evaluation of economic indicators going forward.

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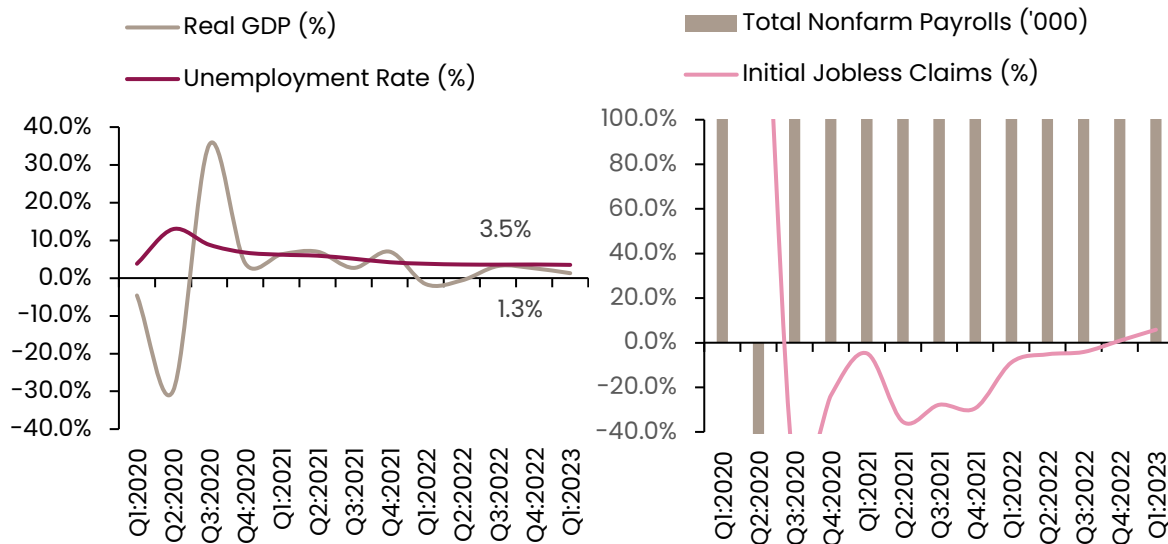
<sup>5</sup> Month-on-Month

<sup>6</sup> Year-on-Year

<sup>7</sup> Quarter-on-Quarter



Chart 3: Analysis of U.S. Macroeconomic Indicators



Source: U.S. Bureau of Labor Statistics, U.S. FRED, ARM Research

Based on the most recent release by the *International Monetary Fund (IMF)*, the U.S. growth is forecasted to slow to 1.6% YoY in 2023 and decline further to 1.1% in 2024. The Federal Open Market Committee has made it clear that there would be no rate cuts in 2023, therefore we anticipate that as the system is affected by the transmission mechanism of benchmark rate hikes, H2:2023 economic growth will continue to be sluggish. On the consumer price side, we believe that inflation may have peaked or be approaching its peak and thus expect the impact on household purchasing power to moderate.

**The United Kingdom: The Inflation Dilemma - A Common Theme**

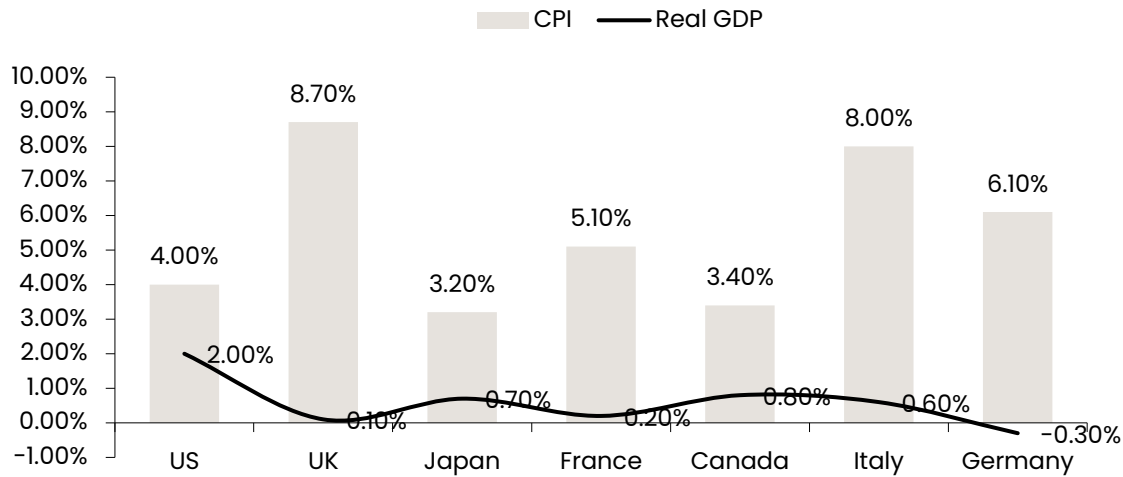
In H1:2023, the United Kingdom’s (UK) economic and political landscape has been characterized by industrial actions, an energy crisis, rising interest rates and a ballooning fiscal deficit. According to the UK Office of National Statistics (ONS), the annual Consumer Price Index (CPI) stood at 8.70% YoY in May 2023, the highest recorded among all the G7 nations in the same period (vs. 4.00%



and 6.10% YoY in the U.S. and Germany, respectively). Moreover, the headline CPI in the UK rose by 8.70% YoY in May 2023 (unchanged from April 2023), and on a MoM basis, it increased by 0.70% (vs. 0.70% in May 2022). However, we see a clearer picture in the core CPI, excluding the volatile food, tobacco, alcohol, and energy prices, surging to 7.10% YoY in May 2023 (vs. 6.80% YoY in April 2023). This is the highest rate increase in over 30 years, driven majorly by an expansion in services CPI (at 7.40% YoY in May 2023 vs. 6.90% YoY in April 2023). In its effort to rein in inflation, the Bank of England has hiked rates thirteen (13) consecutive times to 5.00% as of June 2023, the highest level since 2008. Consequently, the BoE is expected to maintain its hawkish stance with current inflation levels far exceeding the apex bank's target inflation rate of 2.00%. Rising interest rates have also brought to the forefront, concerns around the housing market and mortgage financing. However, it is worth noting many of the mortgaged UK Homeowners tend to take out fixed rate deals, and according to the UK Intermediary Mortgage Lenders Association, house repossession figure stands at 750 or 0.03% of all mortgaged properties as of June 2023 (vs. 46,000 or 0.47% of all mortgaged properties in 2009 following the 2008 credit crisis).



Chart 4: Analysis of G7 CPI and Real GDP



Source: U.K. ONS, U.S. BLS, Eurostat, StatCan, ARM Research

**Economic Austerity: The Panacea for a Fiscal Deficit**

To undo the harm caused by his predecessor's disastrous economic policy campaign, the new UK Prime Minister, Rishi Sunak, stated policy objectives that mainly involve economic growth, lower inflation, and lower debt levels. Contrastingly, his administration also advocates for an austerity program aimed at increasing taxes and decreasing spending in its pledge to restoring financial stability. Notwithstanding this, the impact of the Russia-Ukraine conflict and Brexit has been severe, leading to a tight labour market, soaring gas prices and elevated costs of living. This led to increased government interventions as underscored by the ONS in its recent debt report. According to the report, UK's net debt stood at GBP2.60trn as of May 2023 or 100.10% of GDP, and this is the first time the debt to GDP ratio has exceeded 100% since March 1962. The increase in total debt came after government borrowing surged to



GBP20bn in May 2023, pushed higher by the cost of energy support schemes, inflation-linked benefit payments and higher interest payments on debt.

Based on the most recent release by *the International Monetary Fund (IMF)*, the UK growth is forecasted to decline by  $-0.30\%$  YoY in 2023 and marginally improve to  $1.00\%$  in 2024. While we continue to expect a hawkish BoE, and higher benchmark rates translating to some disinflation in Q3:2023, we opine that economic growth would remain stunted in the UK in H2:2023. We believe the structural concerns in its labour market, stringent contractionary fiscal policies and the energy crisis arising from the Russia-Ukraine conflict would continue to limit consumer purchasing power.

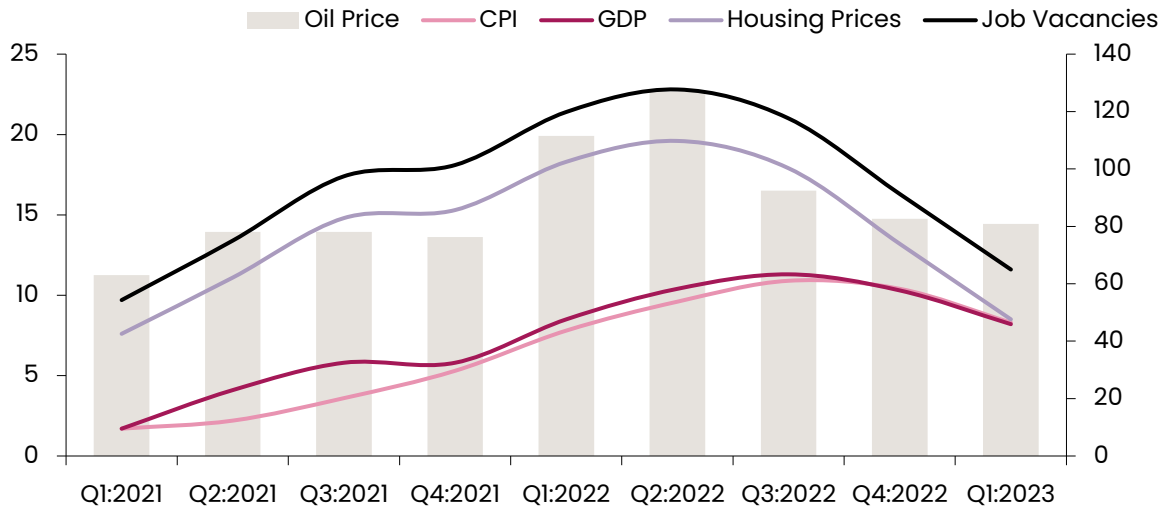
### **The Euro Area: Reforms and Resilience | Weathering the Storm**

The lingering effect of the Russian Invasion of Ukraine continues to weigh on the growth in the Euro Area. These developments have led to weaker economic output, underpinned by the June 2023 GDP report released by the Eurostat, indicating that the single currency bloc was now in a technical recession. According to the report, seasonally adjusted GDP in the Euro Area declined by  $-0.10\%$  in Q1:2023 (vs.  $-0.10\%$  in Q4:2022), which is the global convention for a recession. The salient drivers of the ailing economic activity in the bloc during the quarter was falling output in Ireland, Lithuania, and Netherlands which recorded a  $-4.60\%$ ,  $-2.10\%$  and  $-0.70\%$  QoQ decline in Q1:2023 GDP, respectively. However, the advent of warmer weather conditions, a strong labour market, robust wage growth and the tapering of oil prices, have put downward pressure on overall prices. In May 2023, we note a drop in headline inflation at  $6.10\%$  YoY (vs.  $7.00\%$  in April 2023), and lower core inflation, which excludes volatile food, energy, alcohol, and tobacco prices, at  $5.30\%$  YoY in May 2023 (vs.  $5.60\%$  YoY in April 2023). However, current inflation levels remain far above the European



Central Bank’s (ECB) target inflation of 2.00%, supporting its decision to hike its main refinancing operations rate for the eighth (8th) consecutive time, by 25bps to 4.00% in June 2023.

**Chart 5: Analysis of EU Macroeconomic Variables**



Source: Eurostat, CBN, ARM Research

Based on the most recent release by the *International Monetary Fund (IMF)*, the Euro Area growth is forecasted to expand by 0.80% YoY in 2023 and record marginal growth by 1.40% in 2024. We expect a similar trend in the bloc as other developed markets as the European Central Bank (ECB) sustains its contractional monetary policy programs in its effort to stabilize prices. We expect a downward trend in inflation as a hawkish ECB reengineers the Euro Area back into a gradual recovery phase.

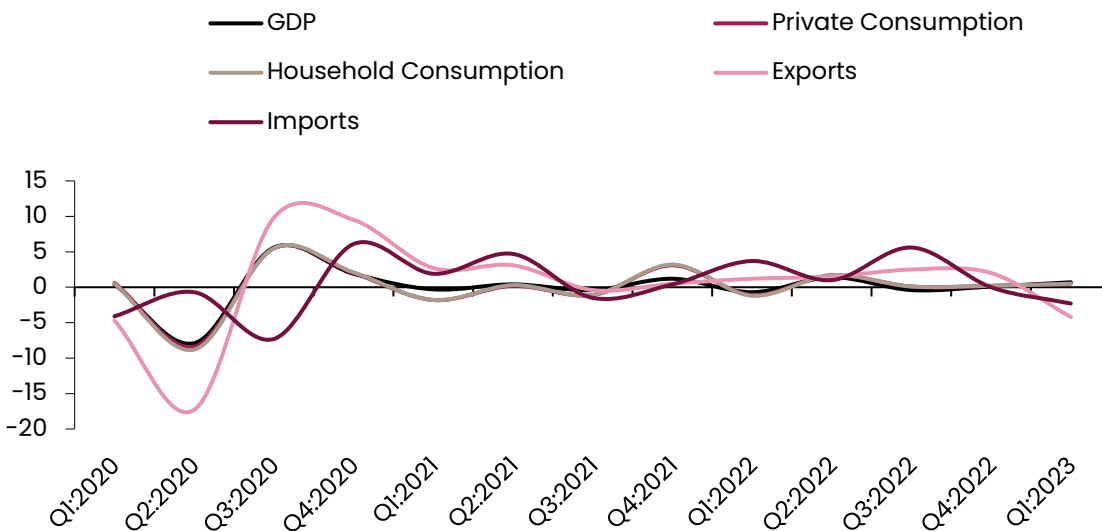
**Japan: Deflationary Pressures | Monetary Policy Unorthodoxy**

Japan is the largest creditor market in the world, according to BMI, thanks to years of current account surpluses that led to a massive accumulation of foreign reserves and other external assets. Historically, Japan has relied on



exports as a development engine, with its current prosperity reliant on the demand from its two primary export markets, the United States and China. According to the Cabinet Office, Japan grew by 0.70% QoQ in Q1:2023 (vs. 0.10% QoQ in Q4:2022). Looking at the inflation data, Japan’s core CPI index, which excludes volatile fresh food prices, rose by 3.20% YoY in May 2023 (vs. 3.40% YoY in April 2023), closing higher than the Bank of Japan’s (BoJ) inflation target of 2.00% for the 14<sup>th</sup> consecutive month. Interestingly however, the BoJ has stuck to its ultra-loose monetary policies with its benchmark rates kept constant at 0.10% since 2016. The BoJ opines that current inflationary pressures are driven by temporary factors, in its attempt to banish the deflation that has plagued its economy since the 1990’s.

Chart 6: Analysis of Components of Japan’s GDP



Source: Statistics Bureau of Japan, ARM Research

Based on the most recent release by the *International Monetary Fund (IMF)*, the Japan growth is forecasted to grow by 1.30% YoY in 2023 and gradually taper to 1.00% in 2024. The BoJ’s unorthodox policies of negative real interest rates amidst rising inflation poses a risk of inflation becoming more entrenched,





leading to a possible reversal of its monetary policy objectives in the midterm. However, current data provides little indication of a rate hike in the short term.

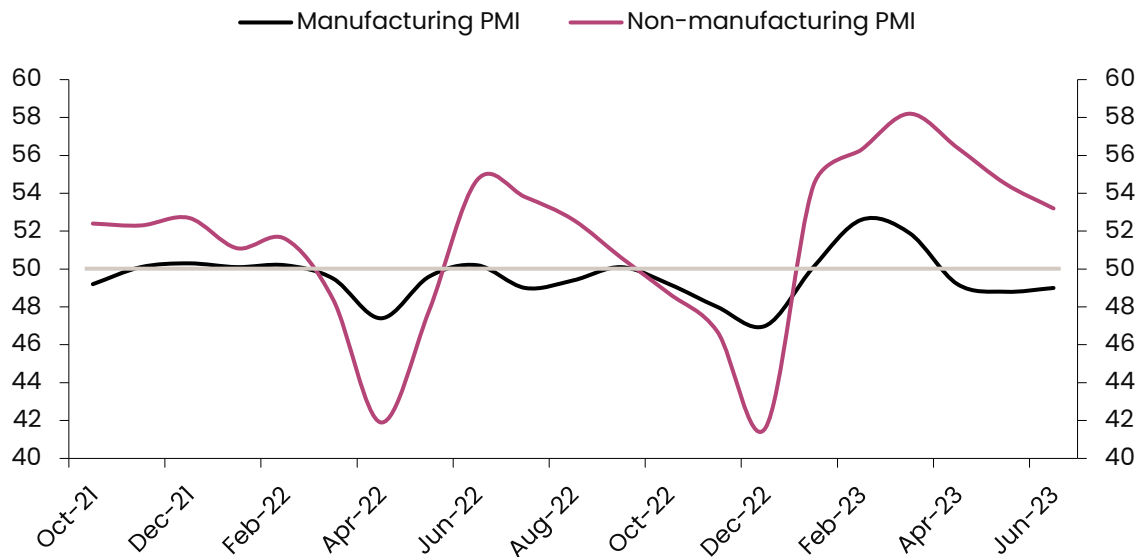
### **China: The Property Market Shock | A Possible Historical Trend Reversal**

In 2023, the world's largest emerging market and the second largest economy in the world, has struggled to free itself from the shackles of the 2020 pandemic. While only just lifting its border restrictions in January 2023, the second most populous country has grappled with stunted growth that has plagued its economy in recent times. Much of the slowdown can be traced to its property market, despite signs of a recovery from a negative spell of credit defaults, a plunge in house sales and mortgage boycotts in 2022. Nonetheless, the Chinese government has committed to strategic interventions in its property market, to prevent a catastrophic property bubble bust. The impact of a decline in the housing market may be more systemic in nature as business often use property as loan collaterals, and the depressed prices will lead to lower private investment, household consumption and job creation. We can see the impact on the economy by looking at the all-important Purchasing Manager's Index (PMI) data, which indicates the overall level of activity in the economy. When the PMI is higher than 50%, it reflects the overall expansion of the economy while PMI below 50% reflects the overall contraction of the economy. In June 2023, the Manufacturing PMI closed at 49% (vs. 48.8% in May 2023), indicating a slower contraction while the Non-manufacturing PMI declined to 53.2% in June 2023 (vs. 54.5% in May 2023) but still above the critical point, indicating the non-manufacturing industry has maintained an expansionary trend this year.



Subsequently, the People’s Bank of China (PBOC) trimmed its one-year prime rates by a paltry 0.10% to 3.55% and cut the five-year rate by the same margin to 4.20% in June 2023.

Chart 7: Analysis of China’s Manufacturing and Non-Manufacturing PMI (%)



Source: National Bureau of Statistics of China, ARM Research

Based on the most recent release by the *International Monetary Fund (IMF)*, China is forecasted to grow by 5.20% YoY in 2023 and gradually slow to 4.50% in 2024. We expect further rate cuts by the PBOC to stimulate spending and prevent the economy from sliding into a liquidity trap, as asset prices continue to trend downwards. Fiscal stimuli targeted at specific sectors including housing, may support growth during H2:2023, propping up the Chinese government debt levels as a result. Additionally, as countries proceed toward technological advancements, the trade conflict between the U.S. and China may play a crucial role in the upcoming months, highlighted by the overt political power struggle between the two greatest economies in the world.



## Middle East and Northern Africa (MENA): Pains of Leverage | An Unfolding Debt Crisis

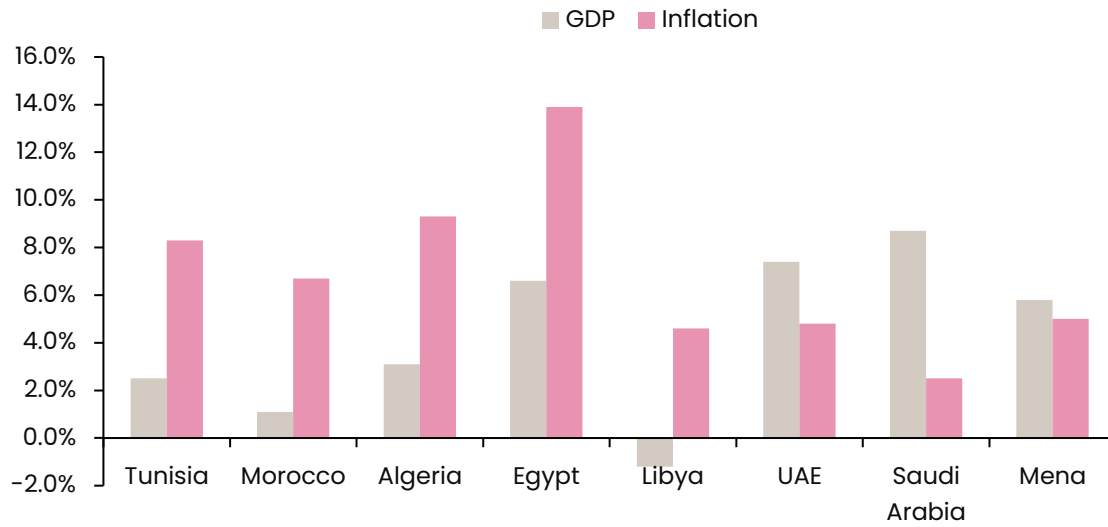
In the MENA region, regardless of the country being an oil importer or exporter, economic pressure was high in all countries in H1:2023 with inflation being a common theme. In Northern Africa, three countries, Egypt, Morocco, and Tunisia, have requested for financial support from the International Monetary Fund (IMF), following the economic distress wrought by the Covid-19 pandemic. The impact of the Russia-Ukraine conflict has further exacerbated this crisis as commodity prices surged, leaving various governments with unsustainable subsidy bill payments. Inflation has been particularly problematic in Egypt, driven by a suspension of subsidy programs and a weakening exchange rate, following currency selloffs amidst lower reserves. Egypt's core inflation, excluding volatile food items, rose to 40.31% YoY in May 2023 (vs. 38.57% in April 2023), according to data from its Central Bank. On a MoM basis, inflation increased by 2.86% in May 2023, relative to 1.72% MoM, recorded the previous month. Despite a 200bps hike in the overnight deposit and lending rates to 18.25% and 19.25% respectively in April 2023, Egypt has failed to attract foreign investments, largely due to the foreign exchange imbalances. This has led to a further widening of the spread between its official and parallel market exchange rates. Citing the lack of foreign investments and foreign exchange (FX) shortage, the Egyptian government received approval from the IMF Board for a USD3.00bn Extended Fund Facility to meet its external funding obligations. Tunisia faces similar macroeconomic factors as a severe drought and lower food subsidies have led to elevated food prices. Austerity measures of higher taxes and decreased spending have depressed consumption, leading to weak economic growth in the country. Contrastingly, according to the National



Institute of Statistics, the Tunisian real GDP was higher by 2.10% YoY in Q1:2023 (vs. 1.80% YoY in Q4:2022). The elevated political risk and inflationary strains in the Eurozone has led to a decline in the demand for Tunisian exports, further aggravating its external funding requirements. These developments led to a possible intervention of an Extended Fund Facility by the IMF, which is subject to broad fiscal and structural reforms. For Morocco, the IMF funding undertakes a different strategy as the approved USD5.00bn Flexible Credit Line is structured as an insurance against tail risk. Unlike the Extended Fund Facility, the Flexible Credit Line is designed for countries with strong macro fundamentals and a strong track record for implementing IMF policies. This facility would lower the country's cost of borrowing, shore up reserves, and reduce perceived risk. Redirecting our focus to the Middle East, we observe that economic performance was slightly insulated from the macroeconomic constraints facing much of the developed world. This is underpinned by the government subsidy programs on various goods to preserve consumer purchasing power. Also, given relatively high but declining oil prices in H1:2023, some Middle Eastern countries like the UAE and Saudi Arabia have adopted a cautious approach with accruing account surpluses as spending has grown more slowly than revenue generation.



Chart 8: Analysis of Select MENA countries (%)



Source: World Bank, ADB, ARM Research

Based on the most recent release by the *International Monetary Fund (IMF)*, MENA’s economic growth is forecasted to slow to 3.10% YoY in 2023 and gradually rise to 3.40% in 2024. The demand for oil is projected to remain weak, given the unfavourable macroeconomic prognosis for H2:2023, supported by the detrimental effects of the political unrest in Europe. As a result, the OPEC<sup>8+</sup> is likely to continue to cut supply to stabilize oil prices and bolster member countries’ revenues. In addition, the pass-through effect of global inflation in major Middle East countries would be minimal, underscored by various government programs aimed at protecting the most vulnerable. In Northern Africa, we expect more countries to approach the IMF for the Extended Fund Facility as their fiscal positions deteriorate.

<sup>8</sup> Organization of Petroleum Exporting Countries



## Sub-Saharan Africa (SSA): Tightening Revenue Inflows | A Debt-Laden Economy

Earlier in the year, the IMF Board approved a USD3.00bn Extended Credit Facility to Ghana, as unsustainable external debts, currency devaluation, declining reserves, and high inflation impede growth. The condition of the facility involves a complete fiscal and monetary policy restructuring, to re-establish macroeconomic stability. According to the Ghana Statistical Service, the headline CPI was 42.20% higher YoY in May 2023 (vs. 41.20% YoY in April 2023), and 4.80% higher MoM in May 2023 (vs. 2.40% MoM in April 2023). After securing the IMF approval, the Bank of Ghana paused its interest rate hikes and maintained its policy rate at 29.50% in May 2023, citing the need for a continuous assessment of the impact of previous hikes. In Nigeria, the inauguration of a new administration led by President Bola Tinubu, kickstarted a series of swift reforms, to address the country's fiscal woes and FX crisis. As of December 2022, according to the DMO<sup>9</sup> and CBN<sup>10</sup>, Nigeria had a debt service ratio of 23.20% of GDP and about 1.11x of revenue, raising concerns of its fiscal sustainability. Total debt stock is also expected to significantly rise in 2023, following the approval of the Parliament to securitize NGN22.70trn worth of CBN Ways and Means to the Federal Government. As a result, the first policy enactment of the new government to cancel the fuel subsidy payments that have been a bane on treasury coffers for many years has been positively received. This is likely to ensure efficient reallocation of government expenditure to producing assets but lead to a higher-than-expected inflation print in H2:2023. According to the National Bureau of Statistics (NBS), the current

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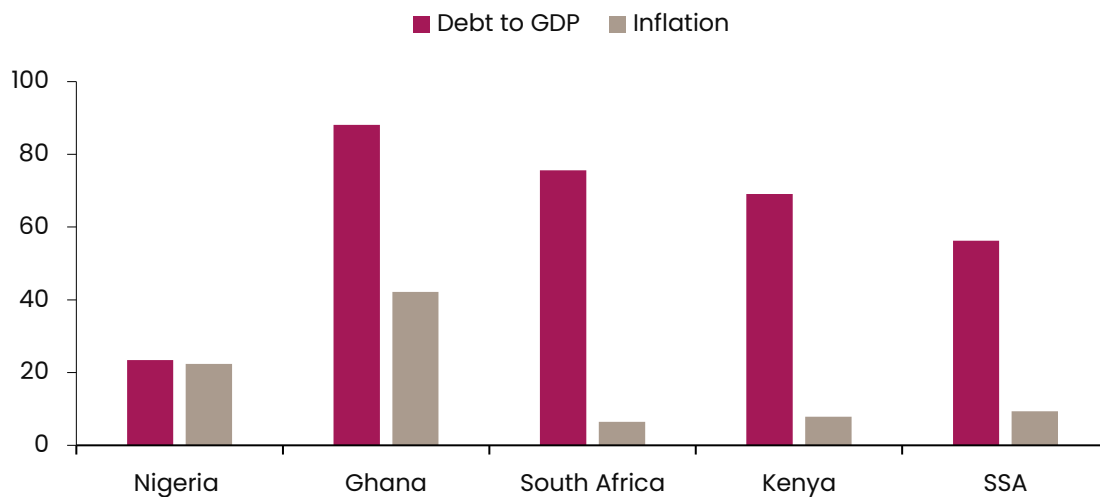
<sup>9</sup> Debt Management Office

<sup>10</sup> Central Bank of Nigeria



headline CPI stands at a 22.41% YoY increase in May 2023 (vs. 22.22% in April 2022) and a 1.94% MoM rise in May 2023 (vs. 1.91% MoM in April 2023). However, looking at the SSA region in its entirety, surging prices have subdued growth underpinning periods of monetary tightening throughout the year. As severely indebted states struggle to fulfil external debt obligations, we foresee an escalation of the financial sector distress in SSA economies amid a tightening of global liquidity. Also, heightened geopolitical tensions within the region and in developed markets continue to pose risks to trade as lower global demand underpin weaker economic activity. Extreme weather conditions are also a cause for concern as flooding and other events related to climate change disrupt business activity in the region.

Chart 9: Analysis of Select SSA countries (%)



Source: IMF, World Bank, Statista, ARM Research

Based on the most recent release by the *International Monetary Fund (IMF)*, SSA's GDP is forecasted to slow to 3.60% YoY in 2023 and gradually rise to 4.20% in 2024. In SSA, we expect the macroeconomic uncertainty in the region buoyed by a combination of weak external demand, high inflation to lead to rising credit



premiums or outright restrictions from the international debt market. With a lack of access to the required funding to finance its external obligations, we expect more countries to approach the IMF for the Extended Facility Program for the cash required to prevent prolonged periods of exchange rate crises. In SSA, we expect headline inflation to remain relatively high, supported by ongoing food and energy disruptions. For import dependent countries, we opine they will be particularly susceptible as currency devaluations subject them to higher import bills.

### **Macro-Strategy**

Macroeconomic trends over last three (3) years brought to the forefront the fickleness of global markets, as correctly predicting near term market events remain a herculean task. However, a common theme among developed nations in H1:2023 was inflation. Most regions recorded record high inflation numbers during the period, albeit showing signs of peaking. After embarking on a hardline hiking campaign for months, we began to observe some signs of disinflation in some countries. Nonetheless, body language suggests the end is all-but-nigh as systemic nations adopted hawkish pauses, conducting a continuous assessment of the impact of rate hikes required to rein inflation to target levels.

We expect the next phase of re-engineering the global economy into a soft landing to be an even tougher task as households and businesses grapple with higher interest rates following prolonged periods of ultra-low interest rates. Assessing the global markets holistically, we opine that opportunities lie in the following strategies:





1. Carry Trade strategies: Despite elevated interest rates in developed markets, emerging market economies post double digit benchmark rates and high interest rate markets with pegged or stable currency may provide an opportunity to take profit.
2. AI Boom: The Artificial Intelligence (AI) Sector seems to be driving the rally in global equities particularly in the U.S., as technological advancements in the sector provide profit opportunities. A long-term view on fundamentally sound AI stocks may provide value to investors.
3. Defensive tickers: Defensive tickers like Consumer Goods stocks tend to outperform on average during periods of inflationary pressure as these stocks provide a shield against higher costs.
4. Treasury Inflation-Protected Securities (TIPS): TIPS provide a strong hedge against inflation as the returns are benchmarked to an appropriate inflation-tracked index.
5. Alternative investments: The uncertainty in global markets bodes well for gold indices as they track gold prices which have historically served well as an inflation hedge.



## Crude Oil Market

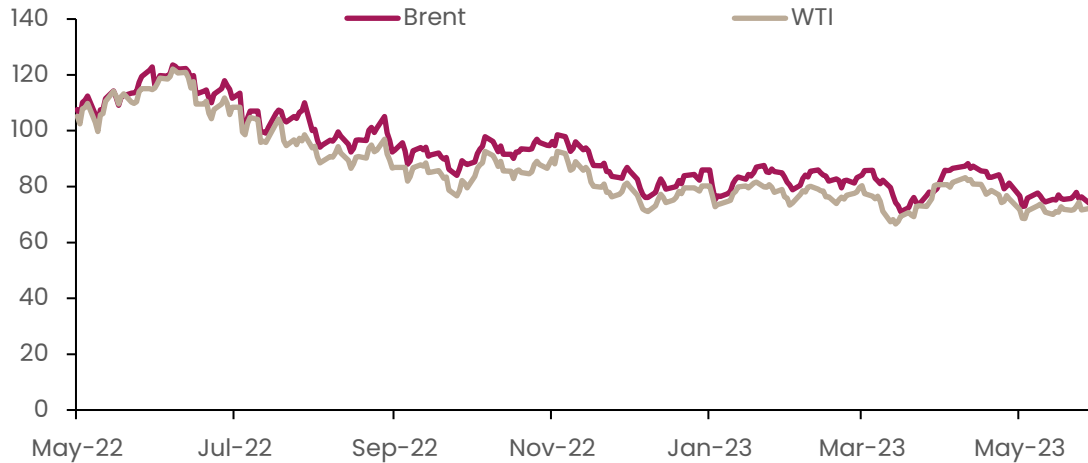
### Volatile Crude Prices

In the second half of 2022, we saw crude oil prices on a downward spiral on the back of economic growth concerns, rising Inflation and fuel consumption levels, among other factors. However, the first two (2) months of H1:2023 witnessed a reversal in oil price trajectory as average spot prices for crude oil rose by 2.40% in January 2023 and 0.32% in February 2023. This increase was primarily driven by strong buying interest in the sector, particularly from Chinese buyers, as COVID-19-related mobility restrictions were lifted, and the Chinese economy continued to reopen. Additionally, robust physical crude oil market fundamentals, especially in the Atlantic Basin and East Suez, played a role in supporting the price increase. Nonetheless, the market remained volatile, experiencing selloffs in futures prices, a rise in US crude stocks, and a decline in refining margins, all of which negatively impacted the value of spot benchmarks. In March 2023, the average spot price declined by 4.00% MoM, settling at 78.45% compared to 81.88% in February 2023. By the end of the first quarter of 2023, the crude oil benchmark recorded significant gains, driven by rising futures prices and a decrease in selloffs in the futures market. According to OPEC data, oil prices climbed by 7.00% MoM in April 2023. The price of ICE Brent crude rose, due to reduced availability for immediate delivery in Europe, resulting from the strikes at French refineries and ports being called off, allowing oil cargoes to be unloaded. Additionally, there was a significant decrease in the amount of oil stored in the United States, and disruptions in oil exports from the port of Ceyhan, further limited availability, contributing to the price increase. In efforts to eliminate surplus in the oil market and maintain oil prices, OPEC+



tightened oil output by an additional 1.66 million barrels per day (mbpd), bringing the total production reduction to 3.66 mbpd. Russia also extended its production cut of 500,000 bpd until the end of 2023.

Chart 10: Brent and WTI (USDpb)



Source: EIA, ARM Research

### US Continues to Lead Global Production in H1:2023

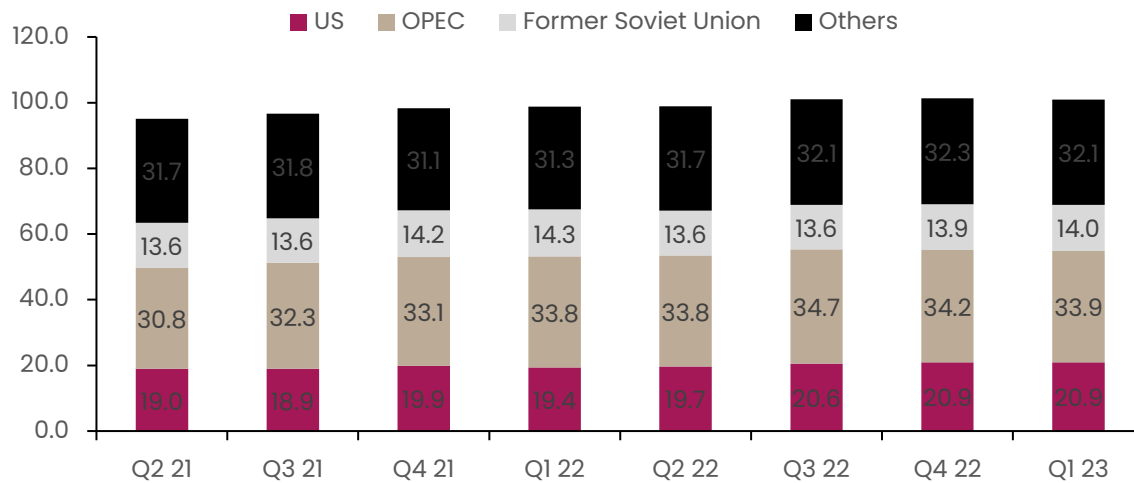
During the first five (5) months of H1:2023, global crude oil production averaged 100.98 million barrels per day (MMbpd), representing a decline of 10 basis points (bps) from H2:2022 at 101.035MMbpd. This decline was primarily due to significant production cuts made by OPEC, amounting to 29.12MMbpd in January 2023, the first month of H1:2023. Notably, Saudi Arabia, one of the OPEC giants, reduced its production by 100,000 bpd to 10.38MMbpd, which had the most significant impact on OPEC's production figures in H1:2023. As a result, average OPEC production fell by 2.15% to 33.86MMbpd in H1:2023 compared to 34.60MMbpd in H2:2022. However, the United States' contribution to global supply continued to grow, with average production increasing by 1.16% to 20.99MMbpd in the first five (5) months of H1:2023, compared to 20.76MMbpd in



the same period in H2:2022. China also experienced notable growth in oil production, with a 4.45% increase over the period, attributed to the re-opening of the Chinese economy.

Overall, expectations are for global oil production figures to continue declining in H2:2023, as OPEC and its allies implement further cuts to maintain oil prices at elevated levels.

Chart 11: Global Supply (MMbpd)



Source: EIA, ARM Research

### Global Consumption Grows Marginally

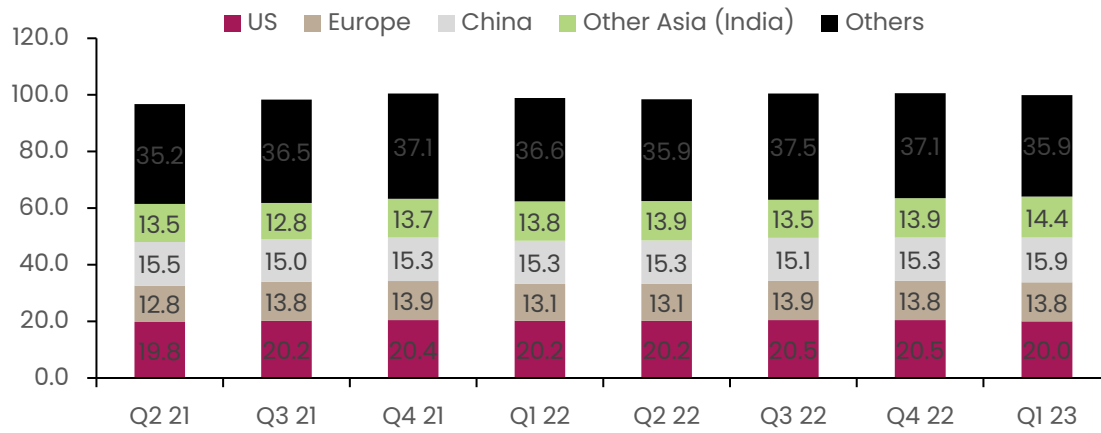
Average global oil demand in H1:2023, reached 100.03MMbpd, a marginal increase of 12bps compared to H2:2022 at 99.92MMbpd. Asia, particularly China, made a significant contribution to the rise in consumption levels. China's average consumption over the period increased by 6.95% to 15.99MMbpd from 14.96MMbpd in H2:2022, reaching an all-time high. This growth can be attributed to a complete revival of industrial activities and a strong, rapid recovery of



China's economy following the removal of COVID-19 restrictions. In contrast, Europe, the US, and the Eurasia region (including Ukraine, Tajikistan, Turkmenistan, Azerbaijan, and Lithuania) experienced a decline in consumption levels in H1:2023. This decline can be attributed to ongoing supply chain disruptions resulting from the Russia-Ukraine conflict, as well as global recession fears and negative economic reviews. Europe's average consumption fell by 4.55% to 13.90MMbpd, the US by 1.12% to 20.26MMbpd, and the Eurasia region by 8.14% to 4.31MMbpd. Looking ahead to H2:2023, it is anticipated that oil consumption in China will continue to rise, driven by projected economic expansion. According to the International Monetary Fund (IMF), China's economy is expected to experience a growth of 5.23% in 2023, representing an increase of 8bps from its previous projection of 4.40%. Moreover, the average Manufacturing Purchasing Manager Index (PMI) in China has shown promising indications for the manufacturing sector, with a significant rise of 10.81% to reach 54.3% in H1:2023 (compared to 49.0% in H2:2022). However, other regions may encounter ongoing challenges and uncertainties in their oil consumption in H2:2023.



Chart 12: Global Demand (MMbpd)



Source: EIA, ARM Research

### The Fragile Balancing Act

The crude oil sector is anticipated to face positive and negative factors which will influence the direction of the market and price in H2:2023. While certain factors may support oil prices, others could pose challenges to the market. On the positive side, OPEC and its allies are expected to continue implementing production cuts in H2:2023, aiming to eliminate the oil surplus and maintain stable prices. Russia's extended production cut and OPEC's commitment to tightening output demonstrate their determination to support the market. These efforts, along with declining US crude stocks and disruptions in oil exports from certain regions, could contribute to a tighter supply-demand balance and potentially support oil prices. Moreover, the Chinese economy is projected to expand, according to the International Monetary Fund's estimates. This growth, coupled with the removal of COVID-19 restrictions and the resulting increase in industrial activities, is likely to drive further growth in oil consumption in China. Asia, in general, may continue to demonstrate resilience in oil demand, providing some support to the global market. However, challenges persist.



Supply chain disruptions stemming from the Russia-Ukraine conflict could continue to impact consumption levels in Europe and the Eurasia region. Global recession fears and negative economic reviews may also weigh on oil demand in certain regions, such as Europe and the US. Volatility is expected to remain a characteristic of the crude oil market in H2:2023. Selloffs in futures prices, refining margin fluctuations, and potential economic uncertainties could contribute to market volatility. Geopolitical developments, such as changes in global trade policies or conflicts in oil-producing regions, could further impact oil prices. Overall, the crude oil sector in H2:2023 is likely to witness a delicate balance between supply-side measures by OPEC+ and demand dynamics influenced by economic factors and geopolitical events. On the balance of factors, we anticipate that oil prices will continue to display volatility throughout H2:2023. Nevertheless, we remain optimistic about the measures implemented by OPEC and its allies in controlling oil prices, which are expected to effectively maintain crude oil prices above USD75pb<sup>11</sup>. On the balance of factor, **our base case forecast for Brent is revised to USD79.5pb.**

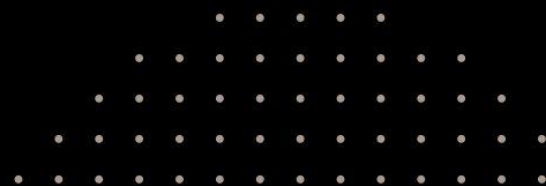
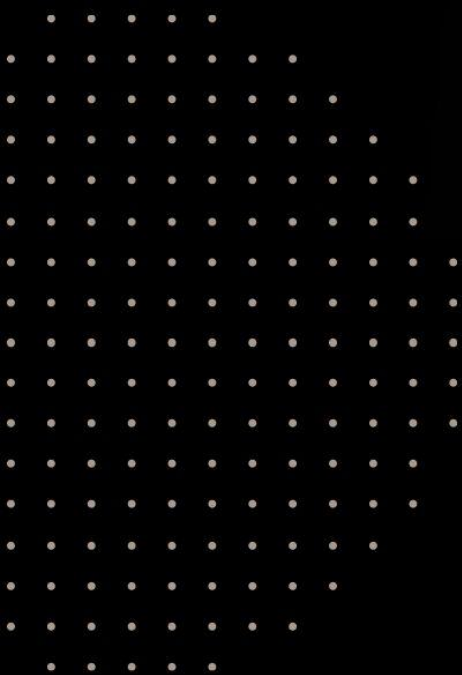
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<sup>11</sup> Price per barrel





# DOMESTIC

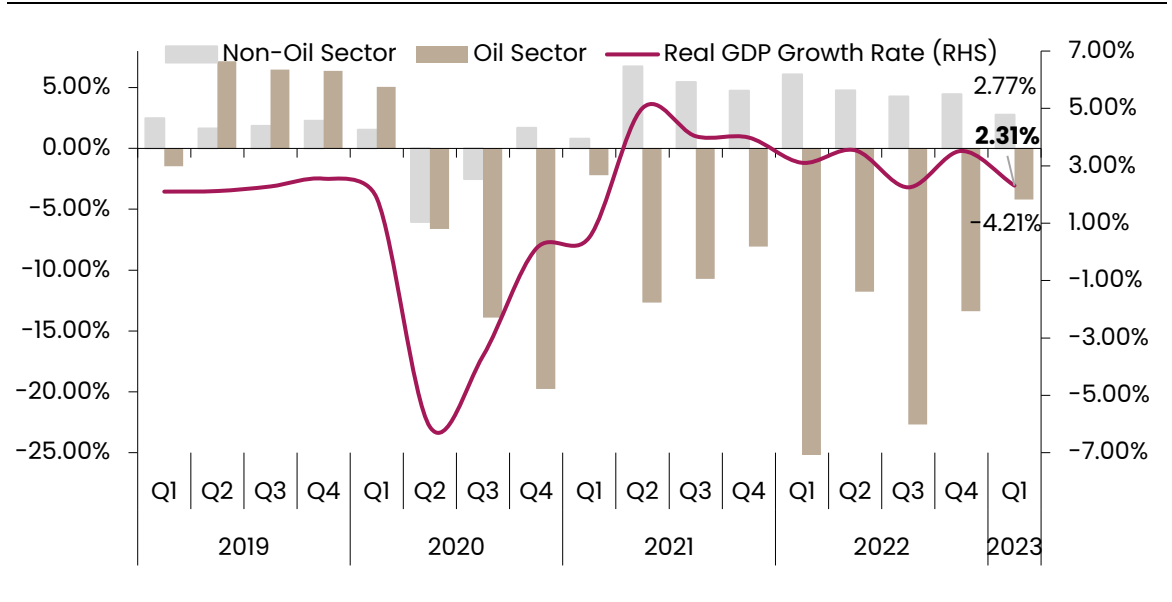




### Nigerian GDP: In the Aftermath of a Triple Whammy, What Next?

The Nigerian economy faced a challenging start in H1:2023, experiencing a turbulent ride. The combined effects of a constrained naira, electioneering activities, and tightening monetary policies exerted a significant toll on the economy. Growth momentum slowed to 2.31% YoY in Q1:2023 compared to 3.52% YoY in Q4:2022. Nevertheless, the Nigerian economy sustained its expansion for the tenth (10<sup>th</sup>) consecutive quarter since H2:2020. The Oil sector’s performance remained dismal, contracting by 4.21% YoY (vs -13.38% YoY in Q4:2022). However, the non-oil sector maintained a decent performance, growing by 2.77% YoY, albeit lower than 4.44% YoY in Q4:2022. Within the non-oil sector, performance was mixed with a touch of highs and lows as the Services and Industries sector grew by 4.35% YoY and 0.31% YoY respectively, while the Agriculture sector contracted by 0.90% YoY (the first YoY contraction recorded).

Chart 13: Analysis of Oil and Non-Oil Sector’s Growth to Real GDP



Source: NBS, ARM Research

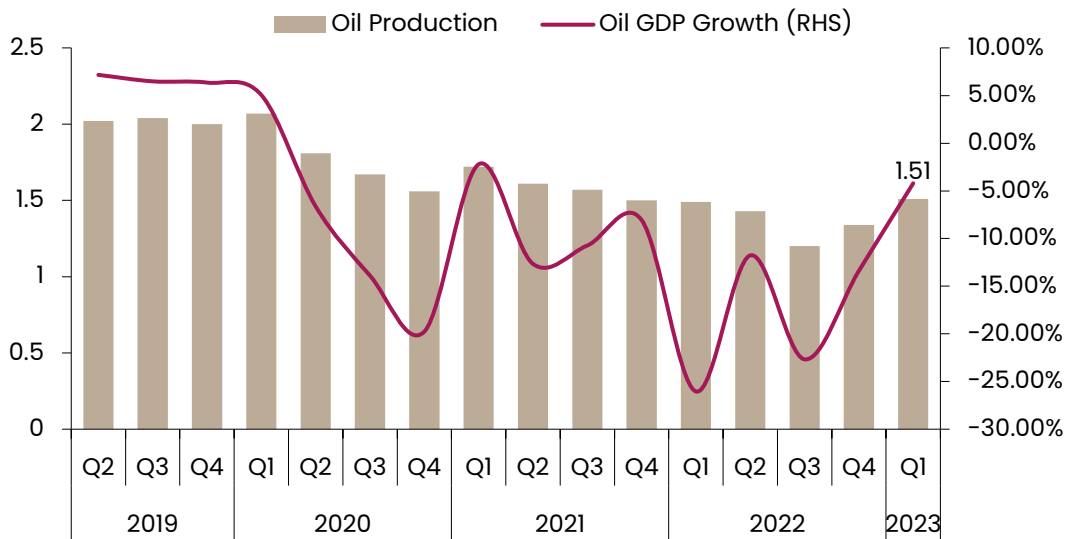


Sectoral Contribution and Performance

Oil Sector – On the Verge of a Positive Inflection Point

The Oil sector’s contribution to total GDP overtime has remained at record lows. This can be attributed to protracted issues such as oil theft and vandalism, exit of IOCs<sup>12</sup>, policy mismatch and the negative impacts of the oil subsidy. However, as predicted in our H1:2023 report, we saw a marginal shift of events in the space. The oil sector contracted by 4.21% YoY in Q1:2023 compared to -13.38% in Q4:2022. This marks the lowest contraction since Q1:2022 (-2.21% YoY). While this does not call for celebration, we believe that we are closer to a positive outturn in the oil sector as premeditated in our Q1:2023 GDP report. We believe that improved oil production is highly probable given the clamp down on oil theft that led to increased oil production in Q1:2023 (1.51MMbpd). Also, we see the recent removal of oil subsidy in June 2023 providing a bit of succour for the sector.

Chart 14: Trend in Oil Production vs Oil GDP



Source: NBS, ARM Research

<sup>12</sup> International Oil Companies



Our H2:2023 outlook for the oil sector is quite positive as we foresee the oil sector expanding and exiting the negative territory. We base our prognosis on the points below.

**Oil subsidy removal:** We anticipate that the elimination of oil subsidies will enhance positive sentiments towards the oil sector and boost productivity within the industry. We believe that current market prices reflect the prevailing market conditions and allow market forces to dictate pricing, fulfilling the long-standing demand of oil marketers. Moreover, this measure helps to mitigate the corruption that has historically plagued oil subsidy payments.

**Dangote Refinery:** The projected attainment of full operational capacity by the Dangote refinery in H2:2023 is poised to bolster the performance of the oil sector. Upon its potential commencement of commercial operations in Q4:2023, the refinery is expected to yield substantial benefits for the economy, estimated at around USD26bn in foreign exchange savings on refined petroleum products and fertilizers. Of this amount, approximately USD23.3bn is anticipated to be saved on refined petroleum products, while USD3bn is expected to be saved on fertilizers. With an estimated refining capacity of 450,000bpd out of the total 650,000bpd, the refinery is poised to effectively meet domestic demands.

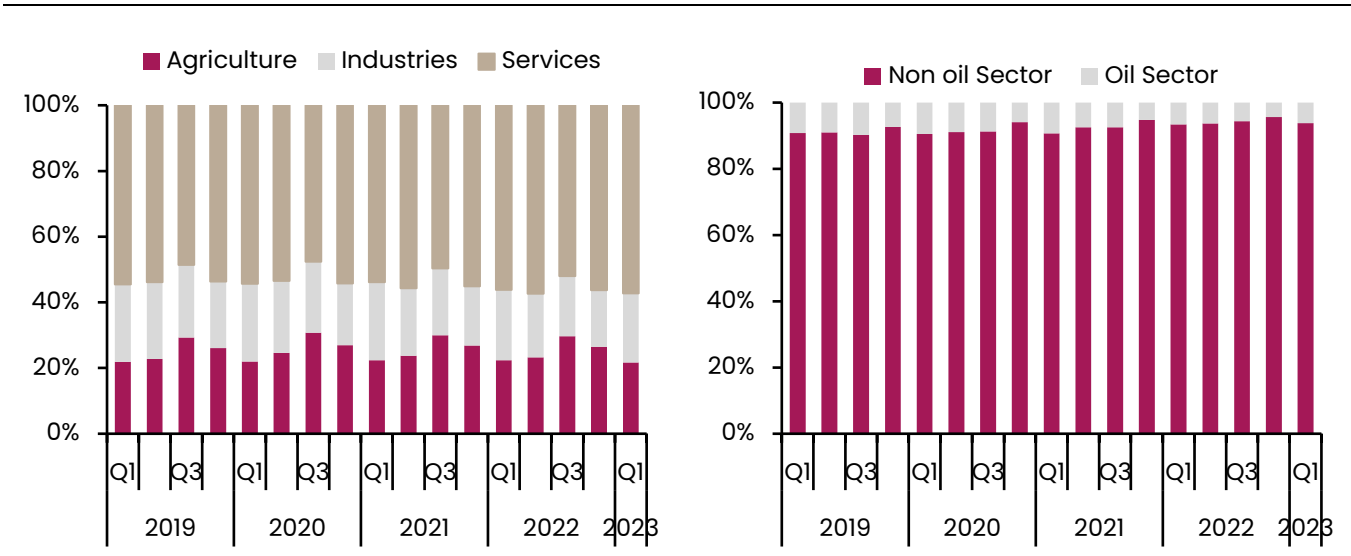
### **Non-Oil Sector – Anticipating a Promising Second Phase**

True to our expectations, the non-oil sector witnessed a slowdown in growth, following the negative impacts of Naira scarcity and election activities that permeated Q1:2023. The sector expanded by 2.77% (vs 4.44% in Q4:2022). The impacts of the Naira scarcity and election uncertainties were well pronounced in the Services and Agriculture sector, given the nature of these sectors. The



Services sector’s growth tapered by 134bps to 4.35% while the Agriculture sub-sector contracted by 0.95% (vs. +2.05% in Q4:2022). In contrast, Industries subsector rebounded from the abyss as it grew marginally by 0.31% in Q1:2023 (vs -0.94% In Q4:2022). While the economic growth momentum slowed in Q1:2023, we expect a notable shift of events in Q2:2023 as we anticipate the full recovery of the economy from the hard grip of hawkish monetary policy, cash scarcity and electioneering activities.

Chart 15: Contribution Analysis of Key Sectors Growth to GDP



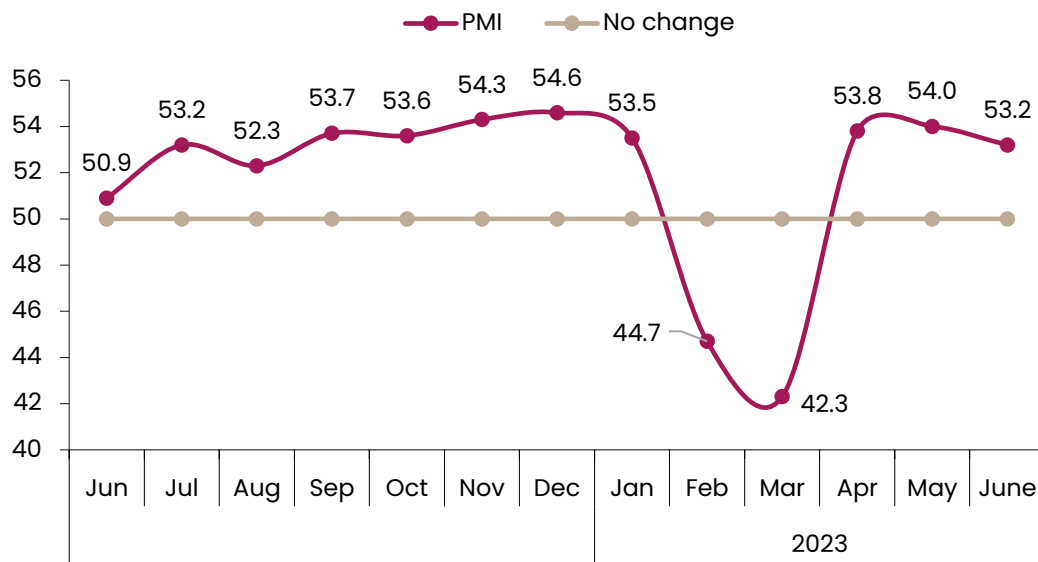
Source: NBS, ARM Research

We expect the improved momentum in H2:2023 as we see improvements in economic metrics. For context, the Stanbic IBTC Bank Nigeria Purchasing Managers Index, which measures economic productivity increased significantly, from a contraction of 46.83pts in Q1:2023 to an expansion of 53.67pts in Q2:2023. Also, the re-introduction of the old Naira notes into the economy calmed the storm that pervaded activities in the Nigerian economy. Furthermore, with elections uncertainties over, and the implementation of new policies by the current administration, we see the economy showing signs of



relief and improvement in economic activities driven by a fresh start. We expect the monetary policy committee of the CBN to largely adopt a wait and see approach in H2:2023. We also envisage the entry of foreign investors into the Nigerian economy amid pro-market policies.

**Chart 16: 12-month Trend Analysis of Stanbic IBTC Bank PMI**



Source: Stanbic IBTC, Bloomberg, ARM Research

**Agriculture: Greener Pastures**

In Q1: 2023, the Agriculture sector contracted by 0.90% YoY, breaking a streak of three consecutive quarters of growth. Within the sector, the Crop production sub-segment's growth slowed down by 48bps to 1.98% YoY, while Forestry's growth declined by 39bps to 1.24% YoY. Other sub-segments such as Livestock (-30.57% YoY) and Fishing (-2.92% YoY) continued to face challenges. The Agriculture sector has been plagued by structural issues such as inadequate infrastructure, outdated farming techniques, limited access to capital, and restricted international market opportunities. **Despite these issues, we anticipate a moderate shift in events during the second half of 2023. We**



anticipate a decent improvement in the Agriculture sector, fuelled by the economy's full recovery from the effects of the cash crunch and electioneering activities. Furthermore, we expect higher harvests towards the latter part of Q3:2023 through Q4:2023, thereby sustaining heightened productivity during that period.

### **ICT – Policy Changes to Impact Growth**

Amid favourable conditions within the domestic market, the ICT sector sustained its expansion streak, growing by 10.32% (vs 10.35% in Q4:2022). Notably, the Telecommunication & Information Services subsector grew by 47bps to 11.71% in Q1:2023. However, growth momentum tapered for subsectors such as Publishing (-194bps to 2.41% YoY), Motion Pictures, Sound recording & Music production (-188bps to 2.68% YoY) and Broadcasting (-61bps to 6.30% YoY). Anticipated in H2:2023 is a significant enhancement in the performance of the sector. We project an improved level of foreign investor participation, primarily driven by recent policy implementations by the new administration. Notably, the suspension of the 2023 Finance Act, which includes the telecoms excise tax of 5%, is expected to attract heightened interest and engagement from foreign investors. *While we observed a notable decrease in the number of subscribers, declining from 227.18mn in February to 226.26mn in May 2023, largely influenced by the challenges experienced in Q1:2023, we anticipate a rebound in these figures. As economic activities fully recover and productivity improves in H2:2023, we expect to witness an upturn in the number of subscribers.*



Chart 17: 12-month Trend Analysis of Telecoms Subscriber Base



Source: NBS, NCC, ARM Research

### Trade: Better Times Ahead

The Trade subsegment’s growth momentum declined by 324bps to 1.31% YoY in Q1:2023. This is not farfetched given the impact of the cash crunch, election uncertainties and persistent hikes in interest rate. While the impacts of elevated inflation unfold further in H2:2023, following the projected increase in prices of food items, fuel, and electricity tariffs. We expect this to drive figures upward.

### Manufacturing: Anticipating A Turn of Events

The Manufacturing subsector expanded by 1.61% YoY in Q1:2023 (vs 2.83% in Q4:2022). There was a general slowdown in all the subsegments under Manufacturing segment safe for Motor Vehicles and Assembly which increased 110bps to 5.41% YoY. Top contributors to the Manufacturing segment such as Cement (-231bps to 1.58%), and FBT<sup>13</sup> (-104bps to 3.90%) witnessed a slowdown

<sup>13</sup> Food Beverage and Tobacco



in growth momentum. TA&F<sup>i</sup> remained in the abyss as it contracted furthered by 251bps to 3.68%. This further depicts the adverse effect of the cash crunch on the domestic economy amid elevated borrowing cost. **We anticipate a boost in performance in H2:2023, supported by the recent improvement in PMI figures, which is a positive indicator for the economy. In Q2:2023, the Stanbic Purchasing Managers' Index (PMI) rose to 53.67pts from 46.83pts in Q1:2023, signalling a positive trend. Additionally, we expect the Oil Refining subsegment to transition out of negative territory in Q4:2023, driven by the full-scale operation of the newly commissioned Dangote refinery.**

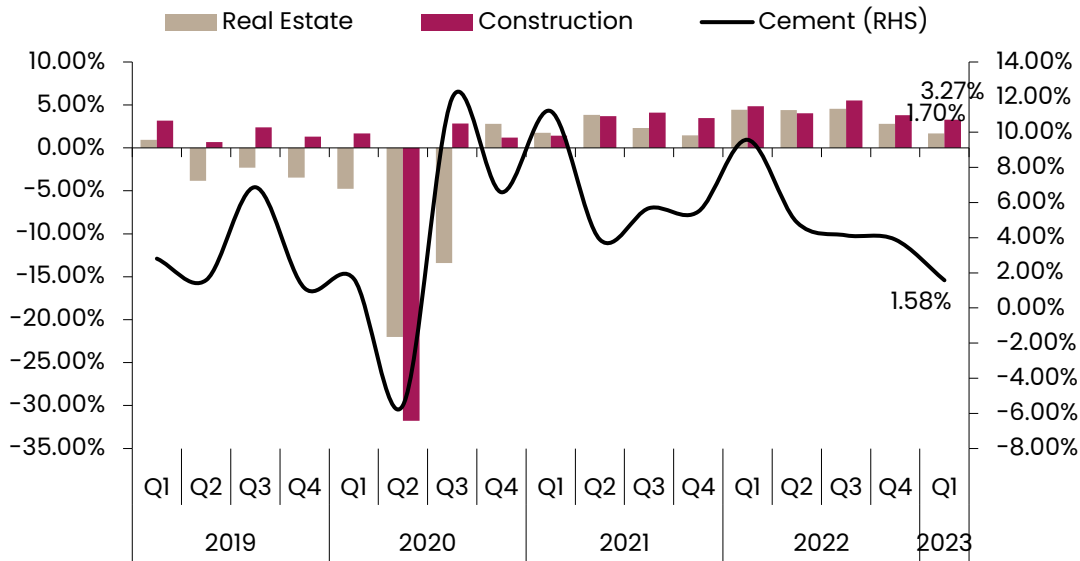
### **Real Estate, Construction and Cement: Cut from the Same Cloth**

The real Estate sector's growth momentum slowed to 1.70% YoY (vs 2.78% YoY in Q4:2022). Similarly, the Construction (3.27% YoY) and Cement (1.58% YoY) sector also witnessed a slowdown in year-on-year growth rate. Over time, these sectors have demonstrated a parallel growth pattern due to their interconnectedness and the shared factors influencing their expansion. These factors include government spending, infrastructure development, the standard of living, diaspora remittances, and foreign investors' sentiments. The current administration has not undertaken any substantial projects or implemented notable policy changes that would impact the Real Estate, Construction, and Cement sector. As a result, the outlook for these sectors in H2:2023 appears gloomy. However, we anticipate a moderation in their performance during this period.





Chart 18: Trend Analysis of Real Estate, Construction and Cement Sectors



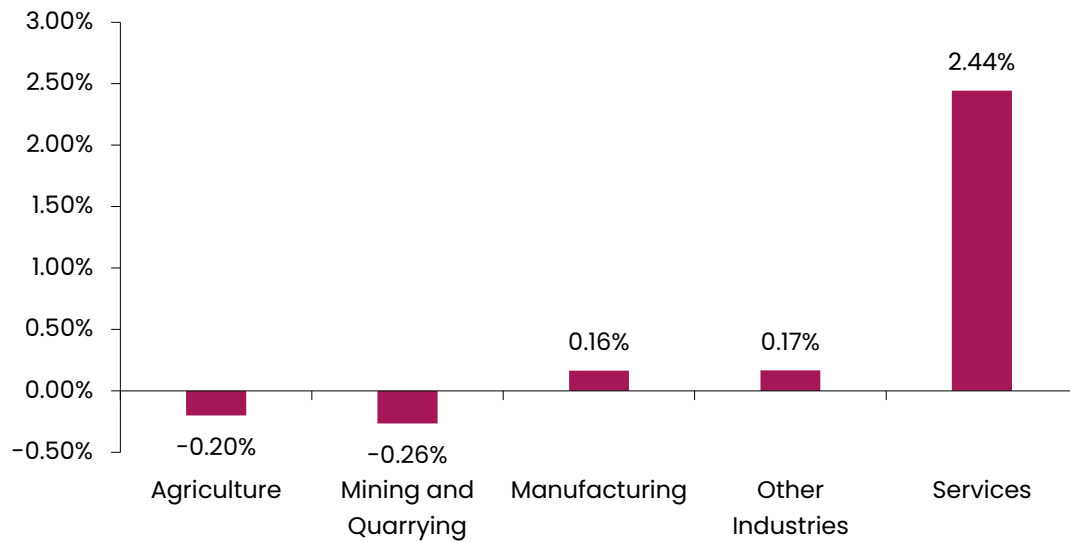
Source: NBS, ARM Research

### Attribution Analysis

During our attribution analysis for Q1:2023, we evaluated the performance of significant sectors of the economy in relation to the total GDP benchmark. Notably, the Services sector took the lead, exhibiting an impressive performance of 2.44%. The Industries sector followed closely with a contribution of 0.17%, while the Manufacturing sector contributed 0.16% to the overall performance. In contrast, both the Mining and Quarrying sector and the Agriculture sector posted negative performances, with a decline of -0.26% and -0.20% respectively.



Chart 19: Q1:2023 Attribution Analysis



Source: NBS, ARM Research

### Outlook: Heading Towards a Moderate Upturn

We maintain our outlook as stated in our Q1:2023 GDP report. In H2:2023, we anticipate a resurgence in the oil sector, moving away from its current state of decline. This positive outlook is based on several factors, including enhanced oil production levels, a rising trend in oil prices, and the projected full operational capacity of the Dangote refinery in the latter part of the year. These combined factors are poised to inject fresh vitality into the oil sector, revitalizing its performance and fostering a renewed sense of optimism.

Likewise, we expect improved performance in the non-oil sector in H2:2023, as the economy fully recovers from the impact of the cash crunch and election activities while it's being succoured by the implementation of pro-market policies by the current administration. Furthermore, sustained growth in the ICT sector is expected, driven by improvement in mobile subscribers and



substantial investments by telecommunications companies to enhance their 4G and 5G network infrastructure in H2:2023.

On a balance of factors, we maintain our GDP forecast at the range of 2.66% for base case, and 1.51% for bear and 2.95% for bull.



## Nigerian Inflation – Policy Shift and Soaring Price Levels

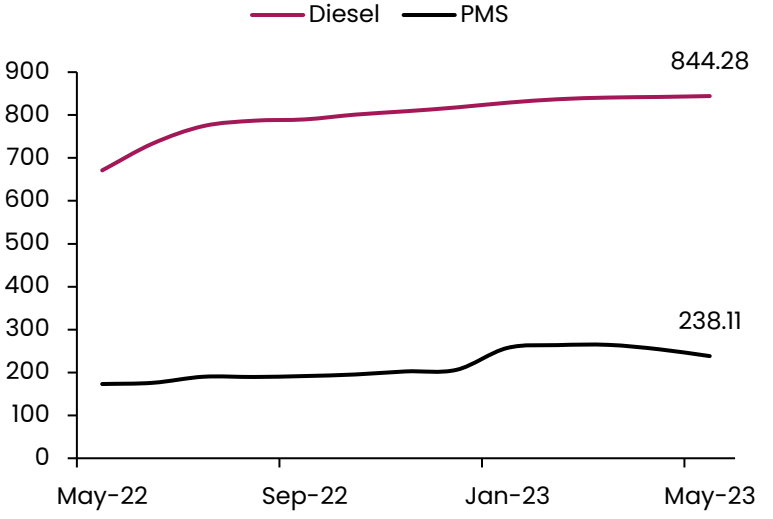
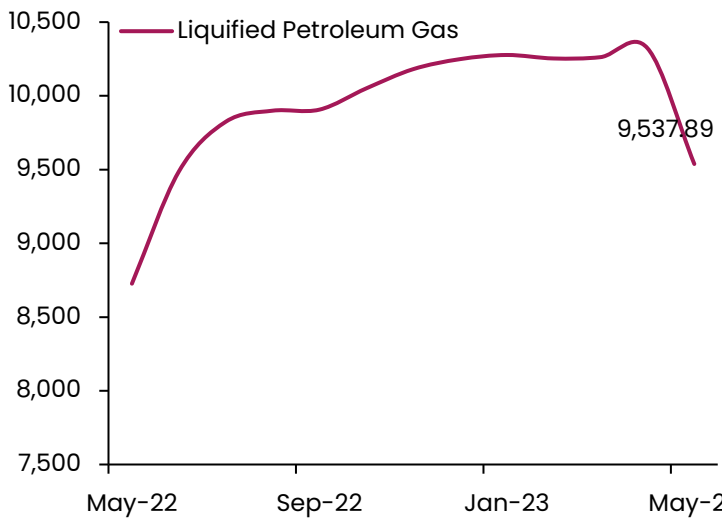
Structural issues plaguing the economy have exacerbated consumer price levels in H1:2023. This is despite the slowdown in prices of global commodities. In this light, inflation rate rose from 21.82% in January 2023 to 22.41% in May 2023, driven by increases in both the core and food components of the CPI basket. Observing the MoM trend, prices have soared in a similar fashion from 1.87% in January 2023 to 1.94% in May 2023. We had envisaged the average inflation rate at 20.60% in our optimistic case for the year. We based this on stable exchange rate, adequate food supply unhindered by insecurity and climatic conditions and the perpetuation of the subsidy regime. Our pessimistic case of average inflation rate of 23.04% for 2023 was hinged on a scenario where the government ignored group activities and ensured market reflective rates for petroleum and electricity, reverted to a floating exchange rate system, and the protracted insecurity in the food producing regions persisted.

Following the Russia-Ukraine conflict, concerns around supply shortages and sanctions had driven crude oil and gas products prices to record-levels in 2022. Coming to 2023, we have since witnessed a gradual decline in Brent crude price, falling by 40.85% to USD72.66pb in May 2023 from USD122.87pb in the same period in 2022. Despite this development, average diesel price in Nigeria rose 25.81% to NGN844.28 over the five (5) month period. Similarly, Gas prices saw a 9.30% increase to NGN9,537.89/12.5kg while Premium Motor Spirit (PMS) rose 37.57% YoY to NGN238.11/litre. PMS price rose sharply in the period irrespective of subsidy payments following the scarcity that engulfed the country in the Q1:2023.



Chart 20: Trend in Gas Price (NGN/12.5kg cylinder)

Chart 21: Trend in PMS and Diesel Prices

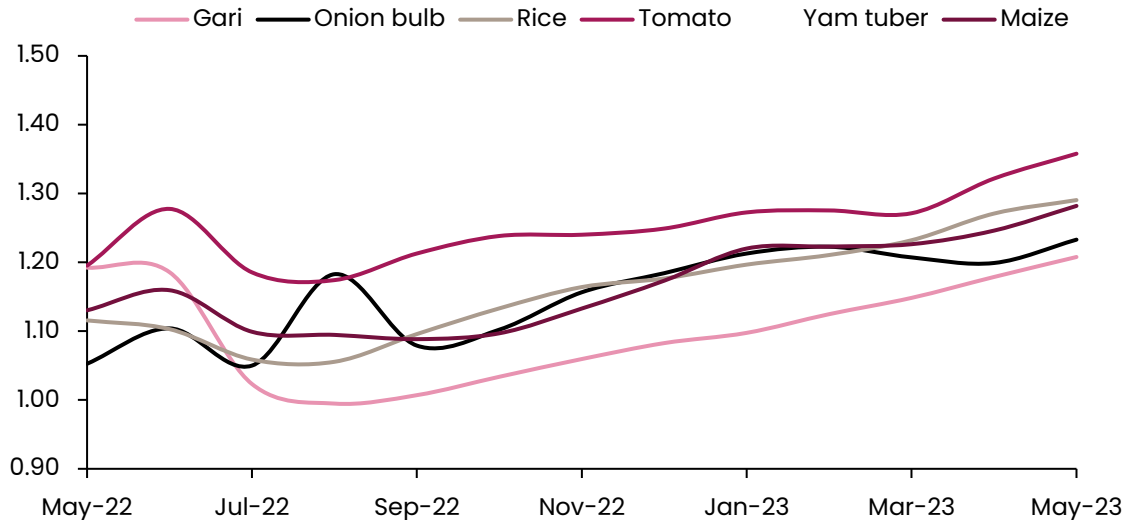


Source: NBS, ARM Research

Food inflation has witnessed a marginal but steady rise since the start of the year. It went up from 24.32% in January 2023 to 24.82% in May 2023 as the prices of farm produce and processed foods increased during the period. We may recall that the flooding that happened towards the end of 2022 led to a significant destruction of farm areas and harvesting activities. The aftermath trickled into the new year amid heightened insecurity in the Northeast, further disrupting livelihood and farming activities. Consequently, we saw YoY increases across staple foods including rice (+15.67%), maize (13.42%) and yam tubers (19.06%) in May 2023. Looking at the MoM trend, food inflation has risen from 2.08% in January 2023 to 2.19% in May 2023 on the back of aforementioned factors.



Chart 22: Trend in Prices of Major Staple Foods in Nigeria



Source: NBS, ARM Research

Core inflation rose from 19.16% YoY in January 2023 to 20.06% YoY in May 2023. The heavily weighted core components witnessed an upsurge, including Housing, Water, Electricity, Gas, and other Fuel (HWEGF) (+39bps) and Transport (+284bps) from January to May 2023. However, on a month-on-month basis, we observed fluctuation in the core inflation data, albeit witnessing a slight downtrend over the five (5) month period which settled at 1.81% in May 2023 from 1.82% in January 2023.

**H2:2023 Inflation Outlook: Price Ascent to Persist on Full Downstream Deregulation**

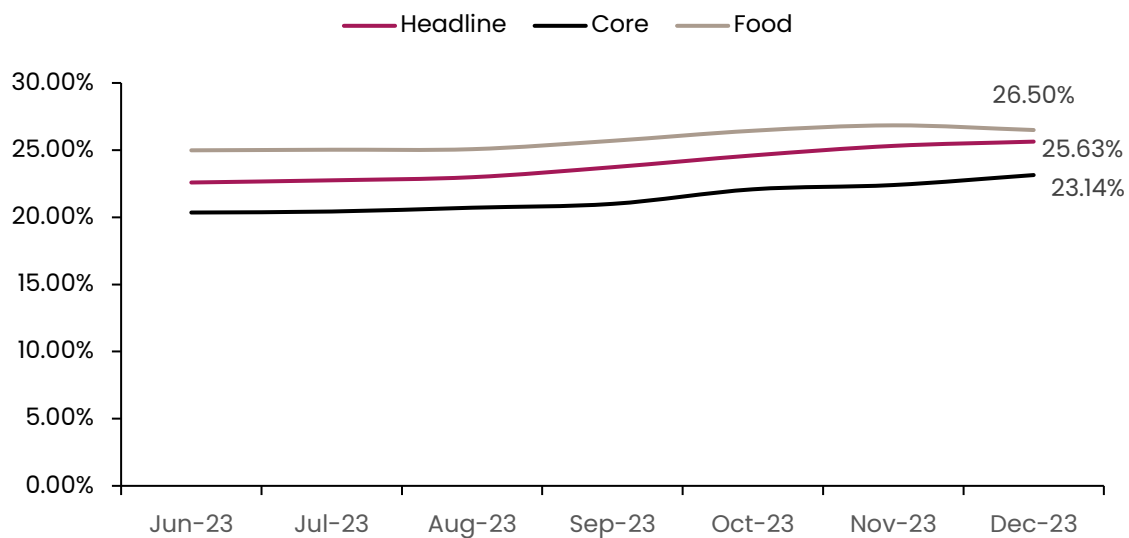
Although, harvest season kicks in from July and is usually accompanied by increased food supply, which ordinarily taper prices, we however, see steady rise in food prices in H2:2023. This outlook is hinged on the impact of insecurity on food supply and likely pass-through effect of the subsidy removal on food



prices. On a balance of factors, we expect annual food inflation to rise to 26.50% by December 2023, and an average of 25.26% for 2023 (2022 average: 20.83%).

We expect Core inflation would be further magnified by higher Premium Motor Spirit (PMS) following the subsidy removal as well as expectation of about 40% hike in electricity tariff in H2:2023, which would result in higher energy costs. Hence, Core inflation should touch 23.14% by year end and an average of 20.68% in 2023 (2022 average: 16.01%). Overall, we expect headline inflation to sustain its ascent in 2023 (as depicted in Chart 23) to reach 25.63% in December 2023, at an average of 23.17% for the year.

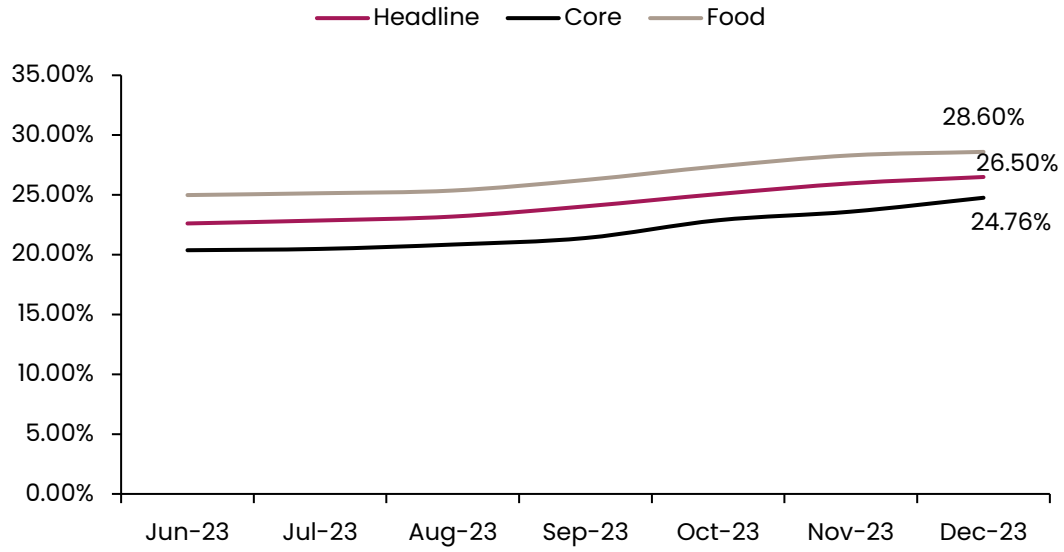
Chart 23: Monthly Inflation Forecast for 2023 (Base Case)



Source: ARM Research



Chart 24: Monthly Inflation Forecast for 2023 (Bear Case)



Source: ARM Research





## Monetary Policy: Hawkish amid Sticky Inflation

In H1:2023, the Monetary Policy Committee (MPC) exhibited unwavering determination as they doggedly maintained their hawkish approach. Contextually, the MPC hiked the Monetary Policy Rate (MPR) by a 100bps during their January meeting, followed by successive 50bps hikes in their March and May meetings. Nevertheless, the Monetary Policy Committee (MPC) held the Cash Reserve Ratio (CRR) and Liquidity Ratio constant at 32.50% and 30.00% respectively. The Committee had analysed a range of global and domestic challenges that had impacted the Nigerian economy during the year. Notably, factors such as the ongoing Russia-Ukraine conflict, escalating energy prices, the US banking crisis, and the persistent upward trend in global inflation were at the forefront of the Committee's considerations.

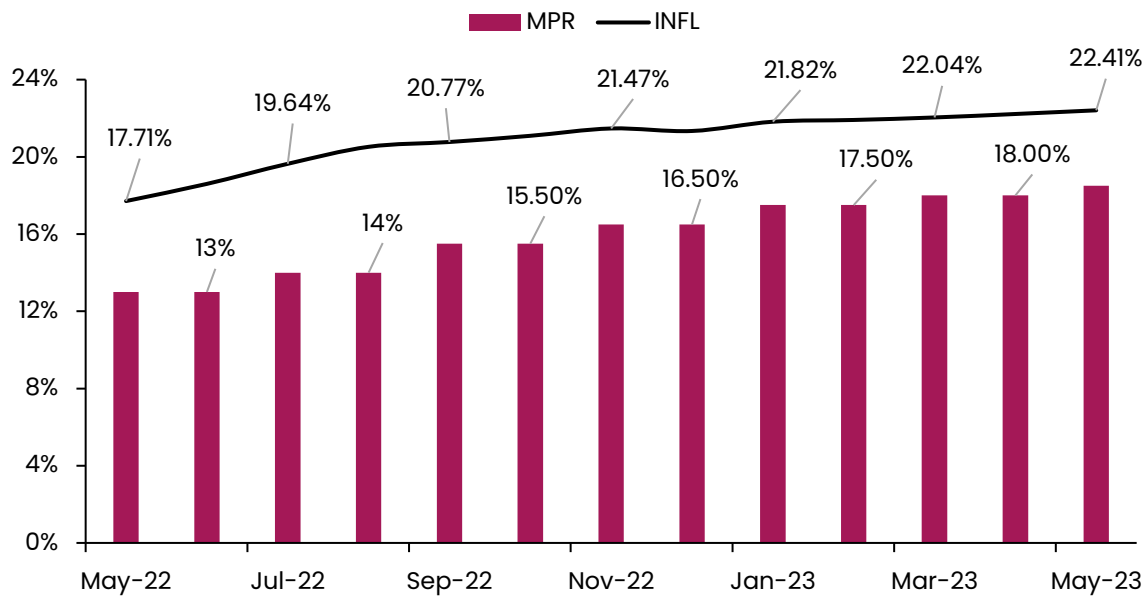
As outlined in our previous H1:2023 NSR report, [Navigating Murky Terrains](#) we maintain the view that relying solely on monetary instruments may not be sufficient to effectively curb inflation. Our stance is based on the peculiarity of the Nigerian inflation, which is more supply driven. Hence, we witnessed an upward trajectory in inflation despite the incessant hikes in MPR. For context, in the five months of H1:2023, Headline inflation rose from 21.82% YoY in January to 22.41% YoY in May 2023.

At the Committee's 291<sup>st</sup> meeting in May 2023, the MPR was increased by an additional 50bps to 18.50%. In line with its consistent approach in its other policy meetings during the year, the Committee retained the CRR and Liquidity Ratio at 32.50% and 30.00% respectively and kept the Asymmetric Corridor at +100/-700 basis points around the MPR. The Committee's decision was influenced by several factors, including the contractionary monetary policies implemented



by major advanced economies, the aftermath of the US banking crisis, and the lingering effects of the Russia-Ukraine conflict. Taking these considerations into account, the Committee deemed it unfavourable to lower or maintain the rate; as such actions would exacerbate inflationary pressures, intensify macroeconomic instability, and undermine the effort to control inflation. Considering these implications, the Committee chose to tighten the rate, expressing optimism that this move would effectively manage demand-driven inflation, reduce the negative real interest rate margin, and instil confidence among investors regarding the efficacy of the monetary policy.

Chart 25: MPR Trend vs Inflation



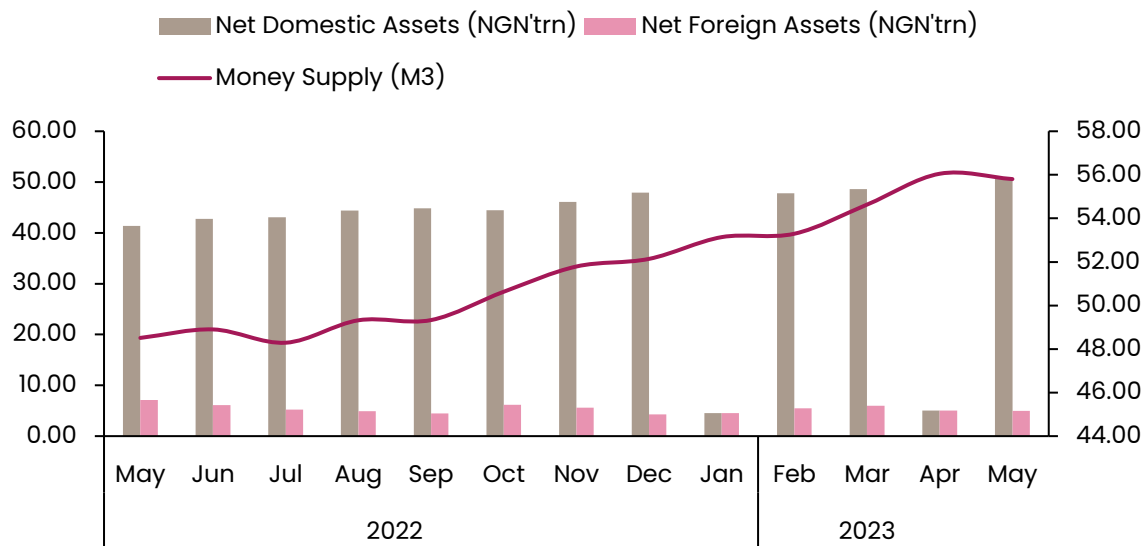
Source: CBN, ARM Research



Increased Net Foreign Assets: Defying the Norm

In H1:2023, Broad Money Supply (M3) recorded consecutive MoM increases from January 2023 to April 2023. However, in May 2023, Broad Money Supply (M3) tapered by 0.44% MoM to NGN55.80trn (vs NGN56.05trn in April 2023). The rise in Broad Money Supply (M3) is on the back of a significant increase in Net Domestic Assets (+1016.10%) from NGN4.56trn in January 2023 to NGN50.85trn in May 2023. The uptrend in Net Domestic Assets largely reflects an uptick in credit extended to the private sector, which grew, by 6.43% over the first five months of the year (from NGN41.54trn in January 2023 to NGN44.21trn in May 2023). Furthermore, it is noteworthy that Net Foreign Assets deviated from its typical downward trend and instead displayed an upward trajectory between January 2023 and May 2023. Following the Central Bank’s hawkish stance, Net Foreign Assets increased by 8.80% from NGN4.56trn in January 2023 to NGN4.97trn in May 2023.

Chart 26: One Year Trend of Money Supply (M3), Net Foreign and Domestic Assets (NGN'trn)



Source: CBN, ARM Research



## Naira Redesign Backfires: Economic Panic Grips Nigeria

The Naira Redesign Policy, implemented by the CBN in October 2022, had adverse effects on the Nigerian economy in H1:2023. The objective of this policy was to mitigate the risks associated with counterfeiting and reduce the overall money supply by redesigning the NGN200, NGN500, and NGN1,000 notes. Subsequently, in December 2022, the Central Bank introduced cash withdrawal limits, restricting individuals and corporate entities to weekly maximum withdrawals of NGN500,000 and NGN5mn, respectively.

To facilitate the transition, the Central Bank commenced the gradual withdrawal of the old Naira notes, with the announcement that they would cease to be accepted as legal tender after February 10<sup>th</sup>, 2022. This led to a significant shift in behaviour, with individuals and businesses exclusively seeking the new notes, and businesses rejecting the old notes from customers. However, the supply of the new notes did not adequately meet the rising demand, exacerbating the situation.

Compounding the issue, a considerable quantity of old notes had been deposited in banks. This combination of factors resulted in a substantial decline in money supply during the first three months of H1:2023, creating a sense of panic within the economy. To provide context, the base money supply (M0), representing the physical currency in circulation, contracted by 3.64% between January 2023 (NGN16.58trn) and March 2023 (NGN15.98trn). In contrast, Narrow money supply, which includes currency in circulation and current account deposits with commercial banks, expanded by 2.34% to NGN21.40trn in March 2023 from NGN20.91trn in January 2023. This expansion was driven by the increased utilization of bank transfers for economic



transactions in Q1:2023, as the scarcity of Naira notes became more pronounced. Consequently, current account deposits experienced a notable increase in Q1:2023.

### **A Downcast Economy: Aftermath of the Cash Crunch Crisis**

Following a significant depletion of the amount of currency in circulation, the Nigerian economy experienced a pronounced downward spiral. For context, GDP growth in Q1:2023 experienced a slowdown to 2.31% YoY (vs 3.52% YoY in Q4:2022). Despite sustaining expansion for the tenth consecutive quarter since H2:2020, the slowdown was attributed to several factors, including the cash crunch crisis, election activities, persistent rate hikes, and underlying structural challenges. Furthermore, the Non-oil sector demonstrated sluggish growth, registering a YoY growth of 2.77% (vs 4.44% in Q4:2022) indicating the effect that the cash scarcity had on various sectors such as the Manufacturing (-122bps to 1.61% YoY), Trade (-324bps to 1.31% YoY) and Agriculture (-295bps to -0.9% YoY).

Supporting the evidence of an economic slowdown, the Stanbic Purchasing Managers Index (PMI) for Q1:2023, contracted to 46.83pts from 54.17pts in Q4:2022. This reflects the negative impact of cash shortages on the overall economic activity. Moreover, the difficulty faced by manufacturers in obtaining cash for business operations resulted in a significant rise in the prices of goods and services. In Q1:2023, average inflation reached 21.92% YoY (vs 21.30% in Q4:2022). This highlights the dual nature of inflation dynamics in Nigeria, influenced by both supply and demand factors.



### Sigh of Relief: A Break from the Policy

In March 2023, the Supreme Court ruled to extend the use of the old naira notes (NGN200, NGN500 and NGN1,000) till December 2023. Consequently, the Central Bank re-introduced the previously phased-out currency notes into the economy and normalcy was restored. Though inflation maintained its upward trajectory (May's print: 22.41% YoY), economic data suggested that the Nigerian economy has found its footing. Following the reversal of the policy, Base Money supply (M0) expanded significantly by 9.82% over two months (April and May 2023) to NGN17.54trn in May 2023 (vs NGN15.98trn in March 2023). Similarly, Narrow Money supply grew by 4.98% to NGN22.47trn in May 2023 from NGN21.40trn in March 2023. Overall, Broad money Supply (M3) grew by 2.14% to NGN55.80trn in May 2023 (from NGN54.63trn in March 2023). Furthermore, the PMI figures rebounded, recording 53.8pts, 54.0pts and 53.2pts in April, May, and June 2023 respectively (vs March's print: 42.3pts), indicating an improvement in economic activity.

### H2:2023 Outlook – MPC to Switch to a “Hold Stance”

Although we expect inflationary pressures to persist, following the removal of fuel subsidy in H1:2023, we do not expect the Monetary Policy Committee (MPC) to sustain its hawkish stance. Our prognosis rests on the expectation of an end in rate hikes by systematically important global central banks (especially in the US) and the new policies implemented by the CBN following the ousting of the former CBN Governor. We expect the MPC to adopt a wait-and-see approach as it assesses the impact of the previous rate hikes on the economy. In our view, inflation has been influenced more by supply-side factors and continuous rate hikes would impede economic growth. Considering this dynamic, we foresee



the MPC adopting a hold stance in the most part of H2:2023. However, we do not rule out a 25-50bps interest rate hike in its July MPC meeting.



## Fiscal Policy: Still no Respite in Sight

In our H1:2023 Nigeria Strategy Report (NSR) sub-titled *Budget Implementation: Full Revenue Implementation Still a Mirage*, we had projected budget implementation of 100% in terms of recurrent expenditure while capital expenditure was expected to lag at 45% of budget numbers based on historical performance. We had also expected revenue to fall short of projected numbers. Our assumptions are premised on lower oil receipts amid moderate oil price and underwhelming oil production.

In 2023, an average daily production of 1.45MMbpd for January 2023 to May 2023 represents a 3% decline from the 1.49MMbpd recorded in the same period in 2022. Recall that the country could not take advantage of the spike in oil prices globally in 2022 as it missed out on potential spike in oil revenues following its underwhelming oil production during the period. Although, we expect oil revenue to receive some boost following the recent PMS subsidy removal which may provide some respite following the termination of its Direct-Sale-Direct-Purchase (or crude-for-petrol swap) contracts which was introduced in 2010. This would allow headroom for improved inflows as evidenced by the higher Federal Allocation Account Committee (FAAC) inflows of NGN786.20bn in May 2023 (vs. NGN655.90bn in April 2023). The reintroduction of a managed float exchange rate could lead to relatively cheaper exports, further improving earnings as export value rises. However, we are still less optimistic of the realisation of the projected oil revenue due to underwhelming oil production.

Elsewhere, the budget had put forth an unrealistic projection for revenue from other sources, particularly the FGN independent revenue (NGN2.62trn est.).

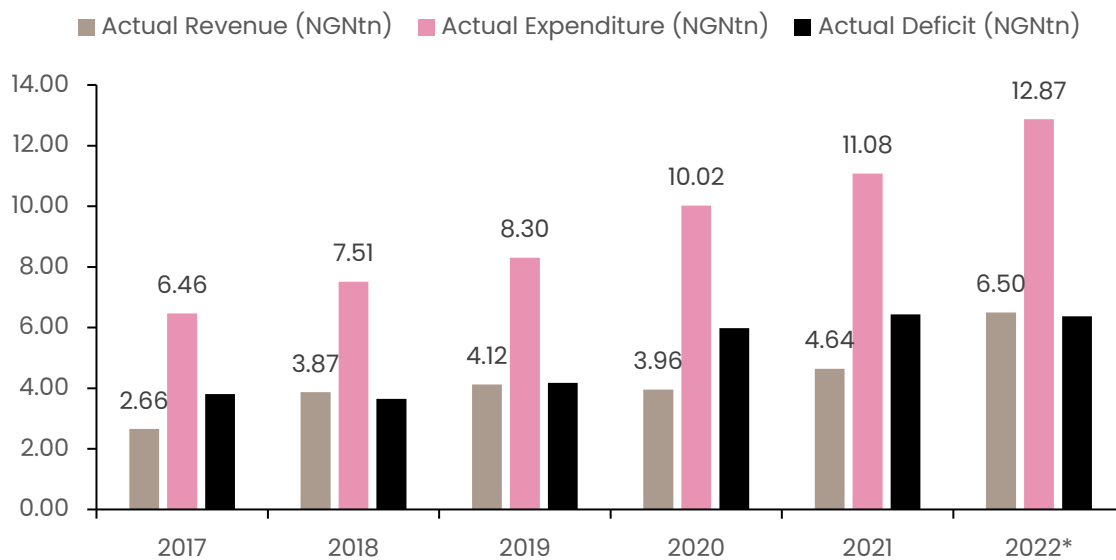




Historically, the FGN independent revenue line has underperformed, realizing NGN625.07bn on a 5-year average.

In contrast, we expect non-oil revenue to post decent revenue growth on account of outperformance from CIT<sup>14</sup>, feeding from solid corporate performance.

**Chart 27: Actual Budget Performance 2017 – 2022F (NGN'trn)<sup>15</sup>**



Source: Budget Office, ARM Research

**Fiscal Deficit – An Unending Gap**

Although we have not had a budget implementation report since November 2022, we believe expenditure would expand due to PMS subsidy retention in H1:2023. We expect domestic borrowing to continue to dominate the rest of the year due to the unfavourable Eurobond pricing, precipitated by the interest rate hikes that have permeated both developed and developing markets in H1:2023.

<sup>14</sup> Company Income Tax

<sup>15</sup> \*\* 2022 performance represents January to November 2022



It is worthy to note that the Senate had approved the securitization of the CBN's Ways and Means lending (NGN22.7trn) with a tenor of 40 years (9% interest rate) and an initial 3-year moratorium on principal payment. We believe this development would put less pressure on the Government with respect to its repayment. Total debt stock as published by the DMO stood at NGN49.85trn in Q1:2023. When we add the Ways and Means balance of NGN22.7trn, total debt stock would rise to NGN72.55trn. Overall, we see debt levels rising in 2023FY and debt-service to revenue ratio to exceed 85% by year-end.

Table 1: Approved 2023 Budget

	Approved 2023 budget	Revised 2022 budget
Oil Production (mbpd)	1.69	1.60
Oil Price (USD/bbl)	75.00	73.00
Exchange Rate (NGN/USD)	435.57	410.15
FGN share of oil revenue (NGN'bn)	2,229.64	2,190.37
Share of Non-oil revenue (NGN'bn)	2,433.15	2,132.08
Total revenue incl. GOEs (NGN'bn)	10,491.65	9,969.17
Total Expenditure incl. GOEs & Project-tied loans (NGN'bn)	21,827.19	18,139.24
Fiscal Deficit- incl. GOEs & Project-tied loans (NGN'bn)	11,335.54	8,170.07

Source: Budget Office, ARM Research

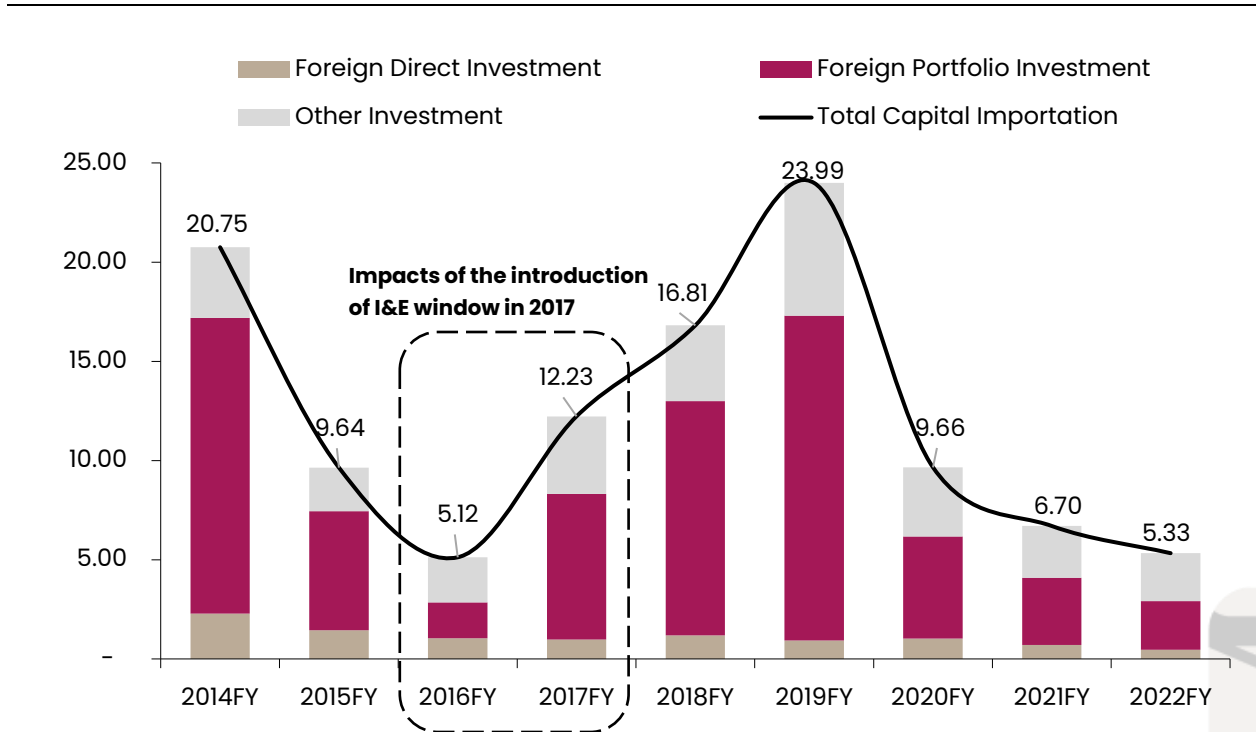


## Capital Importation – Waning Capital Inflows | A Glimpse of

### Hope in the Future?

The importance of Capital Importation figures cannot be overstated, as they serve as a critical indicator of an economy's health and vitality. Unfortunately, Nigeria has witnessed substantial declines in Capital Importation, attributable to a confluence of external challenges and deep-rooted structural issues that have plagued the economy. These incessant issues persist unabated, casting a heavy burden on every facet of the economy, with no respite in sight.

Chart 28: Trend Analysis of Capital Importation and its Sub-sectors from 2014-2018



Source: NBS, ARM Research

Nigeria has three main subsectors of Capital Importation namely;

1. Foreign Direct Investment – This often depicts foreign investors' willingness to take a stable and long-term investment position in the Nigerian economy. It comprises of foreign investors acquisition of substantial stake in companies within Nigeria.
2. Foreign Portfolio Investment – This comprises of investment of funds by foreign individuals, institutions, or entities into financial assets (such as stocks, bonds, or money market instruments) in Nigeria.
3. Other Investment – This comprises of various forms of investment inflows that do not fall under Foreign Direct Investment (FDI) or Foreign Portfolio Investment (FPI).

The Capital Importation report for 2022FY sheds light on the waning interest of foreign investors in the Nigerian economy. The total capital influx into the country contracted by 20.47% YoY, amounting to USD5.33bn in 2022FY, compared to USD6.70bn in 2021FY. This represents the lowest capital importation figure since 2016FY, which stood at USD5.12bn. The decline in capital importation can be predominantly attributed to the prevailing structural challenges and global economic headwinds that have pervaded the Nigerian economy.

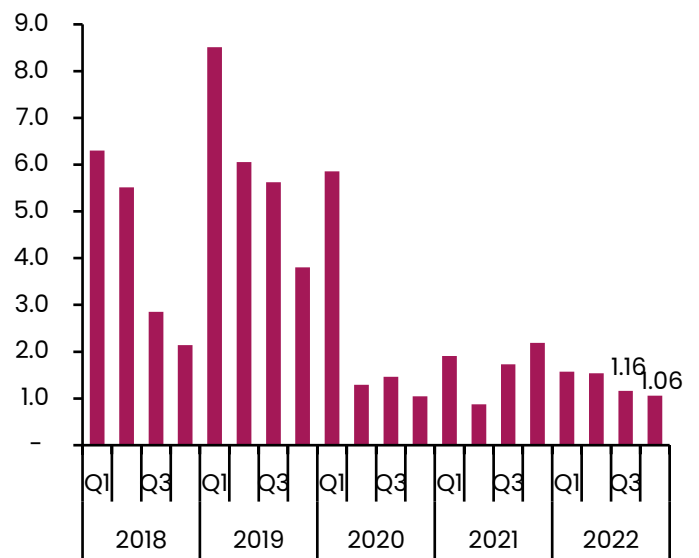
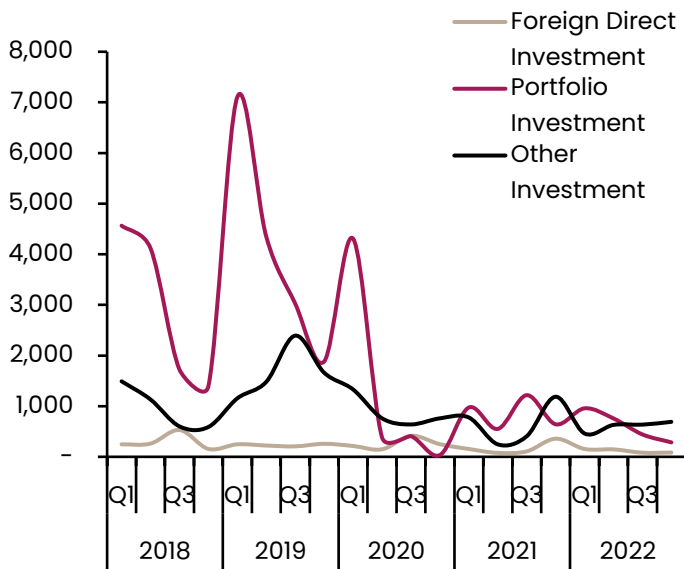
Structural challenges remain a pressing concern for the Nigerian economy, as issues such as insecurity, a substantial infrastructure deficit, foreign exchange illiquidity, and unfavourable monetary policies implemented by the Central Bank of Nigeria hinder economic growth. On a global scale, the Covid-19 pandemic had a significant impact on Capital Importation in 2020FY, with a drastic 59.75% YoY contraction, amounting to USD9.66bn compared to



USD23.99bn in 2019FY. Furthermore, the Russia-Ukraine conflict further exacerbated the decline in capital importation, leading to a 20.27% YoY decrease to USD5.33bn. These factors have collectively contributed to the downward trajectory of capital inflows into the country.

**Chart 29: Capital Importation by Type**

**Chart 30: Total Capital Importation Q1:2018 – Q4:2022**



Source: NBS, ARM Research

**Foreign Direct Investment: Two Sides of the Same Coin**

Foreign Direct Investment (FDI) further dipped by 33.03% YoY to USD468.08mn in 2022FY. This can be attributed to the substantial increase in interest rates by major central banks, prompting investors to exercise caution in frontier and emerging markets and seek safer havens in advanced and mature markets. Additionally, factors such as foreign exchange scarcity, prevailing uncertainties, security concerns, and unfavourable regulations have further contributed to the lack of investor enthusiasm towards the Nigerian economy.



Looking forward, we expect Total Capital Imported for H1:2023 to remain subdued as we believe that the issues mentioned earlier remained predominant in the period. However, in H2:2023, we foresee a decent turn of events. We believe that;

- a. The removal of subsidies on oil and electricity is anticipated to generate interest among international oil companies (IOCs) and foreign energy companies, leading to increased engagement in the Nigerian energy and Oil & Gas sector.
- b. The liberalization of the FX market will possibly drive foreign investors' interest back into the Nigerian economy given the transparency that follows the policy and ease of repatriation of funds.
- c. Additionally, we anticipate that the removal of fuel subsidies will enhance foreign investors' confidence in the Nigerian economy, leading to increased buying interest in Nigerian debt instruments.

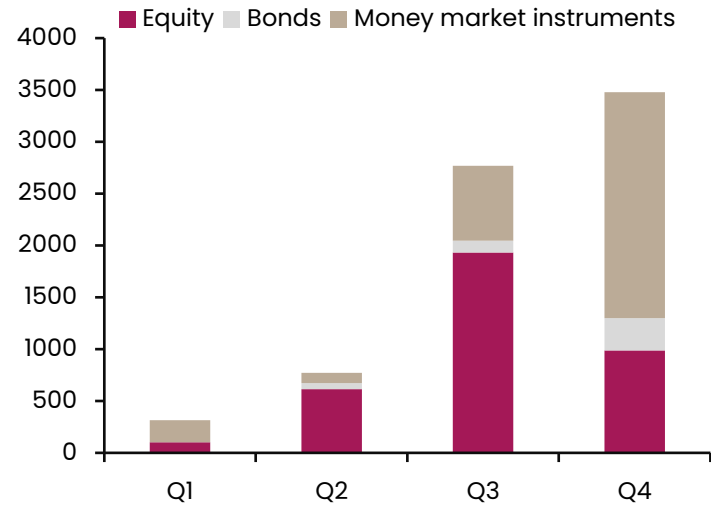
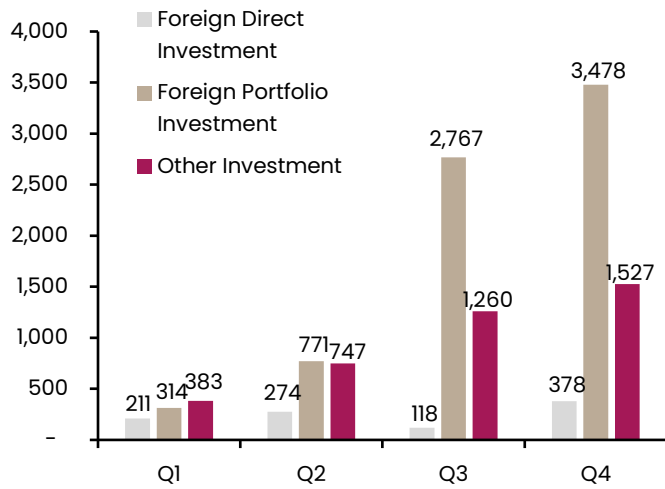
### **Foreign Portfolio Investment: A Jekyll and Hyde Scenario Ahead**

Foreign Portfolio Investment (FPI) declined significantly by 27.86% YoY from USD3.38bn in 2021FY to USD2.44bn in 2022FY. We opine that this is on the back of aggressive monetary policy tightening in H2:2022 by major central banks in the world and the gloomy outlook concerning global economic growth. We witnessed an upswing of yields in major economies which makes the market more attractive, prompting the exodus of FPI from the Nigerian economy to foreign economies. Also, burgeoning debt profile, downgrade by rating agencies such as Fitch and Moody, pre-election uncertainties and insecurity issues further spurred foreign investors apathy towards the Nigerian economy.



Chart 31: 2017 Capital Importation Trend Analysis

Chart 32 FPI Trend (Q1:2017 -Q4:2017)



Source: NBS, ARM Research

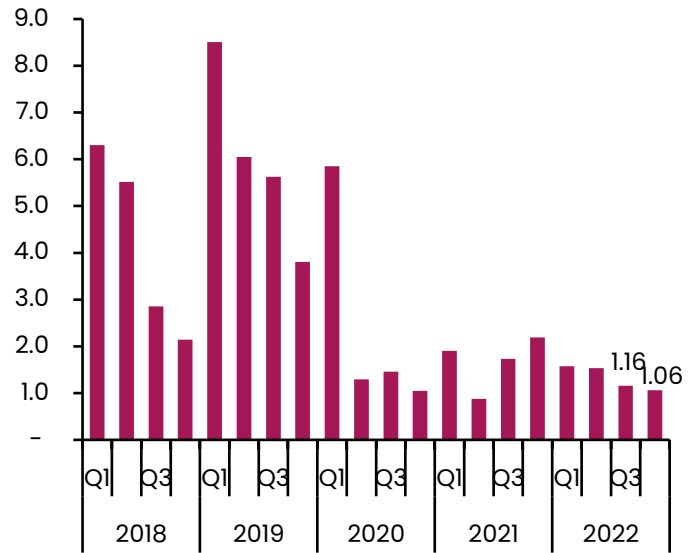
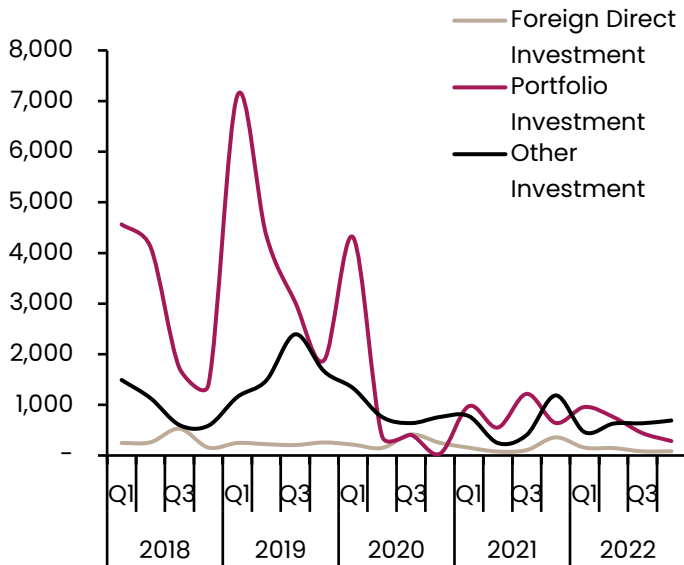
Our outlook for H1:2023 remain gloomy, we do not see a notable shift of event in the period as we opine that the impacts of election uncertainties, burgeoning debt, FX scarcity and aggressive interest rate hikes in major economies will keep numbers subdued.

However, we foresee a notable turn of events in H2:2023. We expect the liberalization of FX market operations to spur a change of event in the economy. We base our prognosis on a similar scenario that occurred in 2017. To put into perspective, on April 21st, 2017, the CBN introduced the I&E window which was implemented to enhance liquidity and facilitate the timely execution and settlement of eligible foreign exchange (FX) transactions. This action contributed to the surge in FPI from USD1.81bn in 2016FY to USD7.33bn in 2017FY.



Chart 33: Capital Importation by Type

Chart 34: Total Capital Importation Q1:2018 – Q4:2022



Source: NBS, ARM Research

### Other Investments Remain Tepid

Other Investments declined 7.55%YoY from USD2.62bn in 2021FY to USD2.42bn in 2022FY. Loans (USD2.3bn in 2022FY) remain the major subcomponent of this Capital Importation type.

We anticipate a subdued performance in Other Investments during H1:2023. However, we project a notable shift in H2:2023 based on past events, particularly in 2017 (as discussed in the FPI outlook). In 2017FY, Other Investments experienced a significant surge, increasing by 72.80% YoY to reach USD3.92bn. We expect a similar trend to emerge in H2:2023.

### Sectors with Highest Capital Importation

Sectors such as Shares, Banking, Financing, Production, Servicing and Telecoms have the highest Capital Importation figures on a 10-year average. Banks such as Stanbic IBTC, Standard Chartered, Citibank Nigeria Ltd, Rand Merchant Bank

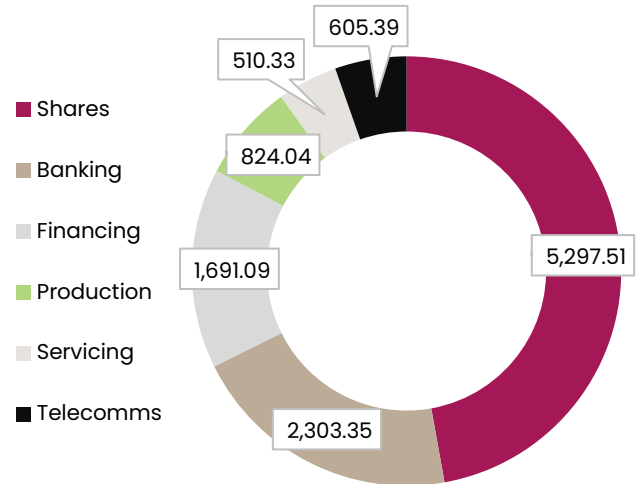
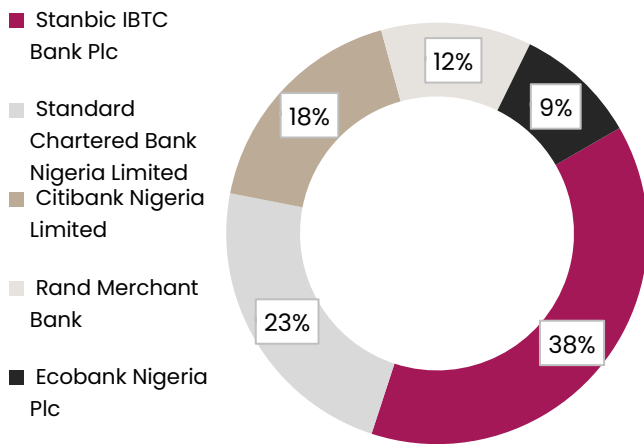




and Ecobank have the highest capital importation contributions on average (2019–2022).

**Chart 35: Banks with Highest Capital Importation**  
(Average from 2019 - 2022)

**Chart 36: Sectors with Highest Capital Importation**  
(Average from 2013 - 2022)



Source: NBS, ARM Research

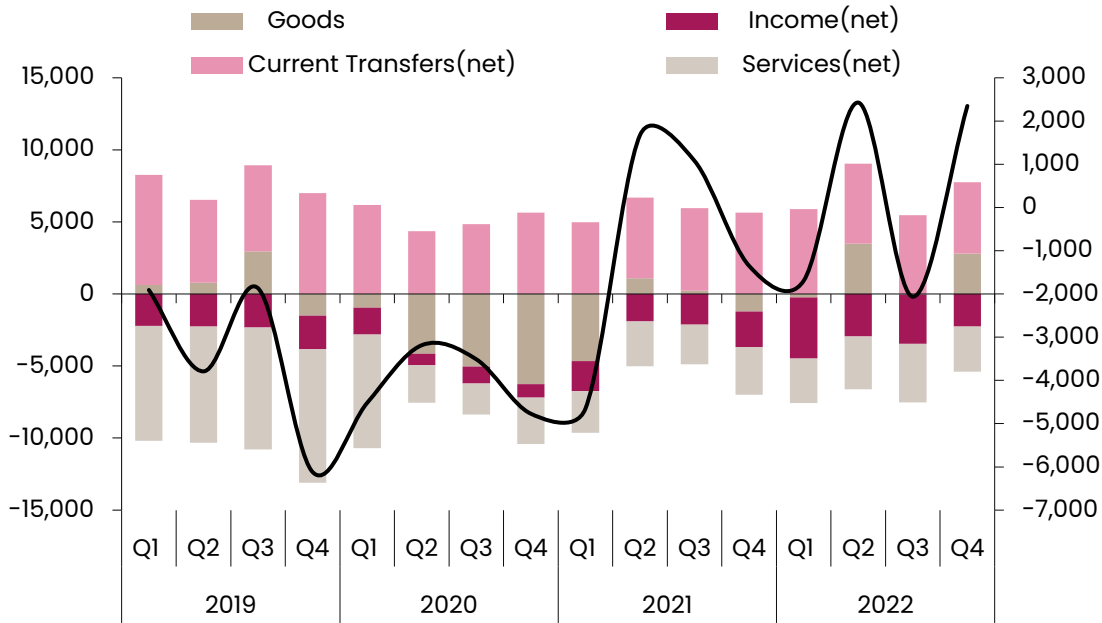


## Balance of Payment – Turning the Tide | Nigeria's Current Account Returns to Surplus Since 2017

2022FY brought good tidings for the Nigerian economy as the Current Account (CA) achieved a surplus (+USD1.02bn) after experiencing consecutive deficits since 2019FY. It is worth noting that Nigeria had consistently recorded a Current Account surplus from 2008FY to 2018FY, except for 2015FY when a deficit of USD15.44bn was recorded. However, in 2019, the Current Account settled in the negative territory at USD13.68bn, primarily due to declines in sub-segments such as Services (-USD33.76bn) and net Income (-USD9.16bn). The surplus in the net Current Account for 2022 can be attributed to a significant increase in Net Goods exports (+231.35% to USD5.99bn). This surge in Goods exports was a result of the uptrend in energy prices driven by the Russia-Ukraine conflict. The substantial rise in oil prices played a crucial role in generating the surplus, especially considering that Nigeria's average oil production for 2022 was 1.14MMbpd, lower than the 1.31MMbpd recorded in 2021. Overall, the favourable outcome in 2022 was a result of the uptick in Net Goods exports, propelled by higher energy prices. This turnaround in the Current Account signifies a positive development for the Nigerian economy, breaking the pattern of deficits observed in recent years.



Chart 37: Trend Analysis of Goods, Services Income and Current Transfers



Source: CBN, ARM Research

### Current Account Surplus – A Rebound from the Abyss Buoyed by Higher Oil Proceeds

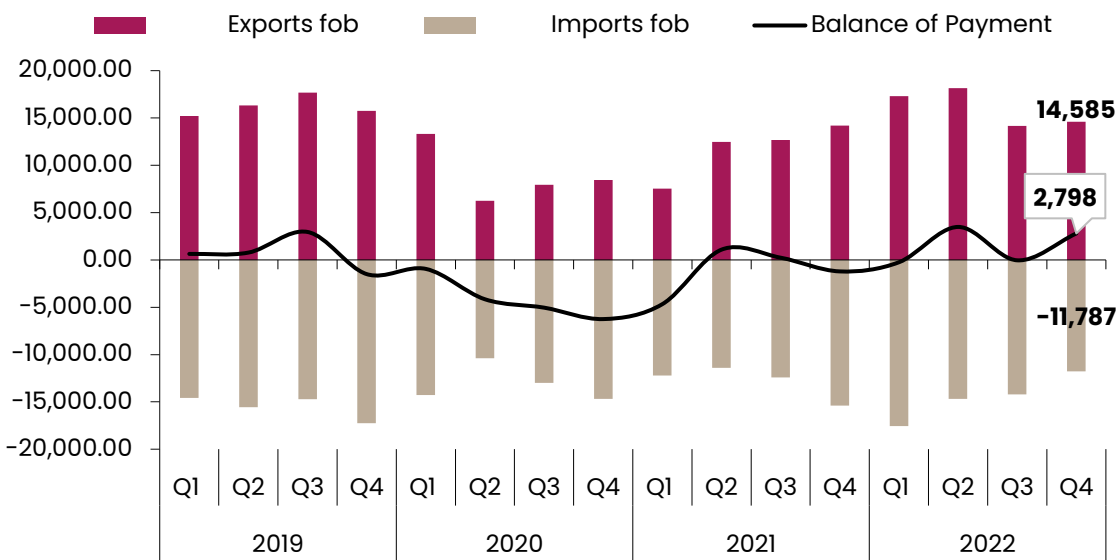
We opine that the significant 131.08% YoY surge in Current Account Figures, shifting from a deficit of USD3.25bn to a surplus of USD1.02bn, can primarily be attributed to the notable 231.35% year-on-year increase in Goods exports. It is important to note that Crude Oil and Gas exports rose substantially by 39.83% YoY to USD57.11bn, while Non-oil and Electricity export proceeds declined by 42.05% YoY, amounting to USD7.12bn. Additionally, Total Imports for 2022FY declined by 41.13% YoY to USD58.23bn. We believe that the Crude Oil Swap Arrangement, implemented by the Nigerian National Petroleum Corporation (NNPC) to exchange crude oil for refined petroleum products may have mitigated the impact of higher crude oil imports on the Nigerian economy. The



arrangement facilitated the exchange of crude oil for refined petroleum products, potentially alleviating the impact of increased crude oil imports.

In summary, the surge in Goods exports, particularly in Crude Oil and Gas, coupled with a decline in Total Imports, played a significant role in driving the Current Account surplus.

**Chart 38: Trend Analysis of Export and Import from Q1:2018 to Q4:2022**



Source: CBN, ARM Research

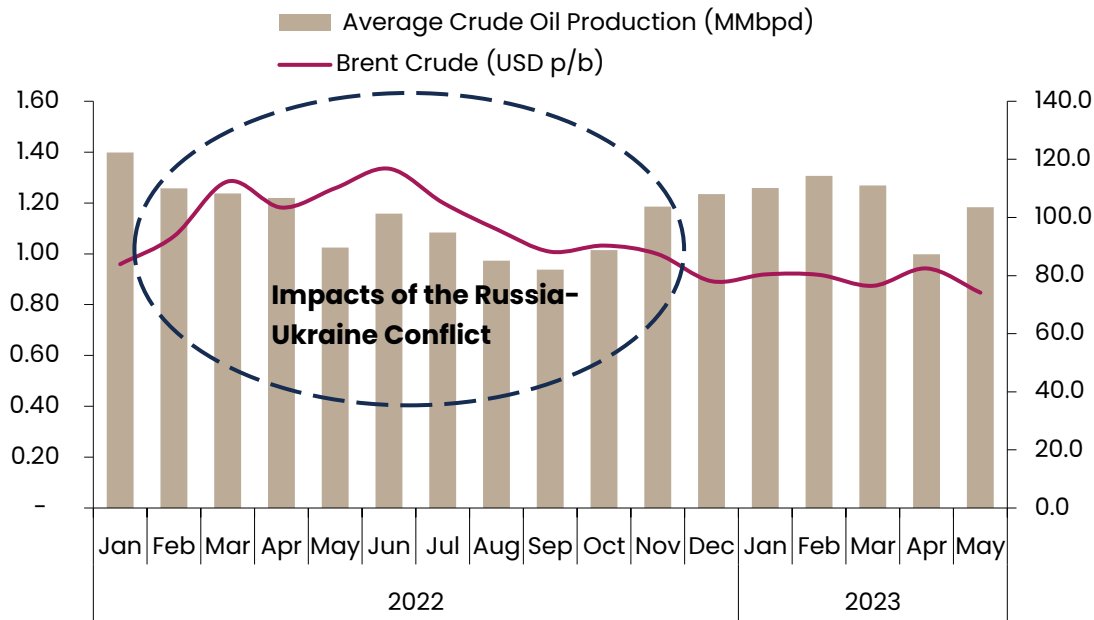
**Goods Export and Oil Price – The Siamese Twins Intertwining Fate**

To further justify our position on the impacts of the Russia-Ukraine Induced oil price increase on the Nigerian current account, according to NUPRC, average crude oil production in 2022FY stood at 1.14MMbpd while average Brent Crude price stood at USD97.10pb. However, average crude oil production in for 2021FY was 1.31MMbpd while Brent Crude price averaged USD70.44pb. This depicts that despite lower crude oil production in 2022FY, the surge in price overshadowed the lower production leading to increased revenue. For H1:2023, we expect a year-on-year decline in Goods export proceeds given the decline in average



crude oil production in the first half of the year to 1.20MMbpd (vs 1.22MMbpd in H1:2022). Also, the general decline in energy prices in H1:2023 (USD78.16pb) compared to USD103.36pb in H1:2022 will further drive goods exports proceeds below the bar.

**Chart 39: Trend of Oil Production in Nigeria and Brent Crude Price in 2022FY**



Source: NBS, ARM Research

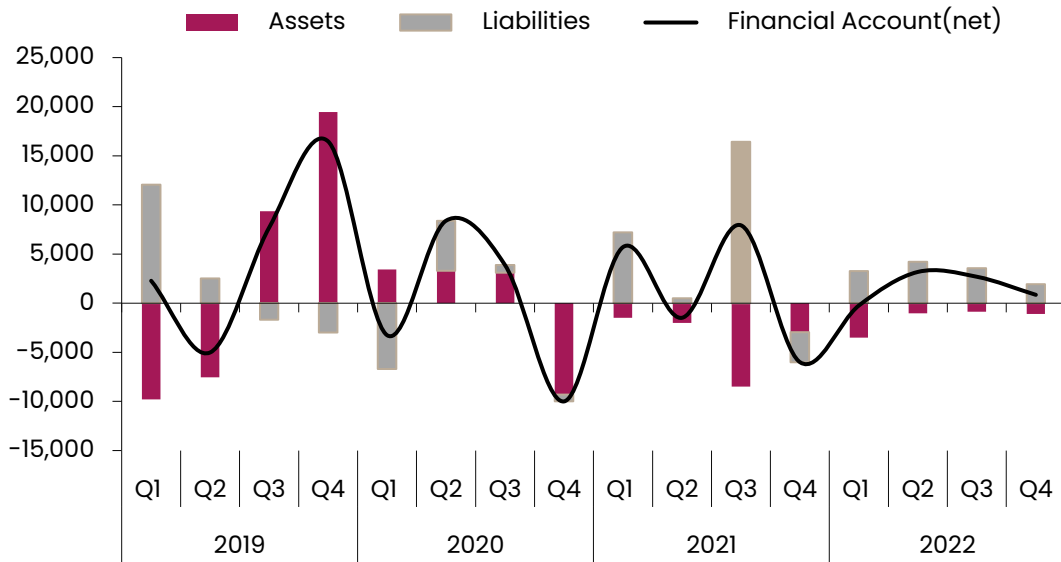
**Capital and Financial Account**

The Net Financial Account sustained its uptrend in 2022FY as it advanced by 5.45% YoY to settle at USD6.49bn (vs 6.16bn in 2021FY). We attribute this to the 83.55% YoY increase in H2:2022. We note that a positive Financial Account can be linked to factors such as decent accumulation of foreign assets or an increase in foreign financial claims held by the country. It also suggests that the country is attracting investments, loans, or other financial resources from



foreign entities. These inflows can be in form of Foreign Direct Investment (FDI), Portfolio Investments, loans, or grants.

Chart 40: Breakdown of the Financial Account from Q1:2018 to Q4:2022



Source: NBS, ARM Research

**Outlook: Moderate Improvement Ahead.**

Considering the aforementioned factors, our projection indicates that the Current Account is anticipated to maintain a surplus in H1:2023, albeit at a moderated pace. However, we anticipate a notable expansion of the Current Account surplus in H2:2023. Our analysis suggests a deceleration in Goods Exports during the H1:2023, influenced by the expected decrease in overall energy prices compared to the corresponding period in 2022, which is likely to diminish the proceeds from Goods exports.

In H2:2023, we hold the view that the Naira's devaluation resulting from the exchange rate unification implemented by the new administration will act as a



catalyst for the growth of Goods export proceeds. We are confident that the introduction of a more flexible exchange rate system will attract heightened foreign investor interest in the Nigerian economy, thereby contributing to a substantial upswing in the various sub-segments of the Current Account.



## Currency

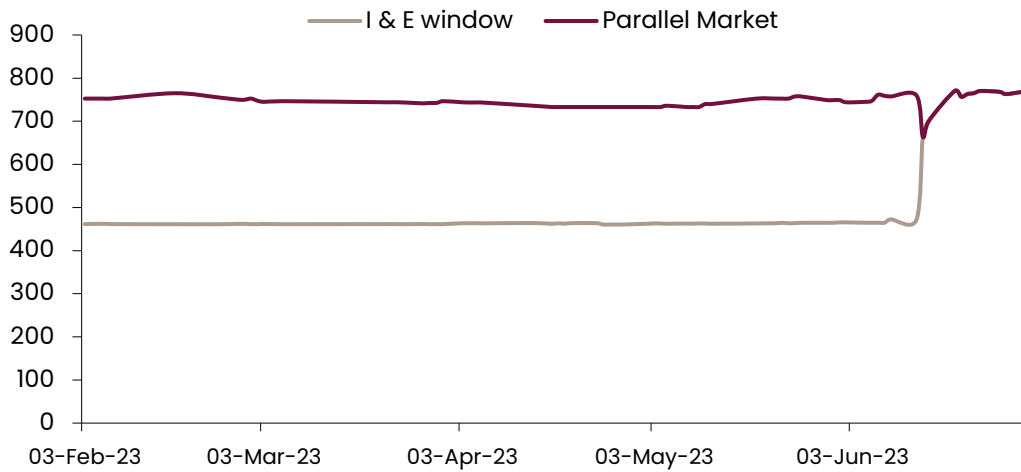
### FX Reforms: A House Cleaning

Upon the inauguration of the new government, swift policies were passed which includes collapsing all its official rates into the Importers and Exporters (I & E) rate. While this was a reform objective in the manifestos prior to the elections, the speed at which it was implemented struck as a positive surprise to many. The reform also sees the suspension of the former CBN governor, Godwin Emefiele, who was generally criticized for his unorthodox policies. Shortly before the rate convergence, the I & E rate was quoted at NGN471.67/USD on the official market and the parallel market rate at NGN760.00/USD or a NGN288.30 (61.13%) premium. The removal of the Naira peg gives rise to a rate convergence and bodes well for the economy as banks can now freely bid for FX on a “willing buyer, willing seller” principle. After the peg was removed, the official rate closed at NGN664.00/USD before overshooting the parallel market rate a few days later. Subsequently, as of 7<sup>th</sup> July 2023, the exchange rate was quoted at NGN776.90/USD at the I & E window. As a result, the CBN discontinued the RT200 Rebate Scheme and the Naira4Dollar Scheme, which were initially introduced to improve inflows at the official exchange rate window. Interestingly, while the CBN has taken the bold steps toward gradually clearing its FX backlog by prioritizing committed FX forward transactions, it has maintained status quo regarding the forty-three (43) restricted items at the I & E window. To further improve FX liquidity, the CBN granted ordinary domiciliary account holders unfettered access to their cash balances. Account holders are now allowed to access their funds of up to a USD10,000 cap per day.





Chart 41: Analysis of Exchange Rate Convergence



Source: FMDQ, ARM Research

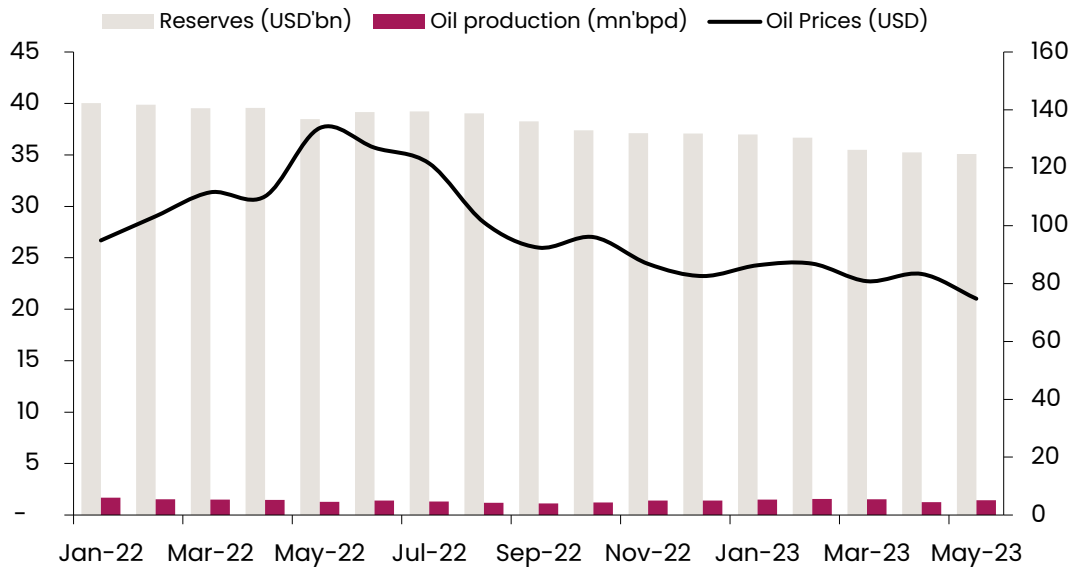
**FX Policy Overhaul: A New Era or a False Dawn?**

While a flexible exchange rate policy is critical for growth in emerging markets with relatively shallow reserves, a transformative policy agenda must follow, else it remains all for naught. Based on further scrutiny, we observe that the foreign reserves have declined 12.86% YoY as of 30<sup>th</sup> June 2023 to USD34.12bn. In that same period, Brent crude oil prices have declined by 33.74% YoY to USD75.41 in June 2023. In terms of oil production, average crude oil production in 2023 declined by 3.00% to 1.45MMbpd as of May 2023 (vs. a 1.49MMbpd average in May 2022). FX Remittances as a percentage of GDP show a similar trend with World Bank estimates putting the number at 4.20% in 2022, a 20bps decline from 4.40% recorded in 2021. Looking at the trade data from the National Bureau of Statistics (NBS), crude oil exports which represent over 80% of Nigeria’s FX earnings and over 79% of exports declined by 8.40% YoY in Q1:2023. From this we can infer that FX earnings have declined over time, giving reason to believe that



increasing demand for FX against a backdrop of lower supply would put increased pressure on the foreign reserves, supporting devaluation prospects. On the balance of factors, we expect that the Naira at the official window would weaken to a range of **NGN780/USD to NGN830/USD** in 2023.

Chart 42: Analysis of FX Reserves, Oil production and Oil Prices

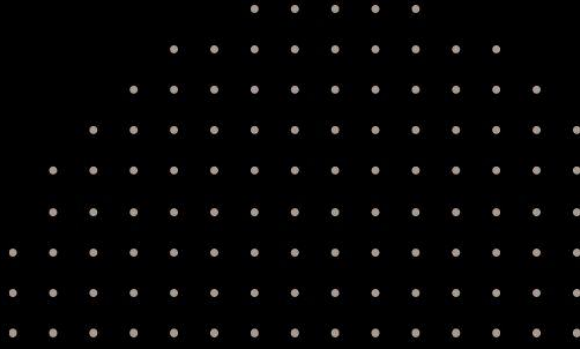
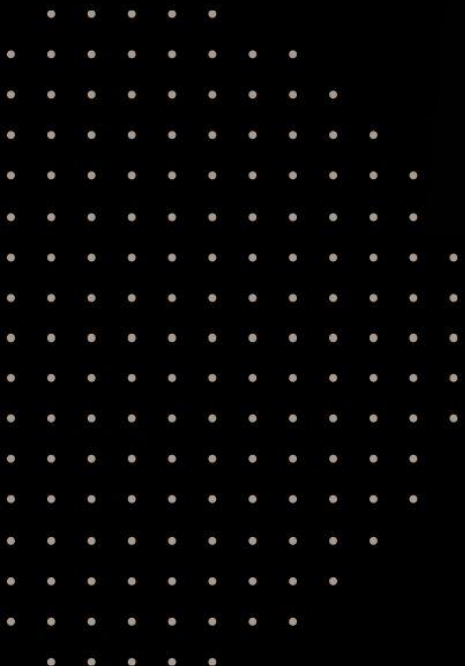


Source: CBN, NUPRC, ARM Research





DOMESTIC  
CAPITAL  
MARKET



## Capital Market

### Equities – A Bullish Takeover: Nigerian Bourse Hits a 15-Year High

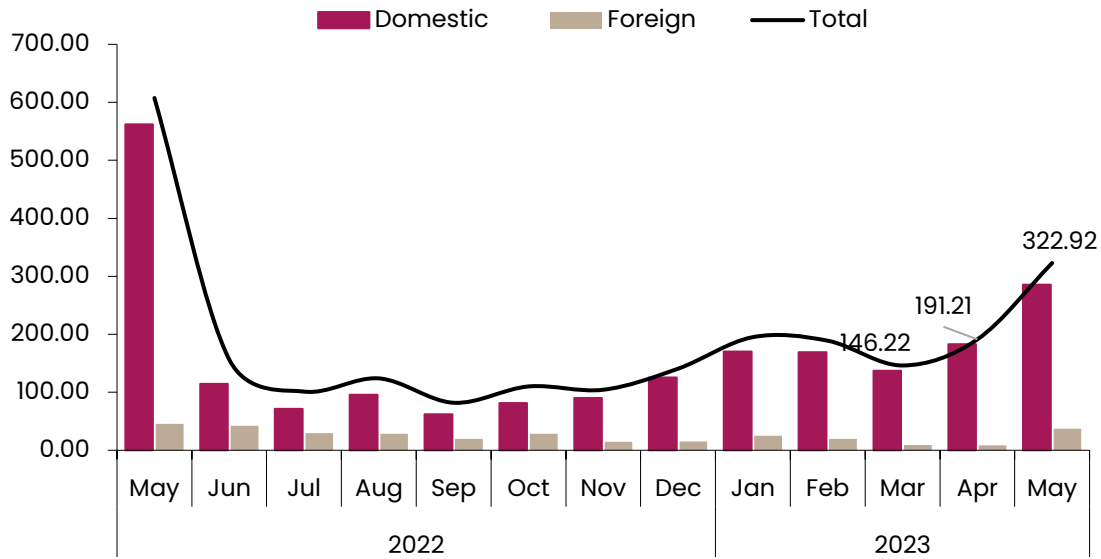
The Nigerian equities market witnessed a bullish era in H1:2023. Despite the impacts of the banking crisis that heralded major economies, The Nigerian equities market remained buoyant amid the storm. We opine that this is on the back of

- a. Sustained January rally
- b. The impact of market rallying events that unfolded in the quarter (e.g., the Transcorp acquisition saga between Femi Otedola and Tony Elumelu)
- c. Mixed sentiments following the release of 2022FY and Q1:2023 earnings result.
- d. Lower yields in the fixed income market amid robust liquidity in the market
- e. Pro-market remarks by the new President during the inaugural speech.

In our H1:2023 outlook, we highlighted factors such as corporate earnings performance, fixed Income yields direction, external conditions, hunt for dividend and exchange rate directions that we believed will chart the course of events for the year. Staying true to our expectations, these factors impacted the performance of the equities market during the first half of the year.



Chart 43: Trend Analysis of Domestic and Foreign Investors Participation on the NGX from Jan to May 2023



Source: NGX, ARM Research

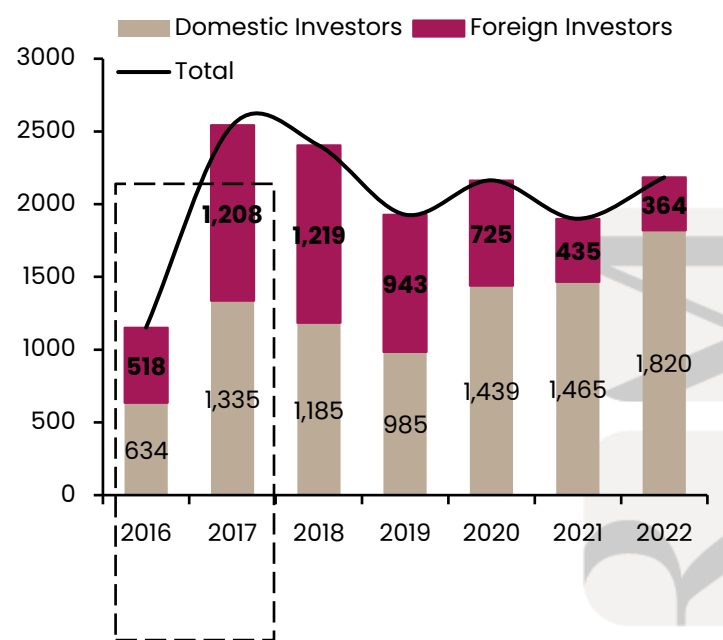
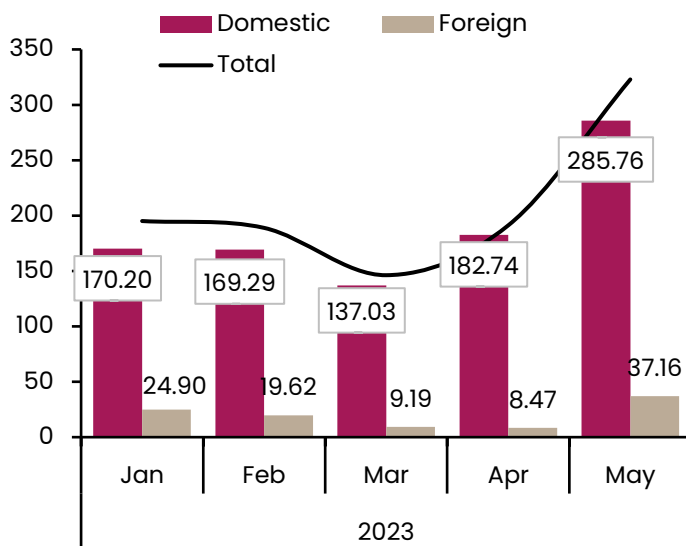
For context, a prolonged January rally and lower yields in the fixed income market bolstered the performance of the local bourse between January (+3.88% YtD returns) and February (+8.89% YtD returns). However, the 50bps hike in interest rate by the MPC of the CBN and mixed sentiments that trailed 2022FY earnings result slowed the performance of the bourse in March (+7.02% YtD returns). The NGX ASI further dipped to 2.25% in April amid elevated yields in the Fixed income market and below expectation Q1:2023 earnings result. However, in May, following the president’s remark on the inauguration day, we saw a substantial surge of 5.22% on May 30th, 2023, marking the most substantial single-day trading gain since November 12th, 2020, when it recorded an impressive ascent of 6.23%. As a result, the NGX performance soared to 8.82% YtD.

June witnessed a notable shift in the FX market as the Nigerian Naira was floated, leading to a significant surge in the equities market's year-to-date



performance of 18.96%. We attribute this growth to increased participation from foreign investors who sought a liberalized FX system that facilitates easy and seamless fund repatriation. Our prognosis is based on the impact of a similar event in the Nigerian market, highlighting the positive effects of the policy transition. On April 21<sup>st</sup>, 2017, the CBN introduced the I&E window, as a result, the Foreign Portfolio Participation rose by 240.48% MoM to NGN110.42bn while Foreign Portfolio Inflow surged by 403.09% MoM to NGN73.15bn in May 2017. By 2022FY, Foreign Portfolio participation surged by 133.20% to NGN1.33trn while total transaction on the bourse soared by 120.75% to NGN2.54trn. Anticipating a similar trajectory, we foresee the liberalization of the FX market exerting a substantial influence on driving Foreign Portfolio Investment (FPI) into the equities market this year.

**Chart 44: Trend Analysis of Foreign and Domestic Participation Between Jan and May 2023**      **Chart 45: Trend Analysis of Foreign and Domestic Investors Between 2016FY – 2022FY**

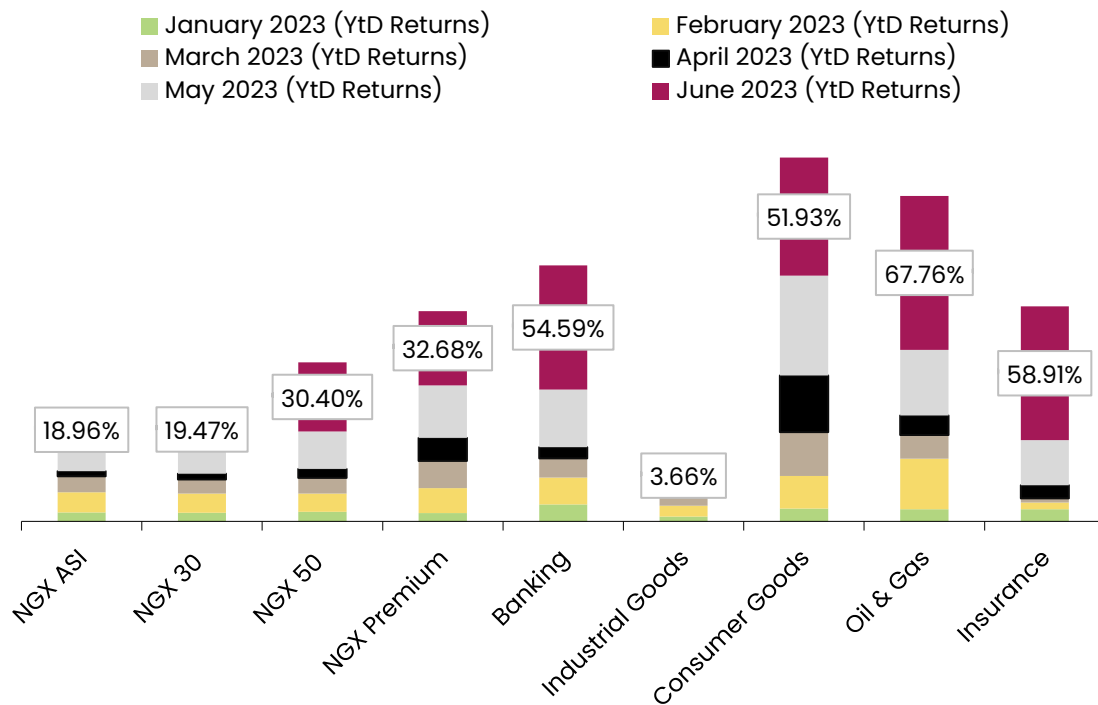


Source: NGX, ARM Research

**Sectoral Performance – The Bulls Reign Supreme Across all Board**

During H1:2023, all sectors demonstrated positive performance, driven by improved sentiments and increased buying interest on the exchange. Notably, the Nigerian Bourse witnessed gains on 72 out of the 120 trading days, with a market breadth of 0.6x, reflecting the overall positive market sentiment. The Oil and Gas sector led the charge with 67.76% YtD returns, followed by Insurance (+58.91% YtD), Banking (+54.59% YtD), Consumer Goods (+51.93% YtD) and the Industrial Goods (+3.66% YtD) sector.

Chart 46: Sectoral Performance of the Nigerian Bourse in H1:2023



Source: NGX, ARM Research



**Consumer Goods Sector – Seeking Gems in Murky Terrains**

The Consumer Goods sector witnessed a bullish performance throughout H1:2023, driven by stronger-than-anticipated earnings for 2022FY and increased investor interest in dividend-paying stocks. Despite cash constraints, election uncertainties, and elevated inflation, the sector achieved a notable 51.91% (YtD) return in H1:2023. Tickers such as BUAFOODS (+108.85% YtD to NGN135.75), GOLDBREW (+106.17% YtD to NGN1.67), PZ (+93.83% YtD to NGN22.00), NASCON (+68.47% YtD to NGN18.70), and DANGSUGAR (+55.76% YtD to NGN25) enhanced the sector's growth. **We believe the current price trajectory does not bode well for the consumer goods sector. We base this position on the sustained erosion of purchasing power, the muted growth in household income, and the seeming difficulty that would be encountered if any other price adjustment is embarked upon.**

**Oil and Gas Sector: Subsidy Removal – The Beginning of a New Dispensation**

The Oil and Gas sector had an impressive finish to H1:2023, achieving a remarkable 67.76% YtD return. This outstanding performance can be attributed to significant sectoral developments. Specifically, the President's announcement on May 29th regarding subsidy removal garnered substantial investor interest. Investors had long advocated for subsidy removal to enhance transparency and facilitate business operations in the sector. Furthermore, the implementation of the Petroleum Industry Act (PIA) served as an additional catalyst, instilling greater confidence among investors in the sector. As a result, the sector saw significant traction in the month of June. Tickers such as MRS (+460.28% YtD to NGN79.00), ETERNA (+213.90% YtD to NGN21.00), CONOIL (+213.21% YtD to NGN83.00), TOTAL (+81.35% YtD to NGN350) were the major





drivers of growth in the sector. We foresee a sustained rally in the sector in H2:2023. We base our prognosis on the factors listed below.

- A. The removal of subsidy is expected to drive FPI and FDI into the Nigerian economy with a significant number of these investors looking into the Oil and Gas sector.
- B. The unification and liberalization of operation in the FX market will enhance ease of doing business and repatriation of funds in the Oil and Gas sector.

### **Banking Sector: Galvanized by the Passing of the Torch**

The Banking sector witnessed a mix of trends in H1:2023. Having to deal with incessant CRR debits, hawkish monetary policies, global banking crisis, and the impacts of default on Ghana debt securities. To put into perspective, in Q1:2023, the emergence of the global banking crisis and Ghana defaulting on its debt obligations sent negative sentiments towards banking tickers. However, the removal of the past CBN governor, Mr Godwin Emefiele, and changes made to the operations in the FX market provided succour for the sector. Despite these domestic and external woes, the sector was able to close on a bullish note (+54.59% YtD). Tickers such as ACCESSCORP (+95.29% YtD to NGN16.60), GTCO (+52.17% YtD to 35.00), FBNH (+56.45% YtD to NGN17.05), ZENITHBANK PLC (+42.71% YtD to NGN34.25), UBA (+61.18% YtD to NGN12.25), STERLNBANK (+140.00% YtD to NGN3.36), UNITYBNK (+114.55% YtD to NGN1.18), STANBIC (+61.45% YtD to NGN54.00), FIDELITYBK (+60.92% YtD to NGN7.00), and were the major drivers of the sector's growth. Looking ahead, we posit that the future bodes well for the Banking sector as we expect 1) More foreign investors' participation on the local bourse with a chunk of these investors hunting tickers in the banking sector.



2) We believe that the recent policy changes will drive traction towards the space.

### **Insurance Sector: A Remarkable Upswing in the Final Stretch**

The Insurance sector witnessed a notable turnaround in June 2023. After experiencing modest year-to-date gains from January to May 2023 (ranging from 1.81% to 19.88%), the sector's performance surged to 58.91% YtD (the second highest sectoral performance), driven by strong 2022FY earnings and the general market rally in June. Commendable performance from various tickers such as LASACO (198.85% YtD to NGN2.60), WAPIC (+107.50% YtD to NGN0.83), MANSARD (+97.50% YtD to NGN3.95), MBENEFIT (+96.30% YtD to NGN0.53) and CORNERST (+83.33% YtD to NGN1.10). We foresee sustained growth momentum in the sector in H2:2023.

We anticipate sustained growth momentum in the sector throughout H2:2023. Our projections are based on several factors contributing to improved earnings during this period, including:

- a. Increased opportunities for securing new insurance contracts from the public sector.
- b. Implementation of initiatives such as the bancassurance model, enabling partnerships between insurance operators and the banking industry to expand their presence in the retail market.
- c. The increase in premium rates by NAICOM, with the basic premium increasing from NGN5,000 to NGN15,000 for private motors, NGN20,000 for staff buses, and NGN100,000 for commercial trucks/general cartage.



**Industrial Goods Sector: A Subpar Performance**

The Industrial Goods sector experienced a varied performance influenced by a combination of electioneering activities, cash constraints, heavy rainfall, and Q1:2023 earnings falling short of expectations. We believe that these factors created conflicting signals for investors, resulting in selloffs of major players' stocks within the sector. WAPCO (+22.92% YtD at NGN29.50) and DANGCEM (+9.20% YtD at NGN285) concluded on a positive note, while BUACEMENT (-5.63% YtD at NGN92.25) faced a downturn. *Moving forward, we anticipate an enhanced performance in the sector during H2:2023. Our outlook is supported by the expectation of improved earnings resulting from the resumption of paused projects and the complete recovery of the economy from the effects of cash constraints and the economic slowdown induced by election activities. Furthermore, we expect improved buying interest in tickers like DANGCEM and Lafarge (WAPCO).*

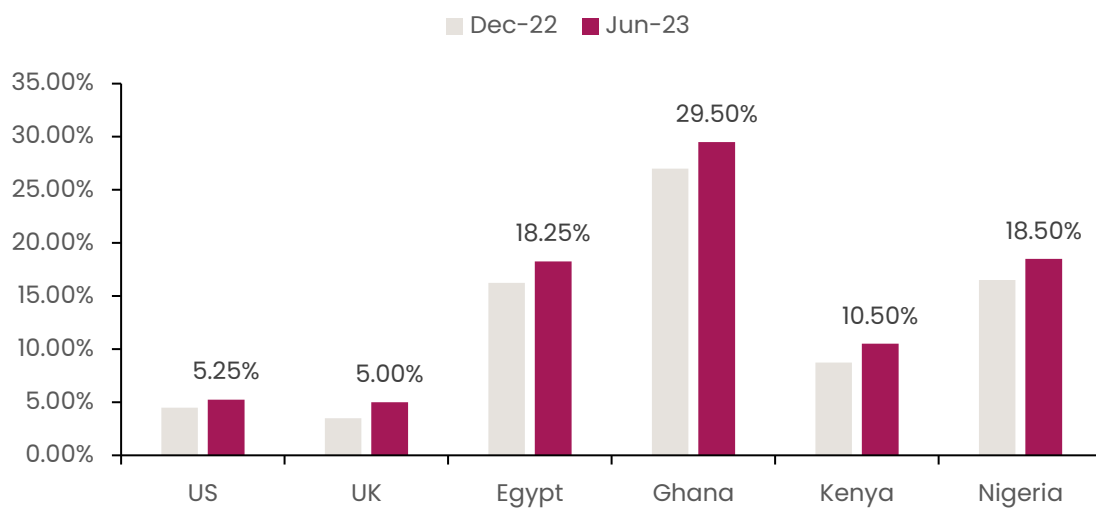


### HI:2023 Fixed Income Market: A Shift in Regime?

Like 2022FY, systemically important central banks across the globe continued cutting back on excesses in monetary funding and hiking benchmark rates in HI:2023, as taming inflation remained their primary objective. In Advanced Economies (AEs), the US Fed has raised interest rate by a total 75bps to 5.25% in the HI:2023, while the Bank of England (BOE) followed suit, hiking rate by a total 150bps to 5.00% at its latest meeting.

In Africa, we notice a similar narrative with Egypt (+200bps), Kenya (+175bps), and Ghana (+250bps) all raising rates. The Central Bank of Nigeria (CBN) towed the part of its peers and raised the MPR by 200bps to 18.50% to curb escalating prices. However, marginal rates at the primary fixed income market responded mostly to liquidity levels in the period, signalling the almost non-existent indicative effect of the MPR in the market.

Chart 47: Policy Rate Movement in AEs and Select African Countries in HI:2023



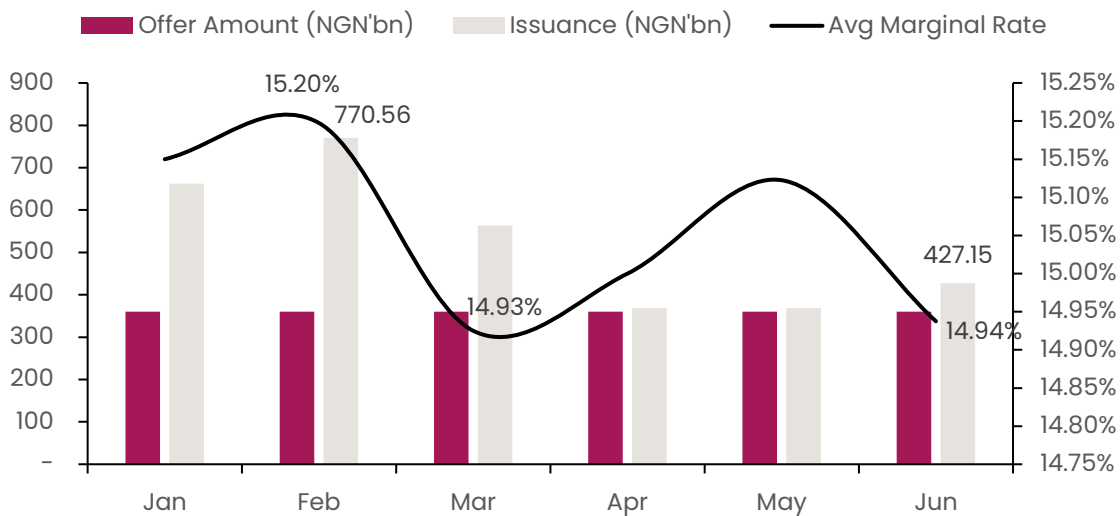
Source: Bloomberg, ARM Research



Like the experience in the domestic Fixed Income (FI) market in H2:2022 when FI yields surged, yields inched higher by 45bps in the first half of 2023. This is due to bearish sentiment in the Treasury Bills market (+96bps in average yields). However, the bond market closed H1:2023 on a slightly bullish note (-6bps).

In the primary bond market, increased liquidity fuelled demand in the first quarter of the year with an average bid-to-cover ratio of 2.41x, with softening implications for marginal rates (-88bps) in Q1:2023. However, demand began to thin out in Q2:2023 evidenced by a lower bid-to-cover ratio of 1.44x. Overall, in H1:2023, demand was higher with a bid-to-cover ratio of 1.93x compared to 1.21x in H2:2022. Similarly, average stop rate increased to 15.06% in H1:2023 compared to 14.24% in H2:2022.

Chart 48: Trend in Bond Issuances and Marginal Clearing Rates (2023)

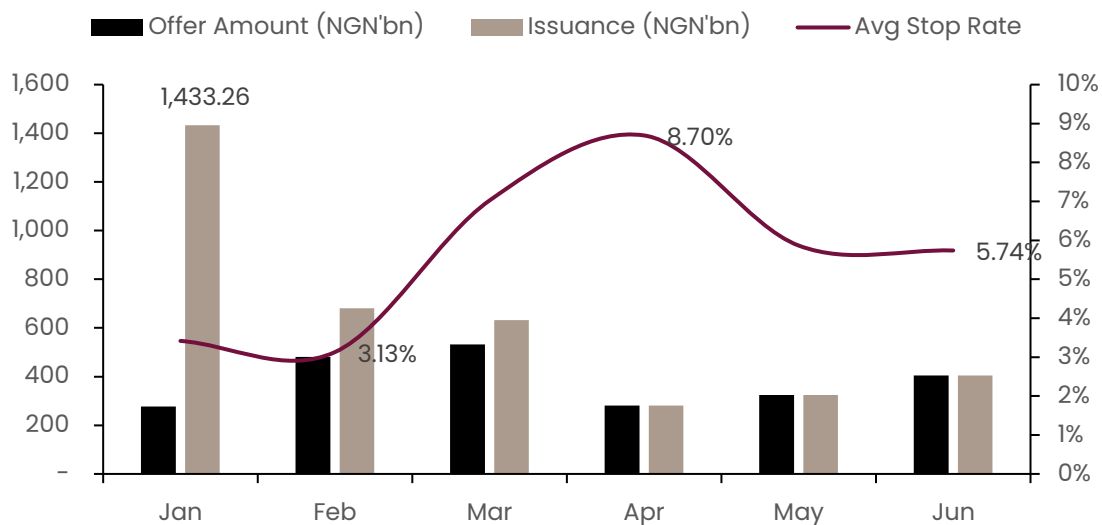


Source: DMO, ARM Research



Elsewhere, demand in the T-Bills primary market was robust at 5.78x in January before decelerating to 3.00x in February 2023 and peaking at 5.62x in June 2023. Average stop rate hovered around 8.70% levels in April 2023 on the back of tighter liquidity conditions. However, in June 2023 the average stop rate decreased to 5.74% following the influx of financial system liquidity, an offshoot of the normalization of CRR across banks in June 2023. This is following the policy changes implemented by the CBN after the ousting of the former CBN Governor, Mr Godwin Emefiele. Overall, for H1:2023, average bid-to-cover ratio stood at 4.13x (vs. 1.93x in H2:2022), signalling higher demand. Consequently, average stop rate decreased to 5.75% in H1:2023 (vs. 7.43% in H2:2022).

Chart 49: Trend in T-bills Issuances and Average Stop Rates (2023)



Source: CBN, ARM Research

We saw elevated supply of bonds from the Federal Government (FG) in H1:2023 as instruments worth NGN3.16trn were sold compared to NGN1.20trn sold in H2:2022. This makes sense, considering the approved budget deficit for 2023 and the government’s deliberate effort to stay clear of the Eurobonds market.



Budget deficit is projected at NGN10.78trn and the share of domestic borrowing is NGN7.04trn. In the first half of the year, net bond sales by DMO (adjusted for the NGN735.96bn maturing bond from APRIL 2023 instrument) totalled NGN2.42trn. Combined with the net sales of Treasury Bills of NGN1.46trn implies a total domestic borrowing of NGN3.88trn.

### **Outlook for H2:2023: Yields to Taper as Liquidity Stays Buoyant amid CBN's Shift to Orthodox Policy**

Going by the books with respect to domestic issuances, the Federal Government (FG) is expected to borrow a balance of NGN3.16trn in H2:2023 based on budget. Nonetheless, historical trends reveal that domestic borrowing may overshoot the budget deficit, especially considering the bearish outturn in the Eurobonds market.

As highlighted in our H1:2023 outlook, debt maturity (and hence, liquidity) profile for H2:2023 lies below that of H1:2023 and coupled with an expected increase in domestic borrowing, rates should naturally see increase in H2:2023. However, we witnessed a U-turn in policy statements by the CBN following the suspension of the former CBN Governor. Hence, CBN began normalization of CRR, boosting the bank's liquidity. Consequently, we saw financial system liquidity close at NGN1.18trn on the 30<sup>th</sup> of June 2023, the highest level since 6<sup>th</sup> of January 2023. In terms of Monetary Policy Rate, we believe the MPR has lost its indicative effect in the market and adjustments to the rate should hardly dictate market trend.

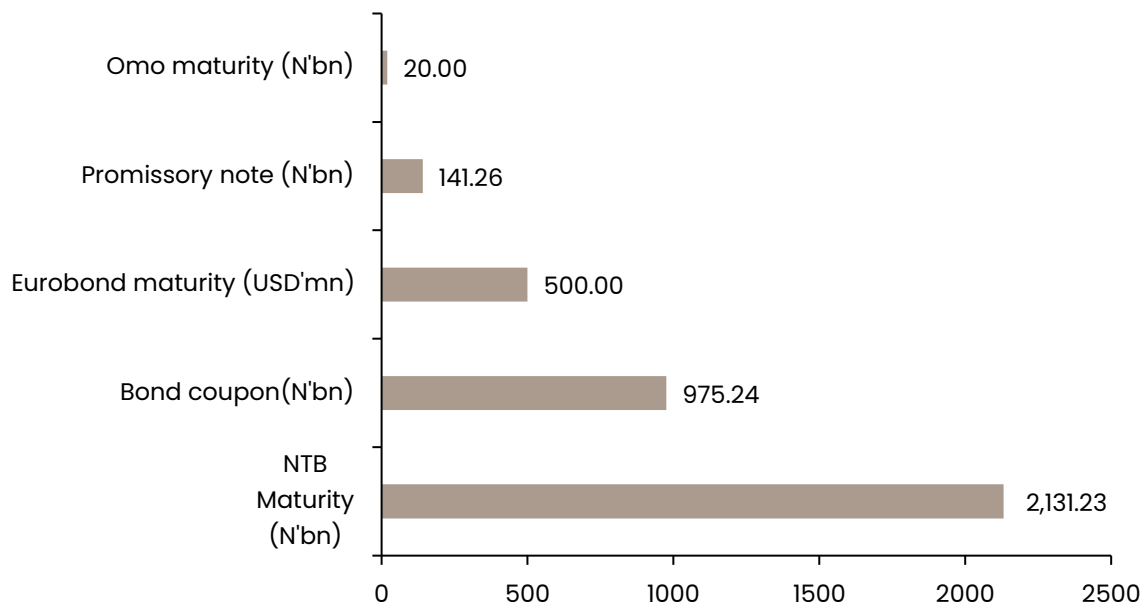
**Overall, we expect average FI yields to taper in H2:2023.** Our prognosis rests on the continued drive of the CBN to shift away from the unorthodox policies. In



this light, we opine that the CBN could allow the special bills issued to bank to mature. It is also key to note that following the securitization of the Ways and Means balances, the government has received approval for the increase of Ways and Means to 15% of the previous year's revenue (formerly 5%). We opine that FG would maintain its use in H2:2023.

A downside risk to our expectation would be if the CBN hold off on allowing the special bills to mature amid elevated government's borrowing.

Chart 50: H2:2023 Maturity Profile



Source: ARM Research





## Capital Market Strategy

### Equities Market Strategy

In H1:2023, the performance of the NGX far-eclipsed consensus analyst expectations, with bull runs driving year-to-date (YTD) returns to double digits. The instantaneous change in policy stance of the new monetary and fiscal authorities appears to have brewed strong optimism among players in the equities market. Thus, we expect the following factors to influence market direction in H2:2023:

1. Corporate Earnings Performance
2. Fixed Income yields direction
3. External Conditions
4. Hunt for Dividend
5. Exchange rate directions
6. Government Policies

For H1:2023, we held that these same factors combined with the expected election related market tilts would significantly influence market performance in the period. This was consistent with the outcome as the major gains were recorded following significant policy reforms like the exchange rate unification by the new government which triggered market opportunities. In H2:2023, we opine that a fiscal revamp and pro-business policies, as well as increased foreign investor participation would support a positive equity performance. We believe that the direction of fixed income yields would continue to play a significant role in the direction of the Nigerian Stock Exchange given the liquidity awash in the market, following CRR debit refunds and seeing as we expect an



influx of a Eurobond maturity of USD500mn and domestic debt maturities of NGN2.29trn in H2:2023. This would likely lead to lower yields leading retail and institutional investors alike to increase allocation into equities in H2:2023 for diversification. In the same breadth, we expect to see some market driven events fueling demand which inadvertently could make way for speculative long interest in some tickers believed to outperform. However, we maintain our view that the logical flow for investments now is in value tickers with good fundamental backings. Our sector recommendations include the - **Banking, Oil and Gas, and Industrial Goods**.

We also opine that opportunities abound for tickers that have decent dividend payment history. Here for us is one of the factors alongside solid corporate earnings, and attractive valuation that makes for the best proposition in H1:2023.

### **Fixed Income Strategy**

We expect a reversal in the direction of yields in H2:2023 as yield curves steepen. In H2:2023, we expect that the yield trajectory would be determined by a host of factors such as:

1. Monetary Policy Rate Direction: We envisage that there would be a slowdown in rate hikes (50bps) with the CBN undertaking a continuous assessment of the impact of previous rate hikes.
2. Inflation Rate: Our expectation for inflation by December 2023 is a headline inflation of 25.63% YoY for a base case and 26.50% YoY for a bear case. Given the current benchmark rate, potential negative real rates may discourage



foreign investors from bringing in capital and making a case for higher risk premiums.

3. Maturity Profile and Financial System Liquidity: In H2:2023, we expect a Eurobond maturity of USD500mn and domestic debt maturities of NGN2.29trn to buoy financial system liquidity. These inflows should support a further downward trend in the yield curve.

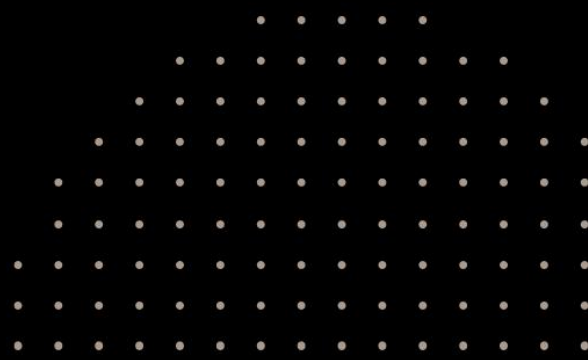
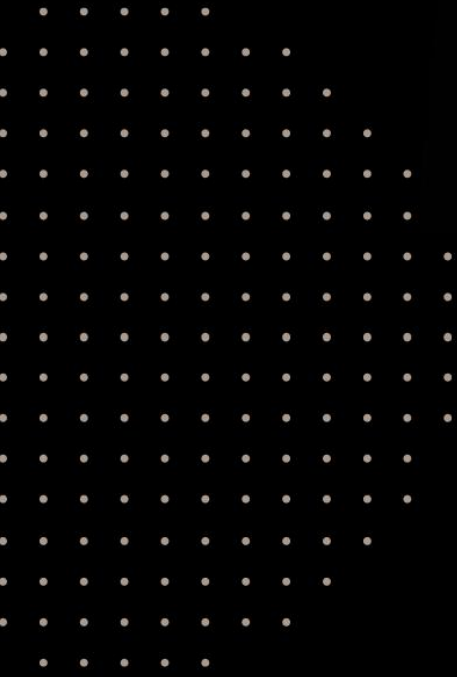
Overall, we opine that yields would taper following the liquidity windfall from CRR refunds and bond maturities in H2:2023. We recommend investors should stay Long on the mid to long end of the yield curve to benefit from Market to Market and Held to Maturity positions.

We note that given the policy statements by the Presidency in announced manifestos, a reversal to the ousted CBN Governor's unorthodox policies is unlikely. Thus, a risk to our outlook is a scenario where the government seeks to address prevailing fiscal imbalances through Eurobond issuances or IMF funding, rather than improved revenue generation, which may lead to a possible credit tightening.





# ESG REPORT



## Sectoral Report on Environmental, Social and Governance (ESG)

In today's rapidly changing global landscape, Environmental, Social, and Governance (ESG) factors have emerged as crucial considerations for companies and investors alike. The recognition of ESG risks and opportunities has grown significantly, as it has become clear that these factors can have profound impacts on the financial growth of companies and the surrounding environment. By analysing the activities within different sectors, investors can gain valuable insights into the ESG issues that may arise from them.

ESG factors include a broad range of considerations that go beyond conventional financial metrics. For Environmental risks, these include issues around greenhouse gas (GHG) and air emissions, energy consumption and management, waste and wastewater generation, hazardous materials management and habitat alterations and ecological impacts. Social risks include human rights and community relations, human capital management, customer and data privacy, access and affordability, product quality and selling practices and product labelling. On the area of governance, we consider business ethics, competitive behaviour, management of legal and regulatory environment, critical incident risk management and systemic risk management.

### Oil and Gas Sector: High Risk

#### Environmental Risks

The Nigerian oil and gas industry operates across three key sub-sectors: upstream, midstream, and downstream. Since the discovery of oil in 1956, this sector has experienced significant growth.



The industry, however, has faced several environmental challenges over the years during the processes of production, refining, and distribution. These issues are primarily related to the emission of greenhouse gases, water pollution, and energy management. They arise from accidental spills, deliberate acts of vandalism, or a lack of proper maintenance. To provide context, according to data from the National Oil Spill Detection and Response Agency (NOSDRA), Nigeria recorded a total of 4,919 oil spills between 2015 and March 2021, resulting in a loss of 235,206 barrels of oil.

In the early years, there were no comprehensive policies regulating oil exploration and production in Nigeria. The government's focus was primarily on maximizing the exploitation of natural resources for rapid economic development.

However, in 1988, the Federal Government of Nigeria enacted the Harmful Waste Decree of 42, which facilitated the establishment of the Federal Environmental Protection Agency (FEPA). Subsequently, in 1989, the National Policy on the Environment was introduced, outlining goals for securing and conserving the quality of the environment to safeguard the health and well-being of present and future generations.

Furthermore, in 1992, the Environmental Impact Assessment (EIA) Act was enacted to ensure that the potential effects of any economic activity are assessed before implementation. In addition, the Petroleum Industry Act (PIA) 2021 was signed into law in August 2021 by the Federal Government of Nigeria. This Act was designed to provide legal, governance, regulatory and fiscal framework for the Nigerian petroleum industry and the development of host communities.



The operational activities of the oil industry in Nigeria have potential to significantly contribute to environmental pollution and degradation and pose risks to human health. It is, therefore, crucial to subject this industry to EIA, environmental monitoring, and audits to address these challenges adequately.

### **Social Risks**

The oil and gas sector poses significant social risks, particularly concerning human and community relationships and the safety and health of its workers. Generally, for many years, the relationship between oil companies and the communities that host them has been strained and this has led to both riots and legal actions.

Both onshore and offshore operations within this industry entail high levels of occupational health risk. Unfortunately, many of these industries have witnessed accidents due to poor safety culture and inadequate safe work operating procedures. The resulting occupational injuries and illnesses impose an economic and human burden, making worker safety a major concern. Various hazards and risks confront employees in the oil and gas sector, including chemical, physical, biological, ergonomic, and psychosocial hazards associated with the nature of their work or the locations where they operate.

To address these risks, the oil and gas industry is subject to various safety regulations, such as the Petroleum Industry Act (PIA). Some reported safety practices within the sector include the availability of alarm systems, the use of personal protective equipment (PPE), effective safety information communication, designated emergency assembly points, visitor safety training, equipment integrity, the provision of first aid kits, firefighting



equipment, dedicated safety officers, ignition control systems, and detection systems.

Implementing robust safety cultural practices yields numerous benefits, including increased productivity, prevention of asset losses, reduced downtime, decreased workers' compensation claims, and improved employee morale. The smooth operation of high-risk oil and gas activities heavily relies on the implementation of sound safety practices.

### **Governance Risks**

The oil and gas sector is highly susceptible to a range of internal and external risks, which can significantly impact the operations and reputation of companies within the industry. External risks often stem from actions taken by external parties, such as the communities that host these companies. These communities may resort to legal action against oil and gas companies for various reasons, such as environmental pollution, land disputes, or social concerns. Such legal actions can result in financial liabilities, damage to reputation, and strained community relations.

Internally, companies may face legal actions initiated by their own employees. These lawsuits typically arise when health and safety policies are not adequately implemented, leading to accidents, injuries, or occupational health issues. Failing to prioritize the well-being of employees can result in legal consequences, including compensation claims and reputational damage.

It is important to recognize the growing significance of environmental, social, and governance (ESG) factors in the investment landscape. Investors are increasingly seeking to invest in companies that align with ESG principles, including robust governance practices. Ongoing lawsuits and legal disputes





against a company can deter investors, as they perceive such risks as indicative of poor governance and potential financial liabilities. Consequently, a company's image and reputation may suffer, impacting its ability to attract investment and maintain positive stakeholder relationships.

To mitigate these risks, companies in the oil and gas sector must prioritize compliance with environmental regulations, engage in transparent and accountable governance practices, and actively address social concerns. By implementing robust ESG frameworks and effectively managing legal risks, companies can safeguard their reputation, attract investors, and demonstrate their commitment to sustainable and responsible business practices.

### **Financial Sector: Medium Risk**

#### **Environmental Risks**

It is a common misconception that financial institutions bear little or no responsibility for protecting the environment. However, this view overlooks the crucial intermediary role that financial institutions play in society. While they may not directly contribute to environmental pollution, they indirectly impact the environment through their financial relationships with companies engaged in environmentally detrimental activities. For instance, when financial institutions provide loans to businesses or customers involved in activities that contribute to environmental degradation, they indirectly contribute to environmental pollution. Additionally, when financial institutions fund or associate with large-scale projects that have significant environmental impacts, they put the environment at risk.

However, financial institutions can impact the environment and climate in a direct manner. This can be by promoting or utilizing renewable power



generation, reducing business travels, and adopting green building standards for operating and maintaining facilities and buildings.

Recognizing the important role of the Nigerian financial sector in environmental protection, the Central Bank of Nigeria (CBN), in 2012, collaborated with the Bankers' Committee to establish a sustainable banking framework called the Nigerian Sustainable Banking Principles (NSBPs). This framework outlines principles that guide financial institutions in supporting sectors such as agriculture, power, and oil and gas in a sustainable manner.

One of the key principles within the framework emphasizes the integration of environmental and social considerations into the decision-making processes of financial institutions. This integration aims to avoid, minimize, or offset negative environmental and social impacts resulting from their business activities.

The implementation of the NSBPs has increased awareness among banks regarding the importance of protecting the environment. This awareness has led to initiatives such as the automation of environmental and social risk management, the adoption of waste management practices, and the implementation of energy efficiency measures.

By embracing sustainable banking practices and considering environmental and social factors in their operations, financial institutions can contribute to the preservation of the environment while still fulfilling their crucial role in the economy.



## Social Risks

The Nigerian financial sector faces various social risks, including human rights infringements, issues of access and affordability, employee engagement, diversity and inclusion, and customer privacy and data protection. Fortunately, the Nigerian Sustainable Banking Principles (NSBPs), established through the collaboration of the Central Bank of Nigeria (CBN) and the Bankers' Committee, provide sustainable guidelines for financial institutions to operate with.

The third principle of the NSBPs emphasizes that financial institutions should respect human rights in their operations, highlighting the importance of banning discrimination against customers based on race, gender, culture, politics, or economic background. In 2022, some Nigerian banks were involved in discriminatory practices regarding the acceptance of payment cards issued by other Nigerian banks. To address this, the CBN issued a circular in December 2022, warning financial institutions to cease this discriminatory behaviour or face appropriate regulatory sanctions.

Furthermore, Principle four (4) encourages financial institutions to embrace gender inclusivity in the workplace. This includes empowering women, promoting women in senior roles, and offering women-specific products. While the CBN set a goal in 2012 for banks to achieve a minimum of 40 percent female representation at top management and 30 percent at board level by 2014, progress has been limited. As of 2021, only 21.3 percent of women had attained top management positions in banks, and only five banks had met the 30 percent threshold for women in board positions. Additionally, only four banks have female Chief Executive Officers (CEOs) as of 2023, highlighting the continued struggle for gender diversity in Nigerian financial institutions.



Principle five (5) of the NSBPs focuses on promoting financial inclusion and extending financial services to individuals and communities that traditionally have limited or no access to the formal financial sector. However, despite efforts, a significant portion of the Nigerian population remains unbanked, with limited access to financial services. A 2020 study by Enhancing Financial Innovation and Access (EFIA) revealed that only 45 percent of Nigerians had access to financial services, with rural areas experiencing even lower levels of banking and financial inclusion.

Customer and data privacy also present social risks for the financial sector. The CBN Cybersecurity Guidelines of 2018 regulate data collected by financial institutions and provide guidelines for protecting customer data. Recently, the Central Bank introduced the Open Banking Operational Guidelines, making Nigeria the first African country to implement such guidelines. While open banking allows institutions to share customer data with consent, it raises concerns regarding data safety. The Central Bank has implemented policies within the Open Banking Guidelines to ensure data security. However, according to the Nigeria Deposit Insurance Corporation (NDIC) in 2021, banks lost NGN7.19bn to fraud, with internet banking fraud at NGN1.83bn and mobile banking fraud at NGN1.26bn. This indicates the need for the Nigerian financial sector to enhance measures for securing customer data and funds.

Overall, addressing these social risks requires continued commitment from financial institutions to adhere to the NSBPs, promote inclusivity, protect customer data, and work towards improving access to financial services for all Nigerians.



### **Governance Risks**

The Nigerian financial sector is exposed to governance risks, which, in turn, contribute to systemic risks within financial institutions. The CBN data reveals that from 1998 to 2018, fifty-three (53) banks were closed down and had their licenses revoked. The Nigeria Deposit Insurance Corporation (NDIC) reports that many bank failures stem from significant insider abuses by executives and owners, insufficient risk management practices, poor corporate governance, and inadequate regulatory and supervisory measures.

Addressing these governance risks is crucial for restoring trust in the financial sector, safeguarding the interests of customers and investors, and promoting a resilient and sustainable financial system in Nigeria. It requires a collaborative effort from all stakeholders, including regulators, financial institutions, and industry professionals, to implement robust governance structures and ensure strict adherence to ethical standards and best practices. Only through these measures, can the Nigerian financial sector mitigate systemic risks and foster long-term stability and growth.

### **Consumer Goods Sector: Medium Risk**

#### **Environmental Risks**

Like the oil and gas sector, the consumer goods sector is subject to environmental risks such as greenhouse gas (GHG) emissions, waste and wastewater management and energy management. There is a growing recognition of the need to reduce carbon footprints. Nigerian consumer goods companies are investing in renewable energy projects, such as solar panels and wind turbines, to power their operations and decrease reliance on fossil fuels. Additionally, initiatives aimed at improving energy efficiency and



optimizing supply chains are being implemented to minimize energy consumption and associated emissions.

Efficient waste management practices have also gained prominence in Nigeria's consumer goods sector. Companies are prioritizing waste reduction and recycling, striving to minimize waste generation and divert waste from landfills. Some companies have introduced environmentally friendly products that eliminate wastage and encourages recycling.

The Nigerian consumer goods sector is actively embracing environmental sustainability within the ESG framework. As awareness of ESG continues to grow in Nigeria, it is expected that consumer goods companies will further integrate environmental considerations into their business strategies, fostering a more sustainable future for both their operations and the Nigerian society.

### **Social Risks**

The consumer goods sector also faces various social risks, diversity and inclusion, labour practices, supply chain management, human and community relationships, product quality and safety and selling practices and labelling.

Companies within the consumer goods sector are recognizing the importance of fostering an inclusive work environment that values diversity in terms of gender, ethnicity, age, and other demographics. By promoting diversity, companies can tap into a broader range of perspectives and experiences, leading to enhanced innovation, employee engagement, and customer satisfaction. Initiatives such as diversity training, mentorship programs, and recruitment strategies that prioritize inclusivity are being implemented to create workplaces that are more equitable. However, a study carried out in 2021



by PWR Advisory showed that the consumer goods sector was the least gender diversified with only 17.46% of female representation in board management.

Another critical social factor is the promotion of fair labour practices and responsible supply chains. Nigerian consumer goods companies are expected to adhere to labour standards that ensure fair wages, safe working conditions, and the prevention of forced or child labour. This includes regular audits and inspections of suppliers to ensure compliance with ethical labour practices. Moreover, companies are increasingly engaging with their suppliers to address any social issues and encourage continuous improvement throughout the supply chain.

Nigerian consumer goods companies are also focusing on supporting local communities and fostering social development. This involves initiatives such as Corporate Social Responsibility (CSR) programs. Companies are investing in projects that promote education, healthcare, infrastructure development, and environmental sustainability within the communities they operate in.

In addition, the sector is witnessing an increasing emphasis on health and wellness. Nigerian consumers are becoming more health-conscious, demanding products that are nutritious, safe, and of high quality. Consumer goods companies are responding by reformulating products to reduce sugar, salt, and artificial ingredients, as well as providing clearer nutritional information on packaging. They are also investing in consumer education campaigns to promote healthy lifestyles and responsible consumption.

Furthermore, ethical marketing and advertising practices are gaining prominence in the Nigerian consumer goods sector. Companies are expected



to be transparent and truthful in their communications, avoiding deceptive or misleading marketing tactics, as prescribed by the Advertising Code.

The integration of social factors into business strategies not only contributes to the sustainable growth of consumer goods companies but also has a positive influence on society.

### **Governance Risks**

Corporate governance in the Nigerian consumer goods sector encompasses a range of practices and mechanisms designed to ensure fair and responsible decision-making within companies. These practices include the composition and independence of the board of directors, the establishment of board committees, and the adoption of codes of conduct and ethics. Strong governance frameworks provide a solid foundation for ethical behaviour, risk management, and long-term value creation.

By implementing these governance measures, consumer companies can make informed and responsible decisions. They can effectively manage risks, such as financial mismanagement, fraud, or unethical practices, that could negatively impact their performance and reputation. Good governance also facilitates compliance with regulatory requirements and ensures accurate financial reporting, enhancing the trust and confidence of investors.

### **Cement Sector: High Risk**

#### **Environmental Risks**

Environmental concerns in the Nigerian cement sector primarily revolve around two key aspects: energy consumption and carbon emissions. Cement production is an energy-intensive process, often relying on fossil fuels as a





primary energy source. This reliance on non-renewable energy contributes to greenhouse gas emissions with potential to exacerbate climate change. Furthermore, the extraction of raw materials, such as limestone, can result in land degradation and biodiversity loss.

To address these environmental challenges, the Nigerian cement sector is focusing on energy management and conservation. Cement manufacturers are increasingly adopting energy-efficient technologies and practices to minimize energy consumption during the production process. This includes the use of alternative fuels, such as biomass or waste-derived fuels, which can reduce both energy costs and carbon emissions.

Additionally, some cement companies in Nigeria have invested in renewable energy sources to supplement their energy requirements. Solar power installations, for instance, have been introduced to offset some of the energy demands in cement plants. These renewable energy initiatives help reduce the sector's carbon footprint and contribute to Nigeria's overall goal of transitioning to a low-carbon economy.

Moreover, cement companies conduct Environmental Impact Assessments (EIAs) to assess and mitigate the potential adverse effects of their operations on the environment. This includes evaluating the ecological and social implications of new cement plant projects, adhering to regulatory guidelines, and engaging with local communities to address their concerns. The EIA study is mandatorily required.

The Nigerian cement sector has generally recognized the importance of environmental sustainability and is actively working towards reducing its ecological footprint. Through energy efficiency measures, adoption of



renewable energy, and cleaner production technologies, the industry can continuously strive to minimize carbon emissions, conserve resources, and protect the environment.

### **Social Risks**

The cement industry in Nigeria is prone to health and safety risks. However, through the implementation of robust health and safety protocols, the risks can be mitigated and controlled. Furthermore, fostering fair labour practices, providing safe working conditions, and promoting diversity and inclusivity within their workforce are crucial.

Generally, the Nigerian cement sector has established corporate social responsibility (CSR) programs and philanthropic initiatives focusing on uplifting local communities, supporting educational and healthcare projects, promoting environmental conservation, and fostering entrepreneurship.

### **Governance Risks**

To promote good governance practices, the Nigerian cement sector has been guided by several regulations and initiatives. The Nigerian Stock Exchange (NSE) requires that for companies to be listed, they must adhere to certain corporate governance codes. Fortunately, the major players in the cement sector are listed on the stock exchange.

Transparency and disclosure are vital components of governance. Cement companies in Nigeria are required to provide timely and accurate information to shareholders and the public. This includes financial reporting, sustainability disclosures, and updates on environmental and social impacts. Enhanced



transparency helps build trust, allows stakeholders to make informed decisions, and facilitates engagement on ESG matters.

By adopting robust governance frameworks, promoting transparency and accountability, and engaging with stakeholders, the sector aims to contribute to Nigeria's sustainable development goals while delivering value to shareholders and society.

### **Telecommunications Sector: High Risk**

#### **Environmental Risks**

The telecommunication sector requires a substantial amount of energy to function, including power for base stations, data centres, and other infrastructure. These energy requirements have been met through fossil fuels, contributing to increased greenhouse gas emissions. However, recently the Nigerian Communications Commission (NCC) urged telecom operators to switch from fossil fuels to renewable energy.

Fortunately, some Nigerian telecommunications companies have recognized the importance of reducing their carbon footprint and have taken significant steps towards environmental sustainability. For example, they have been investing in renewable energy solutions such as solar panels to power their network infrastructure.

While substantial progress is being made in promoting environmental sustainability in the Nigerian telecommunications sector, challenges remain. One of the primary challenges is the availability and reliability of renewable energy sources. The country's power infrastructure is still predominantly reliant



on fossil fuels, making it challenging to access consistent and affordable renewable energy.

### **Social Risks**

The rural population in Nigeria continues to face significant challenges in accessing telecommunications services compared to their urban counterparts. The major telecom providers in the country have primarily focused their investments in densely populated cities, resulting in limited coverage in sparsely populated rural areas. Recognizing the need to bridge this digital divide, the Nigerian government has recently intensified its efforts to improve rural telecommunications access, primarily through development initiatives.

Since the liberalization of the telecoms market in the early 2000s, the government has taken measures to encourage investment in rural areas by incorporating conditions in telecoms licenses that mandate service provision across a specified percentage of the country. While these efforts have positively impacted rural access, a considerable portion of the population remains disconnected.

According to statistics from the Nigerian Communications Commission (NCC), in 2021, there were approximately 25 million Nigerians, mostly residing in rural areas, without access to basic communication services. The New National Broadband Plan spanning from 2020–2025 aims to achieve 70% broadband penetration, covering 90% of the population by 2025. This ambitious goal aims to address the existing disparities and improve telecommunications infrastructure in rural areas, enabling greater connectivity and access to digital services for the underserved population.



Another critical social aspect within the sector is customer satisfaction and protection. Telecommunications companies have a responsibility to provide quality services, address customer grievances, and protect consumer rights. This includes ensuring transparent billing practices, resolving complaints promptly, and safeguarding customer data and privacy. By prioritizing customer satisfaction and protection, telecommunication companies contribute to building trust and strengthening their social reputation.

Additionally, the telecommunications sector has the potential to support social initiatives and community development programs. Many companies in the sector have established corporate social responsibility (CSR) initiatives, which focus on addressing social challenges and making a positive impact on local communities. These initiatives may include supporting education programs, healthcare services, environmental sustainability projects, and promoting digital inclusion.

### **Governance Risks**

One of the key elements of governance in the Nigerian telecommunications sector is regulatory oversight. The Nigerian Communications Commission (NCC) serves as the regulatory authority responsible for setting and enforcing rules and standards in the sector. The NCC ensures that telecommunication operators comply with licensing requirements, consumer protection regulations, and fair competition policies. Its governance role helps maintain a level playing field and fosters a healthy and competitive market.

Furthermore, effective risk management is a critical aspect of governance in the Nigerian telecommunications sector. Telecommunications companies face various risks, including cybersecurity threats, regulatory changes, and market



volatility. To address these risks, companies should have robust risk management frameworks in place. This involves identifying and assessing risks, implementing appropriate controls, and monitoring risk exposure. Effective risk management demonstrates a company's commitment to protecting stakeholders' interests and ensures the long-term sustainability of the business.



**ARM Research**

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**Oyinkansola Aregbesola**

[oyinkansola.aregbesola@arm.com.ng](mailto:oyinkansola.aregbesola@arm.com.ng)

**Samson Owolabi**

[samson.owolabi@arm.com.ng](mailto:samson.owolabi@arm.com.ng)

**Callista Chileke**

[callista.chileke@arm.com.ng](mailto:callista.chileke@arm.com.ng)

**Moyosore Taiwo**

[moyosore.taiwo@arm.com.ng](mailto:moyosore.taiwo@arm.com.ng)

**Busola Akerele**

[busola.akerele@arm.com.ng](mailto:busola.akerele@arm.com.ng)

**David Gwatau**

[david.gwatau@arm.com.ng](mailto:david.gwatau@arm.com.ng)

**Ameerat Adamu**

[ameerat.adamu@arm.com.ng](mailto:ameerat.adamu@arm.com.ng)

**Lutfullahi Aderibigbe**

[lutfullahi.aderibigbe@arm.com.ng](mailto:lutfullahi.aderibigbe@arm.com.ng)



**ARM Securities Contact**

Research	234 (1) 270 1653	<a href="mailto:research@armsecurities.com.ng">research@armsecurities.com.ng</a>
Institutional Sales & Trading	234 (1) 448 8833	<a href="mailto:Trading@armsecurities.com.ng">Trading@armsecurities.com.ng</a>
Customer Service	234 (1) 448 8282	<a href="mailto:customerservice@armsecurities.com.ng">customerservice@armsecurities.com.ng</a>

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