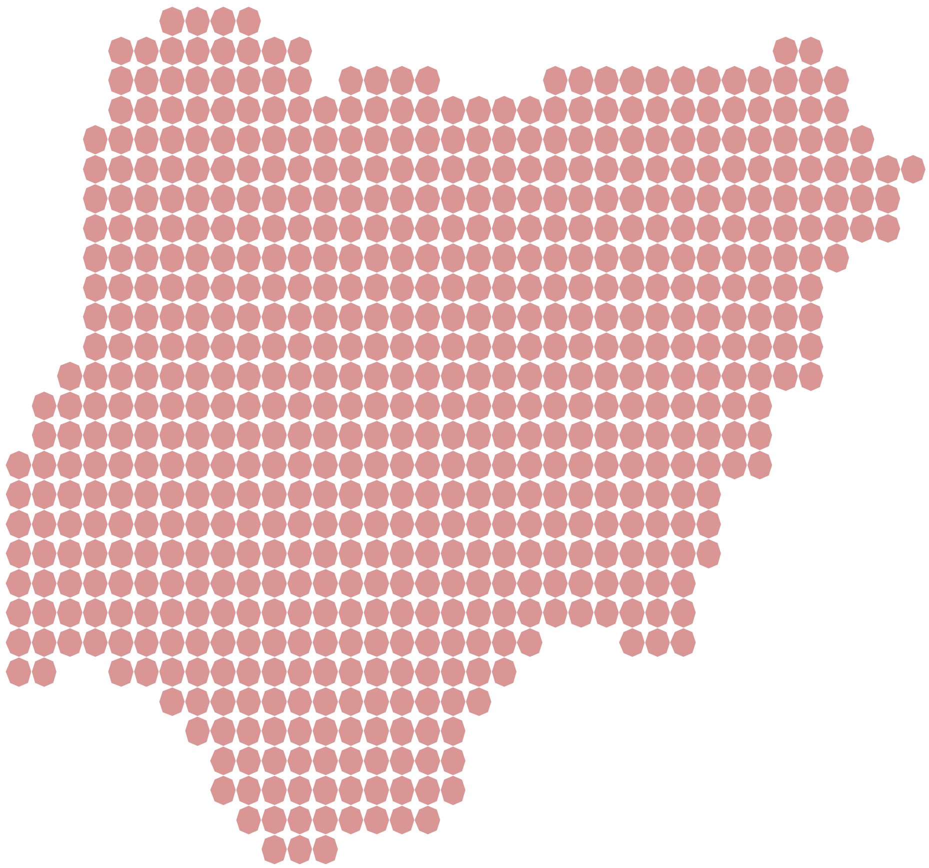

H1 Review & Investment Strategies for H2 2019

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Executive Summary

Nigeria's real Gross Domestic Product grew year-on-year (y-o-y) by 2.01% to N16.42 trillion in Q1 2019, but slower than 2.38% growth to N19.04 trillion registered in Q4 2018. The non-oil sector which accounted for the improved GDP number grew y-o-y by 2.47% to N14.92 trillion. This was majorly attributed to the 9.48% growth witnessed in ICT sector to N2.19 trillion (of which telecoms share of GDP constituted 10.11%). In addition, the Agricultural and Construction sectors revved by 3.17% and 3.18% respectively to N3.60 trillion and N0.67 trillion respectively from the N3.49 trillion and N0.65 trillion printed in Q1 2018.

In the monetary sector, CBN depository corporations survey showed a 4.61% year-to-date increase in Broad Money Supply (M3 money) to N34.90 trillion in May 2019 (see Table M3). This resulted from a 3.82% increase in Net Foreign Assets (NFA) to N19.10 trillion and a 5.59% increase in Net Domestic Assets (NDA) to N15.80 trillion. Nigeria's capital importation increased significantly by 216.03%, quarter-on-quarter, to USD8.49 billion in Q1 2019 (and rose on a yearly basis by 34.61%). A breakdown of the Q1 2019 capital imports showed that Foreign Portfolio Investments (FPI) which accounted for 65.58% of the total inflow rose q-o-q by 305.85% to USD7.15 billion (and 56.54% y-o-y).

Early in the first half of 2019, the monetary authority, against market expectations, cut the monetary policy rate by 50 bps to 13.50% in March 2019 as part of efforts aimed at stimulating private sector-led economic growth. Against the backdrop of ease in financial system liquidity, the over-the-counter FGN bond market witnessed relative bullish activity in H1 2019 compared to H2 2018, resulting in price appreciation (and corresponding decline in yields).

Having seen moderation in fixed income yields in H1 2019, especially for T-Bills, we anticipate an increase in the yield environment in H2 2019. Hence, we advise active portfolio managers to avoid investing the long end of the yield curve in order to mitigate interest rate risk.

In the equities market, all the prominent five sectored gauges had their fair share of the loss in H1 2019 as investors, especially FPIs, diverted their cash away from equities market amid perceived view of less commitment by the current administration to implement market-friendly policies as well as the heightened insecurity in the northern part of Nigeria which has spread to the southern and eastern regions of the country. Nevertheless, we feel that the equities market has been over-beaten by investors. Hence, an upward movement of the general market gauge looks inevitable in H2 2019.

Nigeria's Macroeconomic Environment in H1 2019

Nigerian Economic Growth Sustained Above 2% Mark on Non-Oil Sector

Nigeria's real Gross Domestic Product grew year-on-year (y-o-y) by 2.01% to N16.42 trillion in Q1 2019, but slower than 2.38% growth to N19.04 trillion registered in Q4 2018. The non-oil sector which accounted for the improved GDP number grew y-o-y by 2.47% to N14.92 trillion. This was majorly attributed to the 9.48% growth witnessed in ICT sector to N2.19 trillion (of which telecoms share of GDP constituted 10.11%). In addition, the Agricultural and Construction sectors revved by 3.17% and 3.18% respectively to N3.60 trillion and N0.67 trillion respectively from the N3.49 trillion and N0.65 trillion printed in Q1 2018. However, Oil & Gas sector contracted y-o-y by 2.40% to N1.50 trillion in Q1 2019 (a reversal from the 14.02% rise in Q1 2018). This was chiefly due to the relatively lower crude oil price in the quarter under review (compared to Q1 2018; see Exhibit M2). Quarterly average crude oil price fell to USD64.60 per barrel in Q1 2019 from USD67.70 in Q1 2018.

Exhibit M1: Analytical Presentation of Nigeria's Real GDP

Major Sectors	Q1 2019	Q4 2018	Q-o-Q %Change
Oil & Gas (N 'Trn)	1.50	1.34	11.60%
Y-o-Y %Change	-2.40%	-1.62%	
Non-Oil Sector (N 'Trn)	14.92	17.70	-15.69%
Y-o-Y %Change	2.47%	2.70%	
Quarter GDP (N 'Trn)	16.42	19.04	-13.77%

Share of Real GDP (%)	Q1 '19 Share of Real GDP	Q1 '19 y-o-y Growth (%)	Q4 '18 y-o-y Growth (%)
Agriculture	21.91%	3.17%	2.46%
Trade	16.87%	0.85%	1.02%
Info & Comm	13.33%	9.48%	13.20%
Manufacturing	9.80%	0.81%	2.35%
Mining & Quarrying	9.21%	-2.31%	-1.23%
Real Estate	5.58%	0.93%	-3.85%
Construction	4.09%	3.18%	2.05%
Profes, Sci & Tech Services	3.50%	1.73%	0.46%
Financial Services	3.21%	-7.60%	-4.81%
Education	2.11%	0.18%	0.35%
Other Economic Activities	10.39%		
Q1 2019 Real GDP	N16.42 Trn	2.01%	2.38%

Source: National Bureau of Statistics, Central Bank of Nigeria, Cowry Research

On a quarter-on-quarter basis, the 13.77% decline in economic growth was adduced to the 15.69% decline in non-oil sector, despite the significant growth of 11.60% printed in oil & gas sector in the quarter under review. Meanwhile, monthly Purchasing Managers' Indexes in H1 2019 showed, *inter alia*, slower expansion in business activities amid slower growth in new orders coupled with weakening business and consumer confidence levels.

Nigeria's Composite Purchasing Managers' Index

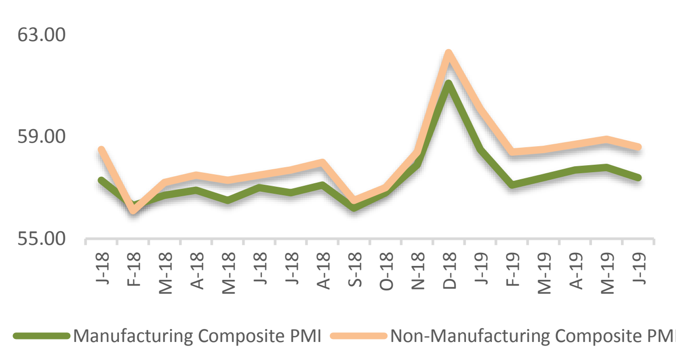
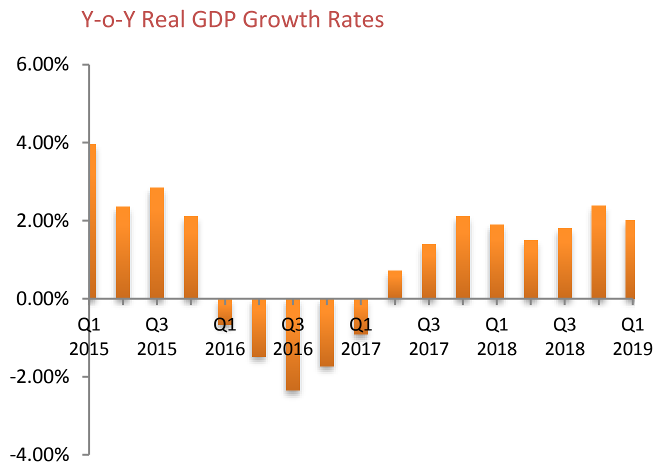
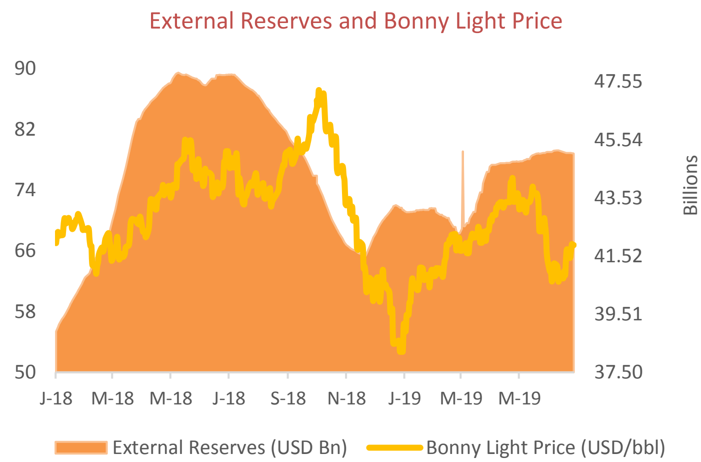
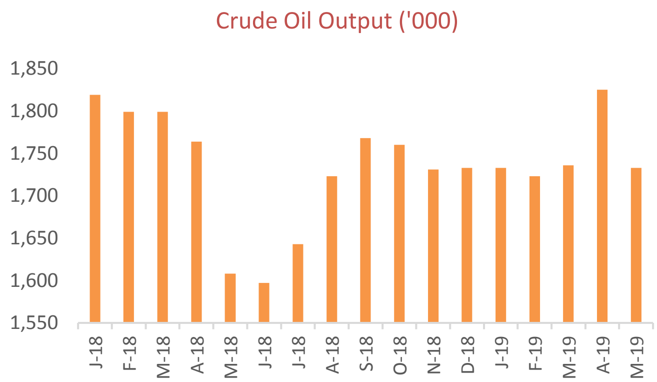
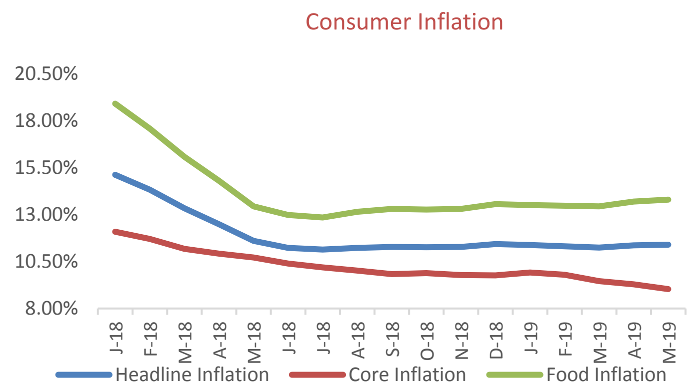


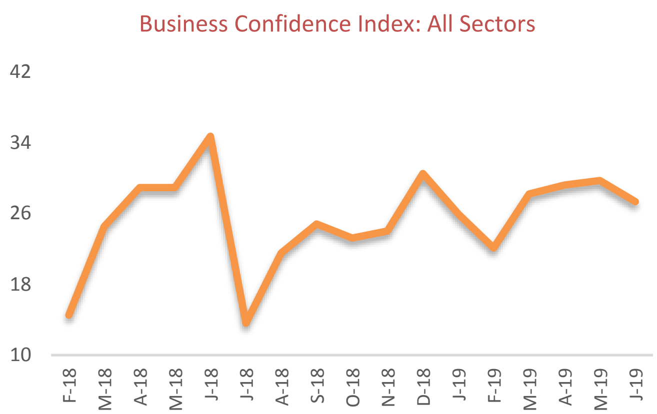
Exhibit M2: Nigeria's Key Macroeconomic Variables

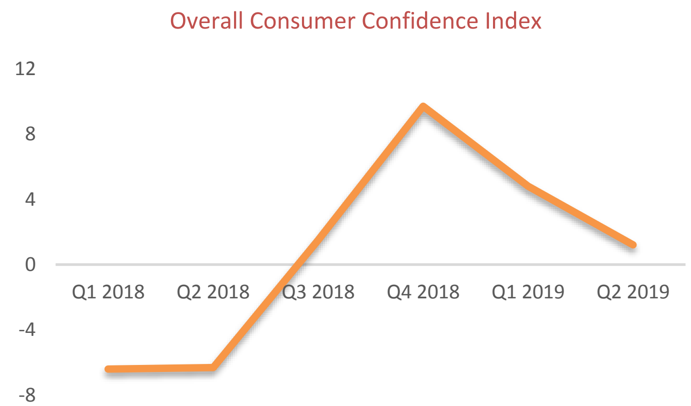












Source: National Bureau of Statistics, Central Bank of Nigeria, Opec, Cowry Research

Headline Inflation Rate Moderates Year-on-Year as Food, PMS Costs Decreased

According to the National Bureau of Statistics (NBS), Nigeria's average headline Inflation rate for the first five months (Jan – May) of 2019 was significantly lower at 11.34% in May 2019, compared to average of 13.38% it printed in the first five months of 2018 as at May. Similarly, we saw significant drop in five-months average food inflation rate to 13.59% as at May 2019 from a five-months average of 16.17% in May 2018, despite the worsened insecurity. In the same vein, average core inflation rate in the first five months moderated to single digit, 9.50% in May 2019 from 11.32% it registered in May 2018 amid average fuel price which fell to N145.50 in the first five-months of 2019 from N165.70 its recorded in the same period in 2018. Also, at the Bureau De Change foreign exchange market, five-months average value of the Naira appreciated to N358.90/USD in May 2019 from N360.23/USD in May 2018. The fall in inflation rate during this period considerably impacted Nigeria's economy positively, given the country's Gross Domestic Products (GDP) which rose by 2.01% in 1Q 2019 as against 1.95% growth registered in 1Q 2018.

Nevertheless, on year-to-date basis, headline inflation rate increased to 11.40% in May 2019 from the 11.37% it printed in January 2019 amid food inflation rate which moved northwards to 13.79% in the same period. The rise in food inflation was partly engendered by festive periods – Easter and Ramadan festivities –, commencement of the planting season, and worsened insecurity which made farmers desert their farm lands to take cover at the internally displaced persons' camps (IDPs). On the positive side, core inflation rate significantly moderated to 9.03% in May 2019 from the 9.91% it registered in January 2019 chiefly due to lower cost of transportation.

Money Supply Rises amid Increases in Foreign, Domestic Assets

In the monetary sector, CBN depository corporations survey showed a 4.61% year-to-date increase in Broad Money Supply (M3 money) to N34.90 trillion in May 2019 (see Table M3). This resulted from a 3.82% increase in Net Foreign Assets (NFA) to N19.10 trillion and a 5.59% increase in Net Domestic Assets (NDA) to N15.80 trillion. On domestic asset creation, the increase in NDA resulted from a 16.69% y-t-d increase in Net Domestic Credit (NDC) to N32.18 trillion, accompanied by a 8.79% y-t-d rise in Other Liabilities (net) to N16.38 trillion. Further breakdown of the NDC showed a 50.24% y-t-d increase in Credit to the Government to N7.3 trillion and a 9.50% rise in Credit to the Private sector to N24.86 trillion. On the liabilities side, the 4.61% y-t-d rise in M3 Money was driven by the 12.43% m-o-m increase in treasury bills held by money holding sector to N7.07 trillion and a 2.80% increase in M2 Money to N27.83 trillion.

The rise in M2 was driven by a 7.34% rise in Quasi Money (near maturing short term financial instruments) to N16.44 trillion, offset by a 3.13% decrease in Narrow Money (M1) to N11.39 trillion (of which Demand Deposits fell by 1.62% to N9.68 trillion while currency outside banks declined by 10.90% to N1.70 trillion). Reserve Money (Base Money) climbed y-t-d by 14.28% to N8.15 trillion as Bank reserves spiked m-o-m by 27.53% to N5.70 trillion, partly offset by a 9.35% decline in currency in circulation to N2.11 trillion.

Table M1: Depository Corporations Survey for May 2019

	Value (N 'Trn)	MTD % Δ	YTD % Δ
Currency outside banks	1.70	(0.77)	(10.90)
Bank reserves	5.70	4.66	27.73
Currency in circulation	2.11	(2.17)	(9.35)
Reserve money	8.15	2.60	14.28
Demand deposits	9.68	1.53	(1.62)
M1 Money	11.39	1.18	(3.13)
Quasi money	16.44	0.76	7.34
M2 Money	27.83	0.93	2.80
M3 Money	34.90	(0.77)	4.61
Monetary Policy Rate (%)	13.50%	0.00	(0.5)
Credit to the Government	7.31	(8.64)	50.24
Credit to the Government Fed	9.98	22.08	66.03
Credit to the Private Sector	24.86	(0.13)	9.50
Net Domestic Credit	32.18	(2.20)	16.69
Net Foreign Assets	19.10	10.25	3.82

Source: Central Bank of Nigeria, Cowry Research

Foreign Portfolio Investors Scramble for Fixed Income Securities

Nigeria's capital importation increased significantly by 216.03%, quarter-on-quarter, to USD8.49 billion in Q1 2019 (and rose on a yearly basis by 34.61%). A breakdown of the Q1 2019 capital imports showed that Foreign Portfolio Investments (FPI) which accounted for 65.58% of the total inflow rose q-o-q by 305.85% to USD7.15 billion (and 56.54% y-o-y). Other investments (mainly comprised of Foreign Loans and other claims) which constituted 27.97% also increased q-o-q by 45.97% to USD1.09 billion (but fell by 26.54% y-o-y). Similarly, Foreign Direct Investments (FDIs) which constituted just 6.46% registered a q-o-q increase of 40.38% to USD0.24 billion (but moderated by 1.32% y-o-y). A more detailed analysis showed that capital inflows from Equities FPIs increased by 110.36% q-o-q (but fell y-o-y by 6.47%) to USD0.66 billion in Q1 2019. However, inflows by Bonds FPIs increased by 173.61% q-o-q (and rose y-o-y by 68.41%) to USD0.55

billion in Q1 2019; also, investment inflows by FPIs in Money market instruments surged by 376.95% q-o-q (and by 67.94% y-o-y) to USD5.92 billion. Meanwhile, Foreign Loans rose marginally by 2.62% q-o-q (but declined by 40.70% y-o-y) to USD0.75 billion in Q1 2019.

A breakdown of capital imports by sector showed that investments in banking accounted for 33.60% or USD2.85 billion and rose by 976.57% q-o-q (as well as 141.45% y-o-y). Other sectors which received relatively large inflows include: shares, financing, production and servicing which accounted for 28.32%, 25.21%, 4.93% and 4.83% of the total capital imports respectively. Furthermore, largest inflow in Q1 2019 worth USD4.53 billion was from United Kingdom (higher than USD2.25 billion in Q1 2018). Following were inflows from the United States and South Africa worth USD1.53 billion (rose from USD1.23 billion) and USD0.76 billion (rose from USD0.49 billion) respectively. Major investment destinations in the quarter under review include; Lagos (USD4.77 billion) and Abuja (USD3.59 billion).

Nigeria's Q1 2019 Merchandise Trade Surplus Shrinks

In a related development, Nigeria's foreign sector was dented from relatively weak year-on-year (y-o-y) merchandise trade activity in Q1 2019. Total exports fell y-o-y by 4% to N4.54 trillion as crude oil exports tanked y-o-y by 6% to N3.38 trillion. However, total imports grew y-o-y by 26% to N3.70 trillion, chiefly on the back of a 99% spike in imported capital goods, parts and accessories to N1.03 trillion, a 175% increase in imported transport equipment and parts to N0.49 trillion as well as a 24% increase in food and beverages imports to N0.39 trillion. Consequently, merchandise trade surplus declined by 53% to N0.83 trillion; total merchandise trade grew by 8% to N8.24 trillion.

In terms of geographical performance, Europe remained Nigeria's biggest export market, having imported goods worth N1.83 trillion (or 40% of total exports) from Nigeria despite a 22.43% y-o-y decline. Next was Asia which grew its purchases y-o-y by 8.09% N1.32 trillion (or 29% of total exports) and then Africa which accounted for 21% of total exports having grown y-o-y by 93.95% to N0.94 trillion. On the other hand, Nigeria's largest imports came from Asia at N1.63% (or 44% of total imports) following a 56.01% y-o-y increase. Next were imports from Europe which fell y-o-y by 38.55% N0.92 trillion (or 25% of total) and Africa which spiked by 535.38% to N0.64 trillion (or 17% of total imports). Ultimately, Nigeria-European merchandize trade yielded the biggest surplus of N0.92 trillion having increased y-o-y by 4.90%. This was followed by a trade surplus of N0.29 trillion with Africa despite a 23.30% decline. On the flip side, Nigeria recorded a trade deficit of N0.31 trillion with Asia (from a trade surplus of N0.18 trillion) mainly due to a 78.81% increase in trade deficit with China to N0.83 trillion.

H2 2019 Outlook for Nigeria's Macroeconomy

Nigerian Economy Remains Prone to External Shocks

Nigeria's oil-dependent external sector outlook appears weakened given that the June edition of Opec's Monthly Oil Market Report, which showed that Nigeria's crude oil production decreased month-on-month by 5.04% to 1.73 mbpd in May 2019, suggests a slowing crude oil market with possible negative implications for Nigeria's oil exports. Specifically, the report foresees slower rise in global oil demand in 2019, by 1.14 mbpd, lower than last month's rate of 1.2 mbpd. Opec's downward revision was mainly predicated on sluggish oil demand data in the OECD region during in Q1 2019; partly resulting from the negative impact of rising global trade tensions, especially between the United States and China, on international trade flows. In another vein, non-Opec oil supply in 2019 is expected to further grow y-o-y at a rate of 2.14 mbpd following a significant increase of 2.91 mbpd in 2018.

Also, given the weaker Q1 2019 foreign trade statistics, Nigeria's vulnerability to external shocks has become more apparent, at least in the short term. We therefore expect sustained suboptimality in overall economic performance given an over-dependence on crude oil and in line with the World Bank's revised growth projection for 2019. The World Bank, in its June 2019 edition of its Global Economic Prospects, reviewed its global growth forecast downwards to 2.6% for 2019, lower than 2.9% which it earlier forecasted in January 2019. Nigeria's growth forecast was also reviewed lower to 2.1% from 2.2% earlier forecast in January (see Table M2).

Table M2: 2019 Real GDP Growth Forecasts as at June and January

Region	Forecast in June	Forecast in January
World	2.6%	2.9%
United States	2.5%	2.5%
Euro Area	1.2%	1.6%
China	6.2%	6.2%
India	7.5%	7.5%
Nigeria	2.1%	2.2%
South Africa	1.1%	1.3%

Source: World Bank's Global Economic Prospects – June 2019 edition, Cowry Research

Weakened Business Optimism Further Signals Sluggish Q-o-Q Real GDP Growth in Q2 2019

We also note that the weaker optimism of local businesses in May (see Exhibit 2), coupled with the rather weak increases in purchasing managers indexes of both manufacturing and non-manufacturing indices in June 2019, is a signal of weak economic growth for Q2 2019. Historically, the second quarter has registered the weakest quarter-on-quarter (q-o-q) growth rates given a 9-year average of 2.96% compared to the third and fourth quarters with average growth rates of 8.93% and 3.92% respectively – although better than an average historical decline of 11.60% in the first quarter. Hence, given historical antecedents and low business optimism we expect weak Q2 2019 real sector growth, q-o-q.

Fragile Consumer Confidence… Any Signs of Respite?

Furthermore, weaker consumer confidence level (see Exhibit M2 above) suggests slower consumption activities, which constitute the bulk of gross domestic product, as fewer consumers were optimistic in their outlook – according to a CBN survey. Specifically, the Consumer Confidence index which registered at 1.2 points in Q2 2019 was 7.5 points higher than the index in the corresponding period of 2018. This may however find support from the highly anticipated implementation of approved N30,000 new minimum wage bill as well as early implementation of the 2019 national budget.

National Budget Implementation Still Vulnerable to Volatile Crude Oil Markets, Huge Oil Subsidies

Meanwhile, we expect suboptimal performance of the N8.92 trillion 2019 fiscal spending plan by the Federal Government, partly due to vulnerabilities to oil price volatility as well as leakages from sustained petroleum product subsidies (estimated to about N713 billion as at 2018). The Federal Government's revenue projection for 2019 of N6.99 trillion (2.34% lower than N7.17 trillion projected for 2018) is expected to result in a fiscal deficit of N1.92 trillion. Projected crude oil revenue component of N3.69 trillion which accounts for 52.70% of total projected revenue – and which represents a 23.41% y-o-y increase from 2018 – is based on a crude oil price benchmark of USD60 a barrel and a daily crude oil production of 2.3 million bpd. We however feel that the oil revenue projection may be a bit unrealistic given the volatility in global oil markets as well as likely short falls in its exports due to a highly competitive global market where Nigerian cargoes remain logistically uncompetitive among some global refineries.

Hence, funding the N1.92 trillion 2019 budget deficit will be mainly based on debt issuances; although we advise the sale of more inefficiently-run public sector assets in order to fund the deficit as well as the reduction or discontinuation of subsidies on premium motor spirit in order to free up limited resources to be more efficiently allocated within the economy.

Table M3: Approved Budget Estimates (N 'Trn)

	2019 Budget	2018 Budget	Change
Appropriation Bill	8,917	9,120	-2.23%
Supplementary	0	0	-
Projected Revenue	6,998	7,166	-2.34%
Appropriation Bill + Supplementary	8,917	9,120	-2.23%
Statutory Transfers	502	530	-5.35%
Debt Service	2,114	2,014	4.97%
Sinking Fund (to retire certain maturing bonds)	0	190	-99.94%
Total Recurrent (Non-Debt)	4,735	3,513	34.81%
Subsidy Re-investment	0	0	-
Special Intervention programme	350	350	0.00%
Capital Expenditure	2,927	2,873	1.86%
Budget Deficit	-1,918	-1,954	-1.84%
Deficit as percentage of GDP (%age)	1.37%	1.73%	-
Daily Crude Oil Production (Mbpd)	2.3	2.3	0.00%
Crude Oil Bench Mark (USD)	60	50.5	18.81%
Exchange Rate (NGN/USD)	305	305	0.00%
Projected Proceeds from Privatisation	210	306	-
Domestic Borrowing	803	824	-2.60%
Foreign Borrowing	803	850	-5.51%

Source: Budget Office of the Federation, Cowry Research

CBN's Dovish Stance, Implementation of Minimum Wage Trigger for Higher Inflation Rate

Amid the northward trend in headline inflation rate to 11.40% in May, an increase for the third consecutive month, our outlook on inflation is one of a further increase in prices as Central Bank of Nigeria embraced a dovish policy stance – to prioritize economic growth by reducing monetary policy rate (MPR) to 13.50% from 14.00% –, and plans to put a cap on the amount deposit money banks (DMBs) can invest in fixed income securities.

Also, the implementation of the new minimum wage of N30,000 per worker will induce demand-pull inflation as workers' spending power increase amid relatively lower supply in goods and services which will lead producers to increase their prices in response. Thus, given the expansionary policy of the monetary authority, we might likely see less aggressive mop up of the liquidity so as not to counter its support for economic growth. Similarly, the intent of the Federal Government to increase VAT by 50% to 7.5% from 5.0% in 2020 will give rise to cost-push inflation as producers will be forced to jerk up their output prices which will be transferred to customers amid higher input costs.

Finally, with the rainy season well underway, we expect continuous build up in average food prices up until the commencement of the harvest season around October this year when we anticipate an ease in food prices, and ultimately, headline inflation.

Foreign Exchange Markets to Remain Stable

Finally, we expect that with the prospect of softened interest rates, especially in advanced economies as they implement accommodative monetary policies to support economic growth, we expect increase foreign portfolio inflows ("hot money") into frontier economies such as Nigeria. This should boost Nigeria's external buffers and further enhance exchange rate stability.

Table M4: Market Rates in United States and Eurozone as at H1 2019

Region	Policy Rate	1 Year T-Bill Rate Movement	Outlook
United States	Current Range: 2.25% - 2.50% Previous Range 2% - 2.25% as at Sept '18	1.87% as at June 28, 2019. 2.63% as at December 31, 2018	Yields may remain soft as both fiscal and monetary authorities seek to further stimulate economic growth. However, trade tussle between U.S. and China to inhibit this growth.
Eurozone	Currently 0.00% Previously 0.05% in early '16	-0.69% as at June 30, 2019 -0.75% as at December 19, 2018	Monetary policy accommodation to be sustained in order to stimulate economic growth

Source: Trading Economics, European Central Bank, Cowry Research

Review of Fixed Income Space in H1 2019

Apex Bank Cuts Monetary Policy Rate in Symbolic Move

Early in the first half of 2019, the monetary authority, against market expectations, cut the monetary policy rate by 50 bps to 13.50% in March 2019 as part of efforts aimed at stimulating private sector-led economic growth. The cut in policy rate was partly informed by earlier observed moderation in inflationary trend (from 11.44% in December 2018 to 11.25% in March 2019), appreciation of the Naira against the US dollar (NIFEX rate fell from N359.18/USD in December 2018 to N356.60/USD in March 2019, I&E FX rate fell from N364.76/USD to N360.49/USD while BDC rate fell from N362.11/USD to N357.10/USD), and slower expansion in economic activity in Q1 2019 as indicated by the purchasing managers indexes (Manufacturing PMI and Non-Manufacturing PMI hovered around 57.67 points and 59 points respectively).

Apparent Boost in Financial System Liquidity amid Increased Borrowings at Discount Window

The financial system appeared to be liquid (closed in net surplus position) in the first half of 2019 as it was bolstered by N3.84 trillion worth of injections by Federation Accounts Allocation Committee (FAAC); although when compared to H2 2018 and H1 2018, FAAC disbursements fell by 16% and 3% respectively. The system also recorded matured T-Bills worth N7.87 trillion which, nevertheless, partly offset the effect of auctions (withdrawals) worth N10.65 trillion which was a strain on liquidity. Furthermore, we saw an increase in standing lending facility to banks worth N12.22 trillion, higher than standing deposit facility worth N7.77 trillion – suggestive of “latent” liquidity challenges faced by some deficit banks which resorted to the discount window of the Central Bank to meet their funding needs. SLF was also significantly higher compared to H2 2018 and H1 2018 by 171% and 78% respectively.

Table F1: Interbank Money Flows					
	H1 2019 (1)	H2 2018 (2)	H1 2018 (3)	1 and 2 %Change	1 and 3 %Change
Standing Lending Facility (N 'Trn)	12.22	4.50	6.86	171%	78%
Standing Deposit Facility (N 'Trn)	7.77	10.29	24.48	-24%	-68%
OMO Sales (N 'Trn)	9.50	8.59	9.02	11%	5%
Primary Market Sales (N 'Trn)	1.14	1.85	1.92	-38%	-40%
Total Outflows (N 'Trn)	10.65	10.44	10.93	2%	-3%
OMO Repayment (N 'Trn)	6.58	9.75	6.05	-32%	9%
Primary Market Repayment (N 'Trn)	1.29	2.49	2.28	-48%	-43%
Total Inflows (N 'Trn)	7.87	12.23	8.33	-36%	-5%
FAAC Inflows (N 'Trn)	3.84	4.58	3.95	-16%	-3%
Net Inflow/(Outflow) (N 'Trn)	1.07	6.37	1.34	-83%	-20%

Source: Central Bank of Nigeria, Cowry Research

Interbank Rates Mellow

Following increased access to the discount window by banks, money market interest rates generally moderated in H1 2019 compared to H2 2018 and H1 2018. Specifically, at the interbank market, Nigerian Interbank Offered Rates (NIBOR) fell across board – NIBOR for overnight funds, 1 month, 3 months and 9 months fell to 5%, 11.61%, 12.63% and 13.54% respectively compared to corresponding levels in H2 2018 and H1 2018 (see Table F2). Against the backdrop of increased system liquidity, Nigerian Interbank Treasury True Yields (NITTY) climbed on the back of bargain hunting activity – NITTY for 1 month, 3 months, 6 months and 12 months moderated to 10.41%, 11.63%, 12.52% and 13.33% respectively (see Table F3).

Table F2: NIBOR					
Tenor	H1 2019 Ending (1)	H2 2018 Ending (2)	H1 2018 Ending (3)	1 and 2 %Change	1 and 3 %Change
Overnight	5	20	14.7	(15.00)	(9.70)
1 Month	11.6145	15.4484	14.4552	(3.83)	(2.84)
3 Months	12.6283	14.665	15.0004	(2.04)	(2.37)
6 Months	13.5422	14.4679	16.2766	(0.93)	(2.73)

Source: FMDQ, Cowry Research

Table F3: NITTY

Tenor	H1 2019 Ending	H2 2018 Ending	H1 2018 Ending	1 and 2 %Change	1 and 3 %Change
1 Month	10.4148	14.9136	12.727	(4.50)	(2.31)
3 Months	11.6292	14.0368	12.7645	(2.41)	(1.14)
6 Months	12.5166	13.412	13.0707	(0.90)	(0.55)
12 Months	13.3327	17.3441	13.0823	(4.01)	0.25

Source: FMDQ, Cowry Research

Commercial Bank Customers Hold Long End of the Stick

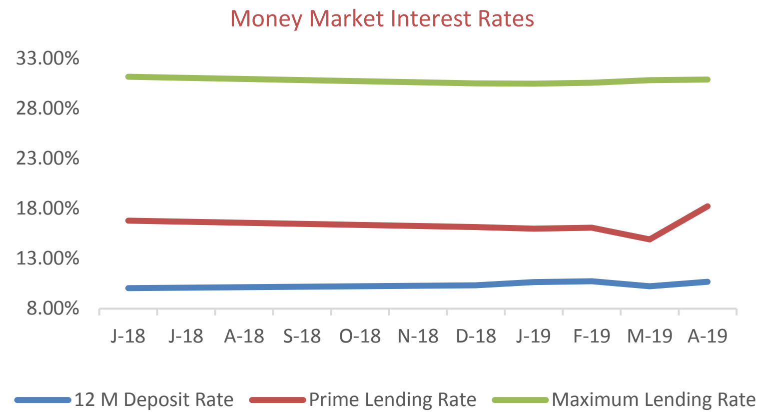
Meanwhile, interest rates at commercial banks appeared to reflect "latent" liquidity challenges faced by some banks which, scrambling for depositors' funds, offered higher deposit rates to customers in the first four months to April 2019 compared to the second half of 2018 (see Table F4). On average, 1 month, 3 months, 6 months and 12 months deposit rates increased to 8.96%, 9.5%, 10.36% and 10.58% in the first four months to April 2019 from 8.95%, 9.46%, 10.06% and 10.25% in H2 2018. In same vein, prime lending rates rose to 18.23% as at April 2019 from 16.17% as at December 2018 as banks sought to sustain their margins in the light of rising deposit rates.

Table F4: Bank Rates

	Apr-19	Mar-19	Feb-19	Jan-19	Dec-18	Sep-18	Jun-18	Mar-18
MPR	13.5	13.5	14	14	14	14	14	14
Savings Deposit	3.91	3.97	4.07	4.07	4.07	4.07	4.07	4.07
1 M Deposit	8.63	9.15	9.05	9	8.99	8.79	8.88	8.82
3 M Deposit	9.15	9.48	9.68	9.69	9.5	9.44	9.38	9.72
6 M Deposit	10.36	10.09	10.34	10.65	10.49	9.76	10.15	10.93
12 M Deposit	10.7	10.23	10.74	10.66	10.33	10.08	10.05	10.21
Prime Lending Rate	18.23	14.92	16.08	16.01	16.17	16.59	16.78	17.35
Maximum Lending Rate	30.89	30.83	30.56	30.48	30.52	30.77	31.17	31.55

Source: Central Bank of Nigeria, Cowry Research

Figure F1: Money Market Deposit and Lending Rates



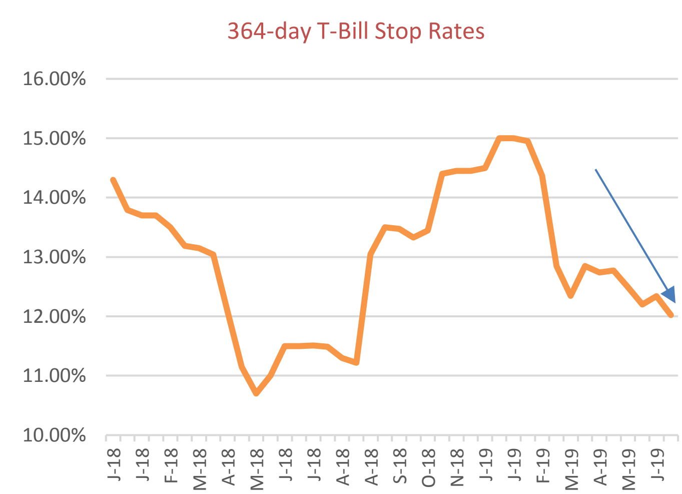
Source: Central Bank of Nigeria, Cowry Research

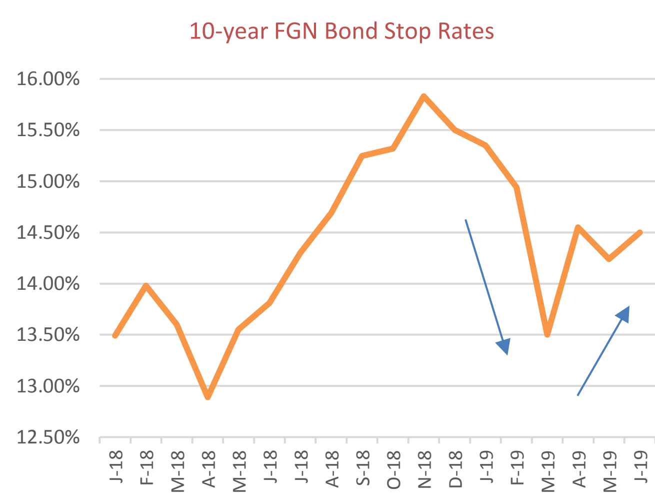
Against the backdrop of increased public sector borrowing, the money market recorded relatively higher commercial lending rates amid flight to safety by deposit money banks.

Stop Rates Decline at Primary Market Auctions on Increased Investor Demand

In line with our earlier published 2019 outlook and Investment Strategies in which we recommended "being invested at the short end of the yield curve, i.e., treasury bills of low maturities, in H1 2019 and to increase duration as we progress into H2 2019" – so as to avoid interest rate risk – we saw increased demand for short-dated instruments at the primary market that resulted in fairly consistent decline in stop rates as portfolio investors chose to hold near cash instruments amid political uncertainties which arose during the 2019 election season. Conversely, we saw an increase in stop-rates of long-dated instruments which reinforced our expectation of higher rates in H2 2019.

Exhibit F1: Stop Rates of Auctioned FGN Securities



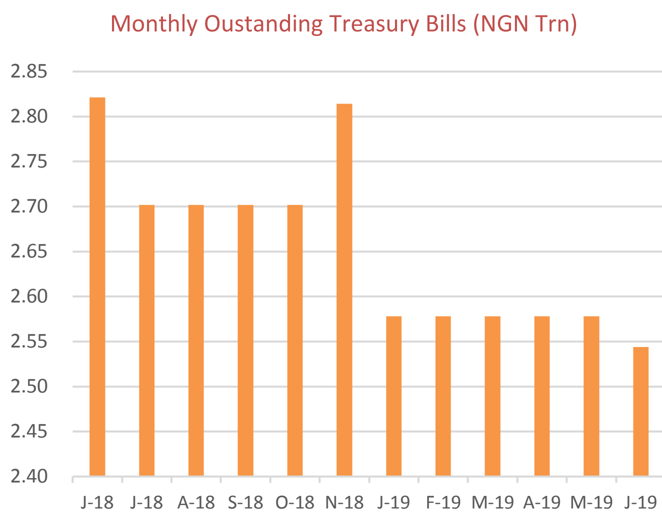


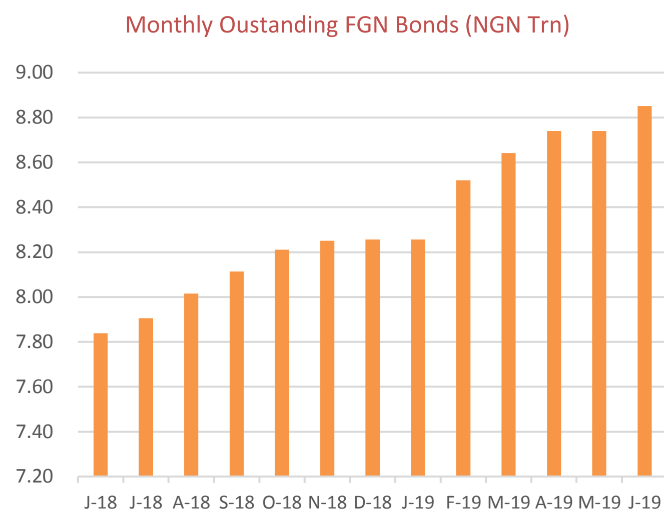
Source: FMDQ, Cowry Research

Federal Government Slows Treasury Bills Auctions in Favour of Long-Dated Papers

Meanwhile, outstanding treasury bills issued by the Federal Government dropped on a year-to-date basis by 9.6% to N2.54 trillion; on the other hand, outstanding FGN bonds increased by 7.2% to N8.85 trillion. The Federal Government, in furtherance to its efforts at increasing the average term to maturity of bonds, debuted its 30-year bond in April. The movements were in line with the government's strategic objective to achieve a portfolio mix of 75% to 25% that is skewed in favour of bonds. The decline in outstanding treasury bills which resulted from a retirement of about N0.27 trillion worth of T-Bills, partly informed the increased demand by portfolio investors.

Exhibit F2: Outstanding FGN T-Bills and Bonds





Source: FMDQ, Cowry Research

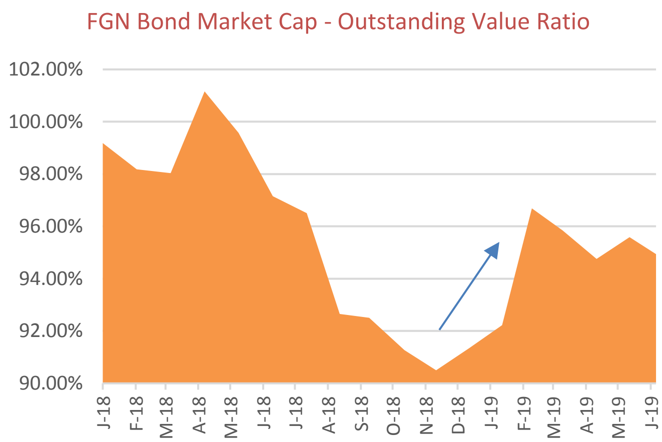
FGN Bonds Traded Over-the-Counter Appreciate amid Liquidity Ease

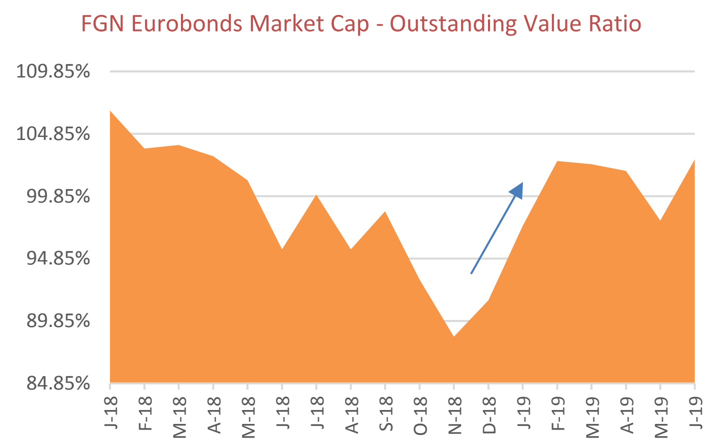
Against the backdrop of ease in financial system liquidity, the over-the-counter FGN bond market witnessed relative bullish activity in H1 2019 compared to H2 2018, resulting in price appreciation (and corresponding decline in yields). The ratio market capitalization to outstanding bonds value averaged 95.01% in H1 2019, higher than 92.46% in H2 2018 (but lower than 98.88% average registered in H1 2018). Regardless of the price appreciation, however, bonds generally traded at discount to par.

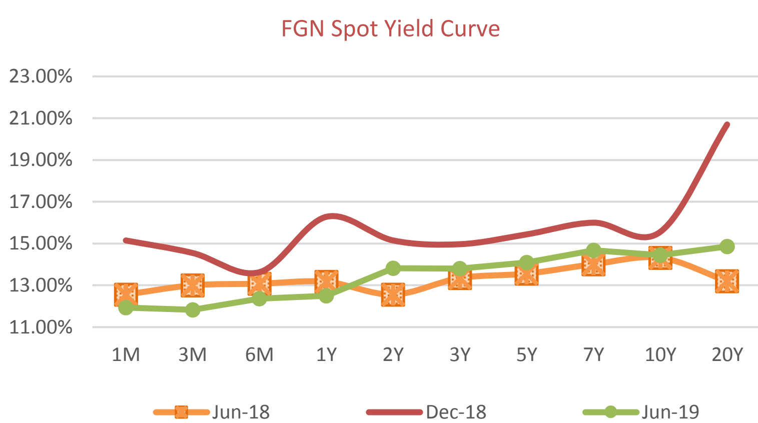
Meanwhile, Nigerian sovereign bonds in the Eurobond market generally traded at a premium in H1 2019 on the back of increased bargain hunting activity. Appetite for the Eurobonds may have been whetted by relatively stronger external sector given sustained growth in external reserves, amongst other things.

Specifically, the ratio of FGN Eurobonds market capitalization to outstanding issue averaged 100.86%, higher than 94.58% in H2 2018 (but lower than 102.35% averaged in H1 2018).

Exhibit F3: FGN Bond Performance







Source: FMDQ, Cowry Research

Nigerian Fixed Income Yield Curve Normalizes in H1 2019…

Against the backdrop of the decreasing yield environment, especially for short-dated instruments, the yield curve normalized at the end of the first half of 2019.

Fixed Income Outlook and Investment Strategy for H2 2019

Having seen moderation in fixed income yields in H1 2019, especially for T-Bills, we anticipate an increase in the yield environment in H2 2019. Hence, we advise active portfolio managers to avoid investing the long end of the yield curve in order to mitigate interest rate risk; but to rather hold near cash instruments (such as near maturing T-Bills) until longer term yields approach their peak. Our position is predicated on our expectation of increased public debt issuance necessitated by the plan of the federal government to finance its 2019 budget deficit of about N2 trillion. The debt will be needed to finance critical infrastructure given that most of government's revenue would be devoted to recurrent spending which is expected to rise, especially in the light of the N30,000 new minimum wage and perhaps, sustained subsidies.

That said, we expect the fiscal authorities to take advantage of the currently cheap T-bills given that it still has room before it reaches its 75:25 per cent Bonds: T-Bills target limit (see Table F6). Therefore, in the near term, we do not expect the government to aggressively issue more long-term debt comprising local and foreign debt in order to contain cost and rate of debt servicing via rollovers – although we expect the FG to issue long-term bonds at higher yields before the end of the year in order to finance its budget deficit. Furthermore, we expect the FG to seek more of concessionary than commercial external debt given that its foreign borrowings has approached a "cautionary level" as the ratio of external debt to external reserves ratio rose to 59% in 2018 from 37% in 2015 (see Exhibit 4) while Implicit interest rate for external debt rose to 7% per annum in 2018 from 3% per annum in the preceding years (see Table F5) – mainly on account of previous issuances of more expensive Eurobonds.

Finally, we advise investors to take advantage of Eurobonds currently trading at relatively high yields as we do not envisage aggressive issuances by the Federal Government – thus limiting interest rate risk. There is also the added advantage of stable exchange rate which will help mitigate exchange rate risk for investors in Nigerian sovereign Eurobonds.

Table F5: Implicit Interest Rate

	2018	2017	2016	2015
FGN External Debt	7%	3%	3%	3%
FGN Domestic Debt	15%	13%	12%	12%

Source: Debt Management Office, Cowry Research

Table F6: FGN Debt Mix

	2018	2017	2016	2015	Target
Short Term Debt to Total Debt	21%	30%	30%	31%	25%
Long Term Debt to Total Debt	79%	70%	70%	69%	75%

Source: Debt Management Office, Cowry Research

Exhibit 4: Analytical Presentation of Public Debt

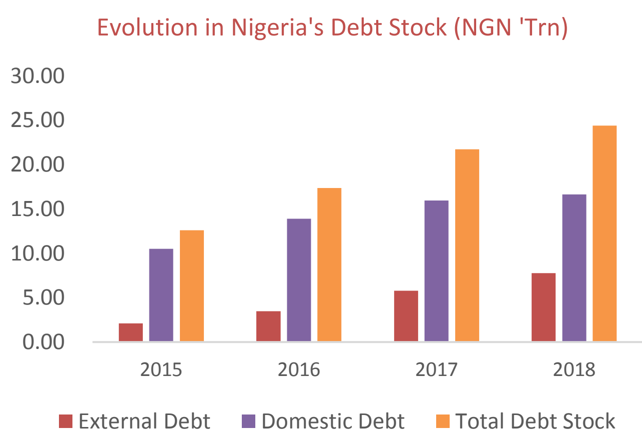
Snapshot of Key Public Sector Debt Statistics from 2015 - 2018				
Amounts in NGN Trillion	2018	2017	2016	2015
State Government Debt	11.61	9.75	6.30	3.77
Federal Government Debt	12.78	11.97	11.06	8.84
Of which:				
Short Term Debt	2.74	3.60	3.28	2.77
Long Term Debt	10.04	8.37	7.78	6.06
Total Debt Stock	24.39	21.73	17.36	12.60
Of which:				
External Debt	7.76	5.79	3.48	2.11
Domestic Debt	16.63	15.94	13.88	10.49

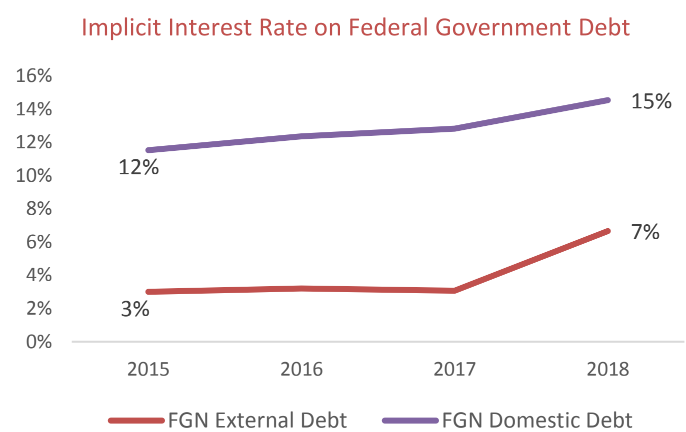
Source: Debt Management Office, Cowry Research

Available data obtained from the National Bureau of Statistics show that in a space of just four years (2015 - 2018), Nigeria's debt profile has increased aggressively – total debt stock grew at a compounded annual growth rate (CAGR) of 17.94% of which external debt grew at a CAGR of 38.49% and domestic debt increased at a CAGR of 12.20% (the Federal Government's debt rose at a CAGR of 9.65%).

Source: Debt Management Office, Cowry Research

It can also be seen that the increase in public sector's external financial liabilities potentially places increased burden on public sector foreign assets (external reserves) as the ratio of external debt to external reserves increased from 37% in 2015 to 59% in 2018.





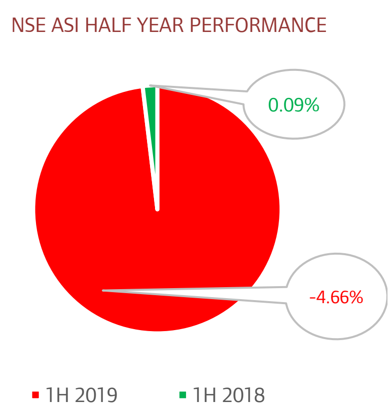
Source: Debt Management Office, Cowry Research

Review of Equities Space in H1 2019

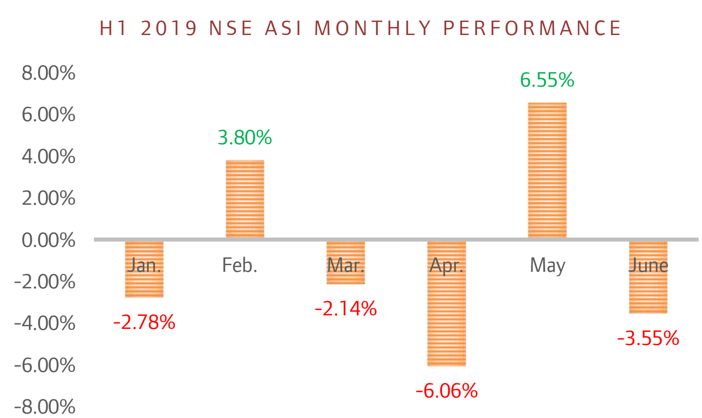
MTN Nigeria's Listing Fails to Lift Equity Market Out of Negative Territory in H1 2019

Having scaled through the hurdle of 2019 general elections, especially the Presidential election in February 23, although tainted with election-induced violence and post-election tribunal cases, investors have remained heavily pessimistic in patronizing the equities market compared with the substantial patronage of the fixed income assets by investors, mostly foreign portfolio investors (FPIs), in H1 2019. Although good buy-interest from all categories of investors greeted the Nigerian Stock Exchange (NSE) before February 16, 2019, the date earlier scheduled for the Presidential election, we saw the enthusiasm melt away after the sudden postponement of the election by Independent National Electoral Commission (INEC) in the early hours of the Presidential election day. Also, towards the end of the second quarter, the euphoria which surrounded the listing by introduction of 20.4 billion shares of MTN Nigeria on the local bourse engendered another positive equity market performance in May (see Exhibit E1), but the performance was short-lived given the general negative investors' mood. Hence, the performance of the domestic bourse dwindled in H1 2019 as the year to date loss of the NSE All Share Index (ASI) stood at 4.66% as against the gain of 0.09% recorded in H1 2018.

Exhibit E1: Stock Market Performance



Source: *NSE, Cowry Research*



How Sector Gauges Fared?

All the prominent five sectored gauges had their fair share of the loss in H1 2019 as investors, especially FPIs, diverted their cash away from equities market amid perceived view of less commitment by the current administration to implement market-friendly policies as well as the heightened insecurity in the northern part of Nigeria which has spread to the southern and eastern regions of the country. Specifically, most hit was NSE Consumer Goods sector; its gauge fell sharply by 16.89% to 622.33 points as most fast-moving consumer goods (FMCG) companies, especially Dangote Flour Mills and Flour Mills of Nigeria Plc, recorded significant decline in revenue amid Apapa gridlock issue which has still not been resolved. Similarly, NSE Oil/Gas, NSE Industrial, NSE Banking and NSE Insurance sector gauges moderated by 16.21%, 12.12%, 8.04% and 2.16% to 253.23 points, 1,087.80 points, 366.87 points and 123.75 points respectively. For banking sector, the recent pronouncement by the Central Bank of Nigeria (CBN) Governor, on banks' recapitalization will shake-up the sector as banks' capitalization might go as high as N250 billion. Tier 1 banks are likely to survive the process without merger amid stronger liquidity position; however, we might see different forms of business combinations amongst the Tier 2 banks going forward.

Table E1: NSE Sector Gauges Performance

	28-Jun-19	31-Dec-18	Year-to-Date %Change
NSE Banking	366.87	398.94	-8.04%
NSE Insurance	123.75	126.48	-2.16%
NSE Consumer Goods	622.33	748.83	-16.89%
NSE Oil/Gas	253.23	302.23	-16.21%
NSE Industrial	1,087.80	1,237.88	-12.12%

Source: *NSE, Cowry Research*

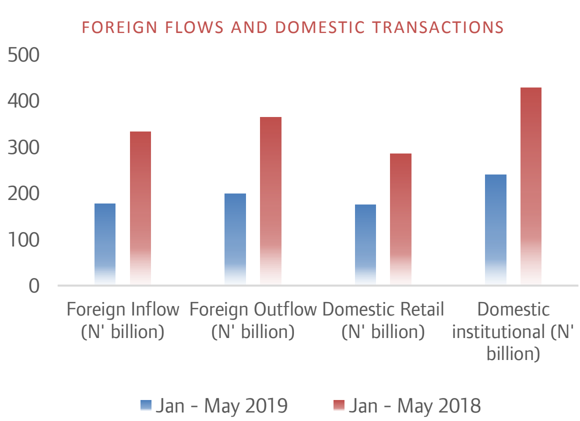


Table E2: Market Activity

	H1 2019	H1 2018	Change
Deals	461,287	644,974	-28.48%
Volume (Mn)	45,785	66,702	-31.36%
Value (N 'Mn)	538,041.34	794,638.08	-32.29%

Source: *NSE, Cowry Research*

Table E3: Top 10 Gainers

Company	28/6/2019	31/12/2018	Change (N)	Change (%)
DANGFLOUR	17.50	6.85	10.65	155.47
CAVERTON	2.57	1.92	0.65	33.85
REDSTAREX	5.50	4.20	1.30	30.95
MTNN*	129.05	99.00	30.05	30.35
UBN	6.85	5.60	1.25	22.32
STERLNBANK	2.20	1.90	0.30	15.79
JAPAULOIL	0.24	0.21	0.03	14.29
TRANSEXPR	0.73	0.65	0.08	12.31
AGLEVENT	0.30	0.27	0.03	11.11

Source: *NSE, Cowry Research*

*We used the Thursday, May 16, 2019 listing price of MTNN to its compute change

Table E4: Top 10 Losers

Company	28/6/2019	31/12/2018	Change (N)	Change (%)
PZ	7.10	12.10	-5.00	-41.32
INTBREW	18.30	30.50	-12.20	-40.00
FLOURMILL	14.00	23.10	-9.10	-39.39
UNITYBNK	0.65	1.07	-0.42	-39.25
NPFMCRFBK	1.05	1.65	-0.60	-36.36
GUINNESS	47.65	72.00	-24.35	-33.82
NEIMETH	0.52	0.78	-0.26	-33.33
CCNN	13.20	19.40	-6.20	-31.96
UACN	6.65	9.75	-3.10	-31.79

Source: *NSE, Cowry Research*

Equities Outlook and Investment Strategy for H2 2019

Will the Bearish Trend Last till the End of H2 2019?

As equities market failed to respond to major stimuli, such as relatively peaceful post-election conduct of the political class and transition of power, inaugural speech of the President as well as the listing of MTN Nigeria’s shares, investors’ hope of a likely strong market rebound is now left on the altars of: the timely release of the President’s ministerial list; the optimism that the appointed ministers would reel out market-friendly fiscal policies; as well as the final judgement of the Presidential election tribunal.

Following a weaker market activity in H1 2019, compared with H1 2018, we saw traded volume and value moderate by 31.26% and 32.29% to 45.78 billion shares and N538.04 billion respectively. However, we expect stimulants such as speedy implementation of the minimum wage which should increase the disposable income of citizens and drive increased participation in the local stock market. Notably, FPIs and domestic institutional investors are also expected to have renewed interest in equities market, given the likely indication that the US Fed would lower its monetary rate to support its country's economic growth. In the same vein, the current low fixed income yields environment in Nigeria which has moderated towards lower double digit should make investors see the need to gravitate towards patronizing the local equities market. Indeed, the need to invest in short term fixed assets makes less investment sense to investors now, as real return on fixed asset investments, especially treasury bills, have become negative amid increasing inflation rate; inflation rate trended upward to 11.40% in May from 11.25%, the lowest it touched in H1 2019.

Given the declining share prices, we fear that the current policy by the Federal Government to continue with subsidy payment, coupled with the high debt servicing cost – as Federal Government debt service to federally earned revenue ratio stood at 56.7% in FY 2018 –, and the excessive dependence on borrowings to finance capital projects, as well as the rising inflation rate could further contribute to the downside risk of the domestic market. These same factors would also create northward pressure on the interest rate as Federal Government is likely to be forced to increase its cost of fund to attract enough subscription for its debts issuances. We expect the Federal Government debts to chiefly be issued locally, which would spur higher rate, given the increasing foreign debts, which put a dwindling pressure on the country's external reserves, and its servicing, which obviously has become more expensive (external debts service rose to 7% in 2018 from 3% in 2017).

Our Take…

Nevertheless, we feel that the equities market has been over-beaten by investors. Hence, an upward movement of the general market gauge looks inevitable in H2 2019. Many companies' share prices are way undervalued and their dividend yields have become incredibly high. This portends good entry-price opportunity for investors to make a "finger-licking" gains in the near term. We may see the falling equity prices tending towards a possible replay of the bearish market in 2016/2017, when the local bourse came under severe bearish attack and profit-making businesses traded below their equity values. Only those investors who exercised enough patience partook in the bullish market run which eventually surfaced in 2017 when the stock market returned a whopping gain of 42.30% to investors.

Our Strategy…

Given the downside risk factors we pointed out earlier in the report, and considering the yields from alternative investments, we will surely be navigating the equities market with serious caution. We will keep tabs on the macro fronts in order to gauge the effect of policy pronouncements on various sectors of the economy and how it will affect the listed companies in those sectors. In addition, we will keep our eyes on companies that have significant market share or rapidly growing market share and doing that efficiently. Companies that shows flexibility in taking advantage of expansion opportunities will also be our target. Nevertheless, we opine that investors should exploit the current buy opportunities in the market as some companies, mostly the tier 1 banks, will announce interim dividend payment before the end of July which could be another trigger for tentative upside movement in banking share prices.

Our Centre of Interest…

For us, we will pitch our tent with companies that have sustainably settled their expenses profitability, consistently paid dividend, trading below their equity values and have good cash position. In the event of further decline in share prices, we feel companies with the above-mentioned attributes, will still deliver good income to investors at year end. Thus, we expect corporate earnings season to play a role in further lifting the domestic share prices as dividend payouts would translate to higher dividend yields amid lower share prices. Hence, we advise a medium-term equities market investment strategy – at least a holding period of nine months.