COVID-19: Implications of the Global Pandemic on Nigeria's Economy and Recommended Investment Strategy

Table of Content

Executive Summary

- Nigeria's economy, which grew by 2.77% in 2019 (higher than 1.91% in 2018) is currently in dire straits as a result of global COVID-19 (coronavirus) pandemic. The situation has created global uncertainty and loss of business and consumer confidence, slowed international trade by weakened demand, and resulted in the plunge in global crude oil prices which will have a huge negative impact on government revenue as well as Nigeria's external buffers.
- Amid hysteria in the financial markets, share prices in the Nigerian Stock Exchange crashed to rock bottom. Even stocks which obviously have good fundamentals like Zenith Bank Plc and Guaranty Trust Bank Plc lost significant value amid investor fears that the expected plunge in foreign earnings of the Federal Government would lead to devaluation of Naira against USD and, in turn, affect the banks' earnings going forward.
- Fixed income yields rose in domestic bond market amid sell offs. On average, yields on FGN bonds rose from 10.76% as at December 31, 2019 to 11.73% as at March 12, 2020; yields on local corporate bonds rose from 11.92% to 12.28% in the corresponding periods. A similar direction of yields was observed for State Government bonds. However, Treasury bills stop rates trekked southwards amid liquidity surplus in the financial system as investors, as expected, chose to remain at the short end of the yield curve in order to mitigate interest rate risk.
- The forex markets were in a frenzy due to the activities of currency speculators. Naira depreciated, week-to-date, by 2.12% to NGN374/USD at Investors and Exporters Foreign Exchange Window (I&E FXW) as at Thursday, March 12, 2020. This autonomous market is the only market segment in Nigeria where foreign exchange rate truly reflects the forces of demand and supply. Therefore, we feel that the apex bank would refer to this market segment for price discovery – in the event that the external reserves drops below USD30 billion (as previously discussed on page 4) – if it decides to increase the official exchange rate (currently at NGN307/USD) to be more market-reflective.
- Reminiscent of 2016/2017 when several banks booked increased loan impairment charges on account of significant non-performing loans due to a decline in oil prices which negatively impacted the oil and gas sector, there is a need to ascertain if the banks are armed for any possible threat of a currency risk. Having perused the financial statements of most tier-1 banks to examine their respective US Dollar based assets and liabilities (see table below), we saw that Zenith Bank Plc appears to be the bank with the best chance of mitigating currency risk.
- It is needful for investors to firm up strategies in order to guard against possible investment loss, should CBN devalue on account of worsening external sector conditions. This has become imperative in the Nigerian financial markets in light of the several headwinds facing the economy. We recommend that investors take long positions in stocks which have depreciated to rock-bottom values. Specifically, investors to bargain hunt cash cows and high dividend yielding stocks as the plunge in prices has accentuated their potential yields.
- In the fixed income space, we expect investors to diversify some of the portfolio to Eurobonds which should protect investors from currency risk and inflation risk in the event of a devaluation. Also, fixed income investors should remain invested at the short end of the yield curve to mitigate against interest rate risk as secondary market interest rates for long term bonds have been observed to be on the rise.

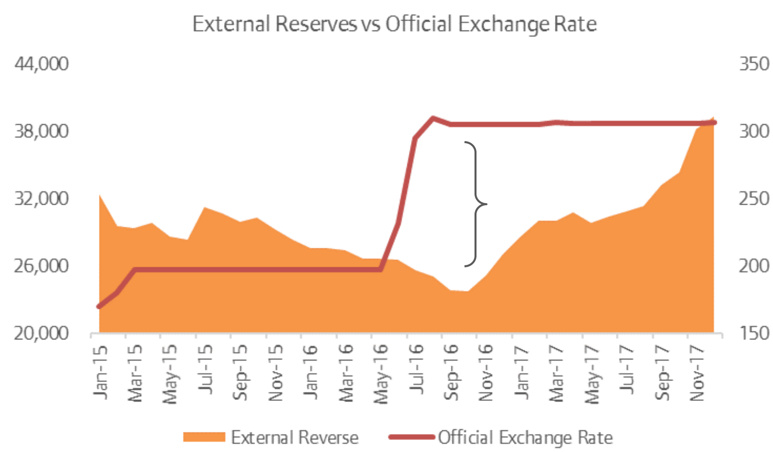
Nigerian Economy and the Threat of Corona virus, Fall in Oil Price

Nigeria's economy, which grew by 2.77% in 2019 (higher than 1.91% in 2018) is currently in dire straits as a result of global COVID-19 (coronavirus) pandemic. The situation has created global uncertainty and loss of business and consumer confidence, slowed international trade by weakened demand, and resulted in the plunge in global crude oil prices which will have a huge negative impact on government revenue as well as Nigeria's external buffers. Brent crude oil prices tanked by 39 per cent from USD58.80 a barrel on February 20, 2020 to USD35.71 a barrel on March 11, 2020 while Nigeria's Bonny light grade plummeted by 40 per cent from USD60.41 a barrel to USD36.49 a barrel during the same period. The decline in oil prices was worsened by the trade spat between Russia and Saudi Arabia that has resulted in an oversupply, leaving the more efficient producers better positioned to withstand the supply shock.

Weakening External Sector Posing Increased Currency Risk

Nigeria's merchandize trade surplus, which declined year-on-year by 58 per cent to N2.23 trillion in 2019 could turn to a deficit in 2020 having recorded a deficit of N579 billion in Q4 2019, leaving the country more prone to devaluing the currency once again and racking up more debt.

With external reserves down to USD36 billion in March 2020, there are increasing calls for the devaluation of the Naira more so as the local currency was devalued in 2016 from NGN197/USD to NGN310/USD at a time when the external reserves stood at sub-USD30 billion levels in 2015/2016.



In 2016, CBN devalued the local currency when the external reserves trended below USD30 billion. Nigeria's external reserves have consistently been on the decline, now at USD36 billion, amid sustained intervention dollar sales and falling crude oil receipts.

Source: NSE, Cowry Research

Funding Inefficiencies Arising from Lower Oil Revenue, Rising Debt Exposure

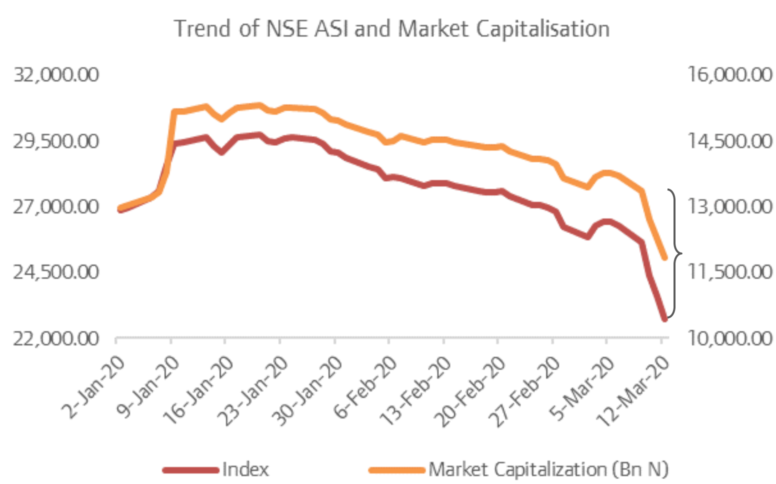
Given that the prevailing crude oil price is well below the Federal Government's budget benchmark of USD57/barrel, there is need to source critical funding needed for infrastructure from elsewhere. Nigeria's total debt stock stood at N26 trillion (USD85 billion) as at September 2019, having spiked from N12.6 trillion (USD63 billion) as at March 2015. The risk of another devaluation, in the event of any, implies higher cost of debt servicing and inefficient budgeting by the Federal Government as most of the revenue will be further deployed towards servicing a higher level of debt, in addition to recurrent expenditure.

This could be exacerbated in the event of adverse credit ratings review which could increase risk premium on sovereign debt. Thus, debt issuances of sub-nationals as well as corporates would be priced at higher premia, translating to higher interest payments which could also be compounded in the event of a significant depreciation in the value of the local currency. However, we expect corporates, especially banks, with net surplus dollar assets to benefit from potential increase in foreign exchange rate.

Impact on Nigeria's Financial Markets – Equities and Fixed Income

Equities Market

Amid hysteria in the financial markets, share prices plunged in almost all stock exchanges in the world in an unexpected manner. Not insulated, share prices in the Nigerian Stock Exchange crashed to rock bottom (see chart below). Even stocks which obviously have good fundamentals like Zenith Bank Plc and Guaranty Trust Bank Plc lost significant value amid investor fears that the expected plunge in foreign earnings of the Federal Government would lead to devaluation of Naira against USD and, in turn, affect the banks' earnings going forward.



The Nigerian equities market plunged 13.64 per cent, week to date, to 22,295.88 points as at Thursday, March amid panic selling by spooked investors in line with the global trend.

Source: NSE, Cowry Research

Fixed Income Market

Fixed income yields rose in domestic bond market amid sell offs as shown in the tables 01 through 03 below. On average, yields on FGN bonds rose from 10.76% as at December 31, 2019 to 11.73% as at March 12, 2020; yields on local corporate bonds rose from 11.92% to 12.28% in the corresponding periods. A similar direction of yields was observed for State Government bonds. However, Treasury bills stop rates trekked southwards amid liquidity surplus in the financial system as investors, as expected, chose to remain at the short end of the yield curve in order to mitigate interest rate risk. Specifically, stop rates for 91-day, 182-day and 364-day bills further moderated to 2.49%, 3.78% and 5.3% as at March 11, 2020 from 4%, 5% and 5.49% as at December 18, 2019.

Trend of Federal Government Bond YTM

Table 01	Maturity Date	TTM	31-Dec-19	31-Jan-20	28-Feb-20	12-Mar-20
FGN BONDS	13-Feb-20	0.12	4.29	2.94	6.09	7.02
	15-Jul-21	1.54	8.20	7.08	6.35	9.26
	27-Jan-22	2.08	10.21	7.08	6.96	9.84
	27-Apr-23	3.32	10.20	8.91	7.35	10.46
	14-Mar-24	4.20	10.00	9.55	6.99	11.75
	23-Mar-25	5.23	10.30	10.09	8.66	12.80
	22-Jan-26	6.06	11.10	9.80	9.94	13.79
	17-Mar-27	7.21	11.28	10.54	10.14	12.74
	23-Feb-28	8.15	11.56	10.77	10.04	12.50
	28-Nov-28	8.91	11.59	10.81	9.99	12.37
	26-Apr-29	9.32	11.61	10.83	10.01	12.21
	22-May-29	9.39	11.61	10.83	10.03	11.65
	20-Nov-29	9.89	11.63	10.86	10.08	10.81
	23-Jul-30	10.56	11.66	10.89	10.36	12.68
	18-Jul-34	14.55	11.68	11.15	10.22	12.33
	18-Mar-36	16.21	11.88	11.19	10.75	12.41
	18-Apr-37	17.30	11.96	11.23	11.93	13.28
	26-Apr-49	29.32	12.89	12.24	11.93	13.28
Average		9.07	10.76	9.82	9.32	11.73

Trend of State Government Bond YTM

Table 02	Maturity Date	TTM	31-Dec-19	31-Jan-20	28-Feb-20	12-Mar-20
14.50 EKITI II 31-DEC-2020	31-Dec-20	0.76	7.99	6.49	6.28	6.76
15.00 NASARAWA I 06-JAN-2021	06-Jan-21	0.54	5.35	4.98	4.82	5.30
15.50 BAUCHI 9-DEC-2021	09-Dec-21	1.24	8.35	6.20	6.70	7.20
17.00 NIGER III 12-DEC-2021	12-Dec-21	1.25	9.45	7.33	7.77	8.30
15.50 ONDO 14-FEB-2022	14-Feb-22	1.12	8.03	5.59	7.11	8.44
16.50 OYO 16-FEB-2022	16-Feb-22	1.21	11.29	9.07	9.91	10.83
16.50 BENUE 27-FEB-2022	27-Feb-22	1.24	9.33	7.18	7.91	8.89
17.50 PLATEAU 30-MAR-2022	30-Mar-22	1.33	10.47	8.56	8.65	9.35
17.00 KOGI II 31-MAR-2022	31-Mar-22	6.46	12.85	10.11	9.21	12.12
17.00 CROSS RIVER 27-MAY-2022	27-May-22	1.49	11.10	9.59	9.00	10.05
16.00 GOMBE 30-MAR-2023	30-Mar-23	1.90	10.56	8.09	7.26	9.35
16.50 LAGOS 30-DEC-2023	30-Dec-23	2.46	11.40	8.86	7.75	10.66
Average		1.75	9.68	7.67	7.70	8.94

Trend of Local Corporate Bonds YTM

Table 03	Maturity Date	TTM	31-Dec-19	31-Jan-20	28-Feb-20	12-Mar-20
14.75 LAFARGE 15-JUN-2021	15-Jun-21	1.26	8.97	7.40	6.93	7.90
16.45 UBA I 30-DEC-2021	30-Dec-21	1.80	10.93	8.09	7.31	9.66
16.48 FIDELITY 13-MAY-2022	13-May-22	2.17	11.38	8.76	7.74	10.64
18.25 DUFIL 1-SEP-2022	01-Sep-22	2.47	11.99	9.73	8.42	11.32
16.00 TRANSCORP I 26-OCT-2022	26-Oct-22	1.49	11.54	9.85	8.93	10.41
17.75 LAPO MFB 19-DEC-2022	19-Dec-22	2.77	13.90	12.10	10.49	13.38
16.00 UPDC 26-APR-2023	26-Apr-23	2.37	13.02	10.62	9.40	12.31
16.54 C&I LEASING I 11-JUN-2023	11-Jun-23	1.91	13.11	10.24	9.48	12.13
16.50 STERLING INV. 3-AUG-2023	03-Aug-23	3.39	11.16	10.13	8.10	11.06
18.50 WEMA FUNDING SPV I 11-OCT-2023	11-Oct-23	3.58	11.09	10.25	8.16	11.16
16.00 FLOURMILLS II 30-OCT-2023	30-Oct-23	3.63	11.58	10.78	8.68	11.69
17.25 FCMB III 8-DEC-2023	08-Dec-23	3.74	11.42	10.72	8.59	11.63
13.25 STANBIC IB 30-SEP-2024	30-Sep-24	4.55	11.16	10.84	8.15	12.15
15.75 UNION II 3-SEP-2025	03-Sep-25	5.48	12.15	11.36	9.31	13.73
16.25 STERLING INV. II 6-OCT-2025	06-Oct-25	5.57	14.18	13.28	11.42	15.79
16.50 WEMA FUNDING SPV II 12-OCT-2025	12-Oct-25	5.58	11.83	10.91	9.08	13.44
15.50 ACCESS BANK 23-JUL-2026	23-Jul-26	5.62	11.86	11.63	13.71	18.05
16.20 UNION III 27-JUN-2029	14-Dec-27	4.81	12.62	11.84	11.01	12.47
13.80 NMRC II 15-MAR-2033	29-Jul-30	6.52	12.59	11.80	11.06	14.37
Average		3.62	11.92	10.54	9.26	12.28

Source: FMDQ, Cowry Research

Foreign Exchange Market

The forex markets were in a frenzy due to the activities of currency speculators. Naira depreciated, week-to-date, by 2.12% to NGN374/USD at Investors and Exporters Foreign Exchange Window (I&E FXW) as at Thursday, March 12, 2020. This autonomous market is the only market segment in Nigeria where foreign exchange rate truly reflects the forces of demand and supply. Therefore, we feel that the apex bank would refer to this market segment for price discovery – in the event that the external reserves drops below USD30 billion (as previously discussed on page 4) – if it decides to increase the official exchange rate (currently at NGN307/USD) to be more market-reflective.

How Insulated are Nigerian Banks from the Threat of Currency Devaluation?

Reminiscent of 2016/2017 when several banks booked increased loan impairment charges on account of significant non-performing loans due to a decline in oil prices which negatively impacted the oil and gas sector, there is a need to ascertain if the banks are armed for any possible threat of a currency risk. Having perused the financial statements of most tier-1 banks to examine their respective US Dollar based assets and liabilities (see table below), we saw that Zenith Bank Plc appears to be the bank with the best chance of mitigating currency risk. It was followed by Guaranty Trust Bank Plc and United Bank for Africa Plc (UBA). However, Access Bank appears to be exposed, having reported US Dollar based net financial liability.

Our Findings

Zenith Bank Plc recorded US Dollar based net financial asset worth N667.26 billion. Its US Dollar-based assets were, aside from loans and advances to customers (N966.76 billion), concentrated on asset lines we consider as less risky – asset classes such as due from banks (N595.05 billion) and investment securities (N222.71 billion) – thus, mitigating against illiquidity. For Guaranty Trust Bank Plc, it printed US Dollar-based asset worth N505.15 billion with a dollar-based cash asset worth (N371.95 billion). Loans and advances to customers amounted to N843.58 billion while investment securities amounted to N62.99 billion. UBA Plc printed just N30.14 billion as dollar-based net asset; however, most of its assets were forward contracts and swap which were off-balance sheet items. On the converse side, Access Bank Plc recorded dollar-based net liability of N1.07 trillion as deposits of US dollars from other banks was high; thus, increasing its dollar-based liability.

US Dollar Based Assets (N' Millions)	Zenith Bank	GTBank	UBA	Access Bank
Cash and balances with central banks	35,289.00	371,955.03	301,584.00	133,256.18
Treasury bills	-	-	-	-
Assets pledged as collaterals	-	-	-	-
Due from other banks	595,047.00	364.36	86,858.00	233.14
Derivative assets	-	26,011.82	45,545.00	31.77
Loans and advances to customers	966,764.00	843,584.78	607,415.00	1,075,093.99
Investment securities	222,712.00	62,998.12	48,052.00	197,294.29
Other financial assets	189.00	17,397.07	16,852.00	-
Total Financial Assets	1,820,001.00	1,322,311.17	1,106,306.00	1,405,909.36
Swap and Forward Contracts	-	-	419,405.00	-
US Dollar Based Liabilities (N' Millions)				
Customer's deposits	816,091.00	656,145.05	607,495.00	889,539.66
Deposits from banks	-	76,565.90	188,546.00	1,154,893.15
Derivative liabilities	-	-	487.00	21.66
Other financial liabilities	-	31,932.06	27,124.00	41,266.32
On-lending facilities	-	-	-	-
Borrowings	297,556.00	52,514.84	671,649.00	279,547.91
Debt securities issued	39,092.00	-	-	110,933.77
Total Financial Liabilities	1,152,739.00	817,157.85	1,495,301.00	2,476,202.47
US Dollar Based Net Assets (N' Millions)	667,262.00	505,153.32	30,410.00	(1,070,293.10)
%age of USD Assets to Total	10.90%	14.31%	20.49%	20.91%

Source: Company Financials, Cowry Research

Our Opinion

Given the above information, should CBN devalue Naira against the USD, we expect that Zenith Bank and Guaranty Trust Bank will be well insulated from this threat; however, UBA might be relatively exposed as off-balance sheet item contributed significantly to its dollar-based asset. More so, we believe that the banks' dollar-based loans and advances would have been given to companies that earn U.S dollars as revenue given their past experiences of the negative effect of devaluation in 2016.

We consider Access Bank Plc to be the most exposed to the threat of devaluation given the net dollar-based liability. Nevertheless, there is a risk of banks' customer facing financial strain as their dollar sale proceeds might be affected by global economic crisis, thus impacting their ability to repay their loans.

Recommended Investment Strategy

- It is needful for investors to firm up strategies in order to guard against possible investment loss, should CBN devalue on account of worsening external sector conditions. This has become imperative in the Nigerian financial markets in light of the several headwinds facing the economy. We recommend that investors take long positions in stocks which have depreciated to rock-bottom values. Specifically, investors should bargain hunt cash cows and high dividend-yielding stocks as the plunge in prices has accentuated their potential yields.
- We also recommend an averaging down of their long positions by reinvesting their dividends in order to boost share count and speed up rate of recovery from unrealized losses while positioning for improved future total returns (capital and dividend yield).
- In the fixed income space, we expect investors to diversify some of the portfolio to Eurobonds which should protect investors from currency risk and inflation risk in the event of a devaluation.
- Also, fixed income investors should remain invested at the short end of the yield curve to mitigate against interest rate risk as secondary market interest rates for long term bonds have been observed to be on the rise.

Disclaimer:

This report is produced by the ***Research Desk*** of Cowry Asset Management Limited (COWRY) as a guideline for Clients that intend to invest in securities on the basis of their own investment decision without relying completely on the information contained herein. The opinion contained herein is for information purposes only and does not constitute any offer or solicitation to enter into any trading transaction. While care has been taken in preparing this document, no responsibility or liability whatsoever is accepted by any member of COWRY for errors, omission of facts, and any direct or consequential loss arising from the use of this report or its contents.