Stanbic IBTC Asset Management Limited
Quarterly Economic Review Q3:2016

ECONOMIC REVIEW

Financial market expectations for a more accommodative monetary policy stance drove the positive performance in global equity market. Consequently, the journey to a gradual recovery in the financial markets came to fruition as the fears surrounding imminent spill overs from the Brexit vote faded away. The United States economy firmed up in Q2 but growth was still disappointing. According to estimates, GDP increased at a seasonally-adjusted annualized rate of 1.1% relative to 0.8% recorded in Q1. Private consumption continued to be the main source of growth while exports remained weak. July payrolls increased strongly, providing reassurance that the U.S. labor market remains solid, whereas growth in retail sales and manufacturing sector declined in the same month. Going forward, household spending is likely to continue as a major boost to economic growth on the back of buoyant consumer confidence, improved employment and faster wage growth.

The UK's economy is beginning to stabilize following June's Brexit vote. Although post-referendum data are still being released, the British economy advanced 2.2% year-on-year in Q2 of 2016, following a 2.00% expansion in the previous period. Indicators such as yearly and monthly retail sales growth in July show that British consumers were unperturbed by the EU referendum result. Expectations are that the economy will grow by 1.5% in 2016, which is up 0.1 percentage points from last month's estimate, on the back of the accommodative policy action taken by the Bank of England.

Also, the Eurozone economy expanded by 0.3% in Q2, in line with expectations but below 0.6% growth in Q1. The Eurozone inflation rose to 0.2% in July from 0.1% in June as a result of higher food, alcohol and tobacco prices. Also, as at June, the Eurozone jobless rate remained at 10.1%.

Similarly, the Chinese economy advanced by an annual rate of 6.7% in Q2 2016, the same pace as in the previous quarter. The figure was slightly above market expectations as it was driven by a faster increase in industrial output, retail sales and new yuan loans while fixed-asset investment eased. On a quarterly basis, GDP expanded by 1.8%, the strongest expansion in three quarters compared to an upwardly revised 1.2% growth in Q1. For 2016, the Chinese government is targeting growth of between 6.5 to 7.0%.

At the home front, data released by the National Bureau of Statistics (NBS) shows that the nation's Gross Domestic Product (GDP) declined by -2.06% (year-on-year) in real terms in Q2 2016. This was lower by 1.70% from the growth rate of –0.36% recorded in the preceding quarter, and also lower by 4.41% from the growth rate of 2.35% recorded in the corresponding quarter of 2015. The implication of which includes retrenchment of workers resulting in the unemployment rate rising by 13.30% in Q2 2016 on a year on year basis while the underemployment rate in Q2 was 19.30%. As such, 32.60% of the total labour force were reported to either be unemployed or underemployed during the period. In reaction to this, the government reiterated its stance to reflate the economy by implementing the approved budget, using the proceeds of proposed $1.5bn Eurobond loan, US$3.5 billion loan from both the African Development Bank ("ADB") and the World Bank and $6bn Chinese loans to fund infrastructure projects in key sectors such as construction and rail way projects. The implication of which should drive the economy on the path of growth.

Furthermore, the Consumer Price Index (CPI) which measures inflation increased by 17.60% (year-on-year) in August, 0.5% higher than July estimate. This rise was attributed to the increase across all divisions that contribute to the Headline index such as Electricity, Housing, Water, Gas and other Fuel, Education and Transportation Services.
During the month, all the major food groups contributed to the increase in the Food sub-index (16.40% year-on-year in August from 15.80% year-on-year in July), although the pace of increase was slower for Fruits, Potatoes, Yam and other Tubers as well as Oils and Fats. In addition, imported foods as reflected by the Imported Food Sub-index increased from 0.2% in July to 20.7% in August. Price movements recorded by the All Items less farm produce or Core sub-index increased by 17.20% (year-on-year) in August, up by 0.3% from July level. The highest increases were seen in Solid fuels, Vehicle parts, Books & Stationeries and Clothing. On a month-on-month basis, the headline index rose by 1.0% in August, marginally lower than the 1.3% recorded in July. This is the third consecutive month of a diminishing increase in the headline Index.

MARKET REVIEW

The Monetary Policy Committee ("MPC") of the Central Bank of Nigeria ("CBN") met on 25/26 of July 2016. Contrary to market expectation of relaxed monetary policy in light of negative GDP growth rate of -0.36% in the first quarter, the MPC decided to tighten monetary policy by adjusting the Monetary Policy Rate ("MPR") upwards from 12.00% to 14.00% while retaining the Cash Reserve Ratio ("CRR") at 22.50%. This action was taken in order to spur liquidity in the Foreign Exchange Market by attracting foreign investors and also to mitigate the effect of negative real return on investment. As such, there was a spike in Treasury bill rates to late teens of between 17.00% p.a. to 18.50% p.a. from a low of 8.00% p.a. to 13.50% p.a.

Furthermore, for most part of the quarter, the CBN continued to mop-up liquidity in the system via OMO & bond auctions thus leaving the system with negative liquidity occasionally, causing Overnight and Open Buy Back rates to hover around an average of 33.00% p.a. and 35.00% p.a. during the quarter from an opening level of 4.00% p.a. and 5.00% p.a. respectively. However, despite the call to ease rates due to the need to stimulate the real economy following two consecutive quarters of negative GDP growth, the CBN in its last MPC meeting for the quarter, in September, retained all monetary policy parameters. The committee opined that the economy needs a fiscal stimulus to jump-start growth as opposed to a monetary response given the high level of inflation. Also, the committee did not believe a further tightening was necessary as inflation is now increasing at a decreasing rate.

In the Foreign exchange market, the CBN governor met with prospective investors and Nigerian debt holders in New York and London in July, and decided to reduce its level of intervention in the foreign exchange market which resulted in further depreciation of the currency from ₦280.50/$ to ₦311.62/$ (a further currency depreciation of 11.09%) at the interbank market while the exchange rate at the parallel market traded as high as ₦490.50/$. On a Year-to-Date basis, the Naira has depreciated by 56.20% and 78.57% at the interbank and parallel markets respectively. In addition, the second tranche of the OTC FX Futures contract (NGUS AUG 24 2016) with a notional value of $152.48m at $/₦310 matured on 16 August 2016. This contract was replaced with a new 12-month contract (NGUS AUG 16 2017) with an estimated offer of $1bn at $/₦241. However, the market continued to experience dollar scarcity partly due to the ban initially placed on nine banks from FX sales. This scarcity led to a further depreciation of the naira and widening of the band between the interbank and the parallel market to c,52.43% from 18% observed in July.

In the equities market the significant decline in daily crude oil production particularly in the first two months of the quarter and failure of the recently implemented flexible exchange rate framework to significantly increase foreign exchange liquidity sent negative signals to local and foreign investors alike. Furthermore, the publication of weak macroeconomic data which indicated that Nigeria was in a recession coupled with the release of subdued H1 2016 results by blue chip companies also dampened investors' confidence in the market. As such, investors' participation and value traded during the quarter decreased by approximately 32.82% to close at ₦299.37 billion compared to Q3 2015 level of ₦445.60 billion. As a direct consequence of the above, the equities market recorded negative performances of -5.36% & -1.47% in July & August albeit a positive performance of 2.67% was recorded in September. Similarly, all sectorial indices recorded negative performances during the quarter with the exception of the Consumer Goods and Oil & Gas sectors. As such, the equity market returned -4.27% and -1.07% for the quarter and year to date respectively compared to 3.34% recorded in H1 2016.

OUTLOOK

We expect market attention to shift from policy uncertainty to political uncertainty in the fourth quarter, ahead of the US presidential elections in November 2016. On the policy side however, mixed messages from the US Fed has again left markets guessing when the next interest rate hike will come to fruition. However, we expect a second rate hike of 25 basis points in December 2016. We are also of the opinion that the stimulus by the European Central Bank ("ECB") will still continue as most countries within the European Union still report weak figures. Overall, we expect a volatile global stock market for the rest of the year, in reaction to macro and political risks.

On the domestic scene, we expect FX volatility to continue amidst structural imbalance between US Dollar supply and demand. Nevertheless the financial inflows should be sustained by government borrowing, which includes the proposed $1.5bn Eurobond loan, US$3.5 billion loan from both the African Development Bank ("ADB") and the World Bank and $6bn Chinese loans. We expect headline inflation to continue to inch upwards at a decreasing rate and to settle at c,18% levels in Q4. The impact of improved domestic supply of food (associated with the onset of the harvest season), combined with tight monetary policy and efforts by the CBN to stem upward pressure in the interbank foreign exchange rate, could result in lower price pressures towards year end. Also the yield curve has remained relatively flat as a result of the interbank liquidity tightening activities of the CBN. We see the risk of a continued inverted yield curve in the fourth quarter, as the CBN continues to face pressure to support the naira via tight monetary policy stance.

Furthermore, the lingering foreign exchange scarcity coupled with record high input cost is expected to continue to dampen companies Q3 2016 earnings especially those in the Consumer Goods sector. Also, we opine that more companies will report foreign exchange losses and lower profitability margins as they continue to focus on repackaging or resizing so as to defend market share. In addition, attractive yields on fixed income investments, the possibility of a rate hike by the US Fed and the outcome of the referendum in Italy is expected to weigh heavily on investors participation in the equity market. Based on the foregoing, we expect a muted performance for the equities market in Q4 2016.

CONTACT US: Efe Omoduemuke or Jide Allo WEALTH HOUSE Plot 1678 Olakunle Bakare Close Off Sanusi Fafunwa Victoria Island Lagos P. O. Box 71707 Victoria Island **Telephone:** +234 (0) 1 2801266 Ext 2314: 2315, Fax: +234 (0) 1 2805442, 2805443 **Website:** www.stanbicibtcassetmanagement.com