



# Executive **Summary**

## The Nigerian Capital Market Report 2021

Capital Market Review: Beyond Omicron,  
The Rise of the **Digital Economy**



**February 2022**

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# Executive Summary

## Introduction- Peaks and Troughs

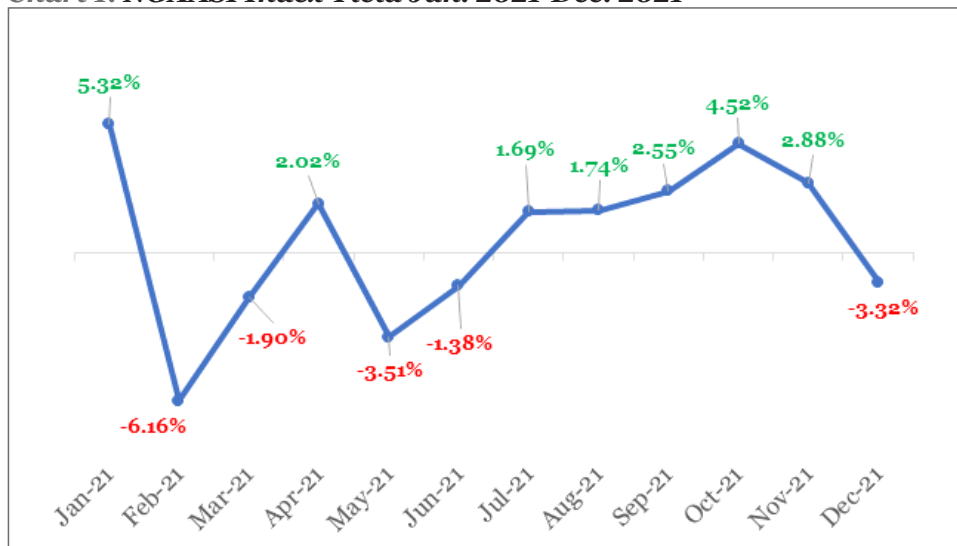
*“The most contrarian thing of all is not to oppose the crowd but to think for yourself” -Peter Thiel*

Thinking independently was a large part of intelligent investor behavior in 2021 as the NGX All Shares Index (ASI) began to shake off the adverse consequences of a COVID-19-induced market meltdown. As global financial markets felt the pinch of disrupted supply chain networks, slow retail demand recovery and rising domestic price levels, investors became increasingly concerned about equity returns and probable fiscal tightness on the back of a global liquidity glut.

With Western nations witnessing historic rises in domestic inflation rates and governments deciding to turn on the fiscal screws, emerging markets like Nigeria saw modest responses. The ASI Index yield fell from -5.32% in January 2021 to -6.16% in February before a modest reversal saw the Index declining by -1.90% in March. The NGX market Index yield went back up at the beginning of Q2 2021 with a yield of +2.02% before crumbling to -3.51% in May and -1.38% in June.

For the rest of 2021, market yields were positive until the Index slumped again in December. Investors saw yields dip five times in 2021, but they also saw market returns positive for seven months of the year.

**Chart 1: NGXASI Index Yield Jan. 2021-Dec. 2021**



Source: Proshare Markets, NGX

The Nigerian market struggled to keep yields positive in 2021, but different moving economic parts ensured that the local equity exchanges remained mildly attractive. The new year 2022 should see more robust gains as investors take an optimistic view of corporate performance, taking a cue from the upward-looking Stanbic IBTC Purchase Manager's Index (PMI), which was at 56.4 of December 2021 as against 55 in November. However, in January 2022, the Index slipped to 54.

Analysts believe that the stock market may experience a gradual cooling of inflation pressures that nudge the Central Bank of Nigeria (CBN) to increase interest rates. Suppose the fiscal financing gap widens by



H1 2022. In that case, the fiscal authorities could raise coupons on domestic bills to encourage local institutional investors and high net worth individuals to buy government debt instruments. The consequence would be the crowding out of the private sector in the domestic loan market and the rise in the cost of private-sector debt. The surge in finance expenses for quoted companies and the increase in money market rates would combine to depress equity prices.

As the Nigerian market saw a gradual resurgence in 2021, other global markets equally witnessed recoveries. The Argentine MerVal grew by +63% in 2021; the French CAC 40 rose by +28.85%, the Austrian Traded Index (ATX) went up by +38.87%.

In 2022, the corporate equity market will struggle to balance the tightness or looseness of fiscal and monetary policy and the direction of global oil markets. Tight monetary policy in H1 could drag the market down a few notches, while fiscal looseness could equally push stock prices lower if monetary policy becomes hawkish or tight. For example, suppose the CBN attempts to control inflation by raising rates simultaneously with increased public spending due to pre-2023 election activities. In that case, the resulting rise in domestic interest rates could hurt several companies on the local bourse or exchange.

To figure out the potential market plays for 2022, our market review report noted that investors would have to watch monetary and fiscal policy during the year while they throw a side glance at the international oil market. With oil prices at over US\$90 per barrel in February 2022 and with oil prices destined to average US\$80 per barrel for the year, some critical variables to watch are the country's oil production volumes and sales. Nigeria's 2022 budget placed oil output at 1.88mbd against 1.86mbd in 2021. The current oil output is closer to 1.66mbd, and there is a slim likelihood that this would change any time soon. The inability to raise volumes beyond 1.7mbd means that revenues would be below budget expectations. A widening budget would require a fiscal plug of either more foreign loans or increased borrowing from the domestic capital market, or a likely increase in tax rates or the tax base.

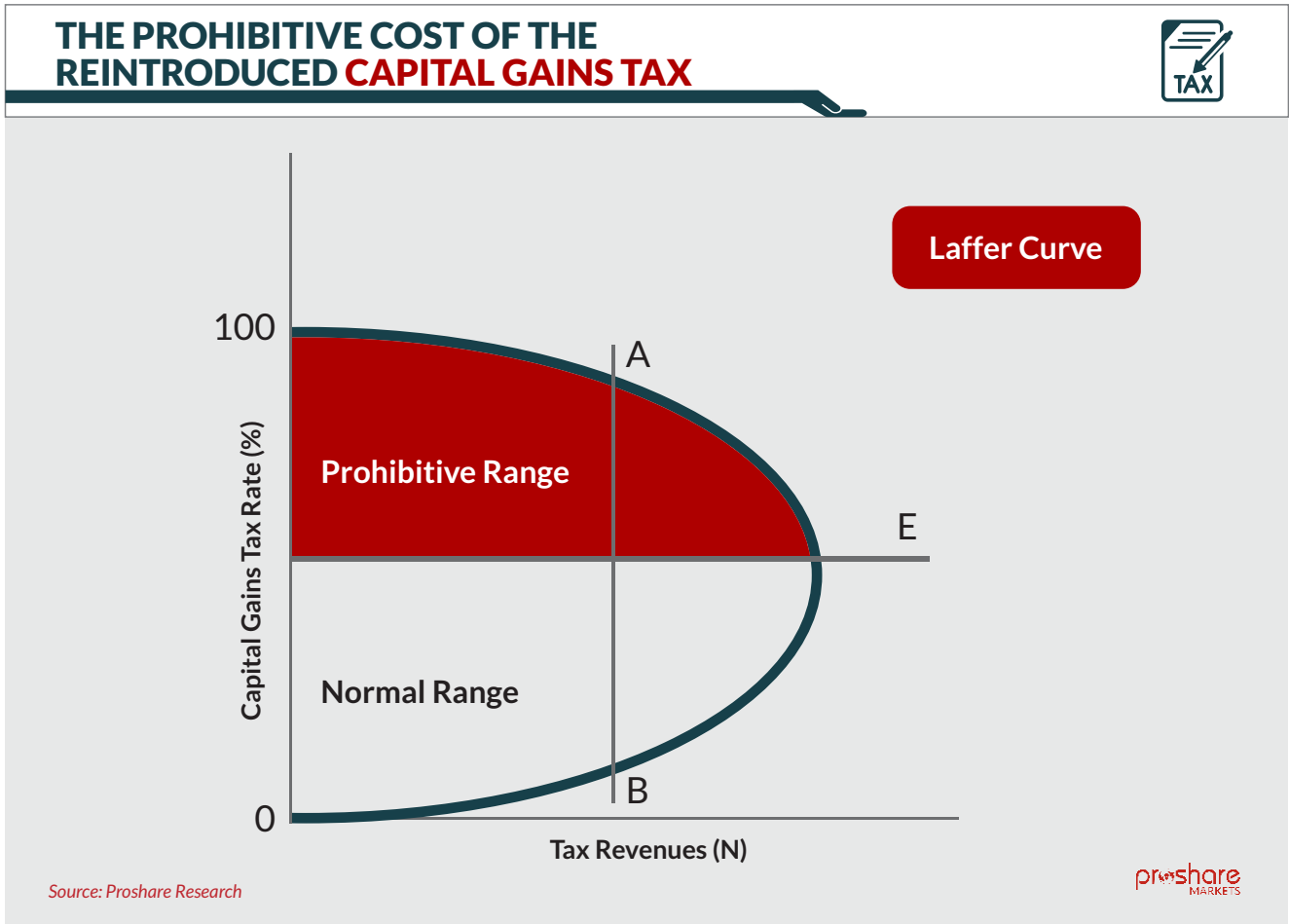
## On the Matter of taxes

While looking at taxes in 2022, our report notes that the year represents the end of the 10-year tax waivers on corporate and government debt instruments approved for commencement in January 2012. The consequence of the lapse of the concession on taxes on debt instruments is that from January 2022, investors will have to pay taxes on the incomes they earn from investments in short-term government bills and corporate commercial papers (Cps). The implication would be that activities in fixed income instruments in the domestic money market would be subject to tax. Analysts would, therefore, have to calculate the after-tax returns of these instruments in the absence of a tax shield.

The reintroduction of taxes on retail transactions on fixed-income investments makes these instruments less attractive. The restored taxes could slow down the growth of the CP market as after-tax coupon incomes could prove to be much lower than the post-tax returns on other investment assets. The federal government's search for internal revenue is understandable given the projected budget deficit of N6.4trn in 2022. Analysts, nevertheless, believe that imposing or reimposing taxes on secondary capital market activities could throw a pail of ice over investors' passion in the capital market and unintentionally slow down domestic economic growth, which would drag back the government's tax revenue. Higher taxes are only pretty when revenues increase as taxes rise; otherwise, raising taxes could be an ugly case of catching smallpox to prevent measles (or what economists would recognize as the Laffer Curve. (*see illustration*)).



Illustration:



### The Fear of Rising Interest Rates

If interest rates rise in 2022, equity markets will see a decline, which would likely adversely affect investor yields. Inflation expectations would equally lead to a short-term rise in rates and lead to a stock market dip. Indeed, a rise in rates would likely see a sell-off of fixed income assets as bond prices fall and yields rise.

The direction of inflation in 2022 would be of interest to investors as they rebalance asset classes within portfolios. Fixed-income assets will increase if coupon rates rise, but if coupon rates stagnate, investors will vote with their feet and search for superior returns elsewhere. With heightened inflationary expectations, investors are likely to weigh their portfolios more heavily with equity and money market assets. Our report shows, for example, that Money Market Mutual Funds provided the best Mutual Funds yields in 2021, a trend that may repeat itself in 2022. The Equity Market Mutual Fund gave the second-best returns, followed by the Fixed Income Mutual Funds and the Mixed Mutual Funds taking up the rear. The report underscored the importance of equity in the capital markets and emphasized the adverse impact on investors' portfolios if interest rates rose notably in 2022.

A rate rise would be contingent on the pace of inflation in 2022 and the preparedness of the CBN to restrain accommodation of fiscal spending through ways and means. Considering that 2022 is a pre-election year, the likelihood of a hard break on money supply growth is slim. The consequence would be



loose fiscal spending combined with accommodating money supply, typically resulting in a sustained gross domestic product (GDP) growth and a moderate rise or fall in interest rates. Analysts are still keeping an eye on the body language of the CBN in Q1 to see if a rate rise would be plausible.

## The Currency Gamble

Nigeria's currency market has been a game of Russian Roulette. In the last twelve months, it has been a one-story narrative of a downward-facing string of values. However, suppose the country can increase oil production and sales to the 2022 budget estimate of 1.88m barrels per day at an average price of US\$80 per barrel. In that case, thenation's foreign reserves should get a shove in the back and rise to between US\$45bn and US\$50bn (in contrast to a consensus analyst forecast of a fall in reserves of between US\$30bn and US\$35bn in 2022).

A potential rise in reserves could lead to a marginal increase in the naira value. Unfortunately, a lot depends on variables that the country has no control over, such as the international price of crude oil and the future global supply and demand conditions. Although most currency traders have opted to short the Nigerian currency believing that in line with **Murphy's law**, what can go wrong can get worse. Suppose the market turns out better than expected? In that case, several currency dealers could go home losing a tidy bundle, including their shirts and blouses, which would be an exciting but unfriendly outcome.

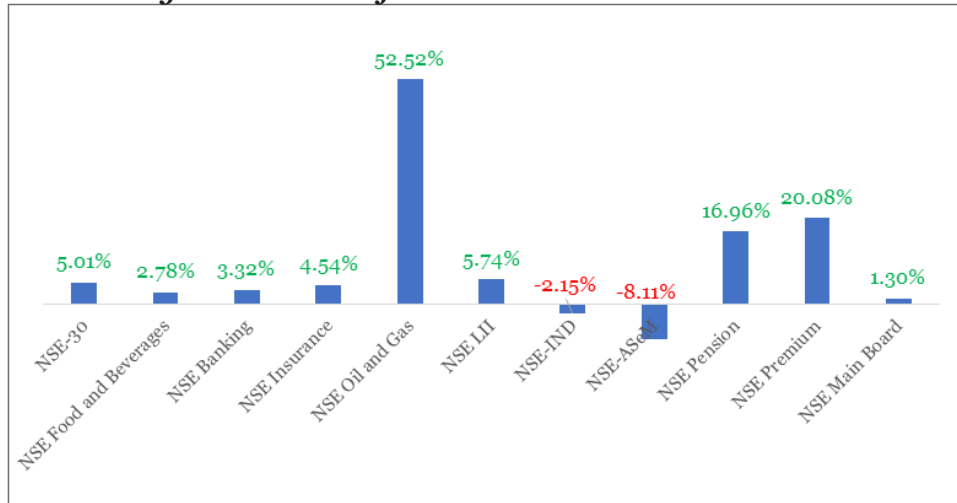
## Markets in Post-COVID Transition

**Section 1** of this report looks at the global equities markets and dissects the performance of equities across Europe, America, Asia, and Africa. The report noted that most of the global stock markets tracked by Proshare closed the year positive amidst economic recovery after the coronavirus pandemic. In the year under review, amongst the Thirty-one (31) stock markets reviewed, (26) were in green which signifies an improvement, (5) stock markets were in red, which indicates losses. Argentina MerVal topped the list with a **+63.00%** gain, followed by Austria ATX and East Israel TA-100 with **+38.87%** and **+31.15%** gains, respectively, to complete the top 3 gainers for the year. Conversely, Hong Kong's Hang Seng, Brazil's Bovespa, Malaysia's KLSE dipped by **-14.68%**, **-11.93%**, and **-3.67%**, respectively, to top the list of markets in the red. The Nigerian Stock Market, our primary monitoring market, the key benchmark index, NSE ASI, YTD closed with gains of **+6.07%**.

The section also reviewed continental and local markets and showed that Africa's markets recovered from a COVID-19-induced decline similar to their Nigerian counterpart (*see chart below*). Compared to the previous year, there was an improvement in Africa's stock market in 2021. Amongst the seventeen (17) African stock markets reviewed, (16) were green showing an improvement, while only one (1) was red, indicating a dip. The Zimbabwe ASI topped the list of gainers with a gain of **+310.51%**, while Lusaka's ASI and Ghana GSE Composite Index were second and third with gains of **+54.89%** **+43.66%**, respectively. Rwanda's RSE ASI was the only loser, with a loss of **-1.90%**.



Chart 2: Nigeria's NGX Performance YTD 2021



Source: Proshare Markets, NGX

**Section 2** of the capital market review for 2021 reviews Fixed Income investments and the local foreign currency market. In contrast to 2020, where investors pulled the rug from under the market as they migrated to equities, in 2021, they chose the bonds and bills market in preference to the equity arena.

The attractiveness of the fixed income market rode on the back of foreign portfolio investors, leaving the domestic equity market in search of better returns elsewhere. It also reflected rising global inflation rates, dragging up interest rates and making bond prices topple as yields rose. Investors crammed into the bonds and bills markets as they decided to take advantage of higher prospective yields to enhance their portfolio returns.

On the other hand, the currency market was a one-way bet, with the naira sliding steadily over the twelve months. A rebound in the post-COVID-19-induced global economy would encourage investors to move to safe-haven assets such as the British pound, United States dollar, Japanese Yen and the European Euro. The report observed that the currency market will have important influence of activities in the capital market in 2022 as both domestic and international investors keep an eye on the dollar-denominated returns of the local market.

**Section 3** of the report looks at other asset classes, particularly Mutual Funds. Mutual Funds did pretty well in 2021, particularly the Fixed Income and Money Market Funds, which saw net asset values (NAVs) rise higher than the average domestic headline inflation rate of around 16% in 2021. Beyond Fixed Income and money market funds, Bond Funds also did well. Bond funds saw NAV growth ranging between +35.89% and +95.80%. Analysts had noted that Bond Market Mutual Fund investors operate at the longer end of the capital market with their required rates of return typically higher than annual inflation expectations.

Mixed Mutual Funds were much less inspiring in 2021 than other Fund categories; the NAV Funds witnessed relatively flat returns across assets. Some outliers existed, but the growth rates were lower than the average domestic inflation rate in 2021. Mixed Mutual Funds instruments are still likely to produce inferior returns in 2022 as investors steer clear of assets with low and highly variable returns. Investors may stick with the 2021 asset allocation playbook in 2022 with Mutual Funds' investments tilted towards Money and Fixed Income Mutual Fund portfolios.

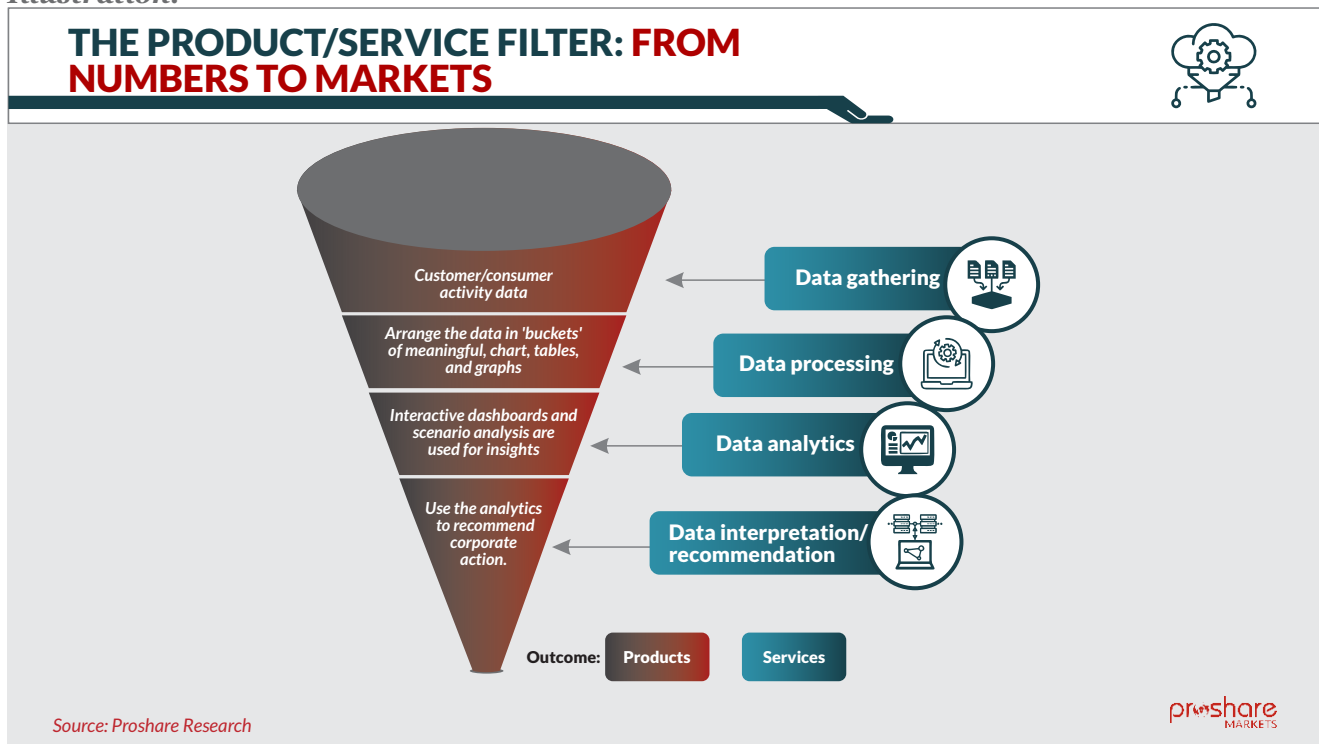


**Section 4** of our report gives a compendium of regulatory rules that shaped the Nigerian capital market in 2021. The report reviewed market regulatory actions in the year. The regulators maintained a steady watch over the market and kept close surveillance in their areas of jurisdiction. Except for the **BOFIA 2020** and **CAMA 2020**, no principal enactment or major regulatory reforms occurred in 2021.

Nevertheless, the separate regulators issued various circulars, draft rules, and directives at intervals to maintain the stability and integrity of the markets. Our 2021-year end market review focused on regulatory actions from the **SEC, NGX, CBN, AMCON, FMDQ** and **NASD**.

**Section 5** of the report reviewed emerging technological trends in the Nigerian capital market and consequences for players and market regulators. The report referred to a recent WiredUK report noting that **“Digitalisation has spread through every sector, creating new opportunities. But just having data is no longer enough-companies need to harness its power to gain competitive advantage, especially when it comes to financial trading”**. The section emphasized that data was not enough to create the competitive advantages that companies would require to create business sustainability. The report's authors highlighted the importance of technology architecture that filters data in a form that provides hindsight, insight and foresight of consumers' service and product delivery expectations (*see illustration below*).

**Illustration:**



Data will increasingly change from a business operation add-on to a central part of the business's value-creation process and the its development of new products and services to fill market 'gaps' or 'white spaces.' In 2022, analysts are convinced that digital technology will be an increasingly urgent hot button issue as corporations battle to rethink and restrategize their businesses as they use blockchain technology and artificial intelligence/ machine learning (AI/ML) to shape the competitive state of play in new and old markets.



## Advice to Users of this Report

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Head, Research

Chief Economist/Managing Editor

# CONTACTS

This report was put together by Saheed **KIARIBE**, Teslim **SHITTA-BEY**, Adaeze **NWACHUKWU**, Bukunmi **ADEJOBI**, Eniola **ENIAFE** and Abdulqudus **ISIAKA**, under approval by Proshare **Research**. Production of report put together by Proshare **Graphics**


## Editorial Team:

Grace 'Jare-AJUWON [grace.ajuwon@proshareng.com](mailto:grace.ajuwon@proshareng.com)


Reshu BAGGA [reshu.bagga@proshareng.com](mailto:reshu.bagga@proshareng.com)

Teslim SHITTA-BEY [teslim.bey@proshareng.com](mailto:teslim.bey@proshareng.com)


Saheed KIARIBE [saheed.kiaribe@proshareng.com](mailto:saheed.kiaribe@proshareng.com)

 PROSHARE NIGERIA: The Upper Room Plot 590b,  
Lekan Asuni Close Omole  
Phase II, Isheri LGA P.O.Box 18782, Ikeja,  
Lagos, Nigeria.

 @proshare

 Proshare Nigeria

 0700 PROSHARE

 +234 805 585 2156

 proshareng

 [contact@proshareng.com](mailto:contact@proshareng.com)

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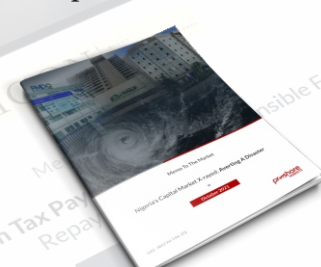
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