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Monthly Market Report

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Issued by: Imara Asset Management Limited
Author: Tony Schroenn, Craig Bandason, Rainer Orth

Market snapshot

May was a very weak month, with markets down in local currency terms, which was compounded by currency depreciation in some markets. The sell-off in emerging and frontier markets that started in April, continued in May. In Africa, the negative performance, comes against the backdrop of a strong 1Q reporting season. We are seeing more opportunities as valuations become more attractive when the price drops and earnings outlook remains intact.

Zimbabwe was up 9.3%, however these gains were dwarfed by a 30% depreciation in the OMIR. All other indices were down with Egypt (-8.5%), BRVM (-8.1%), Nigeria (-8.0%), Morocco (-7.4%), South Africa (-5.3%), Kenya (-4.9%) and Mauritius (-4.0%). Most currencies were down 1-3% vs the USD.

Economic and political overview

Nigeria – Headline inflation fell to 12.5% y/y in April, down from 13.3% in March, which is the 15th month of disinflation. The MPC decided to keep rates unchanged, which was in line with our expectations. We mentioned in our previous factsheet that we believe that for now the Central Bank of Nigeria (CBN) is more focused on inflation as opposed to growth. This was confirmed in their hawkish statement, which mentioned risks to inflation in the second half of the year from government spending and heightened global volatility. 1Q18 GDP numbers disappointed slightly, GDP was up 2% y/y behind expectations of c2.5%, however the number is still well above the 0.8% that was achieved last year. As long as oil prices remain buoyant, we argue below that this is a number that should improve.

We were encouraged by the May Federal Account Allocation Committee (FAAC) allocation of N701bn, which is up 65% over May 2017 (see chart at end of report). We previously noted the increase in NGN/barrel from a low of 7,000 to the high 20,000's. The FAAC is one of the main transmission mechanisms for, and the clearest way to track, money from increased oil revenues going back into the economy. This also gives us some confidence that the budget, finally passed in May, with 25% growth in expenditure, could be executed. This should act as a catalyst for GDP growth via higher capital expenditure and current (mostly salaries and arrears) expenditure. Timeous payment and wage increases should see increased consumer disposable income, reinforcing GDP growth. Cement volumes got off to a weak start, down 5% in January and February but have shown a sustained bounce, up 10% in March and 15% in April and May. We are comfortable that spare capacity in most sectors and hawkish monetary policy, should temper inflationary pressures.

Egypt – Similar to the CBN, the Central Bank of Egypt (CBE) decided to keep policy rates unchanged, citing global volatility and upside risks to inflation (due to elevated oil prices and upcoming subsidy cuts) as the reason. We also believe that the CBE had one eye on the potential impact of portfolio outflows from the carry trade investment in T-bills, which has been a major contributor to FX reserves. Between November 2016 and July 2017 the CBE hiked rates by 700bps following the EGP devaluation, in 1Q18 so far we have seen 200bps worth of cuts, on a net basis policy rates are still 500bps higher than pre-devaluation. The tone of the latest MPC points to perhaps a slower pace of monetary easing as inflation normalises.

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We were encouraged by the credit growth numbers and the corporate earnings from the banks sector. Credit growth was +7% q/q, the strongest quarterly growth number post-devaluation. Retail loan growth (1Q18 retail loans were up 25% y/y) remains a key driver and corporate loans are mainly short term, working capital loans. Corporate loan growth is subdued due to the high interest rate environment and rates need to come down further in order for borrowers to tap into longer term capex loans.

Kenya – The MPC chose to keep rates unchanged preferring to adopt a wait and see approach, in the statement they mentioned the need to see the impact on the economy of the rate cut in March. Despite some corporates and policy makers saying otherwise, we expect inflation to pick up slightly due to food and fuel prices. Our view is that the MPC is unlikely to cut rates further this year. Inflation for the month of May rose to 4.0% y/y from 3.7% y/y in April. The big macroeconomic policy calls will come from government.

We have previously discussed one of the two, namely the framework for interest rate caps, the second policy decision is the proposed income tax bill. In its current form, the two contentious issues in the bill are 1) an increase in CGT to 20% from 5% and 2) an increase in the corporate tax rate to 35% from 30%. The IMF is pushing for improved fiscal management and we believe the tax increases are part of this negotiation alongside rate cap repeal/modification. There is significant push-back from several MPs on rate cap repeal so we see rate modification (repeal of old bill + introduction of a usury law of sorts) as a more likely outcome. The rate cap has definitely dampened credit extension and this self-defeating policy has significantly reduced the growth of SME's which have seen their access to credit drop significantly. In the MPC statement the committee mentioned that private sector credit grew at 2.8% from 2.1% in February.

While credit is growing, it remains low compared to pre-rate cap levels. In the Kenya Commercial Bank 1Q18 conference presentation, the highest growth y/y in credit over the past 12 months to February 2018 was 3.3%. Equity Bank noted in their results presentation that the number of borrowers on their books were cut from 1.2m to 700k after rates were capped. For a fast-growing frontier market, where credit should be an enabler to private sector growth and job creation remains crucial, this number is sub-optimal.

Mauritius – The Bank of Mauritius (BoM) MPC met at the end of May and decided to keep rates unchanged, the key repo rate (KRR) remains at 3.5%. The MPC highlighted that the upside pressures on food inflation started dropping in April and that inflation remains under control. Headline inflation for April was 3.7% y/y but the committee gave guidance that it expects inflation to average 4.2% in 2018, with potential upside risks due to higher oil prices. BoM continues to mop up excess liquidity resulting in money market rates rising.

We listened to the Mauritius Commercial Bank (MCB) 3Q18 conference call and the NIM improvement reflects this. On the call MCB management spoke of a moderate macroeconomic recovery which has led to credit growth of 9% y/y. We have been positively surprised with the capital inflows into Mauritius, which has kept the currency relatively stable and grown FX reserves. As at the end of April, FX reserves were USD6.4bn, up from USD6.0bn in December 2017. The slight negative, was the April tourist numbers, tourist arrivals dropped by 5.8% y/y. However, tourist arrivals are still up 2.3% y/y for the 4 months January to April 2018 compared to January to April 2017.

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Zimbabwe – President Emmerson Mnangagwa formally announced the 30th of July 2018 as the date for the harmonised election to choose the President, National Assembly members and Councilors. We view the announcement of an election date as positive and we are encouraged that the President is inviting international observers. However, the MDC remains suspicious and has been vocal in its opposition to holding elections without significant electoral reform. Nonetheless, we feel elections are likely to go ahead despite MDCs stance. In early polls ZANU PF appears dominant in the rural areas, its traditional support base but the urban areas are much more competitive.

Market outlook

Nigeria – The results season confirms a recovery and clear path to normalisation of the economy. Consumer companies are able to shift volume and we expect pricing to improve, especially later in 2018. We maintain a large allocation to banks and the top consumer names in the food and beverages sector, following the drop in prices during the month, valuations are looking more attractive. Our preferred banks are well positioned to make money from fees. Overall, banks will make less profit from yields as the curve drops in 2018, but higher NGN liquidity, strong growth in trade facilities (LCs) and mobile bank fees will still mean good growth in earnings. Consumer names we hold have traded through tough consumer conditions to gain market share, the announcement of an expansionary budget points to increased liquidity pre-elections, which could be a nice kicker to 2H18. In the same breadth, pre-election instability remains the biggest risk factor to a strong recovery.

Egypt – The economic recovery is continuing as expected and most management teams are positive and expect conditions to improve further. We are seeing volumes recover as wages catch-up to inflation, upside risks to inflation from subsidy removal and rising oil prices, but there is enough positive momentum to maintain the growth trajectory.

Kenya - We expect the modification of interest rate caps despite political noise around the issue. Kenyatta's strong political position, his majority in parliament and public utterances on the need for growth in credit to SMEs supports it. Bank management teams are confident that rate caps will be removed before September. We believe current low Price-to-book valuations and a positive shift in money supply, that rate cap removals will bring, provide a unique asymmetric opportunity. Bullish CAK data supports the mobile money theme we play through Safaricom and Equity Bank. The draft income tax bill is another factor, we believe our investments should be able to absorb the higher taxes given their current growth projections but the proposed increased in CGT from 5% to 20% is a risk factor and if passed will have an a negative impact on the market in general.

Morocco - Our outlook remains unchanged, we continue to search for attractively priced growth investment opportunities with our existing investments showing moderate growth and attractive dividend yields.

Mauritius - The country continues its moderate recovery and we are happy to see the BoM continuing to mop up excess liquidity, which is pushing up money market yields. The 3Q18 MCB numbers reflect this, showing NIM expansion and loan growth of 9% y/y.

Zimbabwe – Zimbabwe has its highest chance of a positive outcome, a lot depends on credible, free and fair elections. We have always taken a long term view to Zimbabwe, preferring to look through the political noise and focusing on identifying corporate champions that can generate shareholder wealth no matter the environment. The start of the year has seen our companies release very strong results despite the chronic foreign currency shortages. We believe we are well positioned to capture the upside following a positive election and have companies that are resilient if the outcome is negative (nationwide vote rigging, violence, lack of legitimacy).