Edition:	December 2018
Region:	Africa ex South Africa
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Market snapshot

Markets (MSCI indices in USD/currencies vs the USD) – A weak December brought to an end a 2018 that started strongly, but ended up being a very difficult year for markets. As the table below shows, there was almost nowhere to hide in 2018.

YTD Performance (%)	LCY	USD
Mauritius	0.7	-0.7
Tunisia	15.7	-5.8
Morocco	-8.2	-10.2
MSCI World	-10.4	-10.4
Egypt	-13.2	-13.8
MSCI EM	-16.6	-16.6
Kenya	-17.9	-16.9
Zambia	-1.4	-17.1
Nigeria	-17.8	-18.6
Botswana	-11.3	-18.8
South Africa	-11.3	-23.6
BRVM	-29.1	-32.4

For the month of December, there were a number of gainers with BRVM + 4.7% (mostly on Euro strength), Nigeria up 1.9%, Morocco +1.1% and SA +0.8%. Kenya was the leading decliner (-3.3%) with Botswana (-2.5%) and Egypt (-2.1%).

Economic and political overview

Nigeria – November inflation came in at 11.28% y/y, almost unchanged from October. 3Q18 real GDP growth came in at 1.81% y/y, which is above the 1.5% recorded in 2Q18, but still below expectations. Non-oil GDP growth was satisfactory at 2.3%, but the oil sector remained in contraction at -2.9% y/y. Part of the problem for the oil sector is access to capital to fund new production wells.

Banks have been in clean-up mode, focusing on debt restructuring rather than new credit. M&A also reflect the low point in the credit cycle. Access Bank, a Nigerian Tier-2 with aspirations of Tier-1 status, announced the acquisition of Diamond Bank in December. The valuation was done at a price to book of 0.4x and Access expects to write off 20-25% or c.EUR400m of Diamond's loan book, mainly related to the oil/gas sector. We believe this is a late stage in the clean-up and expect access to credit to improve in 2019.

The draft FY19 budget was released and the downward revision of GDP growth is very noticeable. Down to 2.1% from the initial 3.5%. It is also noticeable that budget numbers were scaled back for 2019. The oil production assumption for FY19 is 2.3mbpd. Rather aggressive when you compare it to 1.95mbpd achieved in 9M18. The GDP growth projection for 2019 is 3.01%. The slow muddle-through economy, reflects in our bottom-up perspective. Real volume growth is hard to come by. The better consumer companies are doing 2-3% volume growth, while high internal returns on invested capital and strong brand equity allow them to protect price and profit margin. The tightening cycle has had a negative impact on all our corporates, with varying degrees of sensitivity. Elections draw nearer (February 2019), and the policy implications will be significant. Post-elections we hope to see an easing policy stance, which will enable a higher growth trajectory.

We mentioned in our previous reports that job creation will be key in the upcoming election and looking at the NBS labour force statistics report reinforces this point. The headline is that the unemployment rate rose to 23.1% in 3Q18 up from 18.8% in 3Q17. The key stats from the report are below:

- Economically active working age population increased by 4.4m from 3Q17 to 115.5m in 3Q18.
- The number of people employed rose to 69.5m in 3Q18 from 69.1m in 3Q17. Of the 69.5m employed, 51.3m were in full-time employment and 18.2m in part-time employment.
- The number of people classified as unemployed, which means they did nothing at all or worked too few hours (under 20 hours a week) to be classified as employed increased from 17.6 million in 2017 to 20.9 million in 3Q18.

Egypt – Headline inflation in Egypt dropped to 15.7% y/y, down from 17.7% in October (*figures just released last night show December CPI +12.2%*). M/m inflation dropped 0.8%. One of the factors we mentioned last month that was causing the noise in the inflation numbers was the price of fresh fruit and vegetables. Both dropped in the month, down 8.9% and 3.4% m/m. The Central Bank of Egypt (CBE) MPC met again in December and decided to keep all policy rates unchanged. One of the highlights of the MPC statement was their decision to lower the inflation target by 400bps to 9% +/- 3% from 13% +/-3%. This shows us that the CBE remains confident on disinflation path and leaves room for a further easing of rates in 2019. Another statistic mentioned in the press release was that unemployment stabilized at 10% in 3Q18.

In line with some of the pension reform we are seeing across the continent, we read that the investment committee at the Social Insurance Fund, responsible for managing public pensions, submitted a proposal to the Ministry of Finance to raise the pension fund's allocation to the stock market to 5% from the current 2% (current allocation is cEGP5-6bn).

We did not receive any further update on the Ministry of Finance T-bill withholding tax change but we noted upward pressure on treasury yields. Our static analysis shows minimal impact to 2019 bank earnings, and a 5-10% PAT impact for banks in 2020. In reality, we believe the impact will be lower, c.2-3%, as yields adjust to factor in additional tax and some liquidity will be reallocated to loans.

Egypt's FX reserves dropped in December for the first time in two years, falling by USD2bn to a total of USD42.6bn. The drop in NIR was driven by portfolio outflows from the fixed income market, debt servicing, as well as covering foreign currency payments on behalf on some other state entities. The IMF's 5th instalment of USD2bn was also delayed during the month so we should expect a slight recovery in January.

Kenya – Inflation for November came in at 4.6% y/y up slightly from 4.5% in October. Although credit growth remains weak because of the interest rate cap, GDP growth remains high, with a growth projection of 5.5%-6% this year. We stated in the previous factsheet that although IMF raised the debt sustainability risk for Kenya from low to moderate, we are still comfortable with their ability to refinance the 2019 Eurobond and to manage themselves out of the rising debt stock.

Kenya Tourist arrivals grew by 37% to just over 2m tourists in 2018. Tourism earnings grew by 31% to USD1.6bn. We believe there is scope for tourist numbers in Kenya to grow significantly and boost FX receipts in the country.

Morocco – The central bank, Bank Al Maghrib, met in December and decided to keep its key interest rate unchanged at 2.25%. The board gave GDP growth estimates of 3.3% in 2018, 3.1% in 2019 and 3.6% in 2020. Inflation for the full year is expected to come in comfortably below the 2.0% level. CPI was 1.1% y/y in October.

Company updates

No company updates for December.

Market outlook

Nigeria – The results season confirms a slow recovery and clear path to normalisation of the economy. For the most part, 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, valuations continue to look 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 breath, 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 and this is further supported by corporates restocking as demand picks up. Upside risk to inflation from subsidy removal and rising oil prices, but there is enough positive momentum to maintain the growth trajectory.

Kenya – The political decision not to remove interest rate caps removes the opportunity for an asymmetric trade on the banking shares and reduces economic momentum. Despite, a less optimistic outlook, we remain invested on the payments and fintech theme which we play through telco and banking.

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 latest inflation numbers are encouraging and supportive of the BoM monetary policy.

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**.**

Zimbabwe – 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. OMIR allows us to get both liquidity and a reasonable valuation as we wait. Bottom up, the 1H18 corporate results are very strong and the companies in our portfolio have survived hyperinflation before and they have highly capable management teams. Key to Zimbabwe's economic recovery is a fresh capital injection and debt forgiveness/restructuring, we believe that announcements signalling progress in this regard will be catalytic for our investments in the country.