IMARA Asset Management

Monthly Market Report

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Market snapshot

There was nowhere to hide in August, as we saw continued EM weakness compounded by country specific events. In South Africa, the second quarter GDP contraction puts the country in technical recession, the Kenyan parliament voted to keep rate caps on loans and the Central Bank and Attorney General of Nigeria launched two separate attacks on MTN. Egypt was the only riser, up 3.0%. SA led the losers, down 9.0%, followed by Botswana -7.3% and Nigeria -5.8%.

Economic and political overview

Nigeria – In addition to the monthly data, August also had some second quarter releases. Disappointingly, GDP growth came in at 1.5% for Q2 18, down from the 2.0% recorded in Q1 18. On closer inspection, the main culprit was Oil, which contracted by 4.0%, largely due to pipeline disruptions. Non-oil expanded 2.0%, which is still a bit sluggish. There were two strong sub sectors, Telecom, which grew strongly on subscriber growth and data uptake, and construction, from increased infrastructure spending. It was noted in the data release that the consumer remains subdued.

August Headline PMI came in broadly unchanged at 56.1, which still indicates expansion. New order and output growth remains strong despite a slight easing in August from July. Job creation also accelerated.

The Q2 18 current account surplus increased 8% from Q1 18. This brings the surplus at the half year to NGN 4.5tn (USD 12.5bn), higher than the full year of 2017 of NGN4tn.

Egypt – Emirates NBD Egypt PMI rose to 50.3 in July from 49.4 in June. Since its recovery from the low 40's it has not really kicked on, which we believe reflects low capex spending. FX reserves reported stable at USD44.4bn. Interestingly, foreign ownership of Egyptian T-Bills declined to USD17bn from USD18bn. This reflects a sound functioning interbank market. The CBE kept rates stable at 17.25%. It noted that: "the anticipated adjustment of regulated prices in the context of the fiscal reform program pushed headline inflation up to 13.5% in July 2018 from 11.4% in May 2018. On the other hand, core inflation continued to decline for the twelfth consecutive month to record 8.5% in July 2018, the lowest rate for more than two years".

We met with 10 Egyptian corporates at the end of August. The overall message is that the Egypt macro is doing well but Egyptians are not doing well yet. The consumer has stabilised but discretionary spending is weak. A few examples: IDH noted that 'walk-in patient' tests per patient are down versus insured patients. Doctors would only do the necessary tests if not covered by insurance. Tile and sanware producer Lecico noted that tile demand is still 35% below 2016 and would be 50% lower if not for some government sponsored low cost developments.

In contrast, inelastic products have done well with defensive volumes and margin protection. Obour Land, a major player in white cheese, a staple food, continues to grow volumes while protecting margin. Similarly, IDH's insured patient tests are doing well despite price increases. Interestingly, after 18 months of price discounting and destocking, the car market is picking up with some margin recovery. Car volumes are expected at 130k units for 2018 from a low of 100k in 2017 and a peak of 190k in 2015. Cement demand is flat y/y at 54mt which reflects continuing demand and pipeline for residential and commercial property.

Kenya – In Kenya, politics trumped economics. Political will was not sufficient to remove the interest rate caps, for now. The minimum floor for savings accounts was removed, from 70% of policy rate to zero, which offers a bit of respite on deposit costs but not much. We have been here before, faced with an African government making economic policy errors. We are disappointed with events, and a unique asymmetric trade is off the table for now. Removal of interest caps was a tactical opportunity for our investment in Equity Bank but it does not impact our investment case. Dominant player efficiently growing into new product segments of fintech and mobile payments.

Mauritius - steady as she goes. We noted the following extracts from the latest MPC meeting:

- **Rates** - repo rate left unchanged.
- **Inflation** - Core inflation stable at 2.0% over the last two years, despite some recent fluctuations in the headline number.
- **Growth** - the committee had an upbeat outlook on growth and pointed to increased business and consumer confidence as well as increased government spending on infrastructure. Their forecast is for 4.0% GDP growth.

Morocco – A new minister of economy and finance has been appointed, Mr. Mohamed Benchaaboun. He was previously CEO of Banque Centrale Populaire, one the country's largest banks. This is a positive step and we always welcome the appointment of a technocrat, particularly from the private sector. Developments have been favourably taken by the markets, with locals citing the following factors:

- The relative speed of replacement of the former minister should facilitate the preparation of the next 2019 Budget Bill draft.
- The good relationship between Mr Benchaaboun and the Governor of the Central Bank, could help to monitor the MAD gradual floating process.
- Mr Benchaaboun's proximity to the IMF where he began his career as an expert in 1984.
- The good reputation of integrity enjoyed by Mr Benchaaboun within the business community.

Zimbabwe – On 10 September, President Mnangagwa swore in a new and leaner cabinet (reduced from 33 posts to 20 posts). The composition positively exceeded expectations, marking a departure from the past in which the same party loyalists were rewarded and rotated within cabinet, with very little meaningful change. In the current formation there is a progressive blend of youth (minister of youth, sport, art and recreation is a 34 year old female ex Olympian). There are technical skills in critical areas (Ministries of Finance, Mining, Industry & Commerce), while appointments of the old guard (Ministry of Home affairs) and retired military (Foreign affairs, Agriculture) is pragmatic and necessary to retain stability.

The most watched appointment of the new cabinet will be Dr Mthuli Ncube, the new Minister of Finance, former Chief Economist for the African Development Bank. His stated ideas on, and focus areas are:

- **Actively address foreign debt** - engage in order of priority multilaterals like ADB, where it might be easier to get renewed support in the short term and then the Paris Club to renegotiate and restructure Zimbabwe's foreign debt (USD4.5bn). There is a discussion around finalising the Lima plan (which was a proposed structure involving securing a bridging loan from a bilateral creditor to settle the Paris Club).

- **Pursuit of fresh credit lines** - these likely include institutions like CDC (U.K) and China.
- **Fiscal Discipline & policy coordination** - focus on fiscal consolidation with a target to reducing the fiscal deficit to 5% of GDP in the medium term. Focus on better cohesion between monetary policy and fiscal policy, through a closer working relationship with the Central Bank. The intention is to create a Macroeconomic Coordination Committee, comprised of central bank and economic ministries.
- **Currency Reform** - this has been acknowledged as a matter of urgency, however the only view shared so far is that a local currency will be introduced at a future point when the conditions are conducive. He has directly discussed scrapping of bond notes and allowing the USD to become the core currency for now.

To conclude, the sense on the ground is that there is long awaited the political will to make constructive changes in the country and particularly the economy.

Market outlook

Nigeria – The results season confirms a 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 remove 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 3Q18 MCB numbers reflect this, showing NIM expansion and loan growth of 9% y/y. **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. The start of the year has seen our companies release very strong results despite the chronic foreign currency shortages.