IMARA
Asset Management

## Monthly Market Report

**Edition:** **July 2018**
**Region:** **Africa ex South Africa**
**Issued by:** **Imara Asset Management Limited**
**Author:** **Tony Schroenn, Craig Bandason, Rainer Orth**

## Market snapshot

The weakness in May and June continued into July, with the end of month rallies only partially clawing back earlier losses. Egypt closed -4.6%, Nigeria -3.5%, Kenya -1.9% and Morocco -0.6%. Zimbabwe was the star performer, with the index +12.1%.

## Economic and political overview

**Nigeria –** The February elections are starting to make their presence felt as the timetable unfolds. A formal notice of the elections will be made in the next couple of weeks, after which the different political parties have until 7 October to finalize their primaries to competitively nominate candidates. Campaigns for the Presidential and National Assembly formally start from 18 November and end 14 January. The jostling has started and we have already seen some high profile defections from the ruling APC to the opposition PDP. Encouragingly, and this is true for most of Africa, we are not faced with major clashes of economic ideology, rather the challenge is execution and therefore the determinants are technocratic. The recurrent answer we get from management and political analysts is “Look at the composition of the team”, referring mostly to the key posts in finance, central bank and the NNPC.

On the economic front, the recovery grinds on with mixed data. CPI fell for the 17th consecutive month to 11.2% from 11.6%, however the PMI slipped from 57 to 56.8. By most accounts, consumer disposable income remains under pressure, with the main culprit being inflationary erosion of any wage increases.

There are positive signs, cement volumes jumped 20% in the second quarter and the country reached the milestone of zero importation in 2018. Previously, USD2bn or c5% of FX reserves was spent on imports. Substantially higher savings will be made when the local oil refinery comes fully on stream in 2020. Similar progress is being made in agriculture. Pension assets as at 30 June are USD 22.6bn, up 20% annualized.  Importantly, these are all long term policy successes, that have spanned multiple governments, elections and presidents and talk to increased technocracy mentioned above.

**Egypt –** Headline inflation rose to 14.4% in June from 11.4% in May. We had noted that there would be inflation headwinds following the government's decision to cut fuel and electricity subsidies Nonetheless, inflation remains within the target band of 13% +/- 3%.  A number of consumer company results showed strong volume growth for the second quarter, which ties in with what management teams were saying during visits in early July and corroborates what we noted from CIB last month. The general feedback we got is that this trend should continue despite fuel price increases. In line with the newsflow, the Emirates NBD Egypt PMI increased to 49.4 in June from 49.2 in May. Although the figure remains below 50, which would signal expansion, the improvement shows that economic activity is inching closer to expansion. An easing policy would most certainly push the number above 50 but the short term upward pressure on inflation from electricity and fuel prices may result in CBEs MPC keeping rates on hold. Net international reserves also rose higher in the month, growing by USD57m to USD 44.3bn, import cover currently sits at 9.3 months which gives the country a solid buffer in a difficult global macroeconomic environment.

**Kenya –** The IMF recently visited Kenya as part of its second review of the Stand By Agreement (SBA), which expires on 14 September 2018. The visit was constructive, with the fiscal deficit and the interest rate cap being points of contention. With the Finance Bill (rate caps) unlikely to be passed before September 14 and the fiscal deficit disagreements unlikely to be resolved, these issues likely remain contentious and the SBA might expire or be further extended. Recent comments from CBK indicate that the SBA might no longer be necessary, given the accumulation of FX reserves.

The IMF noted in its report that the Kenyan economy continues to perform well, with renewed post-election confidence, favourable weather conditions and increased tourism revenues. July's 4.35% inflation, slightly up from 4.28% in June, is well within the 5% +/-2.5% range.

Remittances for the six months to June rose 56% y/y to a record KES 139bn (USD 1.3bn), reflecting lower costs of international money transfer and the effect of the tax amnesty on undeclared assets abroad. The recent spike is in part linked to the tax amnesty, due to expire in July, but now extended to January.

**Morocco** – The King dismissed the Minister of Economy and Finance on 2 August, citing poor policy delivery. The feedback on the ground is that it was justified, but that he was also being used as a scapegoat to placate the recent boycotts over high fuel prices, blamed on exploitation by certain fuel and food companies. The boycotts were not widespread or damaging, however it is worth keeping an eye on, as it is hard to believe that personnel change alone will remove dissatisfaction.

**Zimbabwe – Election summary.**

- **Final election Result:** Emmerson Mnangagwa (ED) won the presidential vote with 50.8% and Nelson Chamisa (NC) 44.3%. ZANU PF wins 2/3rds majority in parliament albeit less of a majority than before. Zanu PF won 2/3 of seats, while opposition and independent candidates won 1/3 of the seats. Similar to the past, Zanu PF dominated in the rural areas and MDC in the urban areas.
- **Assessment of international observers:** The SADC, AU, EU and commonwealth were all invited to observe elections. None of them have issued their final assessments, with preliminary assessments suggesting that the pre-election/campaign period was peaceful and actual voting peaceful. However, they have all condemned the post-election violence on the 1st of August. The crucial thing here is that to legitimize the result, the elections need to be deemed credible, free and fair. We await these final assessments.
- **Market:** So far the market has been trading sideways with no real change in trading. In July the market was up 12.1%.
- **Policy:** Interestingly, for the first time, we think there is policy convergence between the two parties. They both are going closer to the center and they desperately need to embrace the international community. We have covered this in detail before, but bottom line is Zimbabwe needs BOP support/fresh capital injection. Without it, it's more of the same and nobody will stand for that. To get this funding, fiscal consolidation is needed and numerous market reforms. Some of these reforms we have seen already, including the amendment of the indeginisation policy.

- **What next:** Various scenarios can playout, it is highly likely the MDC Alliance will continue to contest the result and push for the international community not to endorse the result. They will also continue to campaign against the lifting of sanctions. A government of national unity is a possibility, but unlikely with Zanu PF's majority in parliament. A key indicator to watch is OMIR and the black market rates, if they depreciate it's a negative sign, if they appreciate it is a positive sign.

## 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 –** 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. 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. **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 -** 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).