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FDC ECONOMIC MONTHLY

UNIFIED EXCHANGE RATE AT LONG LAST

The Central Bank has released its guidelines for implementing a flexible exchange rate. This has been long overdue, with the CBN finally coming to terms with the need for a currency adjustment. Contrary to analysts' expectations of a dual exchange rate regime, only one market would be at play with a unified exchange rate.

This is welcome news as the unification of rates effectively addresses the uncertainty and speculative factors that have played significant roles in determining the parallel market premium under the fixed exchange rate regime.

According to the Charles Enoch, Deputy Director, Monetary and Financial Systems Department, International Monetary Fund, the shift to exchange rate unification has been part of a broader adjustment program to enhance financial stability and growth. In others, the decision to unify exchange rates was not part of a well defined strategy, but instead occurred in the context of a crisis; when in the absence of fundamental reforms, parallel market premiums widened significantly, making the system unsustainable.

In his paper titled "Moving to a Wholesale Dutch Auction System: Country Experiences", a review of exchange rate unification has shown that in most cases, the trigger for unification was macroeconomic instability and low growth. Foreign exchange markets were characterized by a rationed official market with a fixed exchange rate and an active black market, with the floating rate carrying a high premium.

According to Enoch, successful unification was more likely when the reforms were part of a comprehensive package, involving macroeconomic adjustment (particularly fiscal discipline and credible anti-inflationary policies) and structural reforms, including trade and market liberalization. By contrast, where such policies were not followed, for instance, through continued expansionary fiscal policies, exchange rate pressures emerged, leading to the reversal of unification (Iran in 1993).

INSIDE THIS ISSUE:

In most cases, macro-economic stability was achieved after unification, even where there had been sizeable depreciations, with lower inflation. Fiscal positions improved and gross foreign exchange reserves generally rose (e.g. in India post 1991).[1]

IMPACT OF A UNIFIED EXCHANGE RATE ON NIGERIA

We expect the following to occur in the short to medium term:

- There would be no more uncertainty surrounding the exchange rate and exchange rate policy. Since the rate can move in any direction at anytime, the demand for forex would primarily be for immediate transactions rather than speculative trading.
- Companies and manufacturers would start carrying inventories for a shorter period as the need to front load disappears.
- There would be less demand at the BDCs now that the uncertainty and unavailability premium is gone, resulting in an appreciation at the parallel market.
- There will be a gradual convergence in rates between the unified and parallel markets.

WHAT TO EXPECT

According to a leading U.S. money centre bank in a note released today, the naira is projected to trade between N280-300 against the dollar, while the parallel market rate will stabilize. The supply of forex is also expected to increase. This implies that the new exchange rate is unlikely to depreciate lower than the parallel market rate. In anticipation of Monday's new rate, the naira appreciated from N365/$ to N340/$ in the parallel market. This market is a marginal and fringe segment of the total market. It is also not a true reflection of actual demand but is influenced by speculation, uncertainty and arbitrage activities. One of the expected outcomes is that price leadership will now rest squarely within the regulated market segment. This will be influenced to a large extent by the CBN. The CBN supplies over 70% of foreign exchange to the markets.

[1] Charles Enoch: Moving to a Wholesale Dutch Auction System.

KEY TAKEAWAYS FROM RENCAP'S CONFERENCE CALL WITH NIGERIAN BANK TREASURERS– CULLED FROM RENCAP

Following the recent announcement of the framework of a more flexible interbank market, Renaissance Capital hosted a conference call with Nigerian bank treasurers to get a better understanding of the dynamics of the soon to be introduced flexible market and the implications of this for the Nigerian banks. On the call were Michael Anyimah (Head of Trading, Zenith Bank Plc), Dapo Olagunju (Group Treasurer, Access Bank Plc) and Adebayo Omogoroye (Head of Trading, GTBank Plc). As expected, the issue of a flexible interbank rate was quite topical on the minds of investors, and we had over 140 participants dialed in. If you need the recording, kindly let us know.

The CBN’s decision to adopt a completely market driven FX market came as a big surprise to most market participants, as many had expected a two-tier system under some sort of managed float. It is clear from such a radical change, that the Central Bank of Nigeria could no longer sustain the Naira at the pegged level of NGN197/$. The bank treasurers gave detailed insights on recent developments, addressing many of the concerns of investors. We summarize the key points from the call below:

MECHANICS OF THE INTERBANK MARKET

The banks’ traders held a meeting yesterday to discuss the modalities of the interbank market further. As guided by the CBN governor, the banks expect trading to kick off on **Monday 20th of June**, although there appears to be some level of uncertainty as to the exact mechanics. At this point it is difficult to determine what level the NGN will trade at, given it is dependent on a number of factors, including the quantum of CBN’s supply on the first day of trading.

The banks expect the Naira to trade anywhere between NGN270-NGN300/$, and note the likelihood of some volatility in the initial days of trading.

From the CBN guidelines, we understand that it intends to introduce FX Primary Dealers (FXPDs) – registered authorized dealers designated to deal with the CBN on large trade sizes on a two-way quote basis. To qualify as an FXPD, a bank is required to meet at least two of the three conditions highlighted below:

Minimum shareholders fund unimpaired by losses of at least NGN200bn;

- Minimum of NGN400bn in total foreign currency assets; and
- Minimum Liquidity Ratio of 40 percent

While no official statement has been made regarding the appointments of the FXPDs, we deduce based on FY15 numbers that only seven of the Nigerian banks meet these requirements, skewed towards the larger tier 1 names. They include **FBNH, Zenith, GTBank, UBA, Access, Diamond and Union Bank**. Appointment of these banks as FXPDs could imply they control a relatively higher proportion of FX market volumes, which should be positive for their NIR line. These banks can also have short positions up to 10% of shareholders' funds at the close of each day (from 0.5% currently), implying their trading bias should be to see the Naira appreciate. In addition, the wider short trading position of 10% vs the 0.5% long trading limit, should reduce pressure on the FXPDs to buy dollars at the close of business to close their positions and give them more room to enter forward positions when the cash isn't immediately available. Coincidentally, none of the international banks qualify as FXPD based on our analysis, implying they will be second leg participants in the market.

INCOME INEQUALITY IN NIGERIA

From 2010 to 2014, Nigeria's population grew by 12% while GDP rose by 54% during the same period. This implies increased economic wellbeing and gains for GDP per capita. By 2014, Nigeria's GDP per capita had grown to $3,203, a 38% increase from 2010's level of $2310. At the current official rate ($1=N200), this translates to about N640,000 per year and N53,000 per month. At this level, Nigeria is classified by the World Bank as a lower-middle income country.

BUT WHAT PERCENTAGE OF NIGERIANS ACTUALLY LIVE ON THIS AMOUNT?

Research shows that the minimum yearly income needed to sustain a living that provides the basics in Nigeria stands at $1,016 per year in urban areas (N203,000 per year or N16,900 per month) and $758 per year in rural areas (N151,600 per year or N12,600 per month).[2] However, 74% of Nigerians live below this income level. Out of this, some 40% live under the poverty line i.e. live on less than $1.25 per day.[3] This translates to N7,500 per month and N91,500 per annum, 49% and 48.4% lower than that required as monthly and annual income respectively.

The variance between Nigeria's GDP per capita and the actual average income of the population reflects the problem of income inequality. Income inequality refers to the manner in which income is unequally distributed amongst the population. Nigeria has one of the highest levels of income inequality in Africa with a Gini index of 48.8, compared to the West African and Sub-Saharan averages of 40.9 and 45 respectively (Table 1).[4] At this level, Nigeria ranks 2nd in West Africa, 9th in Africa and 26th in the world.

[2] Basics include: food and water, energy, housing, sanitation, healthcare, education and social security

[3] Mckinsey Global Institute Available at: < http://www.mckinsey.com/global-themes/middle-east-and-africa/nigerias-renewal-delivering-inclusive-growth>

[4] The Gini index measures the deviation of income distribution from perfect equality. The closer to 0 this figure is the more unequal the distribution of income.

Table 1 : *Showing the Gini Coefficient of various countries as of 2013. A value of 0 represents absolute equality. A value of 100 represents absolute inequality.*

Country	Gini Index
India	33.9
US	40.8
China	42.1
Angola	42.7
Ghana	42.8
Mexico	47.2
Kenya	47.7
Nigeria	48.8
Brazil	54.7
South Africa	63.1 [5]

In 2010, the top 20% earned more than 12 times the income of the bottom 20% (Table 2). [6]

Table 2 *Showing the distribution of income in Nigeria over time. As at 2010, the top 20% had over 50% of national income, while the bottom 20% had a meagre 4.41% share.*

Income Recipients in quintiles	1986 (% of total Income)	1998 (% of total income)	2010 (% of total income)
Bottom 20%	6.02%	5%	4.41%
Second 20%	11.41%	8.80%	8.27%
Third 20%	15.52%	13.55%	12.98%
Fourth 20%	23.04%	20.22%	20.33%
Top 20%	45.01%	52.11%	54.01%
Total	100%	100%	100%
Gini Index	38.68	53	48.8 [7]

[5] United Nations Development Programme; Available at <http://hdr.undp.org/en/content/income-gini-coefficient>
[6] Universal Journal of Management and Social Sciences; Available at <http://cprenet.com/uploads/archive/UJMSS_12-1254.pdf>
[7] ibid

CAUSES

Income inequality in Nigeria is so deeply rooted into the very mechanics of the country that many have become desensitized to the problem and lost sight of its genesis. Firstly, the disparity in income is the result of a segmented labour market (into the formal and informal sector). Such segmentation also has its roots in the ailing public education system. The direct relationship between educational level, skill, and income follows the basic principles of demand and supply; as there is a low supply of skilled workers relative to unskilled workers, the price for skilled workers, i.e. wages, are relatively high.

The gap is further exacerbated by the unavailability of jobs and the inaccessibility of credit and financing. Thus, those in the lower class have limited to no opportunities to get a part-time job or a loan to help provide the funds needed to finance their educational or vocational training.

Additionally, demographics can offer an explanation to the income inequality in Nigeria. Urban migration caused by the saturation of commercial activities in metropolitan areas such as Lagos accounts for some geographic variation in income distribution. Likewise, income disparities occur across gender and age with older males (from 34-64 years) being at the benefitting end. This is so, primarily because the 34-64 age group have the advantage of professional experience and presumed expertise and are thus more attractive to employers. Gender inequalities occur because of the profound patriarchal tendencies that exist in our society. 49.1% of Nigeria's total population are females.[8] Yet, as at 2012, women only made up 14% of those in non-agricultural wage employment.[9]

CONSEQUENCES

Poverty and low income implies limited or no access to good healthcare and education for the lower classes. The resulting low skill and productivity has negative connotations for growth. The

[8] EIU, May 2016, Country Forecast- Nigeria

[9] UNDP, Available at: < http://www.undp.org/content/dam/nigeria/docs/MDGs/UNDP_NG_MDGsReport2013.pdf>

unequal distribution of outcomes (income, wealth or expenditure) influences the distribution of opportunities. For example, because the children of the lower classes did not have the same education or training opportunities as those in higher income classes, they will not gain the same economic prospects and are likely to remain in the lower classes. In the end, their output potential will remain low and their ability to accumulate human and physical capital is undermined. This establishes an inequality cycle and hampers social mobility. It is for this reason that inequality poses significant risks for economic growth and stability in the long run.[10]

Income inequality stifles growth and can lead to political and social unrest. According to the International Monetary Fund (IMF), a percentage increase in the share of income of the top 20% will lead to a decline in growth of 0.08% every five years. Alternatively, a 1% increase in the income of the bottom 20% will spur a 0.38% increase in growth every five years.[11] Likewise, an OECD analysis shows that an increase in inequality by three Gini points would drag down growth by 0.35% per year.[12] The rationale for this is based on the fact that the wealthy spend a smaller percentage of their income compared to the lower classes.

In terms of the impact of income inequality on social and political inequality, the economic position of the upper class makes it possible for them to influence policies on labour, taxation etc. The top quintile of the income chain have the loudest voice and thus the greatest political power and capacity to produce desired results.[13] This can create a deep dislike for the upper class, a dislike that can have dire consequences. Essentially, poverty and inequality is at the root of most of the social problems we face in Nigeria today. This includes insurgencies, kidnapping and armed robbery.

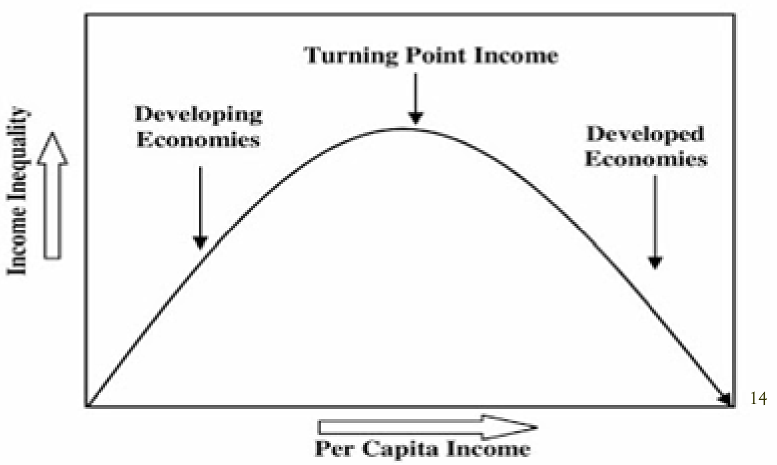
Outlook

It is important to note that some degree of income inequality is a common problem in developing countries. According to Simon

[10] IMF; Available at: <https://www.imf.org/external/pubs/ft/sdn/2015/sdn1513.pdf>
[11] IMF; Available at: <https://www-ombc.imf.org/protected/contents/pubs/ft/sdn/2015/sdn1513.pdf>
[12] OECD; Available at: <https://www.oecd.org/social/Focus-Inequality-and-Growth-2014.pdf>
[13] Wrong, D. Power: Its Forms, Bases, and Uses (2nd ed.). New Brunswick: Transaction Publishers

Kuznet, a high level of income inequality is not just a common problem for a developing country, but an expected one (Chart 1).

Chart 1 *The Kuznets curve showing that a country experiences its highest income inequality during its GDP growth peak.*



Countries in the early stages of development experience low inequality. As the economy further develops, individuals who already have a certain amount of wealth are the only ones that are able to increase personal income by capitalizing on the new opportunities that come with development. Yet, as more development occurs, structures such as the tax system and welfare programs will work to close income gaps, and an increase in GDP and income-per-capita becomes a benefit for all.

Therefore, following this theory, it is safe to say that as Nigeria's GDP continues to grow faster than its population, income inequality would flatten and ultimately reduce. However, this would only occur if the government provides the necessary infrastructure of welfare programs, social security, job creation etc. Some may argue that the United States is a strong example of a country that has not provided sufficient welfare programming, resulting in significant income inequality despite its high GDP.

[14] PERC Research Study; Available at : <http://www.macalester.edu/~wests/econ231/yandleetal.pdf

THE WAY OUT

An understanding of the priorities and needs of the lower class would form an important basis for any policy. The lower classes are more concerned about daily expenses of food and transport rather than investments into the future. This is because their pockets cannot afford the luxury of savings and/or investing. For example, a parent would prefer to send their child to sell plantains by the road side and make a daily profit of N600, rather than spend money to give the child an education and forfeit the income the child could earn hawking. Thus, they inadvertently cut short the prospects of the child in a society where income mobility is rigid.

It is up to the government to develop practical and lasting ways to encourage such parents to let their children go to school. Campaigns to increase general awareness about the value of education and policies to improve financial inclusion and eased microfinance access to the low income groups will go a long way to help increase the economic prospects and available investment and consumption opportunities for them.

Further, additional effort should be put into improving the quality of the public educational and vocational system. These will work to raise the average skill levels of the work force. Programs such as the Lagos Eko Secondary Education Project should be formed and implemented on a national scale. The project was aimed at enhancing the learning outcomes of public schools in Lagos State by improving the student performance in maths, English and biology.[15] Since its start in 2009, through rigorous teacher training and resource investments, the project has been able to raise the percentage of students who obtained a pass and above in Federal exams from 60% to 86% at the senior secondary level and from 30% to 59% at the junior secondary level.[16]

Additionally, with the recent removal of petroleum subsidies, the Federal government has extra income to spend on social schemes that target the lower classes. In 2015, the government spent N1 trillion ($5 billion) on fuel subsidies,[17] such funds can now be

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[15] World Bank; Available at: <www.worldbank.org/projects/P106280/lagos-eko-secondary-education-project?lang=en>
[16] World Bank; Available at: <http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/AFR/2015/12/03/090224b083a7fddc/1_0/Rendered/PDF/Nigeria000Lago0Report000Sequence012.pdf>
[17] The Daily Trust; Available at: <http://www.dailytrust.com.ng/news/general/nigeria-spends-n1tr-on-fuel-subsidy-in-2015-kachikwu/124416.html>

channelled into programs that will work to redistribute income and improve the livelihood for the lower class. Examples include conditional child benefits (that provide financial aid for children who attend school), educational and health fee waivers and food coupons/school feeding programs.

Income inequality has skewed wealth and resources away from the masses to the pockets of the top 20%. On one part, given Nigeria's level of development, inequality is no surprise. Nevertheless, it's the extent of inequality that raises a cause for alarm. As measured by the Gini Coefficient, Nigeria ranks 2^{nd} out of 16 West African countries, 9^{th} out of 54 African countries and 26^{th} out of over 190 countries in the world.[18] Those at the bottom of the income pyramid, who number over 100 million, brawl over a measly portion of the national income pie. Policies to improve the educational system and promote credit accessibility to the lower class will work to curb income inequality and stimulate national growth and development.

[18] World Bank; Available at: <http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/AFR/2015/12/03/090224b083a7fddc/1_0/Rendered/PDF/Nigeria000Lago0Report000Sequence012.pdf

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3. Equipped kitchen with electrical cooker/oven, fridge, deep freezer and washing/drying machine.

Other Facilities:

1. Gym, squash court, steam bath, sauna, swimming pool with bar and barbeque stand
2. 24hrs power supply
3. 24hrs security/CCTV/Alarm system
4. 24hrs Technician on duty
5. Fully equipped play area for children

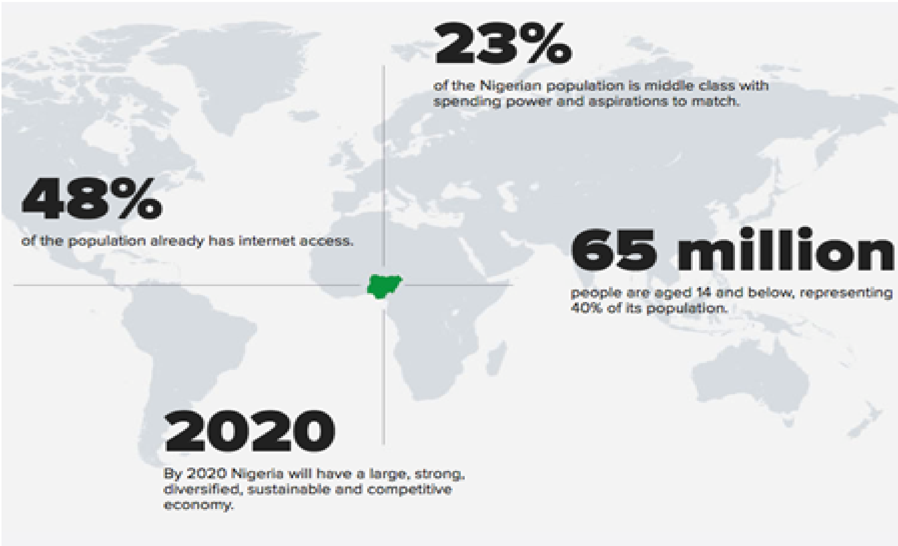
THE NIGERIAN MIDDLE CLASS: A MIRAGE OF SORTS

For several years now, economists and investment firms have raved about Nigeria's rising middle class. Promises were big - the Nigerian middle class was supposed to rocket Nigeria to global economic prominence and the sheer size of this newly wealthy population was an opportunity not to be missed. From 2008 to mid-2014 the Nigerian middle class was delivering on that promise but then catastrophe hit: oil prices plummeted and the shaky foundation upon which the Nigerian class was built started to crumble. Businesses and individuals have been reeling from the dramatic about-face ever since, revealing that Nigeria's lack of infrastructural and social amenities makes the "middle class" in Nigeria extremely vulnerable and almost impossible to sustain.

DEFINITION OF "MIDDLE CLASS"

Economists generally categorize the middle class as individuals or households that fall between the 20th and 80th percentile of the consumption distribution or between 0.75 and 1.25 times median capita income. While there is no one precise definition of what the middle class is there are certain standard of living cues that can indicate middle class status. These include: having a bit of money left to spend (e.g. for a vacation or a car) after taking care of the basics like food and other consumables.

Citigroup's African economist David Cowan has a different view entirely. He believes that the middle class in Africa is non-existent. Instead, Africa has only two super classes: the über-rich, and a large sprawl of poor people who are nevertheless inclined towards consumption.



RISE OF THE NIGERIAN MIDDLE CLASS – POST 2010 ERA

After the Nigerian state gained independence in 1960, oil discovery and subsequent exploration ushered in an economic boom which many today describe as Nigeria's golden years. Young graduates were quickly absorbed into civil service and international oil companies struggled to attract intellectual indigenes with mouth-watering offerings. Volkswagen and Peugeot were quick to set up auto shops in commercial cities as the demand for automobiles surged. This upwardly mobile group of Nigerians was, however, left vulnerable to temporary upheavals in the nation's economy as its number seesawed with economic cycles.

According to African Development Bank (AfDB) data, the size of the Nigerian economy quadrupled between 2000 to 2011. Growth has averaged 8.6% within the period. The Nigerian economy recovered quickly from the effects of the global financial crises of 2008. While many developed economies struggled with GDP growth, the story was quite different amongst emerging markets. Boosted by a recovery in oil prices, Nigeria's GDP between 2008 and 2013 grew by 21.95% while the Euro area grew by -11.63%, Australia by 5.73%

It is therefore not surprising that the growth in the Nigerian middle class shot up sharply between 2005 and 2013.

With a rapidly expanding economy came an increase in employment figures, earnings grew, and the informal sector prospered. Foreign Direct Investment poured in as more private equity firms set up shops in Lagos. The Nigerian Stock Exchange (NSE) All Share Index (ASI) which measures the direction of all the stocks on the exchange gained over 116% between December 2011 and June 2014. This bolstered investor confidence as both local and foreign investors increased their stakes to take advantage of the upward market movement.

CRISES OF EXPECTATIONS

With the economic boom in the country, private investors rewrote strategies and adjusted financial projections. Aside from an infrastructural deficit, all seemed to be in place for Nigeria to finally take its place as the economic leader of Africa. The economic boom was not peculiar to Nigeria, across commodity dependent economies, the future appeared rosy.

However, a series of events in the US and China changed the story for Nigeria. Low interest rates and high crude oil prices encouraged the U.S to commence the exploration of shale oil, which was hitherto unviable. With increased production of cheaper alternatives to Brent crude, U.S. demand dropped sharply. At the same China, which was a major importer of crude witnessed a slowdown in economic growth and demanded less crude as it attempted to switch from export and investment led growth to consumption based. As a result of the reduced demand from America and China and a glut in the oil market, oil prices started to drop sharply from July 2014.

The overall impact of these events was negative for Nigeria. Foreign revenues dropped significantly putting pressure on the naira, which was being supported by the Central Bank of Nigeria (CBN). The resultant effect has been a reduction in the monthly federal allocation to states, delays and reduction in salaries of state workers, job losses and a general decline in the standard of living.

The NSE ASI declined by over 60% from 42,891.85 in 2014 to 23,514.04 in January 2016.

REALITY CHECKS

The slowdown in the Nigerian economy has revealed that which was all too obvious: the structure needed to grow and support the middle class was non-existent. The government's foreign exchange policy on defending the naira has resulted in a huge difference between the interbank and the parallel market rates, with dollars trading at over 60% premium in the black market.

Inflation figures have spiked to 15.6%, many businesses which have no access to dollars at the interbank market have closed, companies are laying off staff as finance costs increase and there appears to be a general feeling of despair.

Most importantly, this abrupt and unexpected change in the socio-economic environment has pushed households, which previously fell into the middle class bracket down the ladder to the lower class.

Nigeria lacks the structural facilities to support a budding middle class. There are no buffers for individuals and households who experience a drop in earnings or purchasing power below accustomed levels. An underdeveloped healthcare system, weak formal educational system and a huge housing deficit ensure that growth recorded in the middle class during periods of boom were lost to the downturn in the economy.

This lends credence to Citigroup's African economist, David Cowan's view as referenced earlier. The middle class in Africa is a farce. There are in fact only two classes: the super rich and the poor.

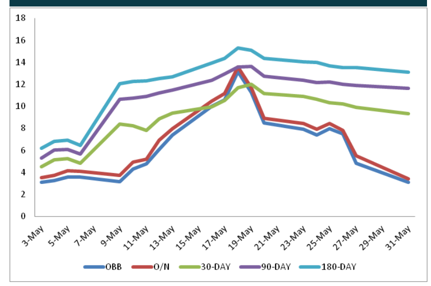
Concerted efforts need to be made by the government in addressing the structural imbalances that make the middle class vulnerable. In this regard, increased private sector participation may provide the much-needed oomph. Accessibility to mortgages (especially for residential homes) can be improved on just as the National Health Insurance Scheme (NHIS) can be strengthened and made more accessible.

Until the structural issues listed above are appropriately addressed, the "Nigerian middle class" will remain a mirage of sorts.

MACROECONOMIC INDICATORS

MONEY MARKET

Chart 2: NIBOR % p.a.



[19]

The opening liquidity position in the month of May was N391.7bn, a 30.6% decline from April's opening position of N564.4bn. Average opening position in May stood at N260.6bn compared to April's average of N423.6bn. This was attributed to the CBN's active stance on mopping up liquidity in the market. The AMCON sinking fund of N93bn was also debited in the beginning of May and FAAC allocations stood at N281.5bn for April, lower than March's rate of N299.75bn, mitigating liquidity in the market.

Short-term interbank rates (OBB, O/N, 30-DAY) averaged 7.54% p.a. for the month of May compared to April's average of 4.97% p.a. Mid month, the OBB and O/N rates spiked to highs of 13.17% p.a. and 13.58%p.a. respectively. Interest rates moved in tandem with market liquidity. The OBB and O/N rates opened at 3.08% p.a. and 3.5%p.a. as at the beginning of May and relatively maintaining these rates at the end of the month. Closing rates for OBB mirrored that for the previous month and the O/N for the month of May was only 27bps lower than that of April.

Outlook

As the MPC maintained status quo on key monetary parameters, interest rates are likely to remain unchanged, moving in tandem with liquidity. FAAC allocations are expected to increase nominally due to the introduction of the flexible exchange rate regime. The increase in state allocations will help states meet their outstanding obligations

OIL MARKET

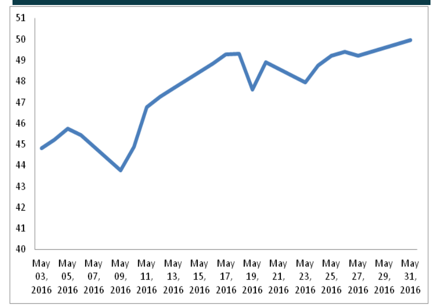
Oil Prices

Global oil prices (Brent crude) averaged $47.6pb for May 2016, 10.2% higher than the average of $43.2pb in the corresponding period in April. Brent crude reached a YTD high of $50pb mid

[19] Source: CBN, FDC Think Tank

month before easing to $49.95pb on the 31st of May. The upward movement was due to supply disruptions caused predominantly by militant attacks on the Niger Delta and wildfires in Canada. According to EIA reports U.S. gasoline stockpiles fell by 1.5 million barrels, compared with expectations for a 157,000-barrel drop. Inventories of distillates, which include diesel and heating oil, fell by 1.3 million barrels, versus a forecast of 891,000 barrels.

Chart 3: Brent Crude Oil ($/b)



[20]

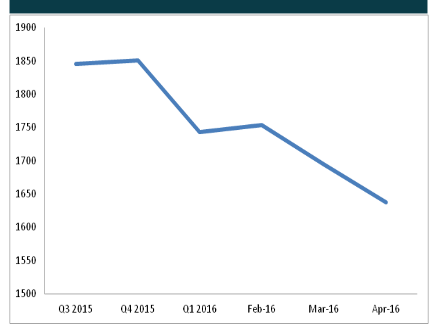
Outlook

The outlook on oil prices is rather bearish due to OPEC's failure to come to a mutual agreement on an output freeze. In addition the recent rally in prices, driven by supply disruptions is believed to be short lived as Canada recovers from its natural disaster. However, the menace in the Nigeria Delta is more endemic and may play a role in keeping oil prices within 45-50 if it intensifies. Hence, the outlook for oil prices in the third quarter is an average of $45pb.

Oil Production

Nigeria's oil production level declined by 57,000bpd to 1.637mbpd in April from 1.694mbpd in March, as reported in OPEC's monthly oil markets report. This figure is estimated to be much lower at 1.4mbpd in May, due to the incessant attacks by the Niger Delta Avengers. This is 36.4% below the 2015 budget benchmark of 2.2mbpd and 22.2% below Nigeria's OPEC quota of 1.8mbpd. This is forcing upstream oil companies affected to shut down production to prevent further losses. The sharp decline in production negates the impact of rising oil prices on revenue. The number of active rigs in Nigeria remained flat at 6. The same trend is occurring on the global front. US active oil rig count declined by 16 to 404 active oil rigs. Hence, signaling a decline in production levels. Nigeria has lost approximately $13.6bn in revenue. At the current estimated output level and oil price, Nigeria's fiscal deficit is projected to widen to 3.1% of GDP in 2016.

Chart 4: Oil Production (tb/d)



[21]

[20] Source: Bloomberg, FDC Think Tank

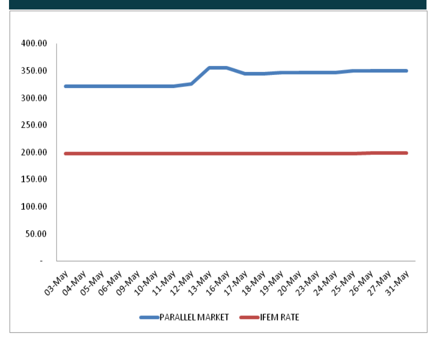
[21] Source: OPEC monthly report

Outlook

Nigeria's production is projected to decline further if the Niger Delta attacks are not curbed. As the OPEC agenda once again derailed from the purpose of freezing output production at January levels, production in other oil producing countries is likely to increase in order to capture the gains from recovering oil prices. However, with production slowing down in Nigeria, the likelihood of market share loss and a reduction in revenue loom.

FOREX MARKET

Chart 5: Exchange Rate (N/$)



[22]

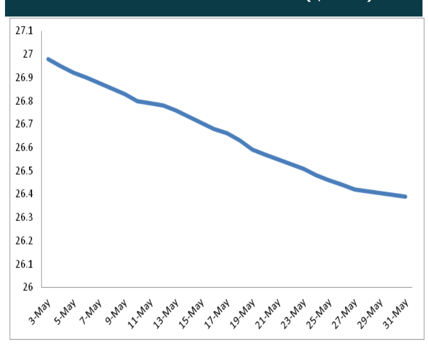
As at May 31st, the naira traded at N350.00/$ at the parallel market, a 9.03% depreciation from N321.00/$ as at 29th April. Interbank Foreign Exchange Market (IFEM) depreciated by 0.76% to N198.94/$ from N197.43/$ within the same period. The MPC announced its intention to adopt a flexible exchange rate system, and also create a critical transactions window. This effectively means the introduction of a dual exchange rate system. While this sends a positive signal to investors and is an improvement from the fixed exchange rate regime being practiced, it is open to abuse. The details of the new exchange rate policy are yet to be released.

Outlook

The naira is set to continue on a downward scale until the exact modulation of the proposed flexible exchange rate is communicated. The MPC introduced a window of funding for critical sectors such as the agric and manufacturing sectors.

EXTERNAL RESERVES

Chart 6: External Reserves($ 'bn)



[23]

External reserves declined by 2.6% ($70m) to $26.39bn on May 31st, 2016. Year to date, the reserves level has depleted by 8.9% ($2.6bn). The external reserves level is 23.5% below 2015's peak of $34.51bn and 14.6% below 2015's average of $30.89bn. The

[22] Source: FMDQ database, FDC Think Tank
[23] Source: CBN database, FDC Think Tank

level of import and payments cover is down to 3 months. Net external reserves level is estimated at $20.89bn, after deducting forward commitments and arrears due under letters of credit. This will bring the net reserves of import and payment cover to 3.4 months. In terms of peer comparisons, Nigeria's import and payment cover is 73% lower than the emerging market average of 11 months. The Indonesian exchange rate reserves level stands at $103bn, while Russia and South Africa have $388bn and $46bn respectively.

Outlook

The Monetary Policy Committee's introduction of a flexible exchange rate system orchestrated gains in the stock market for two consecutive days. When the flexible exchange rate takes effect, the initial impact would be a capital outflow as existing investors pull out of the Nigerian market. Other investors are likely to adopt a wait and see approach until the market stabilizes before bringing in their funds.

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STOCK MARKET UPDATE

The Nigerian equities market was volatile in the month of May as it gained as much as 10.38%, with the All Share Index (ASI) crossing into positive territory for the first time this year.

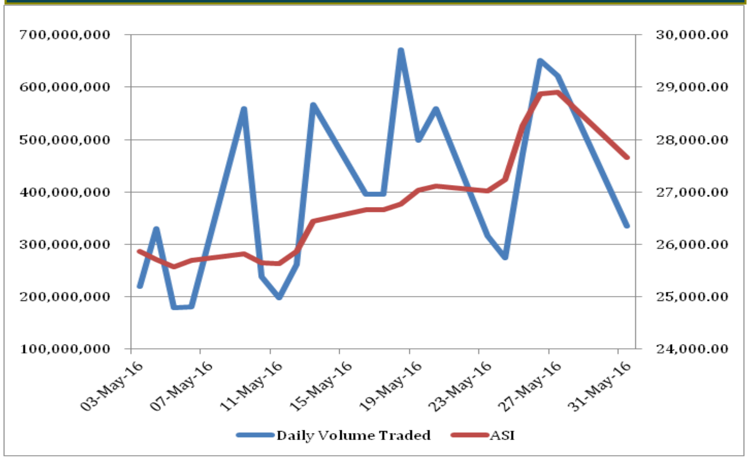
The NSE ASI closed at 27,671.08 up from 25,062.41 in the month of April. Several developments including the Central Bank of Nigeria's (CBN) Monetary Policy Committee (MPC) resolution on the foreign exchange market and Morgan Stanley's decision to place Nigerian securities under a "special treatment" rather than exclude them from the MSCI FM index bolstered investor sentiments. Year to Date (YTD) return on the ASI was -3.42% even though it crossed temporarily into positive territory a day before the last trading day of the month. Market capitalization appreciated to N9.50trn from N8.62trn in the previous month.

The gains recorded on the exchange can be attributed to the wave of positive news, which spurred investor interest. The partial deregulation of the downstream oil and gas sector, which was announced in the third week of, May saw the sector gain 6% in a single week. The signing of the budget by the president also elicited cheers from stakeholders being the much-awaited catalyst expected to boost the economy. The resolution of the Central bank of Nigeria's monetary policy committee (MPC) to allow the naira float on a second official window saw speculators struggling to take position in anticipation of foreign portfolio investors who left the market due to foreign exchange restrictions.

The liquidity weighted SFNG Blue Chip 30 Index advanced by 22.94% in the month of April compared with the 3.27% loss recorded in March 2016. The dividend yield and trailing PE ratio for the Blue-Chip 30 were 4.24% and 5.44x respectively while the 30-day volatility was 24.89%.

Activity on the bourse was positive as the 20 trading days in the period resulted in 14 days of gains against 6 days of losses. Daily changes, representing volatility on the ASI, ranged between -4.29% and 3.78% in the month.

Chart 7: NSE ASI May 2016



[24]

Market activity for the month rose by 56.84% to N52.51bn from the N33.48bn reported in the Month of April. The average daily turnover for the period was N2.63bn, 15.35% above the year-to-date daily average of N2.28bn.

Market breadth was positive at 3.15x in the review period as 41 stocks advanced against 13 stocks that declined while 139 stocks remained unchanged. The best performing stocks include FCMB 71.00%, TIGER BRANDED CONSUMER GOODS 66.34%, DIAMOND BANK 61.15%, OANDO 56.36% and MAY & BAKER 50.00%.

GAINERS			
COMPANY	**31-May**	**29-Apr**	**% Change**
FCMB GROUP PLC	1.71	1.00	71.00%
TIGER BRANDED CONSUMER GOODS PLC	5.04	3.03	66.34%
DIAMOND BANK PLC	2.24	1.39	61.15%
OANDO PLC	7.13	4.56	56.36%
MAY & BAKER NIGERIA PLC.	1.20	0.80	50.00%

Top price losers for the month were CAVERTON OFFSHORE (-19.08) UNIVERSITY PRESS (18.60%), MRS OIL (-18.51) PORT-LAND PAINTS (18.33%), and NCR NIGERIA (14.14%).

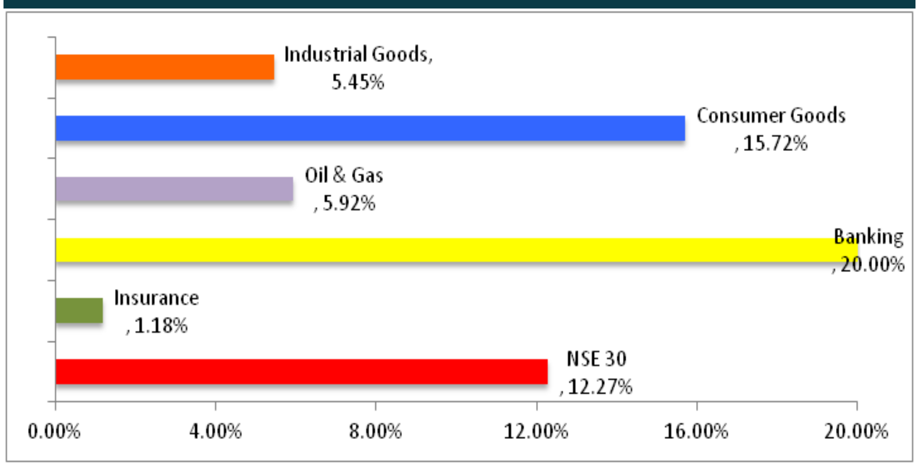
LOSERS			
COMPANY	**31-May**	**29-Apr**	**% Change**
CAVERTON OFFSHORE SUPPORT GROUP	1.40	1.73	-19.08%
UNIVERSITY PRESS PLC.	4.64	5.70	-18.60%
MRS OIL NIGERIA PLC.	36.53	44.83	-18.51%
PORTLAND PAINTS & PRODUCTS NIGERIA PLC	1.96	2.40	-18.33%
NCR (NIGERIA) PLC.	8.99	10.47	-14.14%

[24] Source: NSE, FDC Think Tank

COMPANY	31-May	29-Apr	% Change
NESTLE NIGERIA PLC	784.66	615.26	27.53%
ZENITH BANK PLC	14.98	12.7	17.95%
NIGERIAN BREW. PLC	135	115.89	16.49%
GUARANTY TRUST BANK PLC	19.53	16.77	16.46%
DANGOTE CEMENT PLC	167.01	163.4	2.21%

Despite poor economic data, which was released at the beginning of the month, all sectors recorded positive returns with the financial services sector advancing by 20% during the period under review. The performance of the financial services sector was closely tracked by the consumer goods, which gained 15.72% in May. The oil and gas sector and the industrial goods sector both gained 5.92% and 5.54% respectively even as the insurance sector managed to post a meagre 1.18% gain. Positive returns across sectors can be attributed to policy announcements, which bolstered investor confidence and expectations of increased foreign portfolio investments.

Chart 8 : Sectors in May 2016



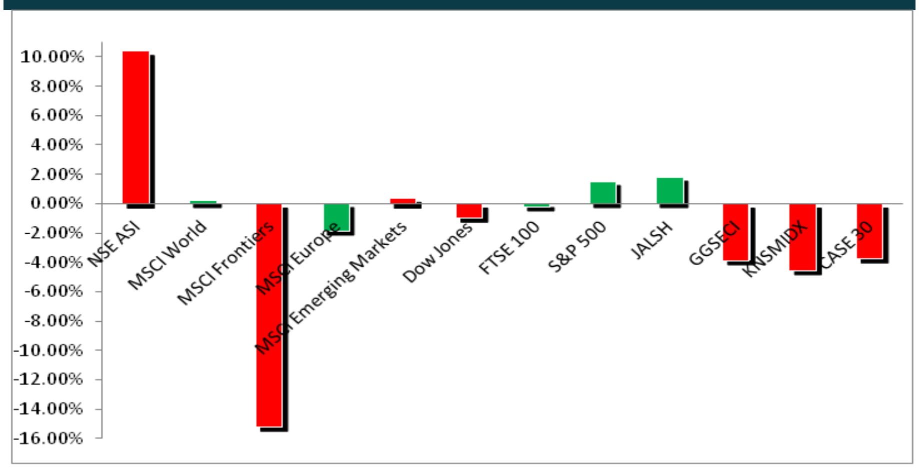
[25]

Amongst major global indices, NSE ASI recorded the best performance as a series of policy announcements renewed local investor sentiments. In defiance of negative economic data released at the beginning of the month, investors took positions in anticipation of an FPI driven market recovery. The Johannesburg Stock Exchange (JALSH) and the S&P 500 managed to chalk up 1.79% and 1.53% whilst the MSCI world gained 0.23%. The major African indices returned negative during the period with the MSCI frontier market recording the worst performance of 15.21%.

[25] Source: NSE, FDC Think Tank

Total value of transactions on the exchange increased by 57.12% from N33.42bn recorded in April to N52.51bn in May. When compared to the same period in 2015, total transactions decreased by 42.21% from the N103.43bn recorded in April 2015. Domestic investors outperformed foreign investors by 17.89% as total FPI transactions decreased from 30.47% in March 2016 to N66.96bn from N96.31bn recorded in April. Monthly foreign inflows slightly outpaced outflows, which was consistent with the same period in 2015. Foreign outflows decreased by 27.73% from N19.04bn in March 2016 to N13.76bn while foreign inflows decreased by 5.71% from N15.40bn in March to N14.52bn in April 2016.

Chart 9 : Global Indices May 2016



[26]

CORPORATE DISCLOSURES

Nestle Nigeria released positive Q1 2016 results, which beat analysts' expectations. Revenue grew by 31.12% from N27.56bn in 2015 to N36.13bn in 2016. Profit Before Tax (PBT) also grew by 59.84% from N3.48bn to N8.73bn in the first quarter of 2016. These impressive figures are attributable to a reduction in cost of sales, net finance costs and internal cost savings initiative.

The directors of Lafarge Africa also approved the acquisition of an additional 50% equity interest in United Cement Company of Nigeria Limited (UNICEM). Egyptian Cement Holdings B.V an entity jointly owned by Lafarge Holcim group and Lafarge Africa Plc currently holds this equity interest.

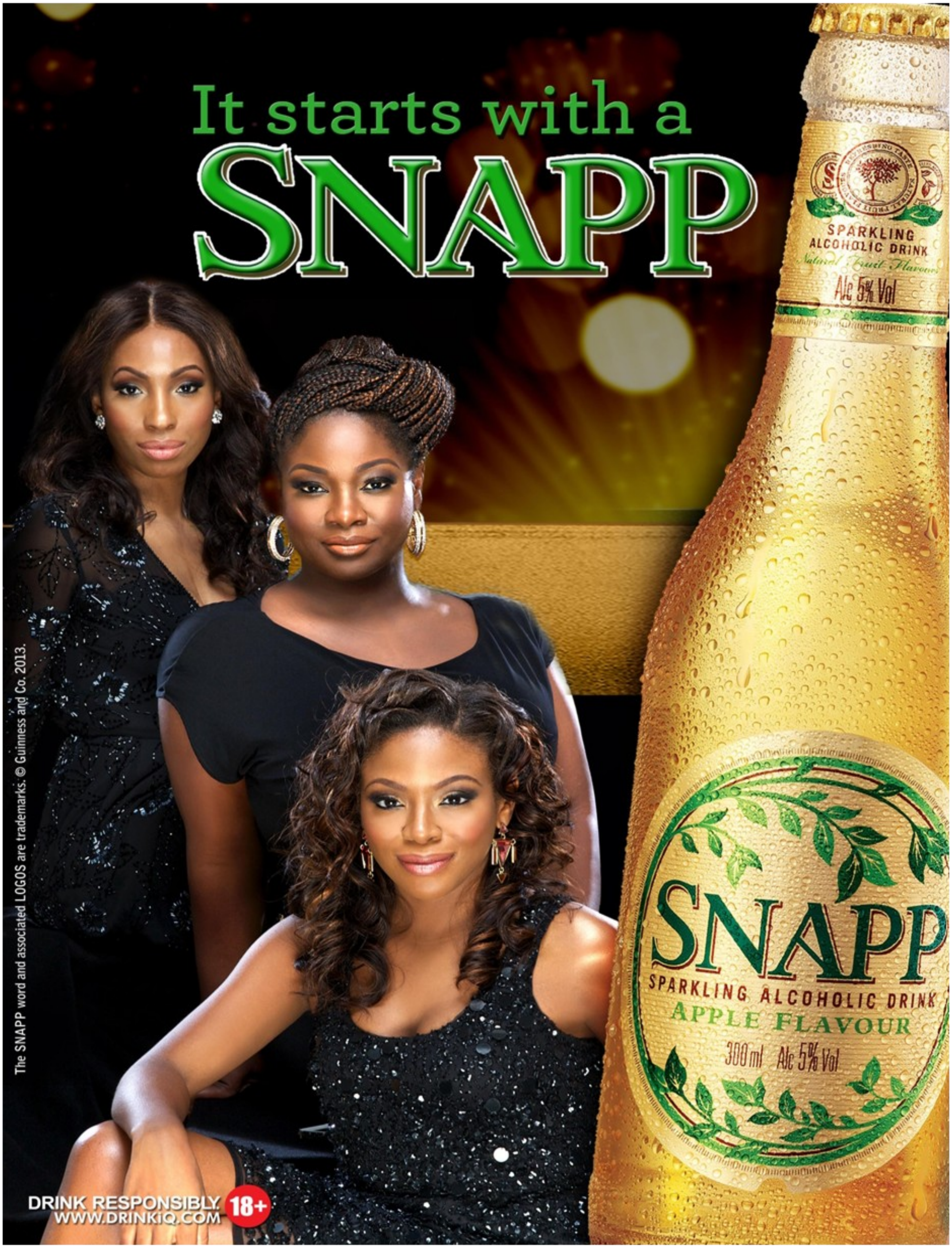
[26] NSE, Bloomberg, MSCI, FDC Think-Tank

Ecobank Transactional Incorporated (ETI) and Old Mutual Emerging Markets (OMEM) announced a new strategic agreement that will strengthen existing ties between the leading pan-African bank and the insurance and asset management giant. This latest agreement will grow the existing strategic bancassurance partnership

OUTLOOK

Given the increased sensitivity of the Nigeria equities market to policy changes, we expect the volatility witnessed in the month of May to sustain through the month of June. Investors will be watching for signals from the Central bank of Nigeria that could impact on the Nigerian bourse whilst speculators take bets on companies, which may post positive results in the first half of the year.

In the face of changing fundamentals and a constantly evolving risk environment, we urge investors to follow market related events closely and adjust positions as the need arises. The last week of June is likely to witness increased activities as asset managers rebalance portfolios.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CORPORATE FOCUS - LAFARGE AFRICA PLC

Sector: Cement and Aggregates

Ticker Symbols: NSE:WAPCO **Bloomberg:** WAPCO:NL
Reuters: WAPCO:LG **FT:** WAPCO:LAG
Shares Outstanding: 4.555b **TP Upside:** 15.37%
Target Price: N84.22 **Market Cap:** N316.56b
2015 Annual Dividend: N3.00
2015 Annual Dividend Yield: 4.32% **Price:** N73

LAFARGE AFRICA PLC: ***Poor Sales Realization Exacerbate Profitability Pressure***

Analysts Recommendation: BUY

Recommendation Period: 12 months

ANALYSTS NOTE

2016 is going to be a tumultuous year for Nigeria. Activities have contracted faster than anyone had anticipated; GDP growth decreased from 5.6% in 2014 to 2.7% in 2015. The lack of urgency to arrest this downward trend has dampened investors' confidence about the future of the country. There may be a silver lining for some industries, however, particularly construction. Capital expenditure (CAPEX) for the 2016 budget has been set at N1.7 trillion as against N557 billion the year before, representing a 215.9% increase and 30% of the total budget (it accounted for 12% in 2015). The federal budget commitment, a low cement consumption per capita 126kg (4x less than the global consumption), and population and urbanization growth are all factors that bode well for cement demand growth in coming years. Lafarge Africa Plc is expected to benefit from this investment in infrastructure in form of earnings and profitability growth. Over the last eight years it has been positioning itself for growth. The company has increased investment in its total production capacity by taking a controlling stake in other players (e.g. Ashaka Cement and UniCem) and developing new production plants. With the promises of this, new budget and its favorable positioning Lafarge should weather the economic storm. As such, we recommend a BUY.

PROFILE

Lafarge Africa Plc (formerly Lafarge Cement WAPCO Nigeria Plc) is a subsidiary of Lafarge Holicum headquartered at Jona, Switzerland, and was established in 1959. Lafarge Holicum controls 73% of the company after the merger of Lafarge WAMPCO Nigeria and South Africa entity. Within the past decade, the company has grown to be one of the leading companies for building materials in Nigeria. The company's operating segment consists of cement, aggregates (e.g. crushed stone, gravel and sand), and other construction materials and services (e.g. ready-mix concrete, concrete products, asphalt, construction and paving.

As part of its consolidation plans to strengthen its stronghold in Nigeria, it has purchased controlling stakes in regional players in the industry such as Atlas Cement (100%), Ashaka Cement (82.4%), and UniCem (50%). It intends to fully control these companies to take advantage of the huge opportunities the country poses as well as compete favorably with other industry players. As evident with Lafarge Africa tender offer for the purchase of Ashaka Cement minority stake of 17.54% valued at N7.68 billion alongside UniCem complete acquisition for N55 billion from Flour Mills of Nigeria Plc. Lafarge's combined business operations has a total production capacity of 12 million tonnes (MT) including ongoing cement production plants. Employee strength of 115,000 and has market share around 30%.

Lafarge Africa Plc 'WAPCO' recently released a dismissal set of Q1'16 numbers, which showed a 29.3% year-on-year (Y-o-Y) decline in revenue to N52.4billion and a loss before tax of N2.2billion, representing a 136% decline (Y-o-Y). The decline in sales turnover can be attributed to intense industry competition, particularly from Dangote Cement, and a weak macroeconomic environment in Nigeria and South Africa, which led to product price reductions. Furthermore, the company's profitability deteriorated due to low sales to offset high operational expense and finance cost. The cost of sales as a percentage of revenue increased to 85.1% in Q1'16 from 66.3% in Q1'15, while operational expense as a percentage of revenue edged higher by 2.02% from 10.2% in Q1'15. Finance cost as a percentage of revenue also rose from 3.5% in Q1'15 to 4.88% in Q1'16.

While these figures are not favorable they are to be expected considering the current economic climate. In the near term, we expect volumes to remain under pressure due to the intensity of industry competition and low government spend. However, we expect government spend in infrastructure to improve post Q2'16. This, in turn, will drive cement demand and have a positive impact on Lafarge's performance indicators.

LAFARGE AFRICA PLC (WAPCO NL) - Standardized

In Millions of NGN except 12 Months Ending	FY 2011 12/31/2011	FY 2012 12/31/2012	FY 2013 12/31/2013	FY 2014 12/31/2014	FY 2015 12/31/2015	CAGR %
Assets						
Total Non-Current Assets	127,944.70	128,140.80	125,187.90	343,732.40	379,135.80	24.27%
Total Current Assets	24,725.60	23,807.80	35,893.90	72,214.10	73,876.60	24.47%
Total Assets	**152,670.30**	**151,948.60**	**161,081.70**	**415,946.50**	**453,012.40**	24.30%
Liabilities & Shareholders' Equity						
Total Non-Current Liabilities	64,023.60	51,738.40	27,928.70	164,646.70	187,473.20	23.97%
Total Current Liabilities	32,595.90	31,850.90	40,181.20	75,719.80	89,387.50	22.36%
Total Liabilities	96,619.60	83,589.30	68,110.00	240,366.60	276,860.70	23.44%
Total Equity	56,050.70	68,359.40	92,971.70	175,579.90	176,151.70	25.74%
Total Liabilities & Equity	**152,670.30**	**151,948.60**	**161,081.70**	**415,946.50**	**453,012.40**	24.30%
Comprehensive Income						
Turnover	62,502.30	87,965.20	98,798.50	260,810.50	267,234.20	33.72%
Pretax Income	10,219.20	21,264.40	27,715.00	40,358.10	29,274.90	23.43%
Income Tax Expense	1,709.90	6,552.70	-552.189	6,537.80	2,276.60	5.89%
Income Before XO Items	8,509.30	14,711.70	28,267.19	33,820.40	26,998.30	25.98%

Source: Bloomberg, Company Data, FDC Think Tank

MANAGEMENT

The Lafarge Africa Plc board of directors is comprised of an outstanding team of individuals with broad experience ranging from finance and manufacturing to accounting. In general, the company's corporate governance standard is high and in our opinion, the management team is credible. The merger between Lafarge South Africa and Nigeria saw management reshuffle and the appointment of Alhaji Shamsuddeen Usman, CON, Mrs Elenda Osima-Dokubo, Mrs Adenike Ogunlesi and Alhaji Umaru Kwairanga.

The company's board is chaired by Mobolaji Balogun Esq. He joined the board in March 2005 and was appointed Chairman of the Board in May 2015. He is an Economics (Honors) graduate from the London School of Economics. He has worked in the mobile telecommunications and the investment banking industry in various capacities was appointed to the Johannesburg Stock Exchange Africa Board Advisory Committee in September 2009. Presently, he serves as the Chief Executive Officer of Chapel Hill Denham Group, a leading independent investment banking firm in Nigeria.

The resignation of Mr. Peter Hoddinott in March 2016, saw the appointment of Mr. Michel Puchercos as the Group managing Director/CEO. His career started in 1982 at the French Ministry of Agriculture and he subsequently served as a Director of Orsan (a subsidiary of Lafarge from 1989). After a brief spell at Agro-Food and Chemical Industries in Europe and Cana group, he returned to Lafarge in 1998. He headed the Gypsum division of Lafarge as Director of Strategy and Information Systems, and later as the Director of Cement Strategy and President of Lafarge South Korea Japan Operations. He is a graduate of the Ecole Polytechnique (1976) and the Ecole Nationale du Genie Rural, des Eaux at des Forets (1981).

In sum, Lafarge Africa executive management team comprises of individuals that possess the requisite experience to steer the company towards attaining its value proposition and improving operational efficiency, enhancing its competitive position and having a huge developmental impact in Nigeria.

WHAT THE BULLS AND BEARS SAY

The Bulls Say:

- Diverse regional presence in the country reduces distribution cost
- Business consolidation creates synergies which will lower overhead cost
- Positive product perception endears customers
- Improved regulatory oversight reduces sharp practices/ provides level playing field for industry players.
- Elimination of foreign substitutes lessen industry competition
- Increased infrastructure spend especially in railway and road networks will ease distribution of product
- Forward integration strategy to help capture value in housing sector

The Bears Say:

- Fierce rivalry from competition 'Dangote Cement'
  - Disadvantaged on cost basis and low advertising compared to Dangote Cement
- Continued slowdown in economic activities in Nigeria and South Africa.

INVESTMENT THESIS

FDC places a BUY recommendation on Lafarge Africa Plc, as the target price of N84.22 offers an upside on the current market price of N73 as at May 13 2016. Even though the Q1'16 result surprised us on the downside in terms of revenues and profitability, we believe the challenges are just in the near term. We maintain our positive outlook due to a rise in infrastructure spending, the synergy effects from the merger and other holdings in associated businesses, the likely increase in the price of cement to adjust to cost inflation, and lower financing costs through repayments from the earnings generation of UniCem among others.

This, in turn, will keep the cement demand static at 2015 level of 21MT. In addition, the stock is trading within the sector at a discount. We see the stock as having an attractive risk/reward profile.

LAFARGE AFRICA PLC VALUATION USING DCF/FCFE

Our intrinsic value for Lafarge Africa Plc was arrived at by using a Discounted Cash Flow (DCF) valuation method. Key assumptions included:

1. A DCF valuation method based on a three year forecasted financial statement;
2. A terminal growth rate of 2% in estimating the company's future cash flows; and
3. A cost of equity of 15.93% (capital asset pricing model), a beta of 1.09,[27] a risk free rate of 10.48% (the rate for a 3-year FGN bond maturing in 2018), and a market risk premium of 5%.
4. The valuation took into consideration a near term outlook such as the company's growth and profitability, value creation from associated investments, industry trends and the prevailing macroeconomic conditions. We forecast a three-year revenue growth CAGR of -2.47%.
5. The target price of Lafarge Africa Plc is N84.22, which is at a 15.37% upside to the current price of N73 as at May 13, 2016.

[27] Financial Times data

3 Year Free CashFlow to Equity Projections				
LAFARGE AFRICA PLC	2015 N'mn	2016 N'mn	2017 N'mn	2018 N'mn
Turnover/Revenue	267,234.2	220,067.4	228,870.1	248,324.0
EBITDA	62,819	36,625	52,988	69,490
EBIT	47,780.8	16,301.5	29,043.8	42,864.1
Less: Cash Taxes @ 13.45%	6,427	2,193	3,906	5,765
Tax-effected EBIT (NOPAT)	54,207	18,494	32,950	48,629
Plus: Depreciation & Amortization	15,038	20,323	23,944	26,626
Less: Capital Expenditures	-59,853	-43,597	-35,925	-42,787
Less: Change in Net Working Capital	-15,511	-12,594	-13,324	-9,699
Unlevered Free CashFlow	-6,119	-17,374	7,646	22,769
WACC @ 11.76%	11.8%			
NPV of Unlevered Free Cash Flow	6,886			
PERPETUITY GROWTH RATE				
		Undiscounted	Discounted	EBITDA Multiple
Perpetuity Growth Rate @ 2%	2%	508,183	364,043	7.31
Discounted Cash Flow	2%	508,183	364,043	7.31
DCF Range (Implied Enterprise Value)			370,929	
Equity Value			370,929	
Implied Price Per Share			84.22	

RISKS

The cement industry has steadily undergone consolidation process thus intensifying the level of competition among the few players Dangote Cement, BUA cement among others. Given the intense industry rivalry, present macroeconomic conditions, late passage of 2016 budget, wage suppression among others, its likely to strain profitability as evident in Q1'16 sector pre-tax profit decline by 32.2% to N53.9bn.

Slowdown in gross domestic product (GDP) alongside security challenges will have a detrimental effect on the company's sales turnover. Thus, less demand to exhaust installed production capacity.

Currency misalignment poses a risk in terms of FX scarcity and refinancing of its dollar debt Unicem (2015E: $270mn) might prove difficult should the currency depreciate. With implication on the company's profitability level.

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RESCUING AND DEFENDING THE NAIRA- WRITTEN BY VICTOR A. ODOZI

INTRODUCTION

This contribution has been triggered by several considerations, including the following:

First, the urging of a long-standing friend of mine who thought that I had something worthwhile to contribute towards the ongoing efforts to stabilise the Naira exchange rate.

Second, it is in memory of the late maverick, Egheomhanre Emmanuel Eyieyien, fondly called "Ëghes", a great patriot and close associate of mine. He died on Christmas Day last year, barely three days after publishing an article, entitled: **Emefiele is Not the Problem**, in which he lamented the travails of the Naira and, inter alia, advocated its devaluation as a realistic step towards restoring exchange rate stability in the Country.

Third, the timing has also been informed by the recent phenomenal crash of the Naira in the free foreign exchange markets, with the Naira crossing what might be called the "bar lev line'' of 400 Naira/Dollar. Indeed, until that point, I was of the firm view that the devaluation of the Naira, as urged by many experts, including those of the IMF, was not, per se, the solution to our Country's foreign exchange crisis. Now, however, I firmly believe that Naira devaluation is inevitable and, indeed, mandatory. The real debate now should not be over whether or not the Naira should be devalued, but when and by how much and the elements of a strategic policy framework to make the emerging exchange rate regime stable and sustainable. It should also be clear that failure to act now will merely postpone the evil day and exacerbate the prevailing foreign exchange crisis. In this connection, it is instructive that three past Governors of the Central Bank of Nigeria (CBN) have spoken out in favour of Naira devaluation. Furthermore, some oil-exporting countries, whose economies have been mired by the collapse of international oil prices, just like Nigeria, have been obliged to devalue their local currencies to ease the unrelenting pressure. For instance, the Russian rouble has officially been devalued by over 50% since July 2014 while the Venezuelan Bolivar was officially devalued by 37% in February 2016 for the same reason. So, Nigeria is not alone on this devaluation issue and the authorities need to recognise that it is inevitable, and the earlier it is done the better for the Country.

Thus, this contribution seeks to make a case for appropriate official downward adjustment of the Naira exchange rate (devaluation) as one of the key elements in a comprehensive and robust macroeconomic policy response by the Federal Government to the prevailing economic and financial crises. It should be reiterated that Naira devaluation, per se, is not the answer and should be undertaken only in the context of a coordinated and coherent fiscal/monetary policy response, backed by complementary supply-side and corrective measures. It should also be stressed that the issues raised and the proposals made in this contribution are not entirely new or original but they remain highly relevant in our present circumstances.

Above all, it should be recalled that our Country faced a similar dire situation some 30 years ago. Then, in mid-1986, after conducting a long-drawn-out and heated national debate whether to devalue or not to devalue, the Military Government under General Ibrahim Babangida mustered the will to devalue the Naira. That was a matter of last resort and a key element in the nexus of economic reform measures introduced under the auspices of the Structural Adjustment Programme (SAP). Although the outcomes of the SAP were mixed, they were, on balance, highly beneficial. Thus, although the SAP is nominally dead, its spirit prevails till this day. Indeed, the SAP ideology of guided market capitalism has continued to inform and inspire policy-making and management under successive administrations ever since. The learning point here is that we had faced a similar situation before as we are in now and that there is a viable option available if the required political will could be summoned to do what is inevitable and unavoidable. We believe that this Government is not lacking in the courage to devalue if it is clear and persuaded that there is a compelling case for it. An attempt is made to present such a case in this contribution.

After work on this paper had virtually been concluded, news came that a currency swap deal had been signed between Nigeria and China. Details of the arrangement, in terms of coverage, transaction dynamics, documentation requirements and take-off, etc., have not yet been provided. Accordingly, only tentative comments on the deal are warranted here. In this connection, it is important to state that any arrangement, such as the one referred to above, that seeks to relieve the prevailing pressure on our external reserves is welcome, provided the terms are right and the benefits are sustainable. Nevertheless, even with the most favourable terms available, the above initiative, which is analogous to a clearing-house arrangement, should be seen as merely complementary to, and not a substitute for, the existing payment arrangements for the settlement of international transactions. Indeed, the US Dollar still looms large in our external transactions and payment obligations and this dominance will remain for long. Thus, the need to deal with the current exchange rate misalignment and the case made for it in this paper remain valid.

SOME CONCEPTUAL AND LEADING ISSUES

i. Factors at Work

The exchange rate, in general, reflects the underlying health or otherwise of an economy, particularly the economic fundamentals of foreign exchange demand and supply, interest and inflation rates, balance of payments position, and growth prospects. The psychology of the market (expectations and speculative activity) and socio-economic and political factors also exert a significant impact on the exchange rate.

The following factors have, to varying degrees, been the driving forces behind the persistent depreciation of the Naira exchange rate since the last quarter of 2014:

- The collapse of oil prices which started in June 2014, resulting in the sharp decline in petrodollar receipts and depletion of our external reserves.

- Gross inadequacy of supply relative to demand for foreign exchange. This has been exacerbated by the removal of 41 items from the list of imports eligible for foreign exchange sourcing from the official market, with those affected being left with no choice but resort to the bureaux de change and parallel markets to meet their otherwise legitimate needs.

- The increasing incidence of hedging and speculative transactions which have swollen an already bloated demand for foreign exchange.

- With the persistent Naira weakness and the spectre of imminent Naira devaluation, there has been increased incentive to hold foreign currency rather than the Naira. Thus, while investors and other potential suppliers of foreign exchange withhold their funds in order to make more profits (gains) later, foreign exchange users are desperate to buy now before the Naira depreciates further or is devalued. This "Naira pessimism" or preference for dollars is a major factor in the continued slide of the Naira in the free segments of the foreign exchange market in recent times.

In summary, increased "Naira pessimism", severe supply constraints in the face of unrelenting heavy demand, the ensuing huge and increasing backlog of unsettled past-due import bills and invisible trade transactions, a large and widening parallel market premium, etc., have all engendered increased uneasiness about Naira exchange rate stability and the well-founded view that the prevailing official rate cannot be sustained for too long, without depleting the external reserves. Consequently, there has been a huge speculative attack on the reserves. Furthermore, the lingering insurgency in the North East and socio-political unrest and violent crimes in some parts of the Country, coupled with weak near-term growth prospects, have all induced increased capital flight, thereby exacerbating the woes of the Naira.

ii. Why Rescue and Defend the Naira?

In making a case for rescuing and defending the Naira, we should begin by stressing the critical role of the exchange rate in the economy.

For a country, such as Nigeria, with an open economy where foreign trade accounts for a significant proportion of the Gross Domestic Product, the exchange rate links the domestic economy with the outside world. Furthermore, it is the most important price which influences most other prices and, indeed, the general level of prices. Consequently, exchange rate levels and movements have far-reaching implications for inflation, price incentives, fiscal viability, export-competitiveness, efficiency in resource allocation, international confidence and balance of payments equilibrium.

Given their widespread impact, it is not surprising that exchange rate developments are a matter of great interest and often concern to Governments, the business community and the general public. In some situations, exchange rate devaluation becomes the government's concern and is beyond the purview or discretion of the central bank. That is why this contribution is being placed in the public domain.

Rescuing and defending the Naira is to ensure that the exchange rate regime is not left to the vagaries and devices of free, unfettered markets which are often manipulated and driven by greed and criminality. It is also to ensure that the exchange rate performs its resource-allocation function efficiently and that the emerging regime is stable and sustainable. Indeed, given its critical role in macroeconomic management, the Naira exchange rate needs to be stabilised and subsequently sustained within an appropriate band or target zone, to make for better planning by economic agents.

AN AGENDA FOR ACTION

i. Some Fundamental Principles

To put the proposals being made in this contribution in context, the following fundamental observations or principles may be advanced**.**

First, the exchange rate is a price. Like all other prices, in a free-market environment, it is determined by the forces of supply and demand. Consequently, and as past and present experiences have amply demonstrated, trying to fix it arbitrarily is an exercise in futility. Indeed, as asserted by Jacques Polak, IMF Director of Research (1958 – 1979, "It is not in the best interest of any country to seek to maintain a disequilibrium exchange rate and no country in the end succeeds in doing so".

Second, macroeconomic management invariably entails delicate balancing acts and difficult trade-offs among key fiscal and monetary variables, e.g.: price stability versus growth; interest versus exchange rates; consumption versus savings; and the short versus long term; etc. Thus, achieving a stable exchange rate might require raising interest rates; devaluation is sometimes required to restore external balance; and devaluation might be unavoidable to achieve a realistic and sustainable exchange rate regime. The policy or operational discretion the fiscal and monetary authorities have depends on the prevailing economic conditions; the degree of divergence of the variables from optimality; and the magnitude of corrective measures called for in order to restore normalcy. Thus, unduly delaying corrective action often results in bigger and more painful adjustment in future.

Third, since the demonetisation of gold in the early 1970's, there has been a generalised system of floating exchange rates. However, in practice, there is nothing like a "clean" or "pure" float whereby the exchange rate is left entirely to the vagaries of market forces. Although there is a continuum of exchange-rate regimes worldwide, ranging from fixed to flexible arrangements, the predominant system is the "dirty" or "managed" float. This entails periodic intervention by the monetary authorities in the foreign exchange markets to achieve certain strategic objectives, such as buoying up the value of the local currency in periods of severe market pressure or reducing its value to restore export competitiveness or improve the trade balance. A few countries have a fixed exchange rate regime either in the context of a monetary union (as in the case of Europe) or under a currency board system (as in Hong Kong and Argentina). Nevertheless, irrespective of the regime chosen, it is important that exchange rate determination is technically sound and realistic and that the rate is stable.

Fourth, after nearly thirty years that stringent trade and exchange controls were abolished in Nigeria as part of the reform package under the auspices of the Structural Adjustment Programme, there has been a gradual return to such controls in recent times, ostensibly to deal with the prevailing foreign exchange crisis. Although these measures may be defended as a last resort and short-term emergency measure, it should be noted that both trade and exchange controls have been firmly established as inferior macroeconomic management tools that have not recorded any success story anywhere in the world. Our own Country's experience during most of the pre-SAP period (1967 to mid-1986) amply demonstrates that such controls are a costly and useless bureaucratic exercise as they are susceptible to serious abuse, corruption and evasion. Furthermore, in the more sophisticated business environment of today, stringent trade and exchange controls will be more easily circumvented by market participants.

Fifth, rescuing the Naira would require the adoption of a comprehensive and robust reform agenda, an important component of which is exchange rate unification as proxied by significant reduction in the prevailing parallel-market premium from about 60% to the generally-accepted threshold over time. It should be stressed that although by itself, the parallel market rate is not all that important as it is not the true rate for the entire economy and only a relatively small volume/value of transactions gets executed at that rate, the difference between the official and parallel market rates (parallel-market premium) matters a great deal. For, apart from serving as an indicator of the magnitude of excess demand for foreign exchange and the potential or prospect for eventual devaluation, an unduly large parallel-market premium, as is the case now, engenders destabilising speculative activity and serious malpractices, including capital flight and the diversion of funds and repatriable export proceeds from the official to the parallel market. Thus, exchange rate levels and trends in this informal segment relative to the official rates, cannot be a matter for benign neglect but should be of policy interest and action.

Sixth, although the prevailing large parallel-market premium is a matter of policy concern, the authorities should be circumspect in dealing with the problem. In particular, the approach to be adopted in the efforts to drastically reduce the premium should be legal, transparent and technically sound. Thus, the temptation to intervene in the parallel market by injecting official foreign exchange therein in order to induce an appreciation of the rate, as some have advocated, should be resisted. Although such an initiative was taken in the mid-1990s, it should be discouraged for the following reasons: it is illegal; it lacks transparency and is susceptible to abuse; and it is of doubtful efficacy and unnecessary given that, once the rates converge in the official market, the parallel-market rate would crash and fall in line with the unified exchange-rate regime. However, the parallel market could only pale into insignificance but would not be completely eliminated even with the efficient and superior performance of the formal market. Furthermore, invoking draconian anti-black market laws and raids by security agents are unlikely to put the informal market currency traders out of business for good. This is because the parallel market accommodates "those left out" either because they are unable to meet their legitimate needs in the formal market or are engaged in ineligible or illegal/criminal transactions. Above all, for many parallel-market operators, currency trading is deeply-embedded in their genetic code and has become a way of life or part of their culture!

ii. Elements of a Policy Package for Rescuing the Naira

Policy Options for Exchange Rate Unification

The unification of the foreign-exchange markets, entailing the significant reduction in the parallel-market premium to achieve a unified exchange-rate regime, is a strategic imperative that needs to be executed in a competent and credible manner**.** There are several possible options for achieving such unification, including the following: merger at the parallel market rate or bureaux de change rate; merger at the CBN/interbank rate; merger at the prevailing autonomous rate which is assumed to be currently well above the official CBN/interbank rate; or merger at a weighted average of the CBN/interbank rate and either the autonomous rate or a rate indicated by the Purchasing Power Parity (PPP).

The above options may be appraised as follows:

A merger at the prevailing parallel market, bureaux de change or even the autonomous market rate would mean a big devaluation of the Naira and is not recommended because of the severe inflationary repercussions.

A merger at the prevailing CBN/interbank rate, which would have been desirable because it carries the least inflationary potential, is not realistic or sustainable, given that it would require drastic demand management measures - a severe liquidity squeeze and fiscal retrenchment – which would drive up interest rates to worrisome and unsustainable levels. Furthermore, in the face of the massive volume of unmet demand and trade arrears, it would require a chunk of our already depleted external reserves to make merger at the prevailing CBN/interbank rate sustainable.

A merger at a weighted average of the prevailing CBN/interbank rate and either the autonomous rate or a rate indicated by the Purchasing Power Parity (PPP) , the latter of which is assumed to be currently well above the CBN/interbank rate, would appear to be the most credible and sustainable option. This preferred option would entail the devaluation of the official exchange rate by about 10 to 15%. It is also envisaged that this measure, which could potentially suck up a substantial amount of liquidity from the system, would significantly reduce the overall demand for foreign exchange and exert a downward pressure on, or induce an appreciation of, the parallel-market rate.

However, it should be stressed that one single dose of devaluation cannot guarantee a stable and sustainable unified exchange rate regime unless it is backed by robust demand management, fiscal measures and supporting supply-side initiatives. Also, what is envisaged is exchange rate convergence or unification which excludes a dual exchange-rate regime, the latter of which implies an official rate for favoured transactions existing side-by-side with an autonomous (second window) rate for others. Let it be stated here in passing that introducing a dual exchange-rate regime is an exercise in futility!

It is appropriate at this juncture to note that the debate over the devaluation of the Naira is long-standing and rages on today, with advocates and opponents of devaluation remaining resolute and vehement in their respective stands. Having made a case for Naira devaluation in this paper, it is only fair that the case of the opponents also be examined here. The case made against devaluation is often based on technical grounds, namely that: Nigeria is highly dependent on imports the demand for which is inelastic while the Country's exports are supply and demand inelastic. Thus, devaluing the Naira would not result in any significant decline in imports nor would it induce meaningful export growth. Furthermore, devaluation would result in imported inflation, with adverse consequences for the ordinary man.

In response to the above devaluation concerns, the following countervailing arguments may be made: First, although demand for basic imports may be inelastic, this does not hold good for luxury and non-essential items. In any case, when the prices of even basic imported items rise unduly high, there would be price resistance by consumers and greater incentive to look inwards and source locally for substitutes, thereby boosting domestic production and employment. Second, with respect to the inflationary repercussions of Naira devaluation, it should be noted that businesses have already factored the devaluation of the Naira in the free segments of the foreign markets into their pricing decisions and that the prevailing prices reflect parallel market rates rather than CBN rates. Thus, devaluation will not result in much higher prices for goods than the prevailing levels which could, indeed be moderated by the effects of disciplined demand and induced supply expansion. In this connection, the recent deregulation of the down-stream sector of the oil industry, should result in improved supply and stabilisation of petroleum product prices below the prevailing general level pre-deregulation, with potential positive impact on inflation. Second, the argument that devaluation would not have any meaningful impact on our exports may be faulted on the ground that devaluation would definitely enhance the price competitiveness of our export products. In this connection, it should be noted that various studies have established that our farmers and exporters do respond to price incentives. Thus, over time devaluation, combined with appropriate export promotion measures, should call forth a significant supply response. Third, devaluation is being proposed here in the context of comprehensive policy reforms, encompassing not only official exchange rate adjustment but also the supporting fiscal, monetary and other measures highlighted below, to make devaluation work. Indeed, the approach here is dynamic as against the static and populist orientation of the anti-devaluation ideologues.

SUPPORTING MEASURES

- Adopt a flexible, market-oriented exchange rate regime based on the target-zone approach.

- Create a truly autonomous inter-bank foreign exchange market whereby the CBN ceases to be the dominant player. Instead, the CBN would be more of a market referee and facilitator, intervening periodically to achieve certain strategic objectives and ensuring compliance with the rules of the game.

- To ensure the depth and viability of the new interbank-based foreign exchange market, it should be funded not only with non-oil export proceeds and other private inflows but also funds sourced from oil-marketing and oil-servicing companies and remittances of oil-producing companies for payment of taxes and royalties while Government receives payments due to it in Naira. The implication of this scenario is that petro-dollar earnings would be kept by the CBN after monetisation and used to boost our external reserves, service our external debt and for occasional strategic intervention in the foreign exchange market.

- Liberalise the prevailing stringent exchange controls and put in place a phased settlement of outstanding payment arrears in order to restore confidence in both our macroeconomic management and international payment systems. However, the requirement of appropriate documentation for end-user transactions should be maintained.

- Undertake the full deregulation of the downstream sector of the oil industry.

- Implement measures to further diversify the economy away from oil and thereby reduce our undue dependence on oil for government revenue and foreign exchange earnings. Similarly, reduce import dependency through meaningful import substitution initiatives.

- Use tariffs to discriminate against luxury and frivolous imports. However, the temptation to resort to high tariffs and large-scale import bans should be resisted as such measures, apart from provoking retaliation by our trading partners, would induce importers to resort to under-invoicing, smuggling and other forms of duty evasion in order to remain profitable. What is required is a robust import surveillance system, backed by effective duty collection, which would be facilitated by a regulatory regime that encourages voluntary compliance and makes resort to the parallel market relatively unattractive.

- Block fiscal and other leakages that abound in the Country.

- Introduce a robust system of public assistance to the manufacturing sector in the form of various fiscal concessions and incentives, particularly to industries suffering from heavy and unfair import competition, such as textiles and clothing, pharmaceuticals, detergents, shoes, plastic products, food, beverages, etc. Such support schemes should be properly targeted and monitored to ensure that the benefits accrue to the intended beneficiaries and for adequate impact.

- Diligently implement the various export promotion incentives to boost production and generate exportable surplus. In this connection, the strategy of export-led recovery or the new "Zero Oil" Economic Agenda now being promoted by the NEPC should be diligently pursued.

- Make concerted efforts to deal with the various infrastructural constraints in order to boost supply, enhance efficiency and reduce the high cost of doing business in the Country.
- Create a stable, business-friendly environment based on effective public-private partnership, with the private-sector as the engine of growth. Also deal firmly with insurgency, corruption and abuse of court processes by litigants and criminal opportunists.

CONCLUSION

In summary, devaluation, if undertaken in the context of a comprehensive and robust policy reform, would yield the following significant benefits: arrest and reverse the depletion of our external reserves; discipline demand for foreign exchange and imports and reduce our vulnerability to external price shocks; induce net foreign inflows; enhance export-competitiveness and growth; enhance government revenue from petro-dollar receipts and taxes; check round-tripping and other rent-seeking behaviour; restore credibility to our international payment arrangements; and promote the diversification and growth of the economy. The important caveat here is that devaluation should be undertaken as a key element of a comprehensive and robust policy reform backed by diligent implementation.

Whether by design or by default, Nigeria is now approaching the dawn of the post-petroleum age. For a country so heavily dependent and for so long on petroleum, it is difficult to contemplate a future without petroleum – so pervasive and critical has been the role of petroleum in our national economy! However, this is the stark reality that we need to embrace. The post-petroleum age in Nigeria comes with both risks and opportunities which policy-makers and other key stakeholders need to be aware of and respond to by appropriately managing the episodic and traumatic transition from fossil fuels to renewables. It cannot be business as usual, with the typical lack of a sense of urgency. In many ways, the measures advocated above for stabilising the Naira exchange rate, provided they are pursued diligently, would facilitate the orderly transition to the post-petroleum era.

Meanwhile, saving the Naira from its prevailing travails would require comprehensive and robust initiatives, some of which have been highlighted in this contribution, together with an identification of the forces at work. The measures mandated include the devaluation of the Naira but it should be reiterated that this is just one, albeit a key element, in the nexus of actions required to be taken. Some of the initiatives would have long gestation periods. However, coordinated and diligent implementation of these and many other initiatives by Government, working with key private sector stakeholders, should yield a realistic, unified exchange rate regime and restore confidence and stability in the foreign exchange markets in the short run. Long-term sustainability, together with reaping the benefits that would accrue from there, will require strong political will by Government and consistent efforts on an ongoing basis by all.

Above all, we need to embrace change, big change! One important implication of the creation of a new interbank foreign exchange market advocated above is that the private sector operators would cease to rely on the CBN for their foreign exchange needs, subject to a transitional phase of not more than six months. This would, no doubt, come as a shock and, for many businesses, it would mean "export or perish"! Although this appears to be a rather risky, even worrisome proposition, it is warranted and inevitable in our present dire circumstances. Indeed, "export or perish" is not a curse, a mere slogan or exhortation. It is a strategic imperative for our economic survival and transformation!

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