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Economic Recovery Plan: Forex Market Efficiency and the Business Environment

For most, doing business in Nigeria is a hassle. Few thrive and many barely survive. A few years ago, a survey amongst business people – from start-ups to established multinationals – would have typically narrowed down the major obstacles to electricity, high cost of borrowing and logistics problems, in no particular order.

Both the economic recovery and growth plan (ERGP) and the Presidential Enabling Business Environment Council (PEBEC) have zeroed in on these obstacles. On the part of the ERGP, unlike many plans before it, it does not take a long-term approach. It is more of an economic policy roadmap that encompasses the 2017 Appropriation Bill and the Medium-Term Expenditure Framework (MTEF), and focuses squarely on improving the business environment. Two of the five key execution priorities listed in the ERGP – ensuring energy sufficiency and improving transportation infrastructure – seem lazer- focused on addressing the problems highlighted above.

As for the PEBEC, it recently detailed a 60-day plan (February 21st to April 21st) to ease the major constraints to doing business in Nigeria. It tackles seven key reform areas that directly align to the World Bank's Ease of Doing Business index indicators: starting a business, getting credit, registering property, paying taxes, dealing construction permits, trading across borders and getting electricity. The objective is to propel Nigeria into the top 100 on the index (from its current position of 169 out of 190) by 2020. Progress will be monitored using methodology similar to that of

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the World Bank's report.

One would be forgiven if they simply assumed that addressing these problems squarely would be the master stroke the Nigerian business community – and even foreign interests – have been waiting for. But the events of the past 24 months have not only altered perception about the vulnerability of the Nigerian economy to external shocks, but unequivocally placed access to foreign exchange – once taken for granted – firmly on top of everybody's list of priorities.

So how does a problem that didn't even exist a few years ago become the biggest problem today? The answer takes us to the remote cause of the economic downturn – an incomplete and belated policy adjustment by the monetary authorities to the oil price shock. Nigeria is an import dependent, commodity-exporting country where oil and gas exports account for over 90% of foreign exchange (forex) earnings. The oil price collapse and the consequent forex crisis plunged Nigeria into an economic crisis.

The average item consumed in Nigeria is more than 60% imported in its content. Yet, since the plunge, businesses have not had consistent access to forex. Where businesses have accessed it, they have done so at almost double the cost. Foreign investors have headed for the exit and this has only served to exacerbate the pressure on the currency. Nigeria is no longer discussed as an investment destination, even amongst the most dare-devil risk takers. At least it will not be until the exchange rate debacle is sorted out.

While the ERGP was clearly put together to inspire confidence amongst investors, the elephant in the room – the structure of the exchange rate market – barely got a mention. The plan says that the Central Bank of Nigeria (CBN) will pursue a sustainable, market determined exchange rate. If there is one thing that everyone agrees on, it is that the foreign exchange market is crucial in the successful implementation of the ERGP.

Recently, rising oil prices and increased oil production have boosted external reserves and given the CBN some room to intervene in the foreign exchange market. Reserves are up to $30bn and the parallel market has appreciated to a seven-month high of N410/$, from N520/$ only few weeks ago. But what happens if oil

prices and production swing the other way? Some are already betting that they will and the parallel market will swing with it. Oil prices have already retreated in response to increased production by the United States. Meanwhile Nigerian production is still 27% below the budget benchmark of 2.2 million barrels per day (mbpd), averaging at 1.6 mbpd. The current exchange rate policy is simply sub-optimal and the vulnerability to external shocks remains.

The implementation of transparent and market driven policies is the only sustainable way to restore market confidence and reduce the divergence between official and parallel market rates. Investors know this and so do the authorities. The latter, however, continues to hold back and delay move towards exchange rate equilibrium. It was delay that got Nigeria here in the first place. The earlier it solves the currency conundrum, the earlier it can successfully execute its ERGP. The earlier it eases the biggest constraints to businesses, the earlier it will encourage foreign investments that will support sustained economic growth.

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Which indicator has the biggest impact on business activity and economic growth?

To turn around the economy, policy reform needs to focus on the exchange rate

As a whole the non-oil sector contracted by -0.22% in 2016. With the first quarter of 2017 ending, policy makers are scrambling to right the ship. Two main levers are available to policy makers: the interest rate and the exchange rate. While both can positively impact the economy, the two levers are not equal. Given Nigeria's import dependence and low investor confidence, policy focus on the exchange rate is the surest way to economic stability.

Focus on interest rates enticing but not enough on its own

Cutting interest rates can impact growth but focusing on it alone cannot have the impact needed to boost economic growth. Interest rates affect consumption, borrowing and investment levels. A cut in the monetary policy rate leads to lower bank rates, which discourage saving and encourage borrowing. In theory, this boosts consumption and economic activity as consumers spend more of their disposable income, and businesses borrow to expand production/output levels. The result should be a reduction in inflation, job creation and reduction in unemployment.

However, low rates do not guarantee increased lending to the real sector, especially in the Nigerian context. A long history of non-performing loans (NPLs) has made banks gun-shy. If they are ready to loan at all they often require significant collateral, which can deter potential borrowers. Low liquidity can also limit loan availability, despite the low interest rates.

On the borrower's side, low investor and consumer confidence can discourage spending, despite a fall in interest rates. Factors that affect confidence include policy inconsistency, political tensions, weak business environment, and negative trends in indicators such as unemployment and growth, all of which are present in Nigeria's economic climate. This same low investor confidence can

also undermine any attempt to grow the economy by increasing rates to attract hot money. In other words, without investor confidence, changes to the interest rate will remain ineffective.

Stability in foreign exchange is the surest way to realizing investor confidence, limiting inflation and ensuring the availability of goods

Stability in the foreign exchange (forex) market, both in rate and availability, is critical. The exchange rate affects the import bill, while forex availability affects the import levels. Where rates are tumbling, currency depreciation is usually passed on to retailers or end-users in the form of higher prices, which translates into inflation. When forex is simply unavailable, it limits the number of goods that can be imported in the first place. This kicks off a vicious cycle of supply shocks and imported inflation. Thus, when oil prices started their free fall in 2015, running the government forex coffers dry, the non-oil sectors were left helpless and unable to perform.

If interest rates were at a record low but forex remained scarce, economic activity would continue to contract. Import dependent businesses – e.g. trade, manufacturing, construction – are unable to operate without forex. The same goes for firms/sectors that need forex for regulatory fees and servicing foreign loans e.g. telecoms, aviation, financial services and fast moving consumer goods. These sectors contribute a combined 52.43% to GDP and when forex is scarce the risk of default on loans is high. This raises the number of NPLs, caps financial service performance, discourages future lending and ultimately dampens investor confidence.

Thus, it follows that since the economy is so vulnerable to exchange rate liquidity, a policy that reforms the forex market to boost dollar availability is the most useful tool for reviving the economy right now.

The CBN has expressed its commitment to boost supply in the forex market. While this is a welcomed development, the fact that oil receipts remain the major contributor to forex earnings, the question arises: how sustainable is this effort?

Policy makers need to simultaneously focus on the fundamental issues: market structure and investor confidence. The forex market's

present oligopolistic structure (with multiple exchange rates) gives room for arbitrage. Likewise, policy inconsistency, political interference and rigid market controls, have kept investors on the sidelines. Once these challenges are tackled, there will be increased inflow of portfolio funds and direct investments. This will provide alternative sources of dollars, at a time when the future of oil prices remains volatile and uncertain.

Global Perspective – Culled from the Economist

Global Perspective: From Deprivation to Daffodils

The World Economy is Picking Up

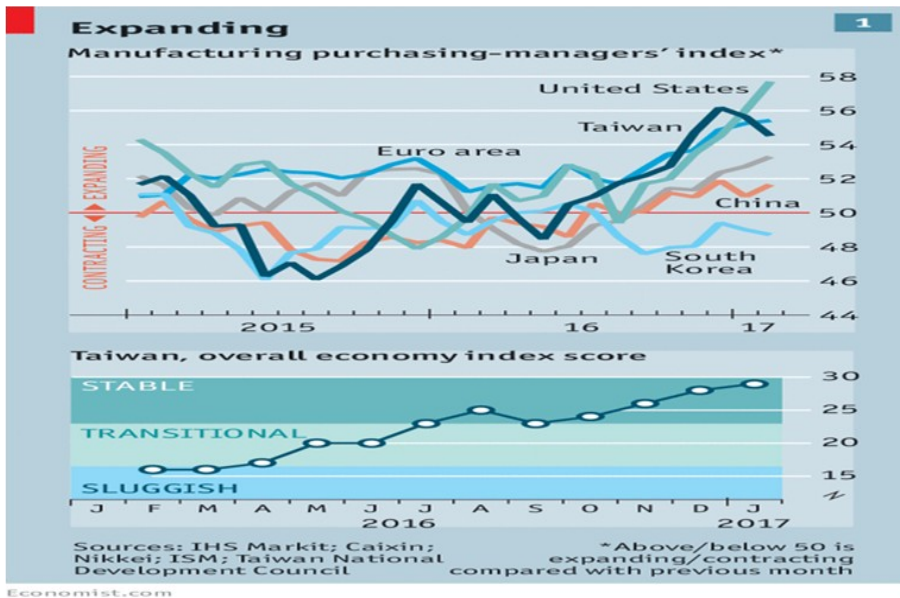
Despite anxieties, the green shoots of global recovery are real

"If Winter comes," the poet Shelley asked, "can Spring be far behind?" For the best part of a decade the answer as far as the world economy has been concerned has been an increasingly weary "Yes it can". Now, though, after testing the faith of the most patient souls with glimmers that came to nothing, things seem to be warming up. It looks likely that this year, for the first time since 2010, rich-world and developing economies will put on synchronized growth spurts.

There are still plenty of reasons to fret: China's debt mountain; the flaws in the foundations of the euro; Donald Trump's protectionist tendencies; and so on. But amid these anxieties are real green shoots. For six months or so there has been growing evidence of increased activity. It has been clearest in the export-oriented economies of Asia. But it is visible in Europe, in America and even, just, in hard-hit emerging markets like Russia and Brazil.

The signals are strongest from the more cyclical parts of the global economy, notably manufacturing. Surveys of purchasing managers in America, the euro zone and Asia show factories get-

ting a lot busier (see chart). Global trading hubs such as Taiwan and South Korea are bustling. Taiwan's National Development Council publishes a composite indicator that tracks the economy's strength: blue is sluggish, green is stable and red is overheating. The overall economy has been flashing green lights for seven months and is pushing up towards the red zone.



This reflects, among other things, demand for semiconductors around the world; this February exports from Taiwan were up by 28% compared with 2016. Although that is the most striking example, exports are up elsewhere in the region, too. South Korea's rose by 20% in February compared with a year earlier. In yuan terms, China's were 11% higher in the first two months of 2017 than in 2016.

This apparent vigor is in part just a reflection of how bad things looked 12 months ago; suppliers who overdid the gloom in early 2016 are restocking. Asia's taut supply chains also owe something to the two-to-three-year life-cycle of consumer gadgetry. On March 10th LG Electronics launched its new G6 smartphone. Its larger rival, Samsung, is due to unveil its Galaxy S8 phone by the end of the month; a new iPhone will be out later this year.

But the signs of life run deeper than just those specifics would allow. Business spending on machinery and equipment is picking up. A proxy measure based on shipments of capital goods con-

structed by economists at JPMorgan Chase, a bank, suggests that worldwide equipment spending grew at an annualized rate of 5.25% in the last quarter of 2016.

The good news goes beyond manufacturing, too. American employers, excluding farms, added 235,000 workers to their payrolls in February, well above the recent average. The European Commission's economic-sentiment index, based on surveys of service industries, manufacturers, builders and consumers, is as high as it has been since 2011. After a strong fourth quarter, the Bank of Japan revised up its forecast for growth in the current fiscal year from 1% to 1.4%. Such optimism raises two big questions: what is behind this nascent recovery and will it take hold?

Lilacs from the Dead Land

The revival's roots can be traced to the early months of last year, when a possible calamity was averted. At the end of 2015 stock markets tumbled in response to renewed anxiety about China's economy. Prices at the factory gate, which had been falling steadily for several years, had started to plunge. There were fears that China would be forced to devalue its currency sharply: a cheaper yuan might spur China's oversupplied industries to export more, fatten profits and service their growing debts.

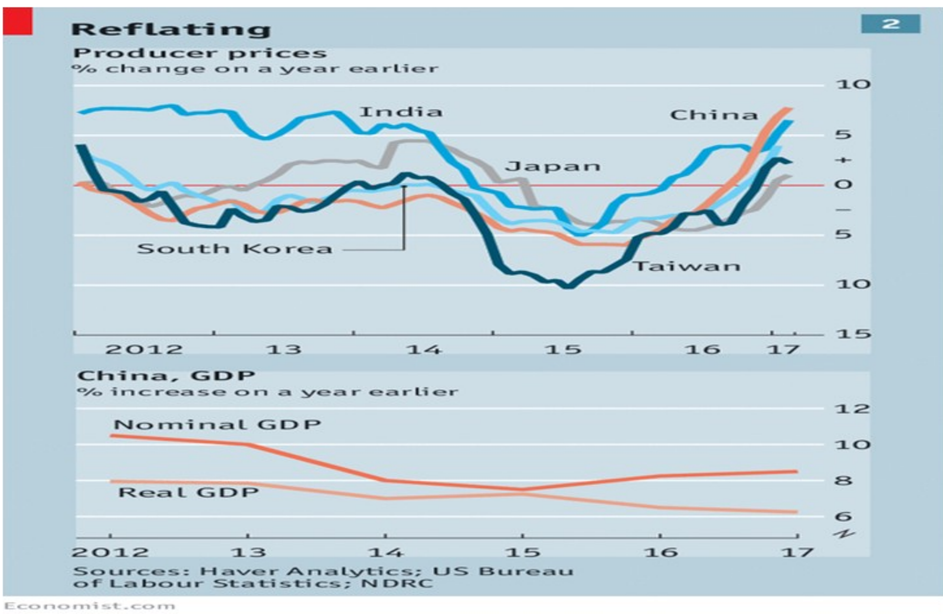
Such a desperate measure would, in effect, have exported its manufacturing deflation to the rest of the world, forcing rivals to cut prices or to devalue in turn. The expectation that China's economy was weakening pushed raw-material prices to their lowest level since 2009. The oil price briefly sunk below $30 a barrel. That worsened the plight of Brazil and Russia, already mired in deep recessions. It also intensified the pressure to cut investment in America's shale-oil industry.

To stabilize the yuan in the face of rapid outflows of capital, China spent $300bn of its foreign-currency reserves between November 2015 and January 2016. Capital controls were tightened to stop money leaking abroad. Banks juiced up the economy with faster credit growth. With capital now boxed in, much of it flowed into local property: house prices soared, first in the big cities and then beyond. Sales taxes on small cars were reduced by half. Between

them, these controls and stimuli did the trick.

Soon stocks of raw materials that had been hurriedly run down started to look skimpy. Iron-ore prices jumped by 19% in just one day last March. Curbs on Chinese coal production underpinned a mini-revival in global prices. Steel prices rose sharply, helped by the closure of a few high-cost mills as well as more construction spending. Oil climbed back above $50 a barrel (though it has slipped back a bit recently).

By the end of the year producer-price inflation in China—and across Asia—was positive again. And China's nominal GDP, which had slowed more than real GDP, sped up again (see chart). Central bankers, who had been employing various measures to forestall global deflation, were mightily relieved. On March 9th Mario Draghi, boss of the European Central Bank (ECB), proudly declared that the risk of deflation had "largely disappeared".



His relief was a recognition that, though a surge in inflation will flood the economy's engine, a gentle dose can serve as a helpful lubricant. At a global level, a bit more factory-gate inflation lifts profits, since a lot of manufacturers' production costs are largely fixed. Fatter profits not only make corporate debt less burdensome, they also free cash for capital spending, which creates further demand for businesses in a virtuous circle.

Since worries about China and deflation receded, spending on things that show some faith in future income has indeed begun to stir. A revival in producer prices and thus profits is leading to business investment around the world. In the last quarter of 2016 business spending in Japan rose at an annualized rate of 8%, according to official GDP figures. Gartner, a tech consultancy, predicted in December that consumers and companies would increase their spending on IT by 2.7% in 2017, up from 0.5% in 2016. John Lovelock, a research analyst at Gartner, says the biggest jump in spending is forecast for the Asia-Pacific region.

Continuous as the Stars that Shine?

In America imports of both consumer goods and capital goods are up. There has been speculation that the "animal spirits" of business folk have been lifted by Mr Trump's election in November, and that cuts in tax and regulations, and a subsequent return of the estimated $1trn of untaxed cash held abroad by companies based in America, will fuel a big boom in business investment.

But James Stettler, a capital-goods analyst at Barclays Capital, notes that "no one's really pushing the button on capex yet". And companies which might benefit from an investment boom are not getting carried away. In a recent profits statement Caterpillar, a maker of bulldozers and excavators, said that, while tax reform and infrastructure spending would be good for its businesses, it would not expect to see large benefits until at least 2018. So far the recovery in global capital spending is in line with what you would expect from the recovery in global profits, says Joseph Lupton of JPMorgan Chase (see chart).

The signs of recovery are encouraging. But can they be trusted? The last few bursts of optimism about the global economy all petered out. In 2010 the rebound from a deep rich-world recession was pulled back to earth by the sovereign-debt crisis in the euro area. As soon as Europe gingerly emerged from recession in mid-2013, hints from America's Federal Reserve that its bond-buying programme would soon tail off prompted a stampede out of emerging markets. This "taper tantrum" blew over in a few months, but it had repercussions. The prospect of tighter monetary policy in America, however distant, hit the supply of credit in emerging markets. The squeeze was made worse in 2014 when the oil price fell from over $100 a barrel to half that in just a few months. The price of other industrial raw materials, which had settled onto a plateau after peaking in 2011, began to fall. The subsequent slump in investment was enough to drag big commodity exporters, such as Brazil and Russia, into recession.

Even so, by the end of 2015 the Fed was sufficiently confident about the outlook to raise its benchmark interest rate by a quarter of a percentage point, the first such increase in a decade. More increases were expected in relatively short order. But the jitters about China, and then Brexit, meant that it was a full year before the next. It has now followed up with another increase in much shorter order.

False dawns were perhaps to be expected: recoveries from debt crises are painfully slow. Spending suffers as borrowers whittle away their debts. Banks are reluctant to write off old, souring loans and so are unable to make fresh new ones. And the world has had to shake off not one debt crisis, but three: the subprime crisis in America; the sovereign-debt crunch in Europe; then the bust in corporate borrowing in emerging markets.

But the initial and most painful stage of economic adjustment in emerging markets is coming to an end. Current-account deficits have narrowed, leaving most countries less reliant on foreign borrowing. Their currencies are a lot more competitive. And interest rates are high, so there is scope to relax monetary policy to boost demand (see chart). Business spending is already rising in response.

The breadth of the improvement—from Asia to Europe and America—makes for greater confidence that a pick-up is in train. A broad trend is a good proxy for an established trend, notes Manoj Pradhan of Talking Heads Macro, a research firm. Nevertheless, some countries are in better shape than others. India and Indonesia recovered quickly from the taper tantrum; their GDP growth has been fairly strong and steady. At the other end of the spectrum, Turkey and (to a lesser extent) South Africa look unlikely to see a big revival soon.

In the middle, there are signs that brutal recessions in two of the largest emerging markets, Russia and Brazil, are slowly coming to an end. Inflation in both countries is receding, restoring spending power to consumers. In Russia inflation fell to 4.6% in February, down from a peak of 16.9% two years ago. In the three months ending in September, GDP growth probably turned positive, according to the central bank, which has cut its main interest rate from 17% in January 2015 to 10% today; more cuts are likely. Manufacturing activity grew in each of the seven months to February, according to a survey of purchasing managers published by Markit, a data provider.

Brazil's economy shrank again in the final months of 2016, but with inflation tumbling towards the 4.5% target, its central bank has cut its benchmark rate by two percentage points, to 12.25%, since October. Further cuts are again likely. Other commodity-producers in Latin America (bar Mexico, where the peso has

weakened since Mr Trump was elected) are also relaxing monetary policy.

The Recent Buds Relax and spread

That is the bull case. What of the risks? One is that tighter commodity markets will stymie consumer spending in the rich world by raising prices. But core measures of inflation that strip out volatile things like food and energy costs remain low: nowhere in the rich world have they reached the 2% rate that is the goal of central banks, the rate seen as necessary for a "normal" cyclical recovery. America is closest to that target; the index preferred by the Fed puts America's inflation at 1.9%, with the core rate at 1.7%. In Europe the core rate is stuck below 1%, with wage growth of around 1.3% last year; but oil prices have pushed headline inflation back to 2%.

There is also the risk of expecting too much. A pick-up in global aggregate demand is good news. But growth rates will always be constrained by how fast the workforce can expand and how much extra output can be squeezed from each worker. In lots of places there is scope for jobs growth; but in America, Japan, Germany and Britain the labour market is already quite tight. With America close to full employment, wage growth has picked up to 2.8%, which is consistent with 2% underlying inflation if productivity

growth stays around 1%. Pay is growing fastest in less well-paid industries, such as construction, retailing, hospitality and haulage, according to Morgan Stanley, a bank.

Wages might perk up yet more if productivity improved. But the post-crisis slump in productivity growth that has affected both rich and developing countries shows no sign of ending. In America output per hour rose by 1.3% in the year to the final quarter of 2016. Europe has not been able to match even that dismal rate. It would take an astonishing shift in productivity for America's economy to manage the 4% GDP growth promised by Mr Trump. A less fanciful view is that American GDP growth might top 2% this year, a bit better than is expected for Europe. Continued investment, and possibly deregulation, could improve productivity somewhat; but they will not provide a step change. Without one, rich-world interest rates are likely to stay well below the levels that were considered normal before 2007.

It is not hard to imagine things that might yet derail the recovery. Though there is a cast-iron consensus that nothing bad will be allowed to happen before the big Communist Party congress in the autumn, China's growing debt pile could still bring markets tumbling down. Populist victories in Europe's various elections could bring about a crisis for the euro. Even if they do not, an end to the ECB's bond-buying programme, which has kept government-borrowing costs at tolerable levels and even allowed a bit of fiscal stimulus to lift the economy, will lay bare the euro's still-unfixed structural problems.

The Fed might tighten policy too quickly, driving up the value of the dollar and draining capital (and thus momentum) from a recovery in emerging markets. Or Mr Trump might make good on the repeated threats he made in his campaign to raise import tariffs on countries he considers guilty of unfair trade, thus taking a decisive step away from globalization just as the world's main economic blocs are at last starting to get into sync.

These risks are not new or surprising. What brings a freshness to the air is that a cyclical recovery has managed to overcome them. There may actually be some rosebuds to gather, for a while.

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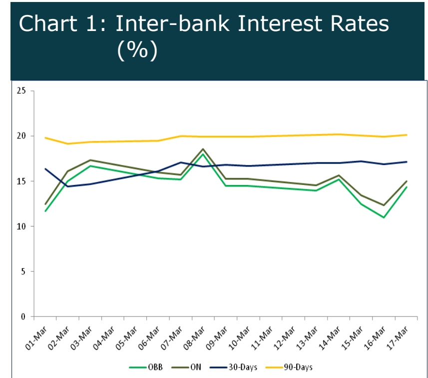
Macroeconomics Indicators

Chart 1: Inter-bank Interest Rates (%)



[1]

Money Market

The opening liquidity position in the money markets on the 1st of March was N51.2bn long, significantly higher than the average position which was N1.07bn.

Short-term interbank rates (OBB, O/N, 30-Day) averaged 15.38% per annum (p.a.) from the 1st to 17th of March, 189bps higher than the corresponding period in February of 13.49% p.a. As at March 17th, short-term interbank rates, OBB and O/N rates were 14.33%pa and 15% p.a. respectively, relative to 11.67% and 12.5% recorded at the beginning of the month. The CBN injected a total of $932mn into the IFEM within the period under review. The naira equivalent (debits) significantly reduced liquidity in the money market. In addition OMO auction of N284.88bn was 224% higher than the OMO maturity of N126.99bn, exerting additional pressure on the illiquid money market.

Treasury bill rates declined during the period under review. As of 17th March,91-day T/bill rate stood at 13.6% at the primary market, this is relatively flat but lower than 13.69% recorded in the corresponding period in February. The decline in T/bill rates can be attributed to the waning demand for domestic debt from the government. The over subscription on foreign debt auctions such as the $1bn Eurobond issue has diverted government attention towards foreign loans offering rates significantly lower than the domestic debt instruments.

Outlook

The MPC's decision to maintain status quo while signaling a move towards an accommodative stance might result in lower interest rates. The disbursement of funds to distressed sectors such as the Aviation, Petroleum and Power sector will improve liquidity in the market. Other injections expected in the market include FAAC disbursements, maturity of government securities and forwards contract. The federal government's disbursement of N500bn London-Paris club refund will also contribute to an increase in system liquidity. The CBN is expected to manage liquidity levels through

[1] CBN, FDC Think Tank

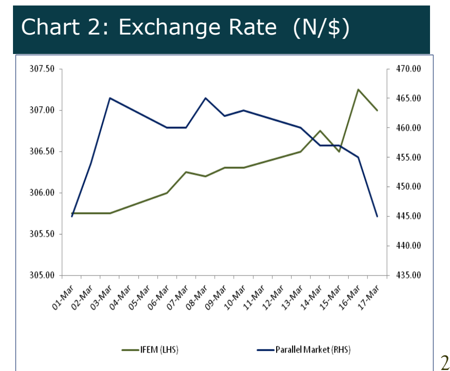
OMO auctions and forwards contract.

Forex Market

Exchange Rate

In the review period, the naira traded at N445/$, but then depreciated to N467/$ before recovering to N445/$ at the end of the period. The naira has recovered 16% of its value in the parallel market due to the CBN's decided to increase the frequency of its intervention at the foreign exchange market. At the IFEM market, the exchange rate depreciated by 0.41% to N307/$ from N305.75/$ at the beginning of the review period. IATA rate stayed relatively flat, closing at N306/$.

Chart 2: Exchange Rate (N/$)

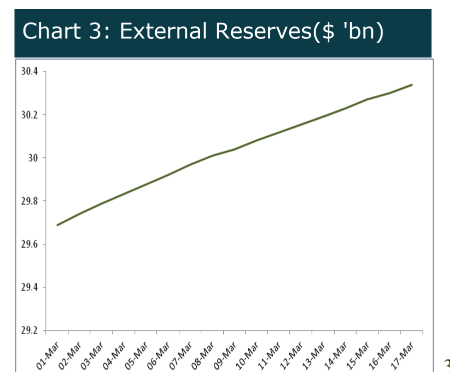


[2]

Outlook

The convergence between the parallel and IFEM rates has commenced albeit marginally due to the increase in aggregate supply. However, the latent demand and segmented market remains a threat to the stability of the foreign exchange market. The IFEM rate is more likely to remain sticky within the band of N305/$ - N310/$ until monetary authorities adjust towards the fair value which is tentatively between the band of N340/$-N370/$. The MPC has expressed has expressed their determination to see further convergence between the two extreme ends of the market. We expect this trend to continue, pending the liberalization of the forex market which is dependent on an elevated oil price and full recovery in oil production.

Chart 3: External Reserves($ 'bn)



[3]

External Reserves

External reserves reached a 14-month high of $30.34bn on March 17th, a 2.19% ($650m) accretion from the opening level of $29.69bn on March 1st. The external reserves level is now 3.80% higher than 2016's peak of $28.96bn and 12.94% below 2015's

[2] CBN, FMDQ OTC, FDC Think Tank
[3] CBN, FDC Think Tank

peak of $34.51bn. With gross external reserves at $30.34bn, import cover is estimated at 6.79 months.

Outlook

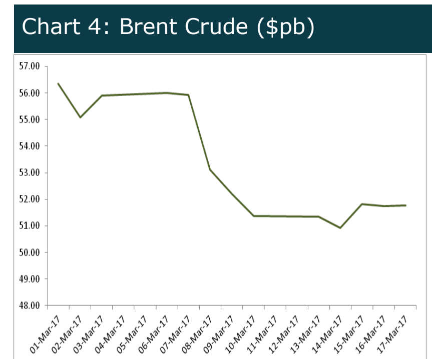
The accretion of the external reserves is expected to continue despite the decline in oil prices due to the improvement in oil production levels. The approval of the $500mn Eurobond tap is expected to boost external reserves. The recent ratings affirmation by S&P for Nigeria at B, is expected to restore investor confidence in Nigeria. Especially with the launch of the economic recovery growth plan (ERGP) that signals Nigeria's credit worthiness to the multinational lenders such as the World Bank. Furthermore, with attractive yields on risk free government securities, investors will be inclined to extend credit to the government.

Commodities Market - Exports

Oil Prices

In the review period, average oil prices was $53.35pb, 4.73% lower than $56pb recorded in February. Oil has traded comfortably above $50pb since the Organization of Petroleum Exporting Countries (OPEC) and 11 other oil producers began cutting output January 1st to help ease the supply glut. The latest data from OPEC shows that the cartel's production in February declined by 139, 500 barrels per day (bpd) from the previous month to 31.96mbpd. The decline further indicates OPEC's commitment to the output curb deal. So far, Saudi Arabia has made the most cuts to its production.

Chart 4: Brent Crude ($pb)



[4]

On the flip side of the energy market, US oil producers continue to maintain an upbeat trend as rig count increased for the 9th consecutive week from 609 rigs at the beginning of the month to 631 on the 17th of March. Conversely, the latest Energy Information Administration (EIA) reported showed that U.S. commercial crude inventories increased by 231,000 barrels in the week ended March 10th, which came in lower than analysts' expectations. Al-

[4] Bloomberg, FDC Think Tank

though, inventory levels declined within the period under review, the trend is not expected to be sustained as shale producers remain resilient.

Outlook

The current price level is funding a revival in US shale drilling, which is offsetting OPEC's efforts to tighten the market. The recent increase in US interest rates had a limited impact on oil prices. However, anticipations of further hikes and the prospect of a stronger dollar will translate into a lower demand for dollar denominated commodities like oil. In addition, stockpiles remain near the highest level in more than three decades in spite of the recent decline in US crude inventories. If this decline is sustained, oil prices will be kept at an elevated level. Also, the possible extension of the OPEC output deal beyond the June 2017 deadline, will form a bullish undertone for the rest of the month.

Oil Production

The relative calm in the Niger Delta region appears to have boosted production as talks between the government and representatives of Niger Delta militants seem to be have yielded positive outcomes. OPEC's monthly report revealed a 3.74% increase in Nigeria's output between January and February.

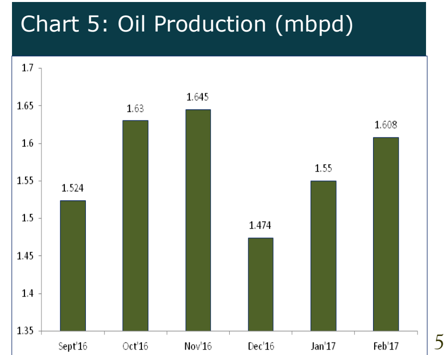


Chart 5: Oil Production (mbpd) [5]

Outlook

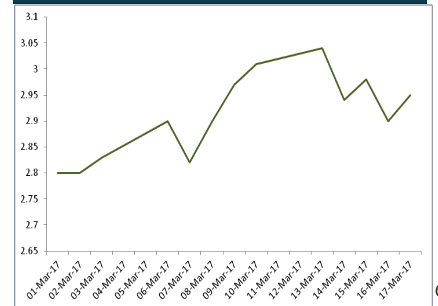
In the coming month, we expect oil production to fall short by 225,000bpd as Shell Nigeria shuts down Bonga deep water oil field for 30 days maintenance. However, this is a planned disruption and will have minimal impact on long term production. In addition, the Forcados pipeline is expected to reopen towards the end of Q2'17.

[5] OPEC, FDC Think Tank

Liquefied Natural Gas (LNG)

In the review period, the average price of natural gas gained marginally by 0.34% to $2.91mmbtu from $2.90mmbtu in the February. The upward pressure on gas prices was driven by the declining U.S natural gas inventories. The latest EIA natural gas storage data recorded a draw of 53bn Cubic feet (Bcf) for the week ending March 10th. This was lower than the draw of 68 Bcf recorded last week and also below market expectations of a draw of around 60 Bcf.

Chart 6: Natural Gas ($/MMBtu)



[6]

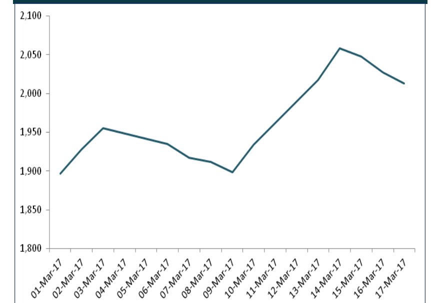
Outlook

Prices may maintain the upward trend pending any significant increase in supply for natural gas. On seasonal grounds, net weather conditions in the US are cold enough to prevent a significant increase in stocks, but not cold enough to trigger a substantial draw. Any further winter storms could have an important impact in supporting prices in the short term.

Cocoa

The average price of cocoa decreased by 1.95% to $1,965/mt within the review period (March 1- 17) from $2,004/mt in February. According to the International Cocoa Organization (ICCO), global production is expected to increase by 15% in 2016/17 while demand will grow at a relatively slower pace, resulting in a projected global surplus of 264,000 tonnes.

Chart 7: Cocoa ($/mt)



[7]

Outlook

Cocoa production surplus is expected to persist this season due to favorable weather conditions and this will continue to suppress cocoa prices. In addition, improved production outlook in West Africa remains a bearish factor for prices.

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[6] Bloomberg
[7] Bloomberg

☎: 7739831, 7798998, 2715414; Email: fdc@hyperia.com; Website: www.fdcng.com

Imports

Wheat

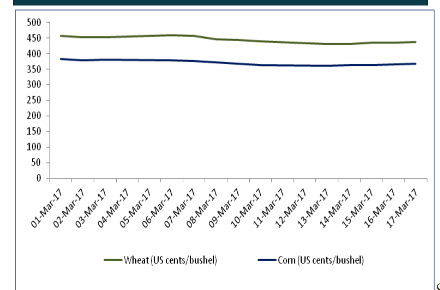
Between March 1st – March 17th, average wheat prices lost 4.76% to $4.36/bushel from $4.57/bushel in February. Global wheat production remains at a record high. International Grains Council (IGC) estimated global wheat production at 752mn tons, higher than previous estimate of 749mn tons. Losses were capped by growing demand. This was because of a strong pace of US wheat export shipments. Export sales for the 2017/18 marketing year stood at 853,400 tons, higher than previous forecasts in the USDA reports.

Corn price fell by 4.19% to $146.30/tonne from $152.70/tonne. Ample global stocks and concerns over U.S President Trump's trade policy are playing a major role in depressing prices.

Corn

In the review period, corn futures declined by 3.95% to $3.68/bushel from $3.82/bushel at the beginning of the month. Expectations of favorable weather conditions weighed on corn futures. Warm weather in April is particularly favorable for the planting of corn, which is the first of the United States' two primary exported crops to be sown.

Chart 8: Corn ($/bushel)



[8]

Outlook

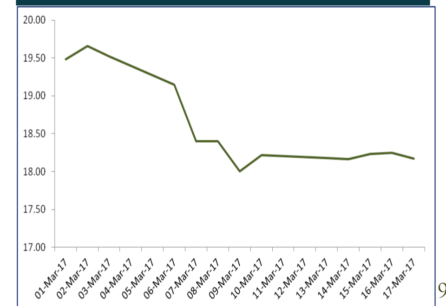
Grain prices are expected to maintain the bearish trend. Wheat stocks are expected to subdue growing demand from China. Corn plantings in the US are likely to increase as US farmers are apt to take advantage of favourable weather conditions. Springtime weather is a major determinant of many corn acres to be cultivated. If weather forecasts maintain an upbeat trend, analysts might be more inclined to maintain or even raise corn acreage predictions.

[8] Bloomberg

Sugar

In the review period, sugar prices decreased by 7.21% to $0.1817/ pound from $0.1948/pound on March 1st. Price traded downwards as Indian sugar mills kept supplies adequate in order to discourage imports in the short term.

Chart 9: Sugar (US cents/pound)



[9]

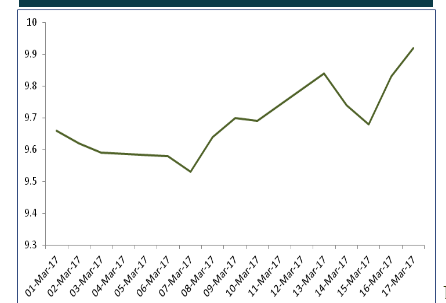
Outlook

A bearish outlook is projected for sugar futures. This is largely attributed to relentless supplies from mills in India. Ample supply from Brazil also contributed to the tepid price movements in the sugar market. Global sugar stockpiles are projected to fall to 77.2mn tonnes, the lowest in 5 years due to production shortfall in major growing regions (Brazil and India).

Rice

Rice gained 2.62% to $4.36/bushel between March 1st – March 17th from $9.92/cwt in February. According to the EIU report, global rice output is expected to slide to 481m tonnes amid weaker than expected output in Asia. China is notably the largest consumer of rice in the world, representing approximately 30% of global demand. Rice consumption in China is expected to expand by an annual average of 1.2% and demand is projected to reach 147.5m tonnes in 2017/18. Improved weather conditions in India and South-east Asia will lead to higher crop yields in the region. In addition, planting in the U.S is expected to rise significantly in 2016/17. However, unfavorable weather in the U.S southern region will reduce crop yield expectations.

Chart 10: Rough rice ($/cwt)



[10]

Outlook

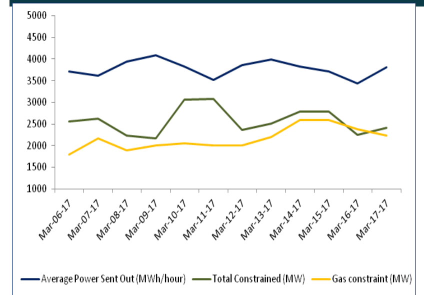
Rice inventories are likely to decline for the third consecutive season due to rising demand for cereals in spite of global production reaching a record high. Rice inventories at 101.7m tonnes is 5m tonnes below the average in the last four seasons.

[9] Bloomberg
[10] Bloomberg

Power Sector

During the period under review, average power sent out improved by 2.58% to 3,812MWh/hour from 3,716MWh/hour. Total power constraints arising from and high frequency reduced by 5.73% within the period under review. The increase of 24% from 1,792MW at the beginning of the period to 2,227MW in gas constraints tapered the quantum of the decline in total power constraints. Although, militant attacks on gas pipelines have reduced significantly, dilapidated infrastructure contributed to the gas leaks which led to the increase in gas constraints.

Chart 11: Power (MWh/hour)



[11]

Outlook

Power generation expected to improve as the raining season approaches. Elimination of gas constraints is not foreseeable in the near term. Extensive reconstruction of power infrastructure will be needed to resolve the issues of gas leakages. The insolvent state of the sector will continue to impede the performance amongst the discos, gencos and TCN.

[11] Nigerian Electricity Supply Industry

Who We Are

Avant-garde Academia Limited (AAL) is an education advisory and counseling service organization that was incorporated in July of 2013. AAL was incorporated as an educational aggregator in grooming candidates to be potential global citizens who will reinvest their acquired skills in Nigeria in future. It is positioned to provide support, assistance and guidance to potential candidates and entrants to Ivy League, Elite and premium academic institutions in America. Our target market comprises parents of children in identified elite Nigerian secondary schools and/or top executives in the business community, who have a strong need for our services.

The market also extends to Nigerians resident in Diaspora, and expatriates resident in Nigeria. In Partnership with Ascent Education Advisors, a reputable Education Advisory Services firm, we have designed a range of admissions solutions to cater for children in different stages of secondary school education.

OUR STRATEGIC PARTNER – ASCENT EDUCATION ADVISORS

A reputable education advisory service firm, the lead consultant Ms. Peggy Hanefors has over 10 years experience in admissions; including a position as the Assistant Director of International and Transfer Admissions at the University of Pennsylvania. She was first reader and evaluator of about 3,000 applications for students from across the globe.

What We Offer

- Information and advice about the American University System and its application process.
- Evaluation of student's record prior to application.
- Assistance in selecting curriculum and summer activities that will match the student's desired course of study and also highlight his/her personality and interests.
- Development of personal application timeline, that includes standardized testing, college visits, application deadlines, etc.
- Help in selecting teachers for recommendations
- Guidance in presenting extracurricular record
- Guidance in putting together an overall great college application that highlights the unique attributes of the applicant
  - Essay topic brainstorming
  - Editing
  - Proof-reading
- Guidance in choosing the most suitable college among acceptances.
- Interview preparation

Our Packages

Package 1: 8th to 10th Grade (Final 3-5 Years)
This package is a program designed for candidates from as early at the 8th grade (Junior Secondary School - JSS 2) of high school. This is a full package with the benefits of all the services we offer in addition to education and assistance with entire college admission process, including an unlimited number of applications.

Package 2: 11th and 12th Grade (Final 1-2 Years)
This package is similar to Package 1 but is designed for students in the final two years of high school.

Package 3: (Per Application)
Unlike packages 1 and 2, package 3 only provides unlimited assistance with applications to pre-determined universities.

We host a Parents Admission Support Forum in Lagos bi-annually with the aim of giving parents the information they need to ensure their child(ren)/wards gain admission into reputable universities in United States of America.

To attend one of our events, kindly contact or visit us at
9a Idejo Street, Victoria Island Lagos.

For more information about Avant- Garde Academia Limited please go to our website: www.avant-gardeacademia.com
For enquiries or consultation E-mail us: info @avant-gardeacademia.com Or call Chinyere Ubani 08039238138 | Tope Vincent 08034017603

Stock Market Update

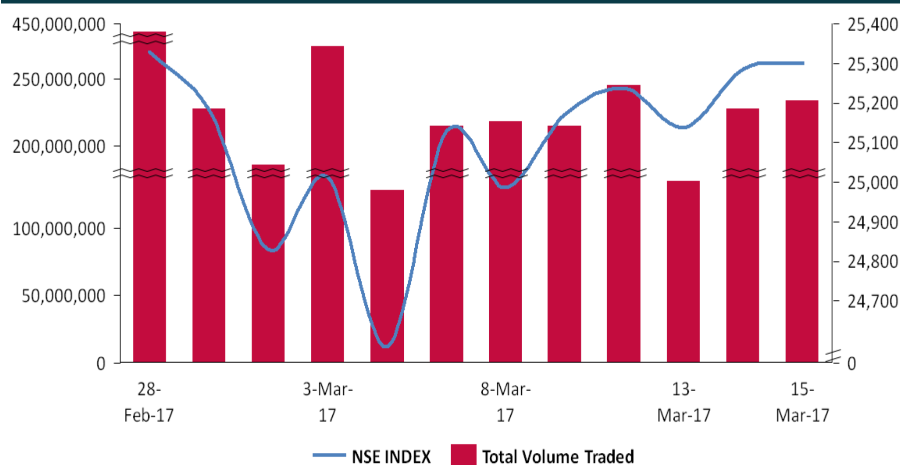
The NSE ASI lost 0.11% to close at 25,301.23 points in the review period despite impressive earnings release and corporate action declarations by Tier-1 banks. This saw the YTD return on the index worsen to (5.85%) while market capitalization closed at N8.75trn. Market PE ratio for the week was 13.9x and the liquidity weighted SFNG Blue Chip 30 Index, showed that the market increased by 1.36% in the period being reviewed.

After oscillating all through the first two weeks of the month of March, amidst impressive earnings releases and corporate action declarations by Tier-1 banks, the Nigerian equities market settled lower. The NSE ASI traded at a low of 24,581.99 before pushing back above the 25,000 points psychological threshold to close at 25,301.23 from February's close of 25,329.08.

Guinness Plc announced its right issue with a March 15, 2017 qualification date at a discount of 17% from the prevailing share price of N70. Debt obligation to its parent company 'Diageo' will be converted to equity so as to de-leverage. Diageo has fully undertaken to cover the right issue on a premise that it is not undersubscribed.

The YTD return on the index worsened to (5.85%), while total market capitalization was N8.75trn having lost N9.64bn in the period. The liquidity weighted SFNG Blue Chip 30 Index increased by 1.36% during the review period, to close at 845.36 from a previous close of 833.98.

Chart 12: NSE ASI March 2017

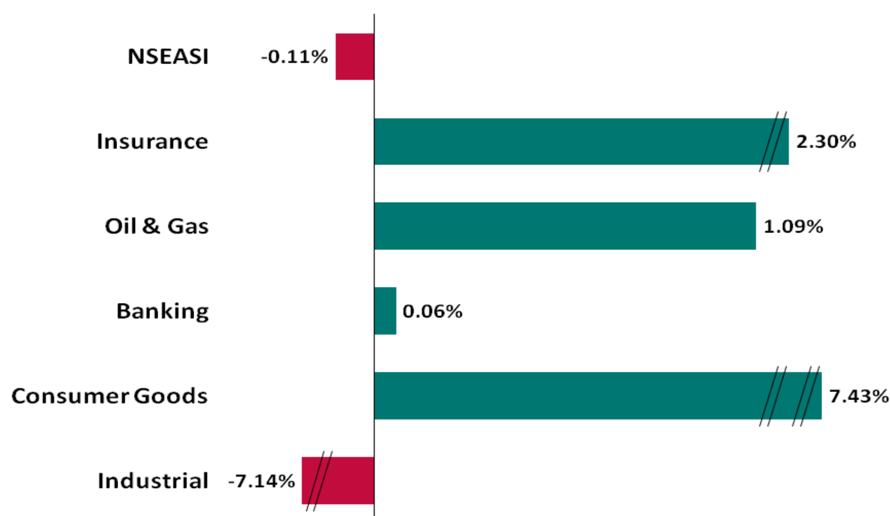


[12]

[12] NSE, FDC Think Tank,

Performance across sectors was mostly positive as all the NSE sub-indices closed higher except the Industrial Goods sector, which declined by 7.14% in the period being reviewed. Stock prices of WAPCO, Dangote Cement and CAP Plc were major drags on the sector as they declined by 11.54%, 5.02% and 5.37% respectively. The Consumer Goods sub-index gained the most, increasing by 7.43% as NESTLE 28.01%, UNILEVER 16.98% and GUINNESS 7.12% buoyed the sector.

Chart 13 : Sector Performance in March 2017



13

The best performing stocks were NESTLE 28.07%, CONTINENTAL REINSURANCE 17.65%, UNILEVER 16.98%, VITAFOAM 12.79% and AIRLINE SERVICES AND LOGISTICS 10.76%.

TOP 5 GAINERS (N)				
Company	Mar 15'17	Feb 28'17	% Change	Absolute Change
NESTLE NIGERIA PLC.	730.00	570.00	28.07%	160.00
CONTINENTAL REINSURANCE PLC	1.20	1.02	17.65%	0.18
UNILEVER NIGERIA PLC.	33.90	28.98	16.98%	4.92
VITAFOAM NIG PLC.	1.94	1.72	12.79%	0.22
AIRLINE SERVICES AND LOGISTICS PLC	3.19	2.88	10.76%	0.31

Top price losers were UBA (-20.1%), NIGERIAN AVIATION HANDLING COMPANY (-18.4%), LIVESTOCK FEEDS (-16.9%), UNITY BANK (-15.2%) and 7-UP BOTTLING (-14%).

[13] NSE, FDC Think Tank,

TOP 5 LOSERS (N)				
Company	Mar 15'17	Feb 28'17	% Change	Absolute Change
UBA CAPITAL PLC	2.82	3.53	-20.11%	-0.71
NIGERIAN AVIATION HANDLING COMPANY PLC	2.00	2.45	-18.37%	-0.45
LIVESTOCK FEEDS PLC.	0.64	0.77	-16.88%	-0.13
UNITY BANK PLC	0.67	0.79	-15.19%	-0.12
7-UP BOTTLING COMP. PLC.	86.00	100.00	-14.00%	-14.00

Corporate Disclosure

Transcorp released its FY 2016 result. Revenue grew by 19.29% from N40.8bn to N59.4bn. The company reported that it incurred an exchange rate loss of about N18.7bn during the year. Profit after tax declined significantly by N3.15bn (144%) from N2.03bn in 2015 to a loss of N1.13bn in 2016. Transcorp trades at N0.72 with earnings per share of -4 kobo as at March 15, 2017.

TOTAL recorded a revenue growth of 40% from N208bn to N290.9bn in its 2016 full year results. The company reported that it incurred an exchange rate loss of approximately N9bn during the year. Profit after tax increased by 266% to N14.8bn from N4.04bn in 2015. TOTAL currently trades at N280 with a PE ratio of 6.3x as at March 15, 2017.

Outlook

We believe that the recent bearish streak on the Nigerian bourse may persist, as macroeconomic fundamentals remain weak, albeit improving. Nevertheless, we expect the release of more earnings results and corporate actions should determine the direction of the market in the short-term.

Corporate Focus - PZ Cusson Nigeria Plc

Sector: Consumer Staple **Ticker Symbols**: NSE:PZ **Bloomberg**: PZ:NL **Reuters**: PZ:LG **FT**: PZ:LAG **Shares Outstanding**: 3.97b **Market Cap**: N55.5bn **TP Downside**: 3.5% **Target Price:** N13.5 **Price:** N13.99 **2016 Annual Dividend**: N0.50 **2016 Annual Dividend Yield**: 3.6%

PZ CUSSON NIGERIA PLC: Trading Environment Remains Difficult Despite an Economic Recovery on the Horizon in 2017

Analysts' Recommendation: HOLD Recommendation Period: 12 months

The manufacturing sector has been faced with lots of challenges. The current macroeconomic conditions – naira depreciation, tight monetary policy, high interest rate environment and security challenges in the North-East region – have all contributed to the deteriorating business environment. PZ Cussons Nigeria Plc (PZ Cussons) is not isolated from the impact of these trends.

Circa 13% revenue growth driven by price increase

PZ Cussons posted sales of N57.1 billion in Q3'17 which represents a 12.8% increase of N6.49 billion. This rise is driven by higher product prices to offset the impact of rising costs. Despite consumer down-trading in the face of higher prices, and the subsequent negative impact product volumes, we believe that higher product price will help stabilize the company's profit.

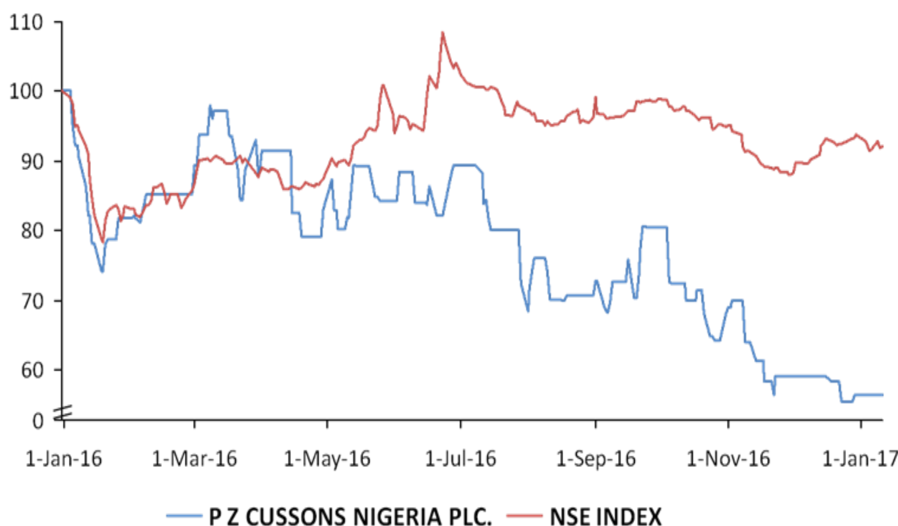
Foreign exchange loss of N6.1bn… a drag on profitability level

PZ Cussons' posted a Q3'17 sales growth of approximately 13%

year-on-year (y-o-y). However, the sales growth and its operational gains of N958.4mn from cost of sales, was undermined by the forex translation loss of N6.1bn; mainly driven by currency depreciation. The result was a profit before tax of N2.35bn, representing a marginal increase of 4.2% from Q3'16. Oil prices are expected to average $55 per barrel in 2017 and recent CBN interventions should help boost dollar liquidity in the forex market; both of which will be beneficial in meeting PZ Cussons' forex needs. Unfortunately, the benefits of any intervention could be largely undermined if policy uncertainty persists, making it next to impossible for companies, like PZ Cussons to plan effectively.

HOLD rating maintained

PZ Cussons trades at a 12-month forward estimated price-to-book ratio (P/BV) and price-to-earnings ratio (P/E) multiples of 2.1x and 37.3x respectively. These are both trading at discounts to 2013 levels of 4.59x and 39.1x respectively. PZ Cussons year-to-date return was -3.52%, outperforming the ASI by 1.24%. Annualizing the Q3'17 figure puts the revenue at N76.2bn, which is above our FY'17 forecast of N73.4bn. This decrease in revenue growth assumes a further naira depreciation which will necessitate another upward price adjustment and additional recognition of translation loss. Overall, this will imply that FY'17 profit after tax (PAT) is projected to decline by 13.41% from FY'16 of N2.12bn. Thus we have retained our HOLD rating.



PZ Cussons Nigeria PLC (PZ NL) - Standardized						
In Millions of NGN except Per Share	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	CAGR
12 Months Ending	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	%
Assets						
Total Current Assets	40,046.50	47,926.00	46,480.60	42,170.10	47,925.30	4.60%
Total Long-Term Assets	24,360.30	24,370.40	24,485.10	25,217.80	26,504.90	2.10%
Total Assets	64,406.80	72,296.40	70,965.70	67,387.90	74,430.20	3.70%
Liabilities & Shareholder's Equity						
Total Current liabilities	17,253.00	21,397.10	23,952.00	19,563.00	27,095.70	11.90%
Total Long-Term Liabilities	4,285.80	4,462.50	4,475.10	4,152.50	3,931.50	-2.10%
Total Liabilities	21,538.80	25,859.60	28,427.20	23,715.50	31,027.20	9.60%
Total Equity	42,868.00	46,436.90	42,538.60	43,672.40	43,403.00	0.30%
Total Liabilities & Equity	64,406.80	72,296.40	70,965.70	67,387.90	74,430.20	
Comprehensive Income						
Revenue	72,154.60	71,343.10	72,905.70	73,126.10	69,527.50	-0.90%
Pretax Income	4,733.60	7,650.30	6,950.00	6,556.80	3,148.20	-9.70%
Income Tax Expense	1,768.00	2,329.10	1,867.20	1,986.00	1,018.50	-12.90%
Net Profit (Loss)	2,538.80	5,321.20	5,082.70	4,570.80	2,129.70	-4.30%

Source : FDC Think Tank, Bloomberg

Company Overview

PZ Cussons' origins date back to December 4, 1948 under the name PB Nicholas & Company Limited. In 1960, it changed to Alagbon

Industries Limited and was listed on the Nigerian Stock Exchange (NSE) in 1972. The business manufactures, distributes and sells a wide range of consumer products across Nigeria including: detergent, soap, cosmetics, medicaments, confectionery, and home appliances. The company remains the market leader in the toilet soap and baby soap segment. It is rivaled by Nestle, Cadbury, GlaxoSmithKline (GSK) and Unilever.

Over the years, PZ Cussons has collaborated with strategic companies to successfully provide products that meet consumers' needs. Furthermore, the company's marketing strategy and effective 25 distribution channels across Nigeria have helped it maintain market share while curtailing the bullwhip effect.

Business Segment	Brands
Home Care	*Cerelac, Golden Morn, Lactogen, Maggi, Nutrend and NAN*
Soaps	*Premier, Imperial Leather, Joy, Duck, Canoe, Drum*
Medicaments	*Robb, Heatol, Super Robb, Medicated Dusting Powder*
Hair Care	*Venus, Joy*
Baby Care	*Nigerian Baby Care, Cussons Baby Range*
Skin Care	*Venus, Stella Pomade, Joy, Carex*
Perfumes	*Dan Duala, Venus Gold, Joy Cologne*
Household Appliances	*Haier Thermocool*
Consumer Electronics	*Haier Thermocool*
Electrical retail	*Cool World*
Nutrition	*Coast; Yo; Nunu; Bliss*
Palm Oil	*Mamador; Kings Refined Palm Olein*

Management

PZ Cussons' CEO is Mr. Christos Giannopoulos. He has a long history with the company. He joined the group in July 1988, and transferred to the Nigerian subsidiary in 2002. He has served in several managerial roles including: Managing Director of Soap & Detergent, Managing Director of PZ Cussons Kenya Plc, Managing Director of Supply Chain, and Chief Operating Officer of PZ Cussons Nigeria Plc. The company's executive management team comprises of Mr. Tunde Oyelola, Mrs. Abiola Laseinde, Mrs. Elizabeth Ebi, Mrs. Yomi

Ifaturotin among others who have worked in PZ Cussons for a considerable time in various capacities.

Given the changing business environment, the management diversification strategy of a diverse brand portfolio and the strategic alliance with related parties in the food processing sector of the economy is working well in averting losses especially during times of uncertainty. However, the rise in input materials alongside operating expenses, driven by the 48% currency devaluation, has pressured the overall company's strategy. As such, management should address certain strategic and operational issues such as:

- Structural changes in the industry, capital allocation and returns to address the risks and to also take advantage of opportunities there-in.
- Pricing actions, market deceleration and changes in the competitive landscape to improve profitability.

The Bulls Say and the Bears Say

Bulls Say:

- Rich product portfolio for personal care, home care, electrical, food and nutrition
- Superior and recognizable brand value
- Robust and effective distribution channels
- Talented and experienced management
- Possible re-instatement of Export Expansion Grant (EEG)

Bears Say:

- Intense competition from other leading players such as Unilever, Cadbury and Nestle
- Rising cost of raw materials and key inputs
- Foreign exchange challenges have put pressure on earnings
- Macroeconomic headwinds have dampened demand for non-essentials

Valuation

We derived our valuation for PZ Cussons Nigeria Plc using the discounted free cash flow to equity (FCFE) method. Our fair value estimate of N13.5 has been adjusted from our December 8, 2016 recommendation of N10.98. This is approximately 3.5% downside on its current share price of N13.99 (as of 24 March, 2017). The discount rate used in the discounted FCFE is the cost of equity (17.4%), which is derived using the three year bond yield of 16.1% (FGN bond maturing in 2019), a market risk premium of 1.8% and an assumed beta of 0.74. The long-term cash flow growth rate to perpetuity calculated is 4%.

PZ Cussons' Q3'17 impressive result, we foresee a three-year revenue compound average growth rate (CAGR) of 4.39%. This is off the back of deteriorating macroeconomic conditions alongside increasing consumer resistance and switch to more affordable substitutes.

PZ Cussons Nigeria PLC (PZ NL) - Standardized			
In Millions of NGN	**FY 2017E**	**FY 2018E**	**FY 2019E**
Turnover/Revenue	**73,421**	**75,330**	**79,097**
EBITDA	10,876	9,689	9,907
EBIT	8,580	7,324	7,447
Less: Cash Taxes @ 31.5%	2,699	2,304	2,343
Tax-effected EBIT (NOPAT)	**11,279**	**9,628**	**9,789**
Plus: Depreciation & Amortization	2,297	2,365	2,461
Less: Capital Expenditures	(2,591)	(2,911)	(3,256)
Less: Change in Net Working Capital	(2,746)	(691)	(427)
Unlevered Free CashFlow	8,238	8,391	8,566
WACC @ 17.4%	**17.4%**		
NPV of Unlevered Free Cash Flow	**6,652**		

PERPETUITY GROWTH RATE			
In Millions of NGN	**Undiscounted**	**Discounted**	**EBITDA Multiple**
Perpetuity Growth Rate @ 4%	75,988	46,964	7.67
DCF Range (Implied Enterprise Value)		53,616	
Equity Value		53,616	
Implied Price Per Share		**13.50**	

Risks to Our Rating and Price Target

We believe the key risks that could keep our rating and target price from being achieved include the following:

- Further weakening of the naira
- Increases in raw material costs
- Possible rise in energy price
- Deteriorating trading conditions driven by weaker consumer demand as well as heightened competition.

Upside risks

- A stronger-than-expected improvement in the economy in H2'17
- Stronger than expected demand

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