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FDC *ECONOMIC MONTHLY*

THE EFFICACY OF NIGERIA'S NEW FOREIGN EXCHANGE POLICY

Recently, the Central Bank of Nigeria (CBN) initiated a policy which saw the naira appreciate to as much as N425/$ within a week. Today, it has resumed its downward spiral. Many are puzzled as to why the sudden change in the direction of the naira. Like any other market across the globe, the foreign exchange market is volatile and responds to the whims and caprices of supply-demand dynamics. This piece offers possible reasons for the reversal in gains. It also analyzes the sustainability of the new foreign exchange (forex) policy by identifying loopholes which may cripple the intended outcome of monetary policymakers.

It is no news that Nigeria has been on the verge of a full-blown foreign exchange crisis since the advent of the slump in global oil prices. While the CBN has been resilient in curbing the potential impact of a one–off devaluation or a free float, the average consumer still feels the impact of a the weaker currency despite the bank's efforts.

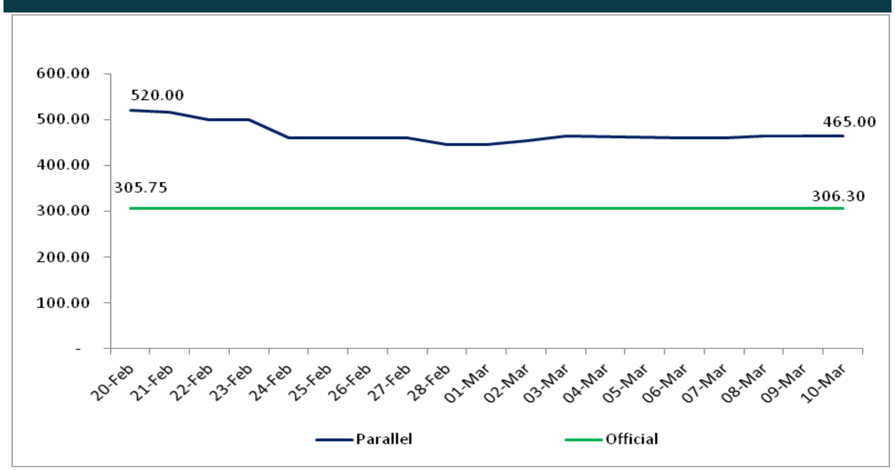
Recently, the CBN attempted to bring some level of support to forex consumers by creating another segment within the foreign exchange market for travel allowance, medical fees and tuition fees. This was viewed as an effective devaluation from the official rate but an appreciation to a segment of the forex demand at the parallel market. A few days after issuing this circular, the CBN delivered on its policy and the parallel market appreciated by 20% during that week to N425/$. The following week it ended on a different note, as the parallel market reversed gains and depreciated to N460/$. This reversal in gains has many worried that the parallel market rate might revert to N520/$ or even depreciate beyond N520/$. The new initiative appears to be weak, at best offering temporary relief to the stressed market. However, before analyzing the sustainability of this policy, it is important to answer a few questions.

INSIDE THIS ISSUE:

WHY DID THE NAIRA APPRECIATE TO N460/$?

During the week when the circular was issued, the CBN increased supply into the market by $371million (mn) to the banks at the spot market and sold $230mn at the forward market. Market participants were expecting the same level of injection the following week, but the supply to the spot market reduced to $80mn and $100mn to the forward market. This sent negative signals into the market stoking concerns about an inconsistency in the level of weekly supplies. Consequently, speculators took advantage of the short window to capitalize on the uncertainty premium attached to monetary policies. While these are all observations made at a first glance, the fundamentals of the market remain the same. The foreign exchange market is an imperfect market with barriers to entry (i.e. 41 items, authorised dealers e.t.c) and price discrimination (Official rate, Forwards rate, tradables and invisibles rate e.t.c). The mechanism for allocation of scarce resources is flawed with supply flowing towards preferred consumers (i.e. 60:40 allocation rule e.t.c). The official exchange rate has remained relatively flat for the most part since the beginning of the year. Consequently, it is no surprise that the level of imperfection has equally resulted in imperfect outcomes.

Chart 1: Forex N/$



[1]

WILL THE LOSSES TO BE REVERSED?

Consistency in policy implementation is paramount. If the CBN fails

[1] Source: CBN, FDC Think Tank

to deliver on its promise to inject forex weekly into the market, it will ignite the speculative premium. However, if the weekly forex flow remains consistent, there will be no cause for panic. All things being equal, the rate should appreciate to the Bureau de Change (BDC) rate of N400/$ over time.

At the beginning of this week, March 6th, the CBN sold $367mn at the forward market which entails a 45-day and 60-day contract. On March 9th of the same week, the CBN supplied $170mn into the spot market with $100mn diverted towards wholesale transactions and the rest to invisibles. When comparing the volume supplied to the spot and forwards market, it appears the CBN is gravitating towards forwards which are viewed by many in Nigeria as post-dated cheques. An agreement to settle at a later date signals that the cash is unavailable at the moment but will be at a later date. This weakens confidence in the CBN’s ability to meet forex demand at the spot market. If losses are to be reversed, the CBN will need to ensure that forex demand at the spot market is equally met on a weekly basis. Nonetheless, it is important to note that, forwards are settled at future dates which means the impact of such an injection will not be felt until the contract matures. Consequently, the market will reflect the impact of this initiative two months from when the contract is settled.

Hypothetically, losses should be reversed if the CBN delivers on its forwards and supply remains consistent at the spot market. In practice, the market is volatile and some latent demand which were eliminated due to the unaffordability of the dollar in the past is beginning to creep up in light of the recent appreciation of the dollar. With such an addition to the demand side pressure in the market, the magnitude of a reversal might be trimmed.

IS THIS POLICY SUSTAINABLE FOR THE CBN?

The gross external reserves are currently at $30.04bn, the highest level since October 2015. The authorities have now achieved reserves accretion of US$6bn since end-October 2016. While there has been no formal statement explaining this marked turnaround, it points to loan disbursements from international lenders: Exim Bank of China in Q3’16; US$600m from the African Development Bank in November; and last month’s successful

US$1.0bn Eurobond sale. The federal government has also reiterated their intentions to tap into the international bond market for the second time this quarter to raise an additional $500mn before the end of March. In addition, the Diaspora bond is expected to be issued later in June this year. Oil prices have remained above $50pb since the output deal in November and production has recovered to about 1.6mbpd – 2.1mbpd. Cocoa, another forex earner, has seen prices decline by 30% year to date (YTD). Nevertheless, foreign investors have demonstrated a keen interest in Nigeria's Eurobond with an oversubscription of over eight times the offered amount. In addition, the Federal Government has unveiled an Economic Recovery Growth Plan (ERGP) which is expected to improve the perception of Nigeria's credit worthiness at the international market. It is safe to conclude that the outlook on forex supply is robust barring any unforeseen circumstances in policy decisions and oil production levels.

However, the structure of the foreign exchange market is still a cause for concern. As the saying goes, "If the foundations be destroyed, what can the righteous do?" In this case, the fundamentals of the foreign exchange market remains flawed with multiple rates and segments.

- Export proceeds : N285/$
- IFEM : N305.75/$
- IATA : N306/$
- Invisibles : N375/$
- BDC : N400/$
- Parallel market: N463/$

Such segmentation in the market will always remain a threat to the stability of the market. Failing to address such an imminent threat means sustainability of the policy will be challenging to attain. Sooner or later the wound will fester and the market will collapse and the CBN will be left with no choice but to let the currency float into the sky.

The new forex policy is a short term makeshift solution to the issues pertaining to liquidity and confidence levels. The underlying problem of an inefficient foreign exchange market mechanism remains. Until the rates across the segmented foreign exchange market converge to a unified rate, the market will always be on the verge of a collapse from speculative activities.

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ECONOMIC COST OF INSECURITY IN NIGERIA

Insecurity in Nigeria has been a source of concern to every Nigerian. Despite its historical reputation as a dangerous and insecure country, recent insurgencies and militant attacks have heightened the level of fear. One aspect that is often not discussed, or at best is tacitly mentioned, is the economic impact of insecurity on the domestic economy. Nigeria's security structure is under pressure from the actions of Boko Haram, Niger Delta militants, Fulani herdsmen and pro-secession groups. While there is a lack of data to quantify the impact that various attacks have had on the economy, the anecdotal effects include loss of property, unemployment, and relocation.

Boko Haram attacks in northern Nigeria in recent times have driven several people from their communities, leaving them homeless and unemployed. The insurgency has eroded the small gains in infrastructure and education in a region in dire need of investment. Thousands of teachers have either lost their lives or have been displaced with the shutdown of numerous schools.[2] A decline in the educational sector will further dampen the region's economic and development prospects. The attacks have also led to an increase in prices of agricultural products produced in the north. Farmers have abandoned their tomato, onion and potato farms, resulting in shortages, even after accounting for seasonality affects.

The militant attacks in the Niger Delta have cost the country billions of dollars through reduced oil production by as much as over 400,000 barrels per day. Oil production shock has resulted in reduced government revenue, foreign exchange pressures, decreased contribution to Nigeria's gross domestic product (GDP) and a prolonged recession. Reduced revenue has impeded the government's ability to execute its budget and plan an effective economic recovery program.

The sectors that have been hardest hit by rising insecurity in the country are agriculture, oil and gas, tourism, education and manufacturing. A report by the International Growth Centre (IGC), entitled "The Economic Costs of Conflict", examines how a weak security system can affect an economy.[3] According to the

[2] Thhttp://punchng.com/boko-haram-killed-611-teachers-displaced-952029-pupils-six-years-un/. Last visited on March 8, 2017

[3] Mueller, Hannes. 2013, "The Economic Costs of Conflict" Working Paper, International Growth Centre

report, there are two ways by which insecurity affects a state:

- A state with weak security lacks the ability to protect the property of its citizens; and
- A state with weak security will fail to control the activity of armed groups in its own territory, thereby resulting in a rise in organized crime and, possibly, armed conflict.[4]

In the first case, when a government is unable to provide formal property right protection, informal institutions usually replace formal arrangements.[5] The informal security institutions are often connected to political or military power, thereby inhibiting investments by the less powerful. For a country in which its citizens have to arrange their own security and where the police seem to only protect the rich, protecting businesses and property becomes expensive. Additional security costs and lack of law enforcement suppresses economic activity.

In the second case, insecurity in an environment with various armed groups leads to a situation where armed conflicts can spring up anytime. The proliferation of different militancy sects in the Niger Delta, as well as various violent groups in several parts of the country, is due to the availability of illegal arms to dangerous individuals. The resulting violence creates fear among citizens, limiting their ability to be involved in economic activities. It becomes even more difficult to attract foreign direct investments.

Finding a mechanism to combat insecurity in Nigeria requires a multifaceted approach which can be grouped into political, security enforcement and economic solutions. A good number of insurgencies arise due to different ethnic groups feeling marginalized in the country. Effective dialogue with their leaders would go a long way in ensuring peace. Political solutions between the government and ethnic groups are critical in a diverse country such as Nigeria. Another tactic is to ensure that security agents are properly equipped to tackle any security threats. A capable security force helps ensure that citizens feel secure as long as they are acting on behalf of the citizens. It is imperative for the government to invest heavily in recruiting, motivating and compensating the security agencies in Nigeria. A third solution is an economic strategy

[4] Ibid, page 26

[5] Ibid, page 26

based on the premise that well-fed and prosperous people are less likely to be involved in violent behavior. The majority of violent demonstrations in the country are carried out by restless youth who have nothing to do. The high unemployment rate in the country has rendered many young men unemployed and targets for conscription by violent groups. A country with an restive youth will have a challenging time attracting investments.

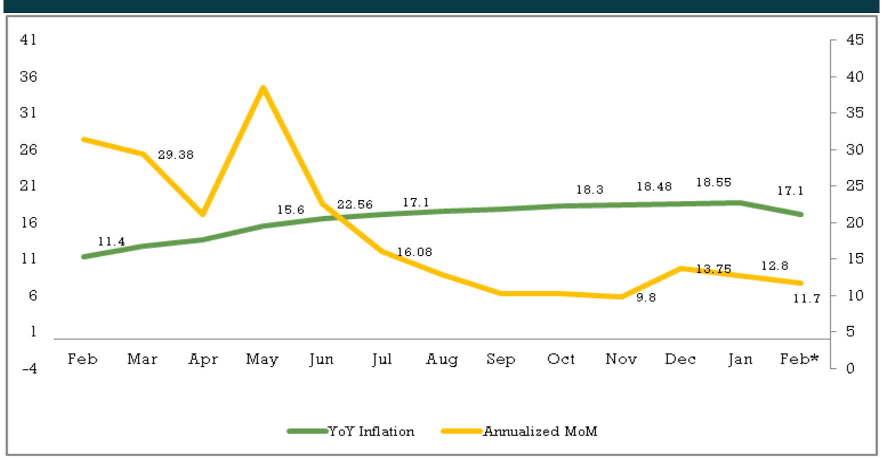
In summary, resolving Nigeria's security challenges will help in ensuring a safer environment for better investment opportunities. Building an economy with poor security not only limits the economic potential of a country, but also puts any achievements at risk of being destroyed or undermined.

FEBRUARY INFLATION LIKELY TO DECLINE TO 17.1%

Headline inflation is almost certainly set to decline for the first time in 16 months when the NBS releases the numbers next week. This forecast is based on a regression model and empirical analysis. Most anecdotal proxies also seem to suggest that the trend of a slowing pace in inflation is consistent with the outcome of our regression. Headline inflation spiked to 18.72% in January as a result of an unexpected jump in food inflation and the impact of record high diesel price at N275 per litre. In January, the core and monthly indexes declined contrary to the direction of headline inflation.

The fundamental reason for this decline is the impact of significant developments in February 2016 (base year effects). In February 2016, distortions in the forex market led to a significant jump in CPI, beginning a trend that lasted for several months. February 2017 has been relatively stable compared to last year; hence we expect a moderation in the increase in CPI from 4.18 in 2016 to 2.0 in 2017. This means that a new trend of declining inflation is on the horizon. This new trend is observed amongst a number of Nigeria's sub-Saharan African peers like Angola and Malawi. It is noteworthy that the anticipated decline in the February numbers does not mean that prices will decline.

Chart 2: Headline Inflation vs Month-on-Month Inflation (%)



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6 Source: NBS, FDC Think Tank

A decomposition of our CPI estimates results in a 0.9% (11.7%, annualized) month-on-month inflation rate. There were no dramatic events in February to differentiate consumer price movements in the month from that of January. However, the end of February marked the beginning of what many believe is the path towards a more liberalized forex market.

The CBN announced far-reaching changes in the forex market with weekly disbursements of $1 million to DMBs at a price of not more than 20% mark up of the IFEM rate. The CBN also sold a significant amount of dollars in the forwards market. The actions of the 'born-again' CBN saw the naira appreciate by 15% in the first seven days. This fueled hopes that the pressure on consumer prices from forex policy inconsistency and market scarcity is on its way to a decline.

POSSIBLE IMPACT

The Monetary Policy Committee is to meet on March 20/21 to decide the course of monetary policy. It is expected that the GDP numbers, which were recently published, and the inflation rate will be major considerations at the meeting. Fourth quarter 2016 GDP growth improved by almost 100bps to -1.3% from -2.24% in the previous quarter, while full year growth rate contracted to -1.51%. The improvement in GDP numbers and anticipated slowing in the inflation rate are likely to sway the committee towards taking up its agenda to pursue a more accommodative stance with respect to interest rates.

US FED RATE HIKE

The Fed is likely to raise rates upon the conclusion of its March 14-15 deliberations. This is meant to be an anchor to the possible inflationary impacts of President Trump's expansionary policies, which may cause instability in prices. The impact of this is a stronger dollar and its inverse relationship with oil prices means that Nigerian oil revenues could be threatened.

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NEXT MPC MEETING – WHAT TO EXPECT

The next MPC meeting is scheduled to hold on March 20/21 and will hold in Lagos. This is the first meeting in which economic fundamentals are taken in isolation of body language and influence. The market will be a major determinant and the economic management team will be monitoring policy statements and impact. In addition, the meeting will occur one week before the IMF article IV board meeting.

The MPC meeting is holding against the backdrop of market reformers versus mixed economy, economic patriots versus rent seeking establishment group and ideological struggle within the APC.

MATTERS ARISING

The considerations include the improving (although still in negative territory) GDP growth rate, tapering inflation (February inflation is projected to ease to 17.1%, forex policy reform in play (naira appreciation of 13% - parallel market) and accretion in gross external reserves. Based on the above, the most probable outcome expected is for the committee to adopt a wait and see approach. This would allow for the recently implemented CBN forex policy to have a full effect on the market. In addition, it seems like the MPC has ignored the month on month decline in inflation as a justification to reverse rate downwards. However, if our estimate for the February inflation figures is accurate, the rational thing to do would be to observe the trend whether it is a blip or Nigeria has reached an inflection point.

Other likely scenarios are for:

- Downward revision in interest rates. The rationale behind this is to inject liquidity into the system due to economic growth pressures and to reduce government debt service obligations.
- Increase interest rates by 100 bps to 15% p.a. The rationale behind this is to check for inflation as well as the divergence in policy and market rates

WHAT OTHER AFRICAN ECONOMIES HAVE DONE

In Sub-Saharan Africa, Kenya and Angola maintained the status quo on monetary policy rates at their last Monetary Policy Committee meeting while Zambia and Uganda reduced interest rates to 14% p.a. and 11.5%.p.a. respectively.

GLOBAL PERSPECTIVE

NIGERIA'S RICE FARMERS ENJOY GROWTH AMID ECONOMIC CRISIS- CULLED FROM THE FT

Agriculture has been a beneficiary of steps to counter effects of dollar shortage

Young men, ageing widows and local chiefs — even civil servants — have taken to the fields to work in rice paddies that stretch for miles around Tarasa, a village in north-west Nigeria.

Two years ago the land in one of the West African nation's poorest and least developed regions lay fallow. But rice farming is now enjoying a boom — a rare bright spot in a country enduring its worst economic crisis in a quarter of a century. "Life is getting better around here," says Labara Hassan, a rice farmer, whose income doubled last year, enabling him to put a new roof on his house. This year, the 30-year-old plans to cultivate a larger area and save towards his dream: a pilgrimage to Mecca.

Nigeria's economy contracted for the first time in 25 years in 2016 as Africa's top crude producer reels from the impact of low oil prices. But agriculture is one of the few beneficiaries of the government's radical steps to counter the effects of a crippling dollar shortage. In an effort to protect its dwindling foreign reserves, the central bank introduced restrictions in 2015 on the allocation of dollars for imports that it said Nigeria should produce locally — including rice. The measure forced importers to source dollars on the black market, driving up their costs and creating shortages of some goods. Some factories closed and companies axed tens of thousands of jobs. Inflation has soared to nearly 19% as the government attracts mounting criticism for its handling of the economic crisis. But as imports became more expensive, demand for locally produced rice — a staple food in Nigeria — soared, drawing businessmen from the south to the north to buy directly from smallholder growers. Prices for Nigerian rice increased nationwide last year by about 60%, according to the National Bureau of Statistics. "They [the measures] created a market for locally grown rice paddy. Now demand exists," says an adviser to President Muhammadu Buhari, who did not want to be identified. "This is a starting point." He adds that it was helping the government's drive to diversify the economy — agriculture accounts for about 24% of gross domestic product, but Nigeria depends on petrodollars for 90% of its export earnings and 70% of state revenues. The country has vast amounts of arable land but produces little of what its more than 180m people eat.

Rice can be grown across the country, yet groceries and markets nationwide stock produce from Thailand and China. Domestic agriculture is dominated by smallholders and subsistence farmers. About 46% of the rice consumed in Nigeria in 2015 was imported, according to the US Agency for International Development. To boost local production, the central bank piloted a scheme last year in several northern states to supply materials such as fertilizer to help poorer farmers. The initial results have been promising. The states included in the pilot reported an increase in rice production of 20% last year compared with two years ago, according to the statistics bureau. The government says it will expand the programme this year.

"Agriculture is our low-hanging fruit," says Abubakar Bagudu, governor of Kebbi state, where Tarasa lies. "It can be a business. It can be a way to migrate from poverty." The challenge to sustaining momentum is ensuring local rice can compete with imports once dollar restrictions are lifted. Experts say inefficient processing and high production costs in Nigeria have typically meant wholesalers have been able to sell Asian rice for less than that produced locally. "There's no doubt that both incomes and opportunities for farmers have increased," says Stefan Kachelriess-Matthess, director of a programme supporting rice farmers that is managed by GIZ, a German development agency. "The risk is that this [demand] is artificial and that locally producing rice is still very expensive." He says the challenge is ensuring that Nigerian rice is produced efficiently enough to ensure it is competitive with imports and cheap enough for consumers, but also commercially viable for farmers.

Another problem is the lack of capacity to mill on a commercial scale. Several of the country's mills are not functioning and most process small amounts of rice. "We have an increase in rice production but it's not commensurate with milling capacity," says Yemi Kale, head of the statistics bureau. Some investors appear to be responding. Aliko Dangote, Africa's richest man, announced last month he too would build a rice mill in the northern state of Sokoto. And about an hour's drive from Mr Hassan's field, workers put the final touches on what will be the country's biggest rice mill when it opens next month. Amit Gupta says his company, Wacot Rice Ltd, has spent almost $30m building the mill in the hope it will be ahead of the curve for a shift that he believes is inevitable. "Countries in the developing world like India have recently moved towards consuming more locally made products and Nigeria will very soon go through this," Mr Gupta says.

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L i m i t e d

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
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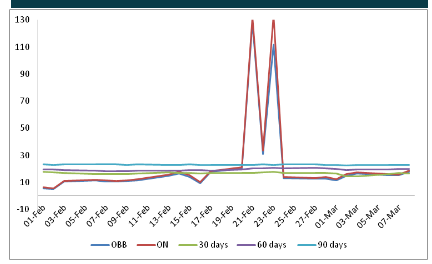
MACROECONOMICS INDICATORS

MONEY MARKET

The opening liquidity position in the money markets was significantly lower on the 7th of March at N15.49bn short relative to N303.41bn long as at February 2nd. The low liquidity in the money market is a result of the combination of OMO auctions and the frequent CBN intervention in the forex market.

Short term interbank rates (OBB, ON and 30-days) averaged 20.78% p.a. between February 1st and March 8th, 9.34% higher than the average rates of 11.34% p.a. recorded in January. The spike in interbank interest rates was as a result of the $1.3 billion sold in the spot and forward market by the CBN. Specifically, the OBB and O/N rates started off the month of February at 5.42% p.a. and 6.25% p.a, before closing significantly higher on March 8th at 18% p.a. and 18.58% p.a. respectively. As at March 3rd, the closing rate for 91-day, 182-day and 364-day were 13.65%, 17.2% and 18.5% per annum (pa) respectively at the primary market auction. The average 91-day treasury bill rates decreased by 21bps to 14.23% (pa) in February from 14.44% (pa) in January.

Chart 3: Short Term Inter-bank Rates (%)



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Outlook

Typically, interest rates moves in tandem with market liquidity and as such we expect interbank interest rates to trend higher in the short term driven by the CBN's forex sales and OMO auctions. The pendulum movement will likely continue in the coming month as gross external reserves reach $30bn whilst the CBN seems determined to maintain stability in the forex market. However, with oil prices down to a year to date low of $52pb, we may begin to see the CBN step back a little in its forex supply.

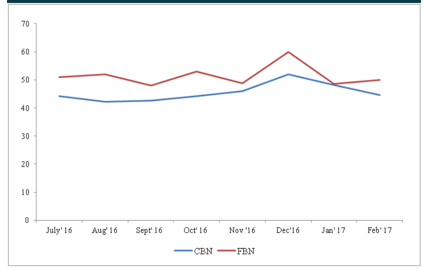
PURCHASING MANAGERS INDEX (PMI)

According to FBN Quest, Nigeria's purchasing managers index

[7] Source: CBN, FMDQOTC, FDC Think Task

(PMI) increased to 50 in February from 48.6 in January. Forex scarcity, power shortages and higher diesel prices continue to weigh on the manufacturing sector. However, it is important to note that import substitution strategies are beginning to gain traction with credit support from the CBN and state investment vehicles.

Chart 4: PMI



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The IBTC PMI reading rose to a 14 month high to the strongest level since December 2015. Headline PMI increased to 52.2 in February from 51.9 in January, mainly attributable to the strong expansion of output. In spite of a reduction in new export sales, new businesses increased in the review period. This led to an increase in purchasing activities as inventory levels rose at a faster pace. However, average cost of input and output charges grew at the slowest pace since the beginning of 2016.

Conversely, the CBN's PMI declined to 44.6 in February from 48.2 in January. Production level decreased from an expansion, delivery time worsened, while new orders, raw materials inventories and employment level declined at a faster pace. Out of the sixteen subsectors, fourteen declined such as paper products. Transport equipment, electrical equipment, plastic and rubber products, while food, beverages and tobacco; appliances and components expanded in the review period.

Outlook

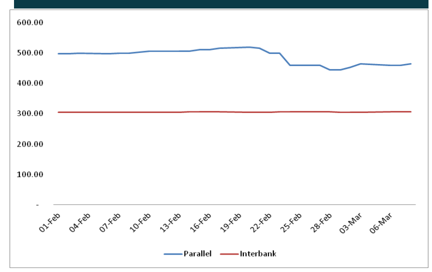
The PMI is about inventory levels and most manufacturers currently have inventories priced at higher parallel market rate between N480 – N500. With the new FX policy implemented by the CBN as well as maintaining consistency in the supply of forex to the spot and forwards market, we may begin to see an improvement in inventory levels in the coming month. This is turn will boost productivity and drive an expansion in the manufacturing sector.

[8] Source: FBN, CBN, FDC Think

FOREX MARKET

EXCHANGE RATE

Chart 5: Exchange Rate (N/$)



[9]

Exchange rate is a function of aggregate supply and demand for dollars. The supply of dollars in the exchange rate market are investment flows (foreign portfolio investment and foreign direct investment), borrowed funds, lines of credit, oil revenue and Diaspora remittances, while sources of demand for dollars are invisibles and tradables.

In February, the CBN announced plans to increase its supply of forex to banks to enable them to meet demands for travel, medical expenses and school fees. Banks are also expected to sell forex to customers with a maximum mark up of 20% on the interbank rate at time of sale. This is expected to increase accessibility of forex, alleviate the current liquidity crisis and ensure competitive rates of trading.

In the review period, the value of the naira has appreciated against the dollar in the parallel market by 7.1% to N465/$ from N498/$ on February 1st. At the end of February, the naira was on a free fall before recovering to N445/$ from record lows of N520/$ on February 20th. So far, the appreciation at the parallel market was as a result of the announcement of the new CBN forex policy reform and intervention auctions of $1.3billion to the spot and forwards market. In the interbank market, the exchange rate depreciated marginally by 0.22% to N306.2/$1 at March 8th from N305.5/$ on February 1st.

Outlook

In the short term, we expect the naira to continue to strengthen against the dollar at the parallel market on the back of the CBN's new forex policy. This latest policy adjustment will provide temporary reprieve as there will be an improvement in forex liquidity at a relatively more flexible rate.

The Nigerian forex market currently has multiple exchange rates and this policy change could eventually create another avenue for

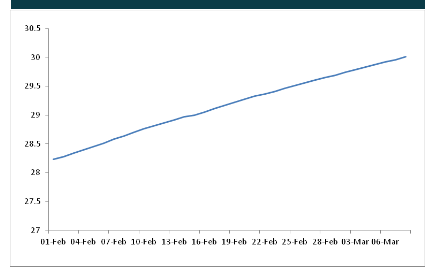
[9] Source: FDC Think Tank

arbitrage, by further fragmenting the market. It should also be noted that the market's structure has not changed. The foreign exchange market is an imperfect market, with the CBN being the price-discriminating monopolist. Although forex liquidity will increase, the current forex policy is sub-optimal and will remain vulnerable to external shocks.

EXTERNAL RESERVES

The 90-day moving average of Nigeria's gross external reserves increased by 6.27% ($1.77bn) to $30.01 billion on March 8th from $28.23 billion on 1st February. This is the highest level since October 2015. The total value of future contracts and outstanding obligations are approximately $6bn, which implies that the net external reserve stands at $24bn. The reserves import and payment cover is 6.72 months. Higher external reserves will reduce speculative attacks on the currency and enable the CBN to efficiently meet forex demand through forward auctions. This will also strengthen the currency at the parallel market.

Chart 6: External Reserves ($bn)



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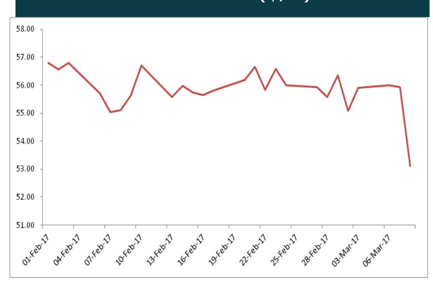
Outlook

We expect external reserves to maintain its upward trend if oil market dynamics on the domestic and international front remain favourable.

COMMODITIES MARKET - EXPORTS

OIL PRICES

Chart 7: Brent Crude ($/b)



[11]

In the review period, average oil prices was $55.72pb, 0.5% higher compared to $55.44pb in January. 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 group's production in January declined by

[10] Source: CBN, FDC Think Tank

[11] Source: Bloomberg, FDC Think Tank

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890,000 barrels per day (bpd) from the previous month to 32.14 million bpd. The decline further indicates a 98% compliance level so far by producers who agreed to curtail their output.

However, oil price slipped to a 4 month low on March 9th at $52.19pb on expectations of higher shale oil production and swelling U.S crude stockpiles. The latest EIA reported showed that U.S. commercial crude inventories increased by 8.2 million barrels in the week ended March 3rd, which came in higher than analysts' expectations. This brings the total U.S. commercial crude inventory of 528.4 million barrels. According to Baker Hughes, the number of active US oil rigs reached a 17-month high of 609. In addition, China recently lowered its growth target for 2017 to 6.5% compared to 6.7% in 2016. China is the 2nd largest economy, as a slowdown in growth dampens oil demand sentiment.

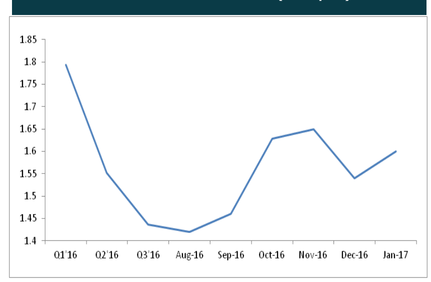
Outlook

The current price level is funding a revival in US shale drilling, which is offsetting OPEC's efforts to tighten the market. The EIA predicts U.S oil output will average 9mbpd this year and a record 9.73mbpd in 2018. The market is also bracing up for an increase in interest rates by 25bps on March 15th by the U.S Fed. This move will give strength to the dollar, which in turn will soften demand for dollar denominated commodities like oil.

OIL PRODUCTION

According to the Minister of State, Ministry of Petroleum Resources, Nigeria's oil production increased to 1.95 million bpd in February. 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 progressing. Acting President, Yemi Osinbajo, during a tour of the Niger Delta region in February, announced that the government had secured funding of over $1billion from Shell Petroleum Development Company to develop the region and improve social services.

Chart 8: Oil Production (mbpd)



[12]

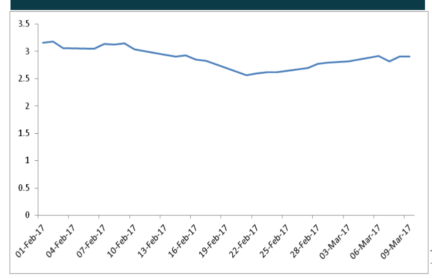
[12] Source: OPEC, FDC Think Tank

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 FG order to relocate IOC headquarters to the Niger Delta region will likely reduce tension in the oil rich state.

LIQUEFIED NATURAL GAS LNG

Chart 9: Natural Gas



[13]

In the review period, the average price of natural gas declined significantly by 12.9% to $2.88mmbtu from $3.31mmbtu in the January. The downward pressure on gas prices is mainly driven by rising U.S natural gas inventories and warmer weather expectations. According to the latest EIA report, U.S natural gas inventories surged by 7 billion cubic feet in the week ended February 24. U.S natural gas inventories are 14.3% higher than the 5 year average of 132 billion cubic feet. The unexpected warm weather across the U.S contributed to record rise in natural gas inventories in the February. Winter in the U.S was not enough to draw down on record stockpile build-up. According to the U.S National Weather Service, the current heating season is 3% warmer compared to last year.

Outlook

Prices may remain low pending any significant increase in demand for natural gas. About half of the U.S population use natural gas to heat up their homes. According to the National Oceanographic and Atmospheric Administration, demand for heating gas this winter season was nearly 20% below average.

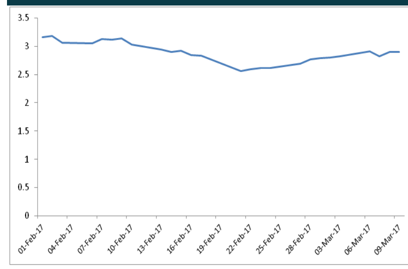
COCOA

The average price of cocoa decreased by 9.12% to $1,982/mt from $2,181/mt in January. The 4 year low record id attributed to an anticipated global surplus in the 2016/2017 season following a

[13] Source: Bloomberg, FDC Think Tank

deficit in the 2015/2016 season. Production in Ivory Coast is expected to increase by 20% to 1.9 million tons from 1.58 million tons estimated for 2015/2016.

Chart 10: Cocoa


[14]

Outlook

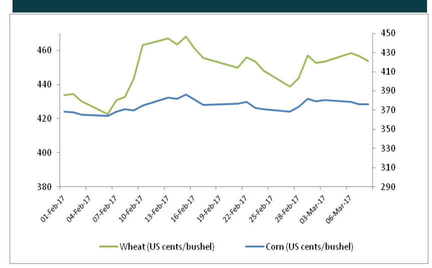
Improved production outlook in West Africa remains a bearish factor for cocoa prices. Cocoa production surplus is expected to continue this season due to favourable weather conditions.

IMPORTS

WHEAT

From February 1st – March 9th, average wheat prices gained 5.89% to $4.49/bushel from $4.24/bushel in January. Global wheat production remains at a record, but reduced this month mainly on lower crops from India and Kazakhstan. Furthermore, the USDA raised its US wheat export forecast for the 2016/17 season by 50 million bushels on strengthening dollar aided by weaker dollar. This was because of a strong pace of US wheat export shipments, resulting in a reduction in stocks to 1.139 billion bushels, compared to expectations for 1.186 billion

Chart 11: Grains



[15]

CORN

In the review period, average corn futures inched up 3.6% to $3.74/bushel from $3.61/bushel in January. U.S government lowered corn supply due to increasing ethanol production and demand. Corn utilization is expected to reach a new record of 5.32 billion bushels compared to 5.20 billion bushel last year. Corn exports from September 2016 through to August 2017 are expected to rise to 2.22 billion bushels compared to 1.89 billion bushel in the previous period. In addition, heavy rainfall concerns in Brazil and Argentina, stalled corn harvests in those regions.

[14] Source: Bloomberg, FDC Think Tank

[15] Source: Bloomberg, FDC Think Tank

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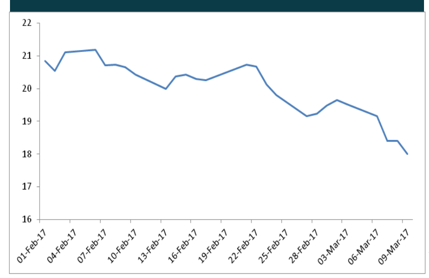
Outlook

Grain prices are expected to maintain the bullish trend. Corn plantings in the US are expected to decline as US farmers are likely to switch towards soybean for higher profit margins. Rabobank expects U.S. sowings will decline and expects the switch from corn into soybeans to increase to as much as 5-6 million acres. In addition to lower plantings, increased demand for corn for ethanol production will contribute to the rally in prices. Lower production estimates from the second largest producer for wheat, India, will remain while US export sales maintain upbeat trend.

SUGAR

In the review period, average sugar prices decreased by 2.63% to $0.1999/pound from $0.2053/pound in February 1st. This is largely attributed to relentless supplies from mills in India. Ample supply from Brazil also contributed to damp price movements in the sugar market. Although, there were a few bullish updates which minimized losses. Global sugar stockpiles were projected to o fall to 77.2 million tonnes, the lowest in 5 years due to production shortfall in major growing regions (Brazil and India). Also, the Brazilian currency strengthened against the US dollar, discouraging producers from exporting more.

Chart 12: Sugar



[16]

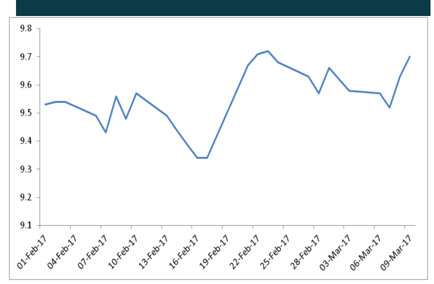
Outlook

Sugar deficit will remain while short term fluctuations in demand and supply estimates will determine price movements.

RICE

The average prices of rough rice declined by 2.35% to $9.55/cwt from $9.78/cwt in January. According to the EIU report, global rice output is expected to slide to 481m tons amid weaker than expected output in Asia. China is notable the largest consumer of

Chart 13: Rice



[17]

[16] Source: EIU, Bloomberg, FDC Think Tank

[17] Source: Bloomberg, FDC Think Tank

rice in the world, representing approximately 30% of world demand. Rice consumption in China is expected to expand by an annual average of 1.2% and demand is expected to reach 147.5m tons 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.

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 tons is 5m tons below average in the last four seasons.

STOCK MARKET UPDATE

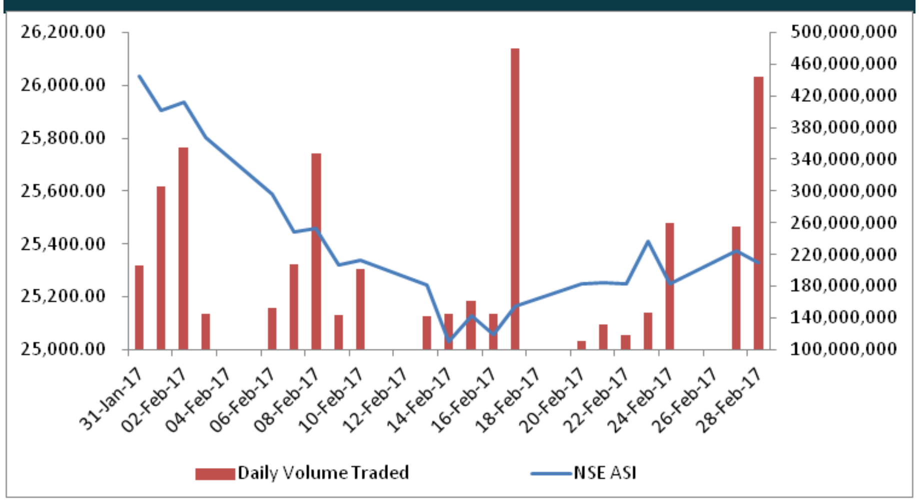
Bearish sentiment continued to dominate the Nigerian equities market, weighed down by weak macroeconomic indicators and lacklustre earnings expectations, which resulted in the persistent sell-off of bellwether stocks. The NSE ASI lost 2.72% to close below the 26,000 points psychological threshold, at 25,329.08 from last month's close of 26,036.24 points.

By way of introduction, 29.46 billion ordinary shares of Jaiz Bank Plc were listed on the Nigerian Stock Exchange at N1.25 per share. Even though JAIZBANK's listing added N36.83bn to shareholder's funds, market capitalization declined by N207.07bn to N8.77trn in the month being reviewed. The year-to-date return on the index moved deeper into negative territory at (5.75%).

The liquidity weighted SFNG Blue Chip 30 Index declined by 4.14% in the month of January, from the 0.88% loss recorded in January 2017.

Activity on the bourse was mostly negative resulting in 9 days of gains and 11 days of losses. Daily changes, representing volatility on the ASI, ranged between -0.84% and 0.63% in the month.

Chart 14: NSE ASI February 2017



[18]

Market activity for the month was quite tepid as turnover declined by 21.71% to N37.06bn from the N47.33bn reported in the month

[18] Source: NSE, FSDH, FDC Think Tank

of January. Average daily turnover for the review month decreased to N1.85bn, 10.19% below the year's daily average of N2.06bn.

Investor sentiment, as reflected by market breadth, remained negative at 0.54x, as 27 stocks advanced against 50 stocks that declined while 100 stocks remained unchanged.

The best performing stocks for the month were BETAGLAS 27.57%, CAVERTON 24%, JBERGER 11%, AIRSERVICE 9.09% and CAPITAHOT 6.63%.

TOP 5 GAINERS				
Company	**Feb-17**	**Jan-17**	**% Change**	**Absolute Change**
BETA GLASS CO PLC.	38.27	30.00	27.57%	8.27
CAVERTON OFFSHORE SUPPORT GROUP	0.93	0.75	24.00%	0.18
JULIUS BERGER NIG. PLC.	38.66	34.83	11.00%	3.83
AIRLINE SERVICES AND LOGISTICS PLC	2.88	2.64	9.09%	0.24
CAPITAL HOTEL PLC	3.70	3.47	6.63%	0.23

Top price losers for the month were UACPROP (35.76%), FO (33.04%), VITAFOAM (28.03%), NESTLE (21.60%) and FIDSON (20.18%).

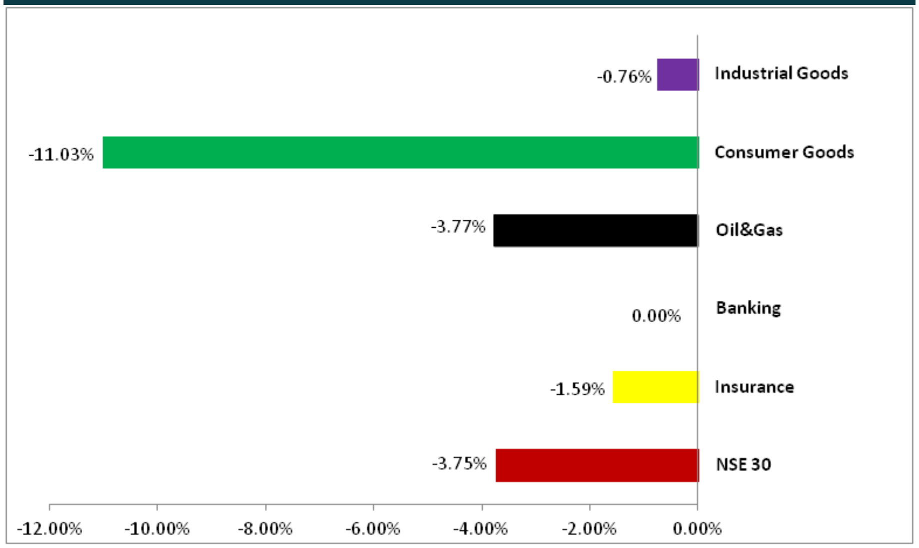
TOP 5 LOSERS				
Company	**Feb-17**	**Jan-17**	**% Change**	**Absolute Change**
UACN PROPERTY DEVELOPMENT CO. LTD	1.85	2.88	-35.76%	-1.03
FORTE OIL PLC.	47.69	71.22	-33.04%	-23.53
VITAFOAM NIG PLC.	1.72	2.39	-28.03%	-0.67
NESTLE NIGERIA PLC.	570.00	727.00	-21.60%	-157.00
FIDSON HEALTHCARE PLC	0.91	1.14	-20.18%	-0.23

5 MOST CAPITALIZED STOCKS			
Company	**Feb-17**	**Jan-17**	**% Change**
GUARANTY TRUST BANK PLC	24.70	23.70	4.22%
DANGOTE CEMENT PLC	168.99	166.00	1.80%
ZENITH BANK PLC	14.70	15.70	-6.37%
NIGERIAN BREWERIES PLC	129.20	139.80	-7.58%
NESTLE NIGERIA PLC	570.00	727.00	-21.60%

All sectoral indices closed lower month-on-month, with the consumer goods index leading the pack, losing 11.03% in the month being reviewed as a result of inflationary pressures which has continuously weighed heavily on consumer spending while higher input costs that cannot be passed on to consumers tighten their squeeze on margins.

Inspite of sustained negative impacts of economy headwind on the banking industry, banking sector index was flat in the month being reviewed. The banking sector's very strong earnings profile and rich dividend payout has continued to increase investors' endearment to its stocks.

Chart 15 : Sectors in February 2017



[19]

CORPORATE EARNINGS

February marked the commencement of another earnings season. So far, only eight companies have released their results and performances have been mixed. Average gross earnings, from released numbers, is up 20.1% while profit before tax increased by approximately 10.3% from prior period. On per sector basis, the profit before tax for the manufacturing sector declined significantly due to foreign exchange translation losses, high costs resulting from currency devaluation, macroeconomic headwinds and increased pressure on consumer disposable income.

Notwithstanding the challenging operating environment in the banking industry, Tier-1 banks posted impressive results. There was a 21.7% increase in average gross earnings, while average PBT rose by 28.4%.

[19] Source: NSE, FDC Think Tank

Banking Sector

Banks	Gross Earnings N'bn	Earnings Growth	Net Interest Income N'bn	%	Net Impairment Charge N'bn	%	PBT N'bn	%
GTBank	N414.6	37.3%	N195.4	22.2%	N62.3	426.2%	N165.1	36.8%
Zenith	N507.9	17.4%	N240.2	6.94%	N32.3	106.4%	N156.9	25.2%
Access	N381.3	13.02%	N139.1	32.04%	N21.9	54.3%	N90.3	20.3%

Other Sectors

Company	Turnover (N'bn)	%	Finance Cost (N'bn)	%	PBT (N'bn)	%
Nestle	N181.9	20.30%	N20.8	328.50%	N21.5	-26.50%
Nigerian Brewery	N313.7	6.70%	N13.6	66.04%	N39.7	-27.20%
Forte Oil	N148.6	19.20%	N6.16	19.80%	N5.34	-23.80%
Dangote Cement	N615.1	25.10%	N45.4	35.60%	N180.9	-37.20%

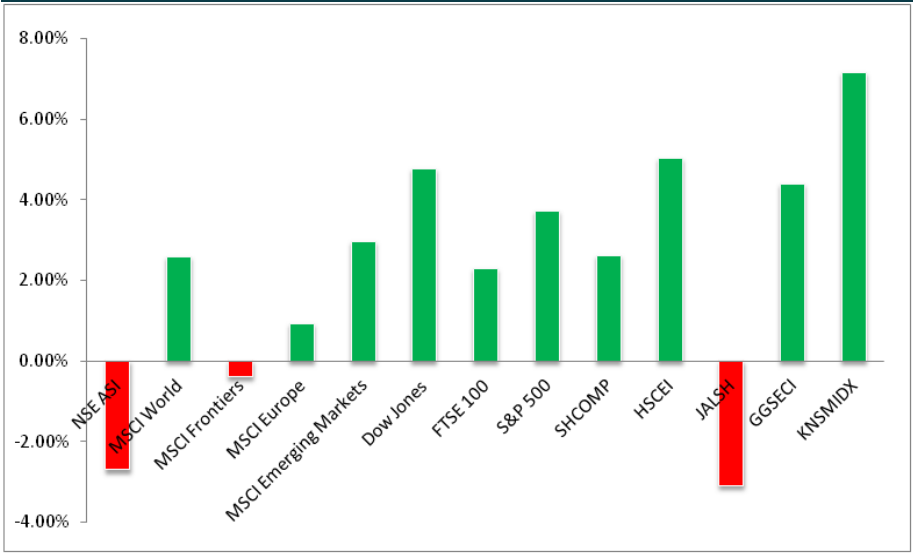
GLOBAL MARKET REVIEW

Performance across the global equities markets was largely bullish in the month of February. Indices in the advanced markets trended higher on Donald Trump's plan to overhaul business taxes and cut regulations in the United States. The S&P 500 increased by 3.72%, driven by investor interests in Aviation stocks, while UK FTSE advanced by 2.31% as manufacturing and industrial production in December surpassed expectation and boosted confidence in the British economy.

Positive sentiment also filtered into the Asian markets. The Hong Kong HSCEI was up by 5.04% while China's SHCOMP appreciated by 2.61% on the heels of improved corporate earnings releases.

Across the sub Saharan African region, performance was generally bullish with the JALSH emerging the lone loser (3.11%), in tandem with the NSE ASI's negative performance. On the contrary, the KNSMIDX and GGSECI advanced by 7.17% and 4.40% respectively in the period under review.

Chart 16 : Global Indices February 2017



[20]

Outlook

The month of March is going to witness the influx of many more earnings releases, which are not expected to be very impressive given the economic environment of the reporting periods. However, we expect the results of banking bigwigs like Ecobank, TOTAL, Mobil, ACCESS and UBA could shape the direction of the bourse albeit not materially.

In addition, the decision of the Federal Government to issue a savings bond which can be bought for as low as N5,000 (Five Thousand Naira Only) will see investors exit the equities market in droves to take advantage of the guaranteed income from the bonds.

[20] Source: NSE, Bloomberg, MSCI, FDC Think Tank

CORPORATE FOCUS

EQUITY REPORT: NIGERIAN BREWERIES PLC

Analyst Recommendation: SELL

Recommendation Period: 365 days

Industry: Food, Beverage & Tobacco

Market Capitalization: N1.13 trillion

Current Price: N133.15

Target Price: N93.98

One of the hardest hit sectors during this recession has been consumer goods, particularly the beverage segment. Some leading companies, such as Guinness, have experienced unprecedented losses. Companies that have managed to stay profitable have witnessed subdued results. Nigerian Breweries' FY'16 showed a decline of 25.3% in profit after tax (PAT). The modest 6.7% increase in revenue during 2016 was due to decreased sales volume following a product price increase in the later part of the year.

The persistent macroeconomic headwinds affected demand in 2016. Consumers are choosing lower priced brands, limiting Nigerian Breweries' growth prospects. The depreciation of the naira and the increase in prices of local raw materials resulted in a spike in costs for the company. Cost of sales as a percentage of revenue increased by 5.9% between FY'15 and FY'16. Though the company is expected to remain profitable in the near and medium term, economic challenges may constrain its earning potentials and lower its valuation.

In analyzing Nigerian Breweries' performance and forecasting an outlook, several factors were considered:

- Compressed margins;
- Sales outlook;
- Macroeconomic conditions and consumer behavior;
- Impact of foreign exchange (forex) fluctuations; and
- The competitive landscape.

Given the country's lukewarm economic outlook for 2017, as well as an unclear forex policy direction, the company's margins may continue to face downward pressure. We do not forecast an improvement in its earnings prospects. Accordingly, we place a SELL rating on Nigerian Breweries PLC.

CURRENCY DEPRECIATION AND RISING RAW MATERIAL PRICES COMPRESS MARGINS

Nigerian Breweries' witnessed increased costs in 2016 due to inflationary pressures and naira depreciation. Higher costs of key domestic inputs, such as sorghum, maize and sugar resulted in an increase in the cost of sales as shown by a decrease in gross margins of 5.9%. The weaker currency also resulted in a 71.4% increase in net finance costs in FY2016.

INDUSTRY AND COMPANY OVERVIEW

The Nigerian brewery industry is an oligopoly (a market structure in which a small number of firms has the large majority of market share) with multinationals competing for market share, alongside local micro-breweries. The dominant players are Nigerian Breweries (subsidiary of Heineken), Guinness (subsidiary of Diageo) and SABMiller. The $2.7 billion industry is expected to grow at a compound annual growth rate (CAGR) of 5.6% between 2011 and 2020.[21] The drivers include the growing population, rapid urbanization, increasing consumers of drinking age, enhanced distribution channels and industry consolidation. Nigerian Breweries Plc is the dominant player with a 65% market share and it has been the top performing brewery company during this recession. The company's marketing strength and its brand recognition within the beverage segment should maintain or even increase its market share.

Nigerian Breweries Plc was incorporated in 1946 under the name Nigerian Brewery Limited. The company has grown into a behemoth in the Nigerian brewery industry through a series of strategic acquisitions. It has a national reach with its extensive facilities

[21] Source: A Focus on the Nigerian Brewery Sector, 2015, GTI Research

of 11 breweries, two malting plants and 26 sales depots. The company is a subsidiary of Heineken NV, which holds a 54.3% stake. Its primary business activities are brewing and the marketing and selling of lager, stout, non-alcoholic malt drinks and soft drinks. Nigerian Breweries' product portfolio includes brands, which are among the most popular in the Nigerian alcoholic and non-alcoholic products space. As the company continues to grow and invest in innovation, more product lines are likely to be introduced to the market.

Its growth can be seen through its financial results. Non-current assets had a CAGR of 10.43% between 2012 and 2016 just as the company's net assets had a CAGR of 22.54%. PAT between 2012 and 2016 was down due to unfavorable macroeconomics. Earnings declined from N38 billion in 2015 to N28.4 billion in 2016. These headwinds decreased its gross profit margin by 5.9%, operating margin by 4.3% and net income margin by 3.8%. Overall revenue increased by 6.7% for FY 2016, up from N293.9 billion recorded in FY 2015. The cost of sales as a percentage of revenue was 56.8% in FY 2016, significantly higher than 50.9% in FY 2015. Marketing and distribution expenses as a percentage of revenue declined by 0.4% to 19.5%, while administrative expenses as a percentage of revenue declined from 8.2% to 7.0% during the period.