FDC Bi-Monthly Update

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In This Issue …

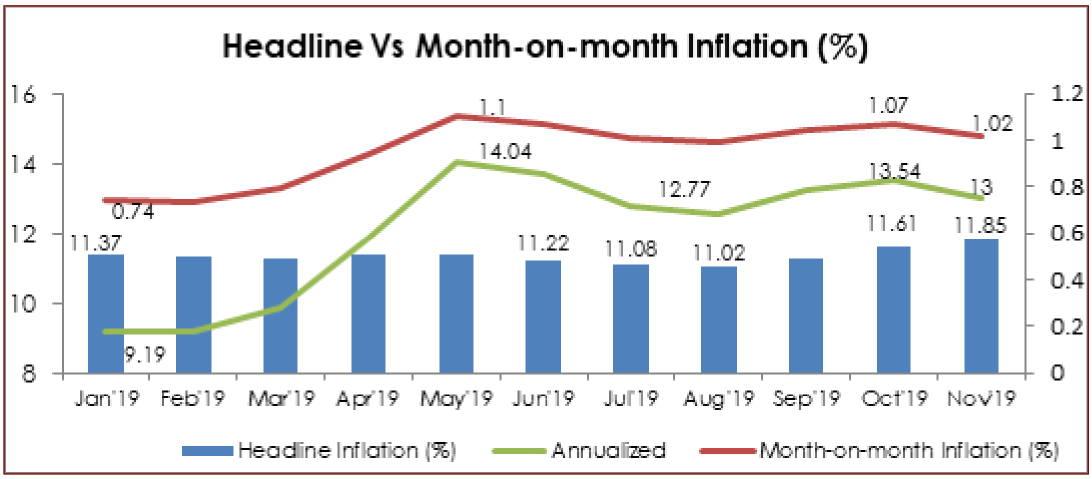
Headline Inflation up, month-on-month inflation down

Oh No!! Headline inflation spikes again in November

As widely expected and consistent with analysts consensus, headline inflation increased by 0.24% to 11.85% in November. This is the 3rd consecutive monthly increase and the highest level in the last 19 months. Cumulatively, the consumer price index has increased by 0.83% since August. Unlike in October 2019, core inflation (inflation less seasonal factor) increased this time by 0.11% to 8.99%. This confirms that the uptick in the general price level is not driven by seasonality alone. Other principal factors responsible for rising inflation include, border closure, speculative trading and money supply saturation.

Rising inflation could induce a change in the monetary policy stance

The CBN introduced a rash of guidelines aimed at reducing interest rates and boosting lending to the private sector. While this is targeted at stimulating economic growth, there is no empirical evidence to validate a positive correlation between increased credit to the private sector and economic growth in Nigeria. At the primary market, T/bill yields across all tenors have fallen sharply below the inflation rate, resulting in negative real rates of return. The continued increase in headline inflation at a time of steady depletion of the external reserves could induce a change in the monetary policy stance of the CBN.



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[1]NBS, FDC Think Tank

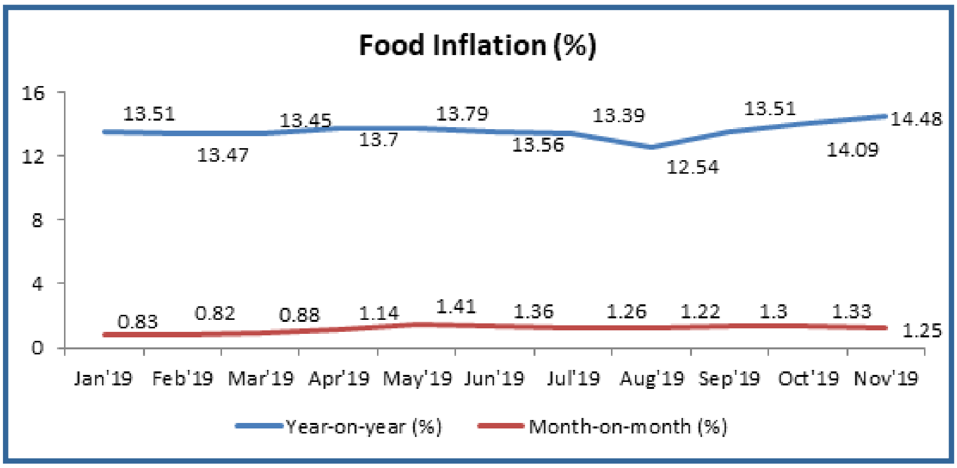
Inflation Data Breakdown

Monthly inflation down marginally to 1.02%

For the first time in six months, month-on-month inflation (a more reflective measure of current prices) moved in the opposite direction of headline inflation. The index declined to 1.02% (annualized 13.00%) from 1.07% (annualized 13.54%) in October. This suggests that the border closure impact is beginning to wane. This is because news of the possible re-opening of the land borders in Q1'20 has prompted the sales of hoarded goods, thus reducing the pressure on prices. The price of a 50kg bag of local rice declined by 10% to N18,000 in November. At a time of policy making apprehension, a reduction in the month-on-month inflation will soothe the nerves of many more.

Food inflation spiked by 0.39% to 14.48%

In the last few years, food inflation had been driven by seasonality and other factors such as flooding. This has now been compounded by the 4-month border closure. The year-on-year food sub-index soared by 0.39% to 14.48% in November. However, the month-on-month food index declined to 1.25% from 1.33% in October. The rise in the annual composite food index was largely due to an increase in the price of commodities such as bread, cereals, oils and fats, tubers, meat and fish. The spike in the price of rice led to a shift in consumption pattern from cereals to tubers, which are produced locally.



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Core inflation up 0.11%

The year-on-year core inflation (inflation less seasonal factors) stood at 8.99% in November, an increase of 0.11% from 8.88% recorded in October. On a monthly basis, the index also increased by 0.05% to 0.79%. This was in spite of the relative stability in the exchange rate. The exchange

[2]NBS, FDC Think Tank

rate was stable across all markets in November. At the parallel market, the naira traded between N359/$-N360/$.

The items that recorded the highest price increase include cleaning, repair and hire of clothing, hospital services, hairdressing saloons and personal grooming establishment, tableware and household utensils, vehicle spare parts, repair and hire of footwear and shoes.

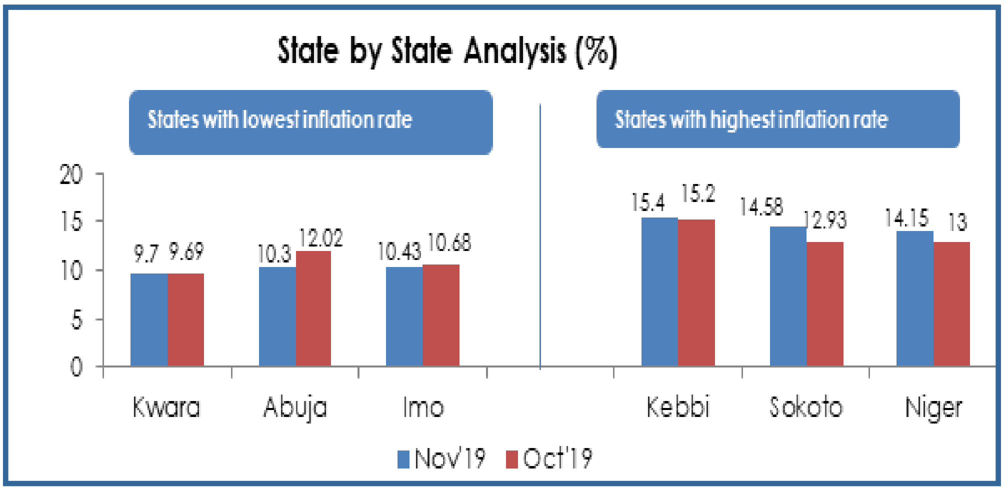
Core inflation is 0.14% below the 364-day primary market T/bills rate of 9.13%. This is indicative of a positive rate of return on investment.

Rural and Urban inflation also increased

In November, both year-on-year rural and urban inflation indices increased to 11.30% and 12.47% from 11.07% and 12.20% respectively in October. However, urban inflation rose at a faster pace than rural inflation. This is happening at a time when the national average price of diesel declined by 0.49% to N225.08/liter. On a month-on-month basis, both indices declined marginally by 0.01% and 0.08% to 0.98% and 1.07% respectively.

State-by-state analysis – Kwara state is the best performing state

Kwara state had the lowest inflation rate of 9.70%, followed by Abuja (10.30%) and Imo (10.43%). The highest level of inflation was recorded mainly in the North West - Kebbi (15.40%), Sokoto (14.58%) and Niger (14.15%). In the last six months, Kebbi state has underperformed all other states as that with the highest rate of inflation. Higher inflation rate erodes consumer purchasing power and reduces return on investment. Hence, the state could be a potential red flag for rational investors.



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[3]NBS, FDC Think Tank

Outlook

The increasing price trend since Q3 is likely to continue into December and early 2020. The policy makers are likely to respond by using special debits and stabilization securities as remedial measures in the short run.

However, since the MPC will be meeting on January 20/21, the CBN may use this opportunity to formally change the monetary policy stance by resuming a tightening cycle again.

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GDP growth: How far can Monetary Policy go?

The year 2020 is poised to be one of economic unpredictability at both the global and domestic levels. While the US-China trade spat has forced revisions to the global growth outlook, markets will also keep a keen eye on elections in the US and the policy response of advanced economies to a global slowdown. For Nigeria, economic progress is projected to continue at its tepid pace before it accelerates. According to the Economist Intelligence Unit (EIU), Nigeria is forecast to grow at 2% in 2020 – unchanged from 2019. This remains below the population growth of 2.6% and implies that per capita income will fall further. However, the IMF still believes that GDP growth will increase to 2.3%.

Growth will be constrained by infrastructure challenges (power shortages, poor rail, road and port facilities). In addition to the infrastructure deficit, the country is also faced with insecurity, elevated inflation and tight credit conditions. With lower oil prices expected to continue, the revenue forecast appears weak even with a projected increase in tax revenue and improvements in tax collection. High debt-servicing costs leave little headroom for the fiscal authorities to manoeuvre and this has left monetary policy as the main lever to drive an economic recovery.

Monetary Tools...Fiscal Problems

The monetary policy framework of the Central Bank of Nigeria (CBN) is one of explicit-inflation targeting. It has maintained a neutral stance by holding rates unchanged four times in the last year, due to rising inflation expectations and exchange rate pressures. However, it has deployed unorthodox measures to stimulate lending as economic growth becomes a stronger consideration. This has yielded positive results as credit to the private sector has risen by over N1.1 trillion since the CBN, in July 2019, mandated deposit money banks to maintain a minimum loan to deposit ratio (of 60% by September 30th, 2019 and then to 65% by December 31st, 2019. Lending rates are declining as a result as deposit money banks scramble to meet the loan to deposit ratio requirement. The CBN has managed to lower lending rates without reducing the monetary policy rate.

Concerns about the impact of this policy on the health of the banking sector – through the possible erosion of asset quality - have become secondary considerations. The National Bureau of Statistics in its Selected Banking Sector Data – 2019 disclosed that the profile of non-performing loans has declined from N2.24 trillion in Q3'18 to N1.1 trillion at the end of Q3'19.[4] Falling non-performing loans at a time of increased credit to the private sector implies that deposit money banks are becoming more innovative in their risk management.

Unintended Consequences

The CBN's inclination towards boosting the supply side of the economy is likely to trigger contradictory pressures in 2020. Policy measures such as the hike in value added tax, the implementation of the minimum wage and cost reflective electricity tariffs will be inflationary. Inflation is already well above the CBN's upper target limit of 9%. The CBN has made it clear that an interest rate cut will only be considered when inflation enters a sustained downward trend and falls below the upper target limit of 9%. Any attempt at monetary loosening now could trigger capital outflows and put pressure on the exchange rate at a time of low oil prices.

Falling interest rates lower the real returns on fixed income assets while also lowering the marginal propensity to save and increasing the marginal propensity to consume. This analysis implies that people will save less and therefore invest less while also consuming more and therefore importing more. The CBN's plan to hike the loan to deposit ratio even further may therefore result in increased pressure on the exchange rate.

[4]https://www.businessamlive.com/q319-banks-npls-moderate-by-n1-14trn/

One Down, Three to Go

But monetary tools can only do so much. Adding gross domestic product (GDP) growth via credit growth to its price stability mandate is laudable considering how fragile and tepid the economic recovery has been. However, tightened credit conditions are just one constraint to growth. And the only one that recent policy guidelines by the CBN can have a positive impact on. The huge infrastructure gap, insecurity and rising inflation are bigger constraints to output than tightened credit conditions. Many would even argue that tightened credit conditions are a consequence of the impediments to growth – which require fiscal policy solutions.

The threat of rising inflation is the CBN's reason for adopting a tightened monetary stance. However, one of the reasons why inflation continues to rise is because increases in money supply are not matched by accompanying increases in aggregate output. Higher productivity and output have in turn been held back by a lack of adequate infrastructure required to drive businesses and incentivize private investment. Deposit money banks in turn consider the risk of lending in such an environment and so include a premium on their loans which in turn increases the cost of borrowing.

While fiscal spending power is projected to be limited in 2020 as a result of weak oil revenues, pressing security needs and debt-servicing costs will take priority. This makes the outlook for improved infrastructure in the near-term rather bleak. Therefore, bridging the infrastructure gap (an estimated $350 billion in the next 10 years[5]) will boost productivity and aggregate output to levels that match money supply – thereby lowering inflation. A fall in inflation will then give the CBN room to loosen monetary policy as substantial growth in lending to the private sector will remain unlikely until the monetary policy rate is lowered.

[5]Chris Ugwu, Dec 11, 2019. "Tapping capital market potential for infrastructure needs," New Telegraph, https://www.newtelegraphng.com/2019/12/tapping-capital-market-potential-for-infrastructure-needs/

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Nigeria's higher education quandary

Over the past three decades, the Academic Staff Union of Universities (ASUU) has battled successive Nigerian administrations, embarking on numerous lengthy strikes, in a quest to compel the federal government to raise the standard of higher education in the country and better compensate lecturers. The 2009 Memorandum of Understanding was signed after a three-month long strike and the 2013 accord ended another strike that lasted nearly six months. More strikes may be inevitable in 2020, as the current government is probably less likely than its predecessors to meet ASUU's demands.

At the time of the 2009 MoU, Nigeria's economy was growing at a robust rate of 8.4%. By 2013, growth has slowed but it was still a respectable 5.4%. However, as we come to the end of 2019, the economy is still showing its battle wounds from the recession that ended in 2017 – the first in 25 years – and the growth rate is crawling at less than 2.5%. Above all, the government is still reeling from its dependency on oil which has seen a decline both in price and output. It is also struggling to raise enough non-oil revenue to maintain the bureaucracy, while plunging deeper into debt. Under these circumstances, it is unlikely that authorities, even if they share the lecturers' aspirations for the education sector, can find the money to substantially boost spending on universities. The fact that other public-sector workers are also pressing government for more money makes it even less likely that ASUU will get its wishes.

High level of unemployment weakens the argument for more funding

Besides the budgetary constraints, the economic case for allocating more resources to higher education has been weakened by the growing number of graduates leaving college unable to find appropriate employment. Official employment data shows that since the second quarter of 2016 joblessness has been highest among Nigeria's post-secondary school leavers. Such high levels of joblessness among college leavers puts to question the notion that spending on education to build a nation's human capital stock is a panacea for spurring economic growth. In reality, the relationship between education and economic growth has not been as straightforward as many policymakers and development economists have assumed. The experience of Nigeria has arguably shown that economic growth is driven by knowledge and skills that enable more efficient production. Producing graduates with skill sets to become successful entrepreneurs or value-adding employees in the public and private sectors is something that Nigerian universities have struggled with.

More and more universities

That said, the high rate of graduate unemployment has not deterred the growth in the number of higher education establishments in Nigeria. There are now 40 federal universities, 44 state universities and 69 private universities, compared with just one university at the time of independence in 1960. Four state and eight private universities were established in 2016 alone. There are also more than 150 polytechnics and technical colleges in the country.

Education in general has been a fast-growing sector of the economy and one of the biggest creators of new formal-sector jobs. This expansion has been partly driven by the increasing demand for higher education. According to the Joint Admission and Matriculation Board, a total of 1.74million candidates registered for the 2018 Unified Tertiary Matriculation Examination, up from 1.27million that applied the previous year. This is more than double the places available (850,000) across Nigerian universities.

Rising youth despondency is a threat to stability

Nigeria's leaders face a very difficult question of how best to deal with the disparity between the limited number of decent jobs being created in the economy and the growing number of young people seeking higher education. This is centered in the belief that a decent higher education holds the key to securing good jobs (either within Nigeria or abroad) and higher social status. The reality is that many of those who want higher education are frustrated by the shortage of places, while many of those who manage to enter and complete their courses end up disillusioned because of the unrealized educational promises.

Growing disenchantment among aspiring young Nigerians, unable to chart a path into middle-class lifestyles, is one of the key contributors to social and political unrest in the country. Disgruntlement with limited opportunities for upward mobility can make the youth susceptible to the ideologies of sectarian groups that blame Nigeria's enduring inequality and poverty on its ethnic or religious composition. Nigeria's fast-growing youth population, slow moving economy and a strong desire for higher living standards is a recipe for social unrest, and there are plenty of causes for a disillusioned graduate to choose from.

Widespread unrest

Virtually every region of Nigeria is dogged by some form of unrest. In the north-east Boko Haram continues to terrorize the population in a quest to carve out an Islamic state. In the south-east, ethnic Igbo separatists are clamoring to re-establish the Republic of Biafra. The attempt by Igbos to secede sparked the devastating 1967-70 civil war. Today's Biafra activists contend that the predominantly Christian Igbos remain marginalized within the federation, and most blame the mainly Muslim northern ruling elites that have historically dominated Nigeria's political system. Their agitation has resulted in a backlash in the north.

In central Nigeria thousands of people have been killed in recent years in clashes between the semi-nomadic, ethnic Fulani herdsmen and farming communities, mainly over access to land. Meanwhile, ethnic nationalist sentiment remains high in the southern oil-producing Niger Delta region where militants demanding local control of mineral resources have attacked the country's oil infrastructure. The violence, which at its height in 2016 slashed Nigeria's crude output by as much as 30%, has subsided in recent years following government talks with community leaders, but the underlying causes of the conflict remain.[6]

[6]Reuters. November 2017. Nigeria's delta avengers militants end oil hub ceasefire https://www.reuters.com/article/us-nigeria-oil/nigerias-delta-avengers-militants-end-oil-hub-ceasefire-idUSKBN1D3268

Competition for limited economic resources

A major underlying cause of most conflicts in Nigeria is competition for limited economic resources. The production of graduates and their accompanying unmet expectations is growing much faster than the economy's ability to create the desired privileged positions.

The acute challenge, however, is that the financial difficulties of the federal government mean its ability to boost spending to appease disgruntled social groups and labor unions is increasingly limited. Rather, policymakers are likely to come under increasing fiscal pressure to enact further cuts, likely targeting fuel and electricity. In the past, the threat of removing such subsidies has also triggered unrest.

A limited threat for the time being, but serious nonetheless

Nigeria has a history that includes a devastating civil war, numerous coups and three failed civilian republics. Although Nigeria's current 20-year-old democracy is more institutionally mature and robust than its previous failed republics, this does not mean that it is immune to disruption or even breakdown. Nevertheless, if the current administration proves continually unable to shift the country onto a more sustainable and robust path of economic development, then the risks to the country's stability will intensify as more and more Nigerians question what they have to lose from pushing for violent change. This makes it all the more imperative for the federal government to prioritize its education sector, but not just by throwing money at the problem to quash the threat of strikes. Rather, Nigeria needs to prioritize the education sector, both with investment and thoughtful policy, to truly help the sector realize its potential and shape the next generations as effective contributors to the society and economy.


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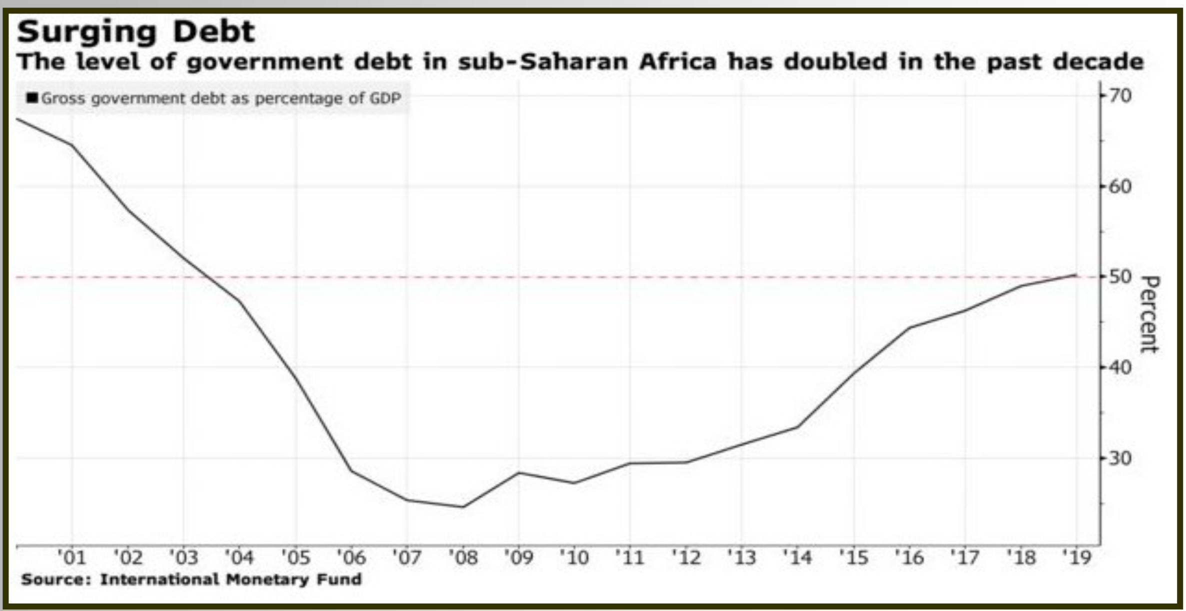
Africa Borrowing like it's the 1990s Worries the IMF

Global Perspective: culled from Bloomberg

Record commodity prices and low global interest rates have encouraged African countries to borrow like they did in the 1990s, but now some are struggling to pay up as their revenue slows along with economic growth. Government debt as a percentage of Gross Domestic Product (GDP) in sub-Saharan Africa has doubled in the past decade, heading back toward the level it reached at the turn of the century. International Monetary Fund Managing Director Kristalina Georgieva said in November this is a cause for concern. Of the 54 countries on the continent, 20 are near or at distressed levels, according to the IMF, which means they face difficulties honoring their obligations.

African governments have raised about $26 billion in international markets this year, from close to $30 billion in 2018, as they took advantage of investors' thirst for returns in a world awash with negative yields. Volatile currencies across the continent increase the risks of borrowing in hard currency and the rising cost of servicing debt could crowd out other expenditure in a region that's home to more than half of the world's poor people.



"The conditions are ripe for a much higher level of debt distress," Sonja Gibbs, head of sustainable finance at the Institute of International Finance, said by phone. "Whatever triggers the next crisis, when it happens, you are likely to see a high degree of contagion risk because investors have been moving into higher yielding assets."

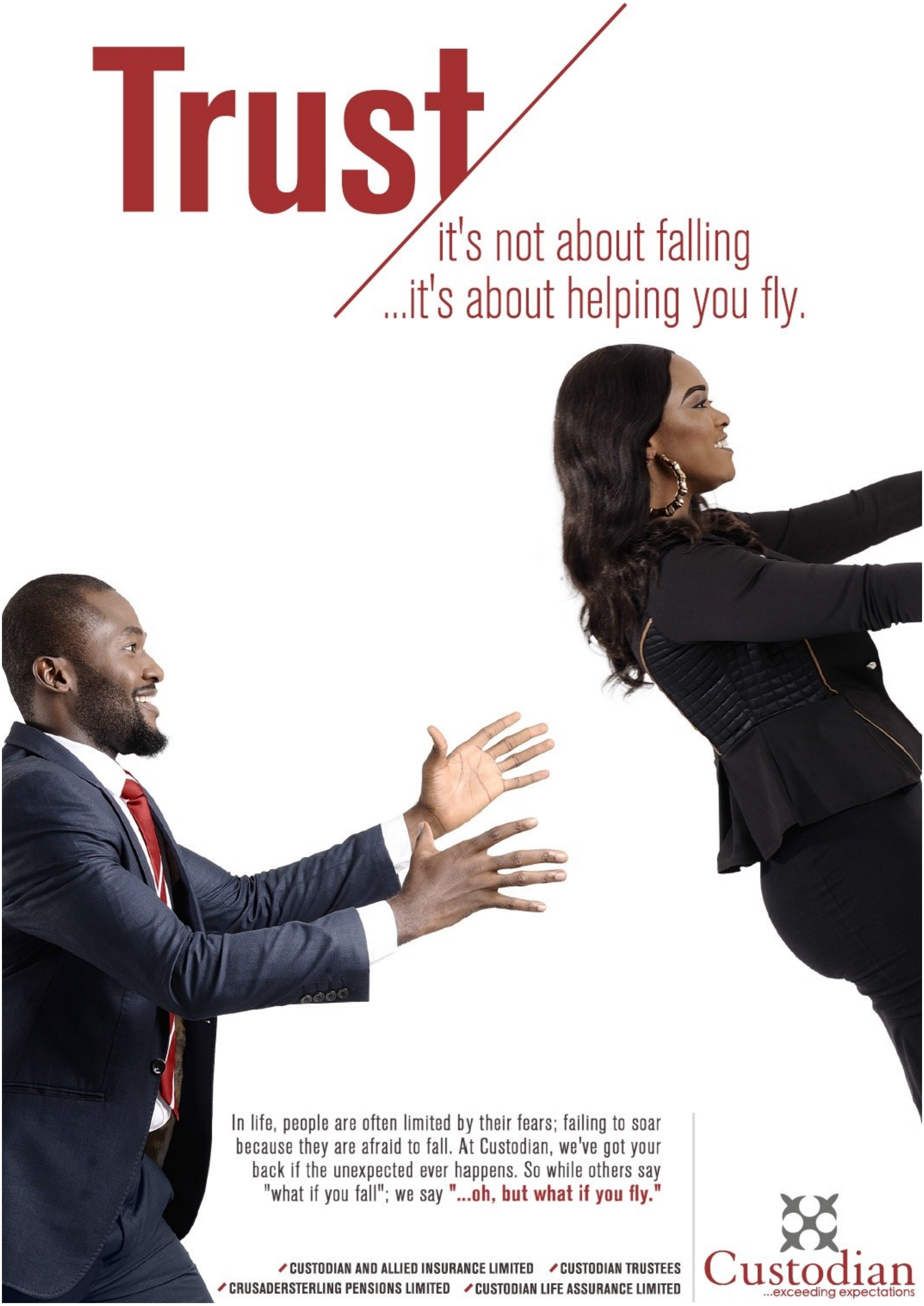
Further fanning fears of a new crisis is the surge in direct credit from China. The China Africa Research Initiative at Johns Hopkins University estimates that the Asian country's government, banks and contractors handed $143 billion in loans to African states and state-owned companies between 2000 and 2017. Still, Africa is far from a debt crisis, its biggest multilateral lender says. "Some individual countries are getting to higher levels in terms of debt-to-GDP ratios, that's the concern," African Development Bank President, Akinwumi Adesina, said in an interview. The debt-to-GDP ratio of Africa is still "well within acceptable limits," he said.

Costly Debt

More reliance on commercial bonds has raised debt servicing costs, diverting funds that could be spent on new roads or schools. Nigeria, the continent's top oil producer, spends about the same amount every year on repaying debt as it does on infrastructure. Countries such as South Africa, the continent's most industrialized economy, are raising debt levels and this year had its biggest Eurobond issuance yet to help plug a widening budget deficit. External debt payments now consume an average 13% of African governments' revenue compared with 4.7% in 2010, according to data compiled by the U.K.-based Jubilee Debt Campaign.

Overspending and crashing commodity prices in the 1990s led to a debt crisis that prompted multilateral lenders and rich nations to write off the obligations of dozens of African countries in 2005. This time around, a debt pardon may not be that easy.

The complex debt structure with opaque terms and mix of different creditors will make any potential restructuring agreement more difficult. "We're concerned that debt relief might now become more complicated," said Jan Friederich, a senior director at Fitch Ratings. "Nowadays there is a greater concern that governments, when they forgive any debts, might not actually help the African countries very much, but might primarily be bailing out the commercial creditors."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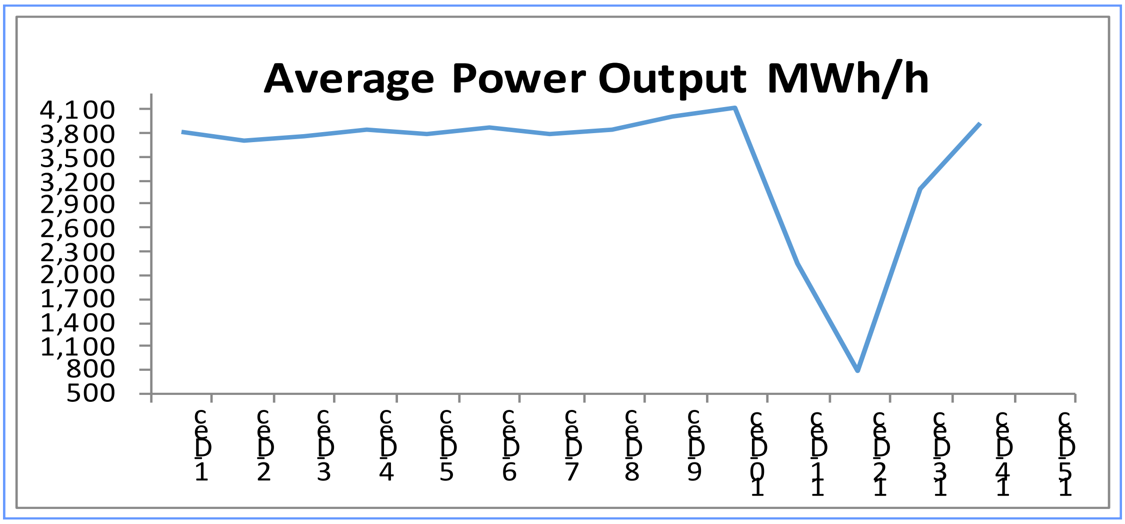
Macroeconomic Indicators
1st - 15th December

Power Sector

The average power output from the national grid within the period December 1st -14th was 3466MWh/h, 4.94% lower than the average output - 3646MWh/h in the first half of November. The dominant constraint was the gas constraint which was predominantly in Afam VI. There was a system collapse of the national grid on December 11. This was due to the strike of the National Union of Electricity Employees. During the review period, total constraint averaged 3392MWh/h resulting in a total revenue loss of N24.42billion (annualized at N636.66billion).



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Outlook

Despite the increased gas constraint, we expect average power output to increase in the coming weeks owing to the decrease in the grid constraint.

Impact

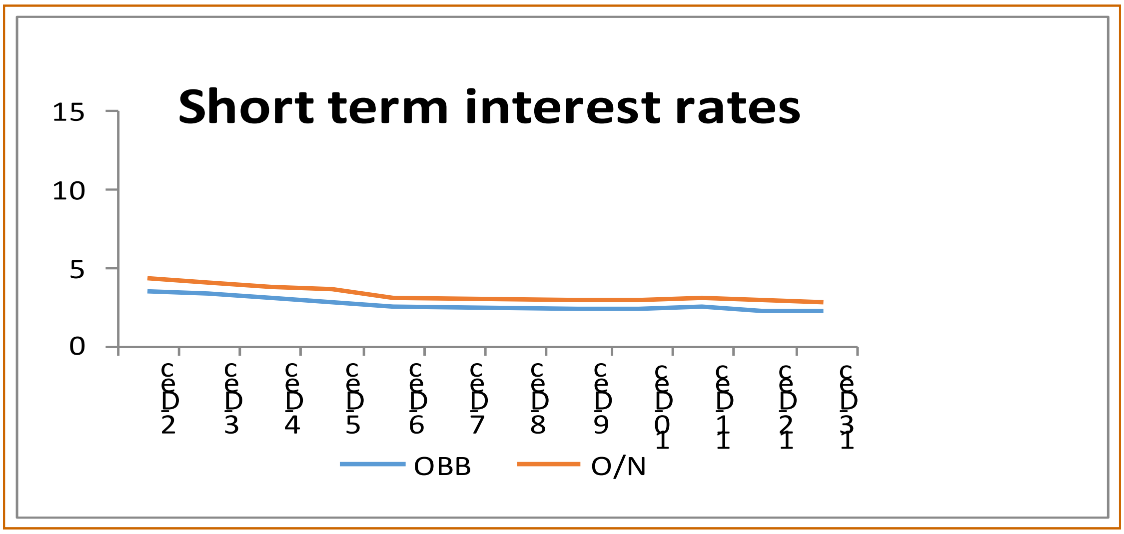
Though, the data showed an improvement in the distribution infrastructure, the gas constraint will cause a decrease in average power output which will make companies that are heavily dependent on power supply to seek for alternative form of energy. This will come in form of increased cost as well as increased prices.

[7]FG, FDC Think Tank

Money Market

The average opening position at the interbank increased by 38.79% to N464.15bn between December 2nd and 13th, from N334.42bn in the first half of November. Average short term rates, NIBOR (OBB, O/N) fell by 306bps to 2.98% p.a. from an average of 6.04% p.a. within the review period in December. On average, OBB and O/N were 2.65% pa and 3.32% pa respectively.

OMO issues and OMO maturities amounted to N479.94bn and N1.16trn respectively in between December 2nd and 13th relative to N849.31bn OMO sales and N1.16trn OMO maturities in the first fifteen days in November. The net inflow for the review period in December was N680.06bn, 118.89% above the net inflow of N310.69bn recorded on November 1st – 15th.



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At the primary market, there was an auction of N45billion on December 11th. The yields show a decline across all tenor. It decreased from 6.5%, 7.23% and 8.37% on November 27th to 5.00%, 6.19% and 6.88% on December 11th respectively. During the review period, yields on 91-day and 182-day declined to 5.00% and 5.35% from 6.00% and 5.94% respectively. While the 364-day T/Bills yield closed flat at 6.62% from 6.62% in the secondary market.

Primary Market

T/bills Tenor	Rate on Nov 27th (% pa)	Rate on Dec 11th (% pa)	Direction
91	6.5	5.00	
182	7.23	6.19	
364	8.37	6.88	

Secondary Market

T/bills Tenor	Rate on Dec 2nd (% pa)	Rate on Dec 13th (%)pa	Direction
91	6.00	5.00	
182	5.94	5.35	
364	6.62	6.62	

[8]CBN

Outlook

We expect Interest rates to fall further in the coming weeks as banks struggle to meet up with the demand by the CBN to increase their loan-to-deposit ratio from 60% to 65% as well as the plan by the CBN to further increase the ratio to 70% in 2020.

Impact

Sustained Increase in market liquidity will cause a continuous decline in short term interbank rates.

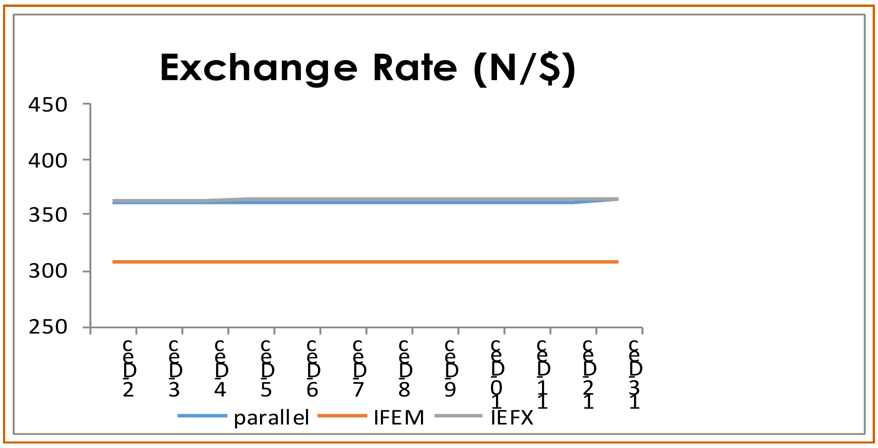
Forex Market

The Nigerian Forex market is segmented with multiple exchange rates. The most important rate is the Investors and Exporters window (IEFX). No less than 55%-60% of Nigerian Forex transactions are traded on this window. The CBN and most exporters and investors use this window. It serves not only as a source of price discovery but also a barometer for measuring potential and actual CBN intervention in the market. Some of the exchange rate determinants are balance of payments, capital inflows and trade balance.

Exchange Rate

The currency was stable across all windows in the foreign exchange market. In the parallel market, the naira depreciated marginally by 0.83% to N363/$ towards the end of the review period, after trading flat at N360/$ for a prolonged period of time. At the interbank foreign exchange market, it traded flat at N306.95 from December 1st till December 10th and closed at N306.9/$ on December 13th.

At the Investors $ Exporters Foreign exchange window, there was also some currency weakness, with the naira losing 0.5% of its value to close at N363.49/$ on December 13th. Between December 2nd-13th, total forex turnover at this window was $2.98bn.



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[9]FDC Think Tank

Outlook

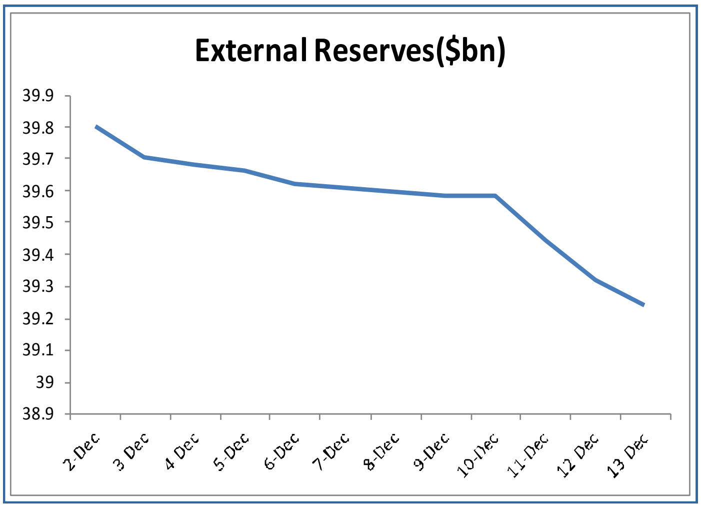
Typically in December, the naira appreciates due to inflows from visiting family and friends. However the recent depreciation maybe highlighting a more fundamental problem that Nigeria's external sector vulnerabilities are worsening. The possibility of a further currency weakness is high especially as the CBN winds down its activities for the year. This means that its forex interventions will reduce and demand pressures will mount.

Impact

A weaker currency occurring alongside rising inflation means that consumer prices will increase more sharply as Nigeria is highly import dependent.

External Reserves

So far in December, the external reserves level has depleted by 1.41% to $39.24bn. The import cover has declined to 9.77 months. At the current pace of depletion, the reserves level may close the year at $38bn

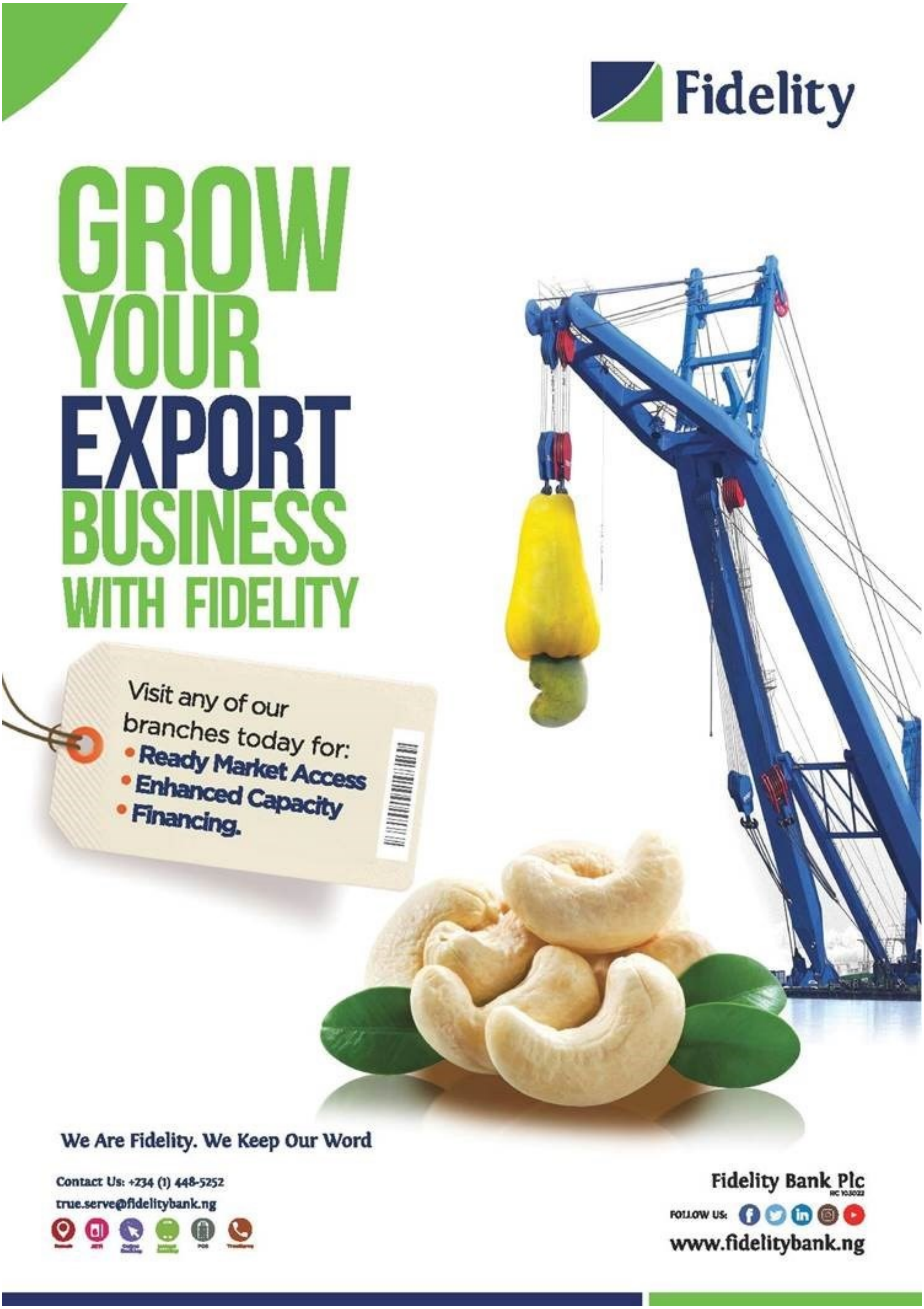


[10]

Impact

A continuous depletion of the external reserves would limit CBN intervention in the forex market. It is also one of the indicators that acts as a proxy of the health of Nigeria's external buffers. It could send the wrong signals to those that are monitoring the indicator to determine the strength of the currency.

[10]CBN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Commodities Market - Exports

Nigeria is an export dependent economy. It derives over 80%-90% of its export revenue from crude petroleum and LNG.

Oil Prices

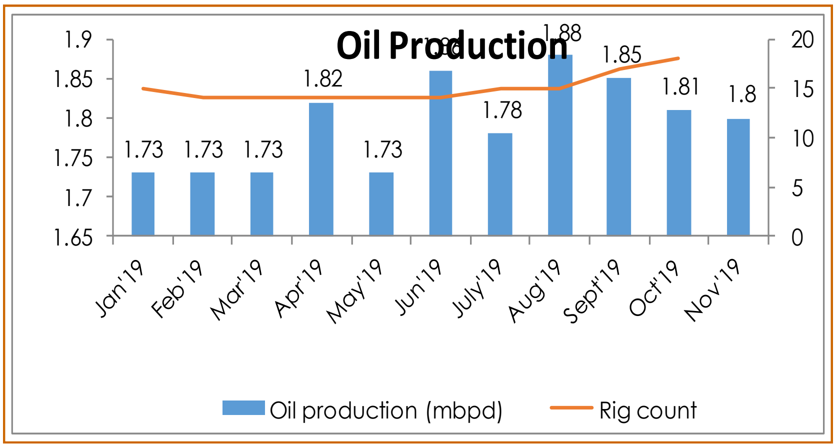
On average, the price of Brent crude rose by 4.65% to $65.22pb between 2nd and 13th of December from $62.32pb in the first half of November. This increase was driven by the decision made in the OPEC meeting to further cut oil supply. Oil futures increased by 7.06% to $65.22pb on December13th from $60.92pb on December 2nd. This was partly due to renewed optimism of a US-China trade deal as well as the decision by OPEC and its allies to cut down oil supply by an additional 500,000bpd to 1.7mbpd.

Outlook

We expect oil prices to close the year at $64-$65pb.

Oil production

Oil production was flat at 1.80mbpd in December. However, OPEC's crude oil production stood at average of 29.55mbpd, 0.51% lower than 29.7 in October. This was due to lower oil output in Saudi Arabia, Angola, Iraq and Iran.



[11]

Outlook

Oil production is projected to hover around 1.8mbpd in subsequent months, barring any disruption in the oil producing states. However, if Nigeria is forced to comply with its OPEC output of 1.774mbpd, its oil output is expected to decline sharply. The countries that would be affected by the additional OPEC output cut of 500,000bpd are yet to be determined. If Nigeria is one of them, it would have significant implications on its oil production levels.

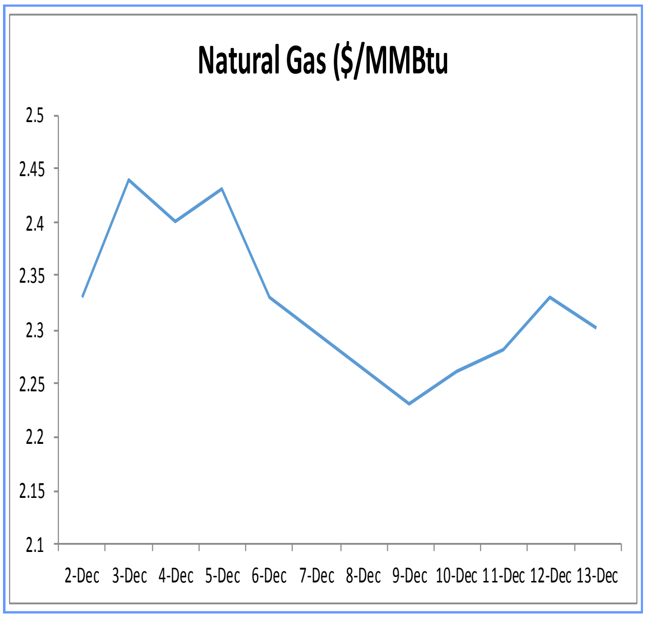
[11]OPEC

Impact

An increase in oil prices will have a positive impact on Nigeria's fiscal revenue and external reserves. However the gains earned from higher oil prices would be offset by the reduction in output. This would impact negatively on Nigeria's fiscal and external buffers.

Natural Gas

On the average, the price of natural gas during the review period was $2.33/mmbtu, which is 15.45% higher than the average price of $2.69/mmbtu between November 1st and 15th. Natural gas price was volatile during the review period, closing at $2.33/mmbtu. This can be attributed to a buildup in US LNG inventories during the period.



[12]

Outlook

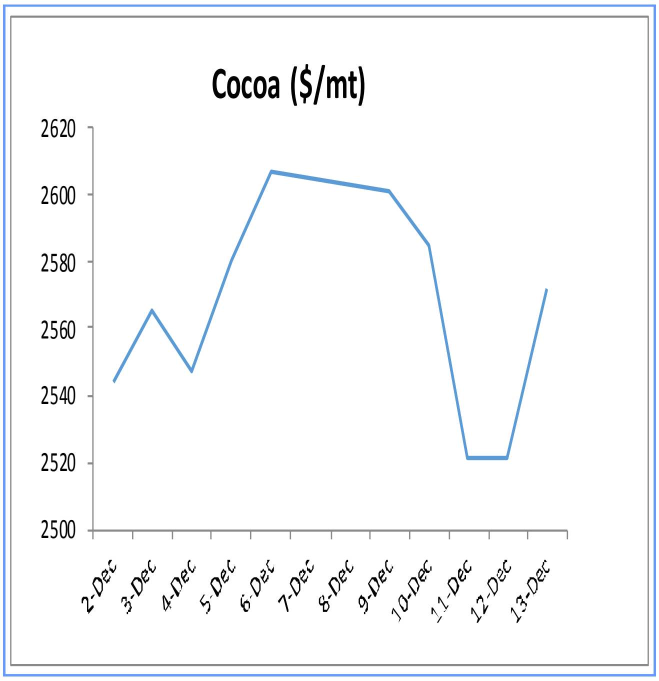
We expect the forecast of warmer temperatures in the Northern hemisphere to keep prices low.

Impact

Liquefied natural gas is Nigeria's second main export; lower prices will have a negative impact on the country's export earnings.

Cocoa

Average cocoa price fell by 0.54% to close the review period at $2,572/mt from $2,586/mt in the first half of November. Prices rose to $2,572/mt on the 13th of December, representing an increase of 1.1% from $2,544/mt at the beginning of the month. The increase in price was supported by strong global demand and reduced supply from major producers- Ghana and Ivory Coast as a result of harsh weather conditions.



[13]

[12]Bloomberg, FDC think Tank
[13]Bloomberg, FDC Think Tank

Outlook

We expect prices to increase further due to strong global demand for cocoa and reduced supply from Ivory Coast and Ghana in the short term.

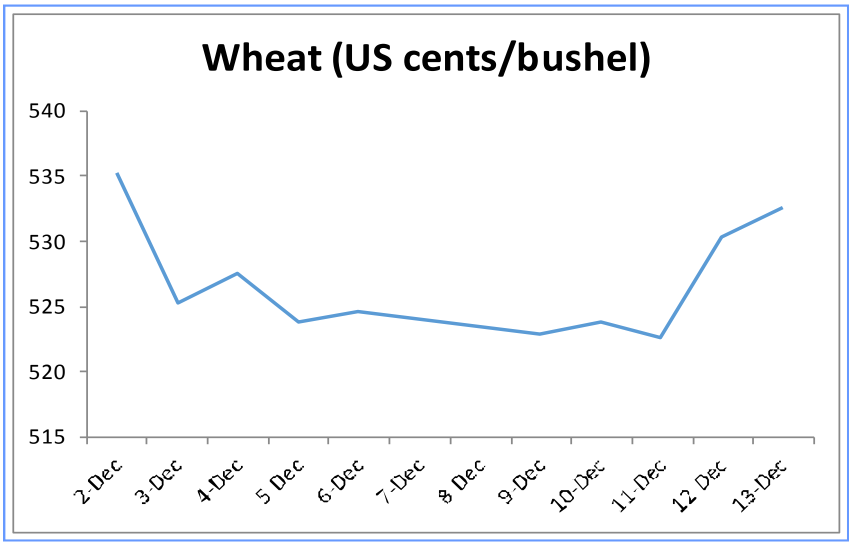
Impact

Cocoa is Nigeria's second main non-oil export commodity. An increase in cocoa prices means higher government revenue. It will also have a positive impact on the country's external reserves and foreign exchange earnings.

Imports

Wheat

The price of wheat averaged $526.8/bushel between December 2nd –13th. This represents a 2.77% increase when compared to the average of $512.61/bushel in the first half of November. Meanwhile, prices fell by 0.93% to $530.25/bushel on December 12th from $535.25/bushel on December 2nd. This was due to tightening global supplies.

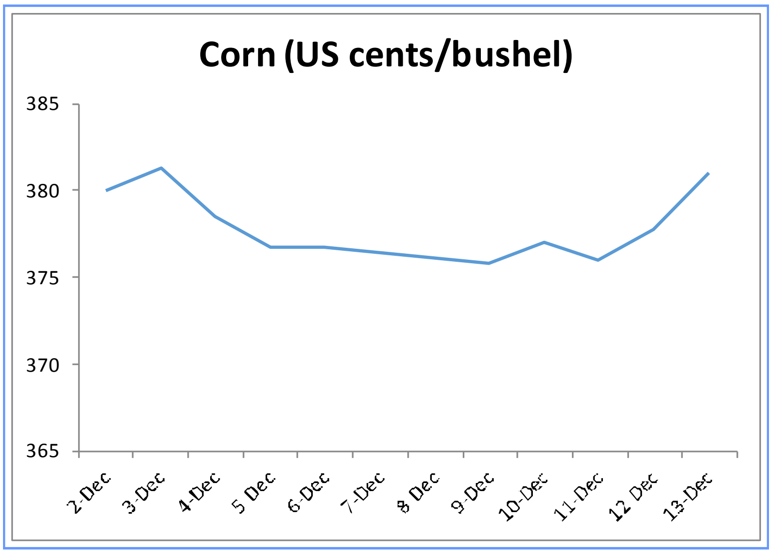


[14]

Corn

The average price of corn increased by 0.55% to $381/bushel in the first half of December from $378.93/bushel in the first half of November. Corn prices at the end of the review period increased to $381/bushel from $380.00/bushel at the beginning of the period. This was driven by the delay in US corn harvest due to unfavourable weather conditions.

[14]Bloomberg, FDC Think Tank



[15]

Outlook - Grains

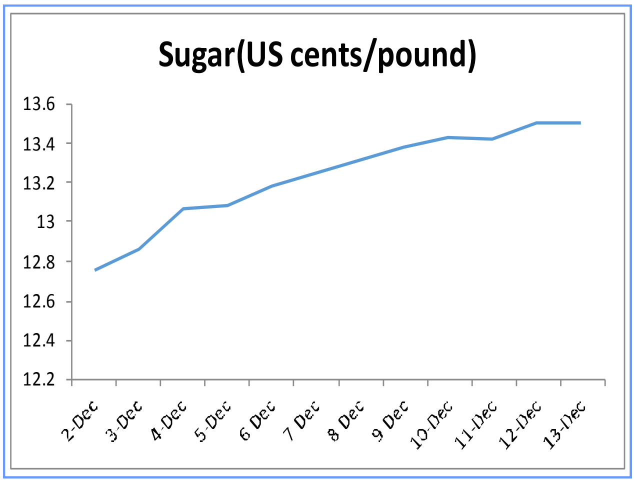
The US Department of Agriculture has revised downwards the US 2019 grain forecast. Possible reduction in output could push up prices in the near term.

Impact

Higher wheat prices will push up production costs for wheat dependent firms.

Sugar

On overage, sugar prices increased by 4.26% to \$13.22/pound between December 2nd and 13th from \$12.68/pound in the first half of November. Sugar prices also rose by 5.89% to close the period at \$13.50/pound from \$12.75/pound on December 2nd. This was partly due to lower production in India.



[16]

Outlook

Decline in sugar supply in Brazil will push prices up in the coming weeks.

Impact

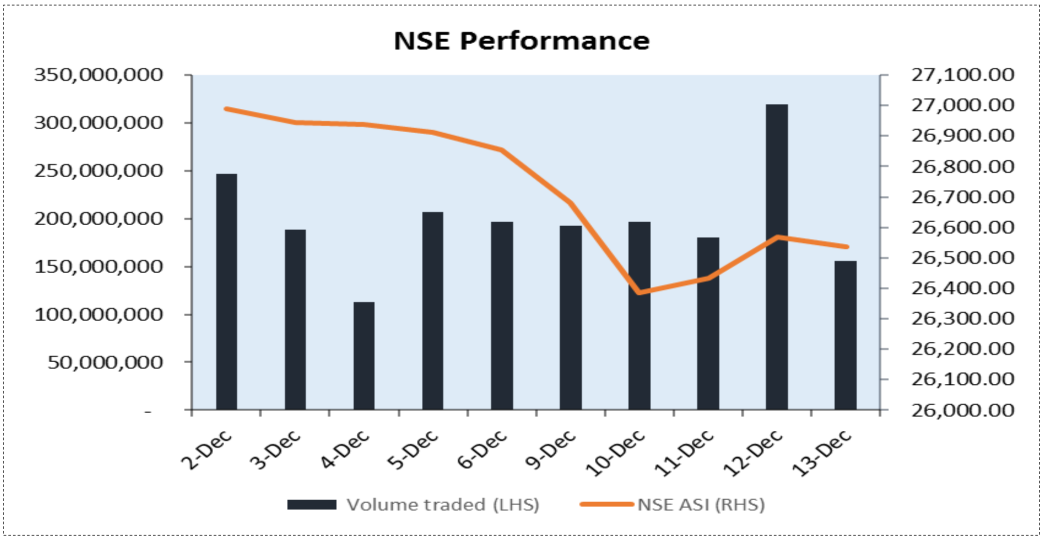
Increasing sugar prices will have a negative impact on Nigeria' external reserves and revenue since Nigeria is the largest importer of sugar in Sub-Saharan Africa.

[15]Bloomberg, FDC Think Tank
[16]Bloomberg, FDC Think Tank

Stock Market Review

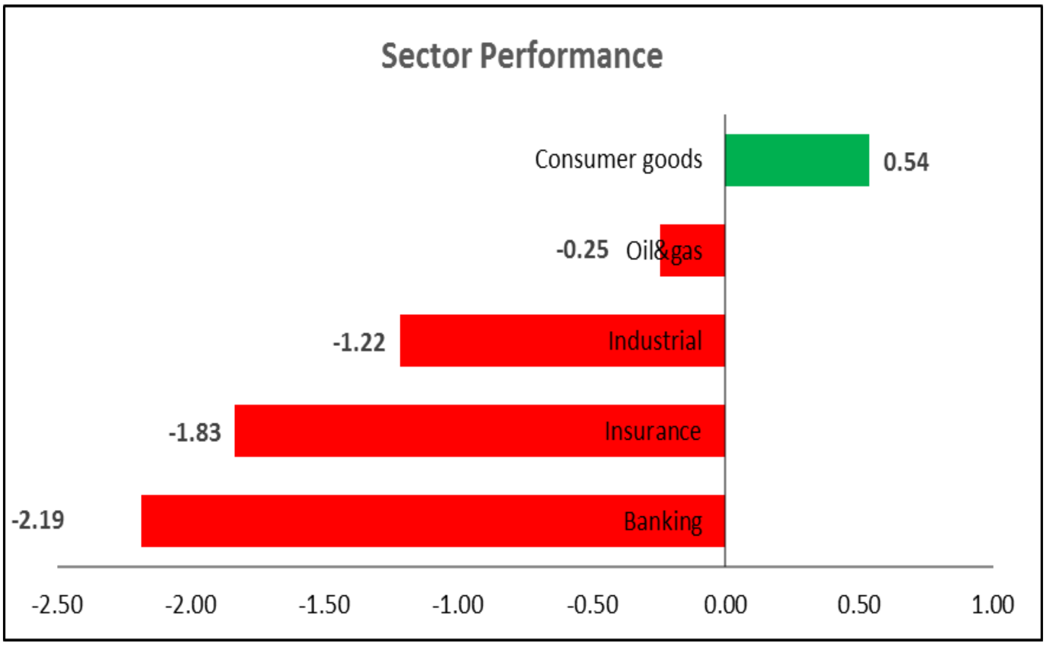
The NSE ASI lost 1.73% to close at 26,536.21 points on December 13th relative to its close of 27,002.15 points on November 29th. In the same vein, market capitalization fell 1.69% (N220bn) to N12.81trn. In the 10-trading day period, the market gained in 2 days and lost in 8 days.

The NSE traded at a price to earnings (P/E) ratio of 7.00x as of December 13th, 1.27% lower than the close of November 29th (7.09x). The market breadth was negative at 0.42x as 22 stocks gained, 52 lost while 91 stocks remained unchanged.



[17]

On the other hand, the market saw a decrease in activity level. The average volume traded fell by 45.76% to 1.47mn units, while the average value of trades declined by 49.53% to N13.51mn.



[18]

[17]NSE, FDC Think Tank
[18]NSE, FDC Think Tank

The sector indices were broadly negative during the review period. The Banking sector lost the most (2.19%), followed by the insurance sector (1.83%), the industrial sector (1.22%) and then the oil and gas sector (-0.25%). The consumer goods sector gained 0.54%

UAC of Nigeria Plc topped the gainers' list with a 21.92% increase in its share price. This was followed by Dangote Sugar Refinery Plc (19.93%), Royal Exchange Plc (14.93%), Trans-Nationwide Express Plc (10.00%) and Okomu Oil Palm Plc (9.77%).

TOP 5 GAINERS (N)

Company	Dec. 02'19	Dec. 13'19	Absolute Change	% Change
UAC of Nigeria PLC	7.30	8.90	1.60	21.92
Dangote Sugar Refinery PLC	13.80	16.55	2.75	19.93
Royal Exchange PLC	37.85	43.50	5.65	14.93
Trans-Nationwide Express PLC	0.90	0.99	0.09	10.00
Okomu Oil Palm PLC	49.65	54.50	4.85	9.77

The laggards were led by Law Union & Rock Insurance Plc (-22.54%), Chams Plc (-21.05%), Arbico Plc (-18.79 %), Fidson Healthcare Plc (-17.33%) and GlaxoSmithKline Consumer Nigeria Plc (-12.50%).

TOP 5 LOSERS (N)

Company	Dec. 02'19	Dec. 12'19	Absolute Change	% Change
Law Union & Rock Insurance PLC	0.71	0.55	-0.16	-22.54
Chams PLC	0.38	0.30	-0.08	-21.05
Arbico PLC	4.79	3.89	-0.90	-18.79
Fidson Healthcare PLC	3.75	3.10	-0.65	-17.33
GlaxoSmithKline Consumer Nigeria PLC	6.00	5.25	-0.75	-12.50

Outlook

We expect sell pressures to push the index down in the near term as traders book profits to meet their needs for the festive period.

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Fleet Management

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- Reverse camera alarm system
- Vehicle Video surveillance
- Fuel Monitoring
- Drivers Behavioral Assessment
- Real time asset monitoring via mobile and web

Citracks Office
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Obanikoro, Lagos
09060005036
07031700000

C&I Leasing Plc HQ
Leasing House, 2 Leasing Drive,
Off Bisola Durosinmi Etti Drive,
Off Admiralty Way, Lekki
Phase 1, Lagos
09038869179-88

C&I Leasing Plc PH
C&I Leasing Drive
Off Elekahia-Oginigba Link Road,
Transamadi Industrial Layout
Port Harcourt
08093909250; 09037793335

C&I Leasing Plc Abuja
2nd Floor Nigerian Reinsurance Building
Plot 784a, Beside Unity Bank
Herbert Macaulay Way,
Central Business District, Abuja
08093928502; 09037761303

citrack.support@c-ileasing.com
www.c-ileasing.com

Corporate Focus: Lafarge plc

Analyst Recommendation: HOLD

Market Capitalization: N223.90 billion

Recommendation Period: 12 months

Current Price: N13.9

Industry: Industrial

Target Price: N14.97

Analyst note

Prolonged rainy season dampens revenue

Lafarge's 9M'19 revenue fell by 30.41% to N163.06 billion compared to N234.30 billion in the corresponding period of 2018. The sharp decline could be partly attributed to longer than expected rain during the period. This affected construction and consequently, the demand for cement dropped. As the rainy season is over, we expect an improvement in the financial performance of the company.

Improved cost efficiencies

Lafarge reported a positive operating profit of N35.54 billion in its 9M'19 financials relative to N19.13 billion reported in the same period in 2018. This is due to a decline of 28.42% in selling and distribution expenses and a sharp decline of 59.89% in administration expenses.

Lower finance cost pushed earnings higher

Lafarge Plc recorded a sharp decline in its finance cost. In 9M'19 the finance cost declined by 52.54% to N16.58 billion from N34.93 billion in the corresponding period in 2018. The lower finance cost reported during the period was due to the company's divestment of its South Africa Holdings (LSAH). The proceeds from the sale of LSAH were used to pay off some carry over debt. Consequently, the company's profit before tax increased sharply by 240.24% to N20.14 billion from a loss before tax of N14.36 billion in the same period in 2018. Likewise, the company's profit after tax increased by 298.33% to N20.57 billion from a loss before tax of N10.37 billion in 9'M 18.

Cement continued to dominate the company's revenue mix (80%), with aggregate, concrete and other admixtures accounting for the rest (20%). Its Nigerian operation accounts for more than 70% of the group's revenue, pointing to the importance of the Nigerian market to Lafarge.

Although Lafarge recorded low revenue, the leverage position of the firm and expectations of stronger margins bode well for future earnings growth. In addition, using intrinsic valuation and taking into consideration its divestment from its South African subsidiary, we place a HOLD rating on Lafarge Africa Plc.

Industry and company overview

Government involvement in the cement industry remains a net positive

Cement manufacturing grew by 6.87% in Q3'19, an improvement over Q2'19 of 1.58% despite heavy rainfall during the period. The top three players, Dangote Cement, Lafarge Africa and Cement Company of Northern Nigeria (CCNN) account for over 90% of the industry's capacity.

The government's focus on local content has rubbed off positively on the cement industry. As a result, Nigeria moved from a major importer of cement to a net-exporter, thereby improving its current account balance and foreign exchange position. The increased investment has also seen productivity and resource utilization improve over time.

The wide infrastructure gap remains a double edged sword. Cement producers looking to fill the demand-supply gap have had to invest extensively in equipment, transportation, and power, to facilitate the production process. This has put considerable pressure on margins, extending the breakeven period of most cement manufacturers. To a lesser extent, competition from unbranded imports has also threatened margins, limiting the potential of price increases. However, cement prices increased from a low of N1,400 a bag to as high as N2,500 a bag in 2017, owing to the gas constraints, a major input in the production of cement. Cement prices have remained sticky downwards so far in 2019, despite the improvement in constraints, hovering around N2,550 a bag.

The cement industry remains a highly capital intensive investment, but the business opportunity from the federal government's attempts to narrow the infrastructure gap has been a key motivator for the continuous capacity expansion of dominant players such as Dangote and Lafarge. The government's proposed capital expenditure in 2019 increased by 1.02% to N8.92 trillion in the 2019 budget.[19]

[19]African Development Bank. 2018. "African Economic Outlook". https://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/African_Economic_Outlook_2018_-_EN.pdf

Lafarge's acquisition strategy, a major asset

Lafarge (formerly Lafarge Cement WAPCO Nigeria Plc) is a subsidiary of LafargeHolcim, the largest cement company in the world. Lafarge Africa has extensively leveraged the expertise and resources of its parent company to penetrate the Nigerian market. It has grown to be one of the leading cement companies in Nigeria with a diverse product mix to cater to the needs of customers across different construction and building activities.

The company's operating segment comprises of cement, aggregates and other construction materials like ready-mix concrete and asphalt among others. Lafarge's aggressive acquisition strategy has facilitated its impressive growth. The most notable acquisitions are Ashaka Cement and United Cement Company of Nigeria ltd (UNICEM). These acquisitions have helped improve its competitiveness in the industry dominated by Dangote Cement.

Income Statement for Lafarge Africa Plc					
N'000	2014	2015	2016	2017	2018
Revenue	260,810,463	267,234,239	219,714,112	299,153,305	308,425,456
Cost of sales	(177,782,717)	(184,703,341)	(179,052,422)	(248,393,638)	(238,742,586)
Gross Profit	**83,027,746**	**82,530,898**	**40,661,690**	**50,759,667**	**69,682,870**
Selling and distribution expenses	(3,915,635)	(4,482,752)	(3,355,737)	(3,685,666)	(7,732,817)
Administration expenses	(25,145,779)	(26,402,625)	(23,737,111)	(41,594,520)	(38,523,225)
Net other operating income	(2,618,057)	(11,159,543)	(1,128,928)	2,406,025	1,383,985
Operating Profit	**51,348,275**	**40,485,978**	**12,439,914**	**7,885,506**	**24,810,813**
Net finance cost	(11,265,533)	(11,211,109)	(35,246,106)	(41,777,520)	(44,253,886)
Share of loss fom JV using equity method	-	-	(12,526)	(140,263)	(65,155)
Finance income					
Profit Before Minimum Tax	**40,082,742**	**29,274,869**	**(22,818,718)**	**(34,032,277)**	**(19,508,228)**
Minimum tax	-	-	(271,163)	(287,672)	-
Profit After Minimum Tax	**40,082,742**	**29,274,869**	**(23,089,881)**	**(34,319,949)**	**(19,508,228)**
Tax credit/(Tax expense)	(6,537,761)	(2,276,596)	39,988,662	(281,460)	10,706,502
Profit After Tax	**33,544,981**	**26,998,273**	**16,898,781**	**(34,601,409)**	**(8,801,726)**

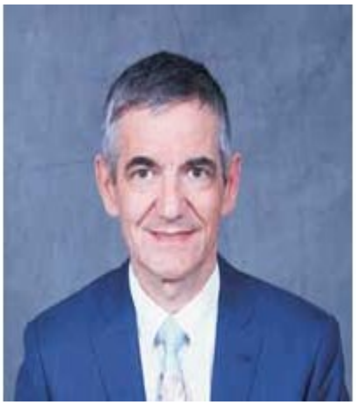
Management

Owing to the acquisition of some of its competitors, such as Ashaka and UNICEM, Lafarge's board of directors is comprised of seasoned professionals with diverse competencies and affiliations. The strategy of the team is to maintain a diverse spread of manufacturing plants across northern and southern Nigeria with a focus on proximity to raw materials. This helps the company to maintain its local appeal as well as reduce inbound logistics for the cement plants. The synergies of the merger with Ashaka and UNICEM are yet to materialize, as management has struggled to keep costs down. However, the consolidation and fundraising expenses are considered one-off costs.

Lafarge's management team is currently led by Michel Puchercos, who started with Lafarge in 1982. He has a proven record of dramatically improving business results through change management practices and process standardization. His stewardship is particularly important now as the management works to consolidate stakeholders' interests and return the company back to its winning ways, following its intensive acquisition period.

Mobolaji Balogun, Lafarge's Chairman, has been on the board of Lafarge since 2005. He is an astute executive with over 28 years of experience in investment banking and mobile telecommunications. Having served on numerous boards in various capacities, Mr. Balogun has leveraged his domestic network and parent company to ensure the company remains a dominant player in the cement industry.

Going forward, the ability of the management to contain cost will tremendously affect the intrinsic value of Lafarge and rekindle investor interest in the stock.



Managing Director

Michel Puchercos

Chairman

Mr. Mobolaji Balogun

What the bulls and bears say

Bulls say:

- Diversified products with strong brand equity
- Strong global brand (LafargeHolcim)
- Good market position
- Wide distribution network
- Product portfolio remains a pivotal input to narrowing the country's infrastructural gap
- Impending increases in Nigeria's infrastructural spend – roads and railway network
- High housing deficit
- Divestment of Lafarge South Africa Holdings
- Capacity expansion for economies of scale
- Positive but slow economic recovery in Nigeria

Bears say:

- Multiple mergers and acquisitions – increasing synchronization cost
- High operating cost environment squeezing profit margins
- Drop in volume sales across business units coupled with aggressive competition to gain market share
- Price taker due to the dominance of the industry leader in Nigeria

Risk and Outlook

The major risks that could prevent Lafarge Africa from achieving its goals of boosting earnings, increasing sales and managing costs is its exposure to credit, liquidity and market risk (currency and interest rate) arising from financial instruments.

Another cause for concern is the cost of synchronizing stakeholder interest. The management will be saddled with the responsibility of aligning stakeholders with diverse cultures and backgrounds. As a result, there might be a delay in the fruition of a synergy in the short-term.

Appendix - Valuation

We derived our valuation for Lafarge Africa Plc by using the Discounted Cash Flow (DCF) methodology. Our fair value estimate per share for Lafarge stood at N14.97, which is a 7.70% upside on its current share price of N13.9 as at December 19, 2019. The discount rate [weighted average cost of capital) of 18.1% is derived using a 14.55% risk free rate, a beta of 0.7497, and a market risk premium of 7.64%. The calculated long-term cash flow growth rate to perpetuity is 2.5%.

We therefore place a HOLD on the shares of the company at the current market price.