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In This Issue ...

Justification for a Cut to the Monetary Policy Rate in a High Inflation Environment

Nigeria's Monetary Policy Rate (MPR), i.e. the cost of obtaining funds from the Central Bank of Nigeria (CBN), needs to be reduced significantly to expand the country's economic output. The MPR correlates directly with lending rates of commercial banks and when it is high (it's currently at 14%), it results in exorbitant borrowing costs for the banks, and their private business customers. While everyone desires reduced interest rates, the fear of the possible inflationary impact associated with an MPR cut keeps the rate high and thus, limits private borrowing. In the short-term, a reduced MPR may be inflationary as access to cheaper money increases consumption and demand in an environment where the market does not have enough goods and services. However, rising prices will be short-lived and soon corrected by lower prices through a medium-to-long term output expansion. Increased private borrowing will support growth resulting in the increased production of goods. Without a reduction in the MPR, Nigeria's double-digit inflation rate will continue in the medium-term, with only marginal monthly declines.

The need to cut the Monetary Policy Rate

In the short-term, the concern is that lowering interest rates will make access to borrowing cheaper, and lead to an increase in consumption and aggregate demand. This higher demand will lead to an increase in prices as goods and services become scarce (inflation). This has, so far, made the prospect of a rate cut unwelcome since the economy already sustains a high inflation rate. However, sometimes more pain is required to see positive results. To use an analogy, one who is suffering from a fracture or dislocation might have to endure greater pain while his bones and joints are being fixed. In the end, however, he will be able to regain mobility that would not be possible if no intervention had been taken. By not addressing the MPR, the Monetary Policy Committee (MPC) is avoiding its role in resetting the broken bones of the economy.

Apart from serving as an incentive for borrowing, a reduction in the key lending rate will also reduce the level of non-performing loans in the banking system from the present 15%, as it becomes cheaper for money borrowers to refinance their loans. The ability of borrowers to repay will lead to a decline in banking firms' costs and widen their expansion prospects.

Potential impacts of a Monetary Policy Rate cut

In the short term, the economy may have to trade-off between lower interest rates and a higher inflation rate when the MPR is lowered. Part of the cheaper borrowings will be channeled to household spending, which will lead to an increase in demand on aggregate. Competition for goods and services will increase prices, which will lead to a higher inflation rate. Consumers' income will be able to buy fewer goods and services with the money they have.

In the long run, however, private business expansion via borrowings will increase the volume of goods and services available in the economy. The increase in aggregate supply will reduce prices of domestic commodities. A larger volume of locally produced goods will also reduce the need for imports. Hence, there will be less imported inflation. The combination of higher domestic production and fewer imports will bring prices down. This will offset the earlier loss in real income when the MPR was first cut.

Evidence from African Peers

Nigeria's peers on the African continent that have recently cut rates have seen a decline in their rates of inflation, while at least one that has maintained the status quo, like Nigeria, has seen its prices rising.

Ghana cut its MPR three times since January 2017. It was at 25.5% in the first month of the year, and subsequently through to August, the rate was lowered by 450 basis points (bps). The year-on-year Gross Domestic Product (GDP) growth rate, which stood at 4.5% in the fourth quarter of 2016, increased to 6.6% in Q1'2017, and thereafter to 9% in Q2'2017.[2] The inflation rate in January was at 13.3%, easing to 12.3% in August.[3] This might have been a result of an expansion in economic output driven by access to cheaper borrowings. It is also worth mentioning that domestic prices in African countries are usually largely determined by the exchange rate as well. Theoretically, prices generally increase when the currency has lost value due to higher import costs. However, despite the fact that the Ghanaian cedi lost 3.66% year to date,[4] its inflation rate has been easing. Zambia equally cut rates three times in the past year. In September 2016, its MPR was at 15.5%. As of August 2017,

[1] Bank of Ghana. 2017. "Monetary Policy Reports". Government of Ghana. https://www.bog.gov.gh/monetary-policy/monetary-policy-reports
[2] Ghana Statistical Service. 2017. "Gross Domestic Product (GDP)". Government of Ghana. http://www.statsghana.gov.gh/gdp_revised.html
[3] Ghana Statistical Service. 2017. "Consumer Price Index (CPI) Press Releases". http://www.statsghana.gov.gh/cpi_release.html
[4] Bloomberg. 2017. "USDGHS Spot Exchange Rate. Bloomberg. https://www.bloomberg.com/quote/USDGHS:CUR.

its MPR had also been cut by 450bps to 11%.[5] Between these periods, the inflation rate significantly declined from 18.9% (double-digit) to 6.3% (single-digit).[6]

Conversely, on the eastern part of the continent, Ethiopia has maintained the status quo like Nigeria, since January 2017.[7] Its inflation rate has increased from single to double digits. It was at 6.1% in January, and as of August, it grew to10.4%. [8]

These examples demonstrate that maintaining the status quo does not necessarily translate to an easing of inflation, while a policy of lowering interest rate does not always cause higher consumer prices.

Conclusion

There is a lot to gain from reducing the MPR in Nigeria as the increase in prices that may accompany it will still be outweighed by a long run decline. The idea of enduring more pain to assuage an existing pain could be a strategic directive in Nigeria's macroeconomic modeling. The country needs to take a different approach in order to avoid being stuck on a path of taking the same measures with the same results. The past year has demonstrated that keeping the MPR constant has not effectively driven the

[5] Bank of Zambia. 2017. "Monetary Policy Committee Statement…". Government of the Republic of Zambia (GRZ)". http://www.boz.zm/news-and-publications.htm.
[6] The Republic of Zambia Central Statistical Office. 2017. "Monthly Bulletins". Government of the Republic of Zambia (GRZ). https://www.zamstats.gov.zm/index.php/publications/category/1-monthly-bulletin.
[7] National Bank of Ethiopia. 2017. "Monetary Policy Framework of Ethiopia". The Government of Ethiopia. http://www.nbe.gov.et.
[8] Central Statistical Agency. 2017. "CPI-2017". The Government of Ethiopia. http://www.csa.gov.et/index.php?option=com_phocadownload&view=category&id=341:cpi-2017&Itemid=146.

Nigeria needs more Policies and less of Politics

There are very few things as riveting as national elections in Nigeria. Sadly, one of the most common characteristics of Nigerian elections is the lack of detail of prospective policies from politicians, compounded by poor analysis from the media. Politicians often make pledges to fight corruption, create jobs and achieve impactful economic growth. However, they stop short of providing details of substantive policies that can be criticized or held accountable to their campaigns. In turn the media feeds these superficial campaigns, spending more time on personalities, religious and tribal affiliations than it does on pressuring politicians to bring substance to the table. As a result, voters do not get to debate them on details such as funding for proposed budgets, labor market reform, restructuring etc. A more mature democracy would have checked these electoral frailties, but in Nigeria, neither voters nor politicians seem ready for change. Citizens need to demand more from the political class. The focus of political discourse needs to shift from "what" will be done, to the more critical "how" it is going to be done.

Same goal, different strategy

Mature democracies understand the role of party manifestos in their campaigns, and traditionally present policies in line with their ideologies. The last U.S election was arguably one of the most contentious and divisive elections in the country's modern history. Both of the main candidates made similar pledges to make "America great again" but as they say, the devil is usually in the details. A good distinction was their respective positions on tax reform. President Donald Trump pledged to cut taxes for all income brackets, while Hilary Clinton wanted to raise taxes for high income households.

The goal in both cases was to boost the economy by putting more money in the hands of the people. Both candidates had different "hows" to the same "what". They tabled their arguments about the financial costs to government and benefits – short and long term – to the citizens. The end game is to improve welfare. Voters in the U.S as well as politicians are cognizant of this and the ability to better articulate the 'how' is usually where elections are won and lost.

Globally, some of the most crucial yardsticks for measuring political performance are jobs and inflation. The Misery index captures this. It measures economic well being by adding seasonally adjusted inflation to the rate of unemployment. History has shown that, a rising misery index typi-

cally reduces the likelihood of the incumbent being re-elected. The misery index has accurately predicted nine of the last thirteen elections in the U.S. Informed voters are simply much more sensitive to the economy and the "how" of making it better for even future generations.

The Nigerian voting culture is different but not for the right reasons. Such details of economic or foreign policy do not motivate the average Nigerian voter. A significant proportion of the electorate would rather vote along religious and ethnic lines.

Many politicians do not recognize the need to show up to publicly televised debates to properly articulate their policies. Perhaps because they know Nigerians are typically moved by grandiose promises; the more ambitious, the greater the appeal. A Nigerian political manifesto seldom includes details like '5% cut in the tax rate for those with annual incomes below N1 million for the next five years, to be funded by increased VAT on luxury goods from 2019'. To stand a better chance of winning at the polls, the Nigerian politician would rather pander to

jostling that come with the elections. Not enough attention is given to details of past or proposed policy. And even when the past is considered, it is done with a focus on grand infrastructure projects.

The Turning Point

A number of questions do arise. How did mature democracies become mature? Do democracies simply just become more mature with time or is there a catalyst to this transition?

The answers lie in the accountability nexus between democratic representation and taxation. The well established connection is simple. No taxation without representation. The higher the taxation, the greater the reason for taxpaying citizens to demand good governance. In the same way, the lower the level of taxation, the less likely citizens will demand representation. Taxation therefore, stands as the anchor for democracy and democratic accountability

Nigeria is a text-book case of limited state dependence on taxes leading to bad governance outcomes. At approximately 6% of GDP, Nigeria's tax revenues are one of the lowest in the world. Decades of a reliance on petrodollars engendered a culture where governments had little incentive to be accountable, responsive, or efficient. Worse still oil rent meant less need for tax revenues and no need to secure large tax bases or enforce tax compliance over the years.

However, for Nigeria, the plunge in oil prices and the accompanying revenue shortfall may just have come with a silver lining – renewed aggression in tax collection and broadening the tax base. Perhaps the time has finally come for the Nigerian voter to hold the politicians to a higher standard.

A shift to Ideology

Aside from the obvious benefit of demanding that our politicians present more than impractical promises, comprehensive policies allow citizens to align their desires of advancing their economic welfare with the economic ideologies of political parties. For a change, voters will be more likely to identify along policy lines rather than tribal lines that is Southern voters may find themselves in agreement with a Northern politician on his/her position on the national minimum wage or education reform or even resource control. The opportunity this approach offers is one where citizens embrace their similarities and differences on issues other than ethnicity and religion.

Taxation may not be a silver bullet, but perhaps the shift to a dependence on tax revenues will alter the political discourse and uplift the level of policy discussion that will transform the polity. The voting taxpayer must simply demand that it does.

How important is the Ease of Doing Business to Nigeria?

Nigeria scaled up 24 spots in the Ease of Doing Business Index, moving from 169th (out of 190) to 145th on the rankings.

The Ease of Doing Business is an index, developed by the World Bank, that scores and ranks countries based on how easy it is to set up and operate a business there.

Topic	Nigeria's ranking 2018	Nigeria's 2017 ranking	Who ranked first in the world?	Who ranked first in Sub-Saharan Africa?
Overall	145	169	New Zealand	Mauritius
Starting a Business	130	138	New Zealand	Niger
Dealing with Construction Permits	147	174	Denmark	Mauritius
Getting Electricity	172	180	UAE	Mauritius
Registering a Property	179	182	New Zealand	Rwanda
Getting Credit	6	44	New Zealand	Zambia
Protecting Minority Investments	33	32	Kazakhstan	Rwanda
Paying Taxes	171	182	UAE	Mauritius
Trading across Borders	183	181	Demark	Swaziland
Enforcing Contracts	96	139	Korea, Rep.	Mauritius
Resolving Insolvency	145	140	Japan	Mauritius

Source: World Bank, Doing Business

Nigeria recorded progress in 8 out of 10 topics. Accordingly, Nigeria is amongst the 10 most improved countries for the 2018. The most notable increases were made in the ease of getting credit, enforcing contracts and dealing with construction permits topics.

The rising prominence of credit bureaus and the increased sophistication of the identity authentication system (Sim card registration, Bank verification number and national identity card) contributed to Nigeria's jump in this index to 6 from 44. This reduced the risk associated with lending, boosting credit availability. However, the net credit to the private sector from DMBs has contracted this year, due to high interest rates. This means that the large portion of credit available

to businesses comes from Microfinance Banks and other non-bank financial institutions.

Also contributing to this improvement is the effective implementation of the goals laid out in the Economic Recovery Growth Plan (ERGP). The move from traditional means of registering a company (with papers) has been replaced with online processes. New companies can confirm name availability, get all the information needed, and download and submit registration forms – all online! Other notable changes are: introduction of the visa-on-arrival option, airport infrastructure development and the removal of baggage-check post in the checking-in process.

Why is a business friendly environment so important?

The Ease of Doing Business is indicative of how favorable an economy is for business operations. These are important considerations for Foreign Direct Investors who are not only interested in the macro-economy but are also interested in the existing regulatory framework, policy and security. Essentially, these investors are interested in anything that can affect the success of their investments.

This brings up the issue of competitiveness.

SSA Country	Ease of Doing Business - SSA Rank	Ease of Doing Business - Global Rank	GDP Growth (%) (Q2'17)	Inflation (%) (Sept'17)	YTD Currency Movement
Rwanda	2	41	4	7.10	-3.52
Kenya	3	80	5	5.72 (Oct)	-0.8
Botswana	4	81	1	3.20	1.23
South Africa	5	80	1.10	5.10	-1.64
Ghana	12	120	9	12.20	-2.26
Nigeria	21	145	0.55	15.98	-11.6

Table comparing SSA countries, across the three major regions (South, East & West Africa), using variables important to investment considerations. The Currency Movement column records the YTD gains and losses in the Spot Exchange Rate. Sources: Bloomberg, World Banks, Trading Economics.

When international organizations are looking to enter into a new region, they examine a wide range of variables such as size of potential market, and the ease of doing business. Investors are looking to avoid markets with a strong presence of politics & bureaucracy, coupled with high operating costs.

In West Africa, for example, Nigeria's growing middle class may attract a global organization that manufactures and sells clothing. However, Nigeria's poor score on ease of getting electricity and trading across borders could deter such an organization. Alternatively, Ghana, which not only performs better on these fronts, but also boasts of a stable exchange rate and faster economic growth (9% in Q2'2017), might prove a preferred market.

The above also applies to investments by domestic businesses. The tough regulatory environment forces businesses to stay small and in the shadows. This is one of the reasons why Nigeria has one of the largest informal economies.

Gross fixed investments make up 14.5% of Nigeria's total GDP. Investments possess the multiplier effect that has the ability to affect other components of the national identity equation. For example, increased investments into domestic sectors with export potential could boost forex earnings and create more jobs. This could, in turn, have positive implications for private consumption.

In summary, the friendlier an economy is to business operations, the more attractive it is for investments, which is a vital catalyst of economic growth and development. Therefore, Nigeria's rise in the Ease of Doing Business Index is laudable and positive for the recovery path.


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Floating exchange rate can cause big trouoble

A Harvard economist argues that the benefits of a flexible currency are oversold.. ***By Peter Coy***

In the eyes of the International Monetary Fund, a country that allows the value of its currency to be determined by supply and demand is demonstrating financial maturity. “Emerging market countries need to consider adopting more flexible exchange rate regimes as they develop economically and institutionally,” said a 2004 IMF paper whose lead author was the organization’s former chief economist, Kenneth Rogoff of Harvard. The IMF’s World Economic Outlook, released this month, says the commodity price bust has been harder on commodity exporters with pegged currencies than on ones with flexible exchange rates, which were able to shore up their economies without running up budget deficits or running down currency reserves.

Yet a new paper by Harvard economist Gita Gopinath argues that some of the benefits of flexible exchange rates have been overstated. The conventional thinking is that a small country can boost growth by letting its currency depreciate because doing so makes its goods cheaper in world markets. But Gopinath cited new research showing that’s mostly not the case, at least in the short run, given that exports tend to be invoiced in dollars rather than the local currency. As a result, the argument for letting currencies float is “worse than you think,” Gopinath said in presenting her research at an Oct. 14 conference organized by the Peterson Institute for International Economics.

The fixed vs. floating debate goes back to the earliest days of the IMF, which was conceived in 1944 when the value of the dollar was still pegged to gold. The IMF’s advice has varied over the years as economic thinking has evolved. In 1953 the libertarian economist Milton Friedman invoked the concept of daylight saving time in a paper titled The Case for Flexible Exchange Rates. In theory, he wrote, everybody could decide individually to get up and go to bed an hour earlier in the summer, when the days are longer, but it’s more convenient to change the clock so everyone does it at once. Similarly, he wrote, if the prices of a country's goods and services get out of line with those in the world market, "it is far simpler to allow one price to change, namely, the price of foreign exchange, than to rely upon changes in the multitude of prices that together constitute the internal price structure."

The opposite solution is to surrender monetary independence. For example, Ecuador, Panama, and El Salvador have adopted the U.S. dollar; and Kosovo and Montenegro, the euro.

It's the in-between countries—the ones that keep their own currencies but try to control their value—that face difficulties. A nation trying to defend an overvalued exchange rate can be overwhelmed by speculators who bet against it, as happened in 1992, when investor George Soros "broke" the Bank of England by forcing it to withdraw from the European Exchange Rate Mechanism, a precursor to the euro. Many economists have argued that currencies should be fully floating if they aren't inalterably fixed. When Stanley Fischer was first deputy managing director of the IMF in 2001, he wrote that the trend away from softly pegged exchange rates "appears to be well established," adding, "this is no bad thing."

But Gopinath and other speakers at the Peterson Institute event emphasized that many countries remain in the murky middle—neither fully floating nor fully fixed—and that this is likely to persist. "The world is messy," said Raghuram Rajan, an economist at the University of Chicago's Booth School of Business, who was governor of the Reserve Bank of India from 2013 to 2016. India lets its currency float but sets a target for the inflation rate.

By the IMF's reckoning, about 40 percent of its member nations have "soft pegs." That's an understatement because many countries that say they don't have pegs in fact do, says Harvard's Carmen Reinhart, who spoke at the Peterson conference and is co-author of a 2000 paper called Fear of Floating. Also, she points out, the IMF categorizes all members of the euro zone as floaters, even though they don't float vs. one another.

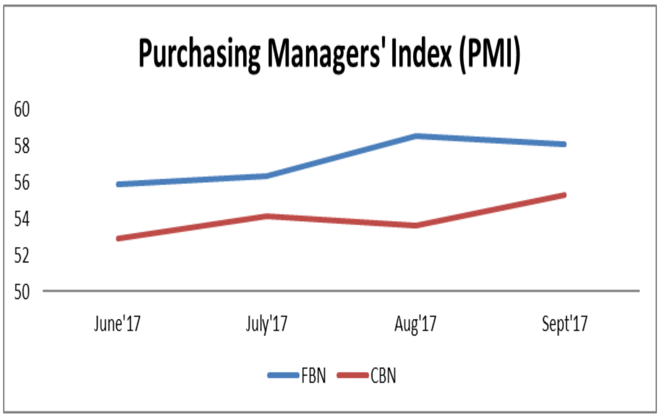
Floating exchange rates can be lethal to small countries. When a currency appreciates, it can encourage inflows of hot money that create asset bubbles. Then, when investor sentiment changes, the sudden capital outflows can trigger a recession. That's why few countries are willing to take a laissez-faire approach. Echoing Reinhart, Gopinath concluded: "Once you include all the other arguments for the disruptive effects of exchange rate flexibility in emerging markets, the rationale for 'fear of floating' is strengthened."

BOTTOM LINE -

Although free-floating exchange rates are generally regarded as a mark of a mature economy, a paper makes the case that their benefits are overstated.

Purchasing Managers Index (PMI)

The CBN's PMI rose to 55.3 in September, from 54.1 in August. This is the 7th consecutive month of expansion reflecting the sustained effect of increased forex availability and accessibility.



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FBN's PMI declined for the first time, after 3 consecutive months of increase, to 58.1 from 58.5 in August. While this could just be market resistance as the index approaches a reading of 60, it also indicates the negative implications of the current high interest rate environment.

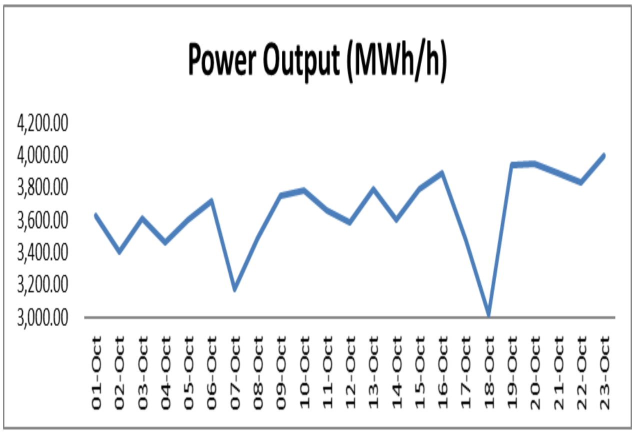
PMI measures expansion in the manufacturing sector. A reading above 50 indicates industry expansion, while a reading below 50 indicates contraction in manufacturing activity. Both FBN & CBN PMI remain well above the expansion threshold of 50

Outlook

We expect the manufacturing sector to remain in the positive territory supported by forex liquidity, stronger investor confidence, and import substitution.

Power Sector

The average on-grid power output from the national grid in October was 3,652.87MWh/h, 5.44% higher than September's average output of 3,464.43MWh/h. On October 23rd, power output reached a YTD high of 3,998 MWh/h. Persistent heavy showers which continued through the month led to an uptick in hydro-electricity, while stability in the Niger Delta region allowed gas to be supplied to GenCos without interruption. During the period, the sector lost approximately N26.7bn, compared to N27.55bn lost in the corresponding period in September.



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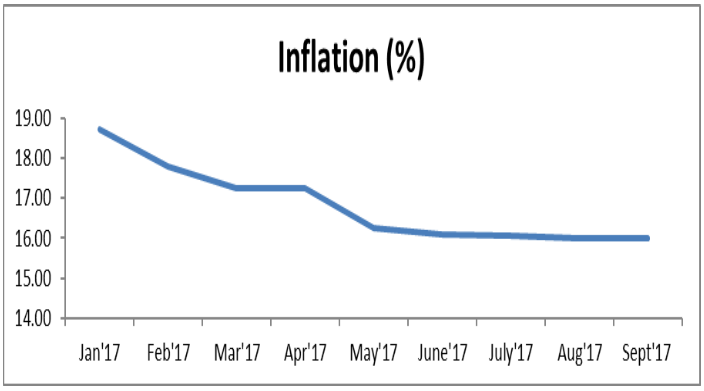
Outlook

The start of the dry season and resulting drop in rainfall levels will lead to a decline in hydro-power. Nevertheless, due to the relative peace in the Niger Delta, gas powered GenCos are expected to produce at full capacity in November. However, an average of 1500-2500MWh/h of generated power is projected to be lost in the next month at the transmission and distribution stages, due to inefficiencies and capacity failures.

[9] FBN, CBN, FDC Think Tank
[10] Nigerian Electricity Supply Industry

INFLATION RATE

Headline inflation eased marginally to 15.98% in September, declining for the eighth consecutive month in 2017, from 16.01% in August. The movement was driven by a fall in core-index and slowdowns in education, housing and electricity. Food index continues to face pressure, rising to 20.32% from 20.25% in August.



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Meanwhile, imported food inflation rose marginally to 31% from 29.8% in July, which could be linked to the recent depreciation in the exchange rate market

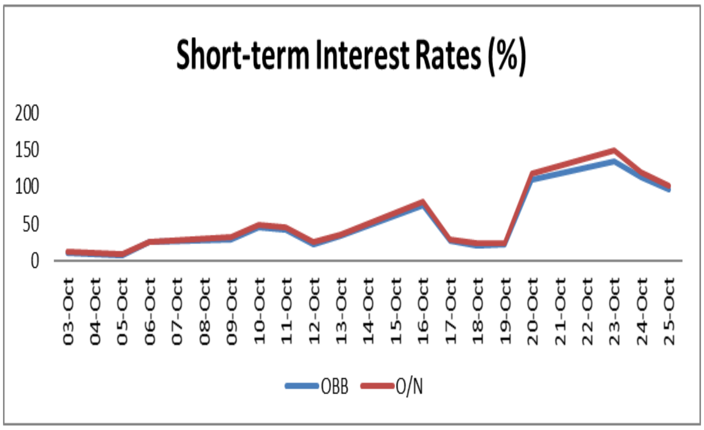
Outlook

The harvest season is expected to reach its peak in the next month, as such, food prices are expected to ease as a result of seasonality. However, as the festive season approaches, we expect an increase in consumer demand to push up prices. With these factors at play, headline index is expected to remain flat, with only marginal movements.

MONEY MARKET

Markets opened at N57.42bn long in October relative to September's opening position of N4.64bn long. Average liquidity in October (3rd-25th) was N156.44bn short relative to the average opening position in September of N61.19bn short. Reduced liquidity in the money market is attributable to a rise in OMO sales that amounted to a total of N732.84bn (N537.94bn in September). Average NIBOR (OBB, O/ N) was 50.2% in October compared to 16.97% pa in September. This reflects the naira shortage in the interbank money market. Short-term interest rates reached a four-month high of 113.33% and 148.33% (OBB, O/N respectively) on October 23rd, before simmering down to 96.67% and 101% on October 25th.

In the secondary market, yields on 91 and 182-day Treasury Bills averaged 18.27% as at October 25th. This is 13bps lower than the average yield of 18.14% on September 25th.



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[11] NBS FDC Think Tank
[12] CBN, FMDQ OTC, FDC Think Tank

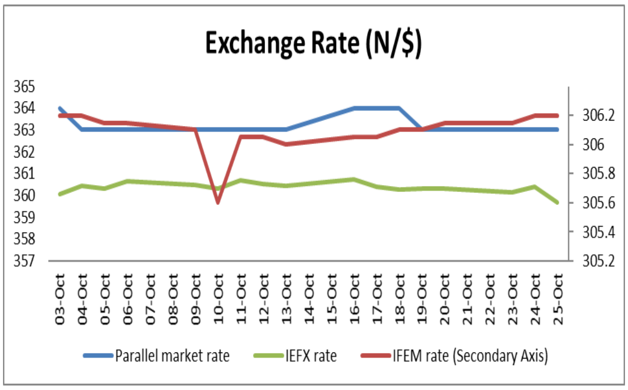
Outlook

Interest rates movements are a function of market liquidity. We expect the volatility in the interbank rates to remain driven by CBN OMO and forex sales, which mop up naira liquidity in the banking system. The Monetary Policy Committee (MPC) meeting is set to hold November. We do not expect the CBN to make any significant changes to its rates. However, there will be some signals that would indicate the apex bank's willingness to adopt a more accommodative policy stance, given the abated domestic bank credit and the FG's high debt burden.

FOREX MARKET

Exchange Rate

The Naira appreciated by 0.27% to N363/$ in October, from N364/$ at the beginning of the month. This is the market's response to reduced demand as off-peak season approaches. Likewise the IEFX window gained marginally to close at N359.68/$ on October 25th, from N360.07/$ on October 3rd. The IFEM rate closed at N306.2/$, the same rate as the opening period (October 3rd), although there were marginal fluctuations in the rate during the period.



[13]

Average daily turnover for the period stood at $240.98m, compared to $196.99m in the corresponding period of September. Total turnover for the period stood at $4.1bn, compared to the $3.15bn sold in September.

Outlook

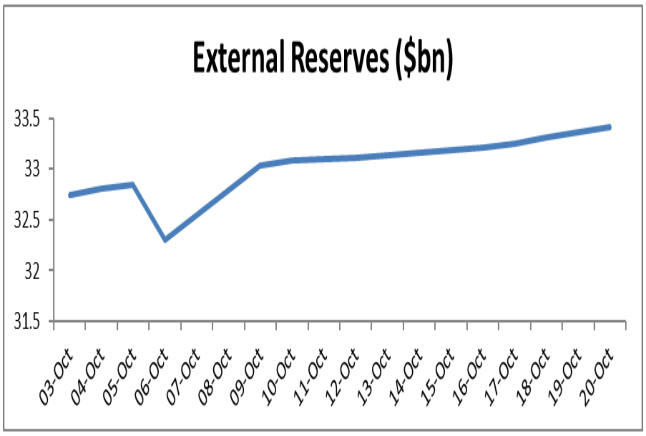
At the parallel market, we expect that strong demand pressure will weigh on the naira as manufacturers and traders build up inventories in preparation for the festive period. On the supply side, we expect the CBN to continue to intervene aggressively in the market. These two factors combined, will cause the exchange rate to remain flat in November within the range of N363-N364.50/$.

[13] Source: FDC Think Tank

External Reserves

Nigeria's gross external reserves gained 2.05% in the month of October, to $33.41bn on October 20th, from $32.74bn at the beginning of the month. This is the highest level since February 2015. Import and payment cover now stands at 9.28 months compared to 8.86 at the end of September.

The increase in forex inflows due to higher oil revenues and stronger investor confidence is the main factor responsible for the upward trend in the gross external reserves level.



[14]

Outlook

We expect the external reserves to maintain its pace of accretion, as the outlook for oil prices and domestic production remain positive.

[14] Source: CBN, FDC Think Tank

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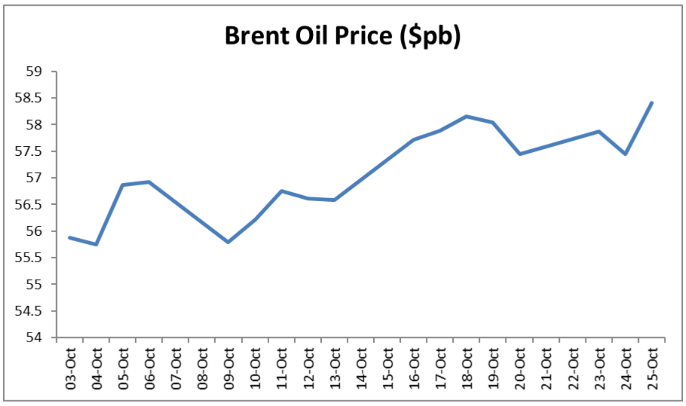
OIL PRICES

Oil prices averaged at $57.07pb from October 3rd-25th. This is 3.54% higher than the average of $55.12pb in the corresponding period in September. The rally in oil prices was primarily driven by geo-political tensions. Friction between Iraq's central government and the autonomous Kurdistan region, over the latter's independence referendum forced Iraq military to roll out an operation to reclaim Kurkik and other Kurds-held areas. This led to a decline in crude exports from Iraq, OPEC's second largest producer. Additionally, tensions arose between the US and Iran when President Trump accused Iran of failing to meet up with its obligations in the nuclear deal. Further complicating the issues, the US Congress approved resolutions designed to curb Iran's ballistic missile programme, and Hezbollah's funding. A breakdown in the bilateral relationship between the two global oil giants, could lead to the re-introduction of US export sanctions on Iran, removing up to 1 million barrels per day from the oil market. This will push up oil prices

Lastly, increased Chinese oil demand in the month contributed to the rise in prices.



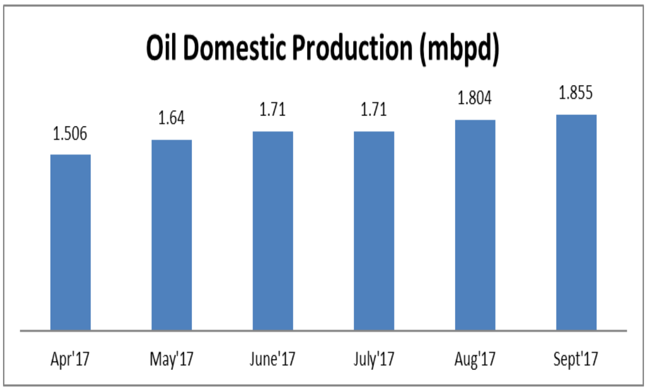
[15]

Outlook

In the last days within the review period, oil prices have inched lower due to increases in US inventories and production levels. Despite this, we maintain cautious optimism for oil prices. Our projection stands at $56-57/pb in November (avg).

Oil Production

According to OPEC's monthly report, oil production in Nigeria rose by 2.83% to 1.855mbpd in September from 1.804mbpd the previous month. The relative stability in the Niger Delta helped drive the output rise.



[16]

Outlook

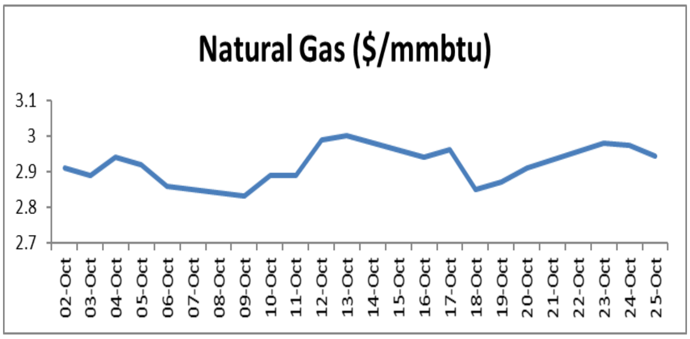
Oil production is expected to remain flat around current levels of 1.8 - 1.86mbpd in the coming months due to the OPEC production cap on Nigeria's output. If Nigeria doesn't comply with the cap, the country stands a chance of being included in OPEC cut in the bloc's December meeting.

[15] Source: Bloomberg, FDC Think Tank

[16] Source: OPEC, FDC Think Tank

Natural Gas

Natural Gas prices averaged $2.92/MMBtu in the period (October 3rd-25th), 2.99% lower than September's average of $3.01/MMBtu. This movement was driven by dampened global demand and expectations of higher stockpiles, as warm weather restricts need for the commodity.



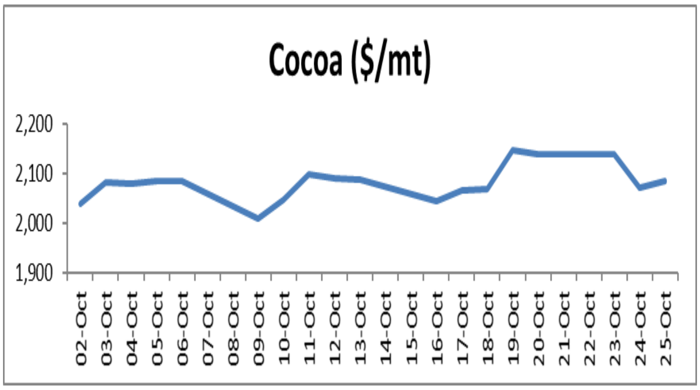
[17]

Outlook

According to the EIA, winter temperatures this year are projected to be 13% colder than 2016 – this will drive up the demand for natural gas for heating purposes.

Cocoa

Average cocoa prices increased by 4.68% to $2,080/mt in October (2nd-25th), compared to $1,987/mt in September. This is the fourth consecutive rise in monthly average prices after ample supply from the top 2 producers- Ivory Coast and Ghana caused prices to dip to year low. Prices reached a six-month high of $2,138/mt on October 20th. Climbing demand has brought back a measure of equilibrium into the cocoa market, especially as the Christmas celebratory season approaches.



[18]

Outlook

The bullish trend of cocoa prices is expected to intensify in the coming month. This will be driven by demand from chocolate and beverage producers. Total US spend on chocolate for 2017 is expected to reach $15bn.

[17] Source: Bloomberg, FDC Think Tank

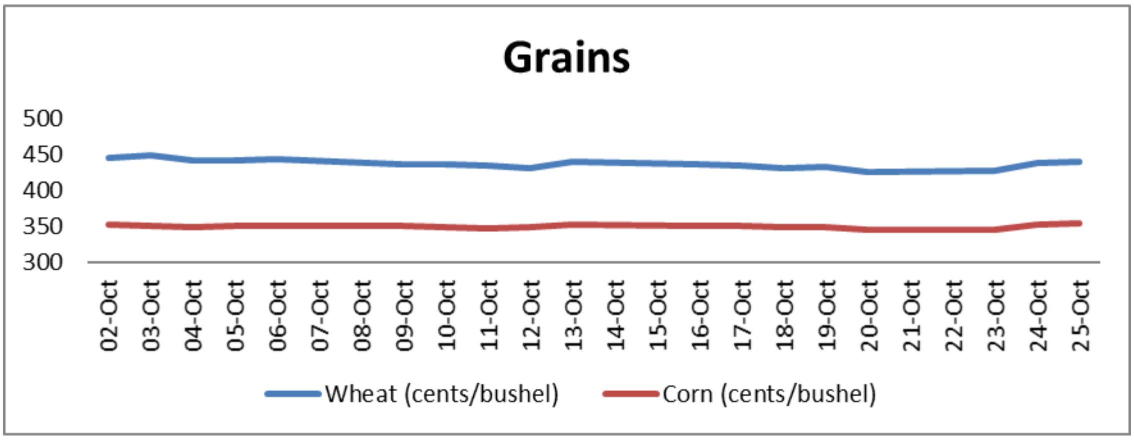
[18] Source: Bloomberg, FDC Think Tank

Wheat

Average wheat prices fell by 1.80% to $4.36/bushel in October (2nd-25th) from $4.44/bushel in the corresponding period in September. Wheat has lost 21.6% since its peak in July of $5.60. The price rally was driven by expectations of a fall in Australia's production as dry winds threaten to slash harvest. Nevertheless, ample global output continues to weigh down on prices.

Corn

Corn prices averaged $3.49/bushel in October (2nd-25th), compared to $3.53/bushel in September. The US corn harvest is gaining full momentum and flooding the market with the commodity, driving down prices.



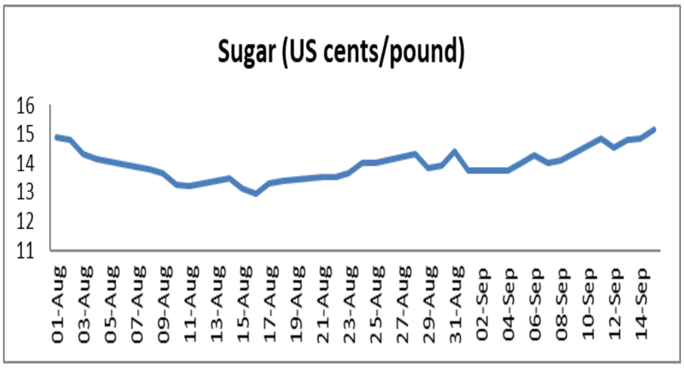
[19]

Outlook

The fundamentals in the grains market persist. Favorable weather and abundant supply continues to keep a lid on price. Thus, we expect grain prices to trade bearish in the short-term

Sugar

Sugar traded choppy during the review period (October 2nd-25th), reaching a high of $0.1439/pounds and a low of $0.1398/pound. Prices averaged $0.1417/pound, 2.27% lower than September's average of $0.1450/pound.



[20]

Outlook

A sharp dip in Brazil sugar output led to a rise in prices in the last couple of days of the review period. We expect this reduction in global supply to provide support to prices.

[19] Source: Bloomberg, FDC Think Tank
[20] Source: Bloomberg, FDC Think Tank

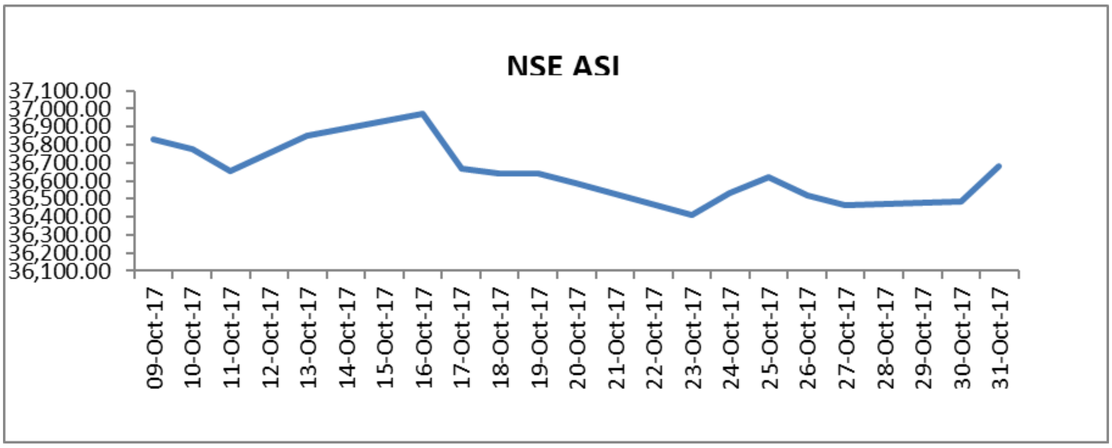
STOCK MARKET

Positive investor reaction to Q3 corporate results saw the NSEASI gain 3.89% to close at 36,680.29 points in the review period. The YTD return on the index increased to 36.49%, while market capitalization closed at N12.69trn. Market PE ratio stood at 12.49x.

The Nigerian equities market returned in the green in the month of October on the back of positive investor sentiment; dictated by the expectation and reaction to Q3 2017 corporate earnings.

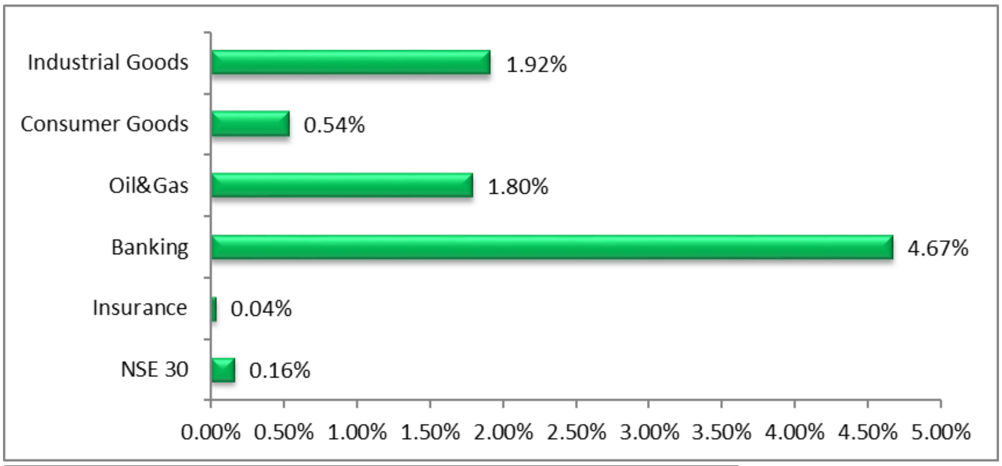
The market increased by 3.89% to close at 36,680.29 from the 35,306.09 points recorded at the start of the review period. The YTD return on the index increased to 36.49% while market capitalization closed at N12.69trn after it gained N52bn during the review period. The market is currently trading at a price to earnings ratio of 12.49x from 13.11x at the start of the review period. Activity on the bourse was mixed resulting in 11 days of gains against 10 days of losses. Daily changes, representing volatility on the ASI, ranged between -0.81% and 0.69% during the review period.

In October, performance across the NSE sub-indices was positive as all sectors closed higher. The banking sub-index performing the best, gaining 4.67%. The NSE 30 sub-index gained the least, increasing by 0.04% during the review period. The oil & gas sector recorded a strong performance, increasing 1.80%, in spite of the Oando debacle. The general performance of the sectors can be attributed to the largely positive Q3'17 results released in the month coupled with subdued sell pressures on most large-cap stocks.



[21]

SECTOR PERFORMANCE



[22]

[21] Source: NSE, FDC Think Tank

[22] Source: NSE, FDC Think Tank

TOP 5 GAINERS (N)				
Company	Oct 31'17	Oct 01'17	% Change	Absolute Change
TOTAL NIGERIA PLC.	345.00	295.00	16.95%	50.00
OKOMU OIL PALM PLC.	43.05	38.00	13.29%	5.05
TRANS-NATIONWIDE EXPRESS PLC.	1.12	1.00	12.00%	0.12
AIRLINE SERVICES AND LOGISTICS PLC.	2.20	2.00	10.00%	0.20

The best performing stocks for the month were TOTAL 16.95%, OKOMUOIL 13.29%, TRANSEXPR 12% and AIRSERVICE 10%.

TOP 5 LOSERS (N)				
Company	Oct 31'17	Oct 01'17	% Change	Absolute Change
NIGERIAN AVIATION HANDLING COMPANY PLC.	2.57	3.46	-25.72%	-0.89
GLAXO SMITHKLINE CONSUMERING PLC.	14.92	19.60	-23.88%	-4.68
FIDSON HEALTHCARE PLC.	1.27	1.66	-23.49%	-0.39
NEIMETH INTERNATIONAL PHARMA-CEUTICALS PLC	0.63	0.80	-22.89%	-2.60

Top price losers for the month were NAHCO (25.72%), GLAXOSMITH (23.88%) FIDSON (23.49%) and NIEMETH (22.89%).

OUTLOOK

With equities still looking attractive at current levels, we may see investors taking position, especially in stocks with good fundamentals, for year-end gains. This may result in the ASI inching up slightly in the month of November.

Who We Are

Avant-garde Academia Limited

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

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

OUR STRATEGIC PARTNER – ASCENT EDUCATION ADVISORS

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

What We Offer

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

Our Packages

Package 1: 8th to 10th Grade (Final 3-5 Years)

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

Package 2: 11th and 12th Grade (Final 1-2 Years)

This package is similar to Package 1 but is designed for students in the final two years of high school.

Package 3: (Per Application)

Unlike packages 1 and 2, package 3 only provides unlimited assistance with applications to pre-determined universities.

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

To attend one of our events, kindly contact or visit us at

9a Idejo Street, Victoria Island Lagos.

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

CORPORATE FOCUS :

UNILEVER NIGERIA PLC.

Analyst's note

Improvement in performance driven by price hikes

In H1'17, Unilever Nigeria posted a 39.7% improvement in revenue to N45.11bn from N32.28bn. This impressive growth in year-on-year (YOY) revenue, on the verge of Nigeria's economic recovery, is due to price increases of key products in its business segments and the penetration of the personal and home care segments. The successful ability to charge higher prices during this period of fragile growth affirms the confidence consumers and customers have in the company. The company is on track to ending the year on a good note.

Even more impressive in the performance in H1'17 is the N3.68bn profit after tax (PAT), up 236.1% from N1.1bn in H1'16. This astronomical growth can be attributed to a reduction in marketing and administration costs, which declined by 16.77% to N5.51bn from N6.69bn, against an increase in revenue. As a result, marketing and administration costs to sales ratio fell to 12% from 21% in H1'16.

H1'17 revenue breakdown confirms that Unilever Nigeria expanded all its business segments, as food grew by 23%, home care by 63% and personal care by 53%. The food segment, which recorded the least growth, maintained a substantial share of revenue, contributing 46% to revenue. Home care and personal care segments each contributed about 27% to revenue.

Analyst Recommendation:
HOLD
Market Capitalization:
N166.5bn
Recommendation Period:
365 days
Current Price:
N44
Industry:
Consumer goods
Target Price: N39.93

COST CONTAINMENT CONTINUES TO BE A CONSTRAINT

On the other hand, Unilever Nigeria has found the issue of cost control to be a herculean task, as production and distribution costs increased by 41.46% to N33.14bn from N23.43bn in H1'16. This was partly due to the increase in the cost of consumables and logistics. In addition, finance costs increased by 100% to N1.72bn from N0.89bn, due to high exposure to banks in the form of fixed interest rates in bank loans and overdrafts. Unilever Nigeria's bank exposure reduced in H1'2017 by 4.62% to N19.95bn, but its unhedged financial assets and liabilities increased by 39% (N13.9bn from N10bn) during the same period in H1'16.

In its bid to ensure some level of financial flexibility, Unilever Nigeria executed a rights issue to raise N58.9bn on the capital market in the second half of 2017. This allows the company to offset some of its foreign currency liabilities, meet its working capital requirements and provide shareholders the opportunity to consolidate their position in the capital market.

Based on the mixed signals in its performance, we recommend a HOLD on Unilever Nigeria stocks.

INDUSTRY AND COMPANY OVERVIEW

Unilever Nigeria is one of the longest serving fast moving consumer goods (FMCGs) companies in Nigeria, with over 12 household brands. It started operations as Lever Brothers Nigeria (West Africa Soap Company) Limited in April 1923, promoting community welfare and delivering superior service. Globally more than 6 in every 10 households make use of at least one Unilever product, with a range of over 400 brands.

Unilever Nigeria's products can be broadly categorized into three business segments: food products including tea, savoury and spreads; personal care products, including skin care and oral care products; and, home care products, including fabric care, household cleaning and water purification products.

Food Products

- Blue Band
- Knorr
- Lipton
- Royco

Personal Care Products

- Close Up
- Pepsodent
- Lifebuoy
- Lux
- Pears
- Vaseline
- Rexona

Home Care Products

- Omo
- Sunlight

Unilever Nigeria has maintained a terrific top line over the years, with a five-year compound annual growth rate (CAGR) of 4.67%. In contrast, its bottom-line has been less impressive, at a five-year CAGR of -11.31%, due to unsuccessful cost containment.

In its bid to reduce production cost, Unilever Nigeria partnered with sister companies in Ghana and Côte d'Ivoire to take advantage of large scale economies. This arrangement contributed about 2% to company revenue, increasing Unilever's FX earnings and access to cheaper raw materials.

FAST MOVING CONSUMER GOODS COMPANIES MOVE WITH THE TIME

Unilever, like other major import dependent manufacturers, have had to enter forward contracts to hedge against the volatility of the naira. This was partly due to the foreign exchange (FX) exposure of the company and the hesitation of the Nigerian money market to extend additional credit to finance private sector activities. Most banks preferred to invest in government securities with high returns and relatively lower risks.

The introduction of the Investors' and Exporters' Foreign Exchange (IEFX) window has somewhat eased importation costs for net importers like Unilever. The availability of foreign exchange in the market has eased the price pressures on the import of raw materials.

Half year results for most FMCGs show a remarkable improvement compared to the same period last year. Access to financing remained a general issue with these companies. Hence, leading FMCGs companies in Nigeria have resorted to raising funds through alternative means, such as right issues and convertible debt notes. This is because the growth potential of these companies far exceeds that of the economy. Yet, the growth recorded by these companies could not push the economy out of a slump.

MISALIGNMENT BETWEEN PARENT AND UNILEVER NIGERIA STRATEGIES

Unilever Nigeria's parent company, Unilever UK, has been known to pursue shareholders' returns by focusing on new product and emerging markets. This is because most of the parent company's products are at the maturity stage, experiencing lackluster growth. They have been known to push growth by investing and controlling medium size companies, aggressively cutting cost and improving efficiency of these acquisitions.

Outside the Nigerian market, Unilever has moved to gradually divest from its food brands, while focusing on its personal care and home care business segments.

Unilever Nigeria, on the other hand, has focused on short term growth with emphasis on operational intensity and cost efficiency to grow market share and reinvest in its iconic brands. This has been quite different from the parent's strategy. A move by Unilever Nigeria to divest from its food brand might prove to be catastrophic. Also, Unilever Nigeria hasn't embarked on expansion through acquisition of medium sized brands as excess capacity exists to grow organically.

This misalignment might imply that Unilever UK's objective is to grow Unilever Nigeria organically, until the market reaches saturation. Once saturation is realized the parent would assess the option of repositioning. The rate of innovation and the intensity of competition in the Nigerian market points to the need to reposition Unilever Nigeria if it is to maintain its long term relevance in Nigeria.

Income statement for Unilever Plc			
N'000	2012	2013	2014
Revenue	55,547,798	60,004,119	55,754,309
Cost of sales	(33,902,137)	(37,554,111)	(35,584,016)
Gross Profit	**21,645,661**	**22,450,008**	**20,170,293**
Selling and distribution expenses	(12,738,921)	(14,635,446)	(2,516,345)
Marketing and administrative expenses			(13,044,794)
Operating Profit	**8,906,740**	**7,814,562**	**4,609,154**
Finance income	107,867	163,470	168,462
Other income	(11,858)	(23,586)	-
Finance cost	(816,762)	(1,160,831)	(1,909,971)
Profit on disposal of property, plant and equipment			5,590
Profit Before Tax	**8,185,987**	**6,793,615**	**2,873,235**
Taxation	(2,588,374)	(2,069,186)	(460,892)
Profit After Tax	**5,597,613**	**4,724,429**	**2,412,343**

Balance sheet for Unilever Plc			
N'000	2012	2013	2014
Property, plant and equipment	19,265,833	23,224,938	24,830,779
Intangible assets	1,962,124	1,627,836	1,398,037
Other non-current assests	259,986	222,070	398,220
Employee loan receivable	87,807	122,301	128,348
Retirement benefit surplus	143,600	155,642	409,712
Non-Current Assets	**21,719,351**	**25,352,787**	**27,165,096**
Inventories	7,230,127	6,988,379	8,614,597
Trade and other receivables	5,637,668	8,143,362	8,544,431
Employee loan receivable	52,785	85,628	77,215
Cash and bank balances	1,857,693	3,183,958	1,334,916
Assets held for sale	-	-	-
Current Assets	**14,778,273**	**18,401,327**	**18,571,159**
Total Assets	**36,497,623**	**43,754,114**	**45,736,255**
Ordinary share capital	1,891,649	1,891,649	1,891,649
Share premium	45,717	45,717	45,717
Retained earnings	7,896,863	7,410,556	5,541,442
Equity Attributable to Owners of the Company	**9,834,229**	**9,347,922**	**7,478,808**
Non-Controlling Interest			
Total Equity	**9,834,229**	**9,347,922**	**7,478,808**
Deferred tax liabilities	1,233,244	2,340,980	2,853,240
Retirement benefit obligations	2,595,222	2,707,428	2,756,505
Long service award obligations	-	355,974	341,871
Other employee benefits	-	60,846	44,104
Deferred income	-	86,250	128,292
Loans and borrowings	145,183	782,074	762,602
Non-Current Liabilites	**4,182,944**	**6,333,552**	**6,886,614**
Trade and other payables	14,929,943	21,091,750	15,111,163

MANAGEMENT

Unilever Nigeria's Board is led by His Majesty Nnaemeka A. Achebe CFR, MNI, Obi of Onitsha. He is a well travelled monarch, with extensive leadership experience having served as director on numerous company boards.

The management is led by Mr. Yaw Nsarkoh, a Ghanaian who joined the company in 1994. Before his appointment as Managing Director of Unilever Nigeria and Executive Vice President (EVP) of Unilever Nigeria and Ghana in 2014, he served in various positions over the last 24 years within the company. He is a seasoned speaker on business issues and has been pivotal to aligning Unilever Nigeria's vision to that of the parent company.

The Board of Unilever Nigeria consists of other seasoned professionals with good knowledge and technical skills in the consumer goods space. The management of Unilever Nigeria has reiterated its commitment to improve shareholders' value and the company's environmental footprint. But, little has been achieved in the area of cost control, which has limited the impact of revenue growth. This affirms the need for management to review some of its cost control policies. The management need to intensify its adoption of local content and some of the proceeds of the rights issues should be aimed at establishing long contracts that reduce the unit cost of acquiring raw materials.

More than 70% of Unilever Nigeria's ownership is strategically owned; Unilever Oversees Holdings BV Holland and Unilever Oversees Holdings BV control more than 60%, while Stanbic Nominees Nigeria controls about 10% (directly and indirectly). The parent company retains a strong grip on the company and has stated its intention to acquire up to 75% of Unilever Nigeria as part of its long-term strategic plan. This demonstrates the commitment of the parent and the growth potential of the Nigerian market.

His Majesty Nnaemeka A. Achebe CFR

Mr. Yaw Nsarkoh

The Bull and the Bear Says:

- Unilever Nigeria has the capacity to charge a premium due to its reputation, brand equity and footprint in Nigeria
- Unilever Nigeria operates a well diversified product portfolio across premium and value brands to minimize risk
- FMCGs sector continues to thrive in the face of adversity
- Strategic alliance and support from parent company provides a competitive advantage
- Potential to increase FX earnings by intensifying export drive
- Move to achieve 100% local sourcing by 2020 would reduce costs
- Growing awareness and sophistication to drive sales in personal care segment

- Revenue growth largely driven by increase in prices and not volume, which implies lower patronage
- Maturing food product segment and intense competition
- Finance cost containment remains a key constraint
- Increase in parent company control to threaten minority shareholders' interest
- High import dependence exposes Unilever Nigeria to FX volatility

Risk and Outlook

Over the years, Unilever Nigeria has consistently outperformed the economy. This is evident by revenue growth over the last six quarters, which exceeded economic growth throughout the period. The recession experienced last year created a niche market for value brands, as numerous consumers switched to low-end value brands. Most of these brands, through innovation and creativity, are using the path to recovery to further establish a firm customer base to improve their foothold in the market. They pose a real threat to Unilever Nigeria who has lagged in new product development.

Unilever Nigeria has also struggled in keeping costs low, which has encroached on its margins. Assessing the intensity of competitive rivalry in the market, cost control is a critical success factor. The limitation on cost reduction while only maintaining top line revenue means Unilever Nigeria is operating inefficiently.

Being a net importer, Unilever Nigeria is looking to improve its FX earnings, thereby exposing it to volatility in destination countries. Hence, the move by the management to mitigate these risks in the short term will determine the company's position in the long term. We recommend a **HOLD** pending the outcome of the management move to deploy its balance sheet to push growth.

Our valuation of Unilever Nigeria

Using Discounted Cash flow (DCF) methodology, we estimated a stock price of N40.58, which is a 10% downside on the current price of stock of N44.00 as at October 17, 2017. With a discount rate (Weighted Average Cost of Capital (WACC)) of 13.3% derived using a 15.99% risk free rate (FGN 5-year Bond as at August 2017), a Beta of 0.7569, after cost of debt of 13.03%, and a market risk premium of 6.4%. The long term cash flow growth rate to perpetuity calculated is 7.9%

Taking into account both leading and lagging indicators and the H1'17 performance, we forecast a revenue three-year Compound Annual Growth Rate (CAGR) of 9.25%

DCF Valuation for Unilever Plc

N'000	**2017E**	**2018E**	**2019E**
EBIT	10,437,967	11,361,281	12,344,888
Less: Taxes	(3,131,390)	(3,408,384)	(3,703,466)
EBIAT	7,306,577	7,952,897	8,641,421
Plus: depreciation expense	2,430,082	2,621,132	2,719,314
Less: CAPEX	(3,413,496)	(3,922,869)	(4,451,349)
Less: Change in working capital	1,252,908	421,945	2,415,244
Free Cash Flow (FCF)	7,576,071	7,073,105	9,324,630
WACC	13.4%	13.4%	13.4%
Present value (PV) of FCF	5,890,129	4,848,767	5,636,289
Terminal value @ perpetual growth rate (2019)	**2017**	**2018**	**2019**
Terminal value as of 2019	-	-	184,053,416
Present value of terminal value	126,172,622		
DCF Calculation	**Valuation**		
PV of explicit period	16,375,186		
PV of terminal value	126,172,622		
Enterprise Value	142,547,809		
+ Cash	12,474,141		
- Borrowings	(3,942,337)		
Equity value	151,079,613		
Share Price	**39.93**		
Shares outstanding ('000)	3,783,298		