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FDC MONTHLY ECONOMIC UPDATE

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Supplementary budget – is Nigeria ready for the pain?

On December 17, 2019, the president assented to the appropriation bill of N10.59 trillion for the 2020 fiscal year. The benchmark price on which the oil revenues was based was $57pb. However, the unexpected Covid-19 pandemic has precipated a global economic crisis of output, markets and liquidity. Oil prices have plunged owing partly to a cartel war of price leadership between Saudi Arabia and Russia. The oil price has plunged over 50% in 2 months with catastrophic consequences.

The 2020 budget is made up of recurrent expenditure of N4.84trillion, capital expenditure of N2.46trillion and a debt servicing of about N2.7trillion.

The plunge in oil prices has forced a downward revision to its 2020 budget by N1.5trn to N9.09trn, a 14.16% cut. The benchmark oil price assumption has also been cut by 47.37% to $30pb from $57pb. The finance minister stated that recurrent spending would be slashed by 25% while the capital component of the budget would drop by 20%.

The FGN response to the oil price slump is a step in the right direction. However, lower oil price means that Nigeria's risk premium will rise, and so will the cost of issuing new debt instruments – domestic and foreign. This will alter Nigeria's debt profile negatively as the debt to revenue ratio will spike. However, the new ratio will still be within acceptable standards. The downward revision of the economic outlook from stable to negative will make the cost of additional borrowing steep and expensive.

OPEC+ Debacle: Nobody Wins a Price War

The organization of Oil Petroleum Exporting Countries (OPEC) went into its meeting on the 5th of March with one thing on its mind – to signal to the world that it was willing and able to address the shortfall in oil demand triggered by the outbreak of the coronavirus. The cartel proposed an oil output cut of 1.5 million barrels per day (mbpd) – or 1.5% of global supply – till the end of 2020 However, Russia, and in effect, OPEC+ failed to agree to the proposal. The oil market went into a spiral, recording its biggest single day loss of 24% before settling around $33pb. Brent crude prices plummeted to an 18-year low of $24pb as the COVID-19 pandemic continues to wreak havoc on the global economy. This has sparked recession fears amid an oil price war between Russia and Saudi Arabia.

From Russia, with No Love

Before the meeting, Russian President Vladimir Putin was on record as saying that Moscow had no problem with where oil prices were as the possibility of low oil prices was factored into Russia's budget. Nonetheless, in a game of "who blinks first", OPEC made cuts conditional on Russia joining in on the agreement. The Russians called the Saudi's bluff and stood their ground saying that deeper cuts made little sense as it remained unclear how deep the impact of the coronavirus on oil demand would be . The Saudi's made clear their readiness to walk away if they did not get a response in the affirmative. The standoff has since degenerated into a free for all. The Saudi's announced they were ditching the deal and would cut the price of their oil. They are also set to ramp up output by 3mbpd come April 1st.

What was supposed to be a deal to bolster prices has become an all out battle for market share. The UAE are adding 1mbpd to current output while the Russians also plan to boost production by 0.3-0.5mbpd. Markets are especially uneasy because it is the cooperation between Russia and OPEC that has propped up crude prices since 2016. At the time, OPEC – led by the Saudis – entered into a marriage of convenience with a group of 11 oil producers led by the Russians. The 24-country coalition was united in its objective of achieving sustained recovery in oil prices and delivered oil production cuts that exceeded all expectations. They said they would do whatever it took. And they did. Russia's outright refusal to cut output now means the dynamic that a united front once presented has been altered. Things are different this time.

How Resilient is Shale?

The WHO has declared the coronavirus a pandemic and countries like the US and India have imposed travel bans from Europe and the rest of the world respectively. This will only dampen oil demand further. And so with no end in sight for the OPEC+ debacle and oil trading just over $30pb, the entire oil industry is faced with the prospect of whittling down their operations – especially US shale oil producers. According to Wood Mackenzie, "Sustained crude prices below US$40/bbl would trigger a new wave of brutal cost-cutting. Discretionary spend would be slashed, including buybacks and exploration. Unsanctioned conventional projects will also be delayed, and in-fill, maintenance and other spend categories scaled back" .

US shale producers on average require oil prices of over $51pb to fund their capex budgets and pay off debt. Simply put, at current prices, no shale well drilled today is making money. Shale thrived and gained market share when OPEC+ was cutting its way to higher prices. The Russians know more cuts to boost prices is likely to not boost prices as much but will free up market share for shale output. In addition, current sanctions by the US on Russian oil producers like Rosneft and its Nord Stream II pipeline means relations between the 2 countries are less than cordial at the moment. Riyadh and Moscow seem to have finally recognized who the real enemy is and are prepared to live with sub-$40pb oil in the short-term.

It Hits Home the Hardest

Budget benchmark down by N1.5trn, price benchmark now $30pb

For Nigeria, the plunge in oil prices has forced a downward revision to its 2020 budget by N1.5trn to N9.09trn. The benchmark oil price assumption has also been cut to $30pb from $57pb. The finance minister stated that recurrent spending would be slashed by 25% while the capital component of the budget would drop by 20%.

The drop in oil prices also means that the landing cost for Premium Motor Spirit (PMS) has fallen significantly. This drop is reflected in the reduction of the pump price of PMS to N125/liter from N145/liter previously. This also means that under-recovery costs for PMS have been effectively done away with – saving the Federal Government an estimated N457bn.

The incomplete and belated responses to the oil price crash in 2015 were the major triggers of the economic recession in 2016. This time, the Central Bank of Nigeria has come out to say that it will not hesitate to deploy additional measures to shield the Nigerian economy from headwinds and that fundamentals do not currently support a devaluation of the currency. Nonetheless, pressure continues to mount on all segments of the foreign exchange market. The naira slid to N420/$ in the parallel market when the oil price plunge began but has since stabilized to N380/$.

The oil revenue shortfall will also necessitate additional borrowing. However, lower oil prices mean Nigeria's risk perception will rise, and so will the cost of issuing new debt – domestic and foreign. This will alter Nigeria's debt profile negatively as the debt to revenue ratio will spike.

OPEC is likely to convene an extraordinary meeting to figure out a way to reverse the oil price slide. Nigeria's OPEC production quota is 1.77mbpd. In the unlikely event that OPEC+ is rekindled and additional output cuts are agreed on and apportioned, Nigeria is likely to be subject to further output cuts. The hope is that the loss in production will be offset by a recovery in Brent crude prices to over $45pb – which even looks wildly optimistic at the moment.

Trust

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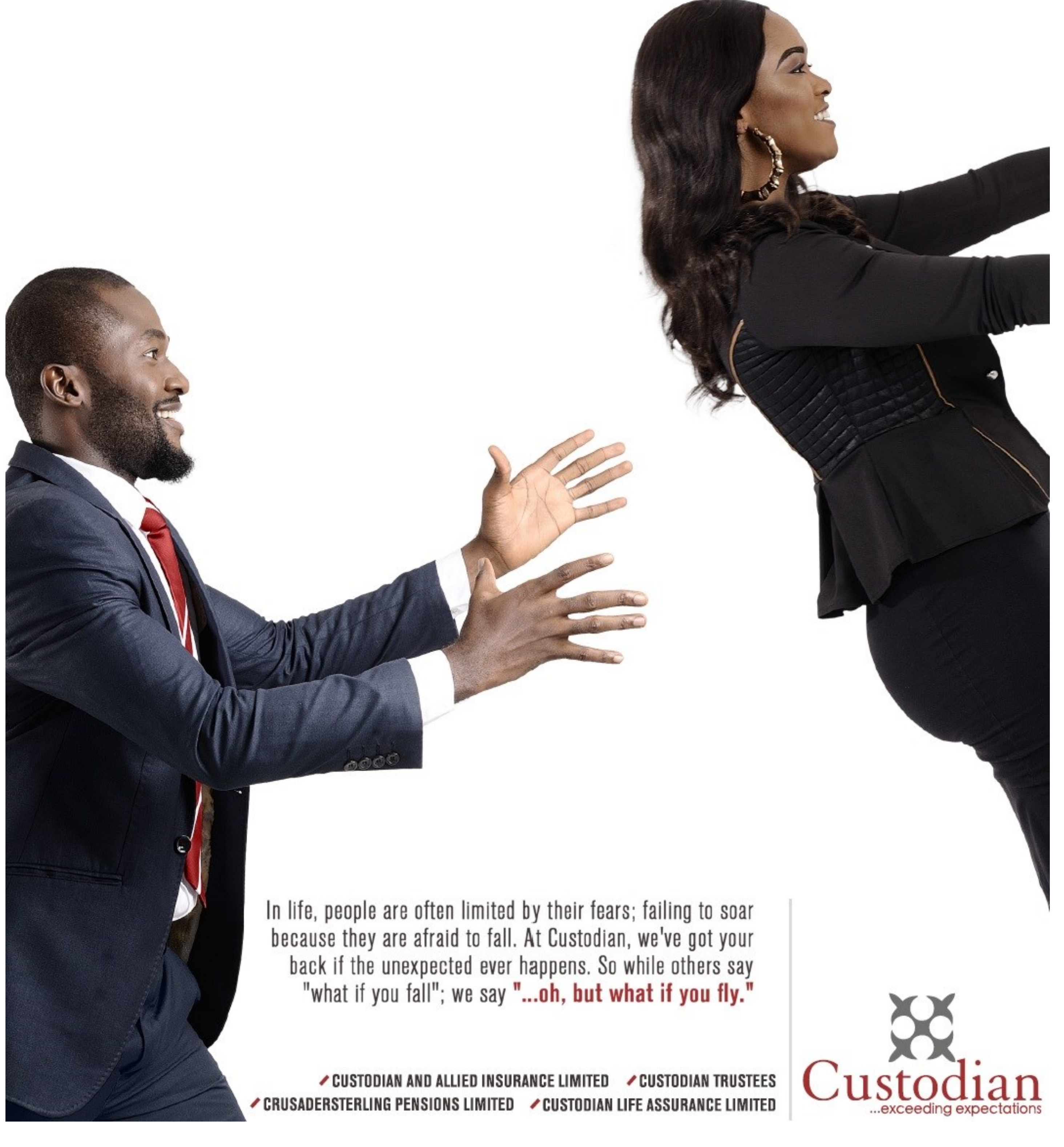


Nigeria records $1.9bn trade deficit in Q4 2019

Nigeria recorded a trade deficit of N579.1bn ($1.9bn) in the fourth quarter of 2019 compared to a surplus of N1.4trn ($4.6bn) in Q3'19 and a surplus of N873.9bn ($2.86bn) in Q4'18. This deficit is the first quarterly deficit recorded since Q3 2016 and was caused by a surge in the value of imports by 37.2% to N5.35trn ($17.5bn). Also, the drop in exports by 9.79% to N4.77trn ($15.6bn) contributed to the trade deficit. Although Nigeria recorded a deficit in the fourth quarter, for the full year 2019, it recorded a surplus of N2.23trn ($7.3bn). The total trade was recorded at N36.15trn, a 14.05% rise over 2018. [1]

During Q4'19, the surge in the value of imports was due to increases in the value of imported machinery equipment and mineral fuels by 47.03% and 60.68% respectively. The top imported products were other electro-diagnostic apparatus (15.81%), motor spirits (10.75%) and unused postage, revenue or similar stamps (4.95%). On the other hand, top exported products were petroleum oils and oils obtained from bituminous minerals (76.08%), liquefied natural gas (9.35%), and vessels and other floating structures (8.49%).

[1]NBS. Note: the exchange rate used, N306/$

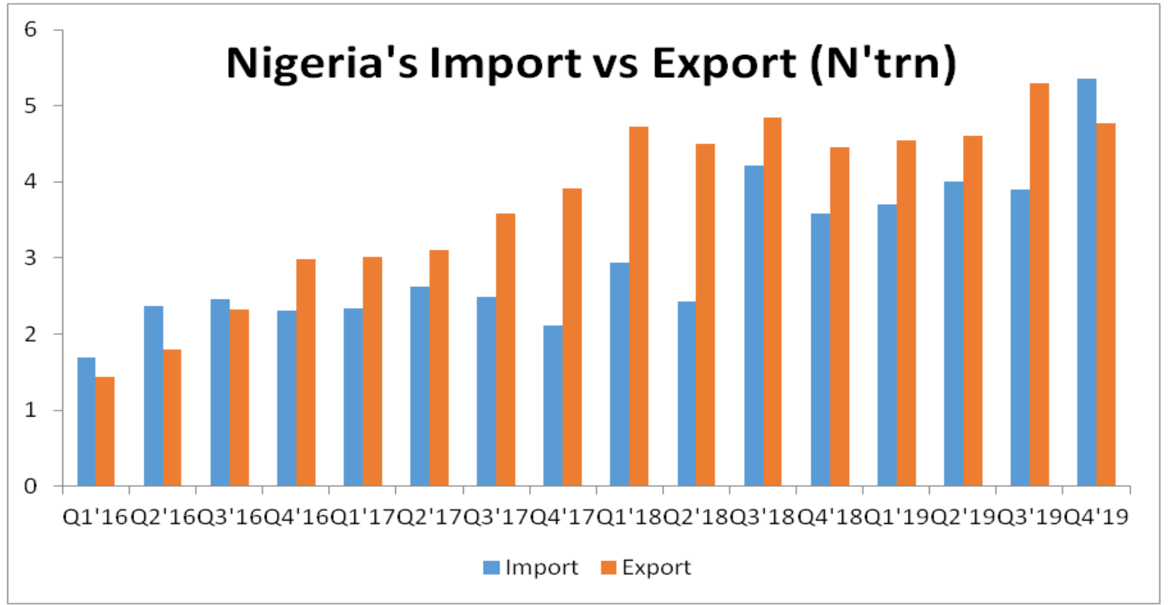
Top Major Trading Partners

Percentage share of Nigeria's Export	Oct'19	Nov'19	Dec'19
India	14.50	14.04	11.30
Spain	12.16	11.89	7.49
France	7.75	8.90	6.88

Percentage share of Nigeria's Import	Oct'19	Nov'19	Dec'19
India	38.79	8.81	7.44
China	15.64	27.60	3.25
Netherlands	8.33	14.32	6.88

[2]

The top major trading partners of Nigeria are countries mainly from Asia and Europe where the outbreak of the covid-19 is more prevalent. The prolonged spread of the virus beyond China where it originated could mean that Nigeria's trade with these countries will be affected greatly as there has been a shutdown in economic activities of most major trading partners.



[3]

Trade Deficit and Economic Growth

A trade deficit does not necessarily hurt economic growth. In Q4'19, Nigeria recorded an expansion in GDP growth by 2.55% from 2.28% in the previous quarter and 0.17% higher than the Q4 GDP growth of 2018. This was the fastest quarterly GDP growth rate since the fourth quarter of 2015. This suggests that the impact of Q4 trade deficit on economic growth was absent.

[2]NBS
[3]NBS

Outlook

The fall in global oil prices in the first quarter of 2020 caused by falling demand suggests that Nigeria's crude oil sales will likely drop. Crude oil accounts for about 75% of the country's total exports and a fall will cause exports to drop in succeeding quarters. China is a major trading partner with Nigeria and the impact of Covid-19 spread within and outside China will disrupt foreign trade as exports are constrained resulting in a sustained trade deficit.

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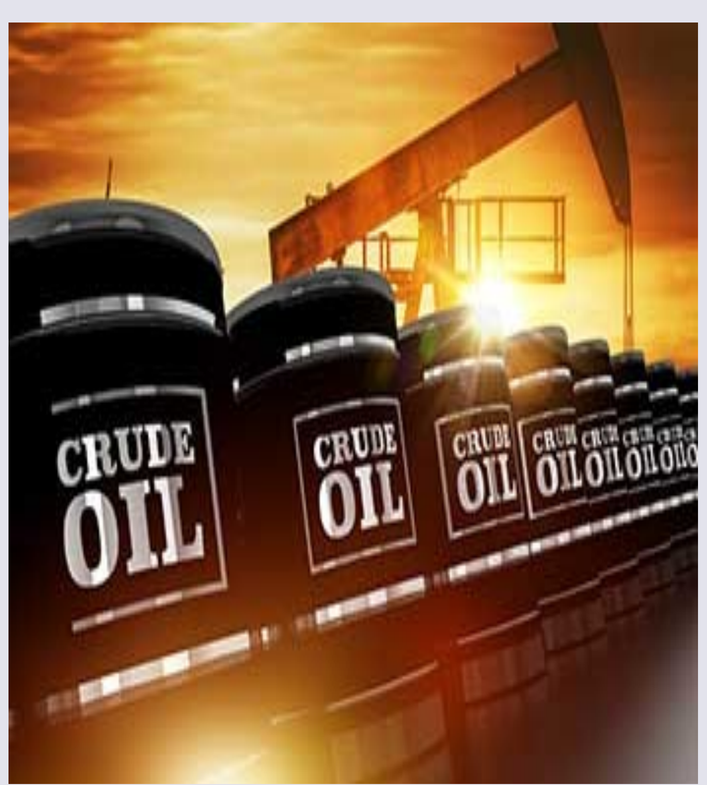
Diversify or drink your crude

Diversification is a risk management method that allows for a variety of investments in a portfolio. A diversified portfolio is imperative to minimize risk and reduce sensitivity to market volatility. For instance, for an economy with a diverse portfolio, an unexpected negative development in a sector will be offset by positive performance in other sectors.

The Nigerian economy is quite diversified when it comes to output. According to the National Bureau of Statistics, in Q4'19, the oil sector contributed 7.32% to GDP, while the non-oil sectors contributed 92.68% to GDP. In the mix, agriculture contributed 26.09%, industries 20.27% while services were the largest contributor at 53.64%. However, in terms of revenue, the Nigerian economy is mono-cultural. Crude oil accounts for approximately 85% of Nigeria's foreign exchange and about 70% of the country's revenue.



Many promises, little headway, still far off-target

The current administration, through its "Zero Oil Plan" laid out in the Economic Recovery and Growth Plan (ERGP), indicates that it is indeed committed to the nation's economic diversification.

The core of the ERGP framework is to get the economy out of recession, achieve macroeconomic stability and diversify the economy. Over the years, a lot has been said, little has been done and the impact is still minute.

The diversification plan specifically takes an interest in the development of agriculture, particularly with respect to farming and agribusiness, which have the potential to generate the large numbers of jobs needed for the country's fast-growing labor force.[4]

Due to this, the Central Bank of Nigeria (CBN) introduced policies such as the Anchors Borrowers program to revive the sector and enhance diversification. The apex bank also restricted about 44 items from accessing dollars for import, forced commercial banks to increase lending and the country also closed its land borders to boost domestic production. However, despite its effort to improve growth in the sector, agricultural exports in the third quarter of 2019 were just N42.1bn - less than 1% of the total export, which shows that there is a long way to go.[5] The nation's export is still dominated by crude oil and the macroeconomic environment remains at the mercy of the price vagaries of the oil market.

Countries to phase out gasoline and diesel cars

The UK has disclosed its intention to phase out the sale of new gasoline and diesel vehicles by 2035, five years earlier than initially planned. This will leave the consumer with the choice of either an electric or a hydrogen-based car. This move was enacted to fight the climate crisis and reduce carbon emissions to zero by 2050. Other countries that intend to ban gasoline cars include Denmark – 2030, Germany – 2030, Ireland – 2030, with many more having similar goals.

[4]Intelligence Unit, September 4, 2018. "Zero-Oil Plan makes some headway, but is far off target." The Economist. https://country.eiu.com/article.aspx?articleid=987167082&Country=Nigeria&topic=Economy&subtopic=Current+policy
[5]2019.NBS. Q3 Foreign trade statistics report

Of the top 10 importers of Nigeria's crude oil, two countries (Netherlands and China) plan to ban diesel and gasoline cars. More so, at least one state in eight of the top 10 countries signed the fossil-fuel-free street declaration, which is committed to banning emitting vehicles by 2030. This indicates that in no time more countries will be committed to the movement.

Top Importers of Nigeria's Crude oil	Territory/Cities to ban emitting vehicles	Commencement date
Netherlands	Amsterdam	2030
Spain	Madrid/Barcelona/Balearic Island	2025/2030/2025-2035
US	Seattle/Los Angeles	2030/2030
France	Paris	2025
South Africa	Cape Town	2030
Italy	Rome/Milan	2024/2030
China	Hainan	2030
Canada	Vancouver/British Columbia	2030/2025

Impact of the gasoline ban on Nigeria

Nigeria needs to brace for the impact of a gasoline and diesel ban. For a country whose revenue is mostly dependent on oil and its budget hinged on higher oil production and prices, the impact will be significant.

Currently, global oil prices are affected by the coronavirus outbreak, which is denting demand and the price war between Saudi Arabian and Russian. The price of Brent crude sank to about $33pb on March 9th - the lowest level since early 2016, when the official naira rate was last devalued and Nigeria slid into recession. The immediate impact of the drop in price was a depreciation of the currency to N368/$ and further to N420/$ before recovering to N368/$ at the parallel market. If

the price war between the two countries continues and the outbreak of the virus bites deeper, Nigeria's revenue and foreign exchange earnings will decline, indicating that the Nigerian economy is only as stable as the global price of its main export: crude oil.

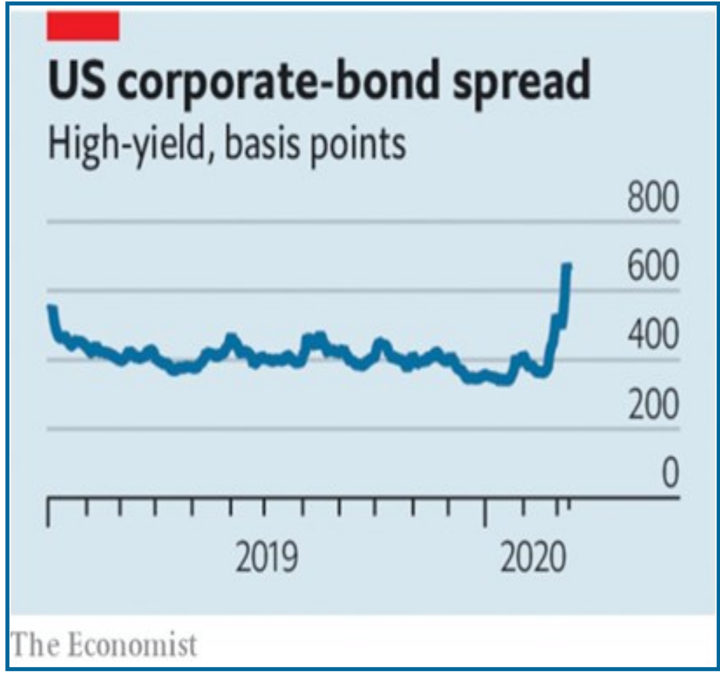
In the coming years, a drop in demand owing to the ban on gasoline and diesel vehicles will be a double blow, resulting in cutbacks of government activity due to shortage of funds, increased deficits, higher debt from borrowing, currency depreciation, depleted reserves, an economic slowdown or even a recession.

How To Deal With A New Sort of Financial Shock

The subprime crisis is not a good guide to markets today

When faced with a bewildering shock it is natural to turn to your own experience. As covid-19 rages, investors and officials are scrambling to make sense of the violent moves in financial markets over the past two weeks. For many the obvious reference is the crisis of 2007-09. There are indeed some similarities. Stock markets have plunged. The oil price has tumbled below $40 a barrel. There has been a flurry of emergency interest-rate cuts by the Federal Reserve and other central banks. Traders are on a war footing—with a rising number working from their kitchen tables. Still, the comparison with the last big crisis is misplaced. It also obscures two real financial dangers that the pandemic has inflamed.

The severity of the shock so far does not compare with 2007-09. Stock markets have fallen by a fifth from their peak, compared with a 59% drop in the mortgage crisis. The amount of toxic debt is limited and easy to identify. Some 15% of non-financial corporate bonds were issued by oil firms or others hit hard by the virus, such as airlines and hotels. The banking system, stuffed with capital, has yet to seize up; inter-bank lending rates are under control. When investors panic about the end of civilization they rush into the dollar, the reserve currency. That has not yet happened.



The nature of the shock is different, too. The 2007-09 crisis came from within the financial system, whereas the virus is primarily a health emergency. Markets are usually spooked when there is uncertainty about the outlook six or 12 months out, even when things seem calm at the time—think of asset prices dropping in early

2008, long before most subprime mortgage borrowers defaulted. Today, the time horizon is inverted: it is unclear what will happen in the next few weeks, but fairly certain that within six months the threat will have abated.

Instead of tottering Wall Street banks or defaults on Florida condos, two other risks loom. The first is a temporary cash crunch at a very broad range of companies around the world as quarantines force them to shut offices and factories. A crude "stress test" based on listed companies suggests that 10-15% of firms might face liquidity problems (see article). Corporate-bond markets, which demand precise contractual terms and regular payments, are not good at bridging this kind of short but precarious gap.

In 2007-09 the authorities funneled cash to the financial system by injecting capital into banks, guaranteeing their liabilities and stimulating bond markets. This time the challenge is to get cash to companies. This is easy in China, where most banks are state-controlled and do as they are told. Credit there grew by 11% in February compared with the previous year. In the West, where banks are privately run, it will take enlightened managers, rule tweaks and jawboning from regulators to encourage lenders to show clients forbearance. Governments need to be creative about using tax breaks and other giveaways to get cash to hamstrung firms. While America dithered, Britain set a good example in this week's budget.

The second area to watch is the euro zone. It is barely growing, if at all. Central-bank interest rates are already below zero. Its banks are healthier than they were in 2008 but still weak compared with their American cousins. Judged by the cost of insuring against default, there are already jitters in Italy, the one big economy where banks' funding costs have jumped. On March 12th the European Central Bank promised additional liquidity for the banking system, notably to support lending to small and medium-sized firms (but did not cut interest rates). The danger is that it, national governments and regulators fail to work together.

Every financial shock is different. In 1930 central banks let banks fail. In 2007 few people had heard of the subprime mortgages that were about to blow up. This financial shock does not yet belong in that company. But the virus scare of 2020 does create financial risks that need to be treated—fast.

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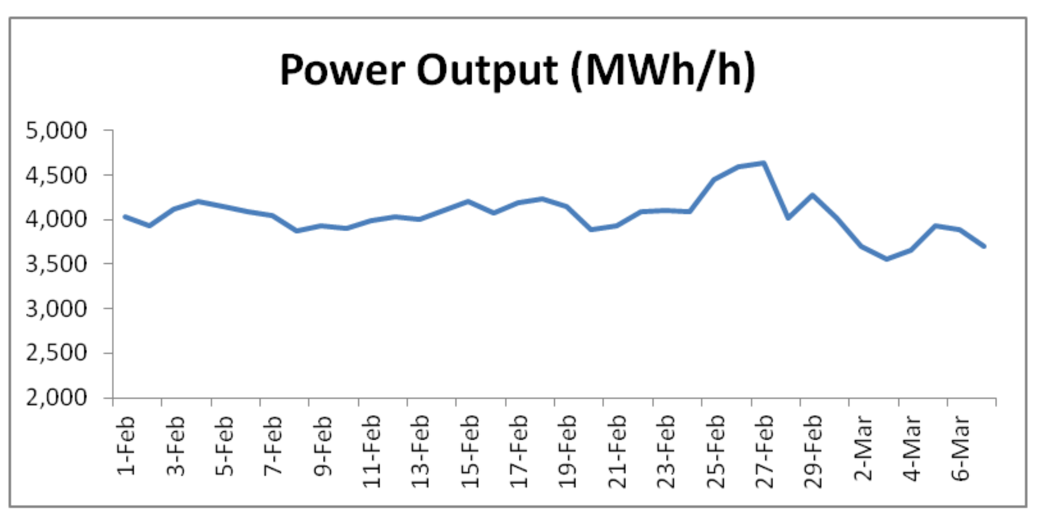
Macroeconomic Indicators - February

Power Sector

The average power output from the national grid was 7.67% higher in February at 4,114MWh/h, compared to January's of 3,821MWh/h. Gas remained the major constraint to power generation primarily in Ihovbor NIPP and Sapele NIPP plants. Although, the presence of water constraints caused average output to decline further in the middle of the month. Towards, the end of the month, there was no water constraint, hence, the uptick in power output. Total constraint was 114,521MWh/h, resulting in revenue loss of N54.96billion (N659.52billion annualized).

So far in March, average power output is down 5.97% to 4,014MWh/h from 4,269MWh/h on February 29. It continued the declining trend to 3,694MWh/h on March 7 driven by gas constraints. This resulted in a revenue loss of N14.62billion (N175.44billion annualized).



[6]

Outlook

As we approach the raining season, we expect a pickup in hydro power and this is expected to boost power output in the coming weeks.

Impact

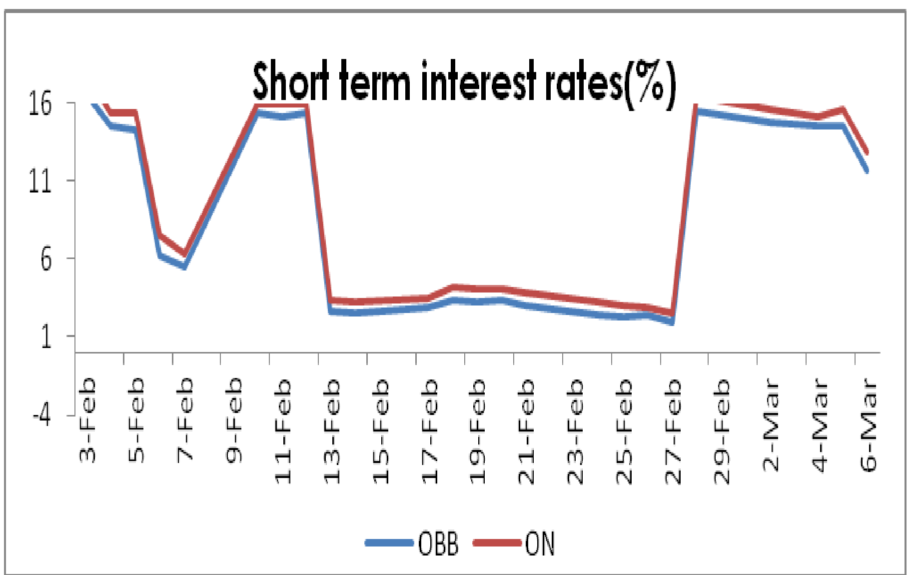
As rainfall persists, water constraints will decline significantly. This would increase power supply and in turn reduce the operating cost of firms and households. Meanwhile, the implementation of the electricity tariff in April will serve as additional support to the power sector and improve power supply in the near term.

[6]FG, FDC Think Tank

Money Markets

The average opening position of banks fell by 22.10% to N346.68 billion in February from N445.01 billion in January. Meanwhile, average liquidity for banks so far in March stands at N234.75 billion.

In the month, naira liquidity in the system increased due to a net inflow of N1.30 trillion. Total OMO sales were N1.12trillion compared to repayments of N2.42 trillion. Nonetheless, average NIBOR (OBB/ON) rose by 133bps to 7.83% from 6.50% in the previous month. OBB and ON rates started the month at 16.50% and 17.83%, before declining sharply to 2.00% and 2.50% respectively on February 27. However, it reversed the trend to close the month at 15.5% and 16.42% on February 28. So far in March, NIBOR (OBB/ON) rates have averaged 15.01%, 718bps higher than the 7.83% recorded in February and are trading at 11.71% and 12.86% respectively.



[7]

At the primary market, there was a Treasury Bills auction of N258.50 billion on February 13 and 27. Both auctions were oversubscribed by 86% and 180% respectively. Compared to January 29, rates at the 91-day, 182-day and 364-day tenors fell by 50bps to 3.0%, 4.0% and 8bps to 5.7% respectively. Similarly, in the secondary market, the 91-day and 182-day tenors declined by 50bps and 8bps to 2.85%pa and 3.59%pa, while the 364-day went in the opposite direction, increasing by 101bps to 5.01%pa.

[7]CBN

The Nigerian interbank treasury true yields (NITTY) rates, declined by 19bps (2.83% pa), and 42bps (3.55% pa) for the 30-day and 180-day tenors, meanwhile it increased by 16bps (3.46% pa) for the 90-day tenor.

T/bills Tenor	Secondary market rates as at Feb 03(%pa)	Secondary market rates as at Feb 26 (%pa)	Direction	Primary market rates as at Jan 29 (%pa)	Primary market rates as at Feb 12 (%pa)	Direction
91	3.35	2.85	⬇	3.5	3.0	⬇
182	3.67	3.59	⬇	4.5	4.0	⬇
364	4.00	5.01	⬆	6.5	5.7	⬇

NITTY Tenor	Rates on Feb 03 (%pa)	Rate on Feb 26 (%pa)	Direction
30	3.02	2.83	⬇
90	3.30	3.46	⬆
180	3.97	3.55	⬇

[8]

Outlook

As the CBN continues to manage naira liquidity through its use of OMO bills, we expect market to liquidity to decline and this could push up interbank interest rates. In addition, the Monetary Policy Committee (MPC) is scheduled to meet on March 23/24. A likely outcome is that the committee could increase the MPR by 50bps to 14% pa in order to reduce inflationary pressures.

[8] FDC Think Tank

Impact

Higher interest rates could adversely affect bank earnings under pressure and negatively weigh on private credit growth.

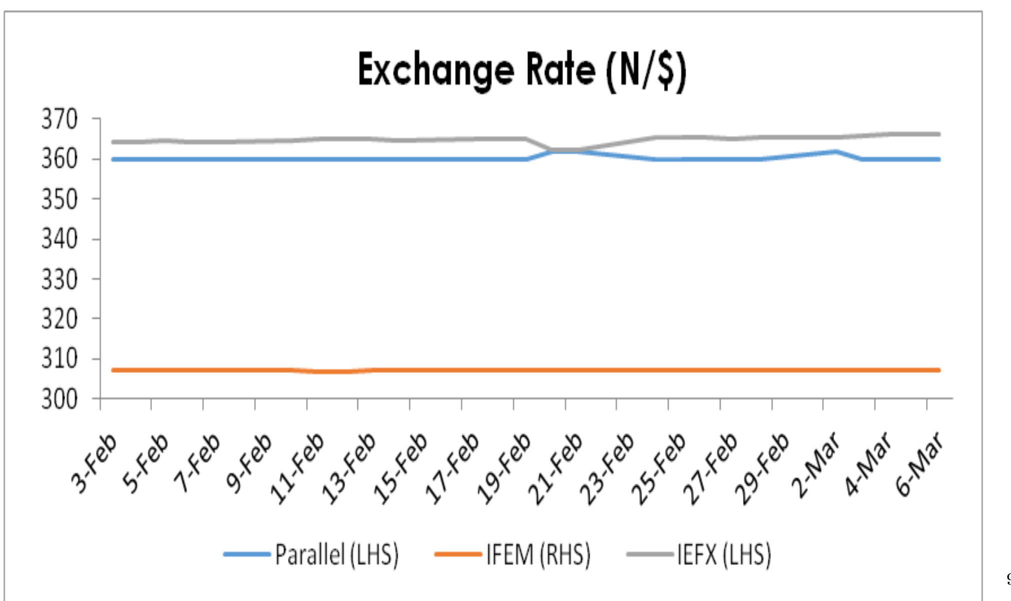
Forex Market

The Nigerian forex market is segmented with multiple exchange rates. The most important rate being the Investors and Exporters window (IEFX). No less than 55%-60% of Nigerian forex transactions are traded at this window. The CBN and most exporters and investors use this window. It serves as not only 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

At the parallel market, the naira traded flat at N360/$ in February. Meanwhile, it depreciated sharply by 15.28% to N415/$ on March 12, owing to panic buying in the forex market. This response was triggered by the global market uncertainties arising from the covid-19 pandemic and the price rift between Saudi-Arabia and Russia that led to a slump in oil prices. However, the currency recovered the following day to N368/$ following the release of the CBN's circular on March 12. The CBN bucked the idea of devaluing the naira despite low foreign inflows and mentioned that the current external reserves is sufficient to meet demand in the forex market. Also, the bank promised to investigate and penalize any individual involved in speculative activities in the forex market.

Similarly, at the IEFX window, demand pressures resurfaced, as the naira lost 1.18% to trade at N368.47/$ on March 13 from N364.17/$ on February 3. The CBN sold a total of $761.55mn in February as against $253.38mn in January.



[9]

Outlook

The depreciation of the naira at the IEFX window shows that currency pressures are starting to build up and this could spill over to the parallel market in the coming term.

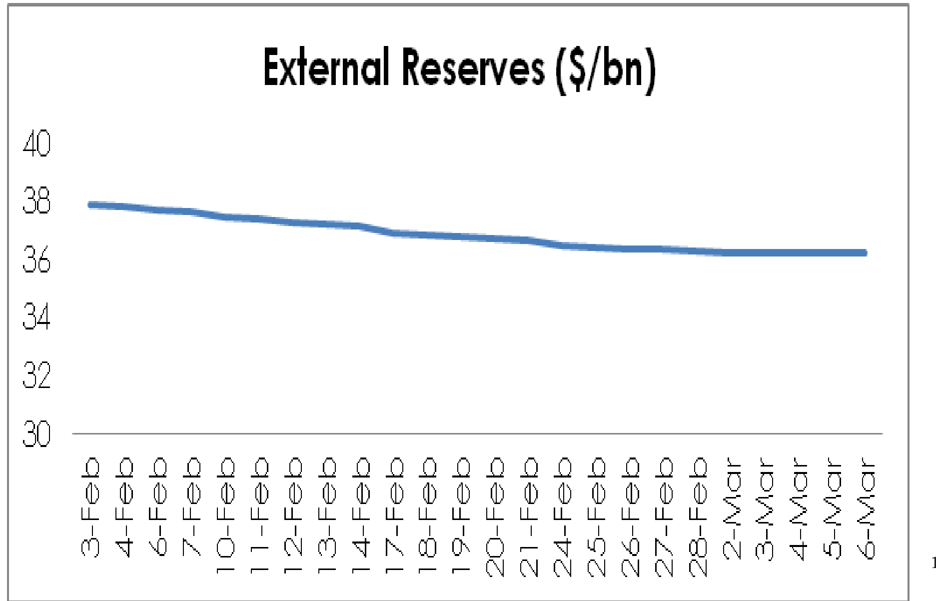
Impact

Currency instability will adversely weigh on the value of the country's currency. Thereby increasing the risks of international trade and tapering investments. It will also increase the cost of importation and reduce profit for firms.

External Reserves

The gross external reserves depleted by 4.50% to close at $36.30bn on February 28 and has lost 4.54% to $36.16bn so far in March. Currently at $36.16bn, it can only fund 9 months of import cover. The depletion rate is expected to intensify especially with the slump in oil prices and the resultant effect on Nigeria's oil receipts and buffers

[9]FMDQ, CBN, FDC Think Tank



[10]

Outlook

External reserves are likely to deplete further, ranging within $34 - $35billion in the coming month. This is because oil receipts are plummeting amidst the coronavirus and the discord between Saudi Arabia and Russia concerning further oil production cut.

Impact

The stability of the exchange rate is a function of how robust the external buffers are. Nigeria's reserves are at a worrying level and the CBN may have to adopt forex rationing measures to shore up the reserves and stall a run on the currency.

[10]CBN

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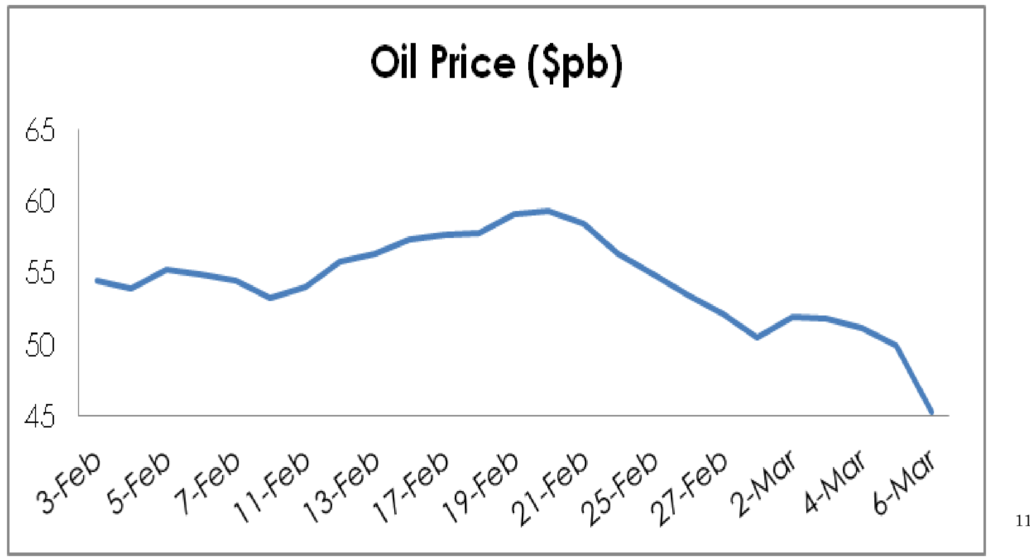
Commodities Market - Exports

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

Oil Prices

In February, the average price of Brent fell by 12.88% from January's average of $63.68pb to $55.48pb. Oil prices maintained a bearish trend to close the month at $50.52pb. So far in March, oil prices crashed to $31pb, recording a 4-year low and the largest decline since the Gulf war in 1991. Although there was a slight recovery by 18.32% to $36.68pb (intraday) on March 9, the deadlock between Saudi Arabia and Russia on oil production quota coupled with the lingering negative impact of the coronavirus could reduce global oil prices further.



[11]

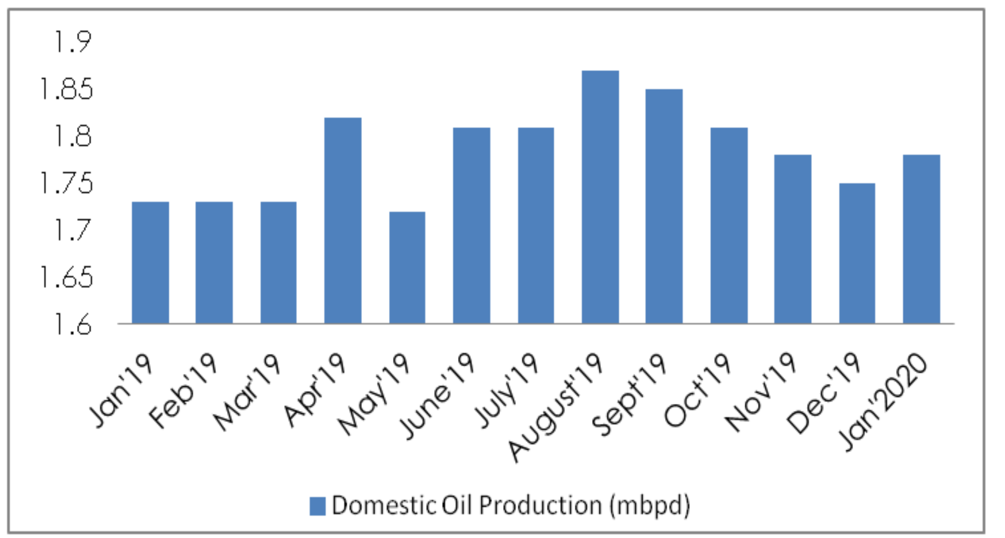
Outlook

We expect oil prices to maintain the bearish trend in the near term. This is due to the unexpected price war between Saudi Arabia and Russia and lower demand from China amidst the lingering negative effects of the COVID-19 epidemic.

[11]Bloomberg

Oil Production

Nigeria's oil production increased to 1.78 million barrels per day (mbpd) in January from 1.75mbpd in December 2019. This is 0.56% above the OPEC's quota of 1.77mbpd for the country. However, the country's rig count fell from 17 to 14 in January. This shows that drilling and exploration of oil declined in January. Total OPEC oil production in January averaged 28.86mbpd and owing to higher output in Saudi Arabia and Nigeria. On the other hand, output levels depleted in Libya, Iraq and Kuwait.



[12]

Outlook

Due to the dwindling oil prices resulting from the COVID-19 outbreak, OPEC+ had a meeting in February proposing a 600,000bpd cut in oil production to support oil prices. However, on March 5/6 another meeting held, wherein the cartel proposed 1.5mpbd cut. This led to a dispute between two major oil producing states (Saudi Arabia and Russia) causing oil prices to decline further. There is no conclusion yet, but if the cut pulls through, Nigeria could be forced to cut its domestic oil output.

Impact

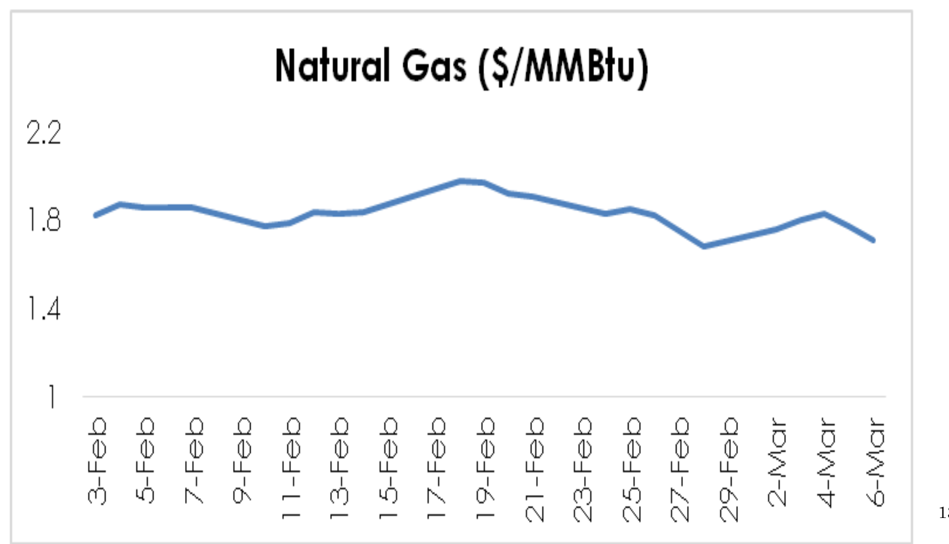
Nigeria is more sensitive to changes in oil production compared to price. Oil receipts also account for over 70% of the country's income and approximately 90% total export. Therefore, a cut in oil output levels coupled with sharply lower oil prices would result in depleting oil revenue, fiscal position and balance of trade. In addition, the FG has set up a committee including the

[12]OPEC and Baker Hughes

finance minister and the CBN governor to respond to the negative sentiments surrounding the oil market. The committee is expected to prepare a supplementary budget and revise the 2020 budget, such that they cover a new oil price benchmark and the current global market instability amid the coronavirus.

Natural Gas

The average price for Natural gas stood at $1.85/mmbtu, 7.96% lower than the $2.01/mmbtu average recorded in January. In the month, LNG prices spiked to $1.98/mmbtu on February 18, before retreating to close the period at $1.68/mmbtu. The declining trend persisted into March, as prices fell to $1.71/ mmbtu. The decline was primarily due to lower demand from China owing to the coronavirus outbreak.



[13]

Outlook

We expect LNG prices to decline in the coming term. This is largely attributed to the lingering coronavirus outbreak that has tapered demand from China and a surge in LNG production from the United States.

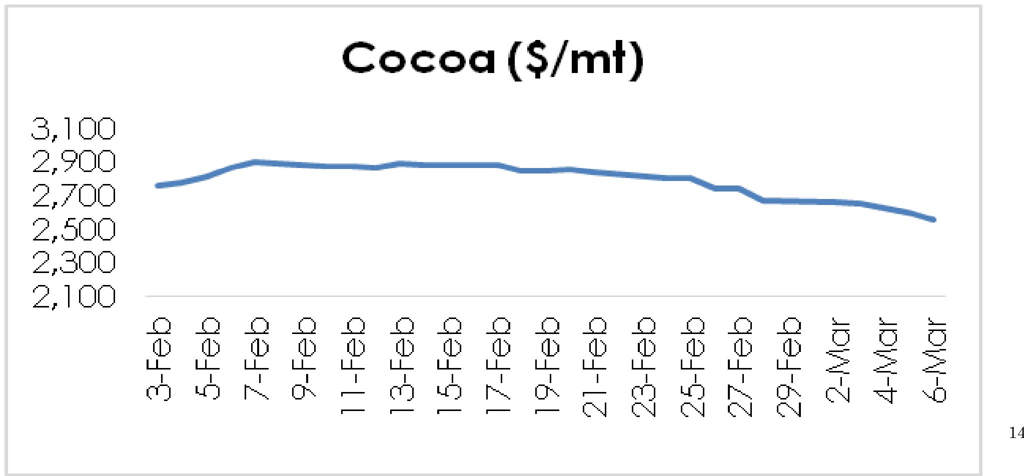
Impact

Natural gas is a major export for Nigeria that accounts for approximately 13% of the country's export earnings. Lower prices will adversely affect export revenue and lead to an unfavourable balance of trade.

[13]Bloomberg

Cocoa

The average price of cocoa rose by 5.65% to $2,825/mt in February from $2,674/mt in January. Similarly, cocoa prices increased by 5.15% to $2,898/mt on February 7 from $2,756/mt on February 3. However, prices reversed the upward trend to close the month at $2,672/mt on February 28. The declining trend spilled over to the beginning of March, to trade at $2,561/mt. This was despite poor weather conditions limiting supply in Ivory Coast and Ghana.



[14]

Outlook

We expect cocoa prices to pick up next month due to supply shortages from Ivory Coast and Ghana because of poor weather conditions hindering output.

Impact

Higher cocoa prices will have a positive impact on Nigeria's export revenue and support a favourable balance of trade.

[14]Bloomberg

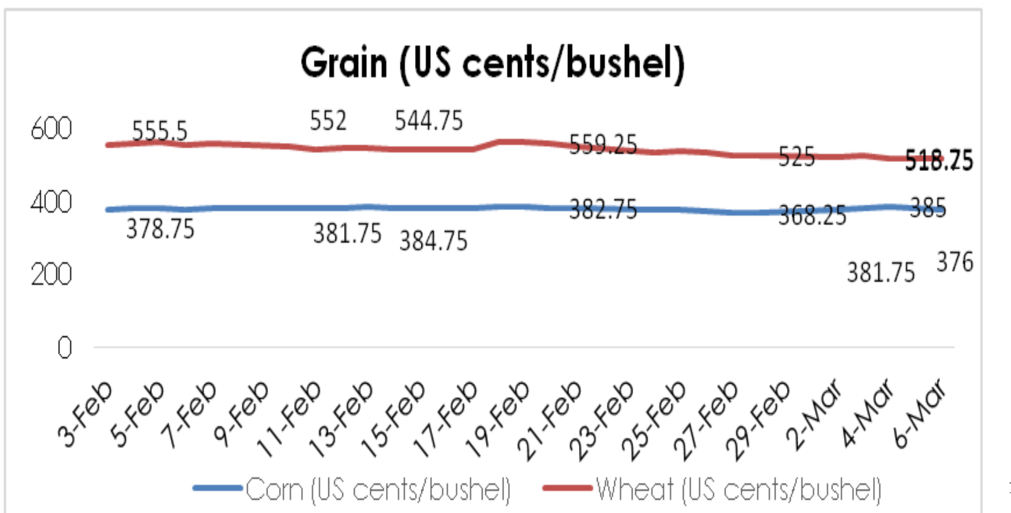
Imports

Wheat

In February, the average price of wheat was down 2.95% to $548.38/bushel from $565.05/bushel in January. During the month, wheat prices declined by 5.49% to close at $525/bushel from $555.5/bushel on February 3. The downward trend is still evident in March as wheat prices hit a 4 -month low of $515.75/bushel. This was partly due to increased supply from the United States.

Corn

On the average, the price of corn decreased by 1.53% to $379.82/bushel from the average of $385.74/bushel in January. In the month, corn prices inched up on February 19 to $386.25/ bushel from $378.75 on February 3. This was partly due to supply shortages from the United States. However, the upward trend was reversed to close the month at $368.25/bushel on February 28. So far in March, corn prices are picking up ($385/bushel on March 4) as sentiments rise on the commencement of the planting season. Generally, grain prices declined in the month as a result of lower demand from China, because of the coronavirus outbreak.



[15]

Grains- Outlook

We anticipate an uptick in grain prices as the planting season commences. This could cut supply of grains in the global market and support prices in the near term.

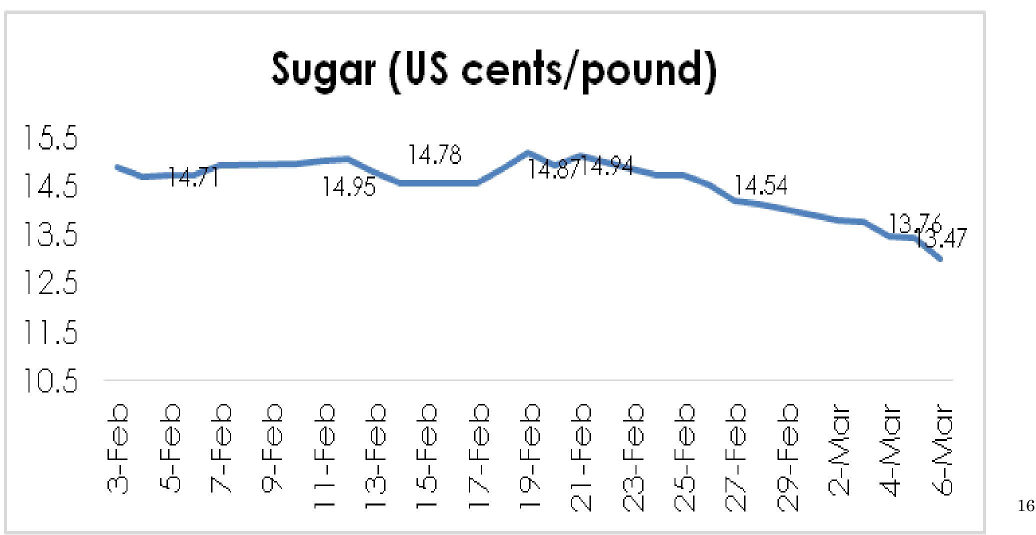
[15]Bloomberg

Impact

Nigeria is a major importer of grains. Therefore, higher grain prices will adversely affect the country's import bill. This could further push up prices of finished goods made from grains.

Sugar

Sugar prices averaged $14.78/pound in February, 4.30% higher than the $14.17/pound average in January. In the month, sugar prices were volatile. This was partly due to hostile weather conditions and low sugar mix ratio in Brazil and Thailand. Meanwhile, sugar prices recorded a 3-month low of $13.02/pound on March 5.



[16]

Outlook

We expect sugar prices to trend downwards in the coming month due to tapered global demand and sentiments around increasing exports from India.

Impact

A decline in sugar prices will reduce Nigeria's import bill on sugar.

[16]Bloomberg

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Stock Market Review

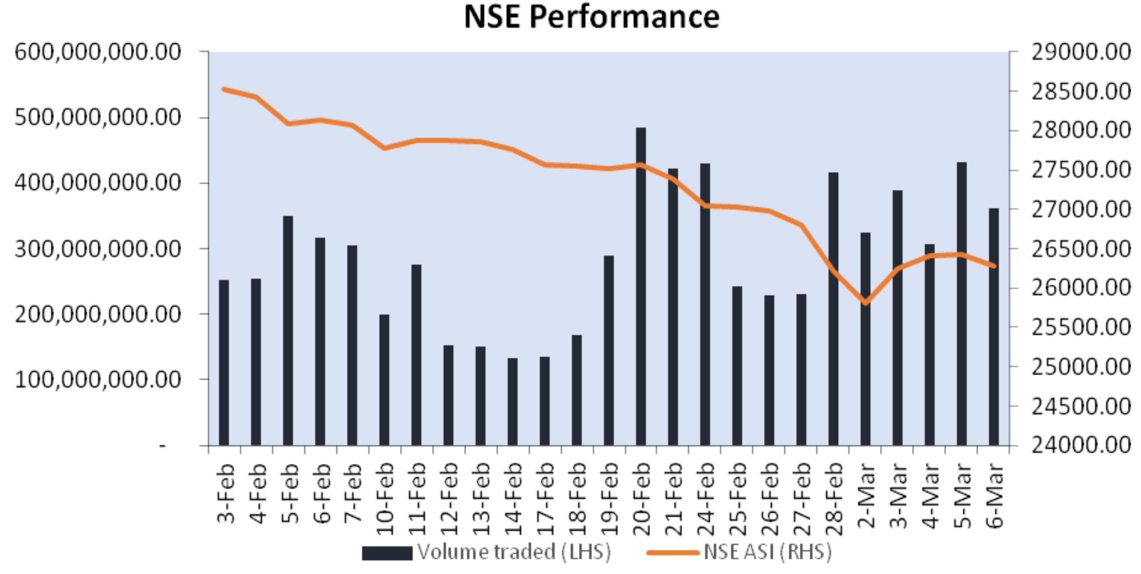
In February, the NSE lost all the gains recorded in the prior month, as it lost 9.11% compared to the 7.46% gain in January. As at March 6, the market has gained 0.24%.

The market closed at 26,216.46 points in February compared to 28,843.53 points in January. The average daily turnover declined by 29.88% to N3.73bn in February from N5.32bn in the previous month.

Period	ASI % change	Total Deals	Total Mkt Cap	Total Turnover	Total Volume	YTD gain/loss
January	7.46% ↑	107,077	323.69	N116.94bn	8.44trn	7.46%
February	(9.11%) ↓	80,407	286.92	N74.58bn	5.44trn	-2.33%
March	(0.24%) ↑	23,494	68.35	N26.02bn	1.81trn	-2.10%

[17]

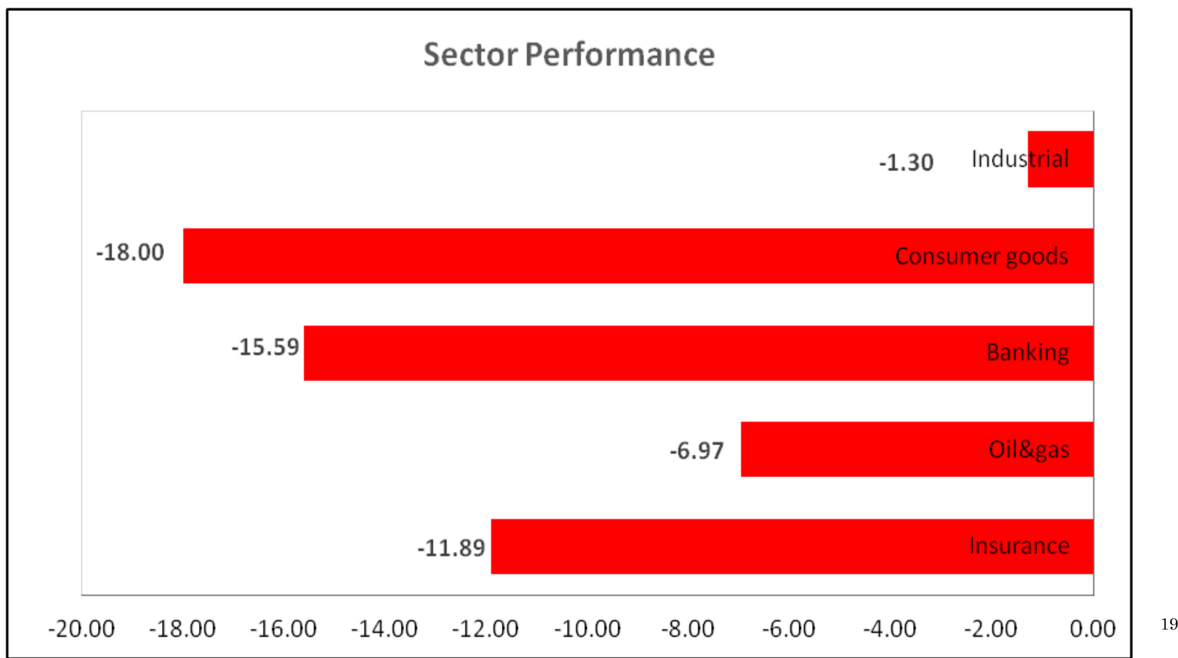
The NSE traded at a price to earnings (P/E) ratio of 7.94x as at February 28th, which is 0.13% lower than the close of January 31st (7.95x). In February, the market breadth was negative at 0.18x compared to 0.94x in January. There were 12 gainers, 68 losers while 83 stocks remained unchanged during the review period.



[18]

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

On the other hand, the market saw a decrease in activity level. The average volume traded declined by 29.16% to 271.80mn units, while the average value of trades fell by 29.89% to N3.73bn.



[19]

The sector indices were negative in February. The consumer goods sector (-18%) lost the most, followed by the the banking (-15.59%), insurance sector (-11.89%), oil & gas (-6.97%) and industrial sectors (1.30%). In the first trading week in March, sector indices have remained negative. The consumer goods, banking, insurance, industrial and oil & gas sectors lost 22.69%, 14.05%, 11.68%, 7.7% and 6.03% respectively.

In the month of February, United Capital Plc topped the gainers' list with a 31.84% increase in its share price. This was followed by Law Union and Rock Insurance Plc (16.88%), Livestock Feeds Plc (14.55%) and African Prudential Plc (10.85%) and Union Bank of Nigeria Plc (8.33%).

TOP 5 GAINERS (N)				
Company	Feb. 03'20	Feb. 28'20	Absolute Change	% Change
United Capital Plc	2.45	3.23	0.78	31.84
Law Union & Rock Insurance Plc	0.77	0.9	0.13	16.88
Livestock Feeds Plc	0.55	0.63	0.08	14.55
African Prudential Plc	4.24	4.70	0.46	10.85
Union Bank of Nigeria Plc	6.00	6.50	0.50	8.33

[20]

[19]NSE, FDC Think Tank
[20]NSE, FDC Think Tank

The laggards were Skyway Aviation Handling Co Plc (-48.67%), Ecobank Transnational Inc Plc (-27.52%), Oando Plc (-27.03%), Red Star Express Plc (-26.97%) and Royal Exchange Plc (-26.67%).

TOP 5 LOSERS (N)				
Company	Feb. 03'20	Feb.28' 20	Absolute Change	% Change
Skyway Aviation Handling Co Plc	4.15	2.13	-2.02	-48.67
Ecobank Transnational Inc Plc	7.45	5.4	-2.05	-27.52
Oando Plc	3.7	2.7	-1.00	-27.03
Red Star Express Plc	4.45	3.25	-1.20	-26.97
Royal Exchange Plc	0.3	0.22	-0.08	-26.67

[21]

Outlook

The bearish outlook of the NSE was driven largely by the mixed corporate earnings and negative investor sentiment in February. We expect the negative NSE performance to persist in the near to medium term as investors remain cautious of the negative impact of the fall in oil price and spread of COVID-19 on the global financial market.

[21]NSE, FDC Think Tank

Corporate Focus: Presco

Market Capitalization: N40.45billion

Current Price: N40.45

Industry: Agriculture

Analyst's note

Weak pricing weighs on revenue

Presco Plc released its unaudited FY'19 results in February and it showed a 6.85% decline in its revenue to N19.88bn relative to N21.34bn 2018. The year on year deterioration could be partly attributed to the almost 11% decline in global crude palm oil prices.

Higher operating expenses weigh on earnings

Despite a decline in global price of CPO, the company recorded an increase of 13.5% in its cost of sales and this dampened gross profit. The company's gross profit declined by 12.6% to N14.49 billion from N16.59 billion in the corresponding period in 2018.

Operating expenses moved in the same direction during the period

Selling, general and administrative expenses, which account for 95.6% of Presco's operating expenses, increased by 18.17% to N7.54 billion in FY'19.

Finance costs also increased, rising 46.87% to N1.88billion. The unimpressive performance of the Nigerian Stock Exchange (NSE) made debt capital the preferred funding option in the capital market. Due to the high operating costs and finance costs, the company's PBT and PAT declined by 12.66% and 8.08% to N3.93 billion and N4.28 billion respectively.

Company to continue to benefit from governments policies

The Nigerian government in its effort to diversify the revenue base of the country has adopted a protectionist strategy. The most recent been the closure of the land borders. This protectionist stance is primarily targeted towards the agricultural sector. Therefore, Presco is well positioned to benefit from these various government policies geared towards improving non-oil revenue. In addition to this, the country's palm oil production is 1.02million metric tons, which is 31% lower than the consumption of 1.34 million metric tons. The demand gap of 320,000 metric tons creates room for expansion.

Industry and company overview

The Nigerian palm oil industry has been a major beneficiary of the government's protectionist policy, particularly as it is featured among the list of items banned from accessing foreign exchange. This is consistent with the declaration of the government to discourage the importation of products that can be produced locally.

Despite these developments, Nigeria still depends on imports. Nigeria's demand is roughly 1.34 million metric tons. Only one million of that is met through domestic supply, meaning 320,000 metric tons are imported. This demand for imports paired with a supply glut in the international market and the crash in prices have promoted smuggling activities. This somewhat limited the gains of key players in the palm oil industry. In addition, the long gestation period has limited investment flows into the sector. The major players in the industry include Presco, Okomu, PZ Wilmar and Olam.

Presco began in 1991 as Presco Industrial Limited. The company listed on the NSE in 2002, expanding its reach. The company currently engages in the cultivation and processing of oil palm and palm kernel, through four major oil palm plantations – Obaretin, Sakponba and Ologbo (in Edo State), while the fourth, Cowan, is in Delta State.

Siat SA, the parent company, controls 60% of the company. Siat SA is a Belgian agro-industrial group with core competences in the setup and operation of oil palm and rubber plantations and processing. Some of its major customers include Nestle Nigeria, Wamco Nigeria, PZ Wilmar, and Promasidor among other household consumer goods brands.

Management

Presco's management team is led by Felix Onwuchekwa Nwabuko, a chartered accountant with extensive cross-border experience in project management and consulting. He became the Managing Director of Presco in 2015, having also served in various leadership roles within the group. He was part of the team responsible for the successful listing on the NSE. He is accompanied by a team of versatile and experienced executives, who have built a company with strong fundamentals.

Presco's board has been led by Mr. Pierre Vandebeeck since 2010. Vandebeeck has been instrumental to Presco's successes. He was the pioneer Managing Director, building the agro-processing company from infancy to date and was responsible for the setup of Presco's oil palm plantations in Nigeria. He remains an invaluable asset to the company and has proven to be the vital link between Presco and Siat SA.

MD/CEO

Felix Onwuchekwa Nwabuko

Chairman

Mr. Pierre Vandebeeck

Bulls and Bears say

Bulls say:

- Key player in the oil palm industry
- Alignment between Presco Plc and parent company
- Consistent clampdown on production cost over the years
- Favorable government policies
- Gradual diversification into rubber production
- Experienced and talented management

Bears say:

- Declining commodity prices
- Rising operating and finance costs
- Highly dependent on one commodity
- Highly dependent on government protection to thrive
- Competitive rivalry among the leading players

Risk and Outlook

The major risks that could dampen the attainment of Presco's key objectives and priorities include interest rate risks, regulatory policy risks, currency risks and other systemic risks.

The high-risk premium of the Nigerian economy has adversely impacted the business expansions and operations of companies such as Presco. Similarly, Presco's large funding needs and the susceptibility of agriculture farm-products, especially to weather, pest and storage, have weighed on the debt servicing costs. So, the management of Presco needs to evaluate the adoption of other funding options and other complex financing mechanics.

Economic outlook for the next month

External reserves are likely to deplete further in the coming month. This is because oil receipts are plummeting amidst the coronavirus and the price war between Saudi Arabia and Russia concerning further oil production cut. The slide in reserves will limit the continuous intervention of CBN in the forex market which increases the risk of a currency depreciation. A currency depreciation increases the cost of importation, tapers investments and reduces profit for firms.

In the event that additional OPEC output cuts are agreed on and apportioned, Nigeria could be forced to cut its domestic oil output. This could mean lower oil receipts for Nigeria and further depletion of external reserves (currently close to $35bn).

The likelihood of a further currency depreciation at the I&E window will compound inflationary pressures in the coming month as the import bill increases. Nigeria is highly dependent on imported goods. Thus, a currency depreciation will result in imported inflation.

In addition, the stock market is expected to maintain its bearish performance in the near term. This is owing to the fact that the global and domestic market is weak and there is a lot of negative market sentiment. This increases the possibility of further capital flight.

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