FDC Bi-Monthly Update

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In This Issue ...

No respite for the naira as international flights resume

International flights resumed operations on the 7th of September after a 5-month hiatus induced by COVID-19. The resumption stemmed the appreciation of the naira in the parallel market witnessed last week. The short-lived rally was on the back of the CBN's announcement of the resumption in its weekly intervention to Bureau De Change operators (BDCs) from 7th September to enhance forex accessibility. This ignited panic-selling as speculators anticipated a strengthening of the naira in the parallel market as a result of the increase in supply. The naira has since depreciated by 5.62% at the parallel market (N445/$) in just two days since the resumption of flights after strengthening to N420/$.

The CBN will now sell a total of $10,000 per BDC twice a week at N384/$. The $20,000/week allocation is about 73.3% lower than the previous $75,000/week allocation prior to the COVID-19 lockdown. The impact of increased forex demand by airlines and passengers has outweighed the impact of increased supply on the market thus far and this has triggered further weakening on the parallel market. In the coming weeks, barring increased forex inflows, we are likely to witness further naira weakening at the parallel market as the impact of the CBN's $20,000 weekly allocation to BDCs will be insufficient to match the increased forex demand for foreign travel. This is in addition to the uptick in foreign trade, which will put further pressure on the naira.

The naira could weaken further, back to N470-475/$, in the parallel market as forex receipts remain constrained by lower oil prices and production, amid delays in obtaining the $1.5bn in financial support from the World Bank. With a forex demand backlog mounting (estimated at over $5bn), the CBN could be looking to incentivize Foreign Portfolio Investors (FPIs) with higher yields, to help stem the steady decline in external reserves. With the split of the OMO market in 2019 and lower OMO issuances so far in 2020, the CBN has achieved substantial cost savings in 2020 so there could be ample room to offer FPIs attractive yields to secure more forex inflows.

e-Custom Modernization – Better late than never

The Federal Government has approved $3.1bn for the automation of the Nigerian Customs Service (NCS) operations. The project will be funded through a Public Private Partnership (PPP). The aim is to automate all parts of the customs business (end-to-end) and fully institutionalize the use of advanced technologies to boost the functions of the NCS. This will bring immense value to the country – particularly in the area of revenue generation.

The e-Custom modernization will lead to improvements in clearance efficiency, facilitate trade as well as boost the confidence of all stakeholders. As a result, revenue generated by the NCS is expected to increase exponentially to N66.88trn ($176bn) over a 20-yr period, which comes to N3.34trn ($8.8bn) annually. This means the customs office would generate more than 10 times its previous revenue as leakages due to human intervention will be minimized. Customs contribution to Federal revenue was N357.99bn in 2019. In the first five months in 2020, the government has generated N573bn, 59.87% of the revised 2020 budget of N957bn. With two devaluations of the official exchange rate since March, the NCS is likely to exceed its 2020 revenue target considerably.

The Federal Executive Council (FEC) also approved N13bn for the automation of safety equipment at Lagos, Kano, Abuja and Port Harcourt international airports. The objective is to upgrade and refurbish the safe tower equipment in the aforementioned airports, which would boost efficiency and reduce the workload in the control tower and to automate what was, up till now, an analogue system.

Maize Ban: Food security, but at what cost?

The CBN has approved the importation of maize by only four companies. This decision comes one month after the apex bank banned the importation of maize and restricted maize importers from accessing forex from official sources in an attempt to increase local production and safeguard rural livelihoods. The CBN's actions triggered a maize shortage and a spike in prices. The government is ostensibly seeking to strike a balance between food imports and local production capacities to meet the shortfall. This is in line with its policy on food security and sufficiency. Despite being Africa's largest producer of maize, Nigeria imports about 400,000 tons each year to meet domestic demand. The Federal government also announced plans to release 30,000 tons of maize from the national reserves to animal feed producers to deal with the high cost of poultry production (maize, constitutes over 50% of poultry feed content).

The four companies will import a total of 262,000 tons of maize into Nigeria – Wacot Limited (60,000 tons) Chi Farms (60,000 tons), Crown Flour Mills (22,000 tons) and Premier Feed Mills (120,000 tons). The Nigeria Customs Service has issued a stern warning stating that the exercise would run strictly from August to October during which only the aforementioned 4 companies will be allowed to import maize into the country.

The new development is expected to increase the supply of the commodity in the Nigerian market and moderate its price. It would also reduce the price of products such as golden morn and cornflakes thereby lowering food inflation in the country. Nigeria's food inflation was 15.48% in July and could rise further in the coming months on the back of higher logistics costs. In addition, sorghum which is a substitute for maize will record a fall in its price due to the cross elasticity effect as the demand for sorghum falls. However, the impact of this development on Nigeria's terms of trade is that the import bill will increase, thereby putting pressure on the reserves level and the naira. In the long-term, the CBN's policy should incentivize corn production and could lead to Nigeria becoming a net exporter of the commodity after attaining self-sufficiency.

Electricity tariff hike takes off

After an extended period of controversy, the electricity distribution companies (DisCos) started the implementation of the new cost-reflective tariffs on September 1. This means an average of a 75% increase for the affluent. According to the Nigerian Electricity Regulatory Commission, the tariff will be service-based and the most vulnerable, consuming less than 50KW per day or that receive less than 12 hours of power supply will be exempted from the cost-reflective tariffs.

Metering deficit hits 6.75million

As part of its commitment to lower metering deficit (currently up 50% to 6.75 million in 2020), put an end to estimated and arbitrary billing and increase household accessibility to meters ahead of the electricity tariff, the Federal Government has approved a nationwide mass metering program and a one-year waiver of import duty on electricity meters. This will help to address the meters at the ports that remain uncleared due to the high cost of import duties.

Conclusion

Adopting cost-reflective tariffs was part of the conditions tied to the disbursement of the $750mn World Bank loan. A cost-reflective tariff implies a system where electricity pricing reflects market fundamentals and removes the reliance on Government subsidies. Whilst this means that some consumers might pay more for electricity, the investment incentive and improved power supply outweigh the costs.

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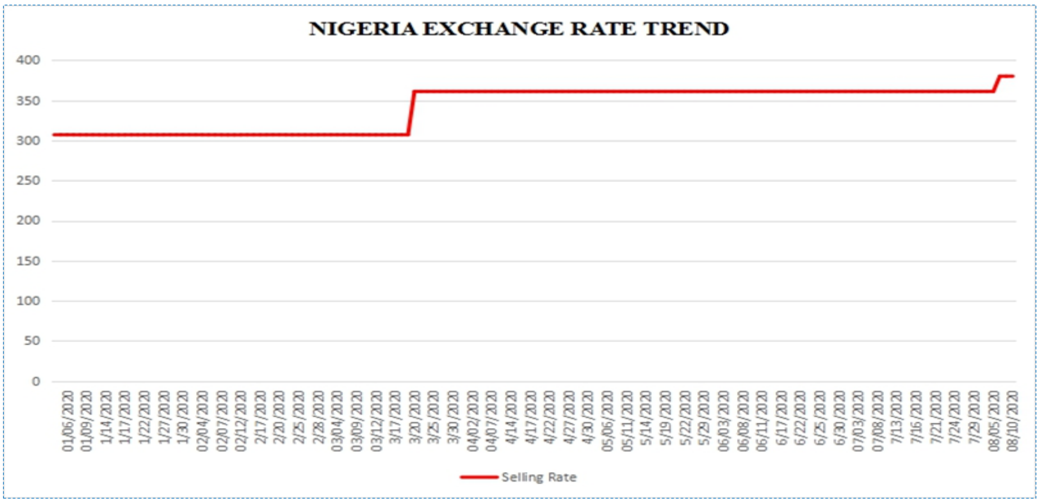
Unification of the exchange rates:
What does this mean and the policy implications?



[1]

The Central Bank of Nigeria devalued the naira at the official exchange rate window by 5.26% on August 6, moving it to N380/$ from N360/$. This recent adjustment is in line with the CBN's effort to converge the exchange rates around the Nigerian autonomous foreign exchange (NAFEX) window rate, which it announced in June. This is the CBN's second devaluation of the official exchange rate in 2020. The first was on March 20 to N361/$ from N307/$. The devaluation is poised to have both positive and negative policy implications, especially given the macroeconomic uncertainty of highly volatile oil prices, rising inflation, COVID-19, and the increasing debt portfolio. Nigeria's inflation rate and total debt portfolio currently stand at 12.82% and N28.63 trillion respectively.

At the NAFEX window, the naira depreciated against the dollar on August 7 by 0.13% to close at N386/$. This was down from N385.50/$ on August 6, which was the day of the CBN exchange rate adjustment.[2] The depreciation shows a narrow exchange rate gap of about N6 as of August 7 between the NAFEX rate and the CBN official rate. Meanwhile, foreign exchange turnover was down 13.54% to $92.22 million (mn) on August 7 from $106.66mn on August 6. The parallel market rate also fell by one naira to N475/$ on August 7, which is N95 higher than the CBN rate. So far, after the second CBN exchange rate adjustment, the naira has depreciated by 0.42% at the parallel market to N477/$ (as of August 24) while the exchange rate remained unchanged at the NAFEX window at N386/$.

[1] CBN Exchange Rate Statistics, FDC Think tank
[2] FMDQ Exchange Rate Statistics, FDC Think tank

The unification of the exchange rates is helpful on a number of fronts. It will help ease regulatory supervision as well as promote transparency in the foreign exchange market. It will limit the cost of CBN interventions in multiple exchange rates and government revenue will be boosted as more revenue will be generated from international trade activities. External reserves will also gain from both the reduction in CBN interventions and the increased trade activities. This will further positively impact trading and foreign investment activities as it ensures that more foreign exchange is available for international business transactions and debt servicing. Finally, government revenue allocated to the Federation Account Allocation Committee (FAAC) for distribution to the 36 states will increase. An increase in the FAAC allocation helps states with their budget implementations, assists in the execution of capital projects at the state level and generally aids economic growth and development of Nigerian states.

Convergence also brings stability, which is favorable for investor confidence in the country, and foreign investment decisions. Stability supports the government and international oil companies with predictability for meeting loan repayment schedules. Stability also helps manufacturers by encouraging continuous production as they can access forex at a uniform rate to source imported raw materials thereby, limiting distortions to manufacturing activities. As a result, the manufacturing sector's contribution to Nigeria's economy should improve, which should in turn positively impact the employment rate and the overall economic performance. Foreign portfolio inflows and foreign direct investment inflows will also increase, which is positive for the capital and money market's operations and development. Finally, the unification of the exchange rate is one of the conditions specified by the World Bank for the $1.5bn loan.

On the other hand, speculative activities in the foreign exchange market (especially the parallel market) are likely to heighten, which will further worsen the liquidity shortage in the foreign exchange market. As a result, banks may be incapable of meeting their forex obligations, which could still drive businesses and investors to the parallel market. Also, investors are anticipating further devaluation, which is likely to further fuel speculative activities in the forex market. Devaluation of the naira will add to Nigeria's inflationary pressure as most industries are import-dependent for their raw materials. Accordingly, the convergence is a bit of a double-edged sword for manufacturers.

While the new stability of the rate will be beneficial as raw material prices will stabilize over the medium term, they are likely to stabilize at higher prices as imports become more expensive. This will increase the cost of production and producers will shift this to the final output in the form of an increase in prices.

Nevertheless, the unification of the multiple exchange rates is a good policy option for Nigeria for all the reasons outlined above and because costs increase regardless of unification or maintaining the gap. While unification will push import costs up, the gap between the exchange rates creates arbitrage opportunities in the forex market for highly influential persons, which also increases costs for businesses. Arbitrage creates the opportunity for influential individuals to create artificial scarcity of dollars especially at the CBN official exchange rate window. This forces businesses to turn to the parallel market to meet their dollar demand, which in turn increases costs in accessing forex. Devaluation also offsets the increased costs of imports by making exports cheaper. This allows local producers to export more, which is positive for their external trade earnings as well as government export earnings.

Going forward, the CBN may have to further devalue the official rate to close the gap with the other forex exchange rate windows. The CBN may also need to adopt a managed floating system to help quicken the exchange rate adjustment process. The managed floating exchange rate system approach to unify rates will aid market efficiency, help deepen market perfection, will require fewer CBN interventions, and is favorable for the country's external reserves and government finances.

Can Nigeria keep Nigerians?
Migration rate after COVID-19

Migration of Nigerians is primarily of two types: emigration and rural-urban migration. The main reason for both types is to find "greener pastures" either in the city, mostly Lagos, or another country, most recently Canada. People want to leave their rural community or the country entirely because of underlying negative factors where they live. Currently, an estimated 20 million Nigerians live in the Diaspora.[3] This is 10% of the total population (200 million). Meanwhile, the population of the metropolitan city, Lagos, increases annually by 3% (currently at 14.3 million).[4]

In addition, the drive to leave the country has made some Nigerians take drastic measures resulting in loss of life. About 3,000 Nigerians in Libya died attempting to cross the Mediterranean Sea, in 2017. Unfortunately, there are currently no adequate incentives to stop this trend. With over 50% of Nigerians below 20 years and the persistent rise in economic uncertainties – sluggish growth rate (1.87%), rising inflation(12.56%), volatile exchange rate (N475/$), high unemployment (23.3%) and poverty levels (42% of Nigerians live below a dollar per day) - the future remains bleak in rural and urban areas.[5]

The COVID-19 pandemic has aggravated the weaknesses in the economy and further widened the gap between where the economy is right now to its potential. Will these trends continue post-COVID-19 and can Nigeria keep Nigerians?

[3]Sharkdam Wapmuk, Oluwatooni Akinkuotu, and Vincent Ibonye, (2014). "The Nigerian Diaspora and National Development: Contributions, Challenges, and Lessons from Other Countries," Kritika Kultura, https://www.researchgate.net/publication/265569685_the_nigerian_diaspora_and_national_development_contributions_challenges_and_lessons_from_other_countries

[4]National Bureau of Statistics, National Population Commission, World Urbanization Prospects, 2020. https://worldpopulationreview.com/world-cities/lagos-population/

[5]National Bureau of Statistics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What are the problems?

A wide range of problems cut across rural-urban migration and emigration.

1. Harsh living conditions – The standard of living including housing conditions, power, and water supply in rural areas does not compare to urban areas. Rural youths dream of a better life in the "city" and are willing to take their chances. The same dreams apply to city-dwellers who yearn for better living conditions by moving to an advanced economy. Factors that tempt them include exchange rate volatility, high food prices, insecurity, social unrest and to an extent, political conundrums. While some rural dwellers leave because of poor living conditions, some urban dwellers leave due to the high cost of living.
2. Fear for the next generation – Everyone wants a better life for their children, even the old woman living in the suburbs of the village. Most do not have a convincing and clear picture of where the country will be in the next few years. The uncertainty forces the decision to relocate to an advanced country or to encourage their children to leave the rural environs for the city.
3. Poverty and unemployment – The limited prospects of getting a job upon graduation continues to rise yearly. About 47% of graduates are unemployed from the total 500,000 that leave college every year and over 80 million Nigerians are considered poor.[6] Hence, fewer job opportunities coinciding with high unemployment will limit the prospects for increased income to lift more Nigerians out of poverty.
4. Education – Rural dwellers leave their states to get better education in the city; meanwhile many others relocate/migrate to other countries to advance their educational qualifications. At the tertiary level, the emigration rate is estimated at 36%. This shows the need for a curriculum and educational facilities review. This is particularly important now that there is a shift to skill/experience/professionalism from theory/certificates.
5. Infrastructural development – The bad roads, poor electricity, no rail system among other underdeveloped infrastructure projects are major constraints to the ease of doing business in the country. Therefore, we find that MSMEs business owners really look forward to leaving the country to create opportunities elsewhere.
6. Institutional problems – Poor implementation of policies, misappropriation of funds, inadequate data and resource misallocation are impeding factors to the development of various states and the economy at large.

[6] Yomi Kazeem, 2016. "About half of the university graduates in Nigeria cannot find jobs" Quartz Africa https://qz.com/africa/603967/about-half-of-the-university-graduates-in-nigeria-cannot-find-jobs/

Impact of emigration

The high emigration rate results in an increase in Diaspora remittances. Remittance inflows rose by 25% from $20.11 billion in 2016 to $25.08 billion in 2018. However, emigration can worsen brain drain across several sectors in the economy, especially the health sector. There is currently a huge deficit in the health sector as Nigeria has just a meager 74,000 registered doctors to cater for a growing population of about 200 million (registered doctors is 0.037% of total population). In addition, an estimated 2,000 medical professionals and doctors leave the country annually.[7] Another impact of a high emigration rate is an increase in capital flight from the country. Between 1970 and 2010, Nigeria lost a staggering sum of $233.9 billion to capital flight transfers,[8] which could have been used to increase the level of industrialization and in turn employment in the country.

Post-COVID-19: Will the migration rate spike?

It is not farfetched to say the pandemic has deepened the current economic paralysis. Thus, with the strong correlation between economic growth/development and the migration rate, there is high probability of the rate rising. In addition, research shows that one in three Nigerians considers emigrating for different reasons ranging from education to better job opportunities and business environments.[9] Therefore, as more economies reopen and people adjust to the new normal to include COVID-19 in the long list of other viruses/bacteria humans currently live with, the emigration rate could increase significantly.

[7]Mercy Abang, 2019. "Nigeria's medical brain drain: health care woes as doctors flee," Aljazeera. https://www.aljazeera.com/indepth/features/nigeria-medical-brain-drain-healthcare-woes-doctors-flee-190407210251424.html#:~:text=According%20to%20some%20estimates%2C%20about,over%20the%20past%20few%20years.&text=Doctors%20have%20blamed%20the%20mass,Nigeria%20it%20is%20just%20%246.

[8]Prof. Igwemma A. A, Assoc. Prof. Egbulonu K. G and Nneji Assumpta C (2018), "Capital Flight and the Nigerian Economy (1986-2016)" International Journal of Development and Economic Sustainability. http://www.eajournals.org/wp-content/uploads/Capital-Flight-and-the-Nigerian-Economy-1986-2016.pdf

[9]CLEEN Foundation. December 18, 2017. "One-third of Nigerians –most of them young and educated –have considered emigrating, study shows", News Release. https://afrobarometer.org/sites/default/files/press-release/Nigeria/nig_r7_pr2_youth_large_majority_of_potential_nigerian_emigrants_18122017_1.pdf

Can Nigeria keep Nigerians? – The way forward

Nigerians will stay in Nigeria if the pace of economic recovery quickens and there is a gradual halt to the disincentives that push Nigerians out of Nigeria and indigenes out of their state. Deliberate actions need to be taken by the government to improve the overall economy. A good way to start could be to address the huge infrastructural gap in both the rural and urban areas. Such focus could speed up rural development and in turn reduce the rate of rural-urban migration that ends up putting pressure on resources in urban areas. Improving infrastructure would also support the business environment. Educational and medical emigration could drop in the event of an uptick in the quality and quantity of educational and medical facilities. Once people perceive an improvement in living conditions they will stay and build the country. The broad goal remains sustained economic development but the process starts with the smaller pieces like fixing power supply, water, flooding, traffic congestion and ease of doing business.

Nollywood blues – Nigeria's film industry has taken a viral knock

But covid-19 may force it to sharpen up

GLOBAL PERSPECTIVE: Culled from the Economist

In the past two decades Nigeria's film industry has blossomed into a mighty national asset. Its romances, family sagas and tales of derring-do are lapped up by many millions of viewers at home, across the rest of Africa and in the African Diaspora. It employs more than a million people and generates nearly $2bn a year from cinema tickets and dvd sales, tv rights, royalties and fees. Lagos, Nigeria's commercial capital and film hub, is said to produce more films than there are stars in the sky.

Films like "Ije", "The Wedding Party" and "2 Weeks in Lagos" have premiered at the poshest international festivals, from Toronto to Cannes. Netflix has set up partnerships. In 2018 it released its first Nigerian film, "Lionheart". In June it teamed up with EbonyLife Films, based in Lagos, to embark on a string of Netflix-branded projects. "Death and the King's Horseman", a play premiered in 1975 by Africa's first Nobel laureate in literature, Wole Soyinka, is to be adapted for the screen.

But covid-19 has given Nollywood a nasty viral knock. Emem Isong, a leading producer, laments the obstacles facing her latest tv series, "City Crimes". She was only two weeks into her six-week filming schedule when a government-imposed lockdown forced her to stop. When production resumed in June, she had to cut her crew in half, buy protective equipment and contactless thermometers, expand accommodation (the crew normally share rooms) and disinfect her locations. The production took much longer. Her budget jumped by a third. She sorely wishes she had taken out an insurance policy.

Yet the pandemic may nudge the industry to tackle some of its shortcomings and improve its chaotic infrastructure. "Maybe this will motivate people to get their own production lots where you can accommodate artists and put all safety measures in place," says Shaibu Husseini, a veteran film critic. [

There is a dearth of good film studios. Moses Babatope, who founded Filmhouse Cinema and FilmOne, a distribution and production company, looks forward to many "better practices".

For one thing, Nollywood would benefit from a national umbrella organisation, overseen by government, that would set standards and would have protected the industry better against covid-19. There are a good two dozen associations and guilds within the industry, but no unifying body like those in Hollywood. The Nigerian government recently set up an ad hoc committee, including actors and comedians, to co-operate against the pandemic. "The industry is so individualistic in its approach," says Mr Husseini. "Nollywood needs a collective front."

That is a challenge. Some of Nigeria's 200 ethnic groups, especially the big ones, have their own film associations. Hausa-language cinema, based in the northern Nigerian state of Kano, has its own label: "Kannywood". "There are so many sub-sections," says Mr Babatope. "For too long the mentality has always been about being giants in our little corners, as opposed to collective, harmonious growth...As we get better, as we get more investments, as we get more attention, you'll find out that the best practices will rub off on us."

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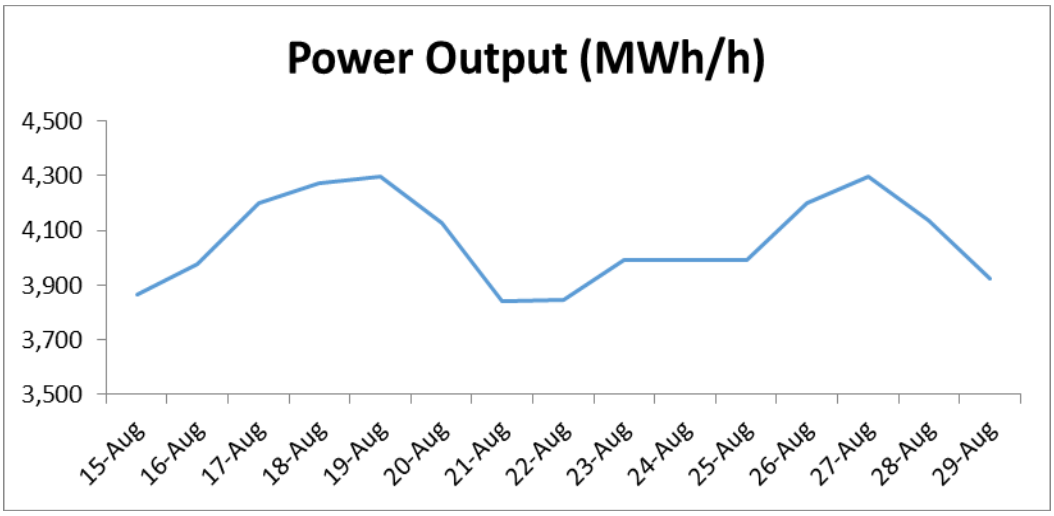
Macroeconomic Indicators August 16th – 31st

Power Sector

During the review period, the average power output stood at 4,064MWh/h, 2.06% higher than the average output in the corresponding period in July (3,982MWh/h). Power output during the period was primarily affected by gas (34,737MWh/h) and grid (31,069MWh/h) constraints. Total constraints within the review period was 66,123MWh/h, resulting in a revenue loss of N31.74 billion (annualized at N380.88bn).

In the review period, the federal government approved a one-year waiver of import duty on electricity meters. This is expected to temporarily ease the cost burden which the Discos bear and positively impact their revenue while it increases meter accessibility to customers.



[10]

Outlook

Power output is largely dependent on gas availability, which has been insufficient and poses a huge threat to power supply. Meanwhile, the cost reflective electricity tariff is expected to commence in September. This will serve as additional support to the power sector and improve power supply. In addition, the approval of five tariff service bands to reflect the relative quality of service experience will incentivize increased power output.

Impact

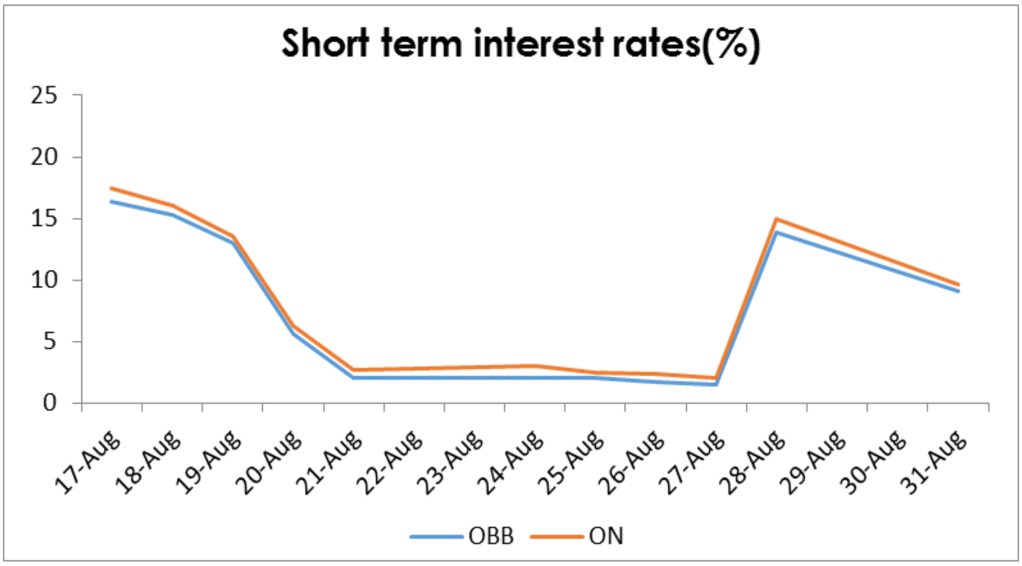
An increase in power supply implies that companies will source less for alternative energy, pushing down their operating costs.

[10]FG, FDC Think Tank

Money Markets

Average liquidity within the banking system fell by 21.36% to N358.58 billion during the period compared to N455.99 billion recorded in the corresponding period in July. The decline in naira liquidity was in spite of a net inflow of N10.86 billion in the review period. Total OMO sales during the period was N169.77 billion while total OMO maturities stood at N180.63 billion.

The NIBOR (OBB/ON) rates averaged 7.86%p.a. in the review period, up 256bps from 5.30% p.a. in the corresponding period in July. Meanwhile, OBB and ON reached a period-low of 1.50% p.a. and 2.00%p.a. respectively on August 27th, before increasing to close the period at 9.10%p.a. and 9.60%p.a. respectively.



[11]

At the primary market, there was a Treasury Bills auction of N197.59 billion on August 26 and the auction was oversubscribed by 12.31%. When compared to the previous auction on August 12, T/bill yields declined at the 91-day tenor while it increased across the 182-day and 364-day tenors. At the secondary market, T/bill yields rose by an average of 97bps for the 91-day and 364-day tenors while it decreased at the 182-day tenor.

[11]CBN

T/bills Tenor	Primary market rates as at Aug. 12th (%pa)	Primary market rates as at Aug. 26th (%pa)	Direction	Secondary market rates as at Aug. 17th (%pa)	Secondary market rates as at Aug. 31st (%pa)	Direction
91	1.20	1.15	↓	1.21	2.37	↑
182	1.39	1.80	↑	1.30	1.00	↓
364	3.20	3.34	↑	2.30	3.08	↑

[12]

Outlook

We expect interbank interest rates to remain at current levels pending any withdrawals or injections into the system.

Impact

A decline in naira liquidity in the system will push up interbank interest rates and increase the cost of borrowing in the money market.

Forex Market

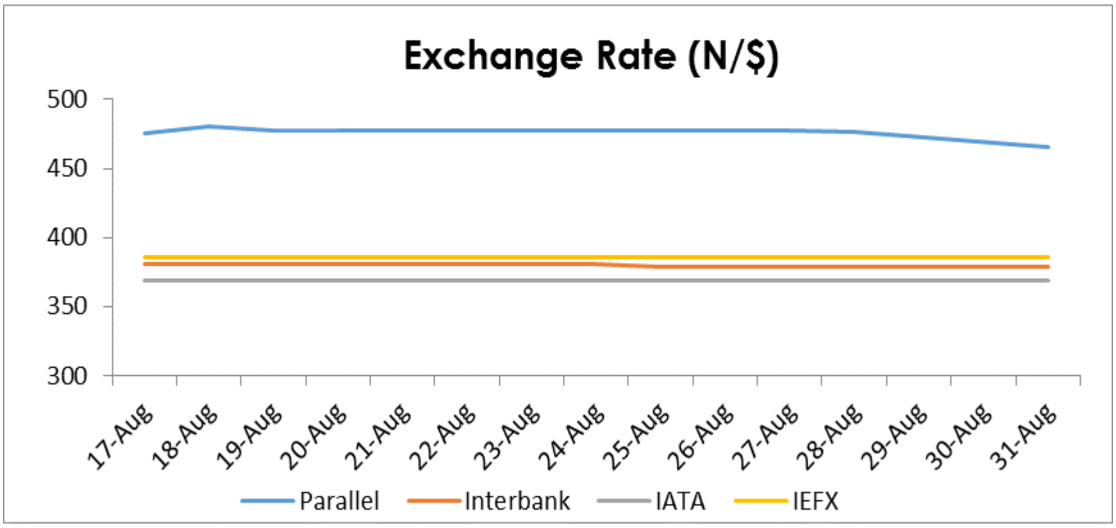
The Nigerian forex market is segmented with multiple exchange rates. The most important being the Investors and Exporters window (IEFX). No less than 55%-60% of Nigerian forex transactions are traded at this window. The CBN and most exporters and investors use this window. It serves not only as a source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

Exchange Rate

The naira was relatively unstable across the various segments during the review period. At the parallel market, the naira was N475/$ at the start of the period, it depreciated to N480/$ on August 18th before retreating to close at N465/$ on August 31st. The strengthening of the currency was as a result of reports of the resumption of CBN forex sales (September 5) to Bureau De Change (BDC) operators as international flights recommence. Between August 17 and 24, the naira remained flat at N381/$ at the interbank market before strengthening to close the period at N379/$.

[12]FDC Think Tank

At the IEFX window, the naira traded within a tight band of N385.67-N386/$ during the review period to close at N385.67/$ on August 31. This represents a 0.03% appreciation in value compared to N385.78/$ at the beginning of the period. Total turnover at the IEFX window increased by 20.37% to $471.6mn in the review period from $391.8mn recorded in the corresponding period in July.



[13]

Outlook

We expect heightened forex demand pressures in the coming weeks driven by the resumption of international flights on September 5th. This would weigh on the naira and trigger currency instability.

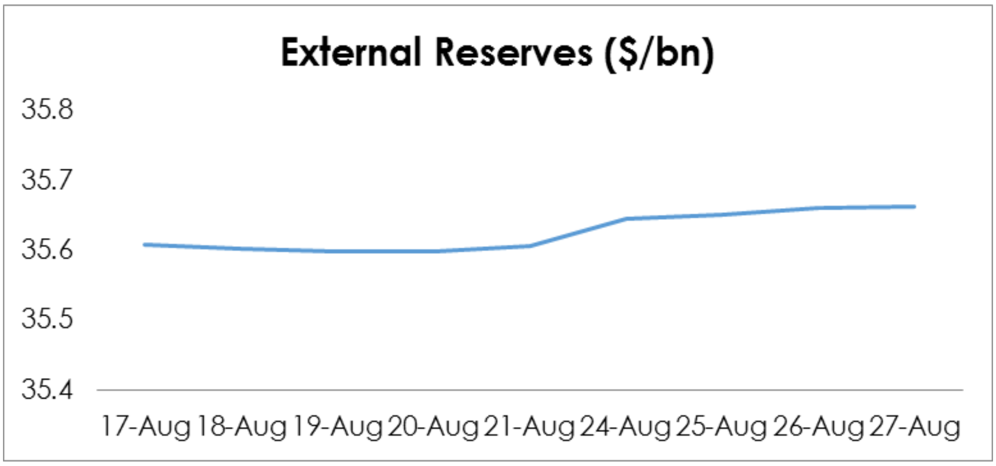
Impact

Exchange rate instability is negative for sectors that are highly dependent on imported inputs such as manufacturing.

External Reserves

Between August 17 and 20, gross external reserves continued its declining trend, losing 0.03% (10.95mn) to $35.60bn on August 20 from the period opening value of $35.61bn. However, external reserves bucked its declining trend on August 21, increasing steadily to close the review period at $35.66bn on August 27 partly due to the uptick in oil prices. This brings the country's payment and import cover to 8.88 months from 8.87 months at the start of the period.

[13] FMDQ, CBN, FDC Think Tank



[14]

Outlook

The increase in forex supply as the CBN resumes forex sales to Bureau De Change operators would cause a resurgence of external reserves depletion, which could fall below $35bn threshold in coming weeks.

Impact

External reserves depletion would negatively affect the CBN's ability to intervene in the forex market which will result in additional pressure on the naira.

[14]CBN

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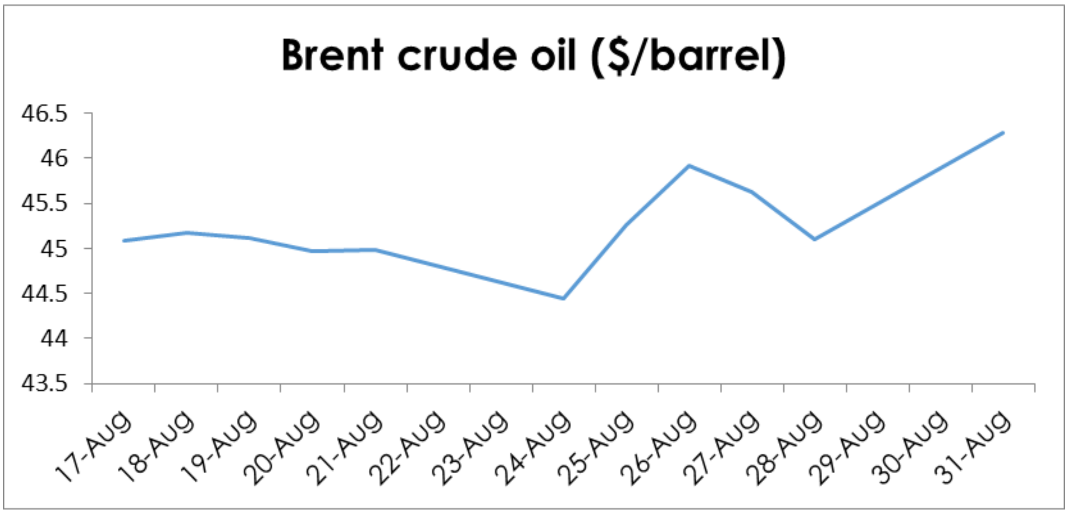
Commodities Market - Exports

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

Oil Prices

Brent price averaged $45.27pb in the review period, 4.09% higher than the average of $43.50pb in the corresponding period in July. Oil prices crossed the $46pb threshold on August 31 as a result of increased global oil demand. During the period, OPEC+ pledges sent positive signals to the global oil market which gave support to oil prices.



[15]

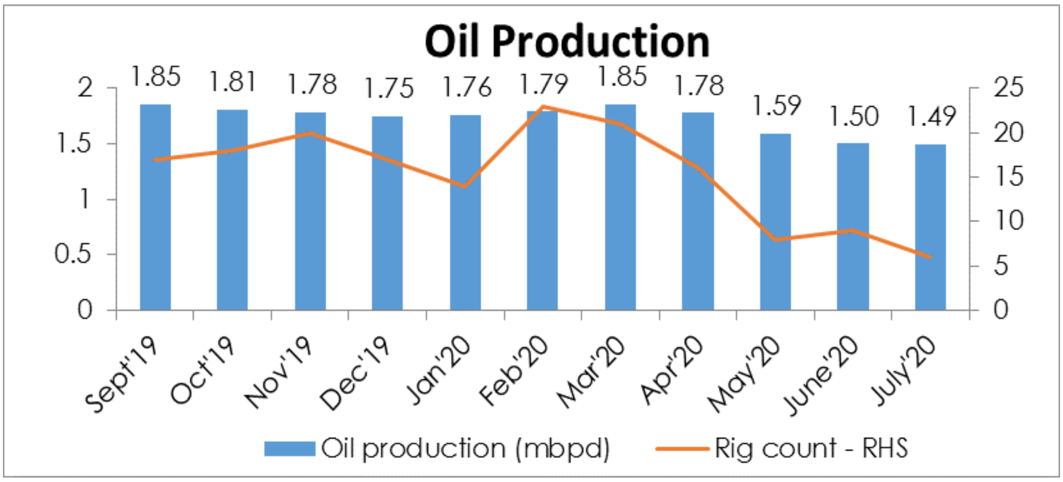
Outlook

Oil prices are expected to further pick up in coming weeks supported by the recovery in global oil demand and the consistent supply cuts by oil producers.

Oil Production

Nigeria's oil production declined marginally by 0.67% to 1.49mbpd in July from 1.50mbpd in June. This was partly due to a drop in the country's rig count to 6 in July from 9 in June. On the other hand, OPEC's crude oil production rose by 4.04% to an average of 23.17mbpd in July from 22.27mbpd in June. Oil output increased in Saudi Arabia, UAE, Kuwait and Iraq, while production decreased in Angola, Congo and Gabon.

[15]Bloomberg



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Outlook

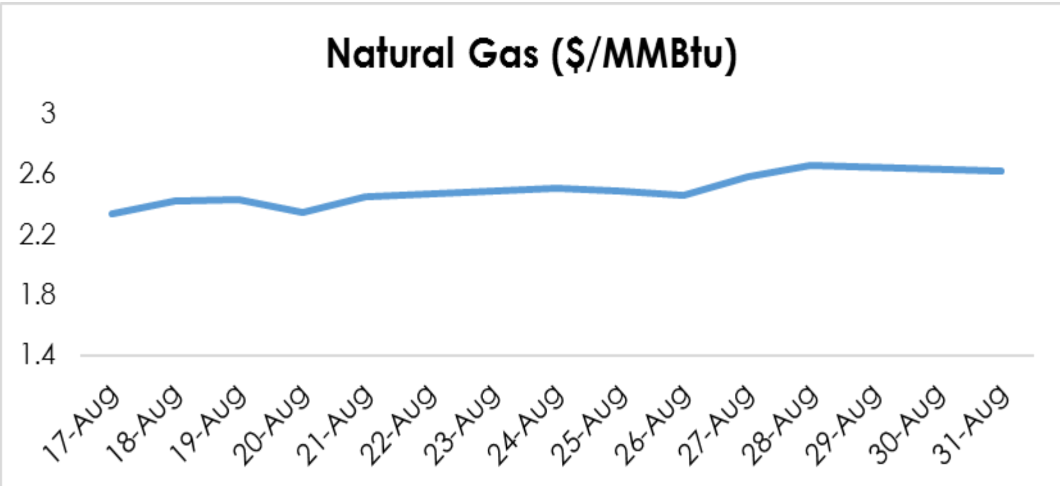
Nigeria is expected to further reduce its oil output in subsequent months in fulfillment of its pledge to OPEC+ to compensate for previous overproduction.

Impact

Crude oil accounts for approximately 90% of Nigeria's total export. A decline in oil output would weigh on the country's export earnings, fiscal and external buff-ers. This would have a negative trickle-down effect on proxies such as exchange rate stability.

Natural Gas

The average price of natural gas rose sharply by 41.71%to $2.48/mmbtu during the review period from an average price of $1.75mmbtu in the corresponding period in July. This was due to a pickup in the demand from China as it entered the colder months.



17

[16]OPEC and Baker Hughes
[17]Bloomberg

Outlook

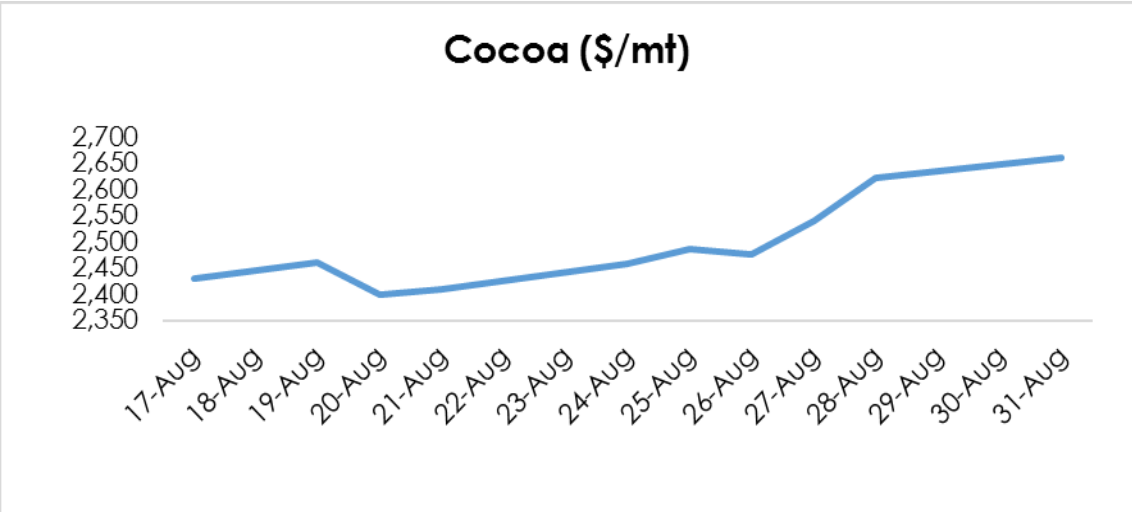
We expect LNG prices to fall in the near term due to supply concerns over the discovery of a new gas field in Saudi Arabia.

Impact

A decline in the global price of LNG will impact negatively on Nigeria's export revenue and fiscal balances as the commodity is one of the country's main exports (13%[18] of total exports).

Cocoa

Cocoa prices averaged $2,490/mt during the review period, 11.06% higher than an average of $2,242/mt recorded in the relative period in July. The increase in price was driven by expectations of global supply shortfalls amid unfavorable weather conditions.



[19]

Outlook

Cocoa prices are expected to edge higher on the back of unfavorable weather conditions leading to cocoa supply shortages.

Impact

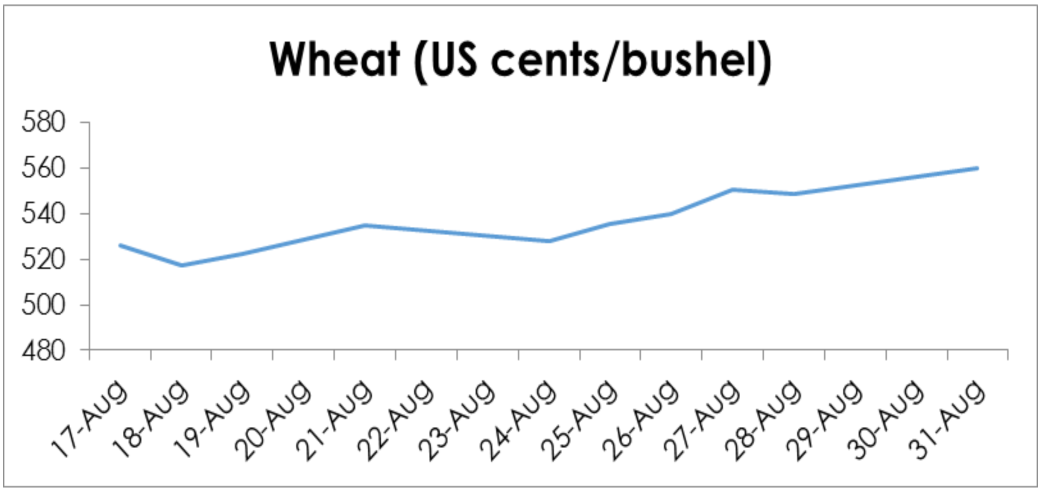
Nigeria is a major producer of cocoa globally and an uptick in the global price of cocoa bodes well for the country's non-oil export earnings.

[18]EIU
[19]Bloomberg

IMPORTS

Wheat

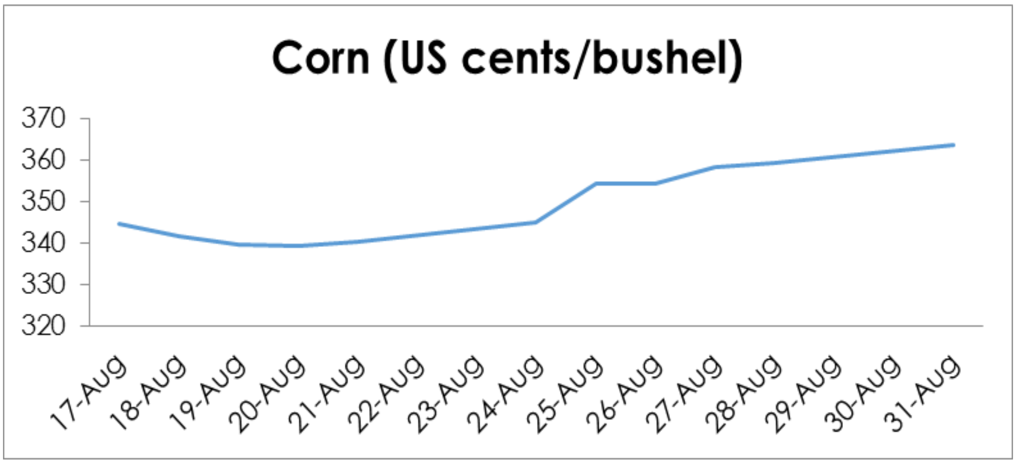
The average wheat price in the review period increased by 0.64% to $535.64/bushel from an average of $532.21/bushel recorded in the corresponding period in July. The increase in price was due to reduced global wheat supply.



[20]

Corn

Corn prices averaged $349.21/bushel in the review period, up 5.09% from $332.30/bushel recorded in the corresponding period in July. The increase in the price of corn was driven by poor crop yields amid unfavorable weather conditions particularly in the US.



[21]

[20] Bloomberg
[21] Bloomberg

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Outlook - Grains

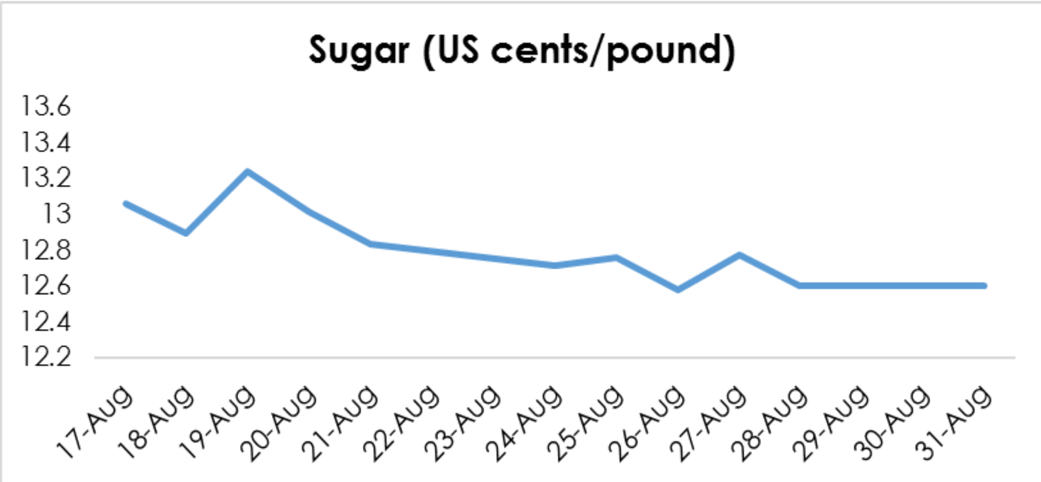
The bullish trend of grains prices is expected to be sustained in the near term due to supply concerns.

Impact

An increase in the global price of grains would result in higher costs of production for companies in Nigeria that depend on grain import.

Sugar

The average price of sugar during the review period rose by 7.73% to $12.82/pound from $11.90/pound in the corresponding period in July in spite of the boost in sugar production in Brazil, which is a major sugar producer.



[22]

Outlook

We anticipate a decline in the global price of sugar in the near term due to a surge in global supply.

Impact

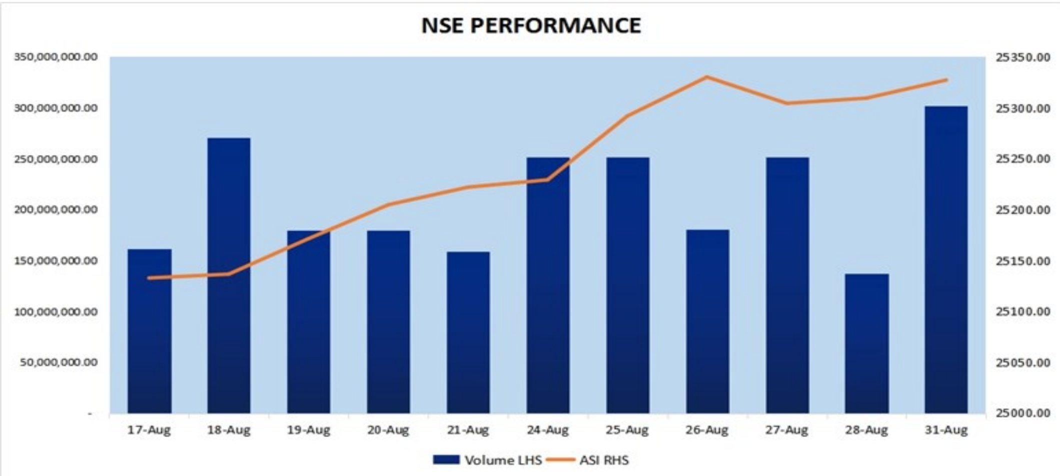
A decrease in global sugar prices is expected to yield a fall in Nigeria's import bill as the country is a huge importer of the commodity.

[22] Bloomberg

Stock Market Review

The Nigerian bourse closed on a positive note in the second half of August as it gained 3.46% to close at 25,327.13 points on August 31st from 24,479.16 points on August 14th (close of the first half of August). In the same vein, market capitalization was up 0.46% (N60bn) to N13.21trn relative to its close of N13.15trn on August 14th. Meanwhile, the market has lost 5.64% YTD so far in 2020. During the 11 trading days of the review period, the market gained in 9 days and lost in 2 days.

The NSE traded at a price to earnings (P/E) ratio of 8.90x as of August 31st, 1.48% higher than the close of August 14th (8.77x). The market breadth was negative at 0.80x as 33 stocks gained, 41 lost while 89 stocks remained unchanged.



[23]

On the other hand, market activity level was negative in the review period. The average volume traded was down 8.68% to 211.18mn units in the second half of August from 231.25mn units in the previous period. Similarly, the average value of trades declined by 24.69% to N1.83bn from N2.43bn in the review period.

[24]

[23]NSE and FDC Think tank
[24]NSE and FDC Think tank

The sector indices were broadly positive during the review period. The insurance sector gained the most (3.67%), followed by the consumer goods sector (2.77%), industrial sector (1.16%), oil & gas sector (0.56%) and banking sector (0.07%).

University Press Plc topped the gainers' list with a 48.65% increase in its share price. This was followed by International Breweries Plc (34.55%), Champion Breweries Plc (30.99%), FTN Cocoa Processors Plc (30%) and Lasaco Assurance Plc (10.71%).

TOP 5 GAINERS				
Company	**Aug-17 (N)**	**Aug-31 (N)**	**Absolute Change**	**Change (%)**
University Press Plc	1.11	1.65	0.54	48.65
International Breweries Plc	2.75	3.70	0.95	34.55
Champion Breweries Plc	0.71	0.93	0.22	30.99
FTN Cocoa Processors Plc	0.20	0.26	0.06	30.00
Lasaco Assurance Plc	0.28	0.31	0.03	10.71

The laggards were led by C and I Leasing Plc (-18.18%), Associated Bus Co Plc (17.02%), UACN Property Development Co Plc (-10.53%), Guinness Nigeria Plc (-10.39%) and Beta Glass Plc (-9.99%).

TOP 5 LOSERS				
Company	**Aug-17 (N)**	**Aug-31 (N)**	**Absolute Change**	**Change (%)**
C and I Leasing Plc	4.40	3.60	0.80	-18.18
Associated Bus Co Plc	0.47	0.39	0.08	-17.02
UACN Property Development Co Plc	0.95	0.85	0.10	-10.53
Guinness Nigeria Plc	15.40	13.80	1.60	-10.39
Beta Glass Plc	61.55	55.40	6.15	-9.99

Outlook

We expect that the stock market performance will be volatile in the medium term. The steep contraction of the economy at -6.10% in Q2'2020 will negatively impact investor confidence. Meanwhile, the positive outlook of the financial sector which was up 28.41% (highest growth in Q2) may drive bargain hunting – especially for banking stocks – in the medium term. Yet, increased demand of stocks from bargain hunting may not be sufficient to drive a sustained positive market performance as the economy is expected to fall into a technical recession in Q3'2020.

Corporate Focus: Flour Mill Nigeria

Analyst's note

Market Capitalization: N77.91bn
Current Price: N19
Industry: Consumer Goods

Flour Mills of Nigeria (Flour Mills or FMN), a leading integrated and diversified food business and agro-allied group reported impressive results in both Q4'20 (end March) and Q1'21 (end June), beating most analysts' expectations. The performance implied a significant positive impact of last year's border closure. The company reported a 14.7% increase in revenue to N154bn in Q1'21 while profit for the period jumped by 17.2% to N4.97bn. The solid growth in revenue was mainly demand driven as price increase was negligible despite forex challenges. The increase in bottom line was driven by revenue growth as the company reported an increase in operating and interest expense at 3% and 7% respectively. The result also suggests FMN fared better than peers in spite of the Covid-19 pandemic, with gross margin expanding by 4.3% to 16.5%, its highest since Q4 2015.

Flour Mills has shown its capability to deploy solid strategy to be able to capture opportunities presented by recent government policies. However, naira devaluation remains a source of significant risk to its operations. This is because the company is largely dependent on imports with about 75% of its raw materials sourced in the international market and the current economic conditions will hinder the company from passing the full cost to consumers. Management has stated plans to increase domestic sourcing of raw materials from 25% to 40% by 2024 which will reduce the company's exposure to forex.

THE FLOUR MILLING INDUSTRY

Nigeria, with a population size of 203.23 million people and a population growth rate of about 2.6% (according to the World Population Review), is the largest importer of wheat – the primary raw material of milling companies – in sub-Saharan Africa, and this is expected to be the case going forward, with imports expected to increase by 200,000 MMT (about 4%) in marketing year ('MY') 2019/20 to 5.6 million metric tons compared to MY 2018/19 numbers based on food, seed, and industrial (FSI) usage. This growth in FSI wheat consumption is a consequence of increasing urbanization, population growth, and change in taste as consumption of wheat-based products in the country has increased.

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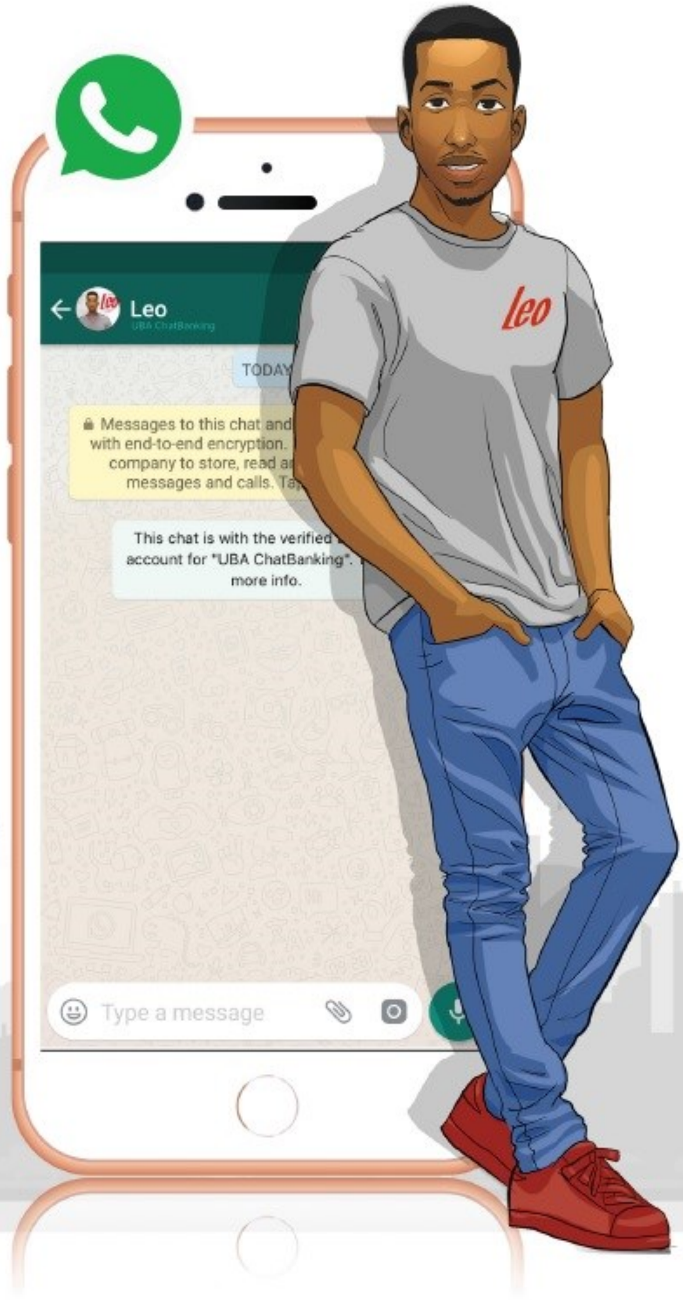

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The Nigerian government, however, is looking to 'incentivize' industry players to source their raw materials locally by requiring millers to purchase local wheat at a fixed price of $400 per metric ton, compared to the global market price of $500/MT. Having said that, this incentive isn't working because wheat farmers would rather sell to not-for-profit organizations or export at premium rates than sell to industry players. Also, unfavorable characteristics of locally-sourced wheat – higher protein content, lower moisture, and lower gluten – compared to its import substitute is another reason the industry is still largely import-oriented.[25]

In addition, macro-economic indicators have been negative due to the contraction in economic activities (negative growth rate, rising inflation and unemployment). Consumer disposable income has also fallen sharply.

The flour milling industry is oligopolistic in nature with high barriers to entry and high concentration. The industry is dominated by very few players. The three largest players account for approximately 75% of the total revenue, with Flour Mills of Nigeria ('FMN') accounting for about 32% of the total market share. Key players within the industry operate at an average capacity utilization of about 50% or less but FMN is estimated to operate at about 70%, and this has enabled the company to maintain its market dominance across the different regions in the country.

FMN was incorporated in September 1960 as a private limited liability company and has been serving the needs of generations of Nigerians ever since. In 1978, FMN became a public limited liability company and its shares were subsequently listed on the Nigerian Stock Exchange. The company's interest in becoming the nation's leading food business company is furthered by entities operating in agriculture, livestock feed and pasta manufacturing.

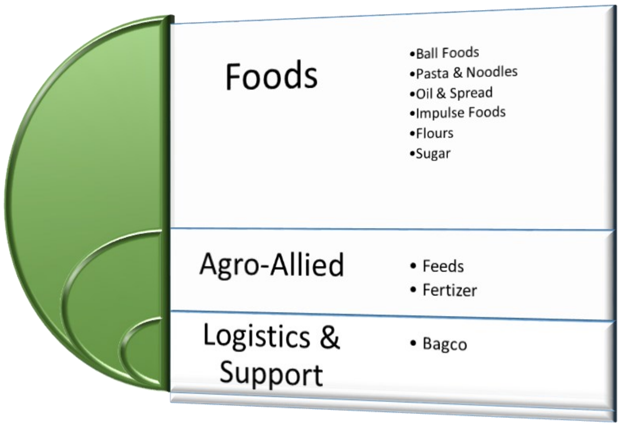
The company's major revenue sources are from sales of goods and rendering of services. Its revenue stream by segments include Food (with products like Golden Penny-: Spaghetti, Noodles, Wheat, Flour, Semovita, etc.), Agro-Allied (Products like Vegetable Oil, Soya Oil, Margarine, and NPK fertilizers), Sugar (Golden Penny Sugar), and Support Services

- Food: - includes processing, production, and sales of flour, rice, pasta, snacks, sugar and noodles.
- Agro Allied: involves farming of maize, cassava, soya, sugar cane and oil palm; also production and sales of fertilizer, edible oils and livestock feeds.

[25] United States Department of Agriculture | Foreign Agricultural Service

- Sugar: - Harvested sugarcanes are processed, refined into sugar, and sold as granulated or cube sugar, likewise sale of by-products from sugar refining.
- Support services: - This segment manufactures and markets laminated woven polypropylene sacks and flexible packaging materials. Another service rendered includes Port terminal operations, Customs clearing and forwarding, Shipping and haulage services, and Leasing of investment property.

The Sugar business was initially integrated in the food segment, but became a stand-alone segment following the acquisition of and the restructuring strategy. It is still striving to maximize its potential, and on existing customers from other product line. It is yet to gain a sizeable market share to complement the resources used and the undergoing business expansion.



MANAGEMENT AND GOVERNANCE OVERVIEW

We find most of the qualities of the board to be in line with best practices. The board is made up of 14 members who have the necessary skills and vast experience across regions that make them more than capable to make sound decisions for the company. The role of the board is separated from the management's, as it is responsible for recognizing the risks the company faces and distinguishing these risks into different categories based on the magnitude and likelihood of said risks occurring.

John G. Coumantaros is the Chairman of the Board of Directors for Flour Mills of Nigeria Plc (FMN), a position he has held since 10th September, 2014. He is an experienced and successful entrepreneur who sits on the Board of several international companies, including ELBISCO, a fast moving consumer food business in Athens, Greece. Mr. Coumantaros has over 30 years' experience in international trade, logistics, manufacturing, and industry, and is passionately dedicated to continuing the evolution of FMN with its Golden Penny Food Brand as one of the leading fast moving consumer food companies and largest agro-allied concerns in Nigeria and in Africa.

John G. Coumantaros

Paul Gbededo, a Fellow of the Polymer Institute of Nigeria and Managing Director of FMN's Agro-Allied Business, has been the Group Managing Director/Chief Executive Officer of FMN since 1st April, 2013. He was educated at the Polytechnic of North London UK and Rubber Institute and Associateship of National College of Rubber Technology in 1980. He also holds an MSc. Degree in Polymer Technology (1981) of Loughborough University of Technology, UK. Paul's over 30 years' career with FMN Group started at Nigerian Bag Manufacturing Company Plc (1982 – 1998). He has also served as a pioneer General Manager/Director for Golden Pasta Company Limited, a former subsidiary (now a division) of Flour Mills – which has grown to become Africa's biggest pasta plant.

Paul Gbededo

Bulls and Bears say

Bulls say:

- Large market size in Nigeria and market leadership
- Good regional presence in Nigeria
- Well experienced management
- Change in consumer tastes toward wheat-based products

Bears say:

- Weak consumer spending and decreasing disposable income
- Sustained gridlock along the Apapa wharf road
- Increasing competition from smaller brands

Risk and Outlook

The key risks that could prevent Flour Mills of Nigeria from achieving its strategic goals and meeting shareholder expectations include; Financial and non-financial risk.

Financial risk like; Foreign exchange risk, Credit risk, Liquidity risk (ability to meet short term obligations), Commodity price risk in terms of price movement and unavailability of raw-material, importation ban on key raw materials, and interest rate risk among others.

Other risk includes; Cyber security risk, reputational risk, loss of market share to competitors, regulatory compliance risk.

Although FMN has invested extensively in its backward integration of Agro-Allied product; the company is still relatively exposed to exchange rate volatility on purchases of raw materials and exporting of products to neighboring countries. This shows the importance of a stable foreign exchange market.

Despite the severity of the risks facing Flour Mills, the solid risk management in place, alongside its backward integration agricultural projects, growth and its productive use of debt to fund expansion shows that the company has a viable investment plan. As such, it is a company with prospects to enhance shareholder value.

Outlook for the next month

In the coming month, we expect the economic reform agenda of the government to pick up steam as rising inflation, shrinking growth, weaker naira and bleak unemployment figures point to a significantly deteriorating misery index. We also expect the COVID-19 infection cases curve to flatten further,

Oil prices averaged $45pb which is $2 higher than the average of $43 in July. This triggered the upward review of PMS prices. Further price increases will lead to further hikes in PMS prices in the coming months. Oil production is likely to fall further, in line with OPEC+ sanctioned cuts to Nigeria's quota. We anticipate heightened forex pressures on the back of the resumption of international flights from September 7th. The CBN will increase forex supply as a result but this will be outweighed by forex demand by airlines and passengers. This will also increase the pressure on external reserves and weaken the naira after a brief appreciation.

Inflationary pressures will persist due to higher logistics cost, exchange rate pass through, higher electricity tariffs and PMS pump price. August inflation is likely to cross the 13% threshold. The GDP growth contraction, rising unemployment, mounting inflation and exchange rate pressures, present the MPC with a quadrilemma at its next meeting in September. We expect the committee to lean towards a more accommodative monetary policy stance in an effort to stimulate GDP growth and lower unemployment.

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