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In This Issue …

Fitch Revises Nigeria's Outlook to Stable from Negative

Fitch Ratings, one of the global credit rating agencies, recently revised Nigeria's outlook to stable from negative while affirming the country's credit rating at 'B'. The revision reflects an improvement in the domestic economy following the gradual phasing out of lockdown restrictions and reduced external pressures attributed to the CBN's forex rationing measures and partial exchange rate adjustment. The IMF's $3.4bn loan, amongst others, also helped to moderate the impact of the COVID pandemic and lower oil prices on the economy

Impact

Foreign investors rely on credit ratings to assess a country's credit worthiness, which in turn, influences borrowing costs. The revision of Nigeria's outlook to stable from negative is expected to improve Nigeria's risk perception, thus increasing the country's ability to borrow from the capital market while lowering Nigeria's borrowing costs. The President is set to submit the 2021 appropriation bill to the National Assembly this week. The fiscal deficit is expected to widen to N4.48trn (3.6% of GDP). The improved credit ratings, if sustained, will enable Nigeria access

loans at more favourable terms and lower the country's debt service burden. Timely passage and implementation of the budget will aid the realisation of the government's economic recovery efforts.

In addition, the positive revision to Nigeria's outlook is also expected to boost investor confidence in the Nigerian economy which should spark renewed interest from Foreign Portfolio Investors (FPI). FPI inflows fell sharply by 91.06% to $385.32mn in Q2'20 from $4.31bn in Q1'20. The projected increase in FPI will support the country's reserves level ($35.75bn as at October 2nd), which has been severely affected by dwindling oil prices and cross country movement restrictions.

The potent risks to this outlook include a further drop in oil prices, dollar scarcity and difficulty in repatriating funds, resurgence of COVID infections leading to a precision lockdown and halting international travels and trade as well as a possible default in government's debt repayment.

OPEC – Compliance or Bust

The Organization of Petroleum Exporting Countries (OPEC) and its allies (together called OPEC+) met on September 17, 2020 to reassess plans to further ease output curbs in the coming months, and to assess compliance levels amid wavering global demand recovery. The outcome of the meeting was predictable – total compliance or bust. The Joint Ministerial Monitoring Committee (JMMC) urged OPEC+ members to take further measures, if need be, to prop up oil markets as the global economic recovery stutters. While not announcing additional output cuts, the JMMC emphasized the need for full compliance to agreed quotas – as well as for compensatory cuts by members who had previously exceeded agreed volumes.

Backdrop

OPEC eased output cuts from 9.7 million barrels per day (mbpd) in August to 7.7mbpd in September, amid signs of demand recovery and steadily rising oil prices. But the recent resurgence in COVID-19 cases has dampened the outlook for global oil demand. The cartel went into the meeting following a second consecutive downward review of its oil demand forecast for 2020. According to its monthly oil market report (MOMR) for September 2020, the cartel now expects the COVID-19 pandemic to lower oil demand by 9.5% or 9.5mbpd from 2019 levels. OPEC also adjusted its outlook for non-OPEC supply to a less gloomy contraction of 4.1% as shale oil output recovers. The cartel now fully acknowledges that the negative effects of COVID-19 will hit harder and linger for much longer than previously anticipated. In its report, it says "the impact of COVID-19 related developments on already fragile global economic conditions remain[s] challenging and will require coordinated global policy action from all market participants". [1]

[1]OPEC MOMR, September 2020

Added Pressure

In the build up to the meeting, oil prices fell below $40 per barrel (pb), for the first time since June 25, before recovering to $42pb. This was due to a growing oil glut amid a slow recovery of Asian demand. The bearish sentiment was further fuelled when Saudi Arabia cut its October selling prices in response to a spike in global COVID-19 infections. The bearish sentiment was in spite an improvement in compliance to OPEC+ output cuts. It is also noteworthy that as we enter autumn, the effect of the US summer driving season on oil prices (which typically represents the peak in demand) will fade. In addition, just a day before OPEC met, the US Federal Reserve held interest rates near zero. It also signalled that they would stay there through 2023 until the US achieves maximum employment and 2% inflation. The US dollar rallied in response as markets interpreted the "hold" call as monetary tightening.

A stronger dollar will spark a drain in the current global liquidity surfeit and has negative connotations for capital flows into emerging markets as well as for oil prices. The implications for poorer OPEC members like Nigeria and Venezuela are severe as these countries are battling with deteriorating external balances and widening fiscal deficits.

What next?

In the coming weeks, OPEC+ will be looking to send a strong signal of a united front willing to do "whatever it takes" to drain oil markets of the current glut. That is the only thing under its control right now. With resurgence in global COVID-19 cases and the oil demand picture dimming, a strict adherence to quotas or going above and beyond to keep the cartel's total production below the agreed cut of 9.7mbpd is the only weapon OPEC has in its armoury. Nigeria and other serial defaulters like Iraq, who are grappling with major fiscal challenges, have asked the group to extend the period for compensatory cuts to the end of December 2020. Markets are paying keen attention, not just to the compensatory cuts but to production in the United Arab Emirates that was as much as 20% over the limit. The prospect of increased oil production in Libya remains another major worry. The country, which is in the middle of a civil war that has virtually shut down its oil industry, is exempt from oil cuts. Production is down to 100,000bpd from 1.1mbpd at the end of 2019 and this could be restored soon.

some support. However, in the event of another round of global lockdown measures and oil demand stalling back to levels in the second quarter, is OPEC willing and able to respond in the same measure that it did to prop up oil prices? Given the financial losses incurred by the poorer and more vulnerable members, will a united front based on common interest still be viable? Or will members start lowering their selling prices to gain market share like the Saudi's earlier in the month? This is unlikely, but in the event that they do, it could degenerate into a free for all – the type that led many to believe that OPEC was faced with extinction in 2016 after it faced unprecedented competition from US shale oil production. With the US shale industry on the verge of bankruptcy, OPEC will do well to stay the course and ride out this storm.

The Paradox of Thrift and the Drag on the Nigerian Economy

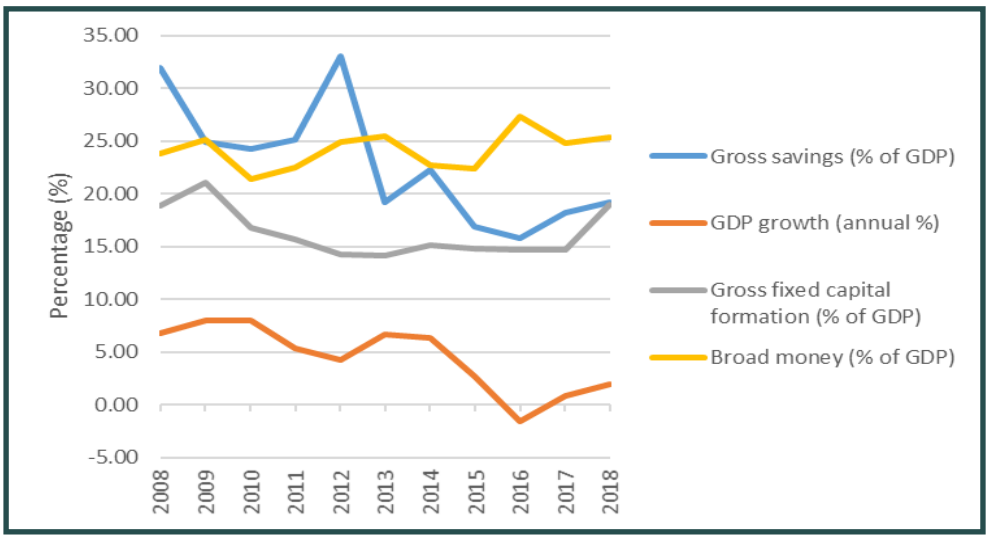
The savings rate in an economy is theoretically a function of households' disposable income, which is the income level of individuals and households after the payment of taxes. Nigeria's national savings rate was last estimated at 19.25% in 2018, 3.4% above the 15.85% recorded in 2016 when the economy was in recession.[2] With the economy at the verge of another recession in 2020, the national savings rate is likely to dip again. Household income levels have been affected by the rise in unemployment levels as companies implemented cost reduction strategies to cope with COVID-induced economic disruptions. The sharp drop in income levels is likely to translate into a reduction in household savings. However, households can also become thriftier after an economic crisis based on a heightened consciousness about their previous experiences.[3] This is evident in the uptick in savings in Nigeria after the 2016 economic recession. Hence, as much as it is expected that savings would rise as the economy rebounds, too much thriftiness among households could become detrimental to the economy.

[2]The World Bank (2020). World Development Indicators. https://databank.worldbank.org/source/world-development-indicators
[3]Ashoka Mody, Franziska Ohnsorge & Damiano Sandri, 2012. Precautionary Savings in the Great Recession. The International Monetary Fund. https://www.imf.org/external/pubs/ft/wp/2012/wp1242.pdf

Paradox of thrift and the Nigerian economy

The paradox of thrift opines that in an economic crisis with prevailing uncertainties, such as the current pandemic, people generally save to protect against further unforeseen circumstances.[4] This implies that instead of a decline in savings to reflect lower income levels, uncertainties about the recovery of the global and domestic economy could keep savings elevated. Empirical evidence from the Nigerian economy however revealed otherwise as savings fell by 1.09% to 15.85% in 2016 from 16.94% in 2015 aligning with the reduction in income.[5] However, in 2017 and 2018, in the aftermath of the recession and with incomes still low, Nigerians remained cautious and savings rose significantly.

A higher savings rate post-recession, despite a relatively low-income level, suggests an uptick in precautionary savings reflecting a lagged effect of the recession on savings. Invariably, as economic activities recover from the severe hit of lockdown measures, improvements in household disposable income may not impact significantly on aggregate demand due to the likely surge in precautionary savings.



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4Corporate Finance Institute (CFI), 2020. "What is the Paradox of Thrift?" Author. https://corporatefinanceinstitute.com/resources/knowledge/economics/paradox-of-thrift/

5The World Bank (2020). World Development Indicators. https://databank.worldbank.org/source/world-development-indicators

6The World Bank (2020). World Development Indicators. https://databank.worldbank.org/source/world-development-indicators

Implications of higher precautionary savings for the Nigerian economy

The tendency of individuals and households becoming thriftier post COVID-19 could prolong the anticipated recovery of the Nigerian economy. Already lock down measures, such as the restrictions on social gatherings, have compelled many households to curb spending on ceremonies as they embrace virtual mediums of interactions. Although the Nigerian government has started to gradually ease these restrictions, there is a possibility that a proportion of the citizenry will continue with the virtual platforms. Nonetheless, relaxed lockdown measures are expected to promote a rebound in economic activities, which is favorable for the country's economic growth trajectory. Meanwhile, the likelihood of an uptick in precautionary savings, as households begin to recover from the impact of the pandemic, could weigh on the economy and slowdown the pace of recovery. The Nigerian economy contracted by 6.1% in Q2'20 from an economic growth of 1.87% in Q1'20, hinged largely on pandemic-induced economic disruptions due to lockdown measures implemented during the period.[7]

Nigeria is headed towards an economic recession in Q3'20 in the absence of informed policy decisions and reforms to stimulate economic growth. There is also the risk of a long road to recovery as prevailing macroeconomic conditions such as negative growth, increasing inflation, external sector weakness and growing unemployment promote higher precautionary savings among the citizenry. The attendant decline in consumption and investment levels suggests the need for increased government spending as well as the implementation of crucial economic reforms to facilitate the recovery of the economy.

[7]National Bureau of Statistics (NBS), 2020. "Nigerian Gross Domestic Product Report (Q2 2020)". Author. https://www.nigerianstat.gov.ng/download/1143

The Never Ending Challenges of Food Security in Nigeria

In August 2019, President Buhari directed the CBN to ban food importers from accessing forex from the official market. This was coming at a time when external reserves was approximately $43.61bn. Twelve months later, President Buhari has again reiterated his disapproval of forex access to finished food and fertilizer importers. Following the crash in Brent price and the sharp drop in revenue, the Federal Government is seeking to ration the country's gross external reserves (which is currently below $40bn).

On the heels of the policy pronouncement and the flood crisis in Kebbi state, reports by Bloomberg and Reuters expressed concerns about the possibility of a food crisis in Nigeria.[8] The rise in food prices amidst unfavorable weather conditions, currency adjustment, hike in PMS price etc. has resulted in a discourse about the idea of food security in the Nigerian context. Sadly, food security, its measurement as well as the different components remain ambiguous to Nigerian consumers, investors and other key stakeholders.

[8]Ruth Olurounbi, Agnieszka de Sousa, William Clowes and Mustapha Adamu. 2020."Bandits Target Nigeria's Farmers and Threaten Food Security". https://www.bloomberg.com/news/features/2020-09-15/a-nigerian-farmer-s-murder-shows-food-security-at-tipping-point

Food security: what is it and how is it measured?

Over the years, the concept of food security has been given different definitions by different international agencies. A common definition is that *"all people at all times have physical, social and economic access to sufficient, safe, and nutritious food that meets their food preferences and dietary needs for an active and healthy life"*. The four components of food security are:

Availability: measures the easy disposal of food items to citizens through the sufficiency of road, rail, and air transport infrastructure.

Access: focuses on household incomes, expenditure and price levels in attaining food security.

Utilization: highlights the nutritional implications of food intake by individuals. For instance, meat consumption in Nigeria is a meagre 9kg per person compared to Middle East and Africa's average of 30.4kg per person.

Stability: This dimension of food security seeks to guarantee that there is a synchronization of all dimensions in order to guarantee a country's food security.

Is Nigeria food secure?

The Global Food Security Index confirms the fragile state of Nigeria's food security as the country ranks 94 out of 113 countries. The index has three components – Affordability, Availability and Quality & Safety – all of which Nigeria ranks and scores poorly. A breakdown of Nigeria's score and rank in the three sub-indices is below:

Sub-Index	Score (out of 100)	Rank (of 113 countries)
Affordability	50.4	90
Availability	45.8	99
Quality & Safety	50.7	79[9]

Using the above metrics, it is obvious that Nigeria is far from being food secure and policy makers must pay more attention to making food available and accessible to all citizens. In addition, Nigeria's ranking, compared to other African peers such as South Africa (ranked 48th) and Botswana (57th), shows that Nigeria is lagging behind its counterparts in food security.

[9]Global Food Security Index. https://foodsecurityindex.eiu.com/Country/Details#Nigeria

Nigeria's journey to food security: The role of food safety net programs

On the journey to food security, research shows that there is no one size fits all approach. The 2007/2008 global food price crisis, which was due to droughts in grain-producing countries, saw different countries adopt varying responses. Whilst Asian countries such as China, Indonesia adopted the suspension/reduction of VAT and other taxes, African countries such as Kenya, Liberia and Nigeria chose to reduce tariffs and custom fees on imports. This shows that a unique response to food security challenges depend on the development needs, social objectives and fiscal capacities of a country.

For Nigeria, a potential option to tackling food insecurity is the use of food safety net programs. Food safety net programs are simply cash or in-kind transfers targeted at the poor and vulnerable. A good example for Nigeria to emulate in introducing efficient and effective food safety net programs is Ethiopia.

Lessons from the Ethiopian Model

In 2005, the government of Ethiopia launched the Productive Safety Net Program (PSNP) as a way of assuring food consumption and providing relief to vulnerable households. Broken down into four stages, the program has so far reached over 8million citizens across four major regions in Ethiopia. The program is funded through a collaborative effort between the Ethiopian government and multilateral agencies such as the Department for International Development (DFID).

The lesson for Nigeria lies in how Ethiopia was able to deliver on the promise of ensuring food security and how vulnerable households were identified. The key take-aways for Nigeria include:

- ***Community engagement:*** The most important task for Ethiopian policymakers was to find and reach the people who needed financial support. Similar to Nigeria, Ethiopia did not have a vast database on the income level of each household. The government chose instead to use information on the districts that were severely affected by frequent droughts. Community committees were also set up with the responsibility to provide information on the families who were in desperate need of cash or food transfers. This helped to build credibility and citizens' acceptance of the government's choice of poor households.

- ***Flexible approach:*** The PSNP adopted a mix of both cash and food transfers to vulnerable households. The government often looked at the peculiarities of each district before deciding which approach to adopt. Communities with meagre amounts of locally produced commodities, bad road networks, few banks and security concerns, often received food payments. The flexibility in approach means that the government was able to offer tailor made solutions and effectively address the needs of the districts.

Conclusion

There is a need for the Nigerian government to pay more attention to food security challenges in the country. Addressing the access, affordability and nutritional aspects of food security would involve a deliberate effort by policymakers to set aside contingency funds and engage key stakeholders. The Ethiopian model offers several learning points for Nigeria to emulate, as this would aid food consumption and reduce the national poverty level.

Inflation Targeting Is a Very Stupid Policy

Global Perspective: Culled from Bloomberg

In trying to increase by a fairly random amount an index of prices that they largely can't control, central banks couldn't have done much more harm.

There is such a thing as good deflation

Much ink has been spilled in recent weeks over the U.S. Federal Reserve's announcement that it will now, in effect, target inflation over the whole cycle. The message from the rest of the developed world's central banks is similar: Most say that if necessary they'll do more to get inflation back on target.

This week Christine Lagarde, president of the European Central bank, laid the groundwork for following the Fed. The ECB will now also allow inflation to overshoot on the upside. Presumably such comments are meant to reassure the handful of people still worried that central banks might move a little hastily once the effects of the pandemic have dissipated and growth and inflation start to pick up.

Economists, strategists and investors have parsed their comments, altered their forecasts and placed their chips accordingly. Yet any discussion of whether inflation targeting is a good thing has been notable by its absence, even before large swathes of the economy were shut down by government edict. This is strange, because to anyone who's not a central banker it has become increasingly clear that inflation targeting is a policy of great stupidity.

When they introduced inflation targeting, starting with the Reserve Bank of New Zealand in 1990, central banks doubtless worried about too much inflation, given their experience in the previous couple of decades. Since the turn of the century, however, they've largely been trying to counter disinflationary forces. Not very successfully, it must be said.

In trying to increase by a fairly random amount an index of prices that they largely can't or shouldn't control, central banks couldn't have done much more harm. They've crushed the savings and finance industry by slashing interest rates to historically low levels and driven the prices of all financial assets to a point where the phrase "unprecedented" scarcely covers it.

Interest rates, bonds, credit, equities, foreign exchange: Not a single market is unmanipulated by central banks. By encouraging sky-high asset prices and huge leverage, they've made it far more likely that the world ends up with the sort of debt deflation that helped make the 1930s depression so awful. Or, failing that, they may be setting us up for an inflationary burst that would hammer the price of pretty much every financial asset.

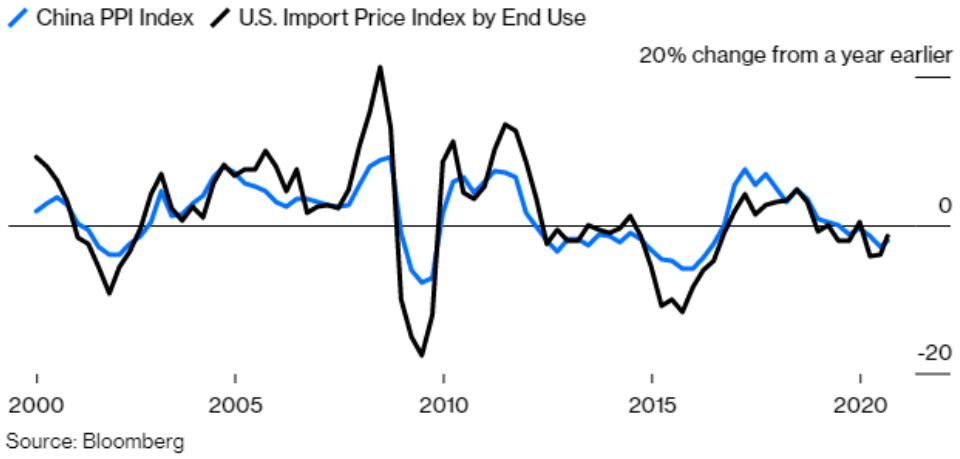
The problems start with what central bankers are trying to achieve. Presumably, if they're to look at inflation at all, they should look only at inflation over which they have some control, to whit domestically generated inflation (broadly, non-traded inflation). However, overall inflation measures also include tradable inflation, which relates essentially to imported goods.

For the biggest economies, roughly a third of overall inflation comes from tradable inflation. And whilst non-traded inflation has remained very stable over the years, the tradable slice has really only headed in one direction: down. Since the global financial crisis, U.S. traded goods prices have fallen about 10 percentage points.

Crucially, these prices are set by North Asia in general and China in particular. If domestic inflation is stable, then the change in the overall consumer-price index must be driven by the far more volatile tradable part. Both the overall direction and the cyclical moves in G7 inflation are thus set by China. Anyone who doubts this should look at a chart of Chinese producer prices and U.S. import prices. In effect, monetary policy in the developed world is dependent on Chinese companies' ability and willingness to turn out things on the cheap.

Spot the Difference

China's producer prices and U.S. import prices move in tandem



Which is where we get to the second problem. This China effect should be a good thing, not a bad one. Such supply-side disinflation is what economists call good deflation. It just means that stuff is cheaper for consumers. The trouble only starts when central bankers try, misguidedly, to offset this imported deflation.

So what happens when they attempt to push overall inflation higher? Simple: Interest rates for the domestic economy end up too low and central banks encourage credit bubbles. The big, crunching problems of the past couple of decades have all been preceded by rapid growth in credit-to-GDP. This applies to the recession after the tech bubble, the global financial crisis and the economic fallout from Covid-19.

You can't blame central banks for a coronavirus. You can, though, blame them for two other things. The first is the amount of leverage, specifically corporate leverage, going into the pandemic. The second is the reason for this buildup of debt: Central banks went into the crisis with, at best, vanishingly small interest rates and balance sheets groaning with assets.

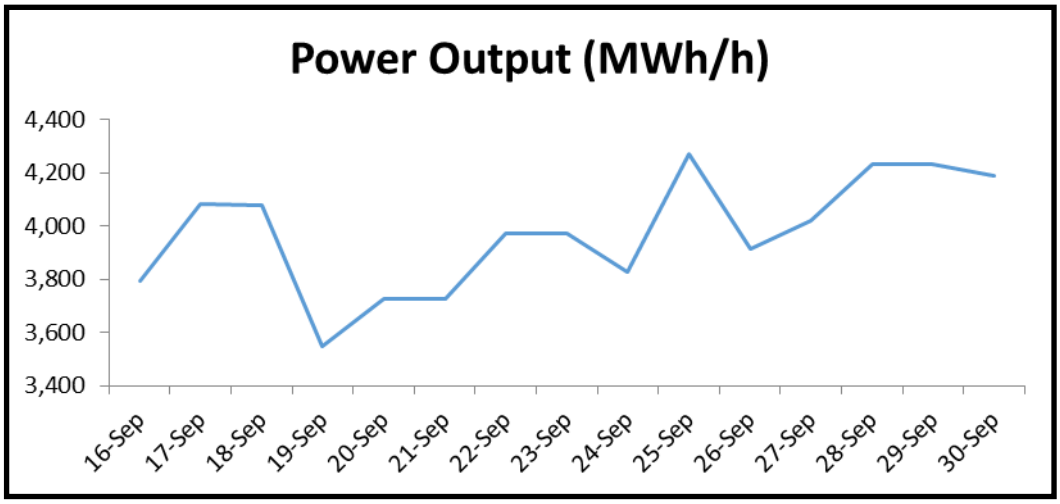
Every new emergency has meant that central banks have had to resort to ever more extreme measures to guard against a vicious debt-deflationary cycle, the conditions for which they helped foster. This time around, the remedy included buying huge swaths of corporate debt. This has encouraged even greater leveraging of companies that were far from shy of debt in the first place. Where's the downside if central banks always bail you out? The answer is: They won't always be able to.

As Andrew Hunt, who runs an eponymous economic consultancy, puts it: "You're climbing ever higher up a cliff so that you can one day fall off at a higher level." Indeed.

Macroeconomic Indicators

Power Sector

The average power output sent out from the national grid fell by 2.24% to 3,973MWh/h in the second half of September from 4,064MWh/h recorded in the corresponding period in August. Gas constraints (34,128MWh/h) accounted for the bulk of total constraints (56,499MWh/h) to power output. A total revenue of N27.12 billion (annualized at N325.44bn) was lost during the period. Meanwhile, the federal government has suspended the electricity tariff increase for two weeks.



[10]

Outlook

We expect average power output to remain within the range of 3,900MWh/h – 4,000MWh/h in the near term. Gas shortages will remain the principal challenge as gas fired thermal power plants account for approximately 70% of total power generation.

Impact

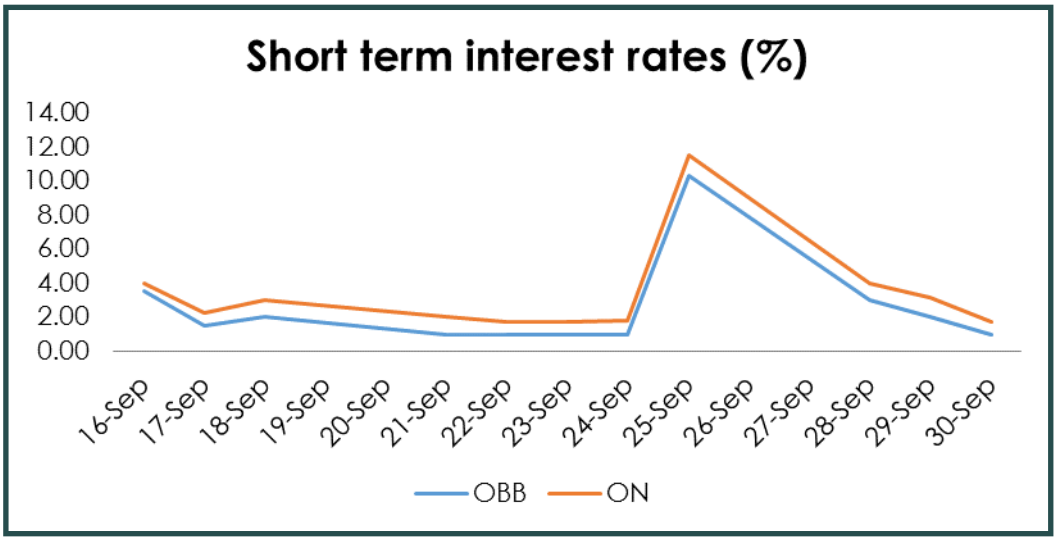
The two weeks suspension of electricity tariff hike is expected to positively impact firms operating costs albeit in the short term.

[10]FGN, FDC Think Tank

Money Market

The average opening position of banks rose by 21.83% to N387.20billion in the second half of September from N317.81 billion in the corresponding period in August. The increase in naira liquidity resulted in a sharp drop in short term interbank interest rates. Average OBB and O/N fell sharply to 2.48%pa and 3.36%pa respectively from an average of 7.50%p.a. and 8.21%p.a. in the second half of August. During the period, OMO bills amounted to N70billion while there were no OMO repayments.

During the period, the monetary policy committee held its penultimate meeting in 2020 on September 21/22. The committee lowered the benchmark interest rate by 100bps to 11.50%pa from 12.50%pa and adjusted the asymmetric corridor to +100/-700bps from +200/-500bps. The CRR (27.5%) and liquidity ratio (30%) were left unchanged.



[11]

Total primary market T/bill auction was N272.72bn in the second half of September. Yields declined across all tenors (91-day, 182-day and 364-day) by an average of 9bps. At the secondary market, T/bill yields moved in different directions. The 91-day tenor increased while the 182-day and 364-day tenors declined.

[11]CBN

Primary Market

T/bills Tenor	Rate on Sep 16th (% pa)	Rate on Sep30th (% pa)	Direction
91	1.09	1.08	↓
182	1.50	1.49	↓
364	3.05	2.80	↓

Secondary Market

T/bills Tenor	Rate on Sep 16th (% pa)	Rate on Sep 30th (%)pa	Direction
91	1.50	1.55	↑
182	1.32	1.20	↓
364	2.50	2.35	↓

[12]

Outlook

Interest rates are expected to remain low in the near term due to the combined effects of the 100bps reduction in the MPR and excess liquidity. Although, we expect increased forex sales by the CBN to cap the fall, it will not be sufficient to push up interest rates.

Impact

Lower interest rates will reduce borrowing costs but could stoke inflationary pressures.

Forex Market

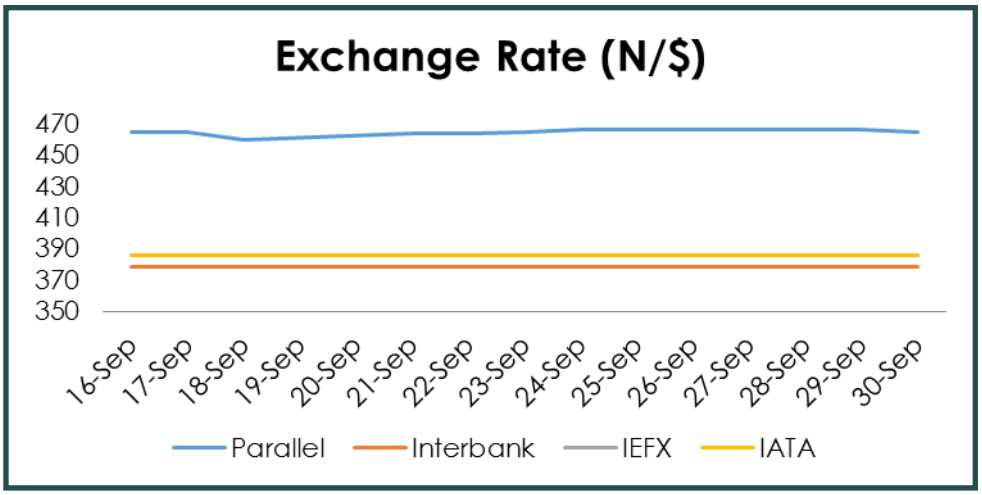
The Nigerian forex market is segmented with multiple exchange rates. The most important rate being the Investors and Exporters window (IEFX). No less than 55%-60% of Nigerian forex transactions are traded at this window. The CBN and most exporters and investors use this window. It serves as not only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

During the review period, the exchange rate was relatively stable across all market segments. At the parallel market, the naira traded within a band of N460/$ -N467/$. It traded flat at N379/$ and N386/$ at the interbank and IATA window respectively.

At the IEFX window, the exchange rate remained within a range of N385.75/$-N386/$. The level of forex activities at the window increased as the average daily turnover rose sharply by 132.4% to $102.67mn from $44.18mn in the second half of August.

[12]FDC Think Tank



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Outlook

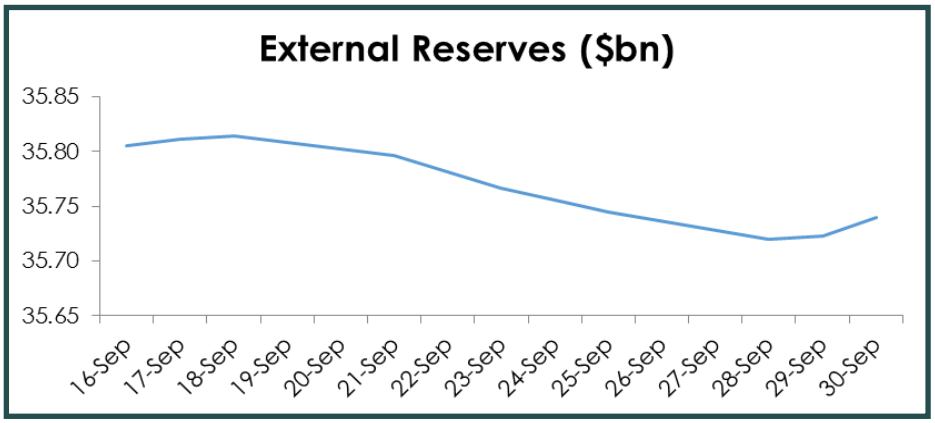
The resumption in international travels and pick-up in trade activities is likely to heighten forex demand pressures. However, we expect the CBN to continue to intervene in the market through its SMIS retail auction and forex sales to the BDCs. This will most likely support the currency. Notwithstanding, the Apex Bank's forex rationing strategy could weaken the naira to N467-N470/$ at the parallel market.

Impact

Currency depreciation would increase the service cost of dollar denominated loans and push up import costs.

External Reserves

The gross external reserves recorded choppy movement during the review period. It increased steadily for the first three days, followed by a steady depletion for 8 days, before retreating to close the period at $35.74bn on forex rationing. Nigeria's import and payment cover closed the period at 8.90 months from 8.91 months on September 15.



[14]

[13]FMDQ, CBN, FDC Think Tank
[14]CBN

Outlook

The gross external reserves are likely to resume the bearish trend on increased forex supply to clear the demand backlog. However, additional loan disbursements from multinational agencies (World Bank) would help to augment the reserves level.

Impact

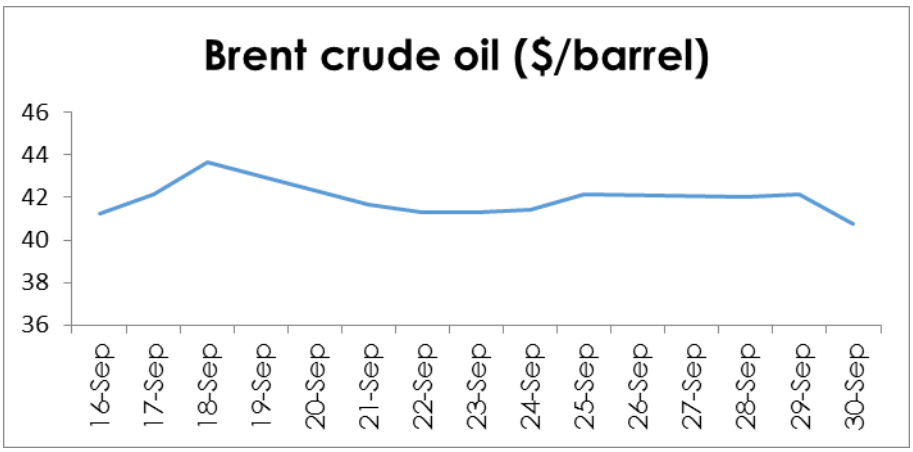
Continued depletion of the reserves level could reduce the ability of the CBN to support the naira.

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

The average price of oil fell by 7.67% to $41.80pb in the second half of September from $45.27pb in the corresponding period in August. This bearish trend was largely driven by concerns over recovery in global demand amid resurgence in global Covid-19 cases. This was compounded by Saudi Arabia's cut to its October selling prices due to weak demand outlook.



[15]

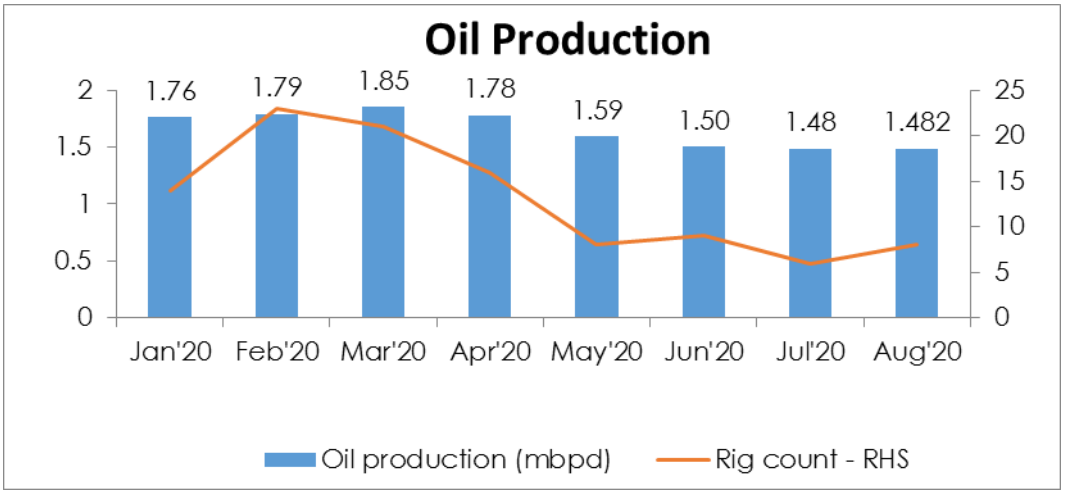
Outlook

We expect prices to remain at current levels due to the slow recovery in oil demand.

[15]Bloomberg

Oil production

Nigeria's oil production increased slightly by 0.14% to 1.482mbpd in August from 1.48mbpd in July. This is 5.11% above the country's OPEC quota of 1.41mbpd. Similarly, the country's rig count rose to 8 in August from 6 in July. OPEC's average oil production was 3.8% higher at 24.05mbpd in August from 23.17mbpd in July. Oil output increased mainly in Saudi Arabia, UAE, Kuwait, Algeria and Angola, while it declined in Iraq.



[16]

Outlook

Nigeria's current oil output (1.48mbpd) is 5.11% above its OPEC quota (1.41mbpd). The likelihood of a pushback from OPEC and its allies further reinforces the chances of Nigeria's oil production dropping below its current level in the coming months.

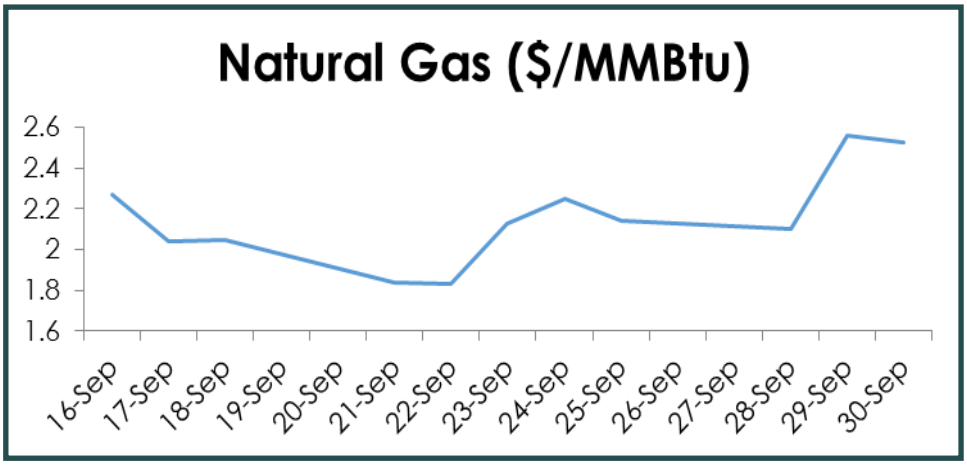
Impact

Lower oil production would further put a strain on government revenue as Nigeria remains more oil production sensitive than oil prices. This would have a negative impact on proxies such as FAAC disbursement. Nevertheless a possible increase in VAT revenue as more business re-open coupled with the exchange rate gains will offset the impact of lower oil revenues.

Natural Gas

During the review period, the average price of natural gas amounted to $2.16/mmbtu, 12.90% below $2.48/mmbtu recorded in the second half of August. The decline in prices was partly due to low demand for LNG especially in China.

[16]OPEC, FDC Think Tank



[17]

Outlook

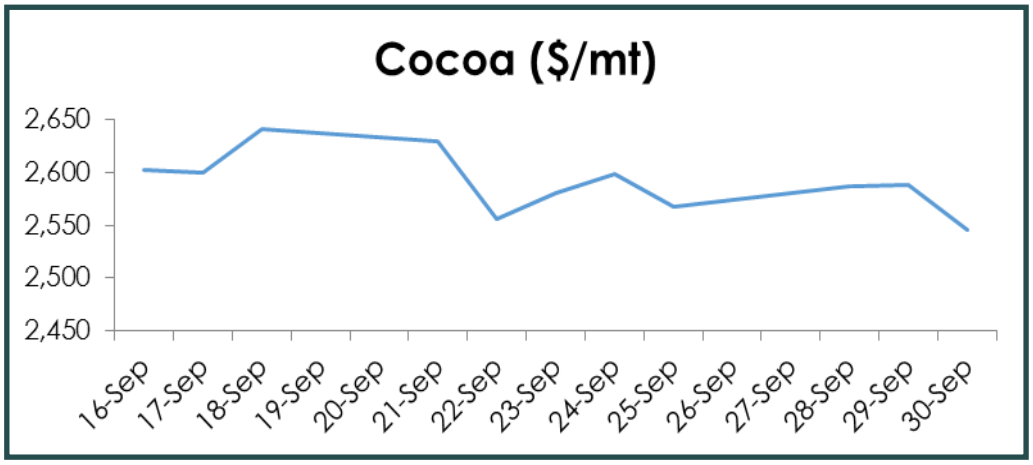
We expect natural gas prices to increase in the near term on expectations that heightening political tensions towards the November US elections could disrupt LNG supply.

Impact

LNG is one of the major export commodities for Nigeria. It accounts for approximately 13%[18] of the country's export revenue. Thus, an increase in global LNG prices will increase Nigeria's LNG export earnings.

Cocoa

The average price of cocoa increased by 4.10% to $2,591/mt in the second half of September from $2,489/mt in the corresponding period in August. The uptick in prices was primarily as a result of supply concerns amid heavy rainfall in Ivory Coast, Ghana and Nigeria.



[19]

[17]Bloomberg
[18]EIU
[19]Bloomberg

Outlook

Cocoa prices are expected to reverse its bullish trend in the coming weeks as harvest of cocoa commences in Ghana and Ivory Coast.

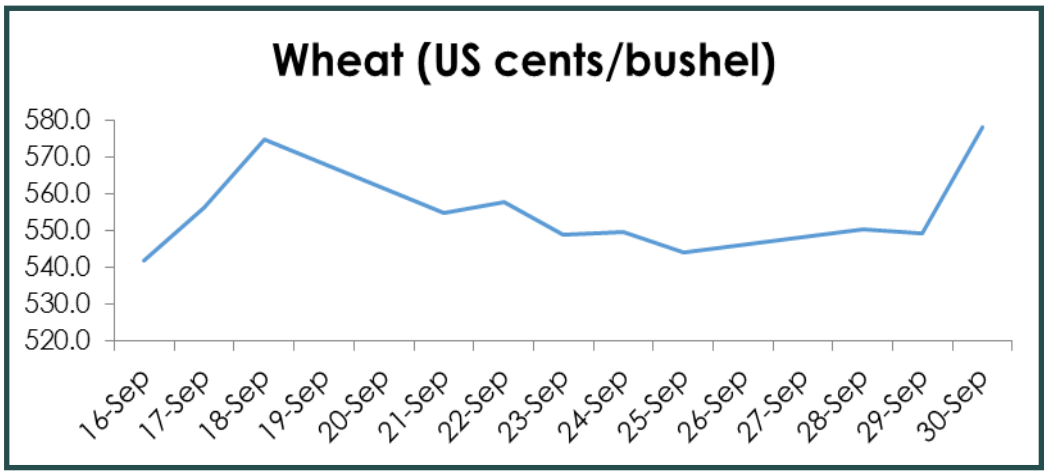
Impact

Cocoa is a major non-oil export commodity for Nigeria. The fall in global cocoa prices would lead to a reduction in export earnings.

Imports

Wheat

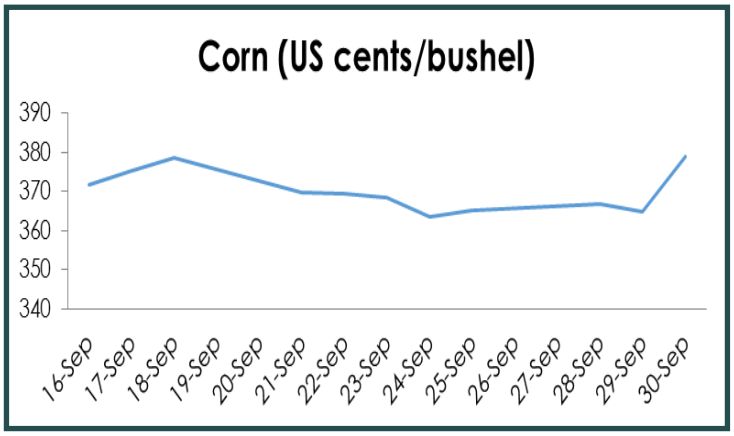
On the average, the price of wheat increased by 3.79% to $555.2/bushel during the review period from $534.91/bushel in the second half of August. The increase in price was as a result of the rise in global wheat demand.



[20]

Corn

Corn prices averaged $370.21/bushel during the review period, 6.18% higher than an average of $348.66/bushel in the corresponding period in August. The increase was partly attributed to high Chinese demand for corn and low crop yields in the US.



[21]

[20]Bloomberg
[21]Bloomberg

Outlook - Grains

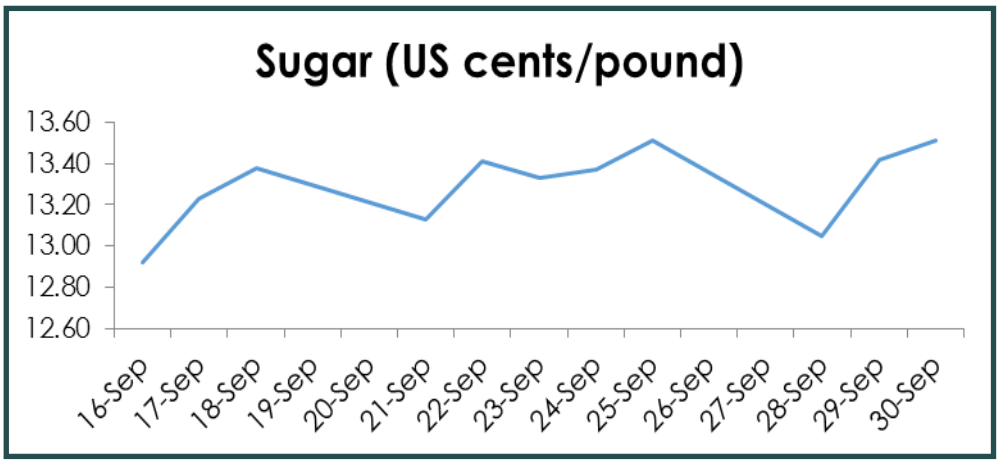
Prices are likely to increase in the near term on the back of supply concerns due to unfavorable weather conditions in Russia.

Impact

An increase in the global price of grains will increase Nigeria's import bill and push up production cost for industries dependent on the importation of grains.

Sugar

During the review period, the average price of sugar increased by 3.66% to $13.30/pound from $12.83/pound in the second half of August. The increase in price was supported by a decline in sugar supply from India.



[22]

Outlook

We expect sugar prices to decline in the coming days owing to tapered global demand for sugar.

Impact

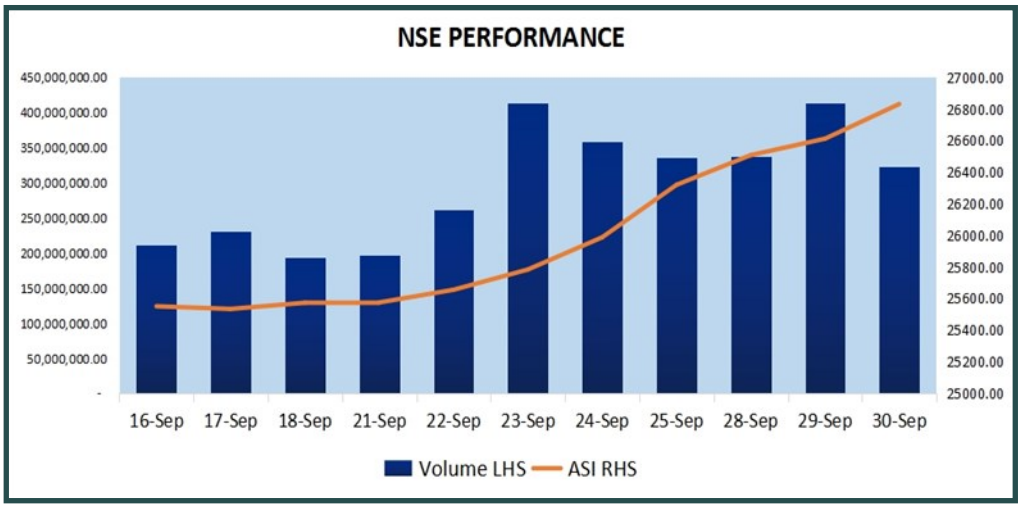
A fall in the global price of sugar will reduce Nigeria's import bill on sugar. It will also reduce production costs for confectioners.

[22] Bloomberg

Stock Market Review

The Nigerian stock market gained 4.82% between September 16-30 to close at 26,831.76 points from 25597.96 points on September 15th. In the same vein, market capitalization was up 5.02% (N670bn) to N14.02trn relative to its close of N13.35trn on September 15th. Meanwhile, the market has lost 0.04% YTD (as at September 30). In the 13 trading days of the review period, the market gained in 10 days and lost in 3.

The NSE traded at a price to earnings (P/E) ratio of 9.46x at the end of the review period, 4.99% higher than the close of September 15th (9.01x). The market breadth was positive at 1.53x as 46 stocks gained, 30 lost while 87 stocks remained unchanged.



[23]

The market activity level was positive in the review period. The average volume traded increased by 21.87% to 297.87mn units during the period from 244.42mn units on September 15th. Similarly, the average value of trades increased by 55.41% to N3.59bn from N2.31bn on September 15th.

[24]

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

All the sector indices were positive during the review period. The consumer goods sector gained the most (5.63%), followed by banking (5.62%), industrial (5.05%), insurance (3.22%) and oil & gas (3.04%).

International Breweries Plc topped the gainers' list with a 21.88% increase in its share price. This was followed by Total Nigeria Plc (21.00%), Nigerian Breweries Plc (19.37%), Consolidated Hallmark Insurance Plc (19.35%) and Prestige Assurance Co Plc (15.38%).

TOP 5 GAINERS				
Company	Sep-15 (N)	Sep-30 (N)	Absolute Change	Change (%)
International Breweries Plc	3.20	3.90	0.70	21.88
Total Nigeria Plc	80.00	96.80	16.80	21.00
Nigerian Breweries Plc	41.05	49.00	7.95	19.37
Consolidated Hallmark Insurance Plc	0.31	0.37	0.06	19.35
Prestige Assurance Co Plc	0.52	0.60	0.08	15.38

The laggards were led by University Press Plc (-27.06%), Associated Bus Co Plc (16.67%), Red Star Express Plc (-14.77%), Northern Nigeria Flour Mills Plc (-10.00%) and Royal Exchange Plc (-10.00%).

TOP 5 LOSERS				
Company	Sep-15 (N)	Sep-30 (N)	Absolute Change	Change (%)
University Press Plc	1.7	1.24	0.46	-27.06
Associated Bus co Plc	0.36	0.3	0.06	-16.67
Red Star Express Plc	3.52	3	0.52	-14.77
Northern Nigeria Flour Mills Plc	4.5	4.05	0.45	-10
Royal Exchange Plc	0.3	0.27	0.03	-10

Outlook

We expect the stock market to maintain its bullish streak in the near to medium term as investors keep rotating their funds to equities due to the low interest rate environment.

Equity Report: Dangote Cement

Analyst Note

Resilient operating performance

Market Capitalization: N2.69trn

Current Price: N158

Industry: CEMENT

Dangote Cement Plc recorded a positive performance in the first half of the year despite notable macroeconomic headwinds. The company's top line increased by 1.95% to N476.85 billion in H1'20 from N467.73 billion in H1'19 despite a 1.5% decline in sales volumes. The decline in sales volumes was largely driven by a 2.8% decline in Nigeria's volumes even though its Pan-African region recorded an increase of 0.7% in volumes. This affirms that Nigeria remains the main driver of performance. The cost of sales rose by 4.79% to N202.42 billion in H1'20 from N193.17 billion in H1'19 driven by higher energy cost.

On the operations side, the company recorded a 1.75% increase in operating profit to N173.48 billion relative to N170.50 billion in the same period in 2019. This increase in operating profit could be partly attributed to a net reduction in operating expenses by 1.52% to N103.69 billion from N105.29 billion in H1'19. The 3.32% decline in sales and distribution expenses to N77.64 billion in H1'20 from N80.31 billion in H1'19 helped to offset the increase in administrative expenses.

The company recorded a 5.8% increase in bottom-line despite a 6.3% increase in finance cost to N20.85bn. The increase in finance cost did not come as a surprise as the company embarked on an aggressive fund raising in the money market to optimize the benefit of the declining yield environment. The company issues the largest commercial paper and bonds in the history of Nigeria's debt capital market and both were oversubscribed.

Industry and Company Overview

The cement industry is an oligopolistic market with fierce competition between the key players (DangCem, Lafarge Wapco and BUA). DangCem is the dominant player in the industry with the largest market share of 59%, followed by Lafarge Wapco (21%) and BUA (20%). The cement industry recorded a negative growth rate of 5.54% in Q2, recording a better performance than the national growth rate of -6.10%. Dangote Cement, the industry leader has recorded a 5-year cumulative average growth rate (CAGR) of 13% compared to the 5-yr national GDP growth rate of 1.4%. The cement industry has benefited from the government's increased spending on construction and civil works so far this year. The exchange rate adjustment impacted positively on DangCem and BUA's revenues due to their export component. However due to the companies' dependence on gas, which is still priced in dollars, the naira devaluation led to higher gas prices and an increase in operating expenses. With respect to their finance costs, the impact of the naira devaluation was minimal, as WAPCO and BUA do not have a dollar debt while only about 14% of DangCem's debt is in dollars. Overall, all three companies recorded an increase in revenue, operating profit and profit after tax, with Lafarge Wapco recording the best performance, as it benefitted from a sharp decline in its operating expenses.

Company Overview

Dangote Cement is one of the many subsidiaries of Dangote Industries, founded by Aliko Dangote in 1981 as a trading business with an initial focus on importing bagged cement and other commodities such as rice, sugar, flour, salt and fish. In the 1990s, the Group made a strategic decision to transition from a trading-based business into a fully-fledged integrated manufacturing operation.

DangCem was incorporated as Obajana Cement Plc by Kogi state government in November 1992. The name was changed to Dangote Cement Plc in July 2010 just before the company listed on the Nigerian Stock Exchange (NSE) in October 2010.

Domestic Champion to Continental Behemoth

Dangote Cement entered the cement market in Nigeria which was dominated by a multinational for over 50 years, took leadership and has established dominance since then. Dangote Group was initially the largest importer of cement. However, its backward integration, which culminated in the commissioning of the Obajana Plant in 2007, pushed its dominance to local production, hence displacing Lafarge WAPCO. The company has an expansion strategy focus in West Africa and is present in 10 SSA countries with plans to expand to four more. Its stock is trading at an earnings multiple (P/E) of 12.92x.

Self-Sufficiency to Exporter

DangCem's export terminal has shifted the country from self sufficiency to being an exporter of cement, with the major buyers of its clinker being China ($588mn), Philippines ($227mn), Ghana ($218mn), Australia ($190mn) and Cote d'Ivoire ($168mn). The export of clinker will provide multiple benefits to the company. It will reduce its revenue sensitivity to the rainy season, a period which usually sees a reduction in building and construction activities. It has also allowed the company to take advantage of the import dependent nature of most African countries and improved its sensitivity to exchange rate risk.

Buy Now and Reap Later

DangCem is the largest company listed on the NSE, accounting for 17% of total market capitalization. This provides investors with an ease in executing investment decisions without having to worry about significant price impact, especially retail investors. Its stock price has shown the most resilience compared to its peers, recording the lowest volatility with a YTD return of 1.4% relative to market (NSE ASI) return of 0.5%. Its vast footprints in SSA (in 10 countries) provide some diversification benefit and the stock provides attractive income which helps boost total return as it has maintained a stable and strong dividend payout to investors. It has a dividend yield of 10.13%.

Management & Government Overview

Dangote Cement's management has successfully operated the company since inception as evidenced by the firm's continuing record of excellent returns on invested capital. Management has done remarkably well in maintaining the firm's reputation as a force to contend with in the industry.

We find most of the qualities of the board to be in line with best practices. The board members have the necessary skills and vast experience across regions that make them more than capable to implement sound decisions. The role of the Chairman is separated from the CEO's and the board looks at risk and strategy on both short and long-term basis.

Alhaji Aliko Dangote

Alhaji Aliko Dangote is the Chairman of the Board of Directors. He holds a BSc in Business Studies from the Al-Azahar University, Egypt. He is the founder and Chief Executive Officer of the Dangote Group. He serves on various boards, foundations, institutes and committees of the Federal Government of Nigeria.

The Bulls Say and the Bears Say

Bulls say:

- Reputable company with a proven track record and strong brand recognition
- The wide infrastructure gap in the Nigerian economic space presents an opportunity for growth
- Better regional presence in Nigeria compared to peers
- Presence across Africa

Bears say:

- Government delay in the implementation and release of funds for capital projects
- Nigerian economy still remains the major driver of revenue
- Low purchasing power of African consumers

Risks

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

The company manages foreign currency risk by monitoring its financial position in each country where it operates. Also, the company manages credit risk by ensuring that it transacts with only credit worthy counterparties.

DangCem manages liquidity risk by managing adequate reserves, banking facilities and reserve borrowing facilities by continuously monitoring forecasts and actual cashflows and also matching the maturity profiles of financial assets and liabilities.

Outlook

The African continent has not been spared from the impact of Covid, despite having fewer fatalities and infection cases, the economic impact has been more severe relative to other continents. Post Covid, many of these African countries will continue to request for debt forbearance and interest standstill from lenders. They will seek additional support from the AfDB, IMF, Afrexim and World Bank. To stimulate the recovery process, these African governments will be investing in a lot of capital projects, spending more on civil works, construction and affordable housing. There will also be an increase in investment in power supply as these economies transition from commodity producers to light manufacturing. The AfCFTA is expected to take effect in 2021. DangCem and Dangote Group's pan African strategy puts it in an excellent position to benefit from all of the above. It stands to benefit from the AfCFTA through lower cost of production, economies of scale and taking advantage of the hub status for refining, pipelines and road networks.

Economic Outlook for the Next Month

We expect a further improvement in the output indicators following the relaxation of the lock-down measures, resumption of international flights and reflationary fiscal and monetary policies. This will ease the pace of economic contraction in Q4'20 (-2.2%). The continued rise in COVID infections and the possibility of a precision lockdown remain a potent risk.

The resumption in international travels and pick-up in trade activities are likely to heighten forex demand pressures. However, we expect the CBN to continue to intervene in the market through its SMIS retail auction and forex sales to the BDCs. This will most likely support the currency. Notwithstanding, the apex bank's forex rationing could weaken the naira to N467-N470/$ at the parallel market.

Currency depreciation will push up import costs, increase service costs of dollar denominated loans and heighten inflationary pressures in the coming months. The CBN expects inflation to close the year at 14.15%.

Nigeria's oil production is likely to fall below its current level (1.48mbpd) in the coming months as OPEC+ enforces strict compliance. This will further deplete oil revenues, negatively impacting on the country's fiscal and external buffers. Nevertheless, we expect higher VAT revenues and exchange gains to support FAAC allocation in the coming months.