FINANCIAL DERIVATIVES COMPANY

WHISPERS

JULY 11, 2024 | VOLUME 14 ISSUE 14

WHEN WE SPEAK, THE WORLD UNDERSTANDS

FDC LIMITED

CONTENTS

The Whispers Overview

In this latest edition of Whispers, the FDC Think Tank delves into recent economic developments and their implications for businesses and corporate strategy. While the cost-of-living crisis is currently challenging, it shows signs of potential improvement, provided that both immediate and long-term strategies are effectively implemented.

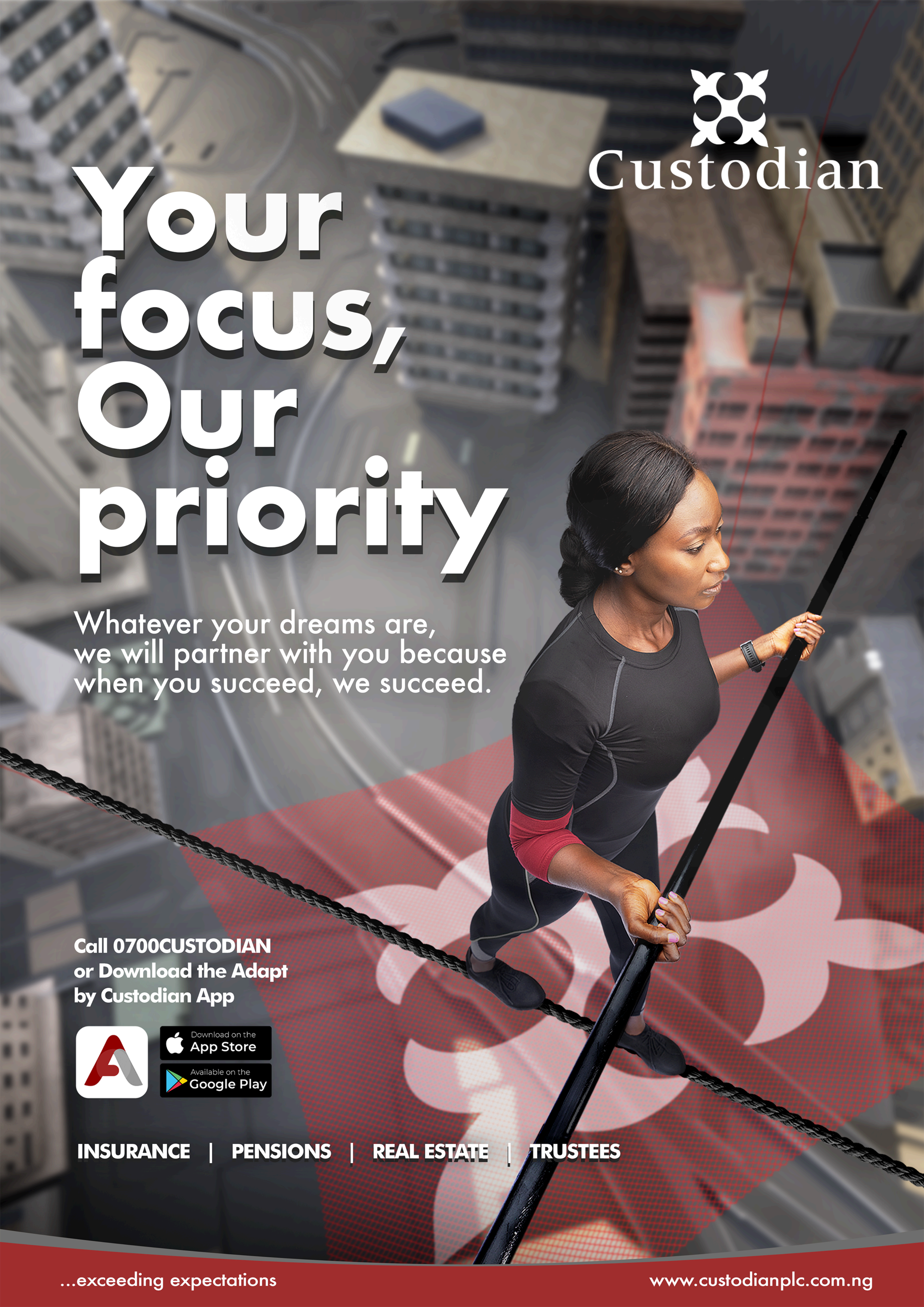
New Policies for the Pain of Old Policies

The Nigerian consumer is facing significant pressures ranging from fuel shortages to high commodity prices, and declining living standards. The elevated cost of living has pushed many to adopt unhealthy coping mechanisms, increasing vulnerability to diseases & epidemics such as the recent Cholera outbreak. To improve welfare, the government has embarked on a minimum wage review, introduced a N2 trillion fiscal stabilization package, and implemented a 150-day duty-free import window for certain food commodities.

However, there are concerns about the use of asymmetric information by individuals with prior knowledge of these initiatives to take early positions. This could hinder the anticipated relief in living costs for the public while enabling these "speculators" to amass significant rent (profits). Additionally, these measures are short-term solutions intended to provide urgent economic relief. For a lasting impact, a clear and detailed plan to address structural challenges such as insecurity and poor infrastructure is essential.

Short-term Cheers, Long-term Fears

After strengthening in June to N1475/$, the naira has begun to slide again. In July, it has depreciated by 3.46% to trade at N1560/$ on July 11. The fiscal authorities' efforts at fiscal stability and the central bank's goal of exchange rate stabilization seem to be mutually exclusive but temporary contradictions. This calls for better coordination between monetary and fiscal policies. A sustained weakening of the naira could lead to higher inflation, worsening the cost-of-living crisis and posing a risk of social unrest.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Nigerians struggle under reforms as the cost of living becomes unbearable

The cost-of-living crisis in Nigeria is concerning. Given the present wage rate ($20) and unemployment (5.0%) bedeviling the country, Nigerians can no longer bear the rising cost of goods and services. Inflation surged to 33.95% in May, driven primarily by food inflation at 40.66%. FDC forecasts a further increase in the June 2024 headline inflation rate to 34.09%. Similarly, the naira depreciated 48.16% in the past year, recording an average of N1,495/$ in June 2024 at the parallel market due to lingering dollar illiquidity.

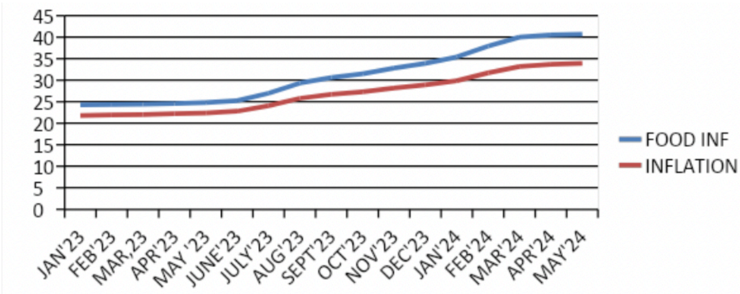
The cost of living in Nigeria worsened due to policy changes (petrol subsidy removal and FX liberalization) implemented by President Tinubu's administration. These reforms, aimed at stabilizing government finances and attracting investors, have increased operating costs for businesses, notably contributing to raising prices that have burdened consumers and exacerbated inflation.

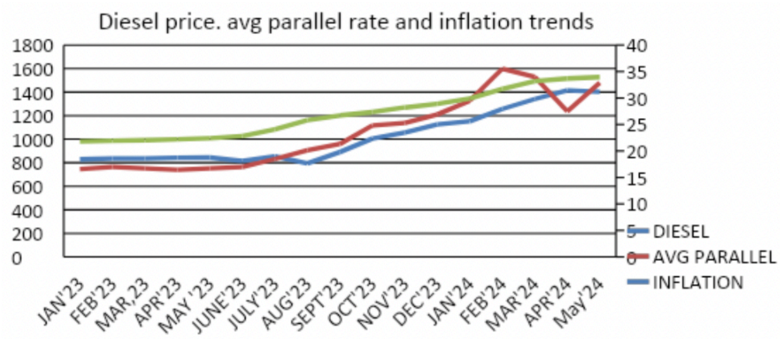
Food is a major driver of inflation in Nigeria, accounting for over 51% of the items in the inflation basket. With prices rising, over 40% of Nigerian households live in extreme poverty, and disposable income consistently declines.

The cost of living crisis, marked by high inflation and eroding purchasing power, affects all citizens, causing job losses, malnutrition, food insecurity, and declining social status. Small businesses struggle with low sales and worsening conditions, while healthcare costs and mental health issues rise.[1] Consumers have prioritized their needs by consuming cheaper products and services, as well as reducing spending on luxuries, jewelry, and skincare for essential commodities, while Labour is requesting for an increase in the minimum wage. We predict the final wage agreement will land between N90,000 and N130,000 monthly. These reforms have significantly impacted Nigeria's middle class, as high inflation and decreasing purchasing power reduce the real value of income and savings.

Commodities	Prices in May 2023 (N)	Current Prices (N)	% Change	Directional Change
Garri (50kg) Yellow	28,000	45,000	61	▲
Rice (50kg) Long grain	35,000	80,000	128	▲
Flour (50kg)	28,500	59,500	107	▲
Beans (Oloyin) (50kg)	30,000	150,000	400	▲
Tomatoes (Basket)	40,000	150,000	275	▲
Pepper (Bag)	20,000	140,000	600	▲
Onions (Bag)	28,000	90,000	221	▲
Palm oil (5 litres)	5,800	6,000	3	▲
Semovita (10kg)	6,800	12,800	88	▲
Noodles (70g carton)	4,100	4,100	83	▲
Sugar (50kg)	42,000	75,000	79	▲

Source: NBS, FDC





Source: NBS, FDC

1. Timi Olubiyi. 2023. How to tackle the impact of inflation on businesses and households. Punch. https://punchng.com/how-to-tackle-impact-of-inflation-on-businesses-households

Consequently, they struggle to maintain their standard of living amid rising prices for essential goods and services.[2] Essential needs and luxuries are increasingly unattainable, with 4 million Nigerians falling into poverty and 7.1 million more at risk in H1 2023, as reported by the World Bank. Additionally, it has become difficult for the middle class to secure pay rises amid obvious price hikes, further challenging their ability to maintain their social status.[3]

Speaking about their spending patterns, Kunle, earning N80,000 monthly as casual staff in a manufacturing firm, struggles to survive due to rising prices and now shares a room to afford rent. Nneka, an account officer and mother of three with a N220,000 monthly salary, can no longer afford basic healthcare and resorts to local herbs due to the high cost of drugs and hospital visits. Dare, a financial analyst, sold his car because he could no longer afford to fuel it due to the surge in the price of PMS and maintenance costs. James, who lives in one of the highbrows in Lagos, could no longer enjoy 24-hour air conditioning or use his gadgets due to a 230% surge in his electricity bill to N225/KwH on April 1.

Flattened household purchasing power has spurred Nigerian FMCGs to adopt sachet or miniaturized products. Due to affordability, consumers now opt for smaller sizes like nylon-packaged milk, flakes, spaghetti, and noodles. This shift, known as "sachetization," sustains demand amidst higher prices for larger items, reflecting shrinking disposable incomes. It spans various products, including alcohol, toiletries, and foodstuffs.[4]

The federal government allocated five billion naira to each state and the FCT for food distribution and pledged N200 billion for investment in farmland. In his New Year speech, President Tinubu vowed to invest N200 billion in nationwide farmland cultivation. Additionally, the CBN raised interest rates to 26.25% on May 21 and Treasury bill rates to control the money supply and inflation, aiming to mitigate the cost-of-living crisis and alleviate economic hardship resulting from recent decisions.

Despite these efforts, Nigerians have yet to see improvements in their livelihoods, with palliatives proving ineffective. Addressing the root causes of Nigeria's poverty crisis and implementing sustainable solutions is imperative to uplift the nation's status as the world's poverty capital.

Lessons from Brazil

Brazil, like Nigeria, has faced hyperinflation due to high budget deficits, excessive money growth, oil and exchange rate shocks, and reliance on global supply chains, resulting in a cost-of-living crisis. In 1999, Brazil adopted inflation targeting, enhancing monetary policy transparency and anchoring expectations following the collapse of the nominal exchange rate peg.[5] Between 2019 and 2022, consumer prices rose by 21.7%, with food prices increasing by 37.5%. Inflation peaked at 12% in April 2022 but dropped to 3.9% by May

2. Olufunke Baruwa. 2024. The disappearing Middle Class. Leadership. https://leadership.ng/the-disappearing-middle-class
3. Khadijat Kareem. 2024. The Middle Class missing comforts. Dataphyte. https://www.dataphyte.com/editorial/pocket-science/the-middle-class-missing-comforts
4. Proshare Research. 2024. Nigeria's 2024 Economic Outlook Report: The Household Economy. Proshare. https://proshare.co/articles/nigerias-2024-economic-outlook-report-the-household-economy
5. G Tullio and M. Ronci.1996. Brazilian inflation from 1980-1993: Causes, Consequences and Dynamics. JSTOR. https://www.jstor.org/stable/157697

2023 due to fiscal measures and aggressive monetary policy.

To address cost-of-living concerns, Brazil's monetary policy committee raised interest rates to 13.75%, capped public spending, and reduced fuel taxes. Fiscal measures included large-scale income transfers, health spending, and credit support for small and medium firms. Additionally, Petrobas reduced fuel prices, and the government prioritized hunger reduction, increased family farm credit, and enhanced food programs and school meal funding. The government's official inflation target is 3.93% in May. This is still below the central bank's upper threshold of 4.5%.[6]

As a result of these reforms, real GDP growth surpassed expectations by over 2.5%, and disinflation was more significant than anticipated, with the Consumer Price Index IPCA index returning to the Central Bank's tolerance band. The high cost of living in Brazil has been mitigated, as households in Brazil experienced relief from food inflation, with prices declining for five consecutive months in 2023 due to increased crops and reduced production costs.

Nigeria's government has been using Milton Friedman's idea that "inflation is always and everywhere a monetary phenomenon," and it increased its interest rate by 750bps in its three meetings on May 21. This is necessary but not sufficient to tackle the cost-of-living crisis.

What actions should the government take to mitigate the effects of its reforms?

To address Nigeria's cost of living, fiscal authorities should complement monetary policies by easing fuel price impacts with targeted subsidies, such as cash transfers or discounts on essentials. Removing VAT on diesel can lower transportation costs while boosting social safety nets and improving access to healthcare and education. Promoting alternative energy, reducing tariffs on essentials, and opening borders for food imports, and suspending import duties on staple foods can influence prices. Raising the minimum wage can counter the effects of subsidy removal and gain worker support.

6. Marcela Ayres. 2024. Brazil's inflation expectations to improve over time, say Central Bank chief. Reuters. https://www.reuters.com/markets/brazil-inflation-expectations-improve-over-time-says-central-bank-chief-2024-05-2

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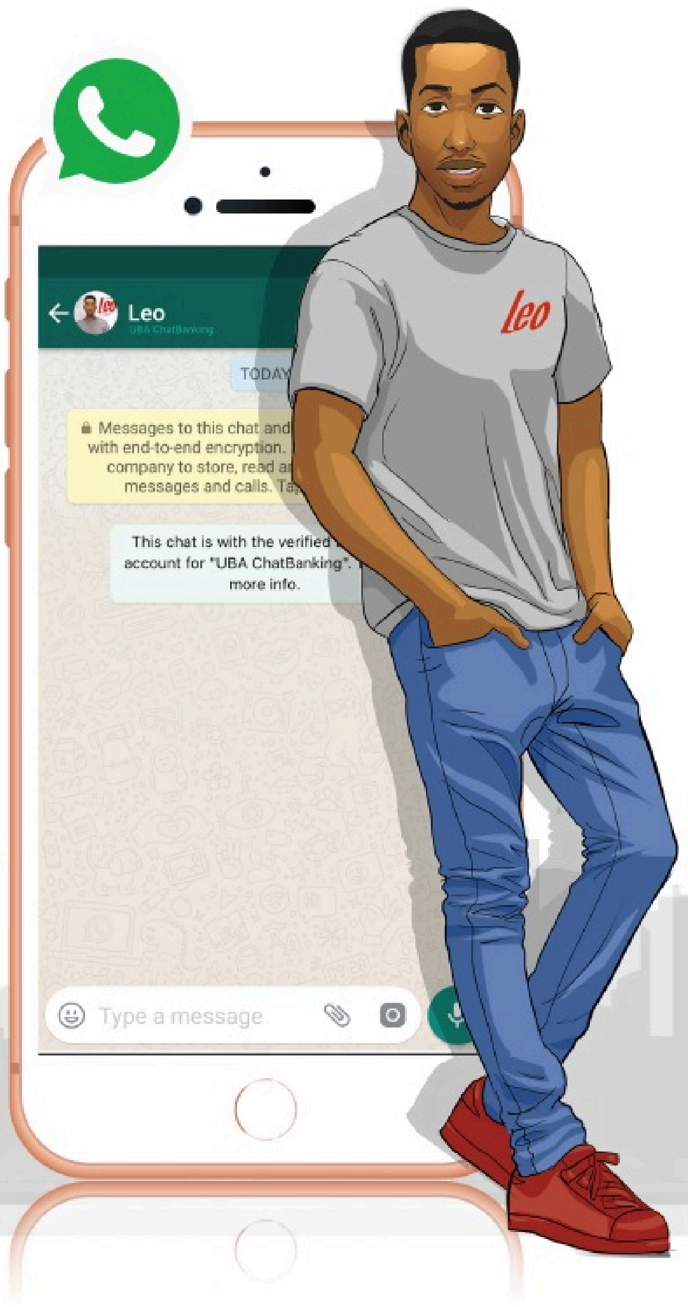

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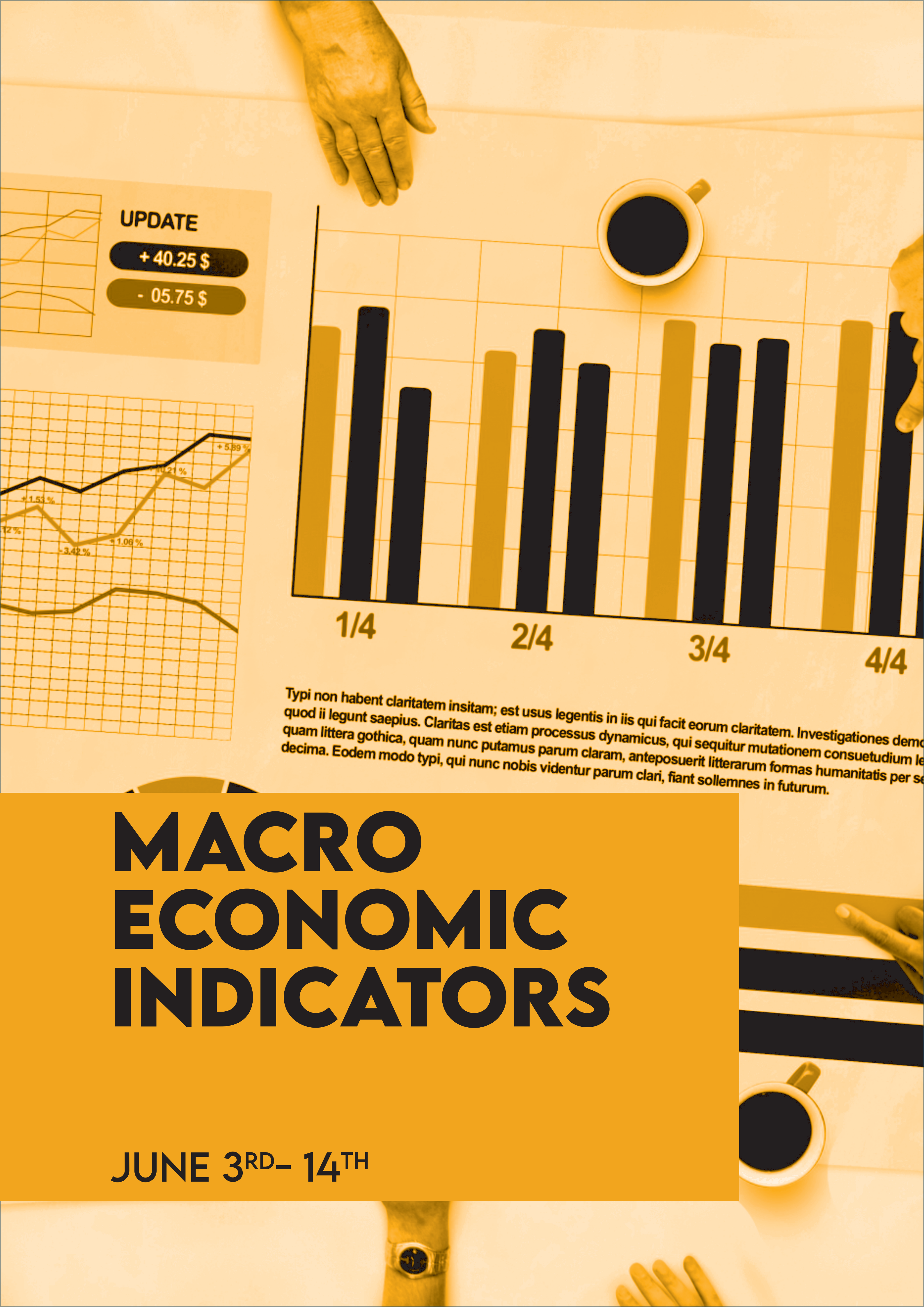


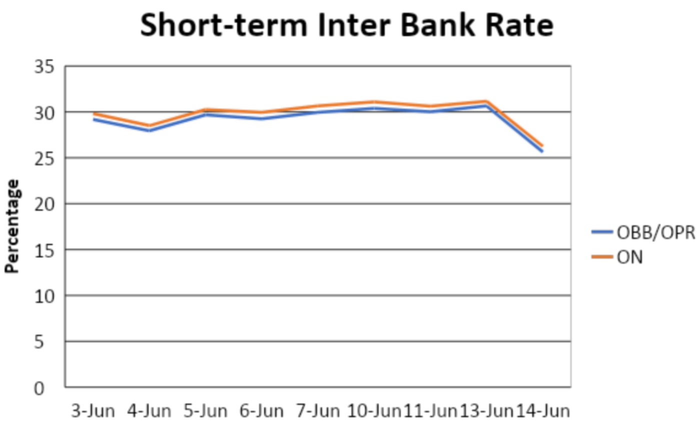
MACRO ECONOMIC INDICATORS

JUNE 3RD– 14TH

MONEY MARKET

The bank's average position was N13.85bn in the first half of June, 45.21% lower than the average of N25.28bn in the first half of May. One OMO sale and repayment were made during the review period. Short-term interbank rates (OPR, O/N) averaged 29.50% p.a., up 64bps from 28.86% p.a. in May.

Two primary market auctions were conducted in the first half of June. A sum of N333.65bn was allotted. This is 65.13% lower than the sum of N956.74bn allotted in the same period in May. On the other hand, primary market repayment during the review period amounted to N275.75bn. Primary market rates decreased across all tenors, whereas, at the secondary market, yields stayed flat at the 91-day, decreased at 182-day, and increased at 364-day tenors in the first half of June.



Source: FDC Think Tank

Tenor	Primary market (June 5th, 2024) (%)	Primary market (June 8th, 2024) (%)	Secondary market (June 3rd, 2024) (%)	Secondary market (June 14th, 2024) (%)
91-day	16.50	16.30 ▼	18.79	18.79 ⟷
182-day	17.50	17.44 ▼	19.43	18.44 ▼
364-day	20.64	20.50 ▼	20.30	20.45 ▲

Source: FMDQ, FDC Think Tank

Outlook and Implication

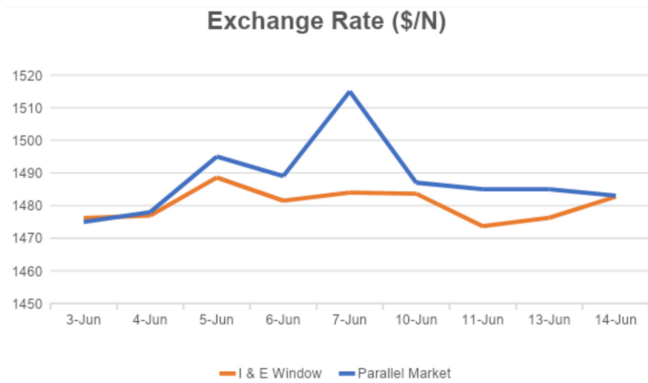
Short-term interbank rates are projected to remain elevated, aligning with the MPR of 26.25% per annum. However, due to the deceleration in inflation growth observed in May, we anticipate that the CBN will maintain the current rates until the July meeting.

FOREX MARKET

The forex market is currently being reformed. Since the adoption of a "willing-buyer-willing-seller" model by the CBN, the exchange rate is allowed to be determined by the forces of demand and supply. Some of the exchange rate determinants are balance of payments, capital inflows, and trade balance.

EXCHANGE RATE

At the Investors' and Exporters' Foreign Exchange window, the naira weakened by 3.86% against the dollar to close at N1,482.72/$ on June 14 from N1,476.12/$ on June 3, as market forces (willing buyer and seller) continue to determine the exchange rates. Similarly, at the parallel market, the currency depreciated by 0.54% to N1,483.00/$ on June 14 from N1,475.00/$ at the beginning of the review period due to a decrease in forex supply.



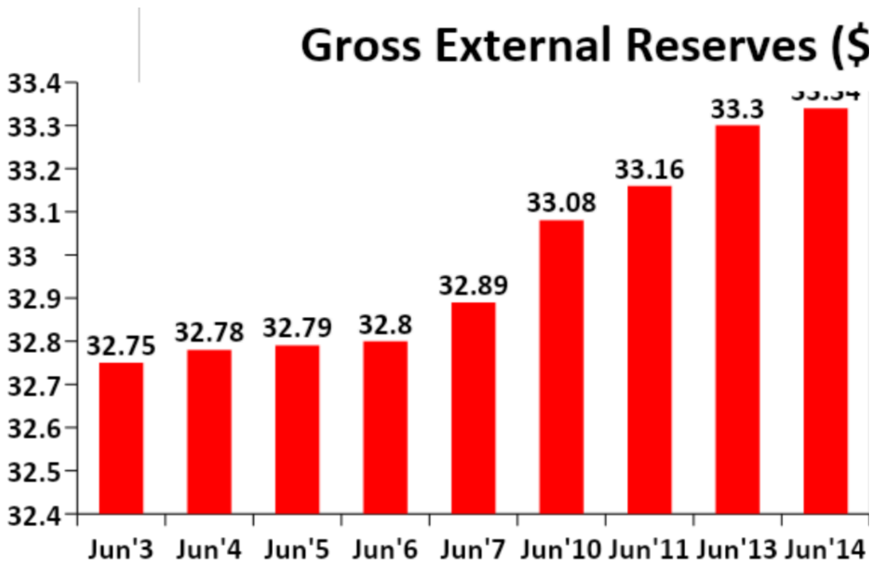
Source: FDC Think Tank

Outlook

Nigeria recently secured a $2.25 billion World Bank loan to finance economic reforms and boost revenue. This is expected to increase forex supply and stabilize the naira in the short term

EXTERNAL RESERVES

The country's external reserves rose by 1.80% to close at $33.34bn on June 14, up from $32.75bn at the beginning of the period (June 3). On average, gross external reserves rose by 1.66% ($54mn) from $32.45bn in May. The rise in reserves can be credited to the inflow of foreign loans and foreign portfolio investments.



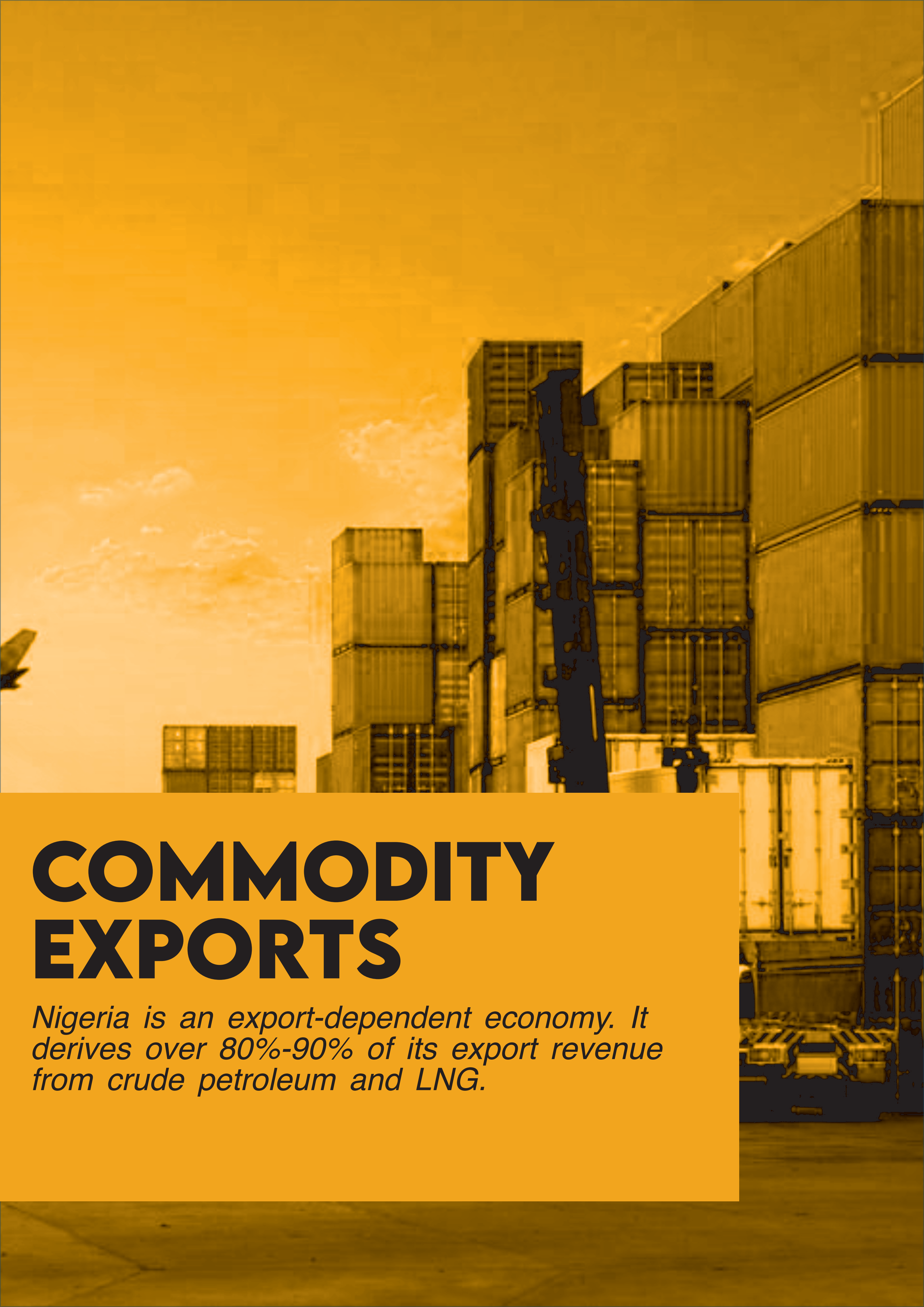
Source: CBN, FDC Think Tank

Impact

An increase in the external reserve is likely to strengthen the naira, enhance investor confidence, and boost foreign direct investments.

Outlook

Reserves are expected to improve further in the near term due to the inflow of foreign loans and an increase in foreign portfolio investments. However, to sustain this growing trend, the country's major source of revenue, crude oil, must increase.



COMMODITY EXPORTS

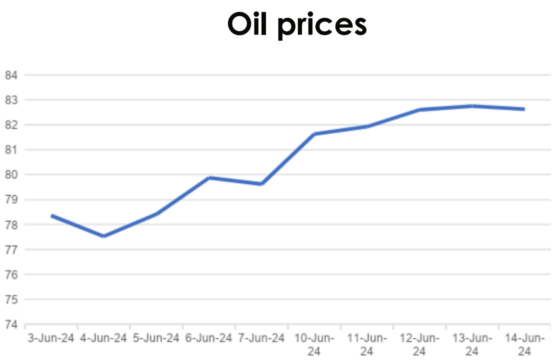
Nigeria is an export-dependent economy. It derives over 80%-90% of its export revenue from crude petroleum and LNG.

OIL PRICES

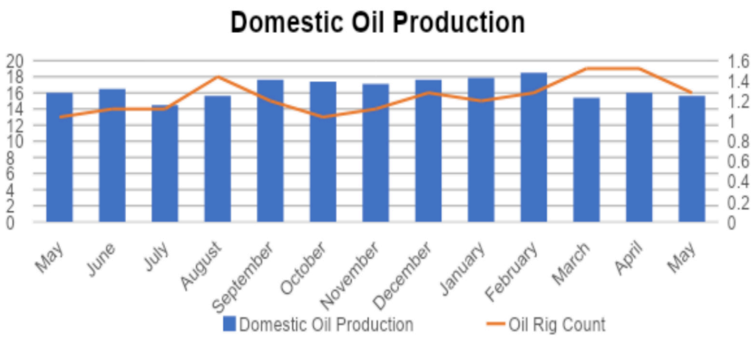
During the review period, Brent's price was up 5.44% to close at $82.62 per barrel on June 14, down from $78.36 per barrel on June 3. A strong demand outlook drove the rise in Brent prices, as investors became optimistic. This increase was further supported by reassurances that OPEC+ could pause or reverse its plan to raise supply based on market conditions. On average, Brent declined by 3.22%, to $80.53 per barrel in the first half of June compared to $83.21 per barrel in May.

OIL PRODUCTION

In May, domestic oil production declined by 2.34% to 1.25 million barrels per day from 1.28 million barrels per day in April. Similarly, the country's oil rigs fell to 16 units in May from 19 units in April. OPEC (secondary source) produced an average of 26.63 million barrels per day in May, marking an increase of about 29,000 barrels per day compared to April 2024. Specifically, Nigeria, Gabon and Equatorial Guinea had the highest oil production, while production in Saudi Arabia, Kuwait, Libya and Congo decreased.



Source: Bloomberg, FDC Think Tank



Source: OPEC, FDC Think Tank

Outlook

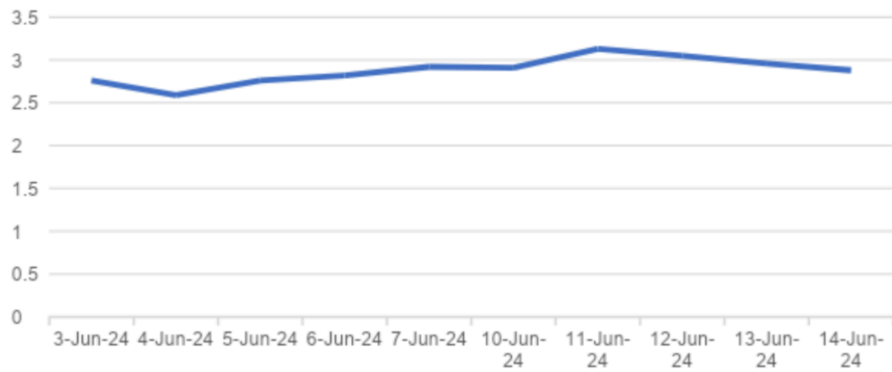
Oil prices are anticipated to rise in the near term as OPEC+, the International Energy Agency (IEA), and the U.S. Energy Information Administration forecast improved oil demand for the second half of the year, aiding in inventory drawdowns. However, due to outdated production infrastructure, theft of crude oil, and high unit production costs per barrel, we do not expect a substantial increase in Nigeria's oil production in the near term. The NNPCL has also declared a state of emergency on Nigeria's oil sector, targeting 2mbpd in 2025.

Implication

The increase in oil prices is expected to support oil revenue and improve external reserves, which impacts the exchange rate. However, Nigeria's low oil production, currently below the OPEC quota and under 1.5 million barrels per day, is a potent risk to the positive outlooks.

NATURAL GAS

The price of natural gas increased by 4.35% to $2.88/MMBtu on June 14 from $2.76/MMBtu on June 3, driven by strong demand from the US and Asia Supply shortages from the US also supported the uptick in LNG prices. According to Reuters, the U.S. natural gas exports declined by 10% to 6.82MT from 7.58MT in the previous month. On average, natural gas gained 29.73% in the review period to $2.88/MMBtu, compared to $2.22/MMBtu in the corresponding period in May.



Source: Bloomberg, FDC Think Tank

Outlook

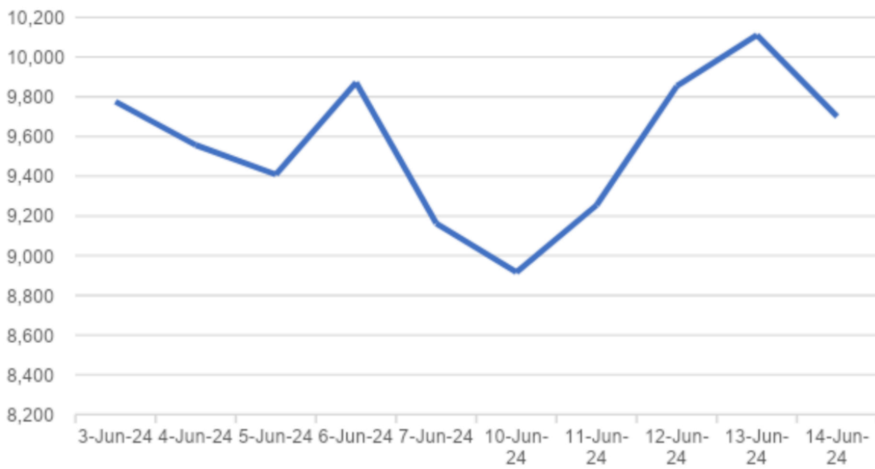
Gas prices are expected to fall in the near term due to increased supply from Qatar, which accounts for 19.48% (78.2MT) of the total global exports. Concurrently, Japan, the world's first largest importer, will lower its LNG demand; replacing it with resurgent nuclear output and renewable energy.

Implication

A decrease in LNG prices will reduce Nigeria's foreign reserves and export earnings. Additionally, domestic production challenges will further exacerbate the drop in natural gas export earnings.

COCOA

The price of cocoa fell in the first half of June to $9,701/mt, down 0.76% from $9,775/mt on June 3. The drop was attributed to Ghana's cocoa regulator projecting a rebound in 2024/2025 production to 700,000MT from 425,000MT in 2023/2024 due to better weather. Ivory Coast, the largest global exporter, also plans to cut out middlemen to prevent supply disruptions and overpayment in its cocoa sector, hinting at better output. On average, the price of cocoa surged by 18.52% to $9,561/mt in the first half of June from $8,067/mt in May.



Source: Bloomberg, FDC Think Tank

Outlook

In the short term, cocoa prices are expected to stay bullish due to lingering supply irregularities from West African producers.

Implication

Rising cocoa prices will likely enhance foreign exchange earnings from non-oil exports and strengthen external reserves.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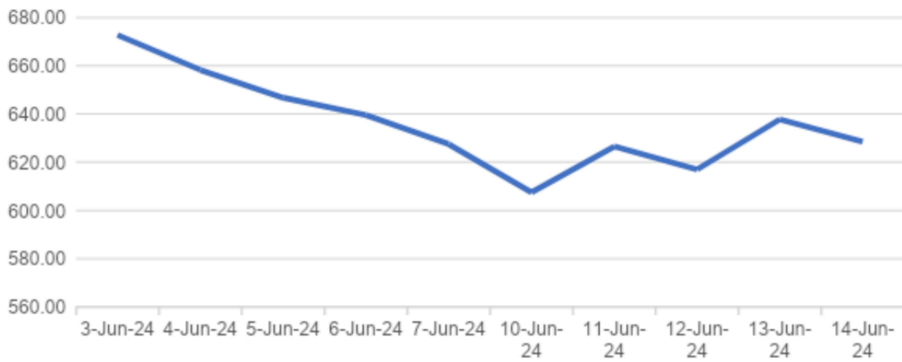
COMMODITY IMPORTS

WHEAT

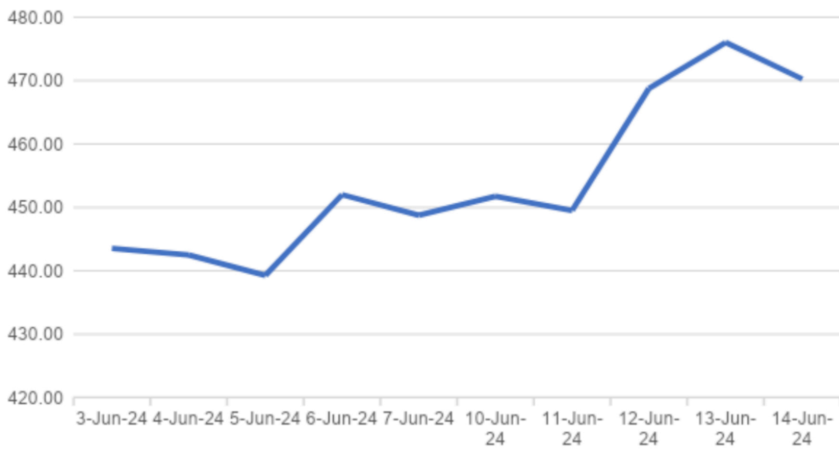
In the review period, the price of wheat declined by 6.58% to $628.50/bushel on June 14 from $672.75 on June 3. The price of wheat decreased due to recent rains improving crop conditions in Ukraine, coupled with the start of the harvest season in Europe. On average, wheat prices fell by 1.12% to $636.20/bushel, compared to the average of $643.43/bushel in the first half of April.



Source: Bloomberg, FDC Think Tank

CORN

The price of corn rose by 6.03% in the review period, from $443.50/ bushel on June 3 to $470.25/bushel on June 14, due to a 5% decline in the U.S. weekly export inspection volume and a lower U.S. crop rating. Corn price averaged $454.23/bushel in the first half of June, down 1.91% from the average of $463.09/bushel in the first half of May.



Source: Bloomberg, FDC Think Tank

Outlook-grain

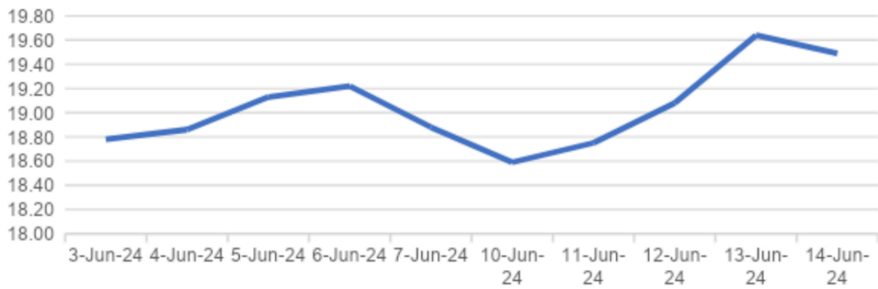
Grain prices are expected to remain mixed in the near term. Wheat prices are anticipated to decline due to improved crop conditions and an expected abundance, particularly in the U.S. Conversely, corn prices will likely stay bullish due to reduced grain output in China, the world's top importer. This will likely increase purchases from exporters such as Brazil, the U.S., and Argentina, driving up global prices.

Impact-grain

The rise in grain prices is expected to increase importation costs and raise manufacturers' production costs. This will also increase the prices of grain derivatives like cornflakes, wheat flour, and bread, exacerbating inflation.

SUGAR

In the review period, the price of sugar increased 3.78% to $19.49/pound on June 14 from $18.78/pound on June 3, as volatile weather intensified in key producing countries, including Brazil, India, and Vietnam. On average, the price of sugar stood at $19.04/pound, indicating a 1.14% decrease compared to the average of $19.26/pound in the first half of May.



Source: Bloomberg, FDC Think Tank

Outlook

The price of sugar is expected to stay high in the near term due to rising production costs in Brazil and low rainfall in Thailand, which could limit supply.

Implication

The increased price of sugar will raise Nigeria's import bill and negatively impact its balance of trade. Additionally, it will heighten inflationary pressures as sugar derivatives become more expensive.

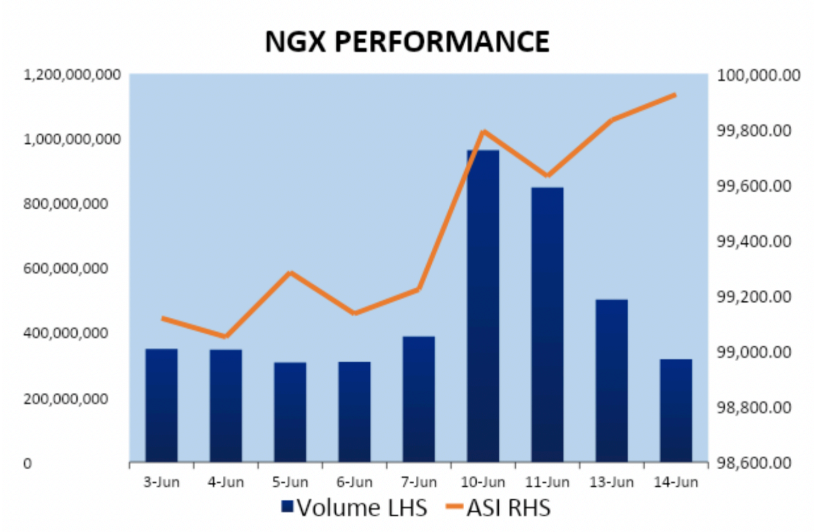
Terms of trade

In Q1'24, the country's terms of trade decreased by 0.12% and are expected to remain negative in the near term. This is due to the 2.34% decline in Nigeria's oil production to 1.25 million barrels per day in May from 1.28 million barrels per day in April. Similarly, falling cocoa prices below $8,000/mt and low output will further deteriorate the trade balance.

STOCK MARKET REVIEW

JUNE 3RD– 14TH

The Nigerian Stock Exchange closed positively from June 3rd –14th, 2024. It gained 0.81% to close at 99,925.29 points on June 14th, down from 99,118.86 points on June 3rd. Similarly, the market capitalization increased by 0.82% to N56.53 trillion relative to its close of N56.07 trillion on June 3rd.



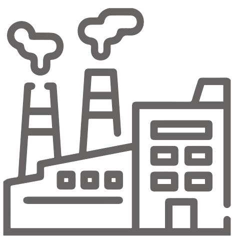
Source: NGX, FDC Think Tank

The market YTD return was 33.64% in the review period. The market breadth was positive at 1.47x, as 47 stocks gained, 74 remained unchanged, and 32 lost. The positive performance of the NGX can be attributed to increased demand, primarily in the Oil and Gas and Banking sector stocks.

The market activity level was mixed in the review period. The average volume traded increased by 9.49% to 481.79mn units from 440.03mn units. However, the average value of trades fell by 5.94% to N8.24bn from N8.76bn in the review period.

The performance of the sectors was positive in the review period, as all sectors gained. The Oil and Gas sector recorded a gain of 5.91%, followed by the Banking sector (3.86%), insurance sector (1.46%), consumer Goods sector (1.45%) and Industrial sector (0.36%).

SECTOR PERFORMANCE



Industrial

0.36

Oil &Gas

5.91

FMCG

1.45

Insurance

1.46

Banking

3.86

TOP 5 GAINERS

Presco Plc, a company specializing in oil palm cultivation, extraction, refining, and fractionation into finished products, topped the gainers' list with a 29.12% increase in its share price. This was followed by Deap Capital Management and Trust Plc (27.27%), Chams Holding Company Plc (26.67%), Eterna Plc (22.45%) and Nigerian Breweries Plc (21.73%).

TOP 5 LOSERS

The laggards were led by Daar Communications Plc, a Nigeria-based media and entertainment company with -17.46%. This was followed by May and Baker Plc (-16.42%), C & I Leasing Plc (-14.14%), International Energy Insurance Plc (-13.14%) and Nascon Allied Industries Plc (-9.91%).

TOP 5 GAINERS

Company	June-03 (N)	June-14 (N)	Absolute Change	Change (%)
PRESCO	267.20	345.00	77.80	29.12%
DEAPCAP	0.44	0.56	0.12	27.27%
CHAMS	1.50	1.90	0.40	26.67%
ETERNA	12.25	15.00	2.75	22.45%
NB	26.00	31.65	5.65	21.73%

TOP 5 LOSERS

Company	June-03 (N)	June-14 (N)	Absolute Change	Change (%)
DAARCOMM	0.63	0.52	-0.11	-17.46%
MAYBAKER	6.70	5.60	-1.10	-16.42%
CILEASING	2.97	2.55	-0.42	-14.14%
INTENEGINS	1.75	1.52	-0.23	-13.14%
NASCON	40.85	36.80	-4.05	-9.91%

Outlook

We anticipate a mixed market performance in the near term. This is due to the projection that the MPC will maintain the status quo in its July meeting and the stability of the naira, both of which could renew investor sentiment in the equities market.

WHISPERS OUTLOOK

- We project a slow rise in June inflation, up 0.14% to 34.09% from 33.95% in May. The base effect and the naira's stability in June will support this.
- The slow pace of inflation increase will prompt the MPC to maintain the status quo or be less hawkish in its next meeting on July 22-23 to monitor the effects of previous rate hikes on inflation.
- Recent fiscal measures, such as the N2 trillion stabilization package and a five-month duty-free window for imported food items, are poised to relieve the masses temporarily.
- However, low revenue generation could threaten the fiscal policy move. Nigeria's revenue relies heavily on oil, which faces challenges from suboptimal production and volatile global prices.
- Oil prices are projected to trend higher in the near term as the ease in US headline inflation to 3% in June from 3.3% in May raises hope that the US Fed would cut interest rates soon. Meanwhile, Nigeria's oil production is expected to remain suboptimal (below OPEC quota and 2024 budget benchmark).
- Lower oil production despite rising oil prices pose risks to Nigeria's recent gains in external reserves, potentially limiting the CBN's capacity to stabilize the naira.

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