



DOMESTIC ECONOMIC AND FINANCIAL MARKET REVIEWS

December 2011

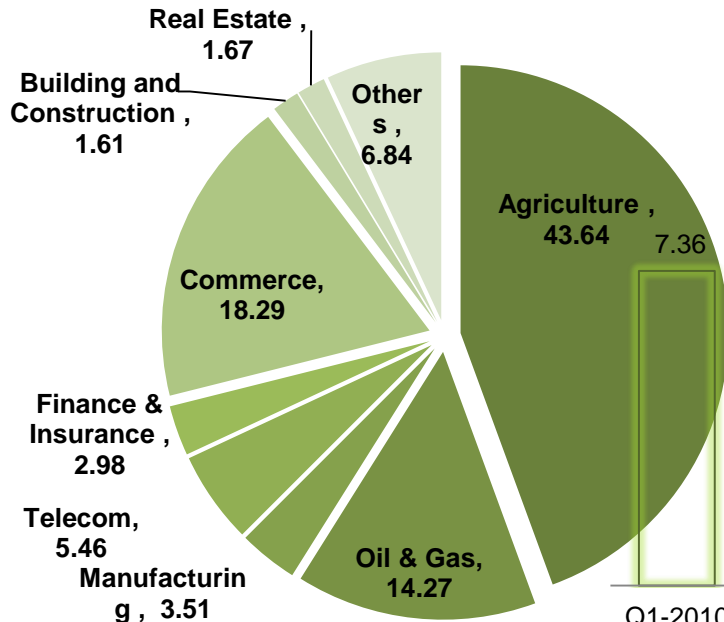
Key Macroeconomic Indicators



Money Market Rates	EndQ4, 2010	EndQ1, 2011	EndQ2, 2011	EndQ3, 2011	Oct. 2011	Nov, 2011	Forecast End 2011
OBB (%)	8.23	9.50	9.71	11.00	14.00	14.41	14.00
Call (%)	8.56	11.00	11.33	11.29	17.00	17.33	17.00+
MPR (%)	6.25	7.50	8.00	9.25	12.00	12.00	12.00
SDR (%)	4.25	5.50	6.00	7.25	10.00	10.00	10.00
SLR (%)	8.25	9.50	10.00	11.25	14.00	14.00	14.00
T-Bill Rate (%)	7.47	9.01	8.06	10.91	15.32	15.07	15.00+
Bond Rate 10Yr (%)	8.31	12.96	12.15	11.75	15.18	13.28	13.00+
NSE YTD Return (%)	8.60	-0.6	0.7	-17.8	-17.2	-19.25	-20.00+
Cons Deposit Rate %	3.44*	3.54	3.95	5.68	5.66	5.70	6.50
Prime Lend Rate (%)	15.74	15.81	15.75	15.87	16.49	17.47	18.00
Max Lend Rate (%)	21.86	22.02	22.19	22.20	23.32	23.32	23.00
Infl. Rate (y-o-y) (%)	11.80	12.80	10.20	10.3	10.50	10.50**	11+
Official FX rate (N/US\$)	149.17	151.52	152.64	154.60	150.01	157.26	160.00
Interbank FX Spread (%)	1.00	2.00	1.00	3.00	6.00	2.22	2.00
Forex Reserve(US\$b)	32.34	33.22	31.99	32.57	32.78	33.06	34.78+
Oil Price (US\$/barrel)	92.46	119.04	113.3	109.7	112.7	111.0	100.25

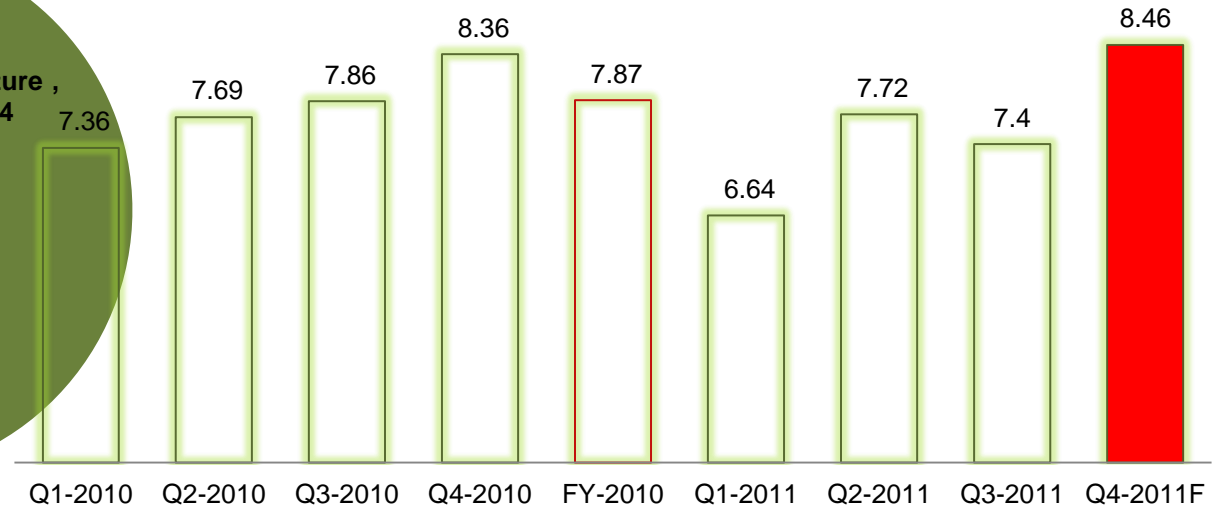
ECONOMIC STRUCTURE AND GROWTH

Latest Sectoral Contribution to GDP (%)



Source: NBS

Real GDP Growth %



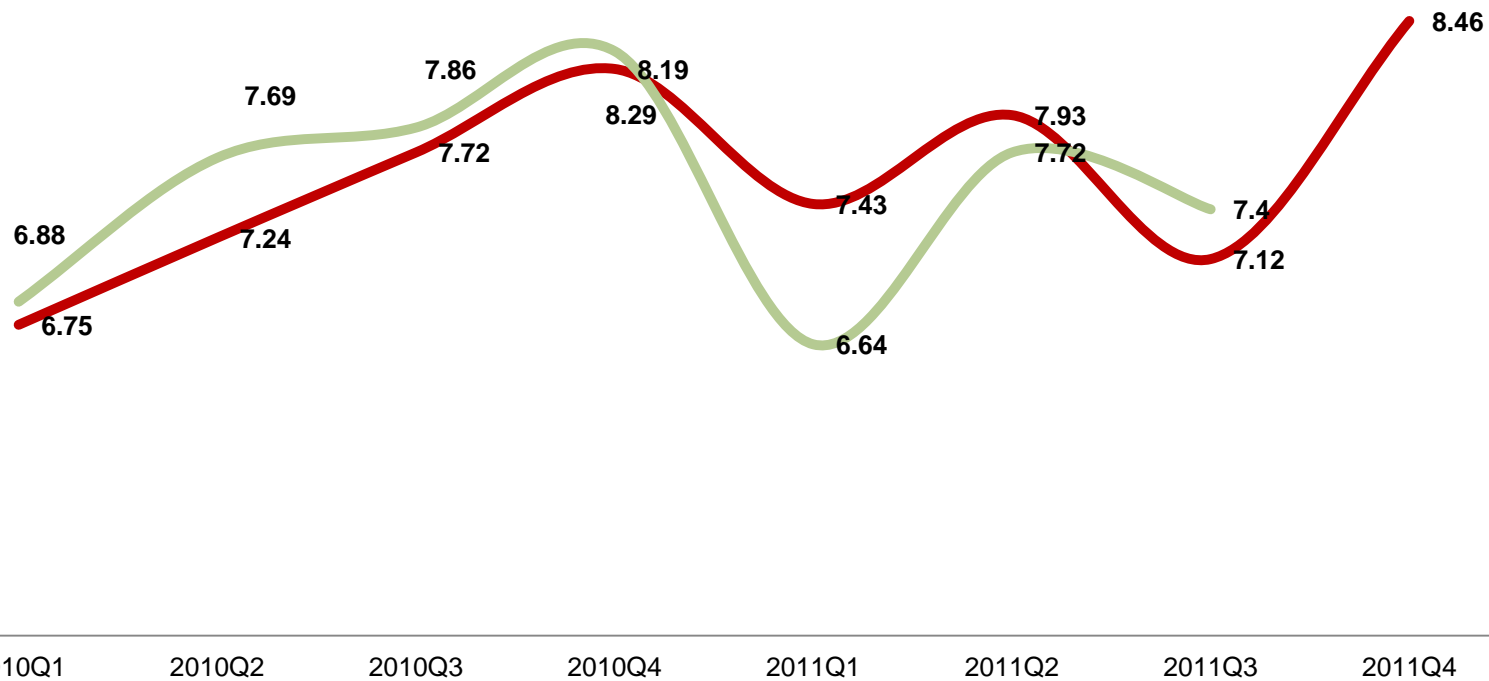
Source: NBS

Red Bars are forecasts

- ❑ Growth in Q3 was impressive surpassing forecast. Q1 and Q2 growth were however below projections although very robust.
- ❑ This was despite low performance of other key economic indicators during the period- Employment figures suggest rising unemployment at 23.7% compared to 21.3% in 2010.
- ❑ The current administration's 'Transformation Agenda' targets an average growth rate of 11.7% per annum between 2011-2015

Real GDP Growth Projection Vs Actual (%)

— Projections — Actual



Source: NBS

Economic Development

MTEF AND BUDGET 2012 BENCHMARK REVISED AS FISCAL PERFORMANCE IN 2011 LAGS

Budget Items	2011	2012Initial	2012Revised
Projected Production (in mbpd)	2.30	2.48	2.48
Budget Benchmark Price (per barrel in US\$)	75.00	75.00	70.00
Average Exchange rate (NGN/US\$)	150.00	153.00	155.00
Expenditure Headlines			
Non-Debt Recurrent(Nm)	2,425.07	2,581.99	2,581.99
Capital Spending(Nm)	1,146.75	1,319.89	1,319.89
Statutory Transfer(Nm)	417.82	345.72	345.72
Debt Service Payment(Nm)	495.10	550.01	550.01
Total Revenue FGN(Nm)	3,348.12	3,693.17	3,528.27*
Aggregate Expenditure(Nm)	4,484.74	4,797.61	4,797.61
Deficit (Nm)	(1,136.62)	(1,104.44)	(1,269.34)
GDP-Est (FGN)	38,427.06	41,101.88	41,101.88
Deficit/GDP (%)	-2.96%	-2.69%	-3.09%

Key Changes in Red *Simulated figure given that other parameters of the budget remain unchanged

- ❖ According to our estimates, the revision resulted in about N150 billion loss in aggregate revenue to government and expanded the projected deficit to above 3%.
- ❖ A breach of the fiscal responsibility act.
- ❖ Fiscal policy therefore remains largely expansionary in scope
- ❖ The PPP outlook of the budget also suggests potential huge business opportunities for investment banking- BGL

25% DOWNSIDE RISK TO THE MTEF AND BUDGET 2012

- ❖ Weakening global economy and consequent bleak outlook for global oil demand and price
- ❖ OPEC revised downward the global crude oil demand forecast d by 0.2% to 89mbpd barrel for 2012
- ❖ Potential improvement in Libya oil production after the political unrest is also likely to put downward pressure on oil price
- ❖ Budgetary performance remains substantially inefficient and below average in first half of 2011
- ❖ On the revenue side, government reported lower than projected net revenues- 35% shortfall in H1, 2011
- ❖ While capital budget releases fell short by 47%, recurrent spending overshoot the budget.
- ❖ Fiscal performance esp. recurrent expenditure will remain largely expansionary as minimum wage is implemented

2011 Budget Performance			
Items (Nbillion)	HY- Budget	HY- Actual	% Shortfall/Increase
FGN Retained Revenue	1,674.10	1,082.88	-35.3%
Expenditures	2,242.40	1,904.98	-15.0%
Recurrent	1,212.54	1,235.19	1.9%
Debt Services	247.56	218.07	-11.9%
Capital Releases	573.38	303.62	-47.0%
Transfers	208.92	148.10	-29.1%
Deficit	(568.30)	(822.10)	44.7%
Current Borrowing	126.11	176.00	41.7%

Source: Budget Office of the Federation

FUEL SUBSIDY REMOVAL – FAILURE WILL COMPROMISE FISCAL ACTIVITIES AND STABILITY

- ❖ The MTEF and budget 2011 are premised on the removal of fuel subsidy
- ❖ The States Govt barred the FGN from paying the subsidy from the consolidation account in September- States effectively opted out of the payment
- ❖ The burden of funding the over N1.4trillion subsidy may have been fully shifted to the FGN going forward
- ❖ Failure to remove the subsidy in 2012 will make government finance unsustainable.
- ❖ Subsidy amount to 40% and 30% of budgeted revenue and spending respectively in 2012.
- ❖ The government agreed budget 2012 will be un-implementable without the removal.
- ❖ The probability of removal is close to zero as opposition within and outside the govt is high- FGN may have postponed the commencement date indefinitely according to media report
- ❖ The implications are; Budget 2012 might survive largely on government borrowing
- ❖ Borrowing may put additional pressure on interest rates and promotes crowding out effects
- ❖ Put upward pressure on debt/GDP ratio- may reach 30% in 2012 from 21% or N6.1trillion currently.

IMPROVED POLICY FOCUS ON AGRICULTURE WILL BOOST ECONOMIC ACTIVITIES

- ❖ The Agric sector is now recognised as the neglected and next growth frontier.
- ❖ Current policy focus and reforms of the sector will boost performance
- ❖ Policy focus on backward integration, development of agro precessing, export orientation and import substitution would draw substantial investment toward the sector,
- ❖ Early positioning would help as shown by progress in Ilorin- (Kwara State) Shongai Farm & Co
- ❖ Market oriented farm subsidies would also create a robust agricultural input sector
- ❖ There is high probability of legislative reform of the Land Use Act 1978 to promote mechanised agriculture

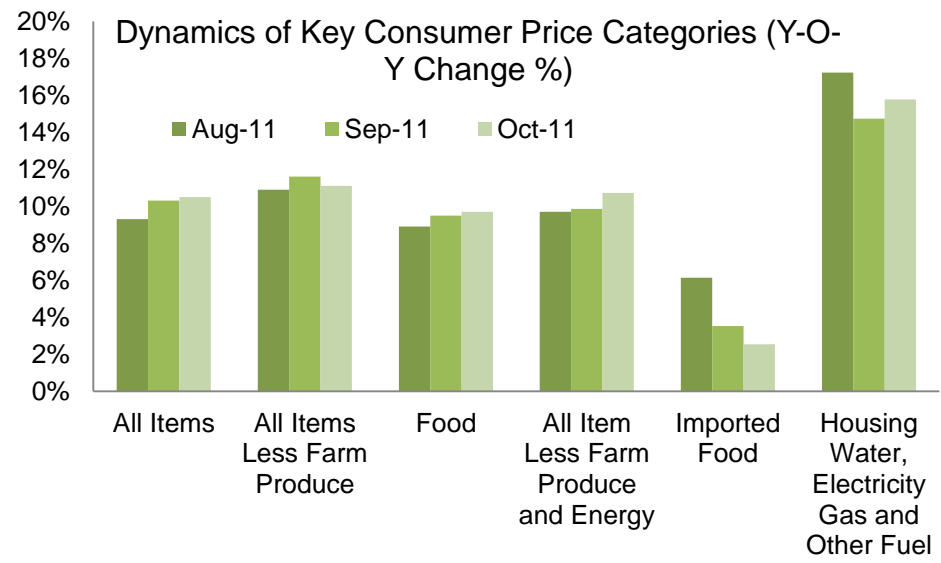
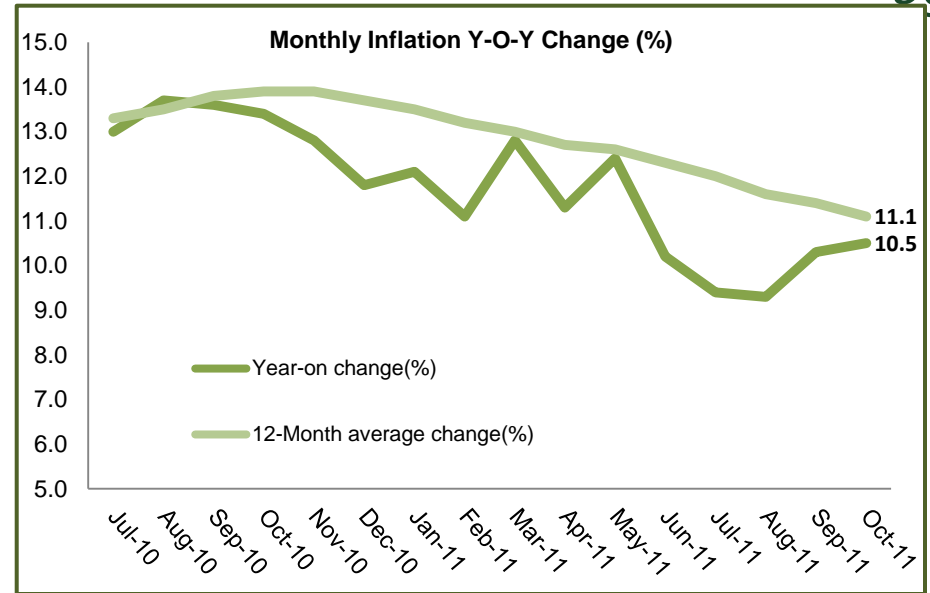
CONTINUED DELAY OF THE PIB BILL WILL HAUNT THE OIL & GAS SECTOR IN THE MEDIUM TERM

- ❖ Investment in the oil & gas sector is shifting from on-shore to off-shore
- ❖ A reflection of the IOC positioning for the passage of the PIB
- ❖ The delay continue to undermine the fiscal sustainability of the Nigerian government
- ❖ Sector growth is stalling and may remain so till the sector is reformed

Inflation

INFLATIONARY PRESSURE IS UNABATING

- ❑ Inflation rate declined and touched the single digit target briefly at 9.3 and 9.4% in July and August respectively
- ❑ It seemed that was a flash in the pan
- ❑ Upward spiral commenced again in Sept and reached 10.5% in October.
- ❑ The main pressure points are from food and house energy prices including water and gas
- ❑ Rural inflation is also excessively high at 12.8% compared to urban inflation of 7.8%
- ❑ Moderating global inflation may be supportive of deflationary imported foods
- ❑ But recent devaluation of the naira may erode the price advantage on imported items in the short to medium term
- ❑ Approaching dry and festive season is likely to sustain the upward pressure on food prices in early 2011
- ❑ Double digit level of inflation might remain for the rest of the year and Q1 2012.



Source: NBS

Monetary and Interest Rates Environment

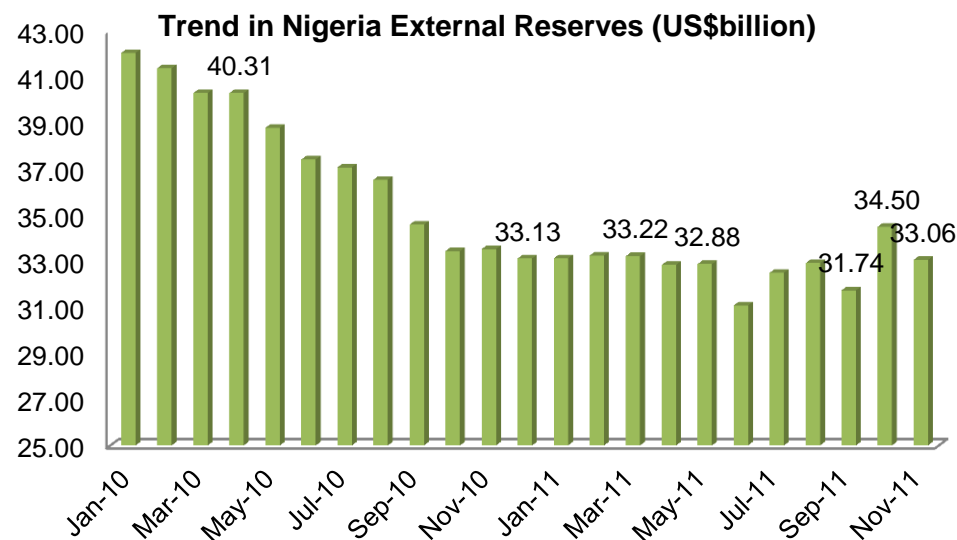


AN END TO TIGHTENING IN VIEW.....

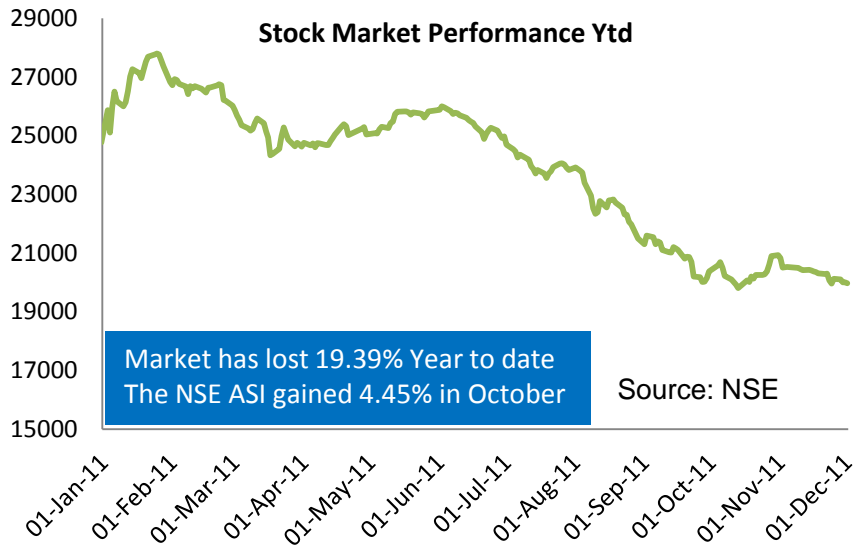
- The monetary authority raised the benchmark rate at every of its bi-monthly meeting in 2011 except at the Nov. meeting
- The MPR has risen by 775bps in 2011 from 6.25% in Nov 2010 to 12.0% in Nov 2011.
- Bank CRR have risen from 2% to 8%. While the NOP of banks in FX to 3% from 5%.
- Tightening was targeted at curtailing inflationary pressure and to achieve single digit inflation target
- Interest rates have therefore heightened and credit curtailed to the real sector
- government costs of borrowing have also risen to near unprecedented level.
- Financial intermediation has therefore become skewed in favour of deposit mobilisation and less of lending to private sector
- Net domestic credit grew by 21% in the first 11 months of the year compared to 23.6% and 40.1% in 2010 and 2009 respectively

MPC No	Meeting Date	MPR	SLR	SDR
80	21-Nov-2011	12.00%	14.00%	10.00%
79	10 Oct 2011	12.00%	14.00%	10.00%
78	19 Sept 2011	9.25%	11.25%	7.25%
77	25-25 July 2011	8.75%	10.75%	6.75%
76	23-24 May, 2011	8.00%	10.00%	6.00%
75	21-22 Mar, 2011	7.50%	9.50%	5.50%
74	24-25 Jan, 2011	6.50%	8.50%	4.50%
73	22-23 Nov, 2010	6.25%	8.25%	4.25%
72	21-Sep-2010	6.25%	8.25%	3.25%
71	5-6 July 2010	6.00%	8.00%	1.00%

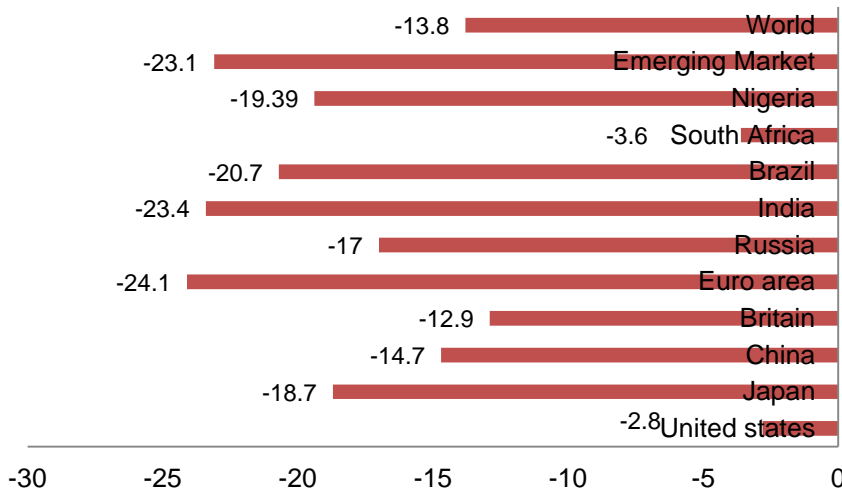
Source: CBN MPC Communiqués, various issues.



Equity Market



Global Equities Markets Performance YTD (%) (LCU)



- ❑ The Nigerian equities market remained on the downside at 19.39% loss YTD
- ❑ Sustained retail investors apathy, systemic liquidity crunch and impressive return on alternative assets classes are largely responsible
- ❑ Baring the above and cautious outlook of the Nigerian economy, equities valuations are very impressive
- ❑ Quarter 3 results of listed companies suggests that fundamental ratios are very strong across key sectors of the market
- ❑ Among selected emerging equities and developed market, Nigerian market is among the least performer ytd.
- ❑ The spate of aggressive monetary tightening threatens potential for reversal in trend.
- ❑ Comparative low yield of the market amongst other asset classes could keep the market low in the short – medium term
- ❑ Possible ease on monetary policy could jumpstart liquidity inflow into the market in Q1

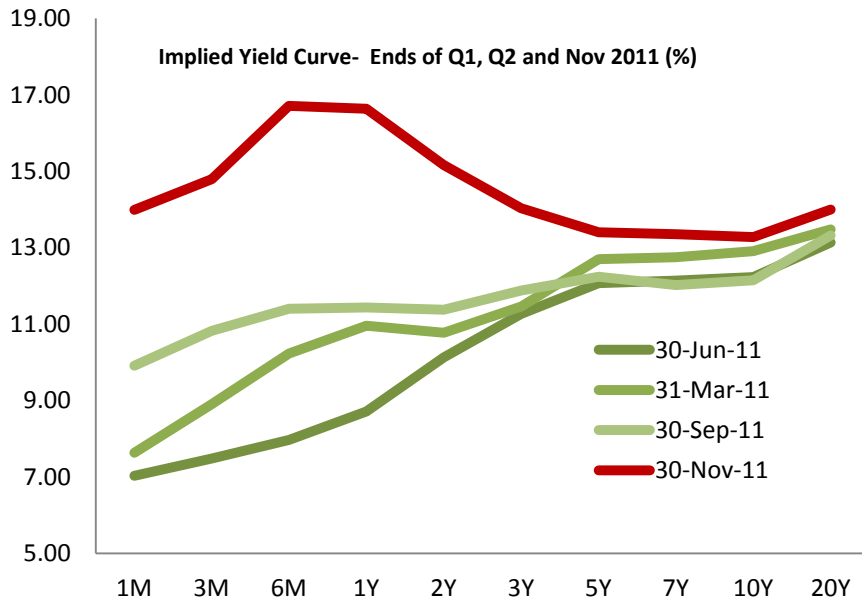
OPPORTUNITIES AND MARKET DEVELOPMENT

- ❑ Comparative current valuation of blue chip stocks suggest impressive opportunities for long term investing
- ❑ Substantial opportunities exist for focused mutual and institutional portfolio investors with high risk profile and long term portfolio outlook.
- ❑ The top tier banks delivered not only impressive valuation in their quarter 3 results but also improved efficiency.
- ❑ On going restructuring in the industry is yielding result- GTB divested fully from GTAssure in a US\$76m deal with Assur African Holding (AAH).
- ❑ The NSE kick started its market reforms programs:
 - ❑ Moved from 3 to 2 markets – Equities Market and Bond Market
 - ❑ Renamed the boards in the Equities Market – Main Board and ASeM
 - ❑ Shifted from 33 to 12 industry sectors in the Equities Market
 - ❑ Reclassified listed companies for better “grouping” within the 12 sectors
 - ❑ Introduced market capitalization classifications for listed companies
 - ❑ Introduced price classifications for listed companies
- ❑ NSE introduces 1st gold exchange traded funds to allow investors to invest directly in gold. ABSA Capital with Vetiva has concluded arrangement to float the gold-backed ETF on the exchange.
- ❑ The introduction of the first gold ETF should deepen the market and increase market activity in Q4.

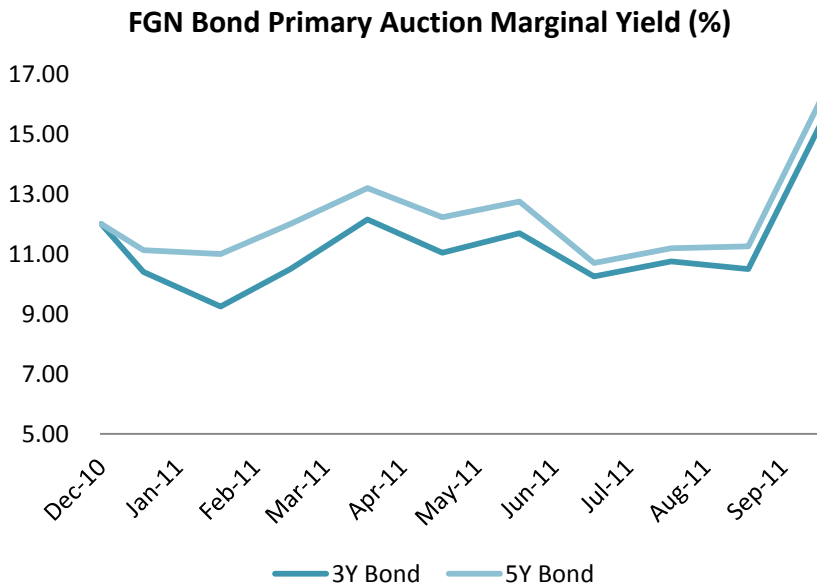
Key Sector Valuation Metric

Sector	PE (times)	Div Yield (%)
Banking	8.8	2.45
Breweries	21.3	0.48
Building materials	24.65	0.48
Insurance	6.64	0.02
Food, beverages & tobacco	16.45	1.07

Market Development - Bond Market

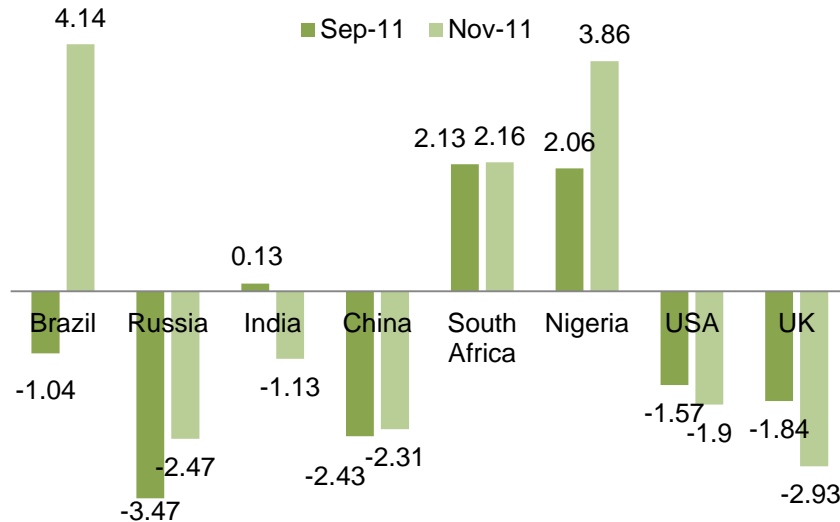


- The yield curve became inverted in November implying that these are not normal time
- short-term interest rates are now above the yield on long term bonds. Hence investors are faced with negative liquidity spread.
- It also signifies a negative outlook for the market in the future and could suggest the onset of a prolonged time of higher cost of borrowing for govt.
- The recent aggressive and inconsistent monetary policy actions may have distorted market outlook
- High marginal yield on primary issues suggest sustained high costs of government borrowing in the short term.
- 3yrs, 5yrs and 10 yrs reissued bonds with shorted maturities closed marginally at expensive yields of 15.5%, 16.3% and 18.0% respectively in October bond issues of DMO.
- Increased funds inflow into the bond market is expected in coming months at the current level of yield.



Opportunities in the Debt Market

Real Bond Yield Across Select Markets in Sept and Nov, 2011 (%)



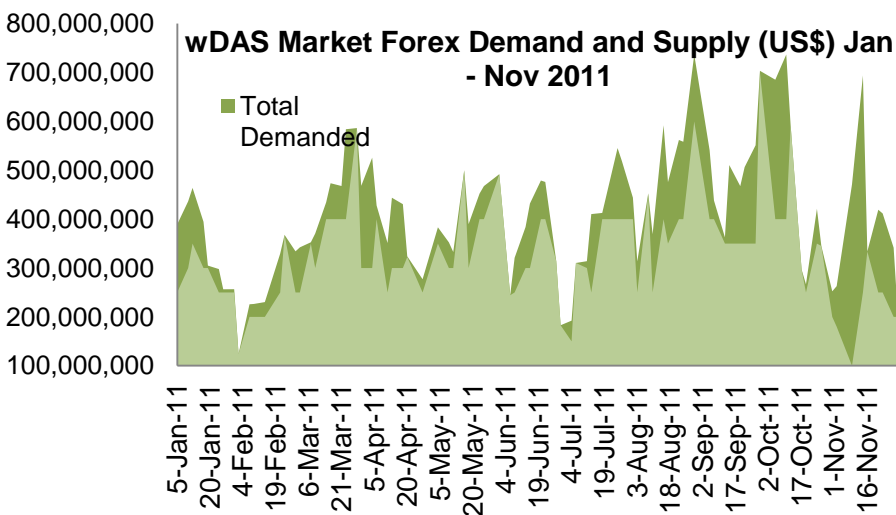
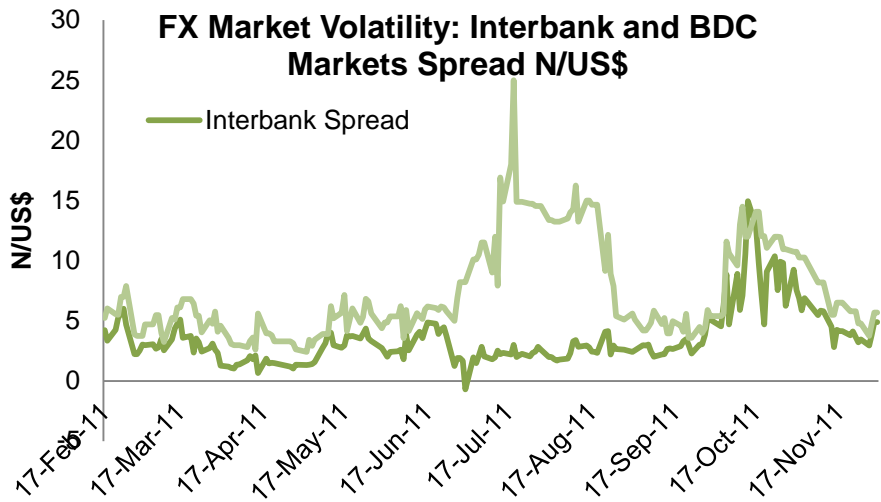
Source: Economist

- ❑ Recent Fitch revision of Nigerian Rating Outlook from Negative to positive could attract global funds into the market
- ❑ The yield on the 6.75% Nigeria Eurobonds due 2021 moderated to 6.20% in November from 7.15% in Sept.
- ❑ The CBN rule that relax foreign investment restriction on longer tenor bond would support inflow into the market from abroad as sovereign outlook improves
- ❑ The commencement of NASD in 2012 should see secondary activities in sub nationals and corporates and further open up that segment of the bond market

- ❑ Nigeria bond market delivers higher real return than others with the exception of Brazil.
- ❑ The real yield surpassed South Africa as a result of aggressive monetary tightening
- ❑ Further expansion in yield is however unlikely in the short term as liquidity flows into the market at the current impressive yield level.
- ❑ The size of the Nigerian bond market is 12% of GDP; hence there is huge room for the market to expand.
- ❑ Specialized bonds- infrastructure bonds, and high yield corporate bonds will boost the market.

FX Market Development

WILL DEPRECIATION OF THE NAIRA HELP?



- ❑ The monetary authority finally depreciated the naira exchange rate to N155/US\$ from N150/US\$ and maintain the volatility band of +/-3%
- ❑ Implying a trading band of N150/US\$- N160/US\$
- ❑ This is to address the persistent volatility and disequilibrium of the exchange rate market
- ❑ Since the decision on Nov 21, 2011, official exchange rate has risen to N157.87/US\$, while the interbank and BDC rates rose to N161.2/US\$ and N162/US\$ respectively.
- ❑ Demand pressure on the official market seems to have moderated and substantial stability experienced in market spreads.
- ❑ Market reaction thus far is appropriate and could be sustainable
- ❑ Exchange rate could therefore be stable around N157/US\$-N163/US\$ in the short and medium term
- ❑ Oil price shock poses further downside risk however and could push the market to the next brink



Outlook

Short Term Outlook

- ❑ Monetary policy may remain tight in focus but a cease in further tightening is likely through Q1 of 2011 as the global economy weather another storm.
- ❑ Economic **growth** is expected to remain strong by the numbers and target growth for 2011 is realistic at 7.98%. A slowdown in 2012 is however unlikely considering the likelihood of shocks to fiscal activities, lag effects of constrained credit and rising unemployment.
- ❑ Lower inflation rate is not expected in the short to medium term. Inflation rate may stay above 10% for the rest of the year and Q1, 2012.
- ❑ Approaching dry season and end of year festivities may put upward pressure on **food** prices. Pass through effect of naira depreciation could erode global price depreciation gain.
- ❑ **Equity** market outlook remains muted: however long term value is available for the perceptive. Recent reforms will help expand the market and increase efficiency. It may however not attract liquidity in the short term.
- ❑ Short and long term opportunity abound in the bond market space through the forecast period. Increased bond market patronage by State governments might be seen in the forecast period.
- ❑ NASD will open up the secondary market space in corporate and subnational bonds with huge and diverse opportunity for early players
- ❑ **Forex** market stability is expected in the short run through Q1, 2012 but the downside risk is high if the global economy enters recession and oil price dips.
- ❑ How the global scenario will impact Nigeria would depend on how much and how quickly trade demand from emerging market like China, India etc can replace potential demand loss from the G3.

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