# Access Economic Quarterly

## Second Quarter 2010

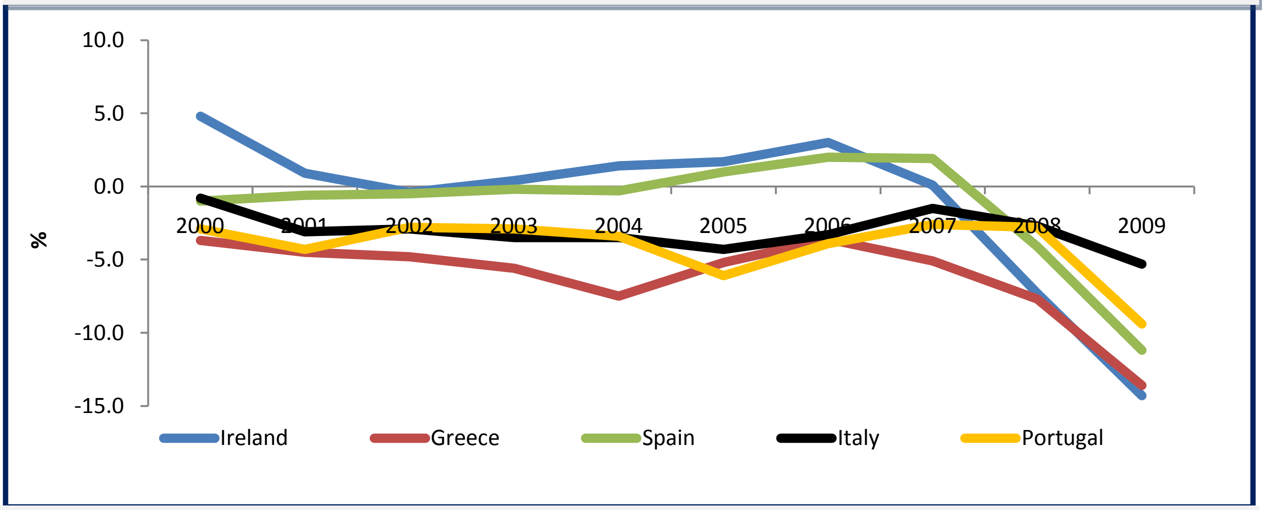
# TABLE OF CONTENTS

# Q2 2010 Economic Review

## Is Global Economic Recovery Screeching to a Halt?

The overall global economic activity appears to have lost the momentum of its rebound during the Q2 2010, as concerns regarding the possibility of a second round of financial crisis spread across global economies. The panic was triggered by the sovereign debt crisis which began in Greece, leading to a cut in their credit rating from A- to BBB+ (the lowest rating of any Eurozone member) by Fitch. Spain's credit rating was reduced from the highest investment grade of AAA to AA+, while Ireland and Portugal were also downgraded as a result of the huge size of their public debts. The current budget deficits and planned cuts in spending in most developed countries may pose further challenges to sustainable global economic recovery.

**Government Deficit/Surplus (% of GDP)**




*Source: Eurostat*

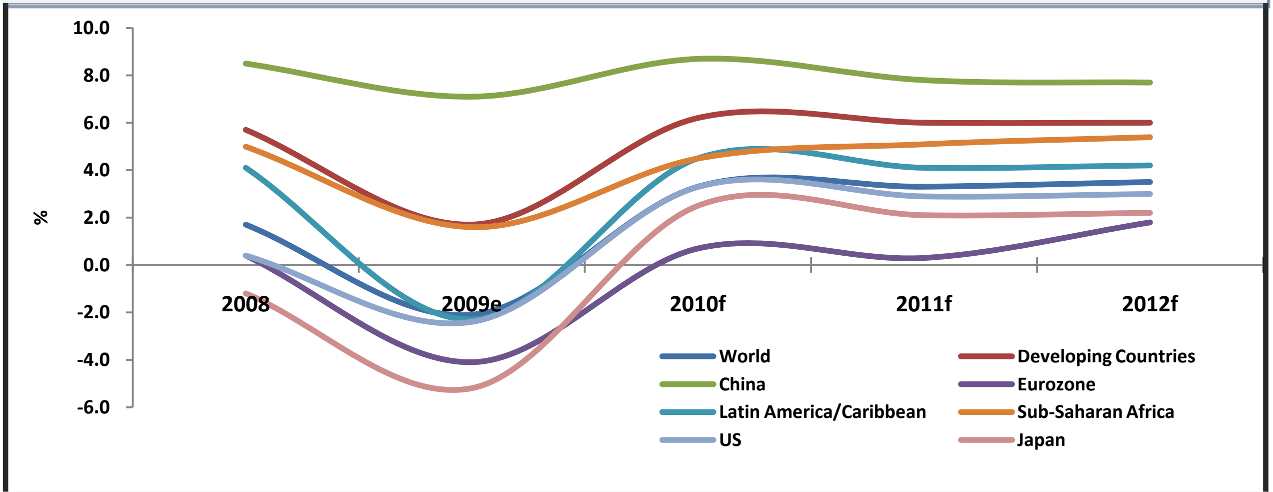
The current fiscal contraction and deteriorating credit worthiness across European economies have weakened the near-term outlook for the Euro, and is anticipated to trigger another round of disorderly currency adjustments. The decline in the Euro's value against the US Dollar may, however, boost the competitiveness of countries that use the currency as it may stimulate the zone's manufacturing and trading activities. The turmoil arising from the credit default appears to have slowed down the nascent recovery in global aggregate demand, international capital flows, investors' confidence, and GDP growth. The challenge of the Eurozone member countries is further exacerbated by their inability to cut interest rate and/ or devalue the currency unilaterally to stimulate domestic investment.

More so, as the fiscal (quantitative easing) measures in major economies continued to wane, there are fears that the unprecedented global economic downturn would take time to heal. Recall that the initial rebound in global economic activities that began in Q2 2009 and up to Q1 2010, was driven mainly by inventory restocking by businesses, as well as quicker than expected rise in export due to fiscal policy stimuli and the effect of the record low benchmark interest rates by respective governments. These measures increased liquidity in both the financial sector and the real sector of the economy, but accumulated overwhelming debts profile from the large size of the rescue packages. The planned cut in spending would continue to undermine the incipient recovery in major economies.

Recent economic data from developed economies indicate a disturbing situation, with unemployment rates remaining high, amid further weakening in manufacturing activities and consumer sentiment. There have been increasing talks that the world economy might be on its way to a double-dip or W-shaped recession, as fears that the Greek-led sovereign debt crisis would result in a contagion across global economies, and therefore stifle global GDP growth. The European Central Bank (ECB) moved to contain the situation during the quarter with the setting up of an emergency fund worth about $750 billion to douse the spread of the crisis and restore confidence in the financial markets. Asia, which appeared resilient during the global economic downturn, could be affected by these adverse developments in Europe due to heavy reliance on export. A slowdown in global trade is bound to have dire consequence for economic growth.

A recent 2010 World Bank projection shows that global GDP would expand by 3.3% in 2010, up from an earlier estimate of 2.7% growth in January and a 2.1% contraction in 2009. The forecast was hinged on strong growth in developing and emerging economies, which grew by 6.2% and 8.7% in 2010, respectively, up from 1.7% and 7.1% as at end-2009.

GDP of Selected Countries/Regions




*Source: World Bank*

# Nigerian Economy

## Political Environment: Tilting towards stability?

In the political terrain, Nigeria witnessed some positive development during the Q2 2010, especially the progress made in the amendment of the 1999 Constitution by the National Assembly. The document was effectively harmonized at a joint committee meeting of the Senate and House of Representatives and forwarded to the State Houses of Assembly for ratification. A total of 50 clauses were altered and would require at least 24 out of 36 states to give their approval for the amended Constitution to become binding. The Constitution amendment was essentially the first by a non-military government since the country gained Independence in 1960. Laws amended include provisions for independent candidacy in elections, financial independence of the Independent National Electoral Commission (INEC) and making it mandatory, rather than discretionary, for the country's President and/ or state Governor to give notice of vacation to the Senate President and Speaker House of Representatives.

The ill-health and eventual death of the erstwhile President of the Federal Republic of Nigeria, Alhaji Umaru Musa Yar'Adua in May 2010 revealed the deficiency of the Constitution, with respect to the absence of President. The President's long absence and lack of detailed information about his health had fuelled political uncertainty, especially in Q1 2010.

Nigeria also recorded some major strides in the fight against corruption, with some law suits instituted by the Economic and Financial Crimes Commission (EFCC) against important ruling party members in Nigerian law courts. Also, the FG had recently hinted of its commitment to apply the Fiscal Responsibility Act in the award and monitoring of contracts.

The peace level attained in Q1 2010 in the Niger Delta region was sustained during the quarter under review. The government granted amnesty to militants between July 2009 and October 4 2009 to stem the spate of vandalism of oil installations and disruption to oil production in the Niger Delta region of the country. The all-out onslaught against installations and personnel at that time, especially in Q1 & Q2 2009, almost led to the near collapse of the economy, with crude oil output declining to between 1.3 - 1.6 million barrel per day (mbpd), from an average of 2.0mbpd pre-crisis. Significant risk to oil output growth stems from militants' mistrust of the FG's action plan following the alleged slow pace of implementation of the Post-amnesty Programme. However, oil production losses recorded in Q2 were mainly due to output shut-in for pipeline maintenance/ repairs at the Qua Iboe, Bonga and Brass Terminals and minimal sabotage attacks on Trans Forcados and Ebocha-Brass trunk lines.

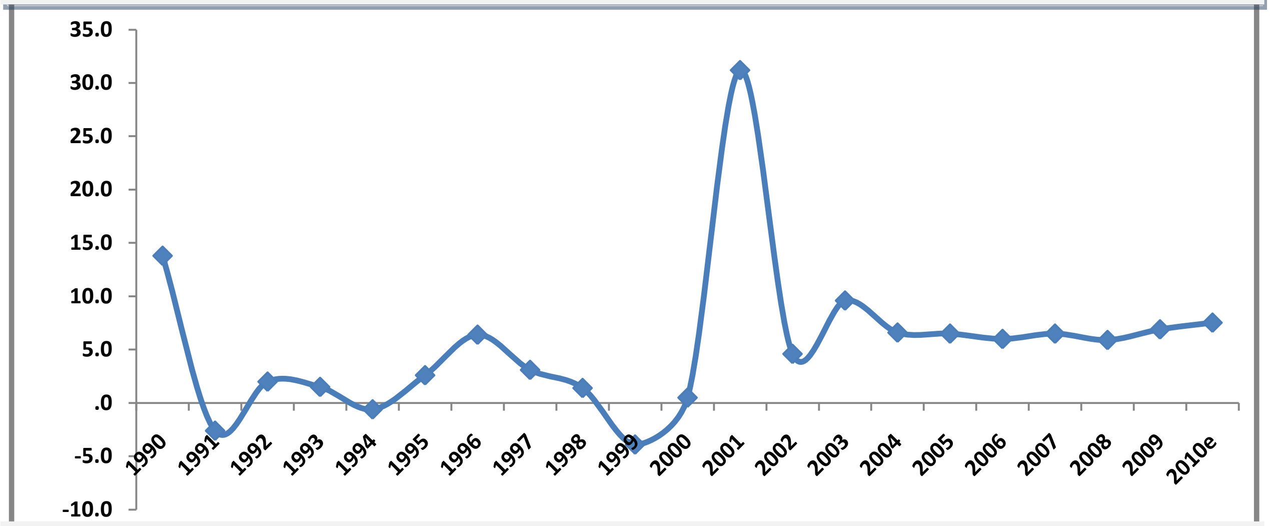
The Nigerian Oil and Gas Industry Content Development Bill (often called the Local Content Bill) was signed by the President into law during the quarter. Under the law, for all contracts relating to the oil & gas Industry, including all aspects of insurance contracts, indigenous companies shall be given the right of first consideration. It also provided for training when requisite skills are inadequate. Multinational oil companies are required to keep a minimum of 10% of annual profit in Nigerian banks, and legal services would be carried out exclusively by Nigerian companies. Effort has also been made to increase investment in domestic gas production, with the FG and major oil companies signing a Gas Supply and Purchase Agreement (GSPA) to boost gas supply/ availability to power plants.

The relative stability in the political environment, coupled with the progress made so far in financial sector reform, could stimulate the inflow of foreign direct investment in the near term. However, political tensions may worsen if the ruling party fails to agree on a consensus candidate for the 2011 General Elections. Furthermore, another major risk to peace and stability is the resurgence of violence in the Niger Delta.

### GDP Growth: Contributions from oil industry steals the show

Available data released by the National Bureau of Statistics (NBS) shows that real gross domestic product (GDP) is estimated to grow at 7.68% in Q2 2010, up from 7.23% in Q1 2010 and 7.22% attained in the corresponding period of 2010. Recent provisional estimates from the Statistics office projects that real GDP would expand by 7.76% and 8.13% in Q3 and Q4 2010, respectively. Like in the previous year, the non-oil sector is expected to remain the main growth driver, with overall GDP growth projected at 7.74% for end-2010, compared to a revised 6.66% growth recorded in 2009. Agriculture, wholesale, retail trade and services are expected to lead the pack. Projected rebound in oil sector GDP is expected to compliment overall growth due to the sustained peace in the Niger Delta region, where most of the country's oil reserves are located.

**Real GDP Growth Rate (% Change YoY)**

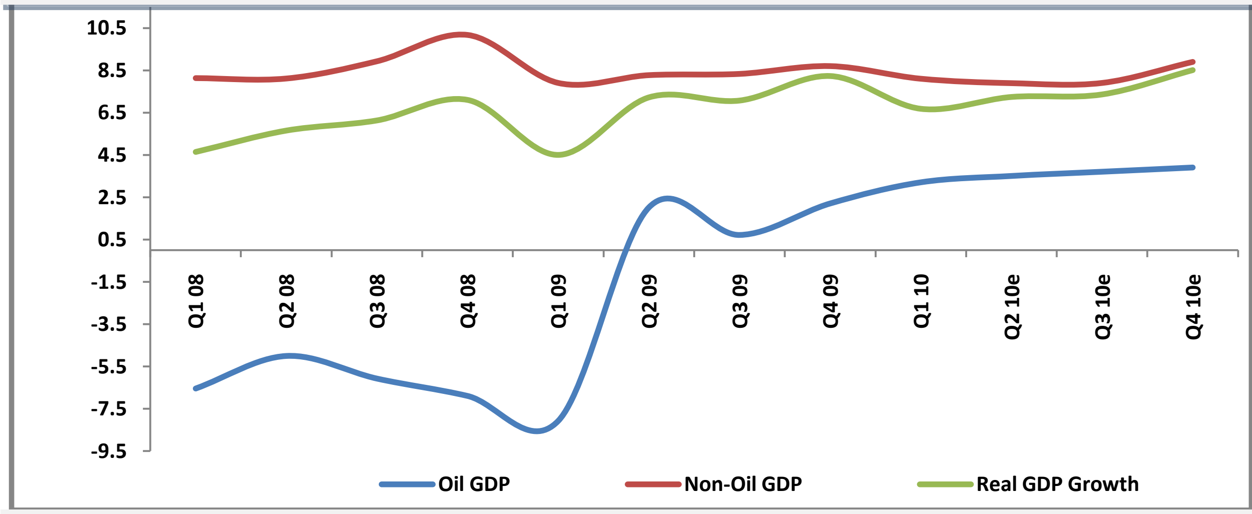



*Source: NBS*

Significant risks to GDP growth remain the volatility of crude oil price, amid current weak global demand fundamentals; political instability; discontinuation of reforms in key sectors; spikes in inflationary pressures; and increased government spending not backed by productivity. Nigeria's economy flourishes during oil booms, as the country's fiscal sustenance is inextricably tied to receipt of oil proceeds to support FX needs of the domestic financial market.

Recently, the National Assembly reviewed key assumptions of the 2010 budget, including the expenditure profile due to marked volatility in crude oil price at the international market. Shortfall in oil revenue and the likely reduction in budget spending may undermine the objective of boosting investments in key infrastructure across the country.

**Real GDP Growth (Quarterly)**




*Source: NBS*

# Monetary Development

### Monetary Policy Stance: Quest for macroeconomic stability takes centre stage

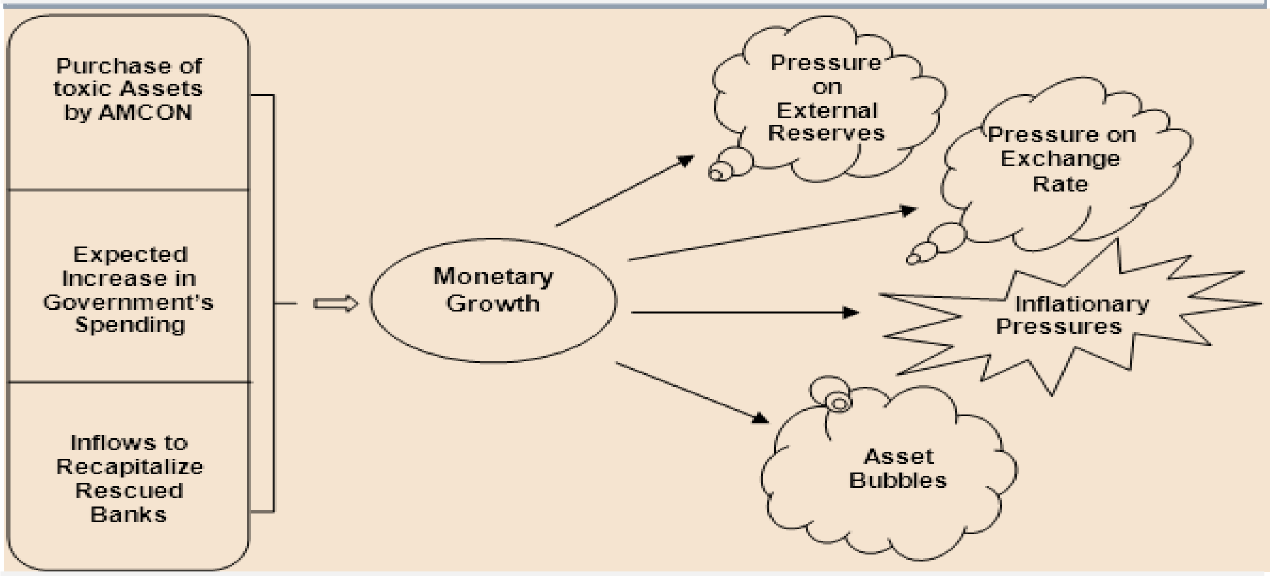
The conduct of monetary policy during the Q2 2010 was geared mainly towards maintaining both internal and external macroeconomic stability to stimulate economic growth via the real sector of the economy. The apex bank reaffirmed its commitment to the quantitative easing policy in a bid to unlock credit to the real sector. CBN believes that the removal of structural and institutional impediments, in addition to addressing the high risk perception of borrowers by banks could moderate lending rates. In recent times, CBN’s measures have been targeted at encouraging real sector lending by maintaining a low cost regime, with an overriding objective of ensuring macroeconomic stability, as well as stability in inflation, exchange and interest rates in the near to medium term to boost GDP growth.

At the Monetary Policy Committee meeting held $10^{th}$–$11^{th}$ May, 2010, the apex bank extended its guarantee of interbank transactions, foreign credit lines, and pension fund placements among banks from December 31, 2010 to June 30, 2011 to boost confidence in the domestic financial market. CBN also left its key policy rate at 6% (same level since July 2009), while the asymmetric interest rate corridor was retained at 8% and 1% for Standing Lending Facility and Standing Deposit Facility, respectively.

The apex bank further made a commitment to avoid decisions that could prevent the realisation of sustainable GDP growth.

CBN expects monetary expansion in Q3 2010 to be driven mainly by increased government spending, purchase of toxic assets by the AMCON and the recapitalization of rescued banks, which may pose significant risks to inflation and generate asset price bubbles.

**CBN Monetary Policy Concerns for 2010**




**Source: Access Economic Intelligence**

The CBN's liquidity management operations are often anchored on the policy rate, OMO instruments, including the two-way quote trading, tenored repo and reserve requirements. These measures are used to influence reserve money (currency in circulation + bank balance) to control money growth, and curtail the upside risks to price stability.

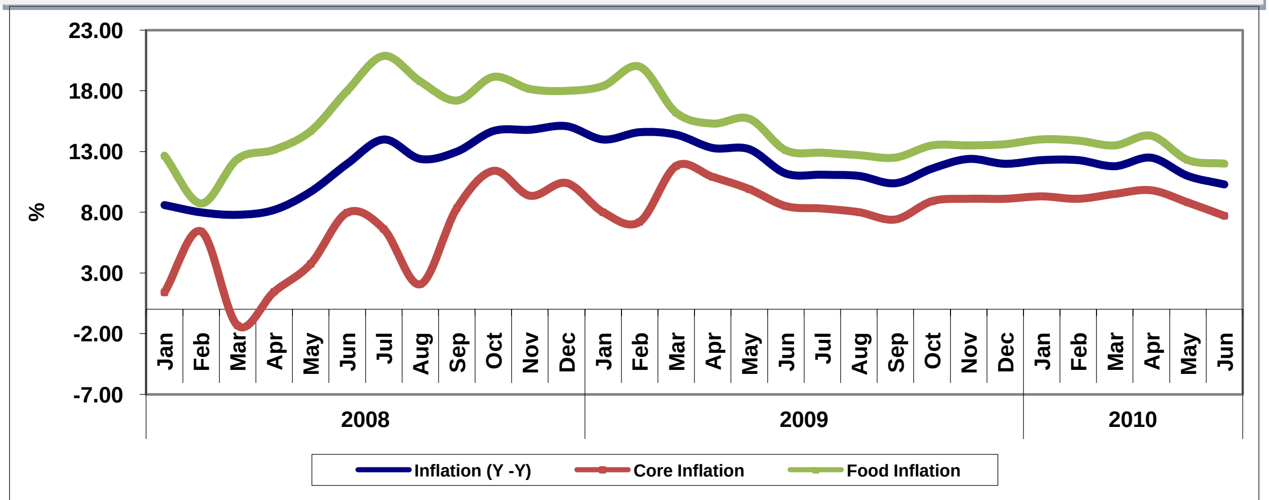
## Inflation: Upside risks still present

During the quarter, inflation rate ebbed from 12.5% in April 2010 to 11.0% and 10.3% year-on-year in May and June 2010, respectively due mainly to fall in aggregate demand. From the data, Nigeria's inflation rate has gradually eased within government's end-2010 11.2% target, though upside risks still abound. Data from the National Bureau of Statistics (NBS) show that food inflation, which accounts for 63.7% of the CPI, declined further from 14.3% in April 2010 to 12.3% and 12% in May and June, respectively, with core inflation declining from 9.8% to 8.8% and 7.7% over the same period. The declining core inflation, arising from current high unemployment rate, coupled with relative stability in wages would further curtail inflationary tendencies.

To stem the upside risks to price stability, CBN has actively used the Open Market Operation (sale of treasury bills), as the primary instrument for liquidity management. The apex bank believes that expansion in banks' deposit which is not matched by liability generation by deposit money banks would support inflationary tendencies.

Meanwhile, the CBN Governor, Mallam Sanusi Lamido Sanusi, has revealed that inflation rate outlook is uncertain and disclosed plans to keep interest rates at low levels, with commitment to maintain stability across all monetary variables. CBN anticipates that the monetary injections expected from AMCON, as well as the expansionary government spending would make the management of the economy difficult in the second half of the year.

**YoY Inflation Rate**




*Source: NBS*

## External Reserves: A fortress still under intense pressure

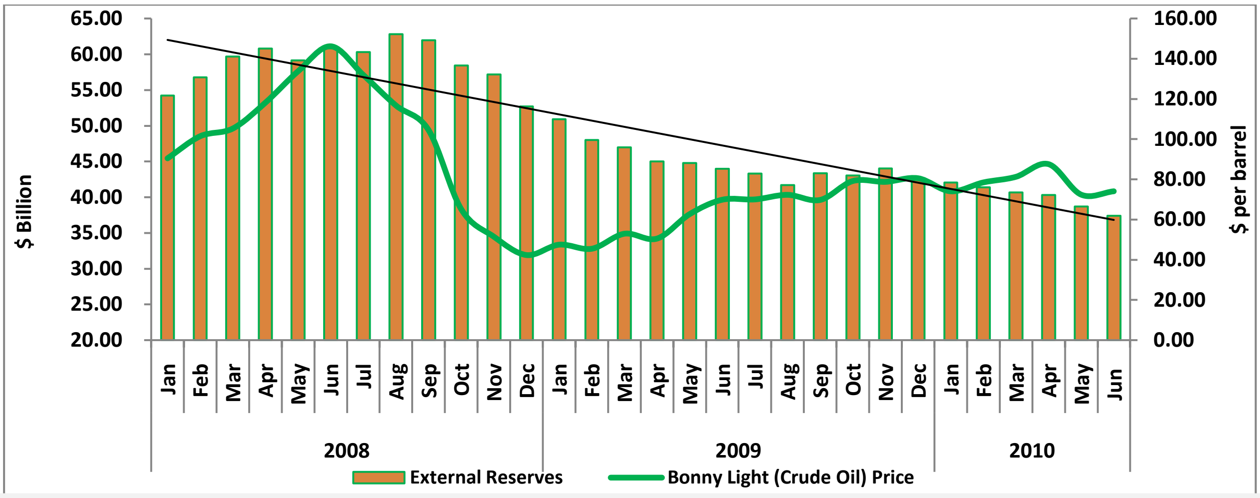
External reserves sustained its downward trajectory during the quarter under review, with the country's buffer declining further from $40.68 billion as at end-Q1 2010 to $37.17 billion on June 30, 2010, representing an 8.62% fall. Reserves stood at $52.7 billion and

$42.43 billion as at end-2008 and end-2009, respectively, after reaching $60.3 billion in July 2008 at the height of the oil price boom of 2007/2008.

The declining external reserve portends significant risk to the value of the Naira, as the country continues to be dependent on FX from oil sales to lubricate the domestic financial market. With the ensuing challenges and expected increase in FX demand for imports as year-end approaches, there may be some pressure on the value of the Naira in the near term. The striking thought now borders on how long the external reserves could meet the higher demand for the Naira. The successful creation of a Sovereign Wealth Fund (SWF) would in the long run provide future streams of income to serve as alternative source of foreign exchange.

In addition, the return of  low investors' sentiment regarding the slow pace of recovery of the global economy, due to the Greek-led sovereign credit default risk, would likely provide significant risk to the country's main foreign exchange earner, as developed countries factors in the downturn in productive activities. Oil price recently experienced marked volatility at the international market, with implications for government revenue.

External Reserves vs Crude Oil (Bonny Light) Price




Sources: CBN & Energy Information Agency

## Exchange Rate: Is the Naira Set for a Precipitous Decline?

At the official market, the value of the Naira depreciated against the US Dollar in Q2 2010 when compared with end-Q1 2010 figures, but appreciated at the interbank market, while it remained stable at N152/$ in the BDC. Naira's value declined, albeit marginally, at the official and parallel markets by 0.14% and 0.5% to N148.50/$ and N153/$, respectively from end-Q1 2010 position and appreciated by 3.9% to N150.05/$ at the inter-bank. In the same period of 2009, the Naira appreciated across all segments of the market, except at the interbank market where it depreciated by 1.5%. Naira has remained relatively stable around N150/$, following CBN's commitment to defend the currency against volatility.

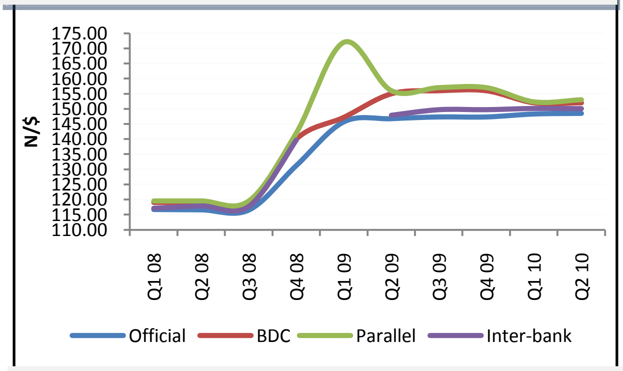
Naira's Exchange Rate (N/$)

| End Period | Exchange Rate | | | |
|---|---|---|---|---|
| | Official | BDC | Parallel | Inter-bank |
| Q1 2008 | 116.73 | 119.00 | 119.50 | 117.08 |
| Q2 2008 | 116.63 | 119.00 | 119.50 | 117.85 |
| Q3 2008 | 116.56 | 118.50 | 119.50 | 117.69 |
| Q4 2008 | 131.25 | 140.00 | 142.00 | 139.65 |
| Q1 2009 | 145.70 | 147.20 | 172.00 | Market Effectively Closed |
| Q2 2009 | 146.75 | 155.00 | 156.00 | 147.85 |
| Q3 2009 | 147.32 | 156.00 | 157.00 | 149.70 |
| Q4 2009 | 148.10 | 152.00 | 154.00 | 149.93 |
| Q1 2010 | 148.30 | 152.00 | 152.30 | 150.11 |
| Q2 2010 | 148.50 | 152.00 | 153.00 | 150.05 |

*Sources: CBN & FDHL*

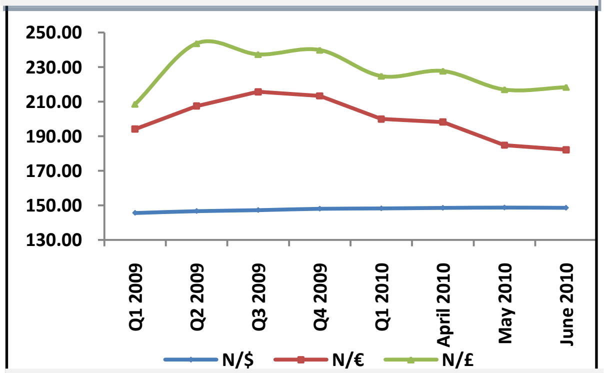
The value of the Naira has shown increased convergence across all segments of the market which can be attributed to sustained high FX supply and transparency of the foreign exchange market, amid the apex bank's resolve to meet legitimate FX demand. However, the threat to Naira's stability is accentuated by the dwindling external reserves.

Naira's Exchange Rate (N/$)




*Sources: CBN & FDHL*

Cross Rates




*Sources: CBN*

The Naira appreciated against both the Euro (€) and British Pounds Sterling (£) in Q2 2010 when compared to Q1 2010. Naira appreciated by 8.9% and 2.9% to N182.24/€ and N218.44/£, and have gained 14.6% and 2.9% from figures as at end-2009. Against the US Dollar, the Naira depreciated marginally by 0.3% and 0.4% from data as at Q1 2010 and Q4 2009, respectively.

CBN's commitment to defend the Naira against volatility by meeting all legitimate FX demand at its bi-weekly auction system would likely support the currency in the near term, with dire consequences for the nation's external reserves.

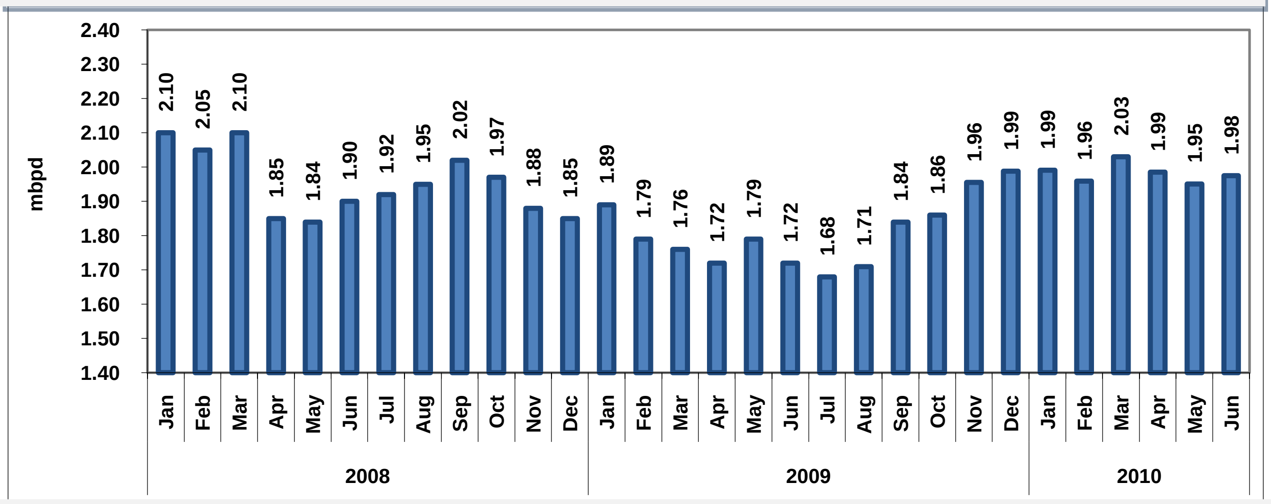
## Crude Oil Prices: Tremor underneath rebound spring

The price of Nigeria's brand of crude oil (Bonny Light), like other varieties of hydrocarbons, declined noticeably at the international market during the period under review. Bonny Light price, which rose from $80.83 per day (pd) as end-Q1 2010 to a high of $87.52pb in April 2010, fell precipitously to below $73pb in May 2010 due mainly to heightened concerns about the probable spread of the Eurozone's sovereign credit crisis. The Ripple-Pebble effect quickly undermined investors' sentiment as well as consumer confidence about the pace of recovery of the global economy. However, at the dawn of the quarter, oil price showed signs of recovery from recent low of $67pb as at end-May, 2010.

The drop in crude oil price was a major concern for Nigeria, with President Jonathan urging a downward review of some key assumptions of the 2010 budget (N4.6 trillion), as well as the proposed expenditure. Crude oil exports contribute over 90% of government revenue in Nigeria and the decline in oil prices has implications for revenue projection which may further plunge government finances into deficit (currently at N1.5 trillion for 2010).

Other factors that might support a rebound in crude oil price include the weakening of the US Dollar against major currencies, increased flow of speculative money, supply bottlenecks resulting from political instability in oil producing countries, elevated demand from China, as well as stabilisation in major economies. However, continuing inventory build up by businesses, non-compliance with OPEC quota, and expected increases in output by non-OPEC countries may undercut increases in crude oil price in the near term.

**Crude Oil Production**

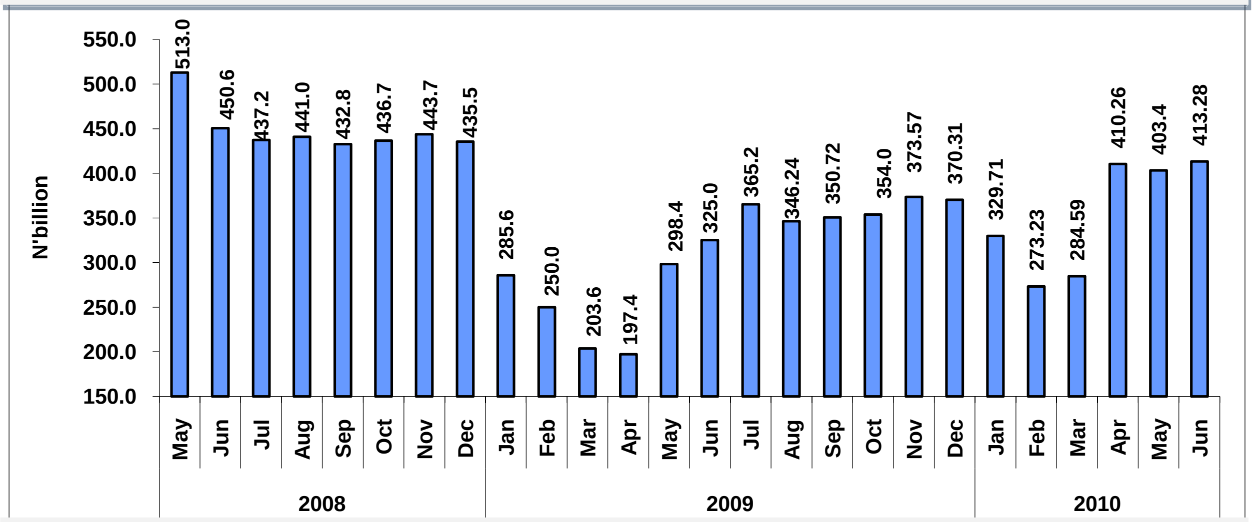



*Sources: OPEC*

## Statutory Allocation: Downside risks on the horizon with SWF peeping

In Q2 2010, statutory disbursement to the three tiers of government by the Federation Account Allocation Committee (FAAC) recovered remarkably from low levels recorded in Q1 2010. The recent upward movement in statutory allocation was driven largely by the elevated crude oil price and sustained crude oil production, following marked decline in Niger Delta restiveness. The Committee shared N410.26 billion, N403.4 billion and N413.28 billion for April, May and June 2010 respectively, compared to an average of N295.8 billion disbursed in Q1. In April, about N339.6 billion was withdrawn from the Excess Crude Account (ECA) and disbursed as accumulated arrears for January - March, due to the use of a lower oil benchmark price before the 2010 budget was approved with $67 per barrel as benchmark price.

**FAAC Disbursement**




*Source: Ministry of Finance*

Nigeria saves oil revenue above a benchmark price into an Excess Crude Account (ECA) to guard against price volatility, which is then shared monthly among the 3 tiers of government. The balance in the ECA (foreign) declined to $3.2 billion from over $20 billion in 2008, while domestic excess crude account stood at N29 billion as at April 2010.

Meanwhile, FAAC has expressed its commitment to implement the approved monthly maximum of N365.8 billion for statutory disbursement collected from mineral and non-mineral revenues. The excess above the maximum amount would be saved into an Excess Revenue Account. Nigeria's financial institutions rely on the monthly statutory allocation for a significant chunk of their liquidity, which dictates domestic interest rates direction.

In the quarter, the clamour for the replacement of the Excess Crude Account (ECA) with Sovereign Wealth Fund (SWF) was revisited. The process to create a SWF began in 2008 fiscal year, but stalled following stakeholders' disagreement over funding modalities. Under a renewed arrangement, Aganga (the Finance Minister) would lead the FG team, while 6 States Governors, one from each geopolitical zone would represent the Governors' Forum in a bid to workout alternative funding for SWF, beside the ECA.

The respective committees are expected to submit their reports by mid-July 2010. An SWF is a more structured savings in stocks, bonds, property or other financial instruments at the international market.  A law to back the conversion of ECA to SWF would curtail liquidity to the financial system in the short-medium term, and result in hikes in domestic interest rates. Oil rich countries, including all OPEC members except Nigeria, have SWF, which may act as an alternative source of foreign exchange.

## Capital Market: A rebound beset by uncertainties

The capital market declined marginally in Q2 2010 compared to end-Q1 2010, although still remarkably up from the low recorded as at end-2009 following the stock market meltdown. The Nigerian Stock Exchange (NSE) All Share Index (ASI), which stood at 25,966.25 points as at end-Q1 2010, rose by 1.9% to 26,453.20 points in April, and thereafter started to decline. In same vein, the market capitalization (MC) of listed equities also declined during the same period.

ASI dipped by 33.8% in 2009 fiscal year, but has since gained a cumulative 24.2% from the beginning of the year-to-date, while MC also rose by 26.1% in the same period. The uplift in market sentiments supported a steady rise in share prices of most equities, buoyed by impressive results of some companies/banks, amid the sustained 'clean up' of the Nigerian financial system and improved reporting standards.

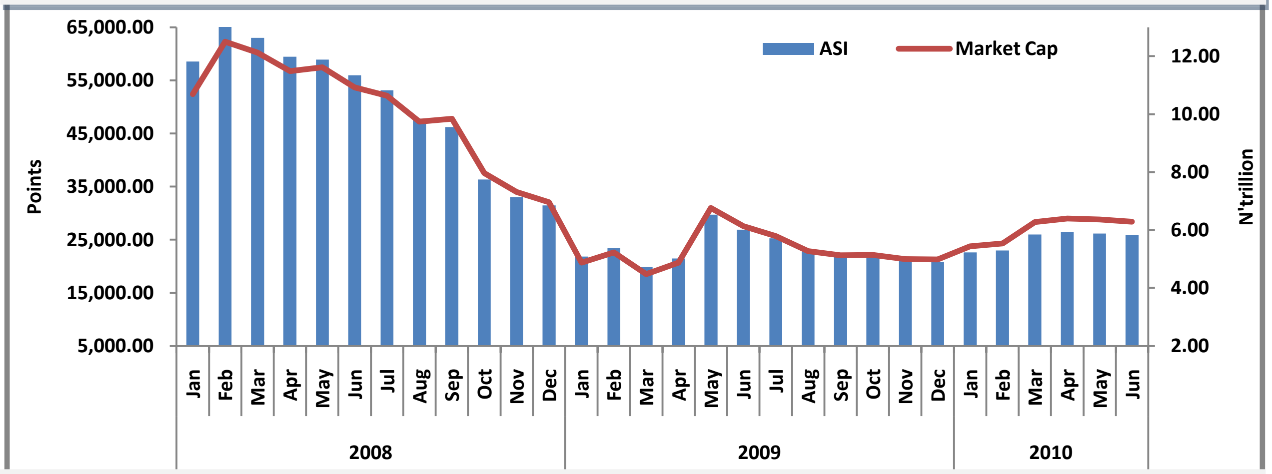
**Stock Market at a Glance**

| Categories | 2007 | 2008 | 2009 | 2010 | | | |
|---|---|---|---|---|---|---|---|
| | | | | End-Q1 | End- April | End-May | End-June |
| ASI | **57,990.00** | 31,450.78 | 20,827.17 | 25,966.25 | 26,453.20 | 26,183.21 | 25,384.14 |
| MC | **10.18** | 6.96 | 4.99 | 6.28 | 6.40 | 6.37 | 6.17 |
| End Period Performance vs end-2009 | **74.73% ⇧** | **-45.80% ⇩** | **-33.80% ⇩** | **29.76% ⇧** | **27.01% ⇧** | **25.72% ⇧** | **21.88% ⇧** |

*Source: NSE*

The market seems to be exhibiting a 'graveyard market' tendency, with occasional sell-off by investors to cut losses. The net gainer has been the bond market, which has received increased patronage in form of flight to safety, despite the current low coupons. Bond prices at the secondary market have maintained an upward trajectory in recent times, trading at premium to its par value, though at the trade-off for low yields. The uptick mirrors the current stock market performance and liquidity situation. We expect that the recent nosedive in share prices to relatively low levels may stimulate another round of purchase of stocks and cause the ASI to appreciate in the near term

**Nigerian Stock Market**

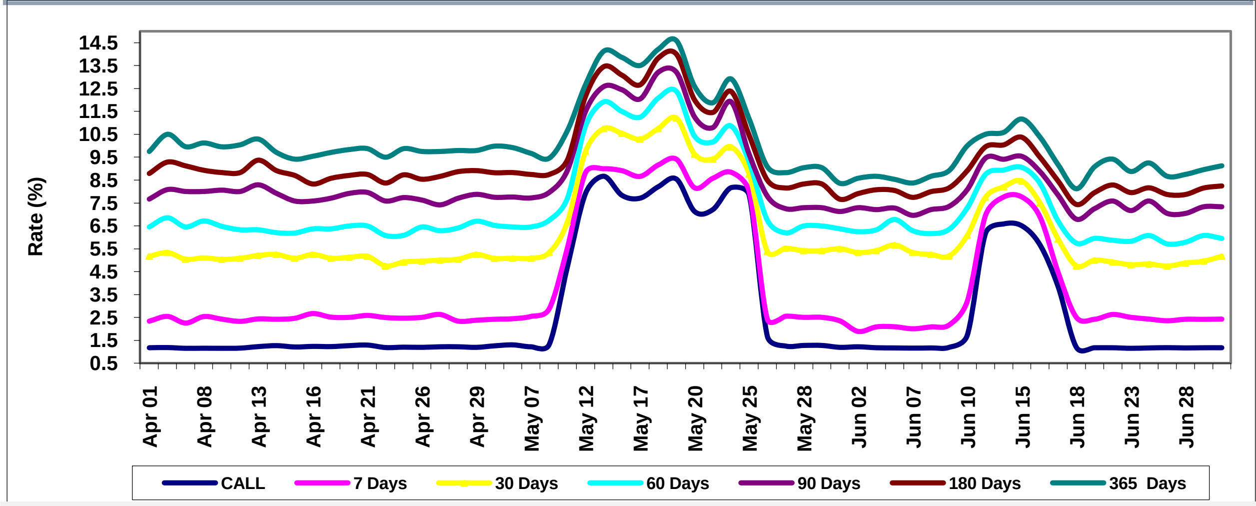



*Source: NSE*

## NIBOR: Responding to liquidity concerns

The Nigerian Interbank Offer Rate (NIBOR) moved in line with the liquidity situation in the financial system, with noticeable volatility witnessed during the quarter under review. The average monthly interbank rate declined precipitously from year start, and tended to bottom out in April 2010. It rose sharply in May as a result of liquidity concerns following delayed disbursement of statutory allocation by the Federation Account Allocation Committee (FAAC). With the release of over N700 billion to the 3 tiers of government, NIBOR nosedived to previous levels across all tenors. The resurgence of liquidity concerns in June was again contained with the release of the statutory allocation.

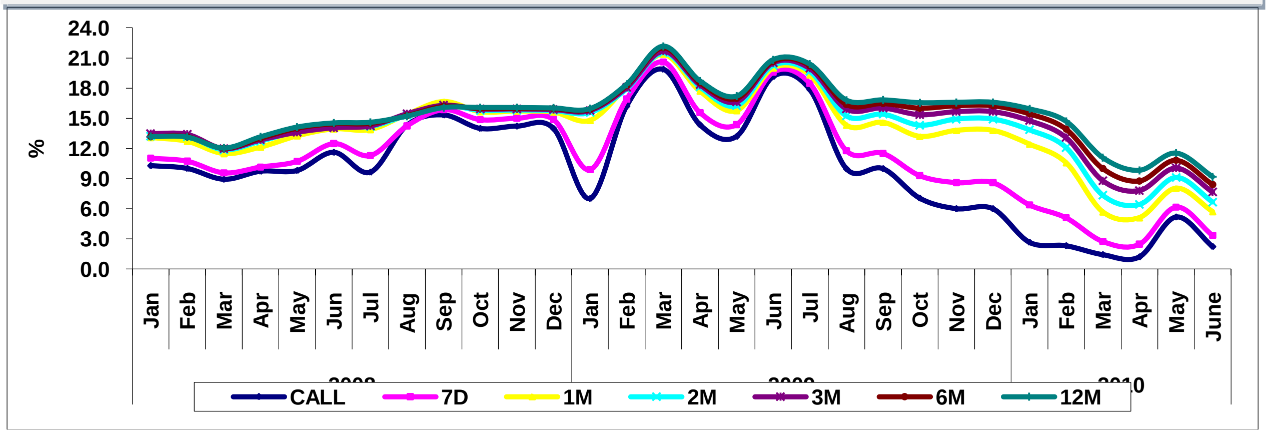
**NIBOR**




***Source: FMDA & FDHL***

Activities of the apex bank via the sale of treasury bills also generated liquidity concerns during the quarter. CBN believes that the upshot in bank deposits and the reserve money, may fuel rise in general price level through monetary growth transmission mechanism. Deposit money banks continued to exhibit risk-averse behaviour in credit creation, following an audit by the CBN which revealed a significant number of non-performing loans in their books.

**NIBOR – Trend Analysis**




***Sources: FMDA & FDHL***

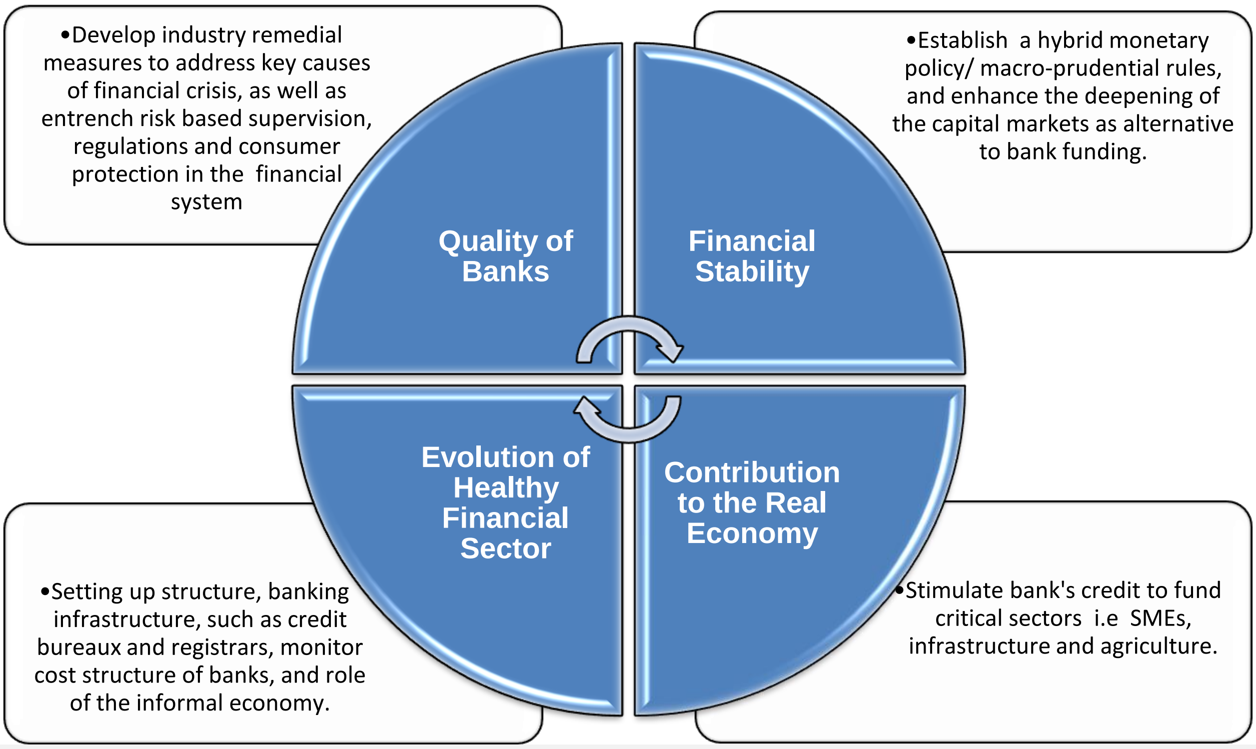
The apex bank's guarantee of interbank transactions which was recently extended to June 2011, coupled with other measures may have boosted confidence in the system.

| CBN Targeted Monetary Injections | | | | | |
|---|---|---|---|---|---|
| **S/N** | **Purpose** | **Established** | **Amount (N' Trillion)** | **Status** | **Tenor** |
| 1 | Bailout package for 8 troubled banks | June 2009 | 0.620 | Already in the system | Unspecified |
| 2 | Commercial Agriculture Credit Scheme | April 2009, but reopened in 2010 | 0.200 | On-going | Tenors: 3, 5 and 10-year |
| 3 | N300 billion - power sector, N200 billion - SME Credit Guarantee Scheme | April 2010 | 0.500 | Modalities released | Maximum tenure of 5 years |
| 4 | Asset Management Company of Nigeria (AMCON) | 2010 | 1.00 | Proposed; modalities still being worked out | 10 years |

*Source: CBN (Various Reports)*

## Financial Sector: Stability getting institutionalised

Nigeria's financial system was relatively stable in Q2 2010 in line with the apex bank's commitment to make macroeconomic stability an overriding objective. In its determination to reform the Nigerian financial system and ensure that banks play a greater role in the real sector of the economy, the CBN recently unveiled a blueprint made up of four pillars depicted below.




*CBN Blueprint for Financial Stability*

During the quarter, the Asset Management Corporation of Nigeria (AMCON) Bill was passed, following the harmonization and consequent adoption by the Committee set up by the two chambers of the National Assembly. The bill has been presented and signed into law by President Jonathan. Though the modalities for the take-off of the company are still being worked out, it is anticipated that it would come on stream in Q3 2010. The proposed company is expected to purchase non-performing assets from banks, and in effect act as a vehicle to repair banks' balance sheets, with the ultimate goal of stimulating credit to the economy.

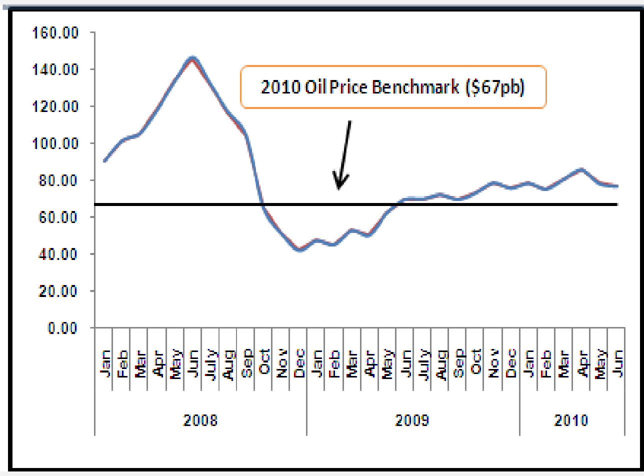
Meanwhile, a recent Fitch Ratings report stated that earnings in the Nigerian banks may remain under pressure in 2010, due to a weaker operating environment, coupled with slow pace of recovery of the global economy. The agency also traced the difficulty to the apex bank's special audit which required banks to reclassify a significant proportion of loans as non-performing and to raise appropriate provisions in line with their findings.

CBN also released guidelines for granting liquid asset status to eligible state government bonds, following decisions arrived at during the Monetary Policy Committee meeting held in March 2010. Under the guidelines, the issuer is expected to maintain a fully-funded sinking fund and the bond rated by a Rating Agency from inception to maturity of the bond. It also provided for the Securities and Exchange Commission (SEC) to monitor projects executed with proceeds of the bonds and the respective state governments establish a debt management department to enhance transparency. The aim of granting liquid status to the bond was to make the bond tradable at the open market in a bid to boost liquidity and investment.

## 2010 Budget: Pressures on the upside

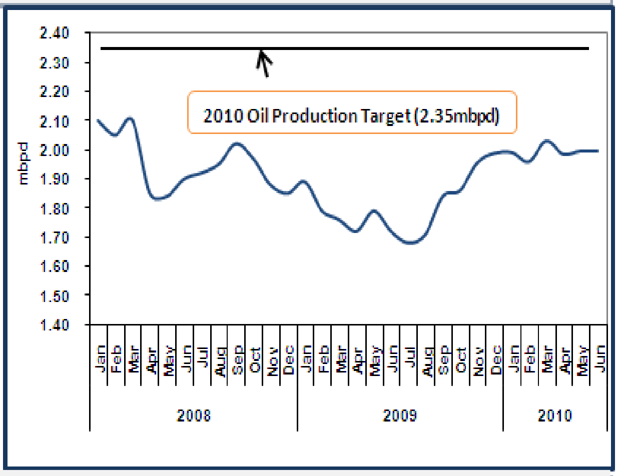
President Goodluck Jonathan signed the 2010 budget worth N4.6 trillion into law on April 22, 2010, which represented a 48.7% increase over the N3.1 trillion approved for 2009 fiscal year. The budget rose by 12.9% over the N4.08 trillion presented by the FG in November 2009 for approval. Key assumptions used in preparing the budget include crude oil benchmark price of $67 per barrel, daily crude oil production of 2.35mbpd, Joint Venture Cash Calls of $7 billion (from $5 billion) and target GDP growth rate of 5.47%, inflation rate 11.2% and exchange rate of N150 /$1. The budget had a deficit of N1.5 trillion, representing about 4.6% of Gross Domestic Product (GDP).

**Crude Oil Benchmark**




*Source: EIA*

**Oil Production Benchmark**




*Source: OPEC*

The performance of the budget was severely challenged in early May 2010, following marked volatility in oil price at the international market. The fluctuation in price prompted a review of the budget's key assumptions by the National Assembly. With the crisis still not abating and the fear of a contagion spreading across global economies, a downward review of the budget may further strengthen the downside risks to GDP growth in the near to medium term. A crude oil output of 2.35mbpd may be overly ambitious if uncertainty surrounding oil business in the country is not addressed. The budget was effectively cut to N4.4 trillion, with oil output and price benchmarks revised to 2.2mbpd and $60pb from 2.35mbpd and $67pb, respectively. Recall that the budget focuses mainly on public works, power and transport and would depend on crude oil for over 90% of foreign exchange earnings.

With the anticipated strain in government's revenue and the huge size of the budget deficit, then the prodding question is how will the budget be financed in the face of current challenges in both the domestic and global economy? A strategy to finance any shortfall by borrowing from the domestic market, which remains susceptible to liquidity movement, has the tendency to crowd-out private sector investment, leading to increases in interest rate. It is worthy to note that borrowing from the international capital market may be unwise at the moment, due to financial uncertainty, as lenders would price in risk to make the loan uneconomical and impracticable.

## Revised Outlook for the rest of 2010:

For the Global economy, we continue to expect a sustained but uneven recovery process for the second half of 2010 and beyond, with the Asian economy leading the pack while Europe may continue to lag for some time. Bank of England (BoE) recently hinted that the exposure of UK banking sector to other European Banks caught up in the currency crisis may renew concerns about counterparty risk, which could further reduce the credit to the economy, and undermine GDP growth. The global outlook remains uncertain, with the downside risks to GDP growth and upside risk to price stability becoming entrenched.

The Nigerian economy has sustained some stability in recent time, including the political environment. President Jonathan has reiterated his commitment to conducting credible elections, with the recent engagement of Jega as Chairman, Independent National Electoral Commission (INEC). Some strides were also achieved in the fight against corruption and the continued resolve to implement the Fiscal Responsibility Act in contract award. We expect the economy to maintain its stability for the rest of the year, provided issues surrounding government revenue are effectively addressed, however hinged on development in the global economy. The economy would likely be characterised by:

- **GDP growth to stay above 6% in the near - medium term.** NBS recently projected that the economy would grow by 7.74% by end-2010, up from 6.66% recorded in 2009. However, the growth trajectory may be undermined by a downward spiral in oil price at the international market, amid weak demand fundamentals, poor state of infrastructure, sustained inflationary pressures and the possibility of breakdown of FG's Amnesty Programme.

- **Moderate inflationary pressures due to CBN's AMCON, SME and Power Sector Intervention Funds.** Expansionary nature of the budget, moderate increase in commodity prices, announcement effect of salary increase for public sector employees and the proposed removal of petroleum products subsidy may pose additional upside risks to price stability. However, inflation appears to be effectively balanced by the continued underperformance of monetary aggregates, well-anchored inflationary expectations, weak aggregate demand, adequate supply of food and petroleum products, as well as stability in Naira's exchange rate.

- **Naira to stay stable against the US Dollar in the near term.** CBN remains the largest supplier of foreign exchange in the economy and with expected increases in sale of FX by oil companies following FG's peace deal with militants, Naira would further stabilize at current levels. Naira's outlook remains tied to size of external reserves, FX demand, sustained high crude oil price, as well as development in global economy.

- **Domestic interest rate to remain stable at current levels.** Decline in statutory returns and the erosion of confidence in the market pose upside risks to a stable interest rate outlook. However, the CBN extension of its guarantee for all interbank transactions from December 2010 to June 30, 2011 will likely stabilize rates at current levels.

- **Equities market to experience rebound from recent lows.** Improved investors' optimism and expected positive effect of the AMCON arrangement would likely put key indicators of the equities market in an upward trajectory in the medium term, when the company is expected to buy up banks' toxic assets.

- **The bond market is set to receive a boost.** We also anticipate an increase in state and corporate bond issues to better fund longer term projects. Also FG has plans to finance N897 billion of its total deficit worth N1.5 trillion from the local bond issues.

- **Banks earnings likely to be suppressed,** as competition is expected to reduce profit margin, especially with respect to interest rate spread. A resurgence in massive deposit mobilization drive may distort the relatively stable interest rates in the money market.

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