Crimson Oak
CAPITAL

Forecasting Q2: Trends & Transformation in the Nigerian Economy

Introduction

Over the past few decades and administration, the Nigerian economy has witnessed downward trends evidenced by different metrics including increased inflation, instability in prices of goods and commodities, and security issues, amongst many others. The Federal Government, under Bola Ahmed Tinubu's leadership, has sought ways to combat these problems – but the citizens/layman still seem to suffer in poverty and want. Mr Bismarck Rewane (CEO, Financial Derivatives Company Limited) shared his opinions on the reforms established by President Bola Tinubu's administration, *"The bad news is that there is pain and* there will be more pain in the short run but the good news is **that there will be gains in the first quarter of 2024***"*. As the second quarter kicks in, the real question becomes, **'Was there any real benefit to the average Nigerian?'**

With the first quarter of 2024 already flown by and the second quarter already ahead of us, several issues bothering the nation are being tackled through policies put out by the government. Some of the key highlights in Q1 include the recapitalisation of banks (national and international banks), the removal of electricity subsidies and the increment in electricity tariffs, the increase in the monetary policy rate (MPR) from 22.75 to 24.75, an upward trend in the value of naira (1 dollar = 1,242.46), amongst other policies and reviews.

We have highlighted nine (9) focal areas that could be impacted by the policy thrust (monetary and fiscal), along with potential trends in Q2.

- Forex/Capital Market
- Prices of commodities in the local market
- Government/CBN Monetary Policies
- Implication of the recent electricity tariffs
- Implication of the recent recapitalisation of banks
- Happenings in the Oil and Gas market (Petroleum sector)
- Metrics and Indicators – GDP, Inflationary rates
- Policies guiding the financial sector – more stiffened, or relaxed?
- Case scenarios in SMEs

1. Forex/Capital Market

A major contributor to the stability of the economy is the FX market. In the course of Q1, the market noticed various ups and downs most especially in the value of the naira against major currencies and share prices of domestic companies within the nation. In a determination to boost the stability of the naira value, the CBN Governor, Mr. Olayemi Cardoso, has initiated measures including lifting the 2.5 per cent cap spread on interbank FX transactions and imposing restrictions on the sale of interbank proceeds, and directives on International Money Transfer Operators (IMTOs). Another major reform implemented by the Apex Bank to mitigate inflationary pressures was to limit the outflow of foreign currency; which had a positive impact on the stability of the local currency.

In the first quarter of the year, the naira value closed at a rate of N1,300/$1, in the black market as compared to N1,206/$1 at the beginning of the year. However, February 2024, witnessed a noticeable increase in the value of the Nigerian currency, naira. This positive development could have a significant impact on the investment climate in Nigeria, which has been struggling with economic and social problems for a long time, making investors hesitant to invest in the country. Additionally, the increase in the value of the naira is also expected to yield a positive impact on the prices of commodities.

How does this affect the average Nigerian? An upward trend in the nation's currency may be likened to a spiral chain. In a situation where the naira appreciates, the economy would experience robust growth and development – beneficial to the average citizen. Furthermore, household items and consumer commodities, whether locally produced or imported, become more affordable.

Possible trends in Q2 – The proposed policies and frameworks issued by the Central Bank will continue to see the naira appreciate against other major currencies, however, there may be cases of volatility in the market rising from fluctuations in global oil prices, declining FX reserves, external debt levels and obligations, and political instability, in the market towards the end of Q2. towards the end of Q2. Additionally, investors may become more optimistic in their portfolio allocation but are advised to consider other macroeconomic vulnerabilities – security threats, and insufficient development in the oil and non-oil sectors).

2. Prices of commodities in the local market

The Nigerian market has been hit with rising inflation over the years, causing the prices of goods and commodities to soar. In recent research by Tradingeconomics, Nigeria ranked 13th out of the top 15 countries with the highest inflation rate in February 2024. Kogi, Oyo, Kwara, Ondo, and Bauchi topped the chart of states with the highest levels of inflation as of February 2024.

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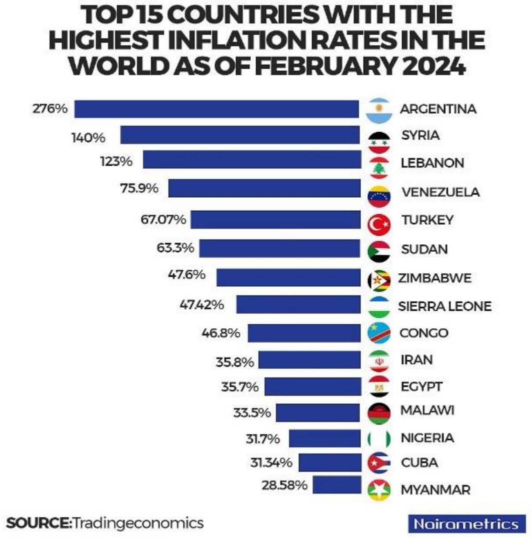

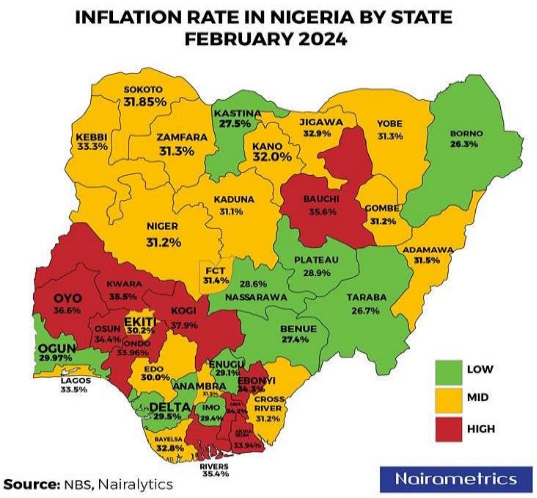

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The increasing prices of commodities can majorly be attributed to inflation, the devaluation of naira in the foreign exchange market, as earlier highlighted, and high dependence on importation. Prices of an imported bag of rice rose to a record high of ₦88,000 within the first quarter, causing groaning amongst Nigerians. In a survey by Nairametrics, the prices of food items grew at an average of 25.02%. This persistent problem seems worrisome to the government and its citizens. Nigerians can now keep their fingers crossed for a breakthrough in the prices of goods and services, given the various policies the CBN is implementing to stabilise the naira and curb inflationary growth.

A report by the National Bureau of Statistics (NBS) depicts that Nigeria's inflation rate soared to 33.20% in March 2024 from 31.70% which was the February 2024 inflation rate. Despite the appreciation of the Naira against the Dollar, the cost of living is still high and while Nigerians have been expectant of a significant reduction in the price of food and basic commodities, this has not been the case.

The price of food which has soared by 40.01% seems to have defied the various monetary policies implemented by the Central Bank of Nigeria.

According to economist, Kelvin Emmanuel, the continual surge in inflation despite the elevation of the monetary policy rate depicts that while the exchange rate is responding to monetary tightening, inflation that is caused by primary production in food supply, higher energy costs for the nine items that form Nigeria's energy basket, and the general cost of transportation, continues to encourage higher Cost Price Index (CPI).

However, issues such as transportation challenges, weather-related disruptions, and policy changes could lead to temporary spikes in prices for certain commodities.

Government interventions aimed at improving agricultural productivity, enhancing market infrastructure, and reducing post-harvest losses are crucial for stabilizing prices and ensuring food security in Nigeria.

3. Government/CBN Monetary Policies

In the possibility of regulating the money supply, the CBN has implemented policies such as the increase of the MPR to 24.75%, increasing the Cash Reserve Ratio by 12.5% (from 32.5 to 45%), and retaining the Liquidity Ratio at 30%.

Experts and financial analysts show optimism in the market and, thus, project the market to maintain a bearish momentum in Q2 as a result of the new regulations and policies.

Simultaneously, the Nigerian Federal Government (fiscal) and CBN (monetary) would keep implementing more policies as they deem fit, to stabilise the overall economy. However, many of these policies may only create temporal stability if exportation is not emphasized.

One of the major activities that may take the main stage in Q2 is the collaboration of the FG with local and foreign investors to boost local production and the nation's export potential. This move by the government will solve the problems experienced by the country.

4. Implications of the Recent Electricity Tariffs: A Dive into the Past Tariffs (From 2023-2024 Q1)

Engaging in a conversation about the prospective development of the Nigerian economy is incomplete without considering the abysmal performance of the power sector. Despite being the largest economy in Sub-Saharan Africa, Nigeria faces growth constraints due to shortcomings in the power sector. The Nigerian power sector grapples with various overarching challenges, including issues with electricity policy enforcement, regulatory uncertainties, gas supply shortages, transmission system limitations, and significant shortcomings in power sector planning, all of which hinder the sector's attainment of commercial viability.

The Federal Government, through the Nigerian Electricity Regulatory Commission (NERC) on 2nd April, 2024 revealed a substantial rise in electricity rates for customers categorized under Band A, now set at ₦225 per kilowatt-hour (kWh), marking a 240% increase from the previous rate of ₦68 per kilowatt-hour (kWh). The Nigerian Electricity Regulatory Commission (NERC) categorizes Band A customers as individuals who receive up to 20 hours of electricity supply per day, comprising roughly 15% of the over 12.82 million registered Nigerian electricity consumers.

The increase in electricity tariffs coincides with Nigeria's deteriorating power supply, attributed to its inadequate power generation and distribution infrastructure. Nigeria currently generates 4,000 megawatts. However, the Minister of Power, Adebayo Adelabu, states that the Federal Government aims to generate 6,000 megawatts of electric power within the next five months.

The Nigerian Electricity Regulatory Commission (NERC) expressed optimism that the increased revenue would incentivize investments in the sector. Additionally, the Commission stated that it would employ various strategies to ensure that customers in Band A receive their daily electricity supply hours from distribution companies (DisCos). The question is, **what is the significance of the substantial increase in electricity tariffs on the Nigerian economy, and what are the forecasts for Q2?**

Some of the potential consequences of the increased electricity tariffs include increased production costs for businesses, potential reduction in electricity consumption, business closures; particularly for small and medium-sized enterprises, higher utility bills, etc. The President of the Abuja Chamber of Commerce and Industry (ACCI), Emeka Obegolu, stated that the recent increase in electricity tariffs may have adverse effects on the ease of doing business in Nigeria. He further emphasized that fostering economic growth, attracting investments, and creating job opportunities hinge significantly on the ease of doing business. There is no doubt that the tariff increase, coupled with other economic hurdles like the removal of fuel subsidies and foreign exchange unification could exacerbate the challenges faced by businesses.

Similarly, Dr. Idumanje, a Public Analyst Officer, suggested that the heightened electricity tariffs could potentially deter foreign direct investment due to the increased operational expenses for companies in Nigeria. Consequently, this could impede economic growth and development in an economy already lacking in foreign direct investment.

5. Implication of the Recent Recapitalisation of Banks

Recapitalisation is a strategic approach employed by companies to strengthen their financial stability or restructure their financial framework. The last bank recapitalisation in Nigeria occurred in 2004. During this period, the Central Bank of Nigeria instigated a substantial recapitalization effort for Nigerian banks, increasing the minimum capital requirement from ₦2 billion to ₦25 billion. This adjustment was set to take effect on December 31, 2005. As a result of this significant rise in capital requirements, the industry underwent a drastic consolidation, reducing the number of banks from 89 to 24 by 2006. The consolidation process entailed mergers and acquisitions, with some banks merging and others being absorbed by stronger institutions. The objective of the 2006 consolidation was to bolster the efficiency and profitability of Nigerian banks, thereby promoting economic growth.

In November 2023, the Governor of the Central Bank of Nigeria (CBN), Olayemi Cardoso, hinted at the potential of increasing the minimum capital requirement for banks, even though the sector had experienced relative stability in the preceding years. He observed that the proposed increment stems from the realization that numerous banks are deficient in capital to support an economy striving for a GDP of $1 trillion, a goal set by the Federal Government of Nigeria.

As expected, the Central Bank of Nigeria announced an upward review of the minimum capital requirement for banks in the country on 28th March, 2024. The Recapitalisation Program in the banking sector is a regulatory effort by the CBN. It mandates banks to raise their minimum paid-in common equity capital to a specific level based on their license category within a two-year timeframe. **The primary objective of the recapitalization is to guarantee that Nigerian banks possess the capacity to assume larger risks, remain resilient during challenging periods, support various sectors of the economy, and enhance trust in the banking system.**

The CBN has provided a two-year timeframe for banks to achieve a new capital requirement of N500 billion for international operations, N200 billion for national operations, and N50 billion for regional operations and merchant banking licenses.

The CBN in its upward review provided three ways to meet the new threshold;

- The injection of fresh equity capital through private placements, rights issues and offers for subscription.
- Mergers and Acquisitions, a likely trend that many banks would adopt.
- An upgrade or downgrade of license authorisation.

It is important to note that these options are not mutually exclusive, and a bank may decide to adopt one or several of them.

FBN Holdings, Access Holdings, Guaranty Trust Holding Company Plc and United Bank for Africa which are tier-1 banks in Nigeria have expressed plans to raise over $3.03 billion (₦3.46 trillion) in fresh capital through the international capital market and the local market. These tier-one banks intend to raise these funds through public offering, private placement, rights issues, etc. This implies that there will be heightened activity in the capital market during Q2.

Analysts have predicted a reduction in the number of banks operating in Nigeria due to the recapitalisation exercise. According to Oyinkansola Aregbesola, a banking analyst at Asset & Resource Management Co. (ARM), there will likely be an increase in mergers and acquisitions as a solution for those unable to raise the necessary additional capital. The Centre for the Promotion of Private Enterprise (CPPE) remarked that the CBN's current strategy and timeline should reduce the likelihood of banks collapsing or engaging in rushed mergers and acquisitions.

A Capital Market Analyst, Ambrose Omordion believes that smaller banks are more likely to consider the option of mergers. He stated that Tier-2 banks may consider mergers and the bigger banks will most likely acquire the smaller banks to increase their operational base across the country and beyond.

Tajudeen Olayinka, an Investment Banker and Stockbroker opines in line with this outlook and stated that the bigger banks may be able to meet this new threshold or acquire the smaller banks.

6. Happenings in the Petrol Market and Foreign Trade

Fuel scarcity resurfaced in Nigeria's commercial hub, towards the close of Q1 as marketers reported limited supply at the depots as a result of the Nigerian National Petroleum Company Limited, which is the sole importer of petroleum, rationed its supply to depots. As a result, drivers spent hours in long queues at filling stations to fill their tanks, contributing to traffic congestion on certain roads.

Bismarck Rewane, the Managing Director of Financial Derivatives Company Limited, predicts that once diesel production begins at the Dangote Refinery, the cost per litre of diesel will drop below N1,000, down from the current price of N1,500. The refinery has commenced supplying domestic marketers with diesel and aviation jet fuel at a rate of 1,225 per litre.

Emerging reports suggest that this action might lead to a reduction in the retail prices of both products in the coming months. Nigeria's reliance on foreign petroleum products is expected to significantly decrease starting in May when the new mega-refinery begins supplying Premium Motor Spirit (PMS) to the local market.

The Independent Petroleum Marketers Association of Nigeria (IPMAN) in its proposal to the management of the Dangote refinery, suggested a lifting price of ₦550 per litre in Lagos. Nigerians remain optimistic to see fairer retail prices of diesel, and PMS across the nation in the second quarter, given the elimination of transportation expenses.

7. GDP-Growth Metrics and other financial indicators

The Nigerian economy can be characterized as having a diversified GDP but a monoculture revenue structure, heavily reliant on the oil and gas sector for revenue.

In the 2024 IMF Nigerian economic outlook reports, the GDP is expected to grow by 3.2%. However, in Q1 2024, the Nigerian economy faced headwinds due to rising inflation, exchange rate challenges, and increasing prices of Premium Motor Spirit (PMS) following the removal of fuel subsidies by the current administration. Non-oil revenue from the Nigerian Customs Service witnessed a 122.5% increase in the first quarter of 2024 compared to the same period in 2023.

As of the end of Q1, the inflation rate in Nigeria stood at 31.70%, compared to 21.82% in the previous period in 2023. According to Proshare, about 70% of domestic inflation can be attributed to foreign exchange rates.

The inflation rate is expected to reduce in Q2 due to the Central Bank of Nigeria's (CBN) monetary policy approach, which includes increasing the Monetary Policy Rate (MPR) from 18.75% to 24.75%. This approach aims to help the naira gain value in the parallel market, as the inflation being faced in Nigeria is largely dollar-driven due to heavy reliance on imports for household and industrial items. Addressing the persistent exchange rate issues from the root will help reduce inflation by focusing on long-term approaches.

Projections – Towards the end of Q2, the inflation rate is expected to drop by an average of 3%. GDP growth in Q2 is also expected, driven by expansionary monetary policy reforms that the CBN will continue to deploy to ensure the naira gains value against the dollar, including increasing the MPR rate. Also, improved oil production and better harvest in the coming months are expected to contribute significantly to the GDP growth.

8. Financial Sectors

The financial sector has been a significant contributor to the sectoral GDP. Due to the recent recapitalization of the CBN, the minimum capital base requirements for banks have increased significantly at the close of Q1. To comply with these requirements by 2026, we anticipate an uptick in mergers and acquisitions within the financial sector, particularly among commercial banks, instead of new share issuances.

The fintech industry in Nigeria is highly regulated, with new policies emerging frequently from the CBN. These policies create a complex web of legal and regulatory requirements for players and investors. In Q1, the CBN issued newly revised guidelines that prevent fintech startups from carrying out International Money Transfer Operations (IMTOs). The CBN also increased the application fees for the IMTO license to NGN10 million.

The decision to further tighten the monetary policy by the CBN will help to contain inflation levels and pressure on the naira. As a result, the fintech space may experience relaxed policies, as investment in bills and bonds will be encouraged by the continuous increase in the MPR.

9. SMEs and the public

Small and medium-scale businesses in Nigeria are grappling with high operating costs, leading to some of these businesses shutting down operations. This situation is exacerbated by factors such as exchange rate fluctuations, inflation, and rising oil prices. Additionally, many SMEs heavily rely on debt capital for their operations. Consequently, more businesses are expected to cease operations in Q2 due to the ongoing increase in interest rates, which will make it difficult for them to access loans from traditional banks.

Furthermore, the policy reforms implemented in 2023 had a ripple effect that further deteriorated the welfare of Nigerian households in Q1 of 2024. The cost of living soared, driven by a sharp increase in general inflation to 31.70%. This surge has significantly reduced household disposable income, as the prices of consumer goods have skyrocketed. Food inflation currently stands at 37.72%, primarily due to the higher cost of transportation resulting from increased prices of Premium Motor Spirit (PMS), as well as persistent banditry attacks and kidnappings in the Northern region of the country. In Q2, prices of household items are expected to continue rising, further reducing consumer disposable income.

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About the Company

Crimson Oak Capital is a private capital and advisory firm based in Lagos, Nigeria with a focus on driving success for African businesses through tailored financial and business solutions, and strategic investments. Our mission is to drive sustainable growth for African businesses and help emerging corporates survive in their business sectors.

Over the years, we have seen companies take advantage of the unpredictable economics and turn around the fortune of their business through strategic repositioning. Hence, we position ourselves as the "firm" that works with emerging corporates to achieve set goals and objectives.

At Crimson Oak Capital, we specialize in business, financial and deal advisory tailored to meet our clients' needs. Our services include advisory, private equity, private credit, ring-fencing, and Accounting as a Service (AaaS). Our integrated approach aims to address our clients' optimal performance, enhance financial stability, and foster sustained growth.

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