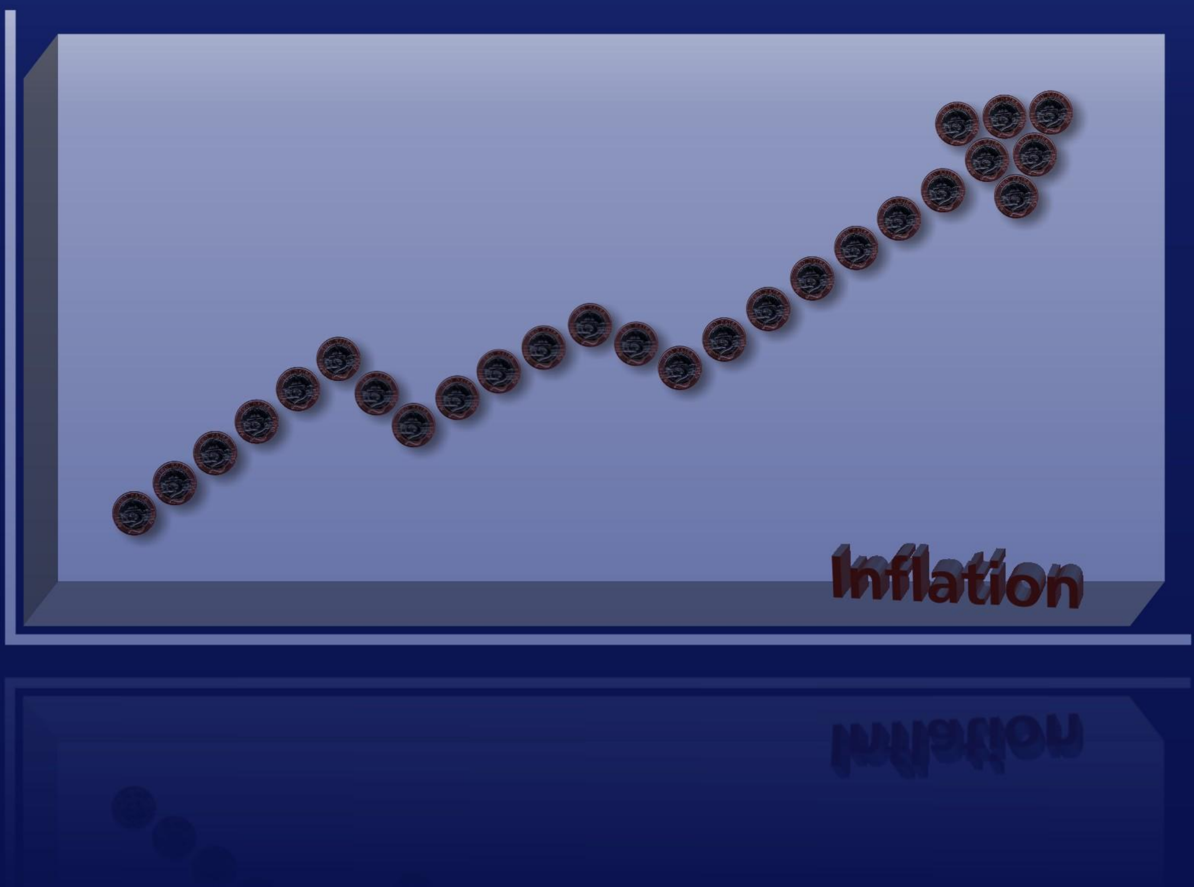
Access Economic Quarterly

First Quarter 2011



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Executive Summary

Global Economy: Changing Lanes, Emerging Markets Taking the Lead

The brisk recovery in the global economy which started in Q3 2009 slowed down its pace of rebound with uncertainty emanating from risk of a sovereign debt contagion across major financial markets. Countries like Spain, Portugal and Greece had their debt ratings lowered by rating agencies due to rising size of the respective countries' deficit. With lingering discontinuities in advanced economies, big emerging markets are gradually increasing their share of the global GDP pie on the back of domestic business reforms that were carried out to reposition their economies. IMF believes that developing economies would grow by 6.5% in 2011 to lift global GDP growth to 4.5% albeit down from 5% growth recorded in 2010; with advanced economies expanding by 2.5%. Meanwhile, the downside risk global recovery remains: foreclosures, rising unemployment and high inflation rates, amid dwindling fiscal space.

Political Environment: Stability Undermined by Electioneering Process

Nigeria's political environment was besieged with fears during the quarter under review, as skirmishes in some crisis-prone states generated concerns in the nation's body polity. The events towards the 2011 General Elections and the rise in spate of bomb attacks threatened security, including the country's capital - Abuja. Hence, the immediate concern for foreign investors is how quick the current political uncertainties would dissipate after the election. This we expect would fully fizzle out by end-Q3 2011. Again, concrete measures expected to be put in place for aggrieved Niger Delta militants would be a major stabilising factor to political stability in the near term.

GDP Growth: Projected to Stay Robust Amid Binding Constraints

The economy expanded by 7.43% in Q1 2011, compared with the 7.36% recorded in the corresponding period of 2010. Sustained growth in non-oil sector, especially agriculture, whole-sale, retail trade and services, remains the major drivers of growth, as GDP was effectively complemented by rebound in oil sector GDP, given the positive effect of FG's Amnesty Programme for militants in the Niger Delta region. However, the binding constraints on the domestic economy remain: infrastructural deficiency and poor access to finance by most economic deficit units, which calls for sustained pursuit of macroeconomic, structural and institutional reforms to revamp the economy.

Monetary Policy Stance: Hawkish to Combat Stubborn Inflation

Monetary policy in Q1 2011 was aimed at maintaining price and financial sector stability, while sustaining the robust GDP growth of recent times. With the adoption of contractionary monetary policy, the monetary authority is sending strong signals of its preparedness to tackle inflation headlong to safe-guard the stability of the banking sector and the nation's currency, amid the belief that the current fiscal expansion has become inflationary. At the March 2011 MPC meeting, the Committee surprised the markets, hiking the key policy rate by 100 basis points (bps) from 6.5% to 7.5% - the third upward adjustment in the current tightening cycle in the last four monetary policy meetings.

External Reserves: A Buffer Inhibited by Rising FX Demand Pressures

Nigeria's foreign reserves position rose slightly by 2.7% to N33.22 billion as at end Q1 2011 from $32.35 billion in Q4 2010, after reaching $36.5 billion on March 6th 2011. The pressure on the country's buffer continues to generate concerns for foreign investors, and increasingly affecting the Naira's value as the country continues to depend on oil export earnings. FX demand may sustain recent high as we approach H1 2011 when most importers are expected to boost their trade. Pressure on the Naira would subside significantly as FX users embrace the recently introduced FX Forwards Market. Meanwhile, Naira's official and interbank rates depreciated by 1.6% and 2.7% from N149.17/$ and N152.09/$ as at end-2010 to N151.52/$ and N156.12/$ on March 30, 2011, respectively. Significant risks to exchange rate outlook stems from the possible impact of political uncertainty, declining external reserves, volatility in crude oil price, amid the fragile pace of global economic recovery.

Stock Market: A Rebound Still Beset by Poor Investors' Sentiment

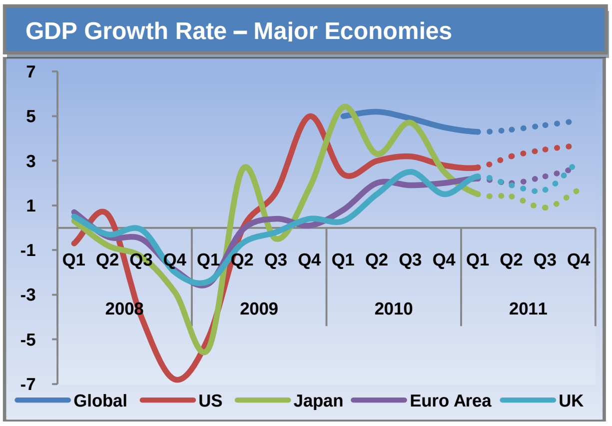
The Nigerian Stock Exchange (NSE) All Share Index (ASI), which stood as at 24,770.52 points in end-2010, rose by 8.3% to 26,830.67 points in January 2011 before declining by 0.6% to 24,621.21 points in March, below levels as at year-start. Market capitalization of listed equities that rose in Q3 2010 following the listing of Dangote Cement shares, also declined from N7.91 trillion to N7.87 trillion, after reaching over N8.5 trillion in January 2011. The NSE ASI dipped by 45.8% in 2008 fiscal year, as foreign hedge funds began to divest from equities and shifted attention to fixed income assets. We expect some gradual rebound in market indices, as AMCON clears banks toxic assets and electioneering-induced shocks subside, amid expected strong rebound in financial results of quoted companies.

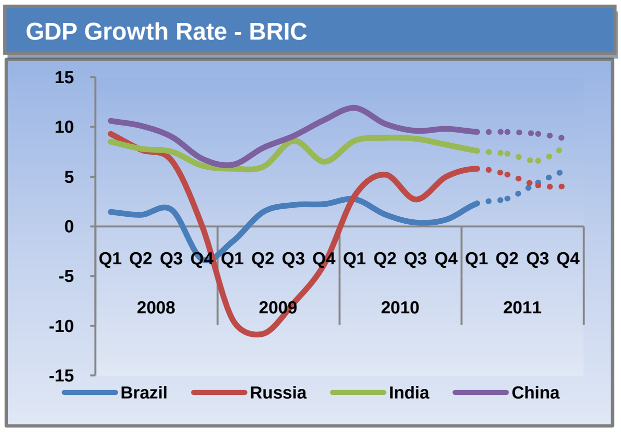
Q1 2011 Economic Review

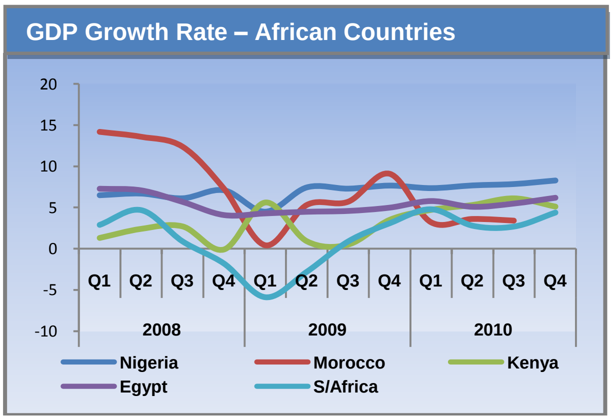
Global Economy: Changing Lanes, Emerging Markets Taking the Lead

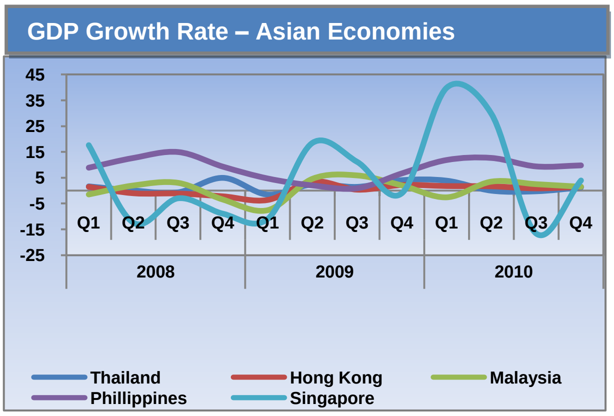
The brisk recovery in the global economy which started in Q3 2009 has slowed down its rebound momentum, with major financial markets still being challenged by risk of a sovereign debt contagion. Countries in the Eurozone including Spain and Greece have had their debt ratings lowered by rating agencies – Fitch, S&P etc. However, European Central Bank (ECB) has developed a new plan to deal with the ensuing uncertainties in the financial markets.

Meanwhile, a recent International Monetary Fund (IMF) forecast for World real GDP growth indicates that global economy would expand by 4.5% in 2011, albeit down from 5% growth recorded in 2010. This growth pattern has shown increased divergences across countries and regions, with advanced and developing economies expected to grow by 2.5% and 6.5%, respectively.







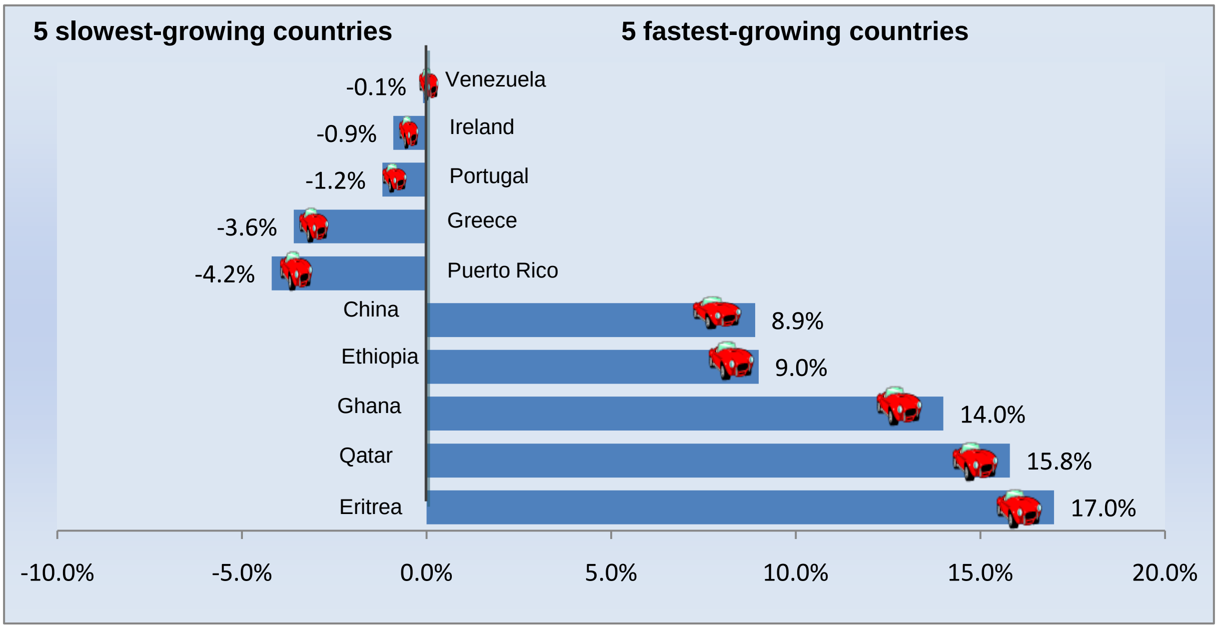


Source: Trading Economics

Nevertheless, the threat to global economic rebound remains the deleveraging across companies with resultant high unemployment rates noticeably away from historical trajectory; impaired financial systems; lagged real sector activities; amid rebound in inflation and cost of funds. One of the most striking aftermaths of the 2008 global economic recession is the era of tight credit expansion in advanced economies, which could in turn undermine growth in developing economies, as remittances and other capital flow/Aids/Grants may nosedive.

The divergence in growth pattern have seen big emerging markets gradually increasing their share of the global pie on the back of domestic business reforms that were carried out to reposition their economies. The schematic below depicts the steady growth of emerging markets into prominence.

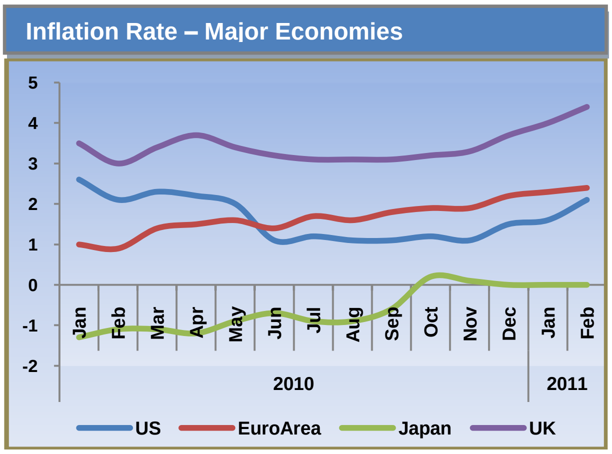
Economists' World Growth League: 2011 GDP Growth Rate Forecast

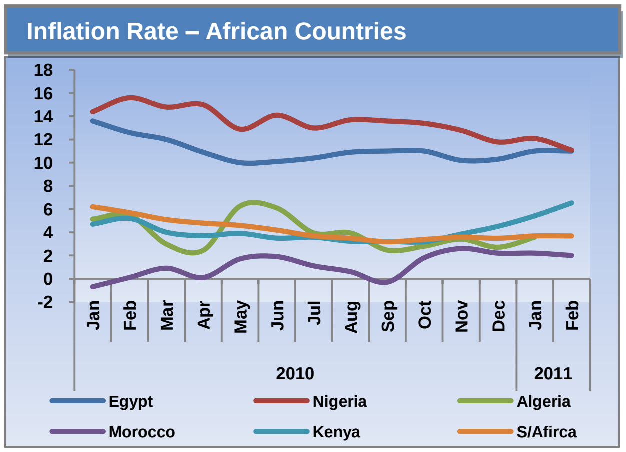


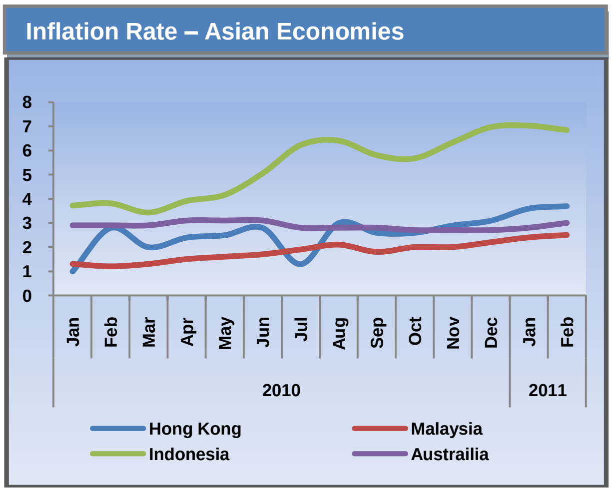
Source: Economist Intelligence Unit, Access Intelligence

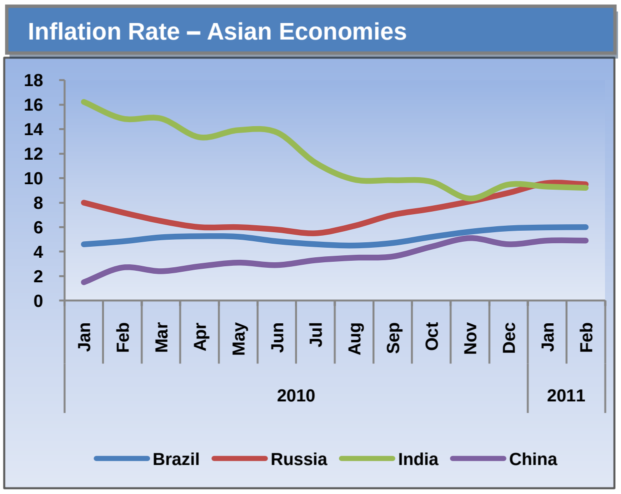
On the back of the rising commodity prices and current record low policy interest rate regime by most global central bankers (to boost aggregate demand), inflationary pressures have picked up and gradually becoming persistent, rather than an outcome of supply-side shocks.

Inflation in advanced economies has maintained a sticky uptrend, especially from the Q3 2010 and up till Q1 2011. To rein rising spate of inflationary tendencies, we expect monetary policy stance of most global central banks to become more hawkish to frontload policy. Inflation in most African countries remain largely structural especially for the land-locked countries that suffers extensively from imported inflation.









Source: Trading Economics

While global output is expected to grow at 4.5% in 2011, the downside risks to the recovery remain: foreclosures, rising unemployment and high inflation rates, sovereign debts default crisis and the contagious effect, amid dwindling fiscal space. To sustain the global growth trajectory, urgent actions to overcome risks emanating from sovereign debt crisis and financial market meltdown in developed economies should be robust, with broad-based policies in place to redress the current fiscal imbalances and concerns on currency pricing.

Overall, we anticipate that emerging markets and commodity-driven economies would consolidate their position in terms of economic output, given current rising commodities prices.

Nigerian Economy

Political Environment: Stability Undermined by Electioneering Process

Nigeria's political environment was besieged with fears during the quarter under review, as skirmishes in some crisis-prone states generated concerns in the nation's body polity. The events leading to the 2011 General Elections and the rise in spate of bomb attacks threatened security, including the country's capital - Abuja. The ruling party People's Democratic Party (PDP) appears to have wade-off the uncertainty generated by the party's implied agreement to 'Presidential zoning', but the issue we believe is far from being over as it remains fundamentally unresolved with frequent defections of key party members.

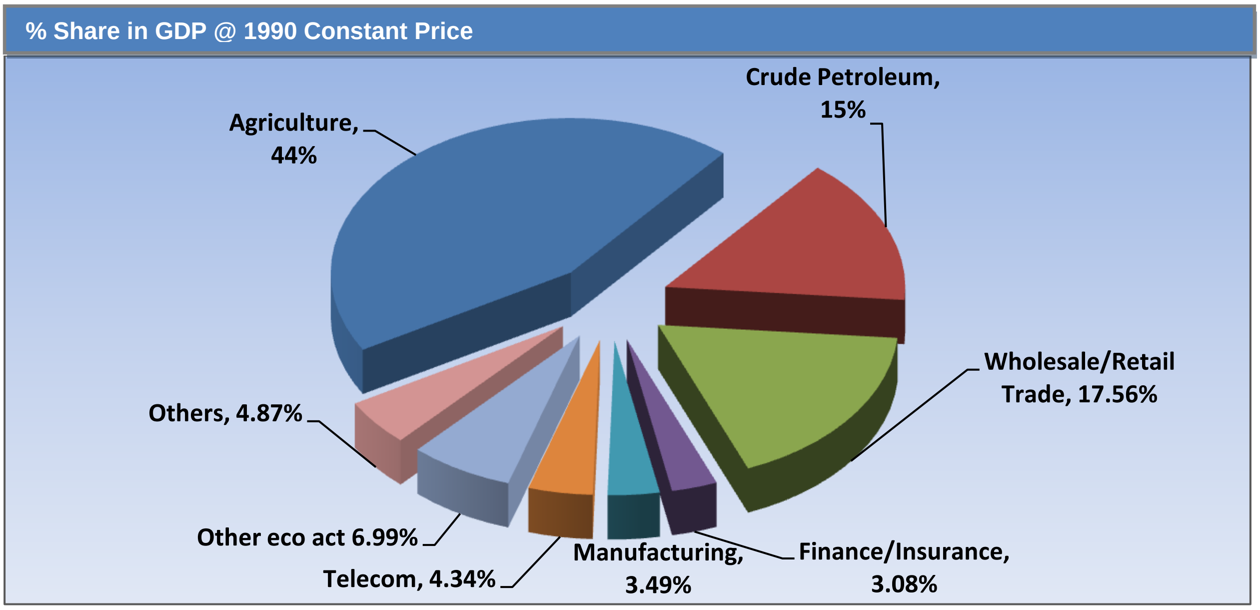
Peace in the Niger Delta was sustained in Q1 2011, although kidnapping and the rising spate of vandalization of crude oil pipelines still prevails. The sustained success of the Amnesty Programme will impact significantly on foreign direct investment (FDI) to Nigeria in the near term and fiscal sustenance in the long run.

Most of the major risks that Nigeria could face in H1 2011 would likely border around issues relating to politics. Election spending; including the implementation of politically-motivated expenditures will likely exacerbate the widening fiscal deficit, as monetary and fiscal policy remains uncoordinated.

Meanwhile, the immediate concern among foreign investors is how quick the current political uncertainties would dissipate after the election, as previous elections were marred by violence and alleged fraud. Again, concrete measures expected to be put in place for aggrieved Niger Delta militants would be a major stabilising factor to political stability in the near term.

GDP Growth: Projected to Stay Robust Amid Binding Constraints

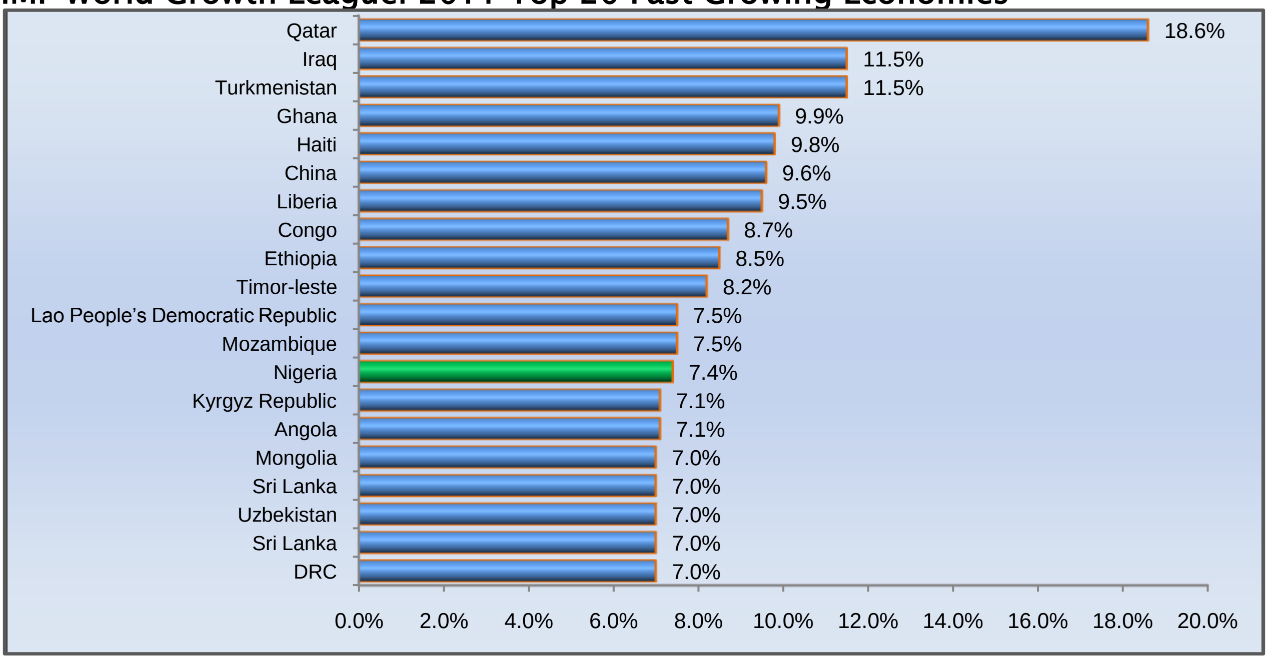
The National Bureau of Statistics (NBS) estimates an impressive output growth of 7.43% for Q1 2011, compared with the 7.36% recorded in the corresponding period of 2010. Sustained growth in non-oil sector, especially agriculture, wholesale, retail trade and services, remains the major drivers of growth, as GDP would be effectively complemented by rebound in oil sector GDP, given the positive effect of FG's Amnesty Programme for militants in the Niger Delta region. The Nigerian economy is still on track in terms of GDP growth, and is expected to grow above 7% in 2011.



Source: NBS (Q3 2010)

Meanwhile, a recent IMF growth projection ranked Nigeria 13th out of 20 fastest growing global economies. The Federal Government had earlier harmonized the 7-point agenda and draft National Economic Empowerment and Development Strategy (NEEDS-2) in a new National Development Plan, with a strategic goal to become a top 20 global economy by 2020, with GDP of $900 million (currently about $210 million).

IMF World Growth League: 2011 Top 20 Fast Growing Economies



Source: IMF Projections

However, the binding constraints on the domestic economy remain: infrastructural deficiency and poor access to finance by the economic deficit units, which calls for sustained pursuit of macroeconomic, structural and institutional reforms to revamp the economy.

Given the current improvement in the oil economy and the growing emphasis on the development of non-oil sector, as well as infrastructure development, the outcome for Q2 2011 is optimistic. The various CBN sponsored intervention funds, coupled with the plan to inject Pension Funds into key sectors of the economy would help to bridge the funding gap and address some GDP growth constraints.

Monetary Development

Monetary Policy Stance: Hawkish to Combat Stubborn Inflation

Monetary policy in Q1 2011 was aimed at maintaining price and financial sector stability, while sustaining the robust GDP growth of recent times. At the meeting held on March 21-22, the Monetary Policy Committee (MPC) surprised the markets, hiking the key policy rate by 100 basis points (bps) from 6.5% to 7.5% - the third upward adjustment in the current tightening cycle in the last four monetary policy meetings. The increase is the biggest adjustment since the 200bps cut in July 2008 adopted as a counter-cyclical mechanism to boost liquidity in the banking sector and avert a domestic credit squeeze following the effect of the global economic recession. The recession had three major transmission channels to Nigeria which led to a broad-based decline in equities, oil price (government revenue) and currency.

While the apex bank's monetary policy stance has clearly become more hawkish in recent times, a confluence of domestic and international circumstances prompted the MPC to frontload its policy, which in our opinion would become sticky at current levels, especially after election-induced inflation fritter away. With the adoption of contractionary monetary policy, the monetary authority is sending strong signals of its preparedness to tackle inflation headlong to safeguard the stability of the banking sector, amid the belief that the current fiscal laxity has become insidious and expansionary.

MPC's decision was in part influenced by rising global inflation on account of high food and energy prices. The move was proactive to prevent the rise in food and energy prices from generating a second-round effect on the economy, via distortion in price expectation. Raising the benchmark interest rate is not the only tool being used by the MPC as it had earlier raised the Cash Reserve Requirement (CRR) Ratio to 2% from 1% and Liquidity Ratio to 30% from 25% during its January 2011 meeting, amid enhanced use of Open Market Operation (OMO) to mop inflationary money in the system.

With regard to the domestic economy the CBN recognized the inflationary impact of the unduly expansionary fiscal stance and the need to pursue sound policies, such as price and currency stability whilst sustaining the current GDP growth momentum and stability of the financial sector.

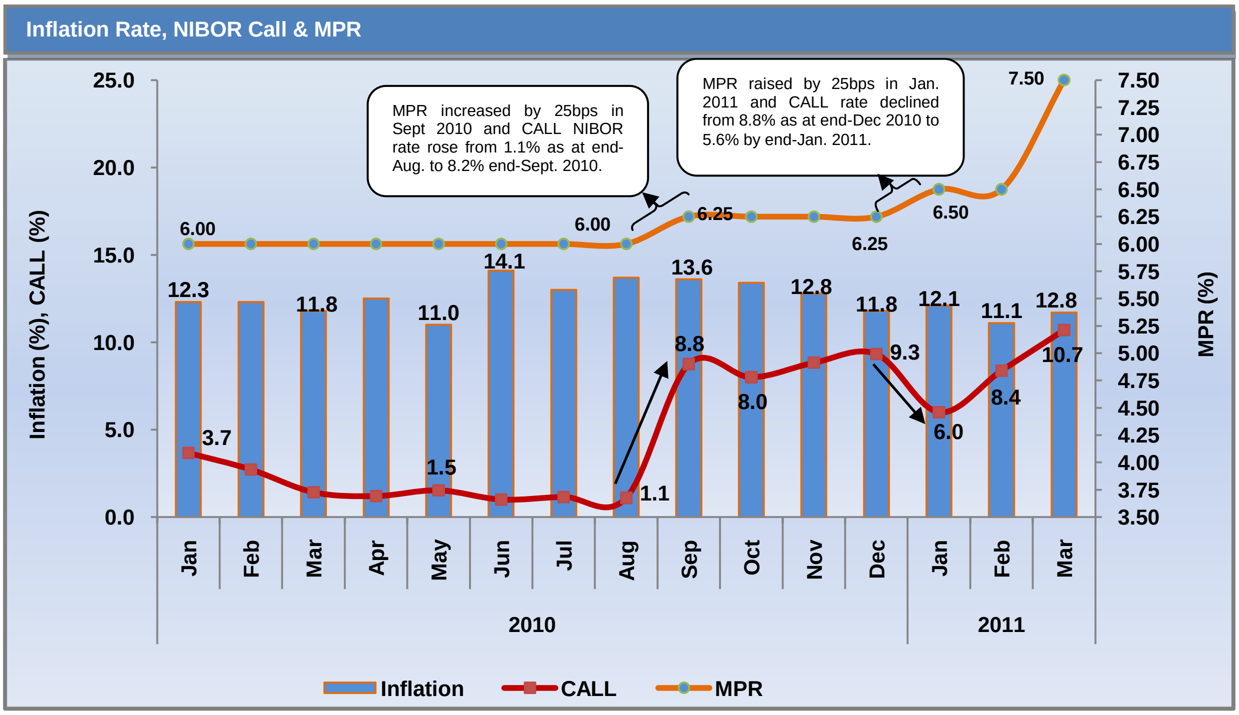
Implications of MPR Hike

Key Considerations	MPC Decision	Expected Effect
Strong Q1 2011 growth rate at 7.43% against 7.36% in Q1 2010. Fall in inflation to 11.1% in Feb. 2011 from 12.8 % and 12.1% in Dec. 2010 and Jan 2011, with the pass-through effect of rising global energy prices and huge fiscal spending to put the rate in higher trajectory. March Inflation jumped to 12.8%. Unsustainability of the rising domestic debt trend and the lack of coordination between fiscal and monetary policy stance. The need for continued exchange rate stability against FX demand pressures.	Increase MPR by 100bps (from 6.5% to 7.5%) Maintain the symmetric corridor at +/- 200bps Keep the Cash Reserve Requirement (CRR) Ratio of banks at 2% and Liquidity Ratio (LR) at 30% Extend CBN guarantee of interbank funds and foreign credit lines by 3 months to September 30, 2011	Rise in domestic interbank rates and yields. Stability in the value of the Naira around N150 3% as liquidity aiding speculative demand is restrained, amid the commencement of FX Forward market. Restrict net private sector credit outflows in the short term.

We expect Naira exchange rate at the respective FX markets to show increased convergence, as speculative pressures induced by the 2011 General Elections subsides. The immediate impact (general increase in rates) is already being experienced in the market. Interbank rates have already trended upward across all maturities and banks are beginning to realign the pricing of their risk assets accordingly.

Analysis of Previous MPR Hikes on the Market

Previous rate hikes had varying impacts on short-term interest rate, depending on liquidity levels and market expectation.



Source: NBS, CBN & Access Economic Intelligence

A major risk to Nigeria's financial system stability is the continued uncoordinated fiscal-monetary policy stance which may induce inflation and FX depreciation, and hence generate discontinuities that could impede the reform progress in the banking sector. Furthermore, fiscal policy is likely to stay loose in spite of the hike, although Government will face a rising cost of borrowing in near term.

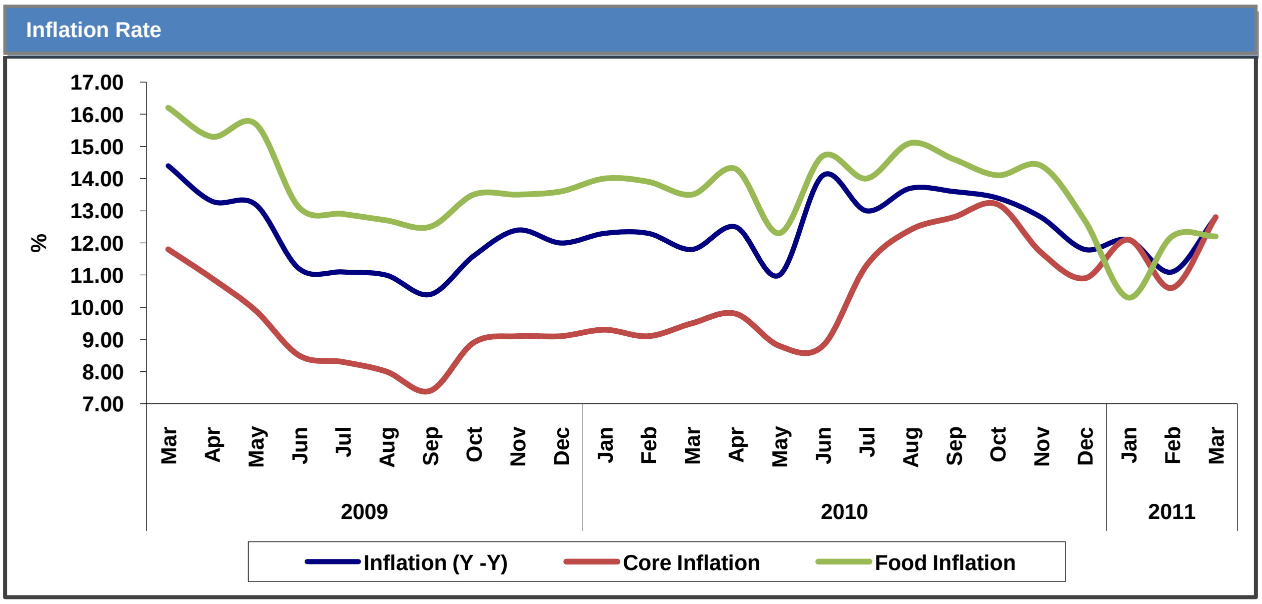
Inflation: A Resurgence of Scarecrow for Monetary Policy

The year-on-year Consumer Price Index (CPI) remained above CBN's single-digit target in Q1 2011, declining first to 11.1% in February from 12.1% in January, before rising steeply to 12.8% in March. While food inflation was stable at February's 12.2% from 10.3% in January (even as the planting season sets in), but core inflation, which covers all items except food item, rebounded to 12.8% from 10.6% in February and 12.1% in January, with pressure still on the upside. The Monetary Policy Committee (MPC) had earlier noted that inflation was no longer an outcome of supply-side shocks and was becoming more persistent.

The increase in inflation was driven mainly by electioneering spending, as anticipated monetary growth from the purchase of toxic assets by the Asset Management Company of Nigeria (AMCON, expansionary 2011 budget and inflows to buy stakes in rescued banks are among factors that could raise money supply in the near to medium term, and put inflation on a higher trajectory. The rise in core inflation is problematic, as it could support cost-push inflation, amid other structural misalignment.

The heightened risks facing economic stability lessened the need for extended low interest rates. Although the policy interest rate was raised from 6.5% to 7.5% at the MPC meeting on 21-22 March 2011, monetary conditions remained largely accommodative, amid CBN's respective low interest credit injection schemes, which should support output growth in the near-medium term at lower costs to the system.

We foresee the rising in oil and food prices to drive headline inflation further this year, a. We expect core inflation to continue to rise due to the lag in transmission from headline inflation, as input costs are projected to increase and pass-through to the final products.



Source: NBS

External Reserves: A Buffer Inhibited by Rising FX Demand Pressures

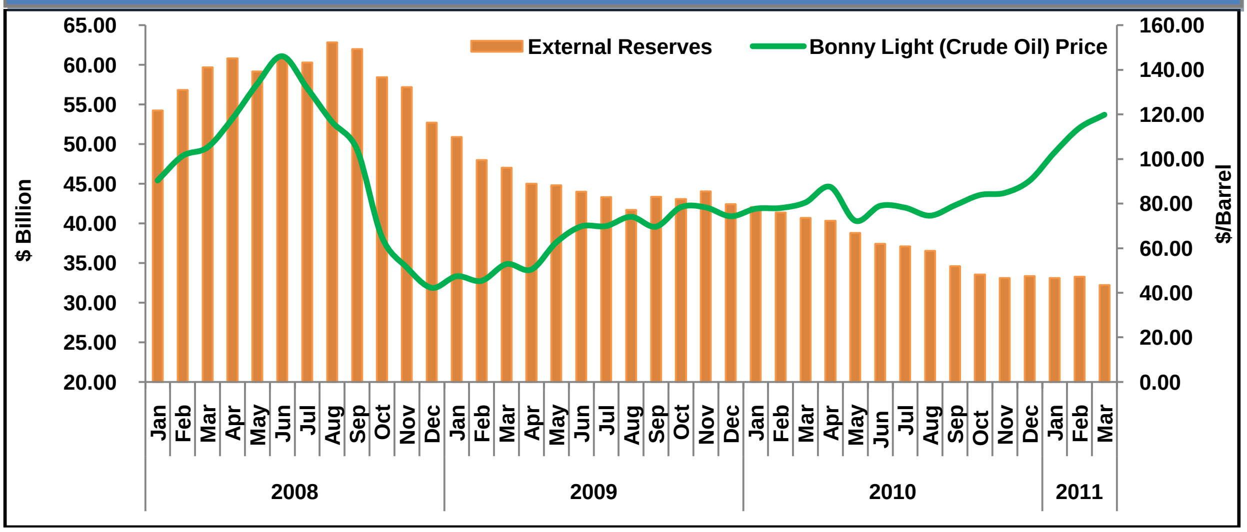
Nigeria's foreign reserves position rose slightly by 2.7% to N33.22 billion as at end Q1 2011 from $32.35 billion in Q4 2010, after reaching $36.5 billion on March 6th 2011.

The rise was driven by the lagged effect of sustained high oil output (following the relative peace in Niger Delta) and price which hits $116.9 per barrel on March 30, marking a 29-month high. Nigeria's external reserves have remained resilient over $30 billion, with downside risk to its growth on the rise.

The pressure on the country's buffer continues to generate concerns for foreign investors, and increasingly affecting the Naira's value as the country continues to depend on oil export earnings. At the March 21-22, 2011 MPC meeting, the Committee reaffirmed its commitment to a stable exchange rate regime in a bid to stem inflation, but noted that the solution to the continued depletion of the country's buffer rests on proficient diversification of the economy. It is in this regard that the diversification of the country's export base becomes critical.

Despite the declining reserves, Nigeria still ranks high on Africa's external reserve chart; with the apex bank dismissing fears that the Naira would be devalued. Reserves stood at $62.8 billion in August 2008 due to the high price of crude oil during that period, but declined to $52.7 billion, $42.43 billion and $32.35 billion as at end-2008, 2009 and 2010, respectively.

Nigeria's External Reserves (2008 – Q1 2011)



Source: CBN & Energy Information Agency (EIA)

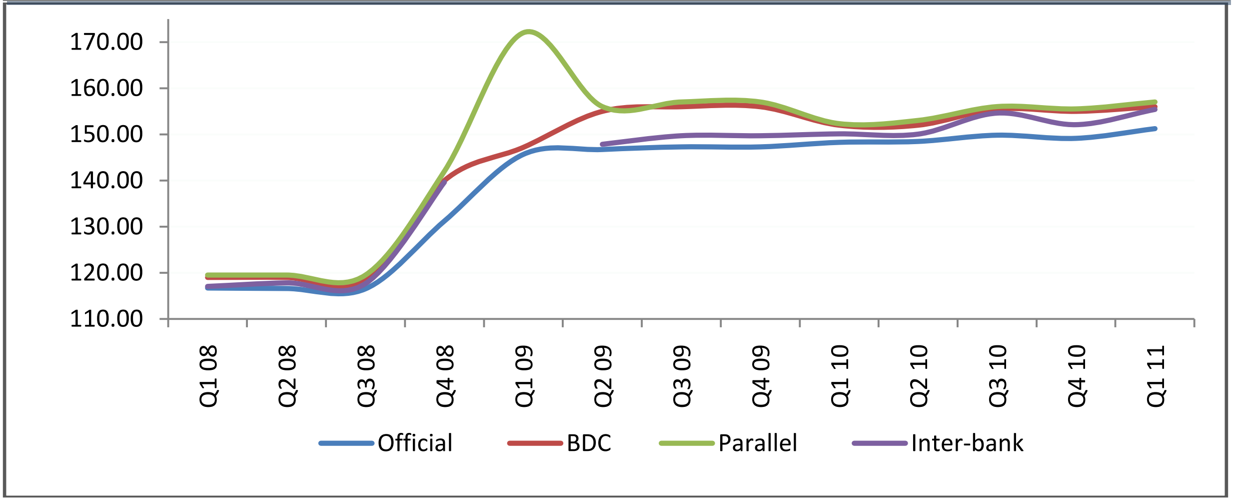
Exchange Rate: Naira Remains Pressured

The Naira exchange rate viz-a-viz the US Dollar remained relatively pressured due to the sustained rise in FX demand on the back of the country's declining FX reserves and increased capital outflow. Naira official and interbank rates depreciated by 1.6% and 2.7% from N149.17/$ and N152.09/4 as at end-2010 to N151.52/$ and N156.12/$ on March 30, 2011, respectively.

During the period, FX supplied via the official Wholesale Dutch Auction System (WDAS) platform was $5.2 billion as against $6.8 billion demanded during the same period. The shortfall put pressure on interbank rate, and resulted in a widened gap when compared with rates at the official window during the period under review.

A noticeable development at the exchange rate market is the increasing divergence among different rates which can be attributed to FX supply shortfall and uncertainty at the respective markets. The spread between interbank and official rates have worsened with depleting external reserves. We expect interbank rates to remain pressured in response to the tightness in the FX market and month-end dollar sale by oil companies to brighten up the outlook.

Naira's Exchange Rates



Source: CBN & FMDA

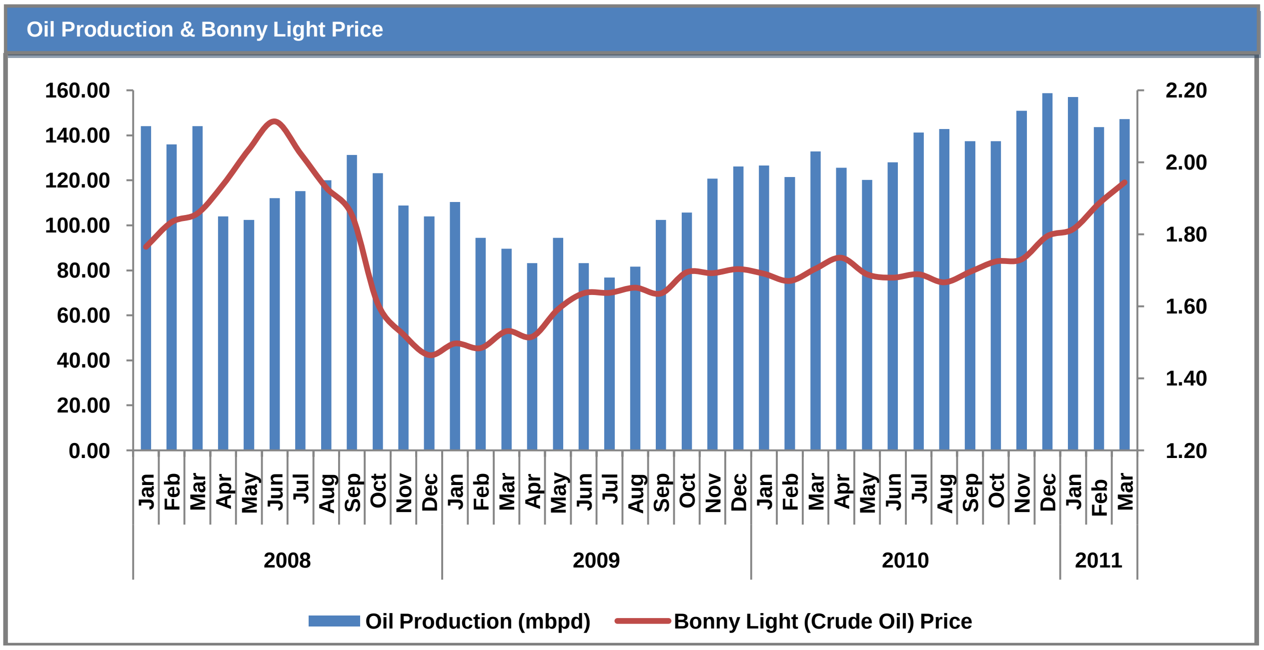
Recall that the swing in the currency in December 2008 (when FX rate depreciated from N118/$) was mainly due to sustained fall in oil price, amid militants' activities in the Niger Delta. Attacks on crude oil facilities also curtailed amount sold by oil companies in their month-end sale at that time, thus the steep pressure on the country's currency and exacerbated fiscal sustenance.

Significant risks to exchange rate outlook stems from the possible impact of political uncertainty, declining external reserves, volatility in crude oil price and slowdown in crude oil output, amid the fragile pace of global economic recovery. The risk to a declining external reserves is the potential strain on the Naira (which may likely depreciate in the near term), as the country continues to depend on oil exports for FX. Return of attacks on crude oil facilities would also curtail amount of FX sold by oil companies which could pressure the currency further and undermine the country's export earnings.

We believe that the current strong fundamentals of the Nigerian oil sector (sustained high oil price and output) will boost CBN chances of keeping the currency stable within its N150/$ ± 3% implied target.

Crude Oil Price: Carving Out Its Range

By end-Q1 2011, crude oil (Bonny Light) price had risen precipitously to $119.04 per barrel (pb) from $95.16pb as at end-Q4 2010. Oil price was $98.24pb and $109.6pb in January and February 2011, respectively. The recent uptrend in crude price has been driven mainly by uncertainties surrounding possible disruption in global crude oil supply following wave of unrest sweeping across Middle East and North Africa (MENA). On the other hand, crude oil output IN Nigeria remained consistently high above 2 million barrel per day (mbpd) in Q1 2011 and has risen significantly from its post-recession level, following the Federal Government Amnesty Programme in 2008 which also helped to curb Niger Delta skirmishes and attacks on oil & gas facilities in the region.



Source: OPEC & EIA

Meanwhile, the Organization of Petroleum Exporting Countries (OPEC) expects world oil demand in 2011 to grow by 1.4 million barrels per day (mbpd), slightly down from 1.8mbpd in 2010. The cartel, however estimated that demand for its crude would average 29.8mbpd, up slightly from 29.3mbpd recorded in 2010, with non-OPEC supply projected to increase by 0.5mbpd in 2011, following growth of 1.1mbpd last year.

Some analysts believe that an average crude oil price in excess of $115pb in 2011 would provide a remarkable downside risk to global economic growth. The sustained high oil price has elevated manufacturers' input cost across major financial markets and is beginning to pose a challenge for policy makers to attain their desired inflation targets.

Crude oil is currently carving out its price ranges, with Bonny Light, WTI (NYMEX) and Brent averaging at $104.5pb, $102.85pb and $102.4pb, respectively in Q1 2011. Given that oil is a finite resource and the world population continues to grow, supply might eventually fall short of demand. Hence, we believe that long-term fundamentals support high oil prices, as manufacturing output expands across countries/regions.

Meanwhile, the risk to a sustained growth in oil indices at the international market stems from the possibility of a marked price volatility resulting from business cycle downturns and geopolitical shocks. A wide-scale development and acceptance of oil alternative might also depress price in the future.

Stock Market: A Rebound Still Beset by Poor Investors' Sentiment

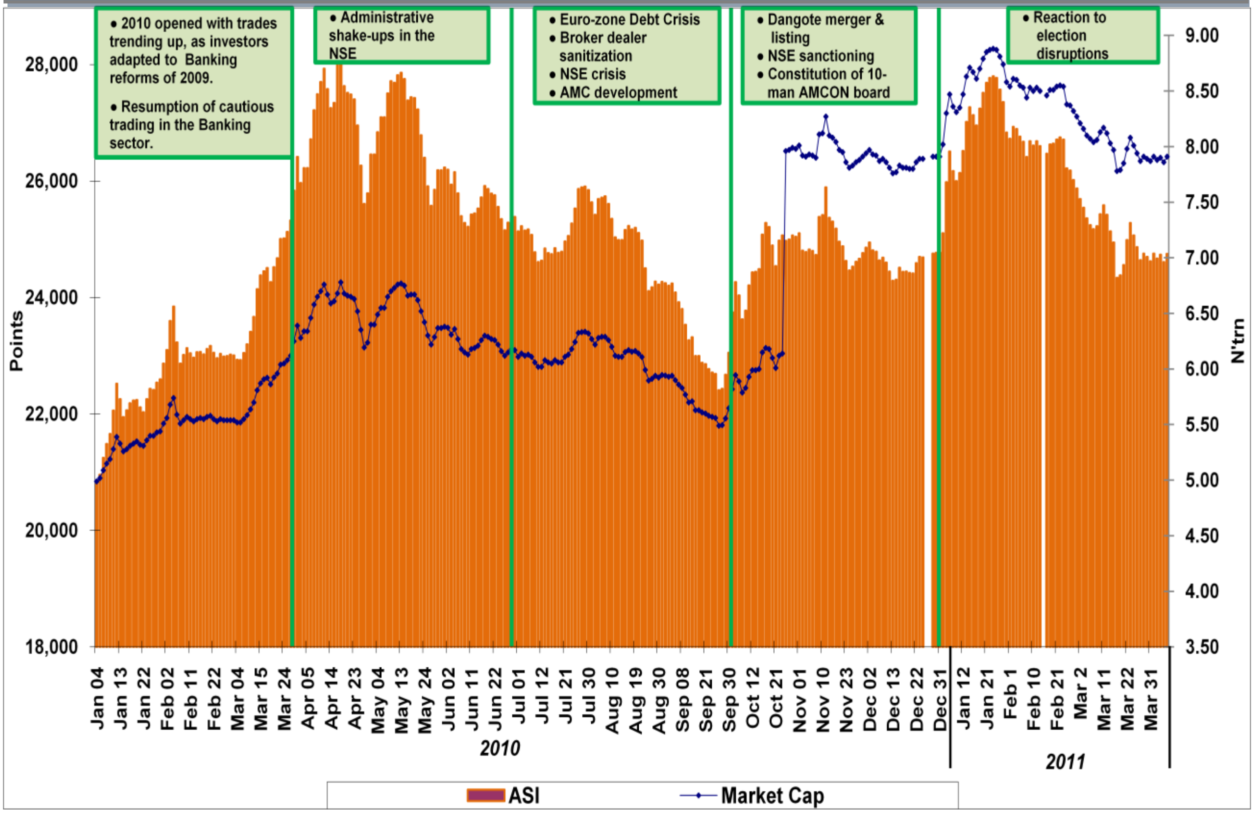
The Nigerian Stock Exchange (NSE) All Share Index (ASI), which stood as at 24,770.52 points in end-2010, rose by 8.3% to 26,830.67 points by January 2011 before declining by 0.6% to 24,621.21 points in March, below levels as at year-start. Market capitalization of listed equities that rose in Q3 2010 following the listing of Dangote Cement shares, also declined from N7.91 trillion to N7.87 trillion, after reaching over N8.5 trillion in January 2011.

Although, the stock market has recovered from a low end-period performance of 20,827.17 points in 2009, the market continue to face selling pressure resulting from the combined effect of declining investors' sentiment, lower-than-expected financial results, as well as the depressed outlook of global economy.
The NSE ASI dipped by 45.8% in 2008 fiscal year, as foreign hedge investors began to divest from equities and shifted attention to fixed income assets.

NSE ASI and Market Capitalisation							
Categories	**2007**	**2008**	**2009**	**2010**	**2011**		
					End-January	**End-February**	**End-March**
ASI	57,990.00	31,450.78	20,827.17	24,770.52	26,830.67	26,016.84	24,621.21
MC	10.18	6.96	4.99	7.91	8.58	8.32	7.87
End Period Performace (ASI)	**74.73%**	**-45.80%**	**-33.80%**	**18.93%**	**8.32%**	**5.03%**	**-0.60%**

Source: NSE & Access Economic Intelligence

Stock Market Trend



Source: NSE & Access Economic Intelligence

We expect some gradual rebound in market indices, as AMCON clears banks toxic assets and electioneering-induced shocks subside, amid expected strong rebound in financial results of quoted companies. However, investors may be attracted to the higher bond yields at the fixed income market as a result of MPC's benchmark rate hiking cycle could dampen optimism of a marked improvement in market fundamentals, amid recline in market liquidity.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NIBOR: A Return to High Rates?

In Q1 2011, the Nigerian Interbank Offer Rate (NIBOR) continued the spike which started in Q3 2010 following the initial 25 basis points increase in monetary policy rate (MPR) from 6.0% to 6.25%, as CBN pursued contractionary monetary policy stance to stem inflation.

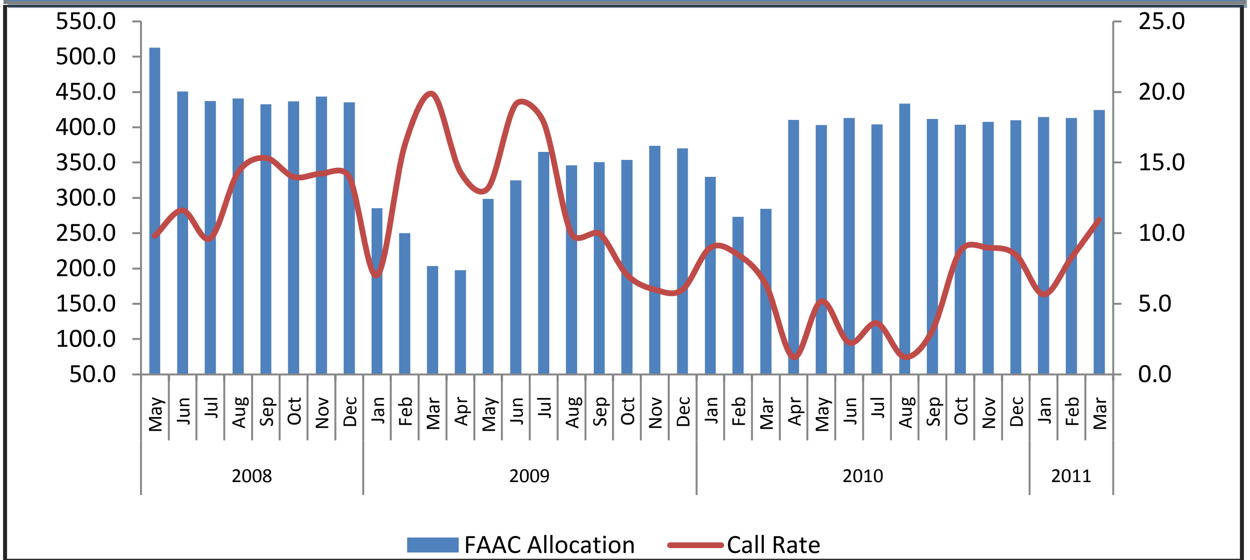
NIBOR

Period	Maturities						
	CALL	7 Days	30 Days	60 Days	90 Days	180 Days	365 Days
Q1 '09	19.8710	20.5968	21.3530	21.5328	21.6864	22.0156	22.1613
Q2 '09	19.1477	19.5785	19.9911	20.2631	20.5300	20.6599	20.8230
Q3 '09	9.9875	11.5077	14.5854	15.4067	16.0368	16.4652	16.8245
Q4 '09	6.0040	8.6013	13.7886	14.9261	15.6744	16.2425	16.5833
Q1 '10	6.3684	2.7535	5.6850	7.3419	8.7979	10.0036	11.0875
Q2 '10	2.2407	3.3531	5.7110	6.6687	7.6693	8.4027	9.1883
Q3 '10	3.1208	3.8146	5.4821	6.5346	7.3604	8.2996	9.0819
Q4 '10	8.4806	9.3056	11.5000	12.5098	13.2559	13.8925	14.4405
Q1 '11	9.7438	10.2670	11.4685	12.2195	12.8663	13.6355	14.3402

Source: FMDA

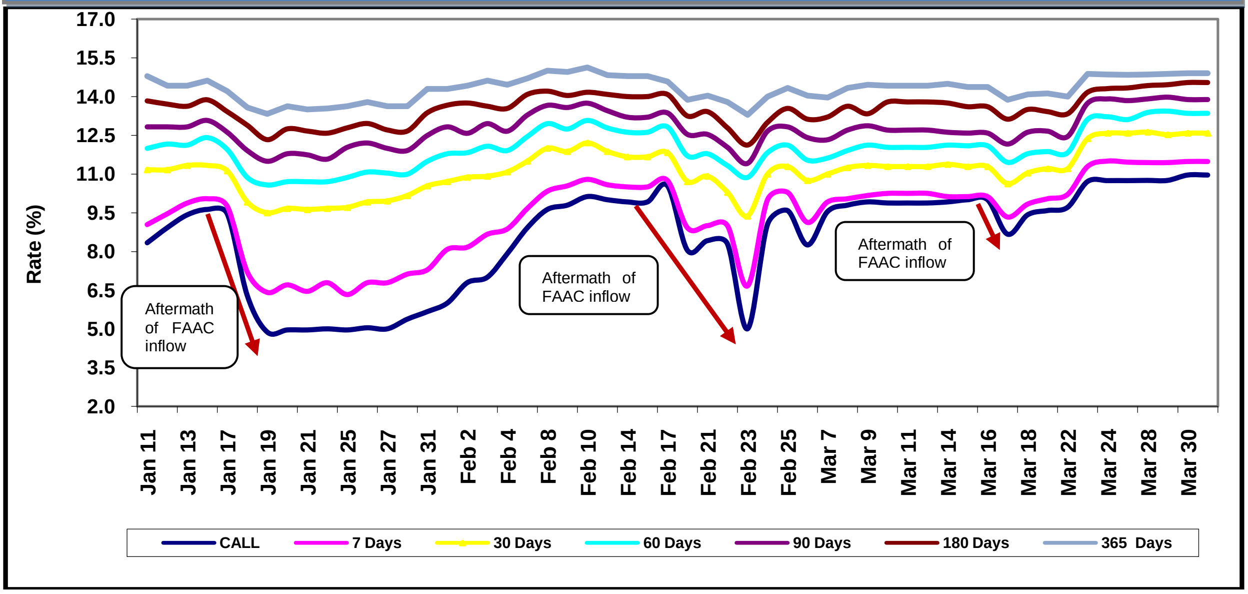
The mid-month's inflows from the Federation Account Allocation Committee (FAAC) into the financial system often always have huge impact, by reducing money market rates across all tenors. Positive net-flow into the money market in matured bills also helps to stabilize rates. Surprisingly, financial instruments with longer maturities declined from Q4 2010 levels, but significantly up from rates at the corresponding period of 2010. Call and 7days instruments were most responsive to market liquidity movements during the period under review.

FAAC and Call Rate



Source: Budget Office, FMDA & Access Economic Intelligence

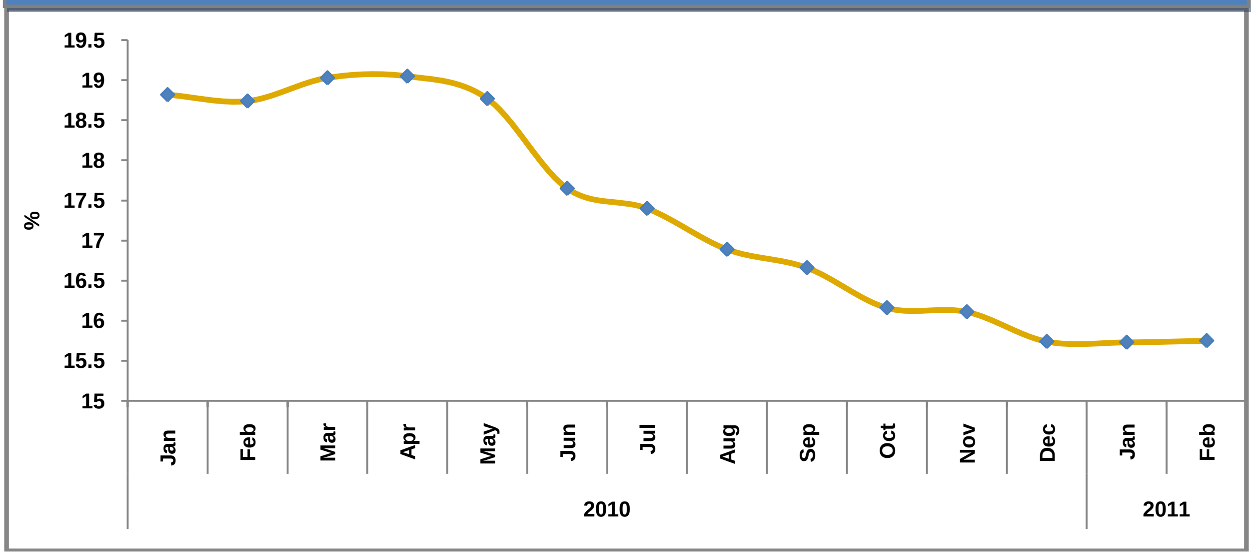
NIBOR Trend in Q1 2011



Source: FMDA & Access Economic Intelligence

Average prime lending rate of DMBs was relatively stable during the Q1 2011, with the rate at 15.73% and 15.75% in January and February, respectively. The inflow of CBN's intervention funds may have curtailed rate increases, amid DMB's low appetite to create risk assets and the lingering high risk perception of borrowers. However, prime lending rate would likely trend upward in the near-term in line with recent MPR hiking cycle.

Average Lending Rate (Prime)

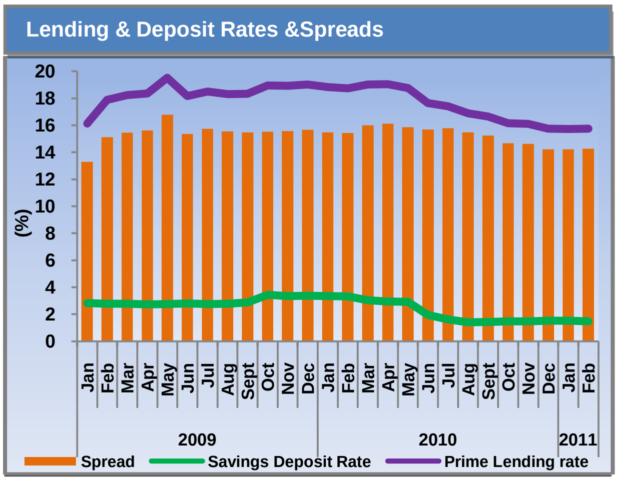


Source: CBN

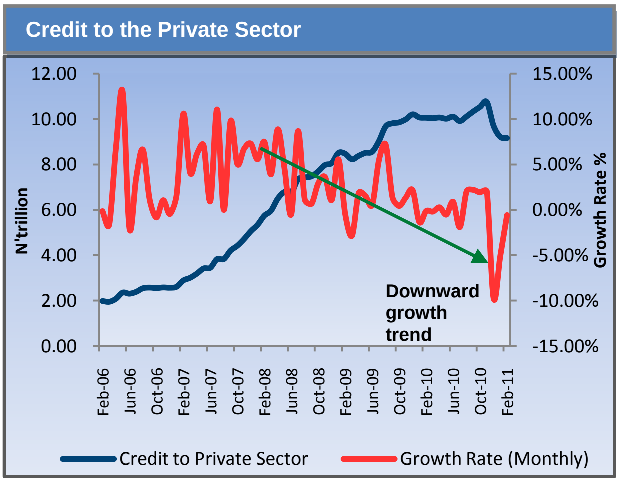
Essentially, the outlook for the interbank rate is on the upside, as lenders price in risks and transaction costs, amid projected liquidity tightness. The question now is: Will the various low interest rate schemes introduced by the CBN help to ameliorate emerging liquidity concerns?

Banking Sector: Financing Issues Lingers On

In line with global trends in 2010, Nigerian banks were actively responding to new pressures being faced from regulators and evaluating considerations that would position them for the revised capital regime. These adjustments and responses relate to strategic questions about business models, capital allocation, management of regulatory relations, technology platforms required for data management and ultimately revenue growth.



Source: CBN & Access Economic Intelligence

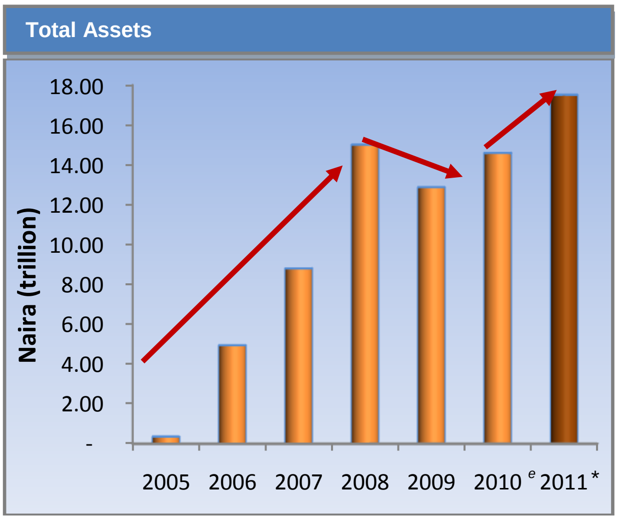


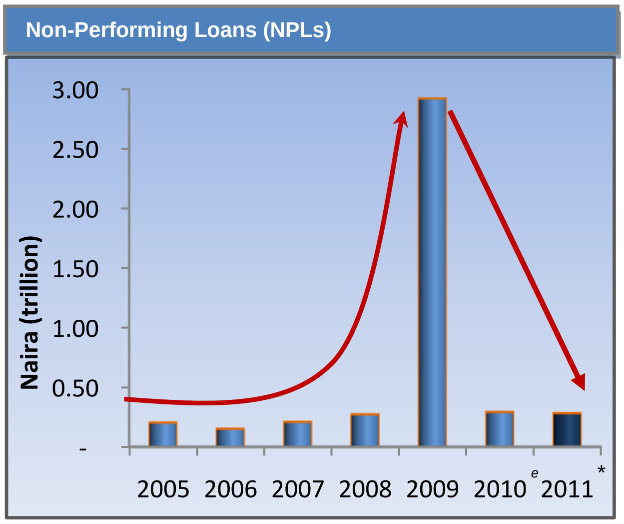
Source: CBN & Access Economic Intelligence

Although Nigeria's banking sector is beyond the days of crisis, the anticipated recovery in lending is yet to fully materialize. Because deposit rates are still low and inflation so high, the incentives are actually against savings, which reduces the pool of available capital for investment. Meanwhile, the spread between deposit and lending rate is expected to thin-out overtime, if cost of fund keeps increases in line with the CBN policy rate.

Currently the sector is at a double-face stage. On one hand, enhanced profits have led to improvements in solvency as a result of write-backs and AMCON bad load purchase. On the other hand, banks' overall lending is not growing at the expected pace, given the CBN efforts to boost lending. Recently, the sector has been largely characterized by heavy borrowing by the Federal Government (FG) through the use of bonds. Banks appear to be highly disposed to public sector lending as a result of their low risk-appetite, with portfolio held on treasury bills on the increase.

The main issue on the assets side of the balance sheet relates to loan growth. Working with official results covering the first three quarters of 2010, it is clear that most banks are not really growing their loan books, with credit to the private sector declining by 8.7% and 5.6% to N9.2 trillion in February 2011 from levels as at Q1 2010 and end-2010, respectively.





Source: Agusto & Access Economic Intelligence *eEstimate *Forecast*

Going forward, the balance of strengths and weaknesses within the banking sector will determine the positioning of the sector by end-2011. The size of the gap between strengths & weaknesses as well as the opportunities and threats is critical and most noteworthy in estimating the sector's direction. Overall, banks remain reluctant to lend, given the unresolved risk perception of borrowers, amid limited credit supply and cross-border financing.

Nigerian Banking Industry SWOT Analysis

SWOT Analysis

Strength

- **Large and growing population.**
- **Regional and global macroeconomic outperformer.**
- **Improving regulatory environment.**
- **Ongoing banking-sector reforms creating a consolidated and much more efficient financial infrastructure.**
- **Highly adaptive to improved technology.**

Opportunities

- **Undergoing process reforms to improve accounting practices and transparency.**
- **Establishment of Asset Management Corporation will allow banks to clear bad debts and return to lending.**
- **Lending to SMEs, as well as agricultural sector is still low, implying much room for growth.**

Weakness

- **Political uncertainties.**
- **Risk-averse stance of banks.**
- **Corruption, both in government and private sector.**
- **Low private sector lending.**

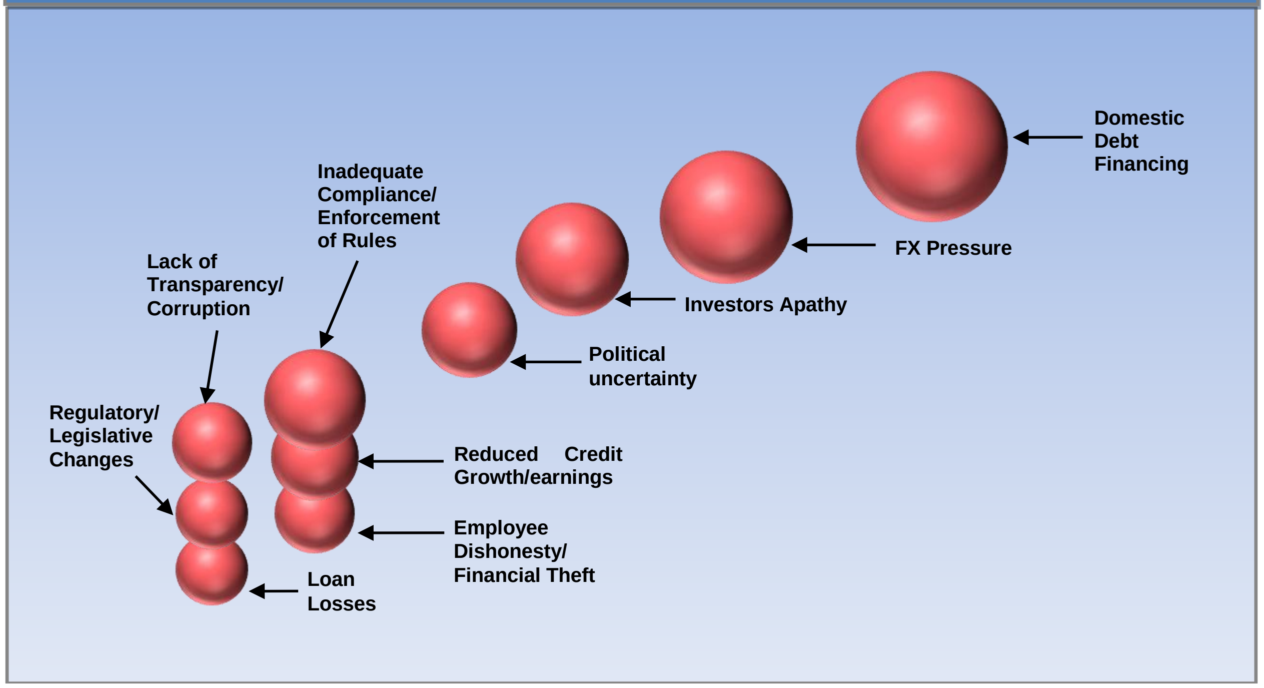
Threats

- **Foreign investor confidence still low and yet to fully recover.**
- **Deposit growth is unlikely to pick up at the weaker banks until after recapitalization.**
- **Rise in inflation figures which would lead to increase in interest rates.**

Source: Business Monitor International & Access Economic Intelligence

Meanwhile, some key risk factors in the Nigerian Banking sector in 2011 are depicted in the schematic below.

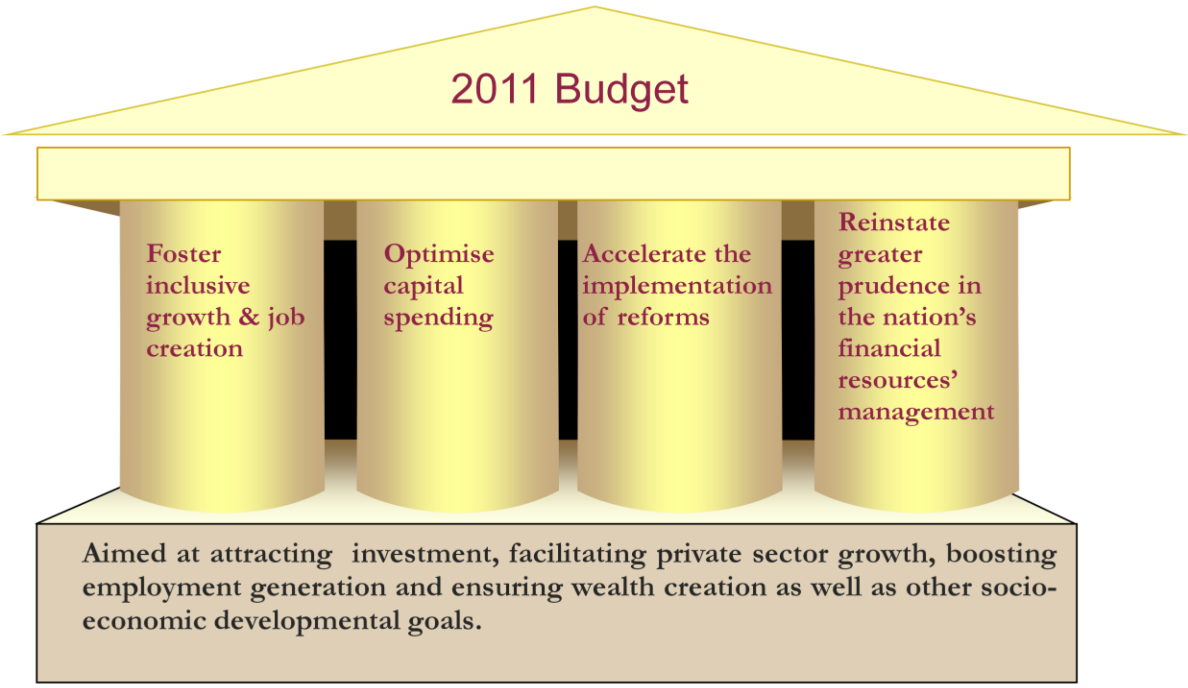
Top 10 Risks in the Nigerian Banking Sector for 2011



Source: Access Economic Intelligence

The 2011 Budget: Loose Fiscal Regime Poses Risks to Sustainability

The 2011 Appropriation Bill is essentially expansionary in nature in an attempt to develop the lingering massive infrastructural gap in the country. The schematic below depicts the budget pillars and its main thrust.



After almost three months of deliberations, the National Assembly (NA) approved 2011 budget worth N4.97 trillion, representing a 12.2% increase over N4.43 trillion proposed by the Federal Government.

FG Budget: Analysis on Key Assumptions

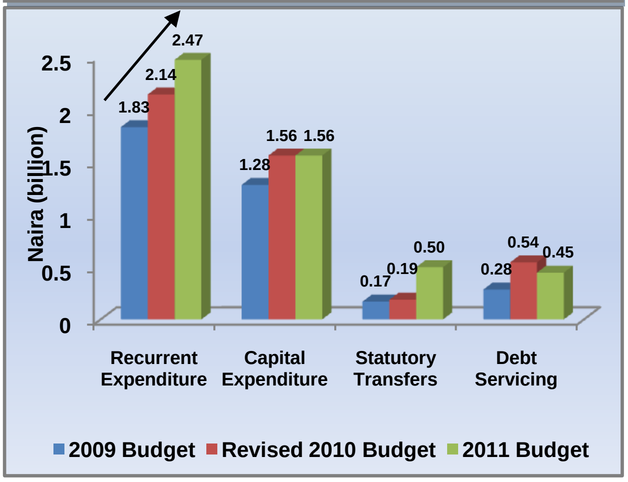
Categories	2010 Budget (₦)	Proposed by FG (₦)	Harmonized Budget by NASS (₦)	Remarks
Total Expenditure (₦ trillion)	5.159	4.226	4.971	• Would most likely be surpassed given that it is an election year. • A supplementary budget may likely be passed in the latter part of the year as usual.
Total Revenue (₦ trillion)	3.179	2.836	3.272*	• Realistic and could be higher if current oil price and output dynamics are sustained.
Budget Deficit (₦ trillion)	1.979	1.389	1.699*	• Budget deficit heightened by loose fiscal regime.
Budget Deficit to GDP (%)	6.06	3.62	4.42*	• An improvement on the 6% deficit recorded in 2010. •Expected to stay above the 3% threshold recommended by the Fiscal responsibility Act 2007. • This figure could rise to 4.5% - 5%, depending on the size of the supplementary budget later in the year.
GDP Growth Rate Target (%)	5.47	7	7	• Achievable, given the huge size of idle capacity that exists in the country with Q1 2011 returning an estimated 7.43% growth. • Backed by expected positive base effect of oil growth and the sustained high contribution from agriculture, real sector as well as wholesale/retail trade services.
Oil Production (mbpd)	2.2	2.3	2.3	• Achievable, given sustained high oil output in 2010 - a positive outcome of FG's Amnesty Programme for Niger Delta militants to curb attacks on oil facilities.

Categories	2010 Budget (₦)	Proposed by FG (₦)	Harmonized Budget by NASS (₦)	Remarks
Oil Benchmark Price (US$/barrel)	60	65	75	• A relatively prudent assumption given the current high level of oil price • The increase means that less will accrue to Excess Crude Account as savings to augment statutory allocation during volatile period or the proposed SWF as an investment vehicle. • Hence, the $10/bbl upward review in the 2011 budget.
Exchange Rate (N/US$)	150	150	150	• The N150/$1 exchange rate is in line with CBN's stance.
Inflation Rate (Year-on-year %)	11.2	10	10	• The target may be unlikely given documented risk to 2011 inflation outlook, amid structural impediment.

*Source: Budget Office & Access Economic Intelligence *Projected Figure*

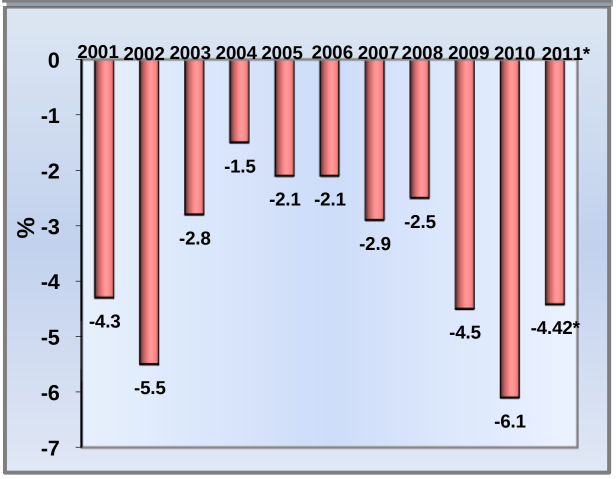
Of note is the rising trend of recurrent expenditure which is still comparatively high in relation to the proposed spending on capital projects. This may undermine the country's capacity to generate future stream of benefits as recurrent spending often constitutes deadweight loss because of its consumptive nature.

FGN Budget Expenditure Mix



Source: Budget Office & Access Economic Intelligence

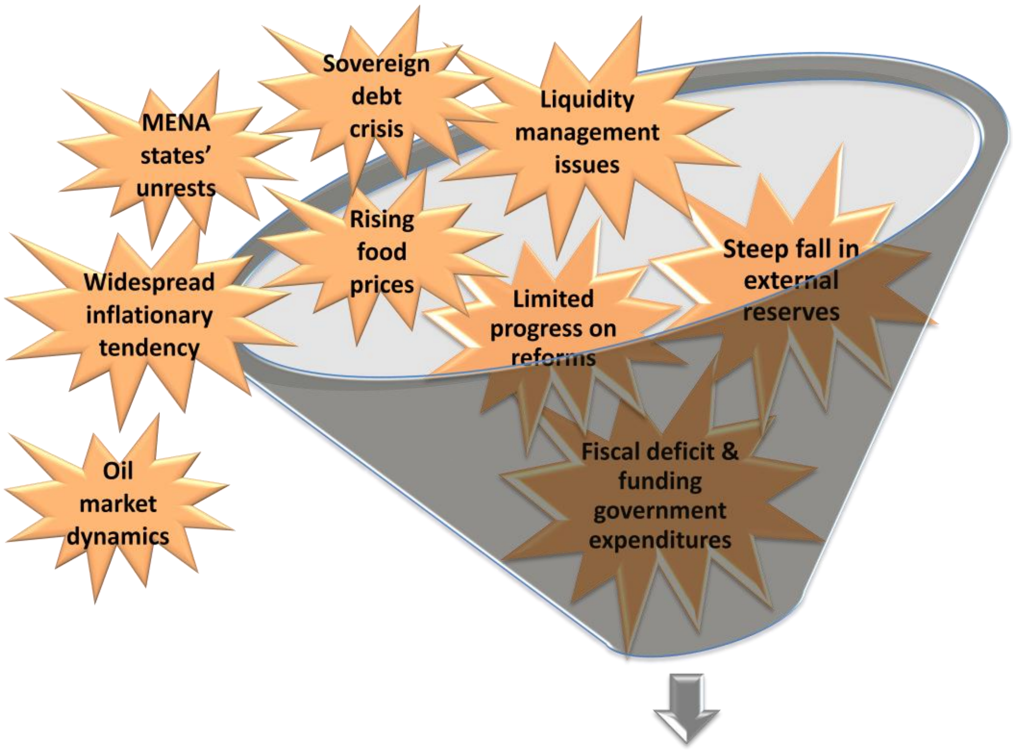
Budget Deficit as a % of GDP



*Source: Budget Office & Access Economic Intelligence *Forecast*

The budget is expected to be funded mainly by crude oil proceeds, implying that volatility in global demand for oil and price would pose significant risks to outlook. The accumulation of deficit has become entrenched resulting in higher debt profile and the cost of servicing these obligations. Meanwhile, with the rebound in the global financial market still fragile, sourcing for funds from the international capital market may be uneconomic and costly.

Snapshot of Potential Risk Factors in 2011



Downside Risk to GDP Growth

Revised Outlook for Q2 2011 and the Rest of 2011

For the global economy, we expect current financial market volatility to dissipate gradually, though it could still act as a temporal break to the economic recovery process across major economies. The myriad factors including depressed US housing market, sustained high unemployment and inflation rates, and concerns on sovereign debts default with its contagious effect may continue to provide downside risks to global GDP growth.

For the Nigerian economy in Q2 2011 and the rest of the year, we expect issues surrounding passage of the Petroleum Industry Bill and Freedom of Information Bill to generate some concerns, with skirmishes in some crisis-prone cities to undermine stability. Again, will the peace in the Niger Delta be sustained by end-2011 and beyond? The on-going sovereign debt crisis in Europe essentially has 3 major transmission channels to Nigeria: equities, oil prices and currencies. It is in this regard that the need to diversify country's revenue base against volatilities in oil price as well as safeguard the value of the currency becomes vital.

- **GDP growth to stay robust over 7.0% in the near - medium term**: We believe that the growth rate would be robust driven mainly by actual execution of desired infrastructure (especially power supply, good road network, boost in manufacturing capacity, amongst others). It is also expected that CBN's respective low interest rate schemes would complement growth with multiplier effect on economic activities. However, the growth trajectory may be undermined by a downward spiral in oil price.

- **Higher incidence of inflation due to near-term monetary growth**: Inflationary tendencies are on the upside which is supported mainly by continued non-coordination of fiscal and monetary policy stance. Electioneering spending, injections to recapitalize rescued banks, high food cost, increasing pressure on the Naira exchange rate, as well as rising cost of funds in the money market would likely sustain inflation rate around 12% - 14% range. A mix of weak aggregate demand and adequate supply of petroleum products will counter the upside risks to price stability. In all, we expect cost-push inflationary pressures (core inflation) to gradually become entrenched by year-end owing to structural bottlenecks and hence, would distort domestic price level.

- **Money market interest rates to stay high in line with MPC's benchmark rate hiking cycle**: We expect further upward movement in domestic interest rates in the near term well over levels attained in 2010 following adjustments in MPR by the CBN. This might curtail demand for credit by the private sector for investment, with attendant implication for real sector growth. However, it is only a marked pick-up in demand for credit that can result in an immediate increase in lending rates by Deposit Money Banks. With CBN's various intervention funds still operational (Power Sector Fund, SME Fund and Agric Fund, etc) to stimulate lending to the real sector, coupled with projected higher than normal statutory allocations this year, domestic interest rates would stay sticky around current levels with rates in short-term financial instruments to be more responsive to market liquidity.

- **Naira/Dollar rate to be moderately pressured**: The depleting external reserve is the main culprit, amid oil sector's strong fundamentals. But if yields/returns on investment stay robust, then outlook for the Naira would be relatively bright, as foreign investors bring funds into the system to slow down the anticipated erosion of the Naira, but political risk is a major inhibition to this scenario. We believe that CBN's resolute defense of the Naira, commencement of FX forward market and insistence on strict adherence to lay down FX rules would help to stabilize the country's exchange rate at current level.

- **Equities market to shake-off currently weak investors' sentiment, with indices expected at higher levels**: The stock market appears to be generally under-valued especially with improvements in corporate profits of quoted companies and the implied AMCON effect. We maintain that the relatively low share prices and a successful 2011 General Elections would take the equities market from the grip of the 'bear' to the 'bull'. However, the higher bond yields may mean that more investors might opt to cut their losses and divest their investment to fixed income securities, rather than equities.

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