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GDP Growth: Remained Poised for Further Expansion

Real gross domestic product (rGDP) is projected to grow by 7.93% in Q2 2011 according to interim numbers from the National Bureau of Statistics (NBS). This figure falls below the double digits target set by the country’s economic planners to meet with the nation’s desire to be ranked amongst the world’s top-20 economies by 2020.

The non-oil sectors continued to remain the major driver of overall growth, with agriculture, wholesale and retail trade, and services contributing 2.39%, 2.04% and 2.08%, respectively.

The combined growth total in the non-oil sectors is 8.46% while the oil sector output growth is estimated at 2.90%. The outlook for 2011 generally looks good, underpinned by the favourable conditions for increased agricultural production, encouraging outcomes of the banking sector reforms and measures to channel credit to the real economy, as well as growing emphasis on the development of non-oil sectors and key infrastructure.
On an aggregate basis, the economy measured by rGDP is expected to grow by 7.98% in 2011 up by 0.13% over the figure recorded in year 2010. The non-oil sectors are expected to continue to drive the Nigerian economy in 2011, with agriculture projected to grow at 5.68% in 2011.

**Monetary Policy: Quantitative Tightening to Counter Inflation**

The Central Bank of Nigeria (CBN) in the period under review adopted a quantitative tightening monetary policy stance. This was consistent with the need to address inflationary expectations of the anticipated excessive liquidity and pressure on foreign exchange market. At its 3rd meeting in 2011, held 23rd - 24th May 2011, the Monetary Policy Committee (MPC) raised the Monetary Policy Rate (MPR) by 50 basis points to 8% citing concerns of expected increase in budgeted expenditure on critical government projects, implementation of new minimum wage and possible withdrawal of petroleum subsidy.
The MPC stressed the importance of continuing structural reforms and infrastructural development to enhance domestic production - one of the measures to reduce the import bill and its pass-through inflation effects.

The Committee also raised cash reserve requirement (CRR) to 4% from 2% as part of its quantitative tightening measures. This took effect from June 8, 2011, to directly impact liquidity in the system. Its pass-through effects on speculative demand for foreign exchange are revealed by data which shows significant decline after the CRR was raised by 100 basis point at the January MPC.

Although the fiscal authorities have declared their intention to fiscal consolidation, analysts are expressing concerns on the need to reduce the systemic pressure exerted by rising government borrowings.

Nevertheless, a further possible increase in the MPR is still anticipated. This is predicated on the evidence of increasing demand for dollars, removal of subsidies on imported petroleum products and rising international food and energy prices, which threaten to stoke up inflationary pressures in the coming months. This policy decision is also expected due to the need to correct the negative real interest rate which has in the last few years heightened the risk of disintermediation.
Inflation: Expectation Still on the Upside

The year-on-year headline inflation dropped to 10.2% in June from 12.4% in May, the year-on-year headline inflation dropped to 10.2% in June from 12.4% in May, representing a 220 basis points fall. Food inflation also dropped to 9.2% from 12.2% in May 2011. Core inflation at 11.5% was also lower than the 13% recorded in May 2011. The fall in headline inflation was primarily due to decline in the prices of some food items & non-alcoholic beverages, imported food items, transportation, clothing & footwear housing and electricity/gas prices.

Worried by rising inflationary pressure, the Monetary Policy Committee (MPC) raised the Monetary Policy Rate (MPR), for the third consecutive time, from 7.5% to 8% at its last meeting held May 23rd – 24th, 2011. The Committee, which also lifted the Cash Reserve Requirement (CRR), had expressed its desire to check inflation which has stubbornly remained at double digits, to single digit.

The CBN Governor, Lamido Sanusi expressed fears that rising government expenditure along with accelerating costs of imported food and unsubsidized fuel products may push up inflation, with the CBN facing an uphill task achieving its single-digit inflation target.
Although the approaching harvest season gives a basis for a positive outlook, inflation expectations remain high owing to the subsisting high fiscal spending (especially at the state level), recent increases in public sector wages, anticipated increase in power tariff, possible removal of subsidy on petroleum products, further liquidity injection due to AMCON activity and elevated global food and energy prices.

**External Reserves: Buffer Likely to Rise With Favourable Oil Fundamentals**

The Nation’s external reserves declined to US$31.88billion as at end Q2 from US$32.76billion at Q1 2011, a drop of 2.7%. The depletion in the reserves was due primarily to NNPC deductions for joint venture cash calls (JVCC) and petroleum subsidies.

![External Reserves & Bonny Light](image)

**Exchange Rate: Commitment to a Stable Currency Takes Priority**

The foreign exchange market remained relatively stable in the quarter under review owing to the deliberate policy of the CBN to increase supply to the market to maintain the exchange rate within a band of N150 +/- 3%, complemented by funding from autonomous sources.

At the WDAS segment, the Naira/Dollar exchange rate opened at N151.52/US$ on April 1, 2011 and closed at N151.79/US$ on June 30, 2011, representing a slight depreciation of 0.18% (or N0.27k). Also, interbank rates opened at N154.07/US$ and
closed at N152.10/US$, an appreciation of 1.28%. The premium between the rates at the WDAS and other segments of the market narrowed significantly towards the end of the review period.

The CBN is expected to continue to favour maintaining the Naira value, within its narrow band, with periodic adjustments to avoid running-down foreign reserves. Relatively strong oil prices—albeit likely to fall in Q4 2011—should allow the maintenance of this policy, although the CBN is likely to move towards greater liberalization of the currency markets once the recapitalization and consolidation process in Nigeria's financial sector is fully addressed.

Even though Nigeria's fiscal metrics and oil-revenue leakages place substantial pressure on the Naira, the recent lifting of the requirement for foreign investors to hold local-currency investments in government securities for at least 1 year is expected to attract new capital inflows and reduce pressure on the nation's external reserves. Analysts anticipate a slight appreciation of the Naira in Q3 2011.
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Crude Oil Price: Upside Force Weakened by Global Macroeconomic Sentiments

Despite the strong showings of Nigeria’s benchmark crude oil (Bonny Light) in Q1 2011; its price performance in Q2 was volatile, moving within a wide range of $110 - $127 per barrel. Starting the quarter at $119.48 per barrel, bonny light price fell to $110.20 per barrel as at end-Q2. Its quarter high was $127.49 on April 29, 2011. The price decline, recorded in the period under review, was due to weakened macroeconomic sentiments across many regions, as well as on the impact of the International Energy Agency’s (IEA) decision to release 30million barrels of oil (0.18% of annual global consumption) from strategic reserves, to offset the disruption to output caused by the war in Libya.

Nigerian crude oil production sustained the upward trend rising to 2.155million barrels in Q2 2011 from 1.99million barrels per day as at end March 2011. This increase may be attributed to sustained peace in the Niger Delta following Federal Government Amnesty Programme.
Activities in the oil sector, with their associated gas components, are projected to grow, in real term by 3.40% in 2011 compared with the 4.56% recorded in 2010. The sector would also continue to benefit from upsurge in world crude oil demand (especially from new champion-economies).

The uncertainty surrounding the fate of the US economy due to its high fiscal deficit levels and sovereign debt crisis in the Eurozone may provide downside risk to sustained rising crude oil prices.

The likely passage of the Petroleum Industry Bill (PIB) in the 2nd half of this year, aimed at overhauling the hydrocarbons sector and increasing Nigeria’s local content in the energy sector, may define the future of the oil industry in Nigeria.

**Stock Market: Is a Rebound Lurking?**

The stock market index rose marginally by 1.5% from 24,621.21 points to 24,980.20 points in Q2 2011. This was a better performance when compared to a decline of 1.9% recorded as at end-Q1 2011. In same vein, the market capitalization (MC) of listed equities also rose marginally from N7.87trillion to N7.99 trillion in the same period. The slight increase may not be unrelated to the relatively robust Q1 2011 results of some listed firms, AMCON activities, amid sustained efforts to ‘clean
up’ the Nigerian financial system and improve reporting standards. Fund-raising activities in the stock market cooled down visibly during the quarter.

The market seems to be exhibiting a ‘graveyard market’ tendency, with frequent sell pressures as investors seek to cut losses. However, the net gainer has been the bond market, which has received relatively higher patronage in form of flight to safety, despite the current low coupons. The uptick mirrors the current stock market performance and liquidity situation. Market watchers are of the opinion that the recent nosedive in share prices to low levels may stimulate another round of stock purchase, leading to appreciation on the market All Shares Index.

**Interest Rates: Tight Liquidity and MPR Hiking Cycle May Distort Domestic Rates**

In Q2 2011, the Nigerian Interbank Offered Rate (NIBOR) moved upward on the average by 146basis points to 13.54% from 12.08% as at end Q1 2011. During the quarter, NIBOR trend was driven by the relative liquidity constraint in the nation’s financial system. CALL, 7-day and 30-day - mostly shorter tenoured instruments rose on the average compared to maturities of longer tenors which slide marginally downward during the period under review. On the whole, average monthly interbank rates responded with a decline at each disbursement of statutory allocation by the Federation Account Allocation Committee (FAAC). On the other hand, the hike in
monetary policy rate (MPR) and CBN’s TBills offer to the market often put NIBOR on an upward trajectory. This monetary policy posture was aimed at mopping inflationary money from the nation’s financial system.

<table>
<thead>
<tr>
<th>NIBOR</th>
<th>End-Period</th>
<th>CALL</th>
<th>7Days</th>
<th>30Days</th>
<th>60Days</th>
<th>90Days</th>
<th>180Days</th>
<th>365Days</th>
</tr>
</thead>
</table>

**Source: FMDA & FDHL**

The apex bank has expressed its willingness to put an end to the current guarantee of interbank transactions by end-September 2011. A removal would likely lead to upward trajectory in domestic rates, as lenders might price in default risk on interbank takings.

Meanwhile, average prime lending rate of Deposit Money Banks (DMBs) remained relatively stable throughout the quarter under review. The stability in the rate may
have been induced by the prevalence of CBN’s low-interest bearing funds in the financial system. These are the manufacturing, power, airline funds, amongst others. However, lending rate would likely trend upward in the near-term, on the back of the apex bank’s quantitative tightening cycle.

**Average Prime Lending Rate**

![Average Prime Lending Rate Graph]

Source: CBN

**2011 Budget: Reawakened Need for Fiscal Discipline**

In May 2011, President Goodluck Jonathan signed into law, the amended version of 2011 appropriation bill. The budget had an aggregate expenditure of N4.48trillion, which is lower by 9.8% when compared to the N4.97trillion passed by the National Assembly in March 2011. Of the sum, recurrent expenditures as a % of the total expenditures amounted to 55.1%, with the balance 44.9% earmarked for capital expenditure.

**Crude Oil Benchmark**

**Fiscal Deficit as % GDP**

![Crude Oil Benchmark and Fiscal Deficit Graph]

Source: Budget Office

Access Economic Quarterly Q2 2011
The budget has a deficit of N1.39 trillion (2.96% of GDP) and within the 3% gap limit as documented in the Fiscal Responsibility Act. FG presented a budget of N4.22 trillion for 2011, which was 18% lower than 2010 budget of N5.2 trillion (including N600 billion supplementary budget).

However, key assumptions in the preparation of the budget were retained. These include crude oil benchmark price of $75 per barrel ($67pb in 2010), daily crude oil production of 2.3 mbpd, Joint Venture Cash Calls of $7 billion (from $5 billion) and target GDP growth rate of 6% and exchange rate of N150 /$1.

The budget is expected to be funded mainly by crude oil proceeds, implying that any fall in global oil demand and price would pose significant risks to the 2011 budget implementation outlook. Recall that the performance of the budget was rather challenged in the last fiscal year (May 2010), following marked volatility in oil price at the international market. The fluctuation in price led to a downward review of the budget’s key assumptions by the National Assembly. With the current debt challenges in major economies, the fear of a contagion spreading across global economies is ever potent. This might erode the demand for crude oil going forward.

**Public Debt: Tendency for a Further Uptrend Still Wide-spread**

Recent data from the country’s Debt Management Office (DMO) shows that the nation’s external debt stock hits $5.398 billion as at end-Q2 2011, representing an increase of 3.3% and 17.9% over figures as at Q1 2011 and end-2010, respectively.
The breakdown of the total external debt stock by instrument type as at end-Q2 2011 shows that the Nigeria owed 85% of its debts to Multilaterals, which includes the World Bank Group, International Fund for Agricultural Development (IFAD), African Development Bank Group (ADB), amongst others. The balance is owed to Non-Paris Group of creditors and funds secured from the Eurobond issuance.

On the other hand, DMO puts Nigeria’s domestic debts at N5.213trillion as at end-Q2 2011, marking a 14.6% and 7% rise over N4.5trillion and N4.8trillion as at end 2010 and Q1 2011, respectively. By instrument, FG owes 62.9%, 29.9% and 7.2% to holders of bonds, treasury bills and treasury bonds, respectively.

![External Debt Stock](chart1)

![Domestic Debt Stock](chart2)

Given this, the nation’s debt position is considered sustainable with debt/GDP ratio of about 18%, which is still within FG’s threshold target of not more than 25%. For developing and emerging economies, 40% is IMF’s suggested debt-to-GDP ratio that should not be breached on a long-term basis. A debt-to-GDP ratio of 60% is often noted as a prudential limit for developed countries. The International Monetary Fund (IMF) believes that crossing this limit would likely threaten fiscal sustainability. Recall that Nigeria effectively reduced significant portion of her external debt of about $36 billion in 2005 through debt-forgiveness/relief.
Financial Sector: Targeted Reforms to Strengthen the System

In Q2 2011, the Central Bank of Nigeria, (CBN) issued new guidelines for the establishment and operation of non-interest banking in Nigeria. The guidelines clarify the contextual definition of non-interest banking, which is not restricted to Islamic banking, but also include other form of non-interest banking not based on Islamic principle. In the review of the governance structure of the banking model, the apex bank removed the reference to Sharia Council and replaced it with Advisory Council of Experts. The broadened scope was aimed at eliminating discrimination on any grounds in the participation by individuals or institutions.

CBN recently revised to $500,000 the FX sales limit to Bureaux de Change (BDC) operating in the country, up from $250,000 set earlier. The review was on the back of support received at the Monetary Policy Committee (MPC) Meeting held in June 2011. The aim was to check the potential for arbitrage or round tripping as a result of the widening gap between the official and parallel market exchange rates. The earlier action was taken by CBN as a result of the persistent high demand for Dollar caused by alleged speculative trading in the Forex market.

The apex bank also announced that banks can now deploy ATMs beyond their premises after an initial order was given to banks last year to stop operating ATMs in other locations. The regulator revised the policy owing to the new policy on cash withdrawal and deposit by customers of banks. The drive is to make Nigeria a cashless economy and encourage the use of electronic payment system. The payment system includes internet banking, telephone banking, electronic payment cards and ATM with the latter being the most popular.

Meanwhile, the Asset Management Corporation of Nigeria (AMCON) disclosed plans to release a new debt recovery strategy to guide the activities and operations of the corporation. The Managing Director and Chief Executive Officer, AMCON, Mr. Mustapha Chike-Obi, said the corporation will work closely with bank debtors with a view to restructuring their loans. The Corporation’s ultimate objective is to ensure that all bank debtors pay back in a bid to stabilize the banking industry and Nigeria economy at large.
Revised Outlook for Q3 2011 and the Rest of 2011

Political environment likely to remain relatively stable, but the Boko Haram menace remains a source of concern.

Macroeconomic environment likely be characterized by:

- GDP growth to stay robust over 7.5% by end-2011 due to increased focus on improving infrastructure – with its multiplier effect on the economy;

- Naira to remain within the indicative N150/$ ±3% target, even as we approach second half of the year when import activities pick-up: - FX Forwards etc to the rescue;

Source: BMI & Access Economic Intelligence

Access Economic Quarterly Q2 2011
- Inflation to likely to moderate upward. In all, we expect cost-push inflationary pressures to gradually become entrenched by 2H 2011, with the likely removal of oil subsidies;

- Debt Purchase: AMCON activities to impact positively on stock market performance, amid the relatively attractive level of most share prices. The current reform in the banking sector when fully completed might boost further the stock market indices.
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