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Downside Risks on Oil Revenue in 2014

November 15th, 2013

Outline

- ▶ Global oil market
- ▶ Current state of the Nigerian oil industry
- ▶ Implications on macro-economic variables
- ▶ Policy adjustments required
- ▶ Outlook



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Global Oil Supply Comfortable now but could Tighten- IEA

- ▶ OPEC crude oil supply was flat at 29.89mbpd in October
 - The cartel has maintained its quota of 30mbpd
 - Next meeting scheduled for December 4
- ▶ OPEC crude's share of global oil supply is down to 33.1% from 34%
- ▶ Non OPEC oil is projected to increase 2.22% to 55.3mbpd in 2014
 - Spurred by strong growth from US and Canada
- ▶ OPEC forecast's 1.2% increase in global world demand in 2014 to 90.82mbpd
- ▶ Demand for OPEC crude is on the decline with shale oil boom



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Global Oil Supply now Comfortable But Could Tighten- IEA

- ▶ The IEA predicts that the US will become the world's top oil producer by 2015
 - Surpassing Russia and Saudi Arabia who constitute 11.6% and 10.4% of global oil supply of 90.37mbpd
- ▶ Cushioning it against disruptions in Africa and the Middle East
- ▶ The oil shale boom threatens revenues for OPEC's 12 members,
- ▶ Whose production is at its lowest in two years
 - Political unrest in Libya and theft in Nigeria



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Implications on Oil Price

- ▶ Global oil prices (Bonny) have softened 8.33% to \$110pb
 - From a YTD peak of \$120pb
 - Brent:\$108pb
 - WTI: \$93pb
- ▶ Premium between heavy and light crude has widened to \$17pb from \$6pb in Q2'13
- ▶ EIA projects Brent crude price to slide further as non-OPEC supply growth exceeds growth in global demand
 - Brent crude is projected to average \$103pb in 2014, WTI: \$95pb
 - EIU projects oil price of \$104.8pb in 2014
- ▶ Discount between heavy and light crude is estimated to narrow to \$8pb in 2014 from \$18 in 2012- *EIA*



Current State of the Nigerian Oil Industry



Current State of the Nigerian Oil Industry

- ▶ Bonny light declined by 6.09% to \$110pb YTD
 - Brent also declined by 6.34% to \$108.54pb
 - WTI is down to \$93.76pb from \$94.42 in January 2013
- ▶ Nigeria's crude output shrank by 7.5% to 1.9mbpd in May
 - Incessant theft and shut ins
- ▶ Budget 2014 is based on an output of 2.38mbpd
 - Nigeria's current production is 20.17% below benchmark
- ▶ Output has been lower in the onshore and swamp operations where Nigeria has JVs
 - Hence, the impact on revenue is more



Factors Affecting the Nigerian Oil Industry

Internal

- ▶ MEND activities
- ▶ Oil theft and vandalism
- ▶ Force majeure

External

- ▶ Global weakness
- ▶ Eurozone crisis
- ▶ Slow demand in China
- ▶ Middle East risk premium

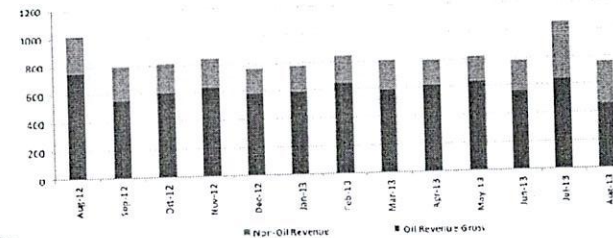


20% oil price decline, production decline to 1.7mbpd
 impact on Macro-economic Indicators

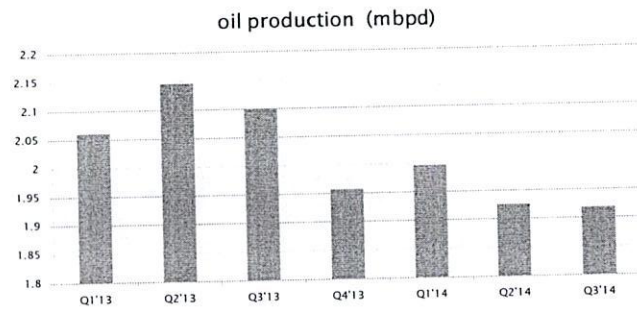
Variable	Impact	Response
GDP Growth	1.5% decline – 55% probability	Increased productivity from power may partially compensate
Government Revenue	Over \$2.7bn(27% decline) monthly decline – 70% Probability	Increase fiscal borrowings Reverse higher interest rates Withdraw funds for several developmental projects
External Reserves	Depletion by an estimated \$18bn - 70% Probability	Delay in payments for offshore processing transactions
Exchange Rate	Rate will fall to N175 due to likely decline in government revenue and reserves accretion	Higher interest rates Increased Govt. spending due to state of emergency and election spending

Price Stable, Output Down,
 Revenue Down

- ▶ FGN revenue declined by 27.6% to N760.29bn in August
- ▶ Due to a 25.1% decline in non-oil receipts and 29.2% decline in oil receipts

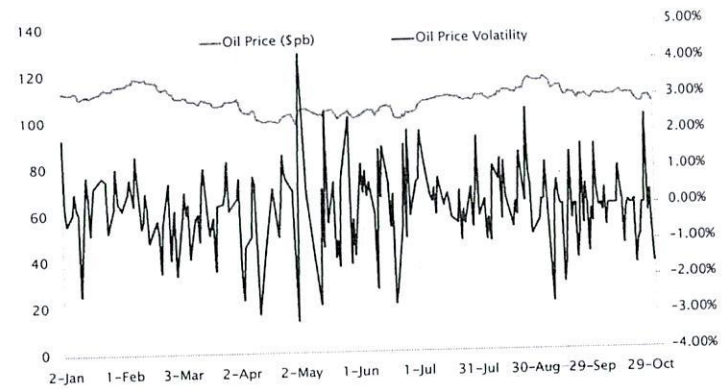


Output on a Downward Trend

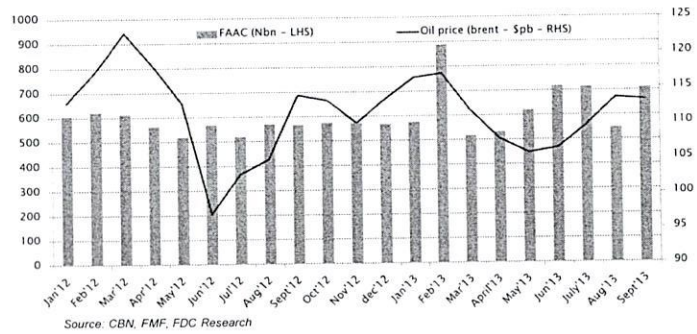


► Slow down in Production in the last two years

Increased Oil Price Volatility in 2013

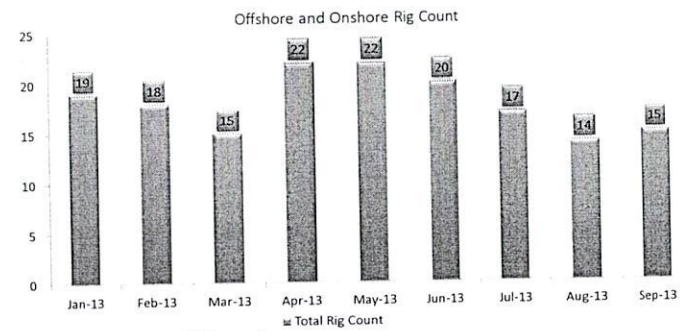


Oil Price Movement Influences FAAC Allocation



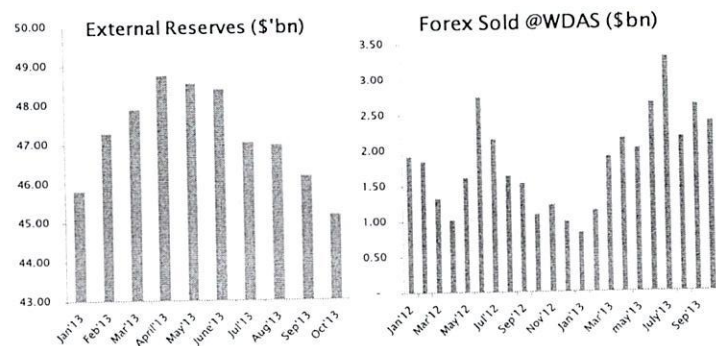
▶ Oil price volatility in 2013 also reflected in the monthly statutory allocation

Rig Count Down



• Low rig count continues to reflect the effect of increasing oil theft in the Niger Delta

Increased CBN Intervention, slow down in external reserves



Source: CBN, FDC Research



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Consequences of Declining Oil Revenue

- ▶ Sharp drop in oil price and production will impact oil receipts and government revenue negatively
- ▶ Decline in revenue below budget assumption poses a risk of a wider fiscal deficit
- ▶ Spending will be difficult to cut back because of 2015 elections
- ▶ Deficit financing becomes imperative
- ▶ Options for financing include
 - External borrowing
 - Print more money



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Possible Policy Response

- ▶ If oil prices fall below \$100pb, expect monetary policy adjustments such as:
 - Reduction in benchmark interest rate
 - Depreciation of the naira in all market segments
 - Official market rate will depreciate towards N160/\$
 - Interbank market rate to depreciate to N162 – 165/\$
- ▶ If average oil production falls below 1.7mbpd, expect structural adjustments:
 - Increased borrowing – external and internal
 - Tinkering with exchange control regulations;
 - Possible devaluation of the Naira



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Exchange Rate Fundamentals

Exchange Rate Fundamentals

- ▶ Oil revenue decline will negatively impact forex receipts and the exchange rate
 - Leading to further depletion in external reserves
 - Insufficient buffer to support the local currency
- ▶ Currently, official market rate: N155.7/\$
 - Interbank rate: N158.85/\$
 - Parallel rate on a downward spiral: N169/\$
- ▶ Impact of a 5% depreciation in the naira will result to
 - Official: moving from N155.7 to N160.5/\$
 - Parallel: from N169 to N177/\$

Where Is the Naira?

- ▶ Based on Purchasing Power Parity (PPP), the naira is overvalued by 13.94%.
- ▶ This is derived by a formula.

$$\frac{\text{Price of goods in Lagos}}{\text{Price of goods in New York}} = \text{Crude PPP}$$

Average Crude PPP- Exchange Rate at WDAS x 100
=13.94%

Naira Price at WDAS

- ▶ The forex market is segmented into:
 - Parallel: N169/\$
 - Inter-bank: N158.85/\$
 - Official: N155.7/\$

Purchasing Power Parity			
Oct-13			
	=N=	US \$	PPP (=N=/US\$)
1 Bottle of Coke (50cl)	100	2	50
2 Heineken	350	1.54	227.2727
3 Hamburger (with cheese)	350	1.14	307.0175
4 Uncle Ben's rice (S. Pkt)	1500	3.72	403.2258
5 Toyota Corolla	4300000	16230	264.9415
6 Rent 3 bdr furnished apt	12800000	36000	355.5556
7 Bottled Water (1ltr)	120	1.49	80.53691
8 Big Loaf Bread	300	3	100
9 Irish Spring Soap (1 cake)	250	2.21	113.1222
10 1 Packet of Benson & Hedges	170	8	21.25
11 Chicken Drumsticks (1 kilo)	800	8	100
12 Eggs (One dozen)	400	3.75	106.6667
13 Average PPP			177.4657
14 PPP Naira equivalent			177.4657
15 Naira Price at WDAS			155.7
16 PPP (%)			13.94
17 Decision: Naira is overvalued			
18 Spot Rate (IFEM)		158.85	
19 Spot Rate (Parallel)		169	
Outcome: Compared to official spot rate of N155.7/\$1, the Naira is overvalued by 13.94%			

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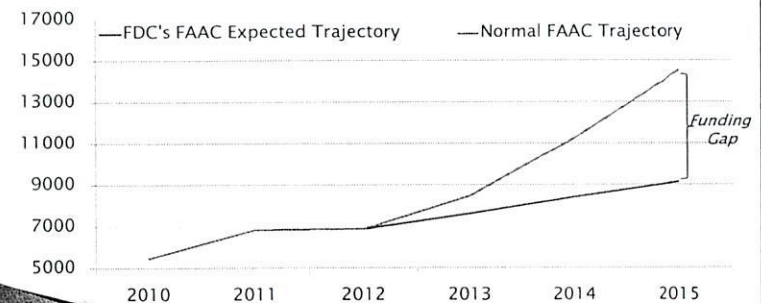
Outlook

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- ▶ Oil prices are estimated to slide further to \$100pb in 2014
- ▶ Production is estimated to remain flat at 1.8-1.9mbpd
- ▶ Fiscal spending to increase, thereby widening deficit gap
- ▶ Further currency weakness as oil revenue decreases
- ▶ Sustained depletion in External reserves as CBN continues to defend the naira

FAAC Projections

- ▶ Anticipated revenue shortfall raises question of funding gap
- ▶ Options available to the government
- ▶ Increase borrowing
- ▶ Print more money





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Thank You

