

## AFRICA RISK CONSULTING

### Nigeria Monthly Briefing June 2016

#### Nigeria Summary 1 June 2016

**Government approves 67% increase in fuel prices, but does not fully deregulate the sector. Labour unions protest the move, although it has broad political backing. Militant attacks and pipeline leakages decrease Nigeria's output by 600,000 barrels a day (bpd) to 1.4 million. Gross domestic product (GDP) contracts 0.36% year-on-year in the first quarter 2016, with Nigeria likely to enter recession in the second quarter.**

#### Government approves fuel prices

The government, on 11 May, approved a 67% increase in **National Nigerian Petroleum Corp** fuel prices.<sup>1</sup> Price regulation uncertainty and foreign exchange controls will continue to deter investment in **Nigeria's** dilapidated oil refineries. The government increased the price of petrol from 86.5 naira (N) (\$0.43) to N145 (\$0.73) a litre.<sup>2</sup> This in effect marks the suspension of the government's fuel subsidy, but not full deregulation of the sector as the government will continue to control retail prices. Petroleum state minister **Emmanuel Ibe Kachikwu** announced the increase, which came into effect immediately.<sup>3</sup> Kachikwu is under pressure to end the petrol shortages that have curbed business activity in Nigeria over recent months.<sup>4</sup>

*"I was delayed at **Lagos Airport** over night after my flight was rescheduled only after we had spent two hours sitting on a **South African Airways** plane which was not able to obtain aviation fuel. The fuel supply situation is turning into a full-blown energy crisis alongside power outages being experienced across the nation. It is extremely disheartening that Nigerians are finding themselves, once more, having to go through untold hardship to obtain petrol and other refined products."<sup>5</sup>*

Fuel marketers have suspended fuel imports as artificially low pump prices ate into their profit margins after the government made no provision for the payment of fuel subsidies in the 2016 budget. The **Product Pricing Regulatory Agency (PPPRA)** has estimated that the total cost of importing and distributing a litre of fuel is N138 (\$0.69).<sup>6</sup> This means that the new upper price boundary will allow marketers to recover their costs and ensure their margins are met. Kachikwu said the government expects this to increase imports and eventually decrease pump prices.<sup>7</sup> Kachikwu also said that the government will begin price modulation, linking the domestic pump price of fuel to international prices.<sup>8</sup>

*"We should be selling at lower prices, but to do so we must be responsible for producing our own refined products. Until we develop enough capacity to refine – by private sector or government –*

<sup>1</sup> Premium Times, 11 May 2016.

<sup>2</sup> Premium Times, 11 May 2016.

<sup>3</sup> Premium Times, 11 May 2016.

<sup>4</sup> Premium Times, 11 May 2016.

<sup>5</sup> Source, energy consultant, Lagos

<sup>6</sup> This Day, 11 May 2016.

<sup>7</sup> Bloomberg, 14 May 2016.

<sup>8</sup> Vanguard, 15 May 2016.

*we can contract-refine, pay only the refinery costs and then bring in the products to sell at our own determined prices."*<sup>9</sup>

Under the new regulations, any Nigeria-based entity can now import and sell fuel subject to regulatory approval and ability to source sufficient foreign exchange. The new regulations also allow importers to use the parallel market to obtain foreign currency. This will increase pressure on the parallel market exchange rate.

*"The subsidy system is simply not working. Our refineries are not working because of the subsidy. Investors will not invest in this sector if there is subsidy. Despite subsidy, Nigerians still pay more for fuel, so what is its essence? We should involve the private sector in the energy industry. We need to change our economic approach in this sector. We cannot hold on to the socialism ideology that is not working for us."*<sup>10</sup>

The timing of the reform – coming amid fuel shortages – has added to a perception that the government lacks a long-term strategic plan for the sector.

*"The government needs to get down to the economy. The removal of subsidy – a policy turnaround at short notice – doesn't inspire investor confidence. It was like we had our backs to the wall and had to react."*<sup>11</sup>

Nigeria's labour unions have protested the price increase. The **Nigeria Labour Congress (NLC)** and the **Trade Union Congress (TUC)** both threatened to begin an indefinite strike on 18 May.<sup>12</sup> The NLC began labour action despite a court ruling prohibiting it, but suspended its strike on 21 May. The unions accused President **Muhammadu Buhari** (2015- present) of a "betrayal of electoral promises".<sup>13</sup> However, oil sector unions **National Union of Petroleum and Natural Gas Workers (NUPENG)** and the **Petroleum and Natural Gas Senior Staff Association of Nigeria (PENGASSAN)** said they were not totally opposed to the price increase.<sup>14</sup>

Opposition to the move is not surprising. The previous government attempted to remove entirely the "notoriously corrupt"<sup>15</sup> petrol subsidy in January 2012, but partially reversed its decision amid a six-day general strike and protests that resulted in the deployment of government troops in **Lagos**.

*"Since 2000, hikes in petrol prices have attracted massive protests from labour unions and each protest has ended in compromises brokered between the unions and the government. As such, attempts to remove the fuel subsidy have always tended to come with varying levels of unrest."*<sup>16</sup>

There is, however, broad political backing for the move which is seen as part of Buhari's reform agenda.

*"If we really want a sustainable economy in line with the change agenda of ending corruption... enriching few and [giving] more money to human and capital development, we must brace up and do what is right. As it is compelled by our current realities resulting from forex shortage due to oil market crisis, what is right is allowing some degree of market freedom, removing subsidy and capping the price."*<sup>17</sup>

The private sector has backed the move despite the potential for increased business costs.

*"With the corruption that had plagued our oil sector for years, should we continue to throw away hundreds of billions of Naira so that 50 odd companies can enjoy the subsidy at the expense*

<sup>9</sup> Source, politician, Akwa

<sup>10</sup> Source, economic professor, Ibanda

<sup>11</sup> Source, consultant, Nigeria

<sup>12</sup> Bloomberg, 14 May 2016.

<sup>13</sup> Bloomberg, 14 May 2016.

<sup>14</sup> Bloomberg, 14 May 2016.

<sup>15</sup> Source, senior western diplomat, Nigeria

<sup>16</sup> Source, former presidential advisor, Abuja

<sup>17</sup> Source, member of house of representatives, Nigeria

*of what those funds can do for over 150 million Nigerians? Even though it is definitely causing pain in the short term, subsidy should be removed so that it can benefit Nigerians ... in more permanent ways."<sup>18</sup>*

Activists who protested previous attempts to revise the subsidy framework have suggested they may support the new policy as part of Buhari's reform initiative.

*"Although critics may argue that Nigerians should rise against the removal of subsidy because they resisted same during the last administration, I contend that the situation is now different and the same parameters cannot be applied. Only a tiny cabal would have benefitted from removal of subsidy under president **Goodluck Jonathan** (2010-2015). This informed the mass demonstrations at the time. But poor Nigerians stand to benefit if subsidy is removed under a transparent leader."<sup>19</sup>*

### Militant attacks cut oil output

An increase in supply disruptions in the **Niger Delta** has cut Nigeria's output by 600,000 barrels a day (bpd) to 1.4 million.<sup>20</sup> This raises questions about whether Nigeria will be able to meet the 2.2 million barrels per day that the 2016 budget is predicated on. The current monthly output level is the lowest since 1989.<sup>21</sup> Kachikwu told the house of representatives on 16 May that militant attacks on pipeline and facilities had resulted in Nigeria losing approximately 800,000 bpd in crude output.<sup>22</sup>

Pipeline leakages have also disrupted operations. **United States (US)**-based **Exxon Mobil Corp** on 13 May declared *force majeure* on shipments of **Qua Iboe** following accidental damage to a subsea pipeline.<sup>23</sup> **Royal Dutch Shell** on 11 May declared force majeure on shipments of **Bonny Light** following a leak on the 600,000 bpd **Nembe Creek Trunk Line**.<sup>24</sup> Militant attacks had disrupted shipments from Shell's **Forcados** terminal and **Chevron's Okan** oil platform, which feeds into the **Escravos** export terminal.<sup>25</sup> Insecurity in 2009 contributed to Shell and partners **France**-based **Total SA** and **Italy**-based **Eni SpA** beginning a divestment programme from the blocks that contribute to the Forcados terminal.

The little-known **Niger Delta Avengers** militant group has claimed responsibility for the Okan attack, and warned of further attacks on oil infrastructure and workers.<sup>26</sup> The Niger Delta Avengers on 12 May gave oil companies a two-week ultimatum to evacuate staff from the Niger Delta or face a "bloody attack".<sup>27</sup> Chevron and Shell have started evacuating non-essential workers and contractors.<sup>28</sup> There is very little information available about the Niger Delta Avengers, but its attacks are relatively sophisticated. The Niger Delta Avengers says it is fighting for a greater share of oil revenue and political independence for the Niger Delta region.

The government has increased its military presence in the Niger Delta amid increased attacks on oil infrastructure.<sup>29</sup> Buhari said on 20 May that he has tasked chief of naval staff **Ibok-Ete Ibas** to restructure and strengthen the military **Joint Task Force** in the Niger Delta to protect oil sector infrastructure and personnel.<sup>30</sup> However, international oil companies have reportedly warned vice president **Yemi Osinbajo** that mismanaged heavy military deployments in the region are likely to

<sup>18</sup> Source, manufacturer, Lagos

<sup>19</sup> Source, political activist, Lagos

<sup>20</sup> Bloomberg, 16 May 2016.

<sup>21</sup> Channel Television, 12 May 2016.

<sup>22</sup> Bloomberg, 16 May 2016.

<sup>23</sup> Channel Television, 12 May 2016.

<sup>24</sup> Channel Television, 12 May 2016.

<sup>25</sup> Channel Television, 12 May 2016.

<sup>26</sup> Channel Television, 12 May 2016.

<sup>27</sup> This Day, 12 May 2016.

<sup>28</sup> This Day, 12 May 2016.

<sup>29</sup> This Day, 23 May 2016.

<sup>30</sup> This Day, 23 May 2016.

exacerbate existing tensions.<sup>31</sup> On 22 May, youth attacked a crude oil pipeline in **Bayelsa State** that Eni subsidiary **Nigerian Agip Oil Co** operates.<sup>32</sup> The youth reportedly attacked the **Tebidaba-Brass** pipeline in a dispute over a commercial contract to manage its surveillance.<sup>33</sup> The amnesty programme provided a source of business and patronage opportunities for former militant leaders. Central to the programme is the awarding of pipeline surveillance contracts. Local communities in the Niger Delta view pipeline surveillance contracts as compensation for their states sharing oil revenue with non-producing states. President Goodluck Jonathan awarded the majority of pipeline surveillance contracts to his **Ijaw** ethnic group, which is in the minority in a number of key oil producing regions.

As well as the increased deployment, Kachikwu emphasised the petroleum ministry's commitment to infrastructure development to increase production.<sup>34</sup>

*"There are still a whole lot of things we need to pay attention to; infrastructure is key but we have not as a country over the last 20 years invested in infrastructure in the oil sector... our pipelines are 35 years old and none has been replaced; we have not been able to put gas infrastructure in place, our refineries are next to comatose and old and we are working hard on them... our critical facilities are at a breakdown state, so no serious infrastructure has taken place."<sup>35</sup>*

### GDP contracts 0.36% in first quarter

The **Nigerian Bureau of Statistics (NBS)** on 20 May published data showing that gross domestic product (GDP) contracted 0.36% year on year in the first quarter 2016.<sup>36</sup> As well as low oil prices and production, foreign exchange and import restrictions have undermined investor and business confidence. The contraction compares to 2.11% growth in the fourth quarter of 2015.<sup>37</sup> The oil sector contracted 1.9%, and the non-oil sector economy contracted 0.2%.<sup>38</sup> Notably, the manufacturing sector contracted 0.7% as it struggled to secure inputs due to foreign exchange limitations as the government looks to shore up foreign exchange.<sup>39</sup> The NBS noted that continuing fuel shortages have resulted in an 8% decrease in labour productivity in the fourth quarter.<sup>40</sup> According to **Central Bank of Nigeria (CBN)** data, the last time the economy contracted was the second quarter of 2004.<sup>41</sup> Declining oil production (see above) will increase the risk that GDP will contract in the second quarter forcing Nigeria into recession. The current second quarter is traditionally the weakest in Nigeria due to delays to the budget increasing economic uncertainty.

### Implications

Higher fuel prices will increase upward pressure on inflation even while the government and CBN continue to prioritise encouraging economic growth. Continued government involvement in price regulation will deter investment in Nigeria's refineries. Nigeria will remain dependent on petroleum imports amid increasing international prices. While subsidy reform is long overdue, the move at this time will risk further slowing economic growth in 2016.

Oil output will not recover quickly. The risk of further attacks on oil infrastructure remains extremely high undermining government reform efforts and deterring foreign investment for rehabilitation and

<sup>31</sup> Reuters, 22 May 2016.

<sup>32</sup> Premium Times, 23 May 2016.

<sup>33</sup> Premium Times, 23 May 2016.

<sup>34</sup> Vanguard, 16 May 2016.

<sup>35</sup> Vanguard, 16 May 2016.

<sup>36</sup> Vanguard, 20 May 2016.

<sup>37</sup> Bloomberg, 20 May 2016.

<sup>38</sup> Vanguard, 20 May 2016.

<sup>39</sup> Vanguard, 20 May 2016.

<sup>40</sup> www.cbn.gov.ng

<sup>41</sup> www.cbn.gov.ng

expansion. Decreased revenue will increase fiscal pressures on the government considering the budget's ambitious revenue and expenditure targets.

Nigeria is likely to enter recession for the first time since 1987. Whether growth then increases is dependent on greater exchange rate stability, and effective government implementation of its fiscal stimulus plan and reform agenda.

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