

# Effects of COVID-19 on the Economy and Business

May 2020

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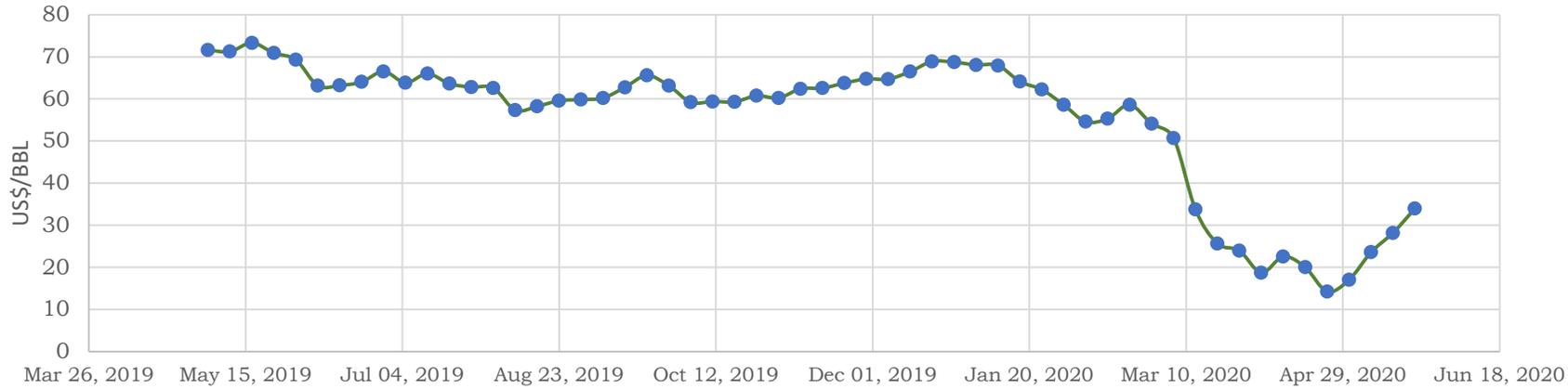
## Introduction

- The outbreak of COVID-19 pandemic which started in Wuhan, China in November 2019 has unleashed very severe economic impact globally
- The COVID-19 pandemic has inflicted heavy toll on global health system while the World is still counting the cost in both financial terms and the number of lives lost
- Global oil prices have plunged precipitously with WTI crude oil prices for April delivery sliding into negative territory
- The global economy is projected to contract sharply by 3 percent in 2020, much worse than during the 2008–09 financial crisis
- Most countries have turned inward with various fiscal and monetary intervention tools in a bid to stabilize their economies



# Crude Oil Prices

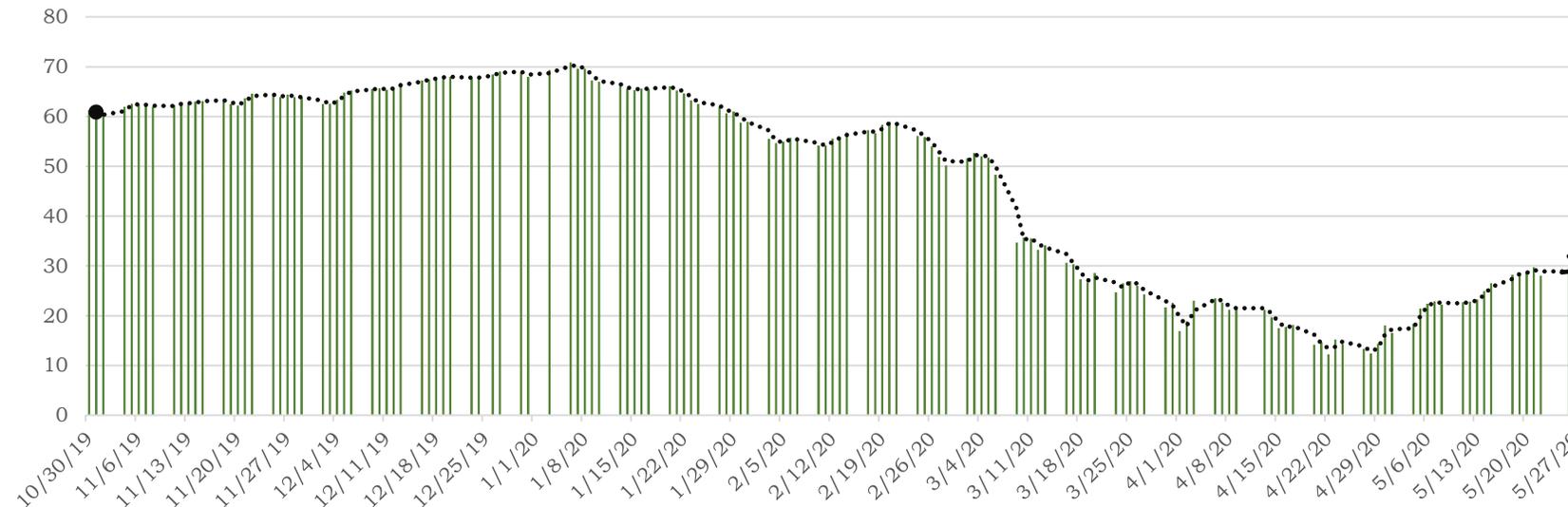
Brent Spot Price (FOB)



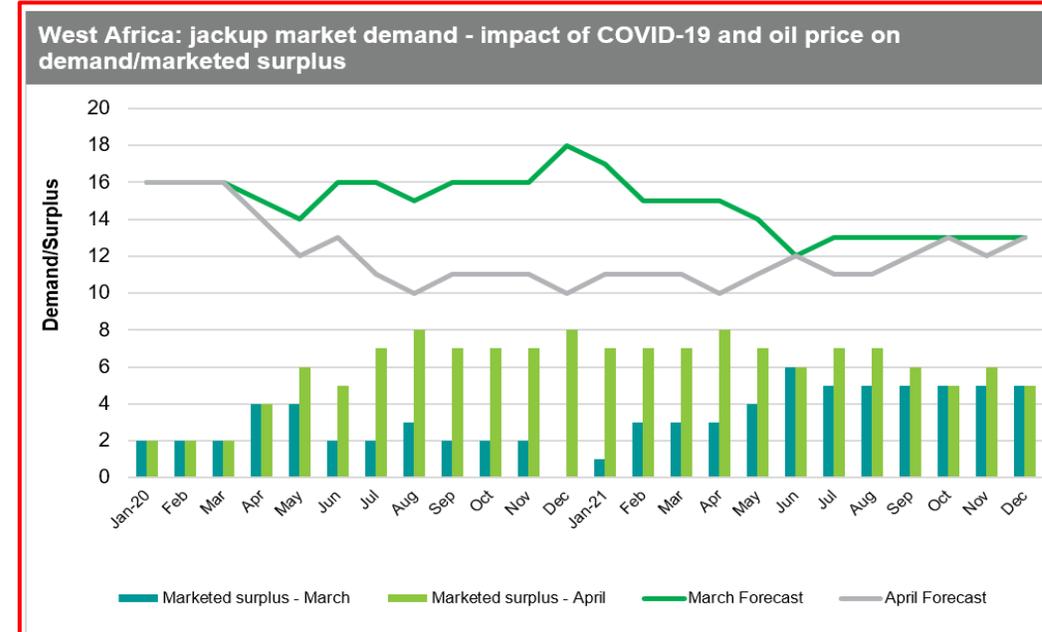
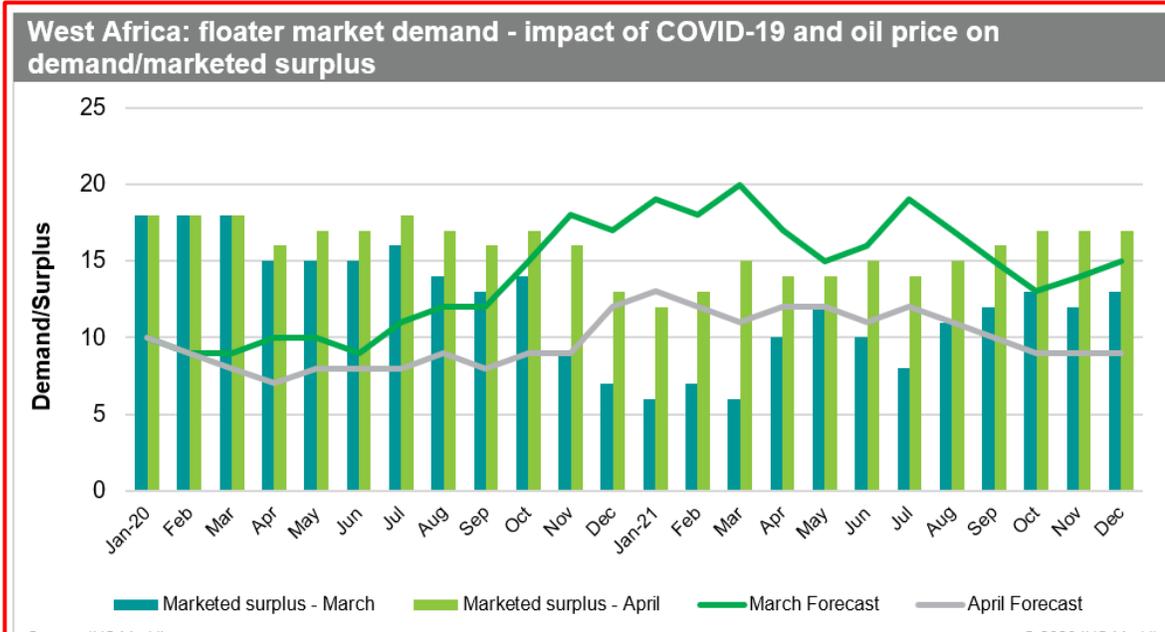
- COVID-19 sent crude oil prices into a wild swing downwards with Brent hitting lowest since 1999
- WTI prices for April delivery went into negative territory amid an increasing oil surplus in the spot market and weak demand.
- The OPEC Reference Basket (ORB) value collapsed by \$16.26, or 48.0%, m-o-m, to \$17.66/b, the lowest monthly level since December 2001.
- ICE Brent declined by \$7.10, or 21%, to average \$26.63/b, while NYMEX WTI fell by \$13.75, or 45.2%, to average \$16.70/b.
- The contango structure of the forward curves of all crude futures benchmarks steepened further, on further worsening of global oil market fundamentals and a rapid increase in global oil inventories.

Source EIA/OPEC

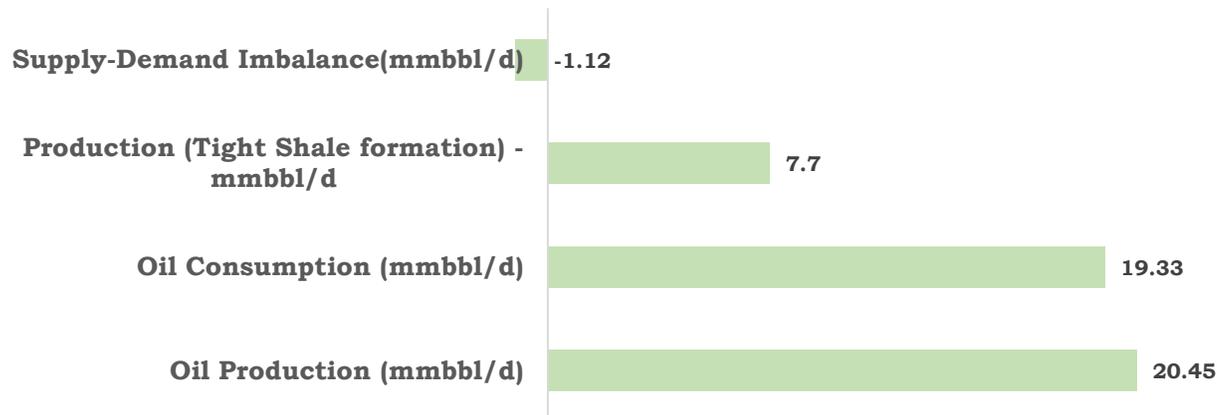
OPEC Reference Basket Price/US\$Bbl



# Oil Rig Demand/Surplus in West Africa and US Energy Balance



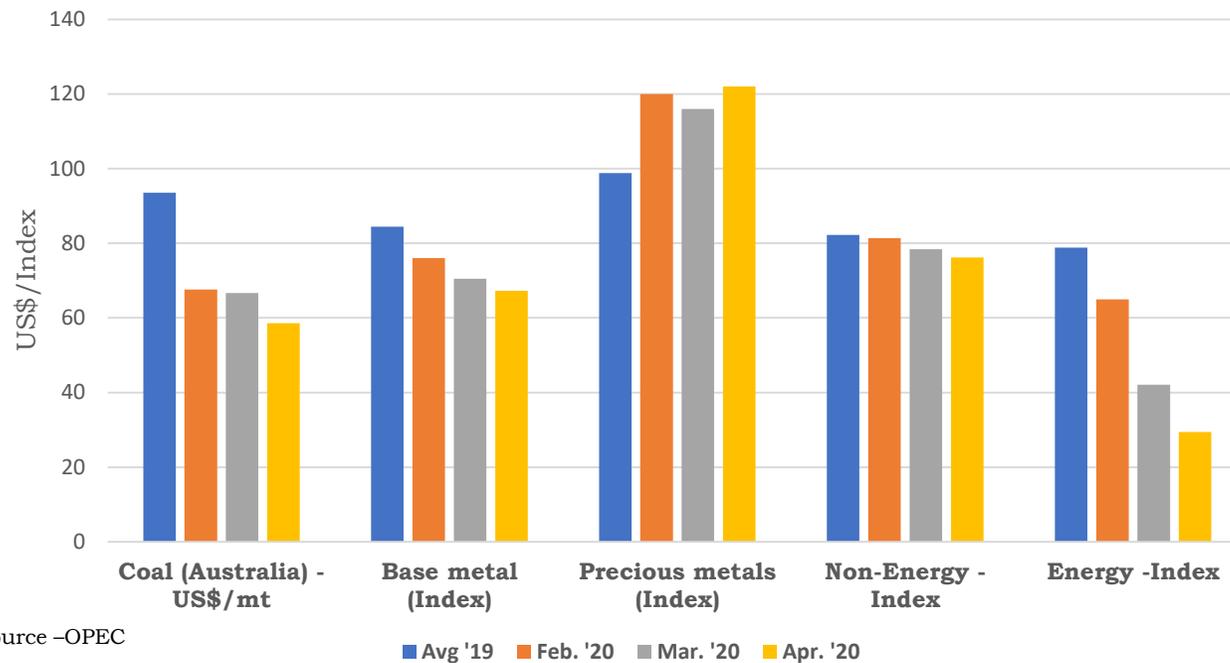
Source -IHS Markit



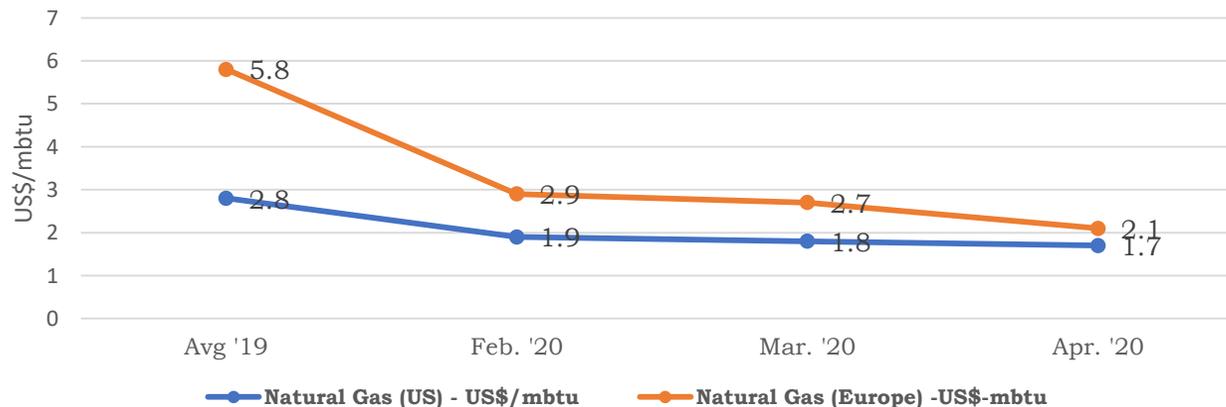
Source -EIA

- 63% of US oil production (Crude Oil) from tight shale
- Production from tight shale formations is uneconomic at low prices
- Production cut-back from shale directly impacts US supply-demand balance
- Energy security top of US policy agenda in the medium term unless prices rally to pre-Covid-19 levels

## Selected Commodities Market Trend



Source –OPEC



- The outbreak of COVID-19 and receding multilateralism in the face of the global epidemic have sent the global economy to a tailspin.
- The energy price index fell by around 30.2% m-o-m in April. World oil demand is projected to drop by 9.10% or 9.07 mmbbls/day
- The non-energy index fell m-o-m by 2.8% in April, with both metals and agricultural commodities retreating.
- Most economies are projected to contract in 2020 - the global economy is forecast to shrink by 3.4%, the US by 5.2%, OECD 6.1%, Japan 5.1% while China is expected to grow by 1.3% in 2020, a huge drop from the 6.1% growth recorded in 2019
- The rate of economic recovery will depend largely on the severity of the pandemic, effective response in flattening COVID-19 new infection curve, domestic and external demand and the scale of monetary easing and fiscal stimulus measures adopted by the various countries.
- Globally, as at May 2020 about US\$9 trillion of monetary easing and fiscal stimulus measures have been put in place to address the economic fallout of the pandemic.
- Germany agrees corporate rescue of Eur 9 billion for Lufthansa, others airlines will need support
- One the biggest in South America and shales producers in the US have filed for bankruptcy, many other industries will require bail-out

### Unemployment

Unemployment is heading towards unprecedented levels in Nigeria and globally. Household consumption account for a significant share of GDP. As unemployment rises GDP will be impacted negatively. State government revenue will also take a hit as PAYE constitutes on the average about 60% of IGR and higher for a State like Lagos

### Corporate Distress/Default Rate

Default rates on loans will rise in 2H20, potentially leading to some sectorial dislocations, supply chain disputes and also impacting financial markets in Nigeria. Expect the level of “sour assets” to trend upwards and this may affect financial sector stability and lead to a call for additional capital. NPL in the oil & gas and power sector may further deteriorate

### Foreign Reserves/Exchange rate

Expect significant pressure on reserves and exchange rate if low oil price regime is prolonged Cost of electricity generation and distribution and electricity consumer metering will be impacted. Expect calls for tariff review and pushback from government and consumers. Some sectors will witness compliance challenges with regulators.

### Inflation

Inflation is likely to spike due to exchange rate related increase in cost of inputs and goods. The commodity price shock will pressure the Naira more unlike Ghana that relies on cocoa and gold with stable or improving prices.

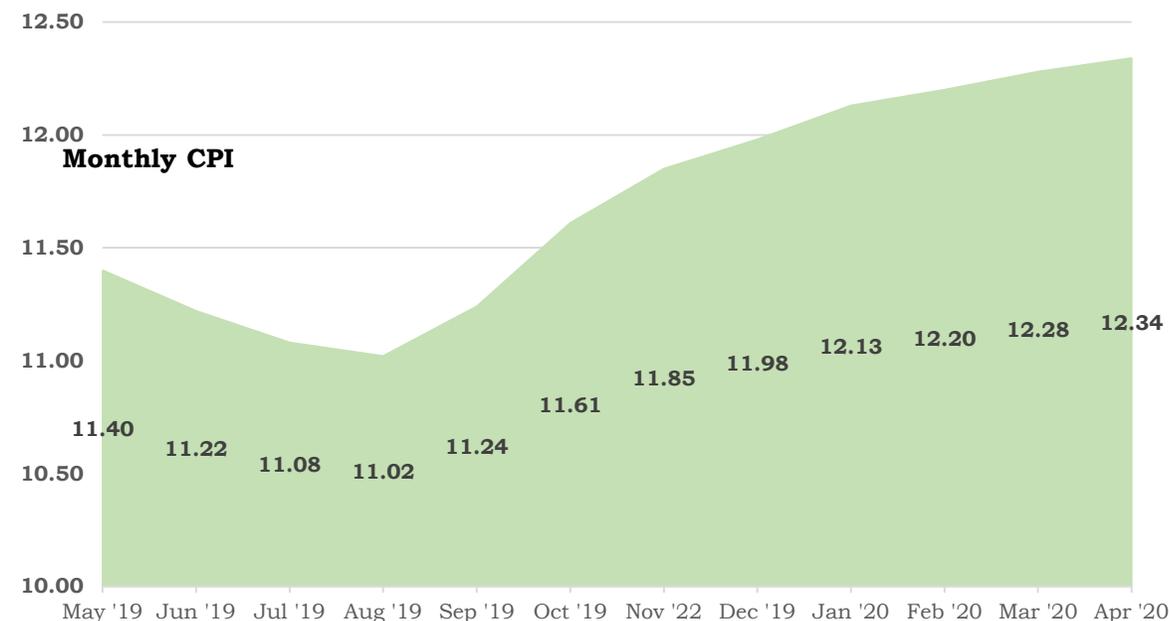
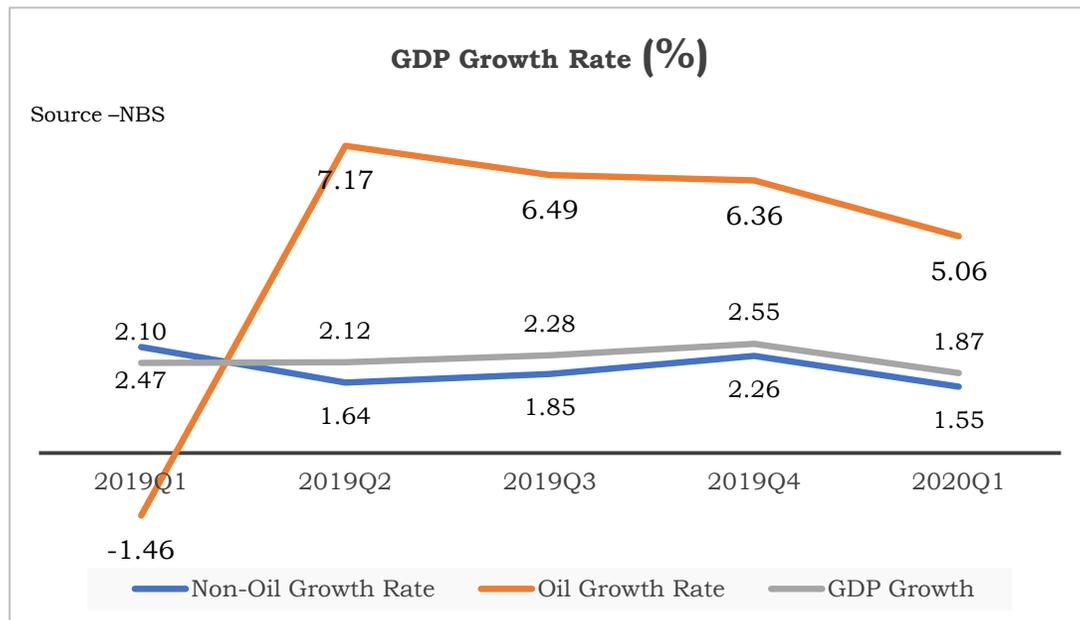
### Rising Public Sector Debt Profile

To shore up dwindling public revenue, a steep rise in government borrowing is imminent. In addition to the US\$3.4 billion loan approved by IMF in April 2020, government is seeking additional foreign loans of US\$5.5 billion. The Stimulus package well should promote long-term investment in the real sector to diversify the economy and grow government revenues

### Import-dependence – Policy Support for Local Manufacturing

Local industries will become less competitive against imported goods especially against the backdrop of huge fiscal support for companies packaged by developed economies around the world. Cost-reduction, shared services with competitors and local content strategy will be key to survival of local entities . Access to credit to be improved with CBN LDR policy and drop in MPR to 12.5%

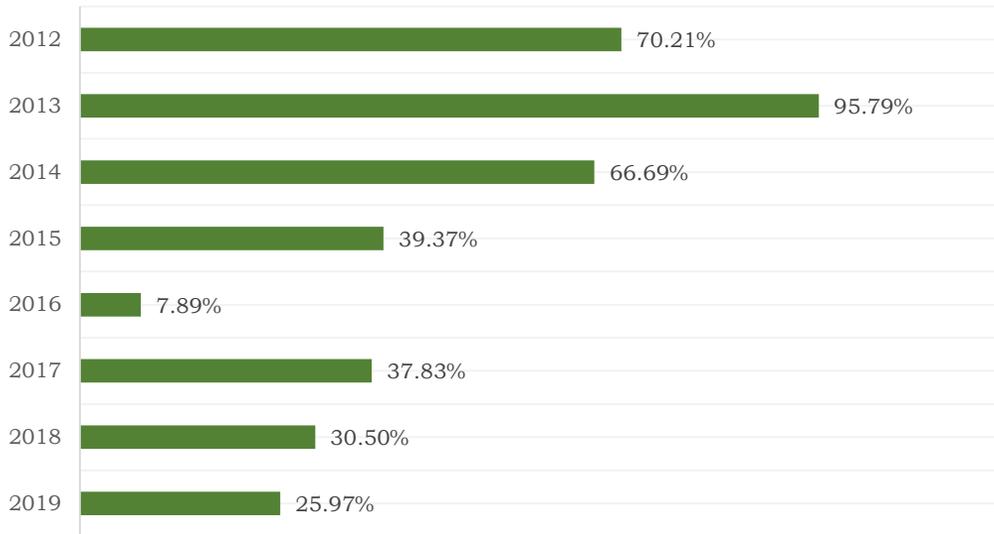
## Key Economic Indicators in Nigeria (1/3)



- Oil price plunge saw little impact on 2020Q1 GDP growth rate partly due to the late lockdown and increased oil volumes during the quarter. We expect 2020Q2 GDP figures to fully reflect the negative impact of the lockdown in late March and the precipitous drop in oil prices. Expected Negative GDP growth in 2020 Q2 & Q3 will confirm the COVID-19 driven recession. Rebound in oil prices should see GDP growth restored in 2020Q4
- Overall, growth shrunk by 1.30% when compared with the preceding quarter (2019Q4), as the share of the non-oil economy declined from 92.68% to 90.50%
- Oil sector recorded a real growth rate of 5.06% (year-on-year) in 2020Q1 indicating an increase of 6.51% points against the corresponding quarter in 2019 but declined by 130 basis points when compared with 2019Q4.
- The non-oil sector grew by 1.55% down from 2.26% and 2.47% in 2019Q4 and 2019Q1 respectively

## Key Economic Indicators in Nigeria (2/3)

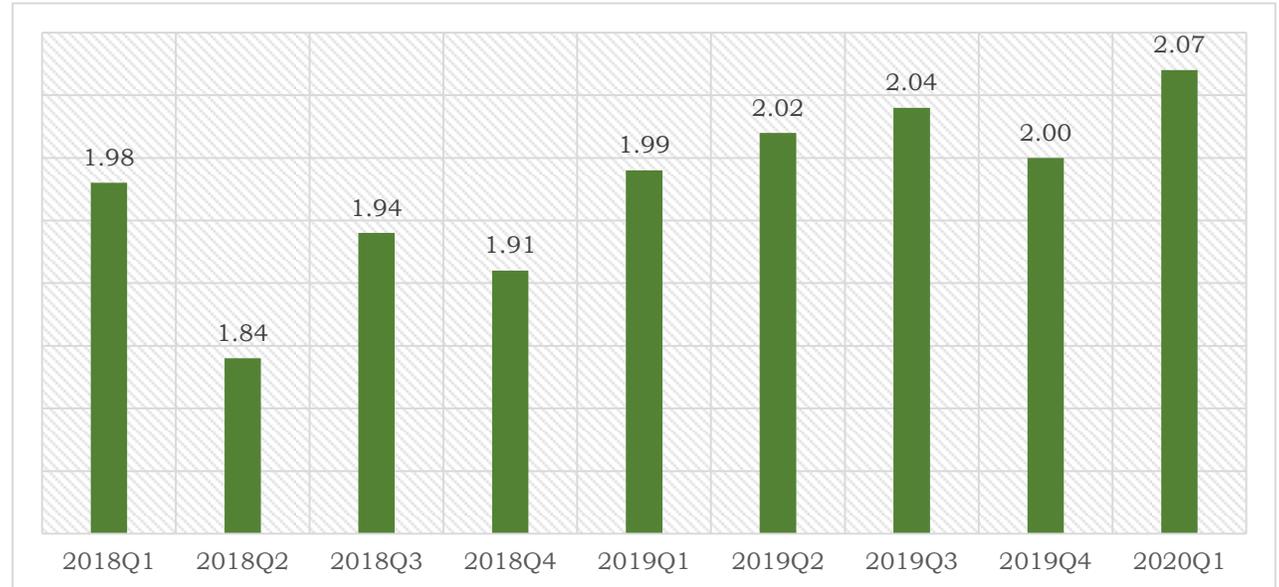
### CapEx to Fiscal Deficit



Source –MoF, CBN, NBS

### Oil Output(mmbbls/d)

Source –NBS

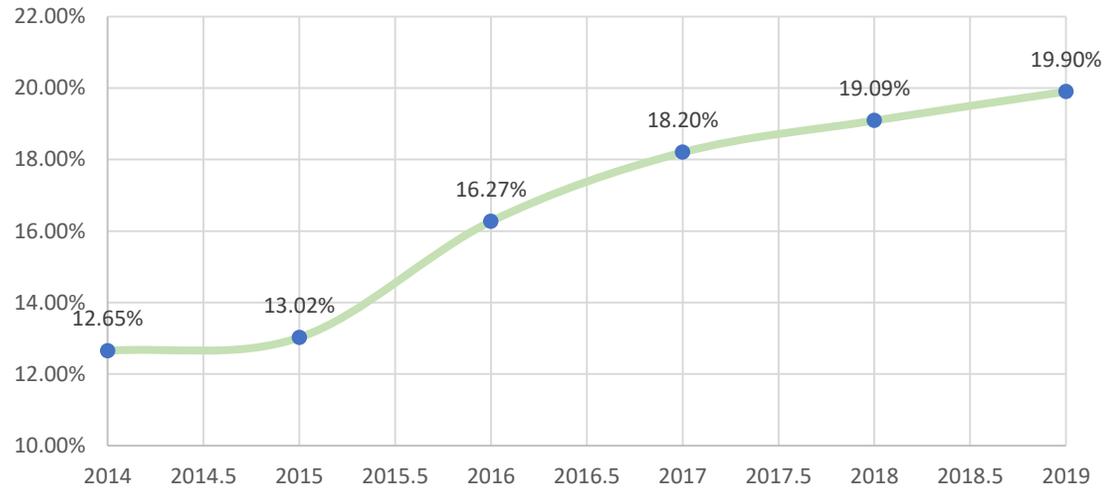


- Oil volumes increased by 0.7 mmbbls/day in 2020Q1 over the last quarter. Production volumes in 2020Q2 may be impacted by supplies curtailment pact between OPEC and Russia. Government has adjusted production from 2.18 mmbbls/d to 1.7 mmbbls/d
- Benchmark oil price already revised downwards to US\$30/bbl from from the initial \$57/bbl
- Non-oil revenue projections not spared from revision. Sale of key assets to shore up flagging public revenue should be considered
- Government fiscal deficit gap expected to rise due to the double-whammy of lower oil production volumes and price
- Unless further structural reforms are embarked upon by the government, CapEx as percentage of Fiscal Deficit may keep reducing . This will expose the country to further shocks and weakens the productive base of the economy

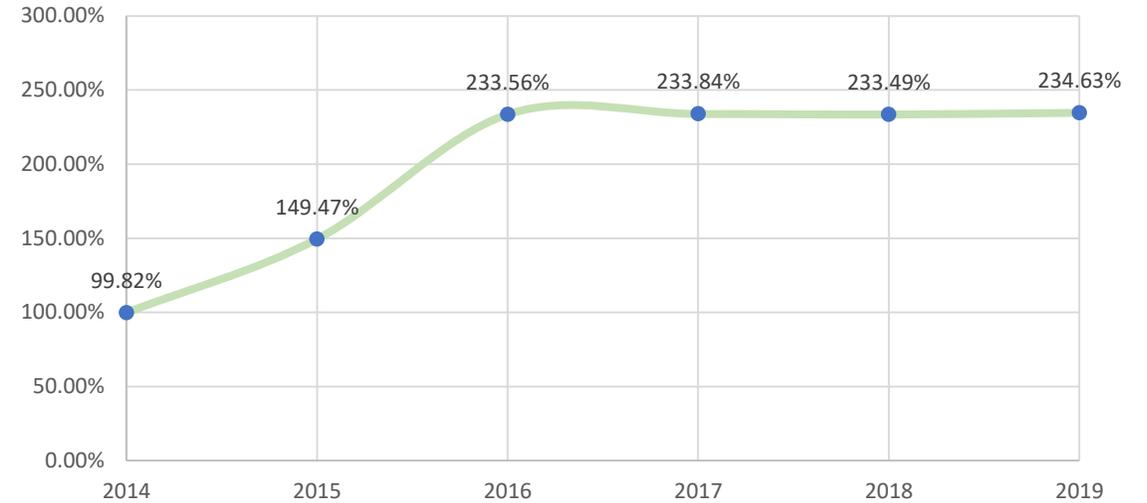
## Key Economic Indicators in Nigeria (3/3)

Source – DMO, NBS and CBN

**Total Debt Stock to GDP**



**Total Debt Stock to Total Revenue**

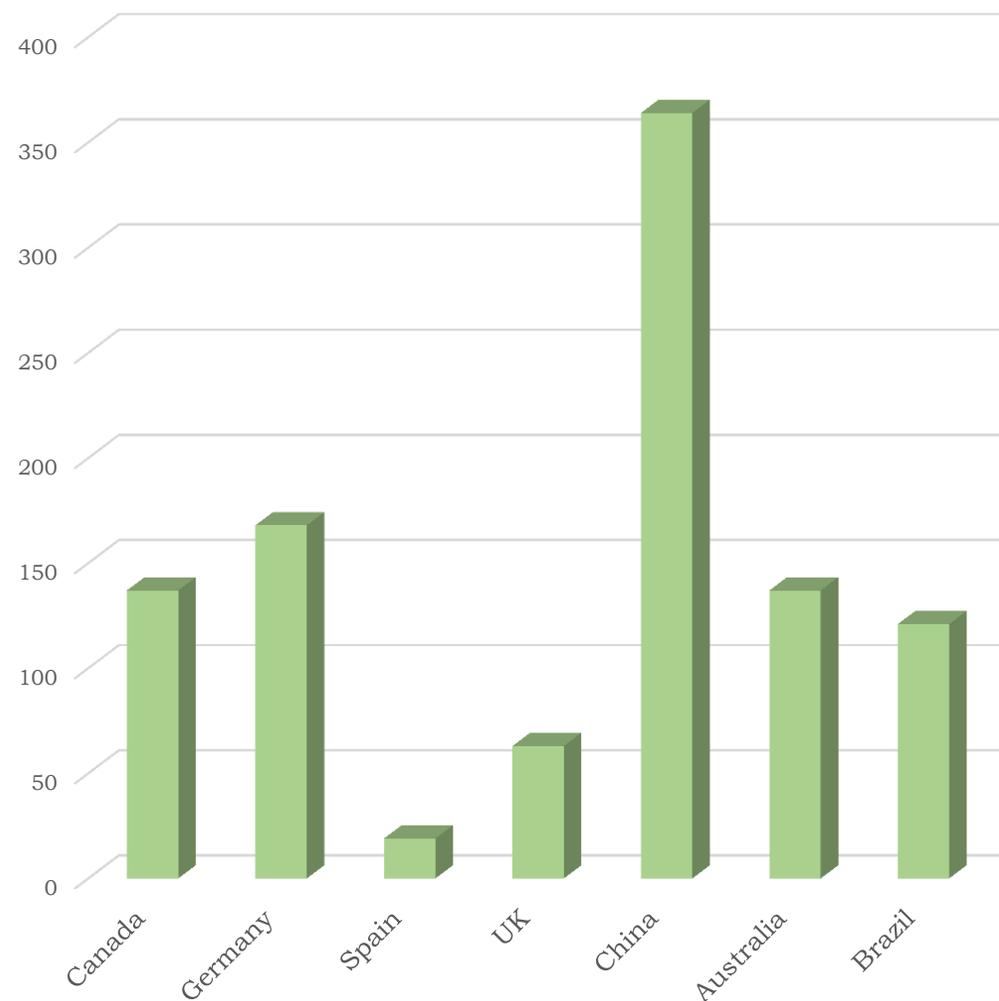


- In spite of the sharp increase in debt to GDP ratio, Nigeria is considered to lie within the threshold of low risk of distress.
- Current macroeconomic environment suggests otherwise as depicted by debt to revenue ratio.
- The decline in global oil prices underscores the Country's vulnerability to revenue shocks
- Offsetting measures such as public sector reform and additional/diversifying revenue sources are necessary reform requirements
- A significant debt profile coupled with low CapEx-to-Deficit ratio will expose the economy to vulnerabilities .

### Federal Government Response

- The Federal Government seeks to cut planned spending in the 2020 budget by about N 1.5 trillion (USD 4 billion), including a 20 percent cut to capital expenditure and a 25 percent cut to recurrent expenditure.
- The Central Bank pledged Post Covid19 N3.5 trillion (USD 9.5 billion) stimulus for key sectors of the economy including 1.1 trillion (USD 3 billion) to boost local manufacturing
- key local pharmaceutical companies will be granted funding facilities for procurement of raw materials and equipment required to boost local drug production;
- N1 trillion in loans to boost local manufacturing and production across critical sectors.
- A 1-year extension of a moratorium on principal repayments for CBN intervention facilities effective March 1, 2020;
- The reduction of the interest rate on intervention loans from 9 percent to 5 percent effective March 1, 2020;
- Strengthening of the Loan to Deposit ratio policy (i.e. stepped up enforcement of directive to extend more credit to the private sector);
- Creation of N50 billion target credit facility for affected households and small and medium enterprises;
- Improving FX supply to the CBN by directing oil companies and oil servicing companies to sell FX to the CBN rather than the Nigerian National Petroleum Corporation;
- Additional N100 billion intervention fund in healthcare loans to pharmaceutical companies and healthcare practitioners intending to expand/build capacity

**Special Intervention by Selected Countries  
(US\$'m)**



### **Risk management capabilities**

- Vulnerabilities will continue to exist in the operating environment and shocks whether global or local will remain a recurring factor. Organisations that have a proactive and structured approach to risk management will always stay ahead of the curve as the next crisis emerges
- Risk management approaches must be seen from an enterprise-wide perspective with capacity to absorb uncertainty, fine-tune key risk indicators and incorporate the lessons learnt from the pandemic into the operating model

### **Supply Chain**

- A shift in business strategy is necessary especially in supply-chain. Reconfiguration of the old supply chain model from offshoring/onshoring to multi-shoring and near-shoring because of risks associated with single sourcing and distance constraints.
- The need for a more flexible and shorter supply chains cannot be emphasized enough stemming from the lessons of the pandemic. The argument for localizing supply chains

### **Long-term view or Through-Cycle Strategy**

- Adoption of a through-cycle mindset that focuses on the long-term after reassessing your competitive advantage while shoring up the balance sheet and capacity in the short term will be decisive in capturing significant value and out-perform peers post-Covid 19.

### **Remote-working**

- The flexibility and other employee value proposition as well as cost optimisation benefits inherent in remote working are value-enhancing options before employers. The notion of sleeping at the office is obsolete.

### **Building digital capacity**

- The transition to contactless operations has gained currency during this crisis. Investment in digital capabilities is critical. Healthcare is a classic case. In the UK, less than 1% of medication consultations in 2019. Under the lockdown, 100% of consultations are occurring remotely
- There is already a big shift to digital and online channels by banks. Online banking rose by 90% during the crisis in the UK. Electronic bills payment in Nigeria rose by 36.6% during the lockdown
- Educational institutions globally have embraced remote learning.
- Car manufacturers in Asia have developed virtual showrooms

### **Corporate Agility**

- Stability and scale should be combined with speed and flexibility. A combination of structural stability, cultural stability and dynamic capabilities or fluidity of changes to strategy in order to respond to fast changing operating environment translates to enterprise agility

## About Tideway Advisory (TAL)

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