



Nigeria Market Update



Policy

The policy environment is being increasingly influenced by the approach of next year's election. In July the Senate amended the constitution, following earlier legislation by the House of Representatives, to enable elections to take place in January with the new Presidential term commencing in May. With the recent changes wrought in the Electoral Commission and the proposed electoral reforms, the administration is attempting to ensure that the forthcoming elections are as free and fair as possible – in contrast to the widely challenged 2007 Presidential elections.

President Goodluck Jonathan has announced his intention to stand, although his candidature is not yet automatic. While his position has been strengthened by recent successes and he has initiated a range of reforms that could boost economic prospects, he will require the endorsement of the ruling People's Democratic Party (PDP). Positioning by potential rivals within the PDP will be intense over the next few months as PDP primaries approach, however it is unlikely that the next incumbent will come from outside the PDP. The balance of its regional and factional forces within the PDP will undoubtedly come into play, although the apparent commitment to alternate the Presidency between representatives of the north and the south may prove less problematic.

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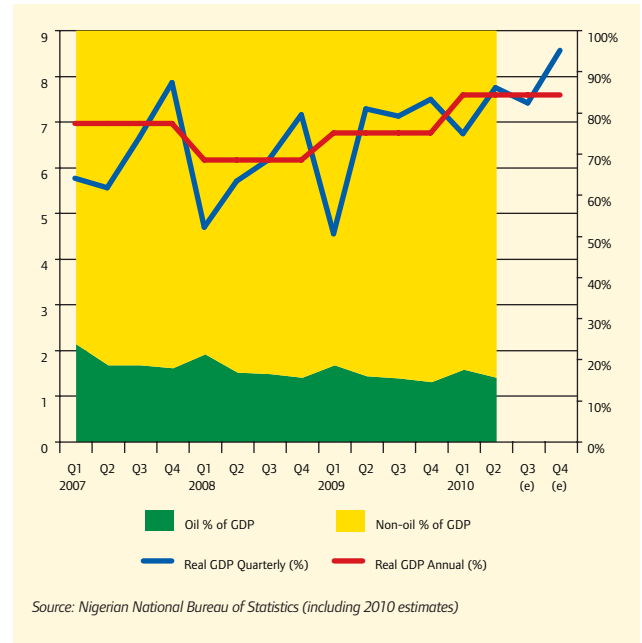


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Since the transfer to civilian rule in 1999 the economy has strengthened significantly, with a sustained growth trajectory largely attributed to the process and extension of democratisation. Notwithstanding the dip in growth recorded in the first quarter of last year, overall real growth in 2009 was robust and, according to recent projections by the CBN, will be exceeded over the course of this year. While in terms of exports the economy, and indeed fiscal performance, is vulnerable to shifts in oil prices the overall economy remains dominated by agriculture. However, increasing urbanisation - three cities have population close to or over 2 million inhabitants, a further three are nearing 1 million residents and another 5 number over 500,000 - indicates that the structure of the economy is likely to undergo further more profound change. In nominal terms, the Nigerian economy is expected to become the largest in sub-Saharan Africa over the course of the next ten years. Government strategy will have to focus increasingly on improving the value-added performance, productivity and labour absorption if this nominal increase is to be translated into real output expansion and sustained GDP per capita growth.

Over the medium-term, the Government intends to bolster growth prospects through the sale of state assets and plans to achieve a sustainable growth rate of 10%, while the establishment of a Sovereign Wealth Fund is intended to manage cyclical flows more effectively. The overall policy thrust will be on infrastructure development and enhancing foreign direct investment. The more market-driven emphasis in strategy is reflected in the proposed abolition of fuel subsidies. Furthermore, the Government has announced that it will end the State's power monopoly and seek to attract private sector investment to expand generation capacity.

Real GDP Growth 2005 -2010





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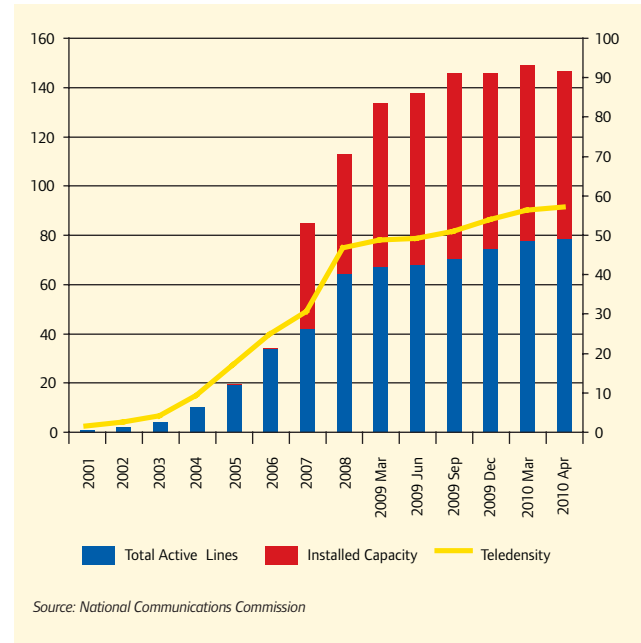
Economics Trends

Real GDP growth achieved in 2009 was 6.7% and for this year official forecasts indicate a return to earlier momentum with growth of 7.8% anticipated. Earlier concerns that the global economic downturn would have a severe impact on 2009 output performance have proved overly pessimistic. However, the export orientation of the economy ensures that current growth prospects are heavily correlated with global performance. Although domestic factors have become increasingly important motors of the economy, with sectors such as telecoms continuing to provide increasingly significant growth.

In the second quarter official data indicates that GDP increased by almost 7.7% compared to 7.5% in the same period last year. As a result output performance for the first half of the year was equal to 7.4% compared with 5.9% in the first half of last year. Growth was again largely the result of the performance of the non-oil sector particularly in the agricultural, wholesale and retail and services sectors. The non-oil sector is equivalent to over 84% of GDP, although the large informal sector ensures that the actual size and dynamism of the economy is significantly understated.

The recent expansion of the telecommunications sector is perhaps indicative of the latent potential of the wider economy if the correct incentives and infrastructure are provided. With the introduction of mobile technology the fixed-line infrastructure that, for a variety of factors, had constrained performance was circumvented. As a result teledensity surged from an extremely limited level at the beginning of the decade to close to 60% by the end. Although growth is no longer exponential, it remains strong with still considerable upside potential. Indeed the expansion of the sector should have beneficial consequences for the wider economy, with a higher communications level offering opportunities for greater efficiency. Furthermore, the already installed capacity allows for future growth while comparisons with both other emerging markets and industrialised economies indicate that further infrastructure expansion can also be sustained (in Britain teledensity reached 120% in 2006). upswing in consumer demand. Agriculture continues to provide the bulk of GDP, over 42% in 2008, and although susceptible to short-term weather fluctuations real growth was 6% in the third quarter, a level sustained in the first and second quarters and consistent with the agricultural growth achieved in over the course of 2008 (6.3%).

Telecommunication Sector Growth (2001-2010)



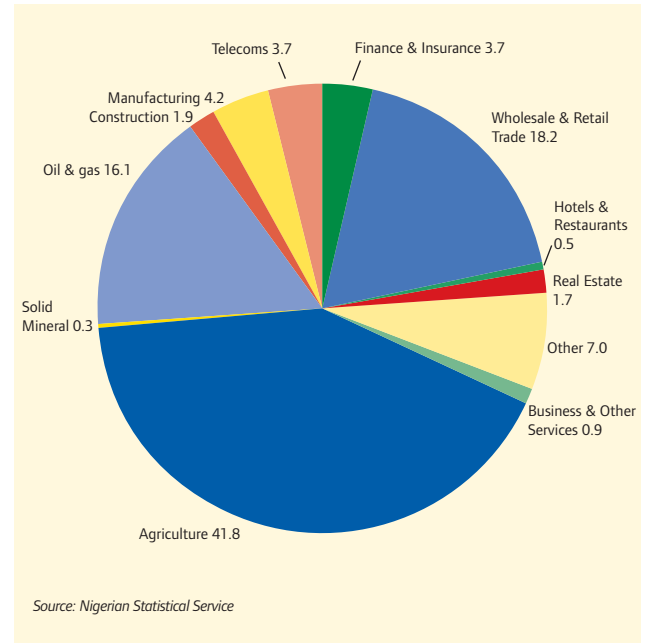


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Overall the service sector provides almost 35% of GDP, of which the wholesale and retail trade is the largest component. Telecommunications, finance, real estate and business services remain comparatively underdeveloped as a proportion of GDP. Nevertheless their evident vibrancy is recorded in the growth rates sustained in the second quarter of this year. Real estate, business services, wholesale and the hotel sectors grew at an annual rate of 10%, 11%, 11% and 12% respectively. Although finance sector growth was more subdued at 4%, attributed to the continuing problems in banking; the strongest performer was again telecommunication with second quarter growth of 34%. Agricultural performance growth was 6% in the same quarter, similar to the corresponding period last year and indeed the year as a whole. Vibrant rates were recorded in manufacturing and construction, 7% and 12% respectively. However, inadequate and unreliable power supplies continue to place heavy constraints on actual economic potential. In the first quarter electricity consumption, as supplied by the PHCN, fell a further 16% from the preceding quarter to 1968 mw/h and industrial output was only maintained through extensive recourse to expensive private stand-alone micro-generators. As a result privatisation of the electricity sector has now moved rapidly to the forefront of the political agenda at the direction of the President.

Second quarter oil sector performance strengthened to 4%, compared to 3% in the previous quarter, building a recovery from last year's much weaker performance – in the first quarter of 2009 the oil sector contracted by over 8%. While Nigeria is often characterised as an oil economy the actual contribution in 2009 was 16% of GDP, a significant decline from 2000 when nearly a third of GDP originated from the oil sector. This reflects less the strength of the non-oil sectors (boosting their proportionate contribution) and more the deterioration of oil production itself which fell from 2.13 mbpd in 2000 to a low of 1.69 mbpd in July last year. Lack of investment in production facilities and actual interruption to and especially theft of output due to political instability in the Delta region contributed to the erosion of oil sector performance. However, with potential proven oil reserves close 40 billion barrels and gas reserves of 5.22 trillion cubic metres the oil and gas sector could, and should, ultimately provide a more substantial contribution.

Sectoral Structure of the Economy (2010 %)





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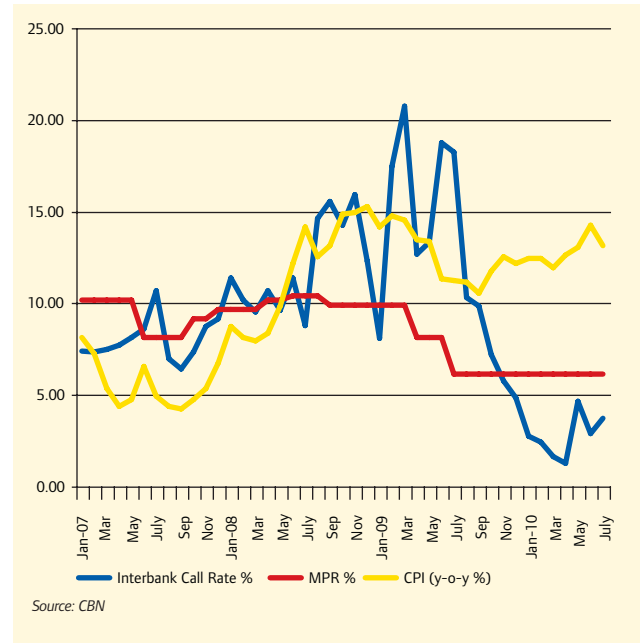
Inflation, Monetary and Foreign Exchange Rate Policy

External prices for grain have surged recently due to fears regarding supply, given adverse climatic conditions in the main producing regions, and the imposition of the wheat export embargo by the Russian authorities. Despite Nigeria's limited food dependency, the global position will add to an already tight regional supply situation as a result of the severe drought conditions in Sahel countries to the north. Much will depend on the how favourable the domestic harvest is. The weighting of food products in the CPI basket (over 50%) ensures that the period of relative price stability achieved since May last year may be coming to an end. Since 2007 inflationary pressures have been compressed by the fact that energy prices have moved in countervailing cycles to agricultural prices. However from the beginning of this year the three main CPI component indices food, non-food and non-food & non-energy have all been firming and moving with increasing synchronicity.

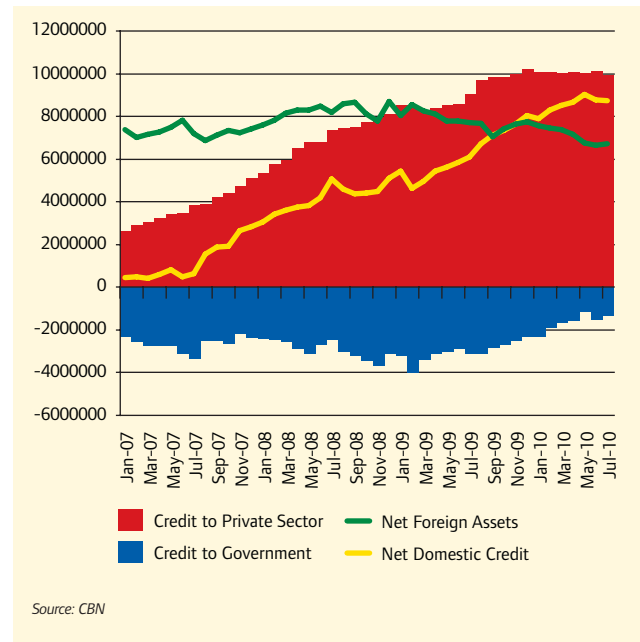
In July, the CPI rose 13.0% year-on-year, easing from the 14.1% recorded in the previous month, although the month-on-month change was an increase of 1.1%. Average monthly food-related expenditure increased 1.5% in July over the previous month with an annual average of 14.5%. The was seen as a result of firming prices for staples such as yam, potatoes, meat, fish, cooking oil, fruits and fresh tomatoes. Excluding farm products, the CPI rose on a month-on-month basis 0.3%, which was attributed to increases in pharmaceutical and household products. Over the 12-months to July 2010 the non-food index average was 11.2%.

Despite the firmness of price pressures, the authorities have continued to pursue an accommodative monetary policy holding the key policy rate at 6% through the first eight months of the year. While this has contributed to a general easing of commercial deposit and lending rates, it has done little to stimulate credit market conditions. Notwithstanding the additional impact of the 2009 fiscal injection, aggregate bank credit increased by only 6.1% in the first quarter in contrast to a rate of 13.1% in the same period of 2009. This however was largely the result of claims of the Government as claims on the private sector actually declined.

Inflation & Interest rate developments 2007-2010



Net Credit Growth (2007-2010)





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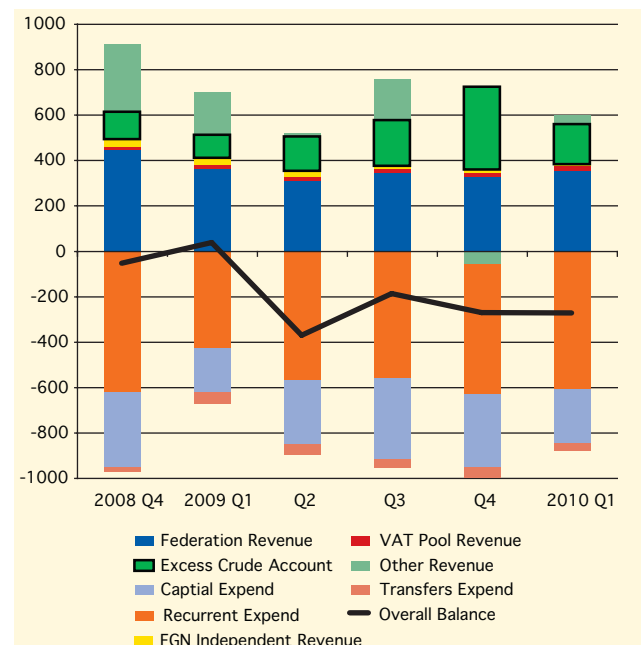
CBN activity seems to have been effective in stabilising the Naira (NGN) at a trading range of 149-151 against the US\$. As part of this process the CBN has banned sales into the inter-bank market of US\$ bought from the CBN in the twice-weekly Wholesale Dutch Auctions (WDAS), while at the same time boosting WDAS availability of US\$ from US\$ 200 million at each auction at the beginning of July to an average of over US\$ 400 million in August.

Fiscal Policy

The latest available data for the first quarter of this year indicates that there was a shortfall of revenues by over a fifth on budget projections. Total revenue collected for the period amounted to NGN 1,652 billion, although this was up 14% on the last quarter of 2009. Gross oil receipts which provide three-quarters of total revenue were down a fifth on expected budget receipts, although 23% up on the preceding quarter. The weaker than forecast revenue performance was due falling petroleum profit tax and royalties. The non-oil revenue harvest, equal to a quarter of the total, was also lower than budget projections by 26% but also lower than receipts achieved in the previous quarter by 7%. This was due to a range of specific tax yields falling short of projections on customs and excise duties, corporate tax and others. As a proportion of the overall economy revenue was equivalent to almost a quarter of GDP, with oil revenues equal 18% of GDP and non-oil revenue equal to 6.3% of GDP.

Similarly, total expenditure in the first quarter was down by 24% on projections and almost 7% down on the preceding quarter. The lower spend was in part due to delays in legislative approval of the 2010 budget which consequently resulted in delays to capital expenditure and transfers. For the year as a whole capital expenditure is projected to comprise 40% of total Federal expenditure the bulk of which is allocated to capital infrastructure projects, some 42% and significantly 7% is allocated to capital expenditure in the Niger Delta. Almost 60% of the budget structure effectively comprises recurrent expenditure, of which 11% is allocated for debt service. As a proportion of projected Q1 nominal GDP, recurrent expenditure was 9.4% while capital expenditure and transfers were equivalent to 4% and less than 1% respectively.

Quarterly Budget Outturn (2008 Q4 – 2010 Q1)



Source: CBN



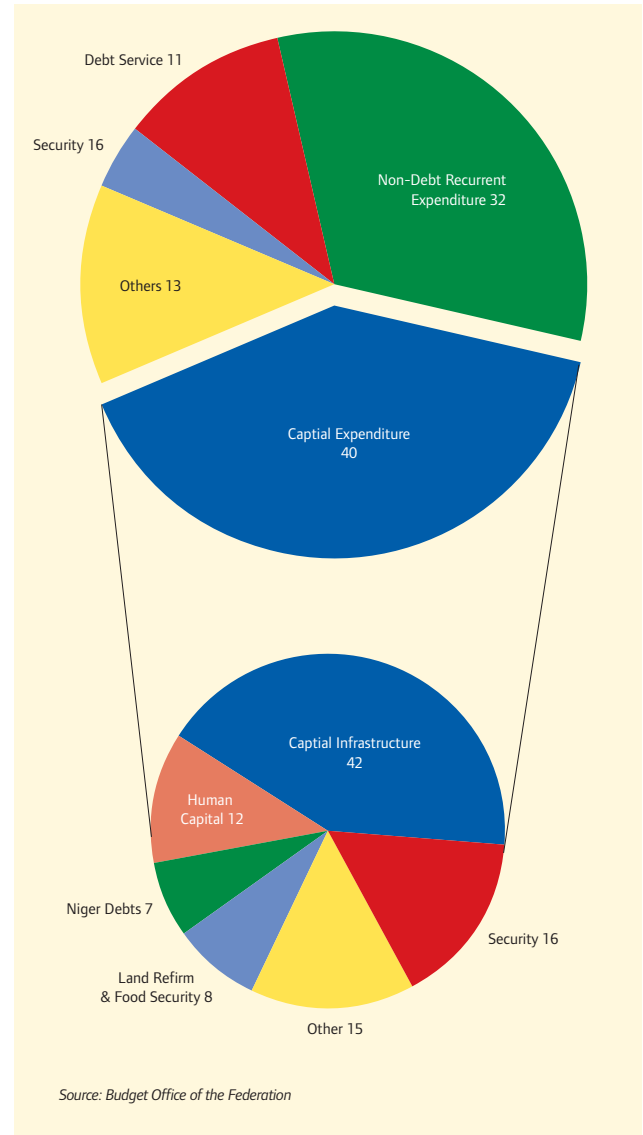
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Overall the budget deficit is forecast to be the equivalent to NGN 1.9 trillion (US\$ 12.6 billion) this year (6% of GDP). The fiscal deficit was estimated to be equivalent to 4.3% of GDP in the first quarter, compared to an estimated 4.1% in the last quarter of 2009. The deficit remains manageable compares favourably with contemporary fiscal deficits elsewhere in the world and was financed largely through domestic issues. The revival of oil prices, which are now trading above US 70 pb, gives some additional comfort as the 2010 budget was based on an average oil price of US\$ 60 pb for the year, although actual levels of sustained production are equally as important.

Exhibiting some considerable determination, given the forthcoming election, the authorities have announced their intention to end fuel subsidies possibly within the next six months. Last year the programme of fuel subsidies costs some NGN 1 trillion (US\$6.6 billion), and a forecast NGN 520 billion (US\$ 3.4 billion) this year. The deterioration of refinery capacity, despite the abundance of crude oil, ensures that Nigeria continues to import refined product to meet most of its domestic demand (almost 80%). The abolition of the subsidy would increase gasoline prices to NGN 115 to 120 a litre from NGN 64 currently. The Government, through the Nigerian Petroleum Corporation guarantees regulated fuel prices by paying importers the difference with market prices - delays in these payments were cited as a factor in destabilising bank balance-sheets last year. The Government aims to offset the social impact of the removal of subsidies by investing in a mass transit system. From the capital budget NGN 10 billion has been allocated to improve public transportation and a number of buses have already been ordered. The Government is also in talks with labour unions to gain their support and avoid social unrest.

As part of its strategy of improving fiscal management and performance, the Finance Ministry has announced the establishment of a Sovereign Wealth Fund (SWF) this October with an investment programme to be focussed on domestic infrastructure. Recent assessment of legal and investment advisers has commenced and formal appointments are expected imminently. The SWF will replace the Excess Crude Oil Account which the Government has often resorted to for financing recurrent expenditure. It is proposed that part of the SWF, provided oil prices do not fall below a specific level, will be protected for subvention by the Government and utilised to fund PPP-style projects with the

2010 Budget Expenditure Structure (%)





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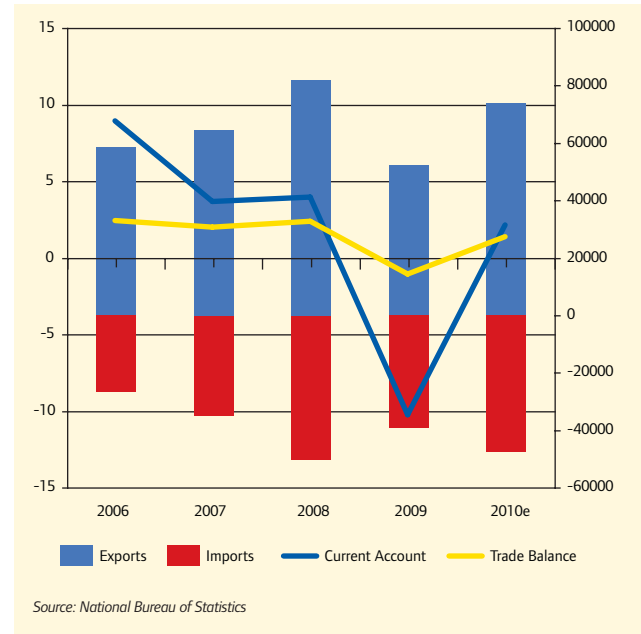
private investors in the construction of roads, railways and ports. It is estimated that the Excess Crude account currently has between US\$ 500 million and US\$ 800 million (compared to US\$ 20 billion in 2007), and should rise to about US\$ 1 billion by the year-end, when it will be transferred to the new SWF. A further component of the SWF will be a stabilisation fund, performing a similar role to the Excess Crude Account but with a more restrictive remit.

External Sector

Nigeria is ranked 100th out of 155 economies in the World Bank's 2010 survey of logistics performance, reflecting the low integration of its manufacturing sector with the regional and global economy. Despite the commitment of infrastructure investment domestic transportation costs are amongst the highest globally undermining the competitiveness of enterprises and constraining incentives for value-added production. Road transportation is the major mode for transporting goods both within the country and to the wider region, but as most domestic fuel requirements have to be imported the potential economic gains of being a major crude oil producer are lost. The proposed cessation of fuel subsidies could further weaken transport performance unless other measures are introduced to secure access to competitive supplies of oil product. A further factor, reported by the World Bank, limiting the development of an effective transport system are the costs of bribes which truck owners and drivers allege they have to pay to negotiate numerous official and semi-official checkpoints. Insurance costs are also high.

Similarly the preponderance of primary products, particularly oil, ensures that there is no significant linkage between trade and employment or labour absorption, in contrast to a number of other global economies. The trading in largely uncompetitive primary products has led to overdependence on oil exports and contraction and reduced diversity of the productive base of the economy. Expanding the value-added component of trade, and indeed domestic production, will require concerted Government action and the attraction of both domestic and foreign direct investment.

External Sector performance 2006-2010 (NGN million)



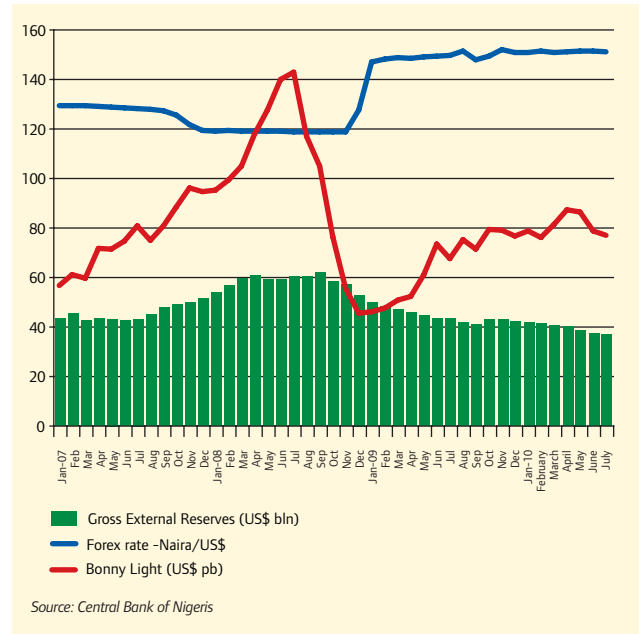


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External sector performance is set to improve this year following last year's more difficult conditions with the current account, on the balance of payments, set to return a strong surplus. Import demand is however reviving robustly. Oil exports improved to 1.76 mbpd by the end of June, recovering substantially from the nadir of July last year when oil exports fell to the equivalent of 1.24 mbpd. Oil continues to comprise almost 80% of overall exports although the performance of other primary products is firming. In terms of cocoa production, for instance, Nigeria is the continent's third-largest producer with the forthcoming harvest expected to increase by 10% this season. Output is set to reach 335,000 metric tonnes as trees planted between 2005 and 2007 become productive, while agricultural outreach programmes initiated under the previous administration have resulted in better husbandry practices. Nigeria is the fourth largest cocoa producer globally, and cocoa exports are the second-biggest foreign exchange earner.

Gross external reserves eased to US\$ 37 billion at the end of July, which represents a fall of close to US\$ 3 billion from the end of the first quarter and almost US\$ 6 billion from the close of 2009. According to the CBN the reserves breakdown was almost 80% CBN holding and 10% Federal Government holding, with the remaining 10% comprising the Excess Crude Account. This contributed to a similar deterioration in the current account balance which also moved into deficit, equivalent to 2% of GDP, in contrast to the large surpluses recorded in the first and second half of 2009, 25% and 12% of GDP respectively. This has caused some considerable rundown in reserves which have fallen over US\$ 20 bn since their peak in the third quarter last year, now standing at the equivalent of US\$ 43 bn.

Gross External Reserve performance 2007-2010





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Banks

Despite the scale and depth of CBN intervention, the actual cost in terms of the Federal budget has so far been limited. Furthermore, no banking institution has failed although credit growth has been poor. The scale of losses have, however, been considerable with declared losses of the banks taken into what can effectively be termed conservatorship equal to two-thirds of total capital in the banking sector. It is now becoming more apparent, despite initial concerns, as to the type of banking structure that the authorities now envisage as appropriate to meet the credit demands of an increasingly dynamic economy. The past structure is seen as one which placed a brake on achieving the economy's real potential and the CBN-driven reforms can be seen as an attempt to correct this.

The enactment of the Asset Management Bill legislation; proposals regarding bank's corporate governance and structure; and the prudential policy guidelines articulate the direction the authorities are taking reform. When AMCOM becomes fully operational credit conditions are expected to revive as its purchase of a range of non-performing loans (NPLs) will enable the banks to restore credibility to their balance-sheets and reduce the existing severe provisioning burden. As a result, NPL levels should ease over the course of the next year and allow banks to take a more assertive stance in credit markets. The availability, via the Bank of Industry, of the NGN 500 billion funding from the CBN, to refinance SME and infrastructure loans will also improve credit conditions. Deposit growth is recovering after falling to a low of 6% year-on-year growth last September; by April deposit growth was 24% year-on-year although for the year overall deposits increased 3% while total credit to the private sector has fallen 1%.

However, despite the accommodative monetary policy, negative real interest rates and the surplus bank liquidity current market conditions are largely determined by the extremely cautious risk-taking policies of the banks. This ensures that only the better quality corporates and, in particular, Government borrowings are acceptable with competition for such assets contributing to some spread compression and the absence by the banks of any appetite for riskier quality assets. Bank and market sentiment is also likely to be dampened by the political factors. The accumulated liquidity held by the banks poses risks the authorities need to address, as the current interest rate environment ensures that stocks are more attractive opportunities for investment by banks – potentially reflating the equity bubble that ultimately destabilised the banking sector last year.



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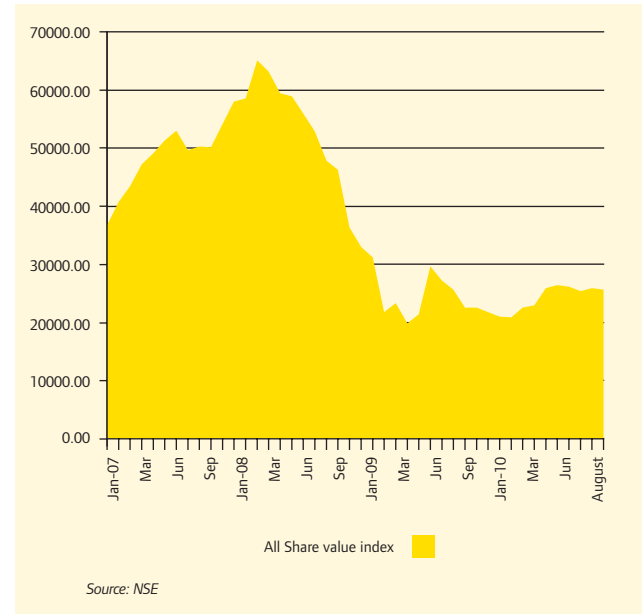
Capital Markets

The Government's revived market-orientated approach is evident in ambitious plans to de-mutualise the Nigerian Stock Exchange. Although the actual process may be more extended than policy-makers envisage it promises to replicate the success of similar reform processes in other Emerging Markets. This is not to understate the fragility of recent equity performance still adjusting to last year's crash when stocks fell over 70% from their peak and accusations of endemic insider trading, widespread price manipulation and outright fraud persist. The proposed reforms do however offer a solution, and one that has been proven to work for exchanges beset by comparable problems.

As part of the de-mutualisation reforms the involvement of foreign investors is seen as key, as is the development of a more comprehensive range of facilities including Islamic products, IPOs, corporate bonds and exchange-traded funds. A major shake-up of management is also being undertaken and the candidate who emerges as the new CEO is seen as indicative of how extensive the reforms will be. The Government has stated that the broadening and deepening of the corporate bond market is crucial to increasing the dynamism of the economy, with new tax laws boosting the attractiveness of debt instruments for investors. It is anticipated that the first in a new wave of IPOs will include listings from the energy and telecommunications sectors. Additionally, the Government is intending to sell NGN 200 billion (US\$1.33 billion) worth of bonds to help revive the country's automobile industry with potential beneficiaries including the local production operations of Volkswagen, Mercedes Benz and Fiat.

Progress has also been made regarding the issue of the Republic's first global bond, which is expected to be placed as early as October and raise US\$ 500 million. Given the dearth of comparable regional paper, investor appetite is expected to be firm and could allow the issue size to be substantially increased. The bond will establish a market benchmark, complementing the wider reform of the capital markets framework. Domestic bond prices corrected in August with the yield curve steepening toward the longer end, however this was short-lived as official fund injections prompted a rally. Liquidity conditions are raising concern about supply shortfalls and could lead to more enhanced issuance of t-bills for the remainder of the year. Initial budget assumptions targeted a deficit of more than 5% of GDP and

Nigerian Stock Market Developments 2007-2010



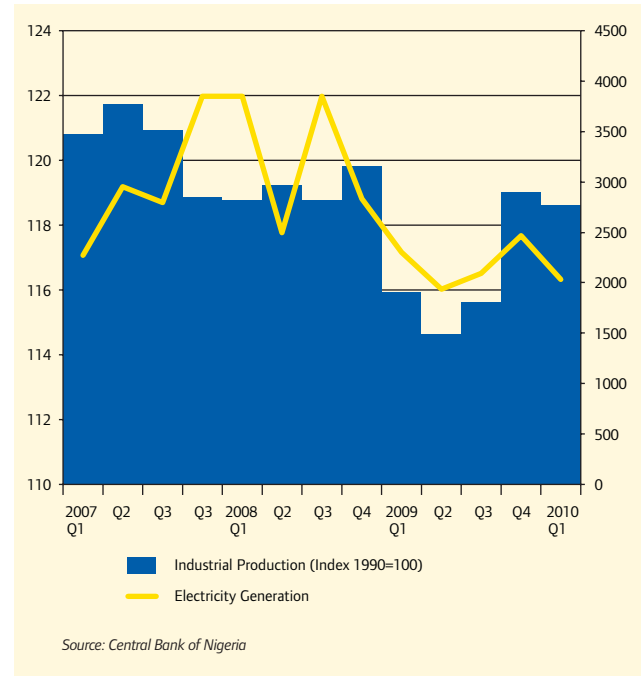


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a sharp rise in domestic borrowing targeted at NGN 897bn. Revised assumptions (notably for the benchmark oil price which was revised to USD 60/barrel for targeted production of 2.25mbd from USD 67/barrel and production of 2.35mbd), if accepted, are likely to negatively affect the monthly statutory allocations from the FAAC, which currently provide a boost to the bond market.

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Power generation & Industrial performance



Power Generation

The President has announced that abolition of the state-monopoly in power generation and the creation of 11 distribution companies to be privatised through sale to domestic and foreign private investors. The impetus for the comparatively radical reform stems from another failure to meet Government targets to boost generation to 6000 mw/h by the end of 2009 - itself a much circumscribed target after previous failures. Foreign direct investment is seen as essential if new power capacity is to be installed and the abundant natural energy resources effectively harnessed. Although previous efforts by the Government have seen considerable resources committed and resulted in significant installed potential capacity, liberalisation is seen as the key to revitalising the sector.



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Generation of 2,000 mw/h was achieved in the first quarter of this year and the authorities are now proposing to achieve close to 14,000 mw/h by 2013. If realised, domestic demand for gas will increase from the current level of 800 mcf per day to 3 bcf per day by 2015. The Government plans to attract the equivalent of US\$ 10 billion of investment as a result of the new strategy. The privatisation plans have drawn interest from Asian, European and American potential investors, however the election and the actual complexity of installing an adequate power generation and distribution network may challenge sentiment. Vested interests may also prove problematic, not least the staff and management of the National Power Holding Company, the state monopoly, which is to be dissolved. Price deregulation and the ability to set new tariffs will be critical to ensuring the commercial viability of the privatisation projects. Transmission will remain under state control but outsourced to private sector management.

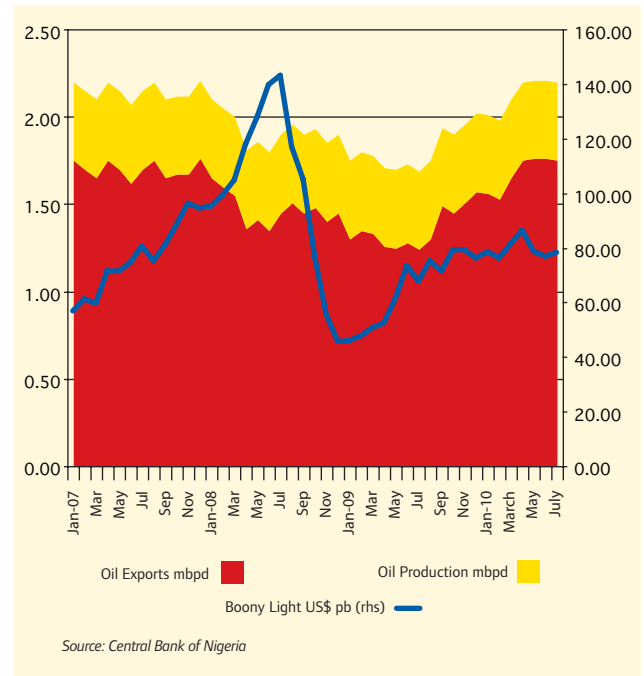
Restoring power generation and providing a sustainable basis for future expansion, is seen as essential by the Government if its plans to take the economy to a new growth trajectory are to be successful. Almost all commentators regard the deficiencies in the electricity sector a one of the major constraints on growth, with Nigeria having one of the lowest per capita power generation ratios in the world.

Hydrocarbons

Crude oil production, including condensates and natural gas liquids, was estimated to have averaged 1.99 mbpd during the first quarter. This compares to an average of 1.94 mbpd during the final quarter of last year, an increase of almost 3%. This was largely due to the impact of the peace agreement in the Niger Delta, although this remains precarious. At an estimated US\$ 79 pb for the first three months of the year prices have remained comparatively stable recently.

Assessment of the environmental impact of oil sector is bedevilled by political, historical and ethnic factors. The recent assessment by the United Nations Environmental Programme (UNEP) of the damage caused by oil spills has generated much controversy, and indeed was halted in some areas as a result of intense local opposition. The fact that funding for the study was provided by Shell has done little to assuage concerns regarding its objectivity and

Oil Sector Dynamics 2007 – 2009





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independence. The final report is due to be published in January but early reports suggest that Shell will be largely exonerated, with the UNEP expected to announce that 90% of the oil spills in Ogoniland are caused by the locals stealing crude from pipelines and that Shell's infrastructure accounts for a mere 10% of the spills. This contradicts earlier research undertaken for the UNEP by environmental experts and the fact that UNEP analysis is largely based on data derived from industry and Government sources has undermined credibility to some extent. The National Oil Spill Detection and Response Agency of Nigeria has reported a total of 3,203 oil spills in the Niger Delta region in the last four years alone. The records of the Nigerian Directorate of Petroleum Resources show that nearly 2.5m barrels of crude oil were spilled between 1976 and 1996, including the Escravos spill of 1978 in which 300,000 barrels of crude oil was spilled into the coastal waters and another, in the same year, caused by tank failure at Forcados Terminal in which 580,000 barrels were discharged.

The much delayed centrepiece of the Government's reform programme, the Petroleum Bill, is expected to secure legislative approval. It is hard to understate the potential impact of oil sector reform, although the proposals are not without controversy. The bill is designed to transform the sector which has suffered from gross under investment, contributing to falling output and productivity. The bill is intended to complement the political reconciliation process in Niger Delta, which has already enabled some restoration of output as a result of last year's peace accords despite its fragility. The aim is to restore potential output capacity to 4 mbpd from current output of near 2 mbpd. As part of the restructuring, the Nigeria National Petroleum Corporation (NNPC) will be divided into more coherent commercially focussed entities able to raise corporate paper. In the past, the NNPC has found it difficult to fund its own share of costs in joint ventures and a restructured corporation will be expected to meet future spending commitments from its own earnings and its capacity to tap global capital markets. Royalty payments and taxes, especially for deep water fields, are expected to increase substantially which has drawn criticism for the international oil majors, who have indicated that the complexity of the proposed structure and the increased costs could delay as much as US\$ 40 billion of investment in new deepwater fields. In particular the oil majors are concerned that the authorities want to increase production sharing agreements from 45% at present to 75%, although this is closer to comparable national producers.

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