23rd December 2015

DRUM COMMODITIES LIMITED

COMMODITY TRENDS IN AFRICA – DR EDWARD GEORGE, ECOBANK

EXECUTIVE SUMMARY

1. BACKGROUND

1.1 On 17th December 2015, Dr Edward George, Head of Group Research at Ecobank, visited Drum Commodities Limited, and provided DCL staff with an insight into the current outlook for commodities in Africa. He separated his presentation into three separate areas:

1.1.1 The outlook for global commodities.

1.1.2 Soft commodities in Sub Saharan Africa (SSA).

1.1.3 The challenge of financing the commodity value chain in SSA.

2. OUTLOOK FOR GLOBAL COMMODITIES

2.1 Dr George highlighted the impact that US monetary policy has had on global commodity prices. In particular, he pointed to speculation surrounding the Federal Reserve's decision to increase interest rates, and its eventual decision to do so on 16th December 2015.

2.2 Dr George felt that although growth in the Chinese economy has slowed, it will still be an incredibly important driver of the global commodity market over the coming years as it is still growing as an economy. It is currently growing at about half the rate that it did during the 2000s.

2.3 Oil prices are likely to remain low for the foreseeable future. Saudi Arabia will flood the market in order to counter the upcoming entrance of Iranian oil to world supply. Furthermore, the low extraction costs coupled with technical advances in the techniques of American shale oil means that it is better placed to respond quickly to oil price shocks.

2.4 Dr George pointed out that commodity prices have been falling in real terms since the early 1900s, excluding spikes caused by World War One, World War 2, the 1973 oil crisis, and the Chinese development boom.

2.5 He felt that a new spike could happen if India emerges as the 'new China'. He highlighted India's surging population, and the fact that it is taking over China's market share on oil imports. However, he pointed out that India's growth is well below China's during the 'boom years' of the 2000s.

2.6 Key Takeaways:

2.6.1 US monetary tightening is likely to squeeze global commodity prices. In particular, strengthening of the US dollar will have a significant impact, driving down commodity prices and increasing borrowing costs.

2.6.2 The impact of China's slowdown could be lessened if Indian demand for commodities increases significantly, as is likely.

2.6.3 Weak oil is the 'new normal'. Plentiful supply is likely to keep prices low. However, as demand responds to low prices and the global economy continues its recovery, it is possible there could be a rally.

United Kingdom: Drum Commodities Limited, Vallis House, 57 Vallis Road, Frome, Somerset BA11 3EG ☎ +44 (0) 1373 453 970
South Africa: Drum Commodities Limited, Office 308 Cowey Office Park, 91-123 Cowey Road, Durban 4001 ☎ +27 (0) 31 208 8812

Incorporated in England: Company Registration No. 4524501 | www.drumcommodities.com | info@drumcommodities.com

2.6.4 If there is a rebound in commodity prices, it is likely to be weak and slow. Political instability in oil producing areas and the impact of El Niño could mean that price volatility becomes more prominent in the coming years.

3. SOFT COMMODITIES IN SSA

3.1 Cocoa.

3.1.1 Ivory Coast continues to dominate, making up 38% of global production. Ghana's crop slumped by 23% last year. However, Ghana is likely to rebound from this, and there is unlikely to be a severe downturn in African cocoa production in the future.

3.1.2 Fluctuating weather patterns caused by El Niño could have an impact, but previous experience suggests that it will most likely mean production remains constant.

3.2 Coffee.

3.2.1 Africa is responsible for 12.8% of global coffee production. Kenya and Ethiopia make up half of this.

3.2.2 Kenya and Tanzania are currently focusing on exporting to developed markets, whilst Ethiopia, Uganda and Ivory Coast are currently looking to export to emerging markets.

3.3 Sugar.

3.3.1 Africa only makes up 4% of global sugar output. 80% currently goes to the EU, and this could be affected by the end of duty free access to the EU from 2017.

3.3.2 Africa is a net importer of sugar, with 71% coming from Brazil. Nigeria is the continent's principle sugar importer, although it has switched its focus in recent years from importing refined sugar, to importing unrefined sugar. In 2000 90% of the sugar it imported was refined, with this dropping to 3.3% in 2012.

3.4 Maize and Rice.

3.4.1 Africa is currently importing huge amounts of grain. Nigeria imports most of its grain from the USA, and was badly affected by the North American drought in 2012.

3.4.2 Nigeria is currently trying to target its rice deficit and develop paddies. Unfortunately, it brought in tariffs on rice imports before domestic production was ready for demand, and there is now a thriving illicit rice smuggling trade on the Benin and Niger borders.

3.5 Palm Oil.

3.5.1 Nigeria is currently the dominant African producer, with market share at around 60%. However, Ivory Coast is catching up in market share. Increase in household income and low prices are currently driving a surge in demand across Africa.

3.6 Dr George highlighted the problem with low yields in Africa currently. 40% of commodities are currently lost to wastage, and this is holding the market back. This is contributing towards the food deficit, which is being driven by a rapidly growing urban population.

3.7 Key Takeaways:

3.7.1 SSA is an extremely diverse producer of soft commodities. The region currently produces a wide array of food and cash crops, both for export and regional consumption. In addition to this, new cash crops such as horticultural goods and speciality coffee are becoming increasingly prominent.

3.7.2 Yields remain low due to low use of inputs. This is particularly frustrating due to the fact that Africa could easily feed itself if wastage was reduced. Much of this comes from the lack of available financing in the agricultural sector.

3.7.3 The food deficit in SSA is growing at an alarming rate. The region is becoming increasingly reliant on imports for wheat, rice and palm oil, and this problem is likely to become worse as urban populations continue to grow.

3.7.4 Value addition is still too low. Most of SSA's soft commodities are exported raw or semi-processed, meaning that their full value is not captured.

4. CHALLENGE OF FINANCING THE COMMODITY VALUE CHAIN IN SSA

4.1 Dr George highlighted the problem of the US$120 billion trade finance gap in Africa.

4.2 In particular, he made it clear that there is a need to provide more opportunities for pre-export finance. He felt that provided the right structure is in place, it can provide far greater levels of trade finance. He used the example of Cocobod in Ghana and Sonangol in Angola to illustrate this.

4.3 Dr George highlighted a number of recent trends that are radically altering the ways in which trade financing is carried out.

4.4 Fund raising: the shadow banking system

4.4.1 Trading houses are increasingly offering a range of services usually associated with banks.

4.5 Fund raising: cooperation between African banks

4.5.1 An example of this would be the Orion Oil deal in Congo-Brazzaville, where Afreximbank, Bank Atlantique Group, BGFI Bank Group and Ecobank Group all collaborated in order to provide trade finance.

4.6 Fintech & supply chain financing

4.6.1 Financial technology (Fintech) companies are increasingly looking to provide supply chain finance. They are often more nimble and flexible than banks in their provision of finance, and offer a less bureaucratic programme for corporates to implement.

4.7 Pre-export finance using Banker's Acceptance

4.7.1 Involves far more oversight along the supply chain, normally with the involvement of both a Monitor and a Collateral Manager.

4.8 Fertiliser financing

4.8.1 The Mars Foundation is currently providing financing for fertiliser for Ivorian cocoa farmers. This is having a positive impact upon yields.

4.9 Key Takeaways:

4.9.1 Financing continues to be undermined by insecurity along the supply chain. The role of collateral managers is therefore becoming increasingly important. The use of collateral managers is now 'the standard' in SSA.

4.9.2 There is plenty of innovation in trade finance, with inventive approaches emerging that raise trade finance and structure deals to the needs of investors.

4.9.3 Working capital and overdraft lending are unlikely to remain as prominent parts of trade financing.

4.9.4 Lack of liquidity (particularly in dollars) is a continuing problem in trade finance in SSA, especially at present due to the slump in commodity prices.

4.9.5 The most important thing in trade finance is to create a structure that mitigates the risks and gives the lender security. Producers, processers and traders all have different requirements for risk mitigation, and therefore it is important to carefully assess the many trade financing options available before moving forward.