

Macro-Economic Report | Monthly Update

Currency & Crude oil market Update – April 2020

Nigerian FX reserves - saved by the bell

- Following the suspension of FX sales to BDCs in March, the CBN took a step further by putting a halt to sales at the IEW in April despite estimated FPI holdings of FI maturity printing at \$1.4 billion over the month. We believe this was done following tight pressure on the FX reserve (\$5.1 billion YTD). Similarly, the apex bank made no purchase in the month given the low level of inflows. Inflows (ex CBN) were lower by 53% MoM to \$387 million. On the other hand, outflows declined by 90% MoM to a record low of \$334 million, suggesting most foreign flows couldn't get repatriated. On balance, net flows (ex CBN) printed at a net inflow of \$53 million compared to a net outflow of \$2.7 billion in the previous month.
- Despite low interventions in the month, the reserve was depleted further by \$1.6 billion over the month. We believe the drawdown can be linked to higher official payments, external debt service and matured swap positions. Elsewhere, rates at both IEW and parallel market weakened by 3.0% MoM and 7.3% MoM to ₦385/7/\$1 and ₦442.5/\$1 respectively.
- In our last update, we expected the CBN's administrative controls to limit the pressure on reserves - with the year-end position estimated at \$29 billion. However, we now see scope for the reserves closing higher than anticipated. Perhaps a coincidence; towards the end of the month, CBN announced resumption of FX sales to SMES and school fees payment shortly after getting approval of a \$3.4 billion IMF loan. The apex bank linked the resumption owing to gradual easing of the Covid-19 lockdown both globally and in Nigeria. Meanwhile, sales to the BDC segment remained on hold pending resumption of international flights. Aside the IMF facility, the FG awaits approval of a \$2.5 billion and \$1.0 billion from World Bank and IMF respectively. We believe this will change the picture of CBN reserves over the year. Although, we acknowledge backlogs of unmet demand and pick up in FX demand as economic activities gradually pick up, we believe receipts of these facilities would help ease the pressure on the reserve. We have adjusted our model to reflect the inflow from IMF as well as resumption of FX sales. On balance, we now see the reserves closing the year at \$28 billion. Upside to our forecast is the receipt of facilities from AfDB and World Bank. Inflow of these facilities could take the reserves up to \$31.5 billion by the end of the year which should help limit further depreciation of FX rates. Irrespective, we don't rule out possibility of mild administrative controls. Downside risk to our forecast are: (i) Covid-19 pandemic getting worse resulting into economies closing longer than expected (ii) crude oil price going lower than anticipated.

Analysts

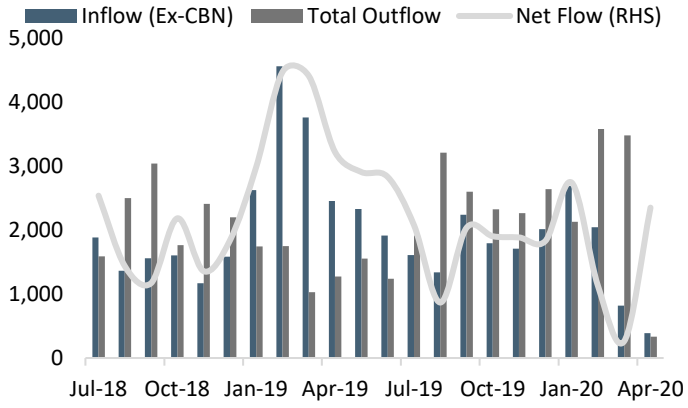
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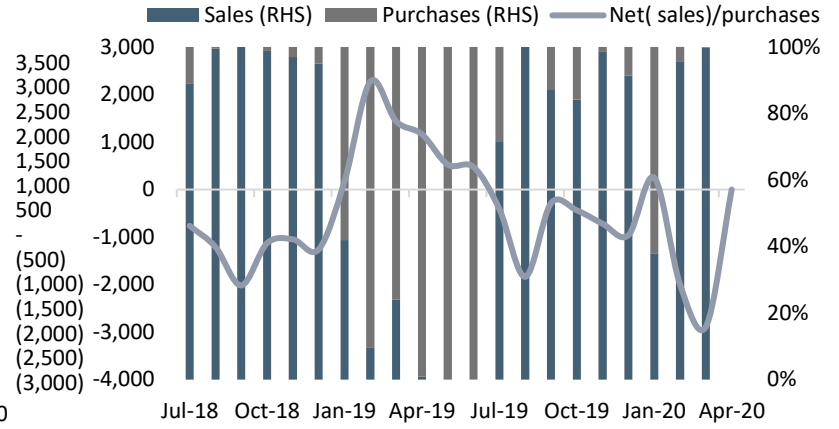
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Figure 1: Foreign Currency flows through the IEW (\$'bn)



Source: FMDQ, ARM Research

Figure 2: CBN Sales/Purchase (\$'million)

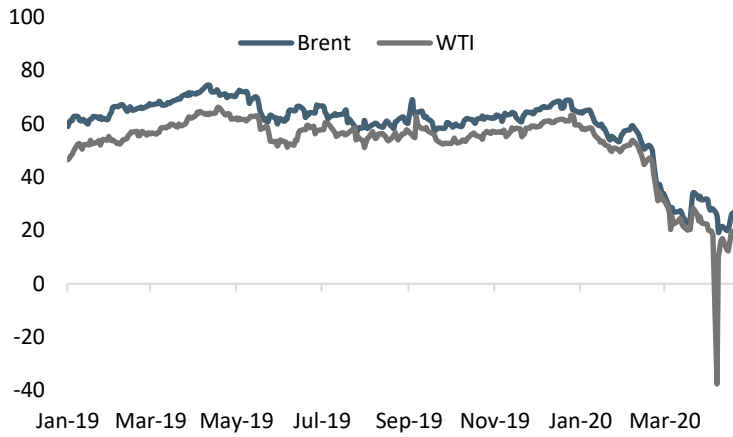


Source: FMDQ, ARM Research

Crude oil update: A Super Contango Crude Oil Market but Recovery in Sight

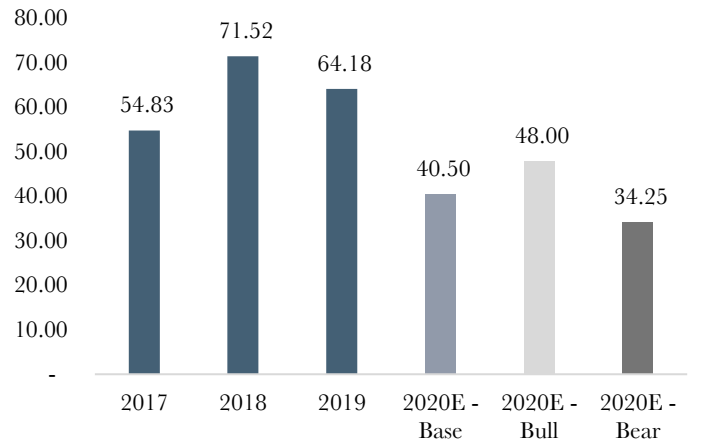
- Average Brent oil price so far this year prints at \$44.84, with the average in April of \$26.6. Oil prices touched a trough of \$19, which was the lowest since 2002. Even more dramatic in April was the plunge in WTI oil price to negative territory for the first time ever in history. The negative WTI prices mirrored unique oil storage challenges in the US which added to underlying concerns of a plunge in demand as most parts of the US was shut down. For context, the US commercial inventory has recorded increases over the past 14 weeks since February, touching a record high of 1.2 billion barrels in the week ended April 24th – the highest since June 2017. This translated to a 61% working capacity utilization, while the Mideast region (Cushing Oklahoma) printed at 81%. As a result, traders holding April contracts at the time (expired in April 21) sought to be relieved of immediate oil deliveries in light of thinned out demand and storage so much they were even willing to pay buyers to take the contracts, hence the negative pricing. This explains the market's super contango position, as Dec-20 contracts currently at ~\$6 premium to current spot price.
 - In response, many oil producers took cover by opting to cut production. For example, in the US, oil production has dropped by 1mbpd since touching the year's peak of 13.1mbpd mid-March, even as many oil majors announced voluntary shut-ins. Other non-OPEC countries such as Norway and Canada, have also signaled plans to cut their respective oil production. Meanwhile, OPEC+ members are scheduled to begin producing in line with the new production quotas from May 1. Further on the positives, prospects for demand have begun to rise, as countries begin gradual re-opening of their economies. Based on the foregoing, there has been a recovery in oil price so far in May, up 20% MtD to \$30/bbl. However, it is worth stating that Nigeria's bonny light crude continues to trade at a discount to Brent of ~\$4/bbl as opposed to ~\$2.5 premium at the start of the year and average \$1.4 over 2019
 - In our last crude oil update (Read [here](#)), we revised our 2020 oil price forecast lower to \$40.5 from our previous estimate of \$47.5. Our forecast is premised on our expectation of a net surplus of 1.34mbpd over FY 20E, with the first half of the year bearing bulk of the surplus.
 - We assume a recovery in demand in the second half of the year (as the COVID-19 impact on economies ease) which could wind down the oil market glut and swing market to a deficit H2 20 – assuming producers continue to keep production at bay. A major risk to our forecast lies in a possible second wave of the Corona virus spread as economies open up, which could warrant another global economy lock down, extend the plunge in demand longer than we estimated, and drive oil prices lower.
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Figure 3: WTI vs Brent Crude oil prices (\$/bbl.)



Source: Bloomberg, ARM Research

Figure 4: Oil Price Forecast 2020



Source: Bloomberg, ARM Research

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