

8 May 2018

Economic Report | Monthly Update

Economic Update – April 2018

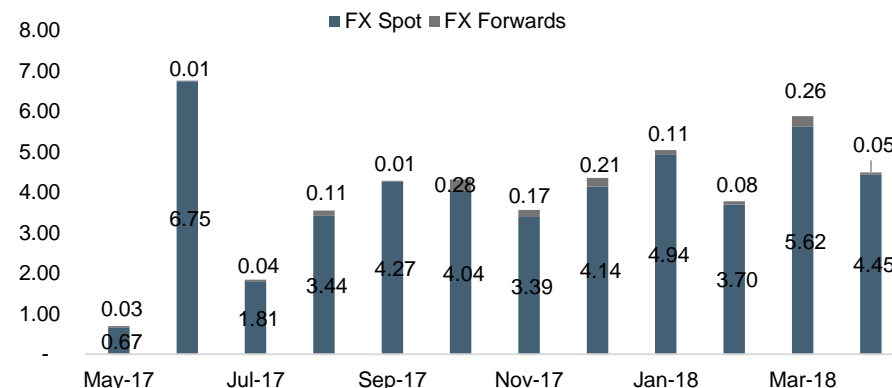
CBN slows tap across markets

Activities at the Investors and Exporters Window (IEW) slowed in the month of April as overall inflow and outflow declined double-digits to \$2.6 billion and \$2.3 billion respectively, with net-supply moderating 60.2% MoM to \$328 million compared to the adjusted \$823 million recorded in March. For spot transactions (-20.9% MoM to \$4.5 billion), the decline stemmed largely from cut back in both sales (-41.4% MoM) and purchases (-18.3% MoM) at the window, while the steep decline in forward transactions (-82.5% MoM) was largely due to the absence of maturing opened transactions during the month which limited sales transactions.

Going by breakdown, the decline in sales reflected cut back in both international and local inflows at the IEW. International inflow declined by 34% MoM to \$1.6 billion (\$2.4 billion in March) due to a 21% MoM decline in FPI flows to \$1.4 billion) even as FDI declined 56% MoM to \$89k. Elsewhere, local inflow dipped 56% MoM to \$552 million. While the decline in Other corporates (-51.8% MoM to \$398 million)—average contribution of 72.6% between June 2017 and April 2018—dealt the biggest blow on local inflow, the declining CBN participation at the window further magnified the decline. Consequently, overall inflow at the IEW printed at \$2.1 billion (March: \$3.5 billion). At the IEW, for the first month since the inception of the window, CBN recorded no sale. However, the apex bank continues to leverage the excess supply at the window to shore up its reserves (+2.4% MoM to \$47 billion).

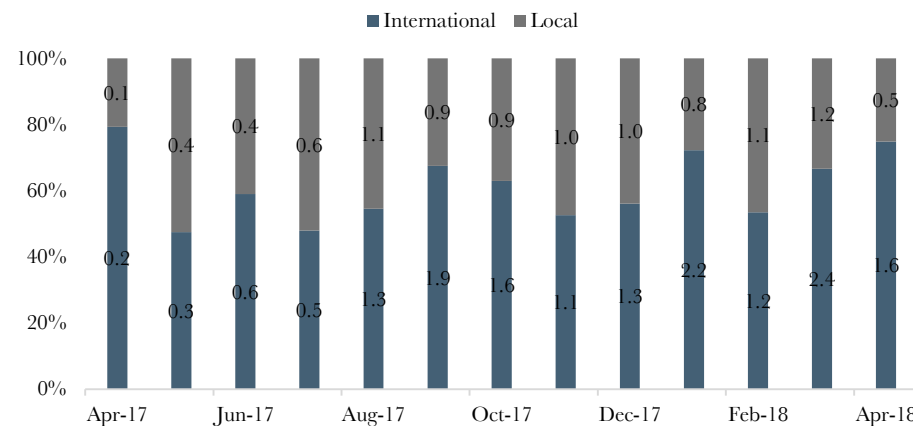
ARM Securities

Figure 1: FX Spot and Forwards OTC Transactions



Source: FMDQ, ARM Research

Figure 2: FX Inflow at the I&E Window (\$'Billion)

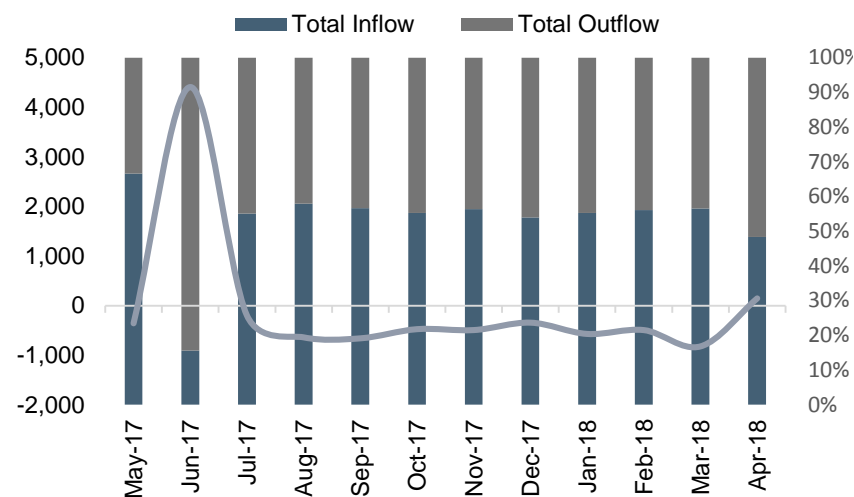


Source: FMDQ, ARM Research. Data estimated using monthly avg. exchange rate at the IEW.

Reflecting the overall moderation in transactions during the month, the apex bank purchase at the window declined 52.7% MoM to \$783 million (March: \$1.7 billion) to account for 35% of total purchases at the window. Also, CBN sales at other segments of the market dropped 19.9% MoM to \$1.1 billion (March: \$1.4 billion). The SMIS (-29% MoM to \$722 million), SMEs (-13% MoM to \$50 million) and invisible (-7% MoM to \$53 million) segments received lower CBN intervention during the month. Notwithstanding the decline in sales, the Naira remained stable across segments of the foreign exchange market. At the parallel market, transactions were consummated at an average rate of ₦360/\$ (+0.08% MoM appreciation versus +0.14% in March). Elsewhere, the NAFEX and BDC rates were relatively flat, appreciating 0.01% apiece to ₦360.11/\$ and ₦360.83/\$ respectively.

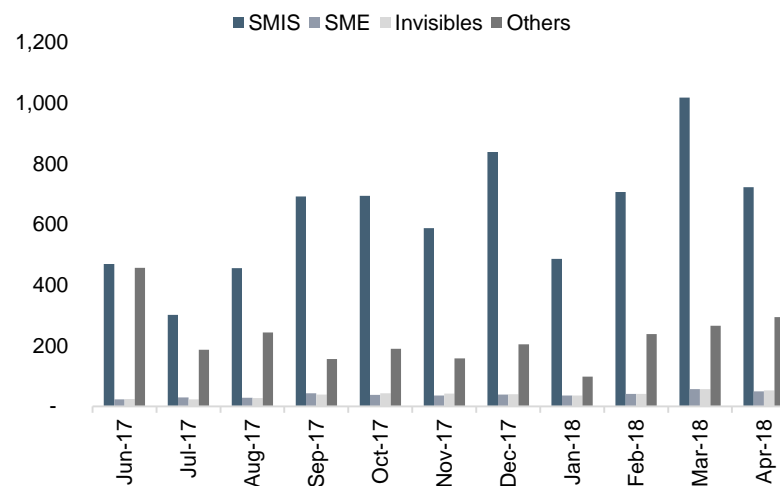
With the impressive flows at the IEW over the last one year and constant net-supply which has given the apex bank an easy reservoir to shore up its reserves, we believe the naira will be in a good state for the rest of the year with a possible convergence of the exchange rates to the NAFEX rate in near term. Adjusting our model for the reserve level of \$47.5 billion and forecast monthly crude oil (\$1.3 billion) and non-oil (\$2.4 billion) inflows, we believe the apex bank is well positioned to continue its aggressive dollar sale across segments of the window, even to accommodate the increasing import demands. Accordingly, with our estimated average monthly reserve accretion of \$549 million for the rest of the years – despite possible outflows via maturing money market instruments by foreign investors estimated at \$9.5 billion – we believe the reserves will close the year at \$51.9 billion with an import cover in excess of 14 months.

Figure 3: CBN Activity at the IEW (\$'000) vs. Balance (\$'billion)



Source: FMDQ, ARM Research

Figure 4: CBN supply to different segments of the market



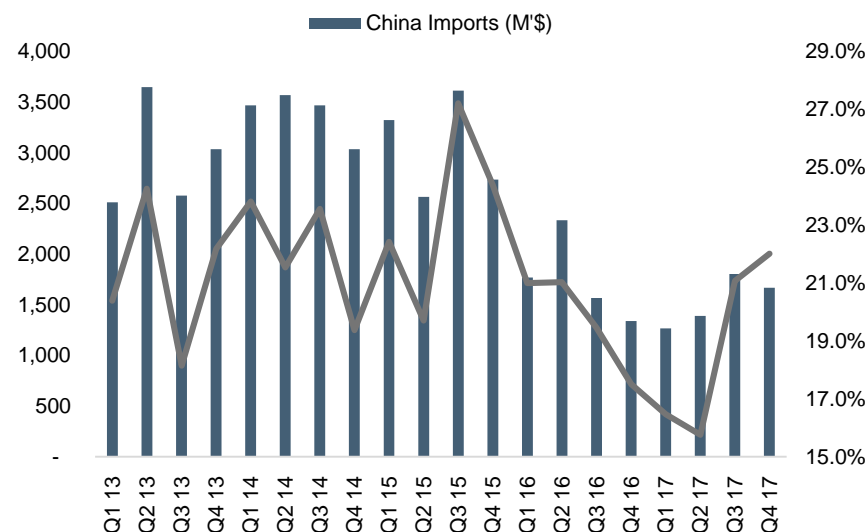
Source: FMDQ, ARM Research

Sino-Nigeria currency swap... a drop in the ocean

Last week, the People's Bank of China (PBoC) announced the approval of a \$2.4 billion (RMB 15 billion/₦720 billion) bilateral local currency swap agreement with the Central Bank of Nigeria (CBN) after two years of negotiation. The facility which is valid for three years (subject to extension upon mutual consent) is aimed at facilitating trade and direct investment between China and Nigeria, with the scope of safeguarding financial market stability and minimize exchange rate risk in both countries, especially Nigeria. The agreement which was conceived after a visit of President Muhammadu Buhari to China between April 11th and 15th 2016, was one of the two major highlights of the visit. The first was an offer of \$6 billion loan to fund infrastructure projects across the agricultural, solid minerals and industry sectors in Nigeria. With the second being the swap agreement, we expect the process of the \$6 billion loan to follow suit.

Given the size of the deal (valid for three years) relative to Nigeria imports from China of \$6.1 billion in FY 17 (FY 16: \$6.9 billion, FY 15: \$12.2 billion) – assuming three years estimate of \$18.4 billion – the swap deal is a drop in the ocean and we do not see any significant impact on dollar demand for China imports which is expected to retrace to the level over 2015 as FX liquidity and improving industrial production ignites inventory buildup. More details to follow.

Figure 5: Nigeria Imports from China and percentage of total imports



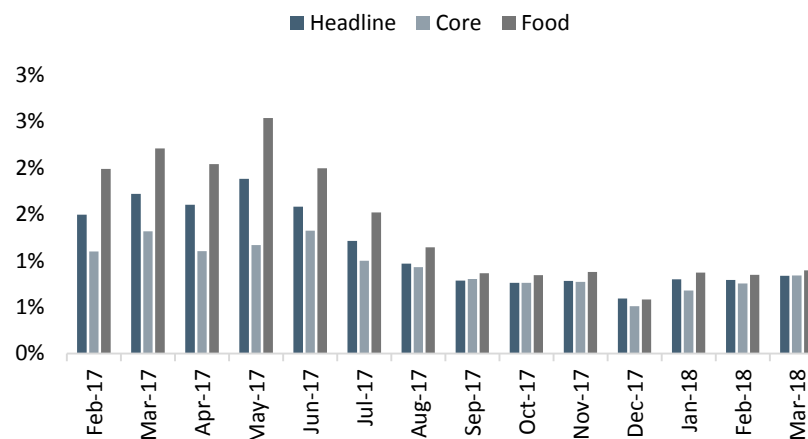
Source: CBN, NBS, ARM Research

Headline inflation nose-dives in March, hits 24-month low

Nigeria's disinflation continued for the fourteenth consecutive month as headline inflation in the month of March declined 99bps to 13.3% YoY from 14.3% YoY in the prior month. The sizeable drop in headline inflation stemmed from both the core (-53bps to 11.2% YoY) and food (-151bps to 16.1% YoY) baskets with favourable base effects from the sub-components being the primary driver of the decline. On a MoM basis, headline inflation rose 4bps to 0.84% from 0.79% in February, with much of the increase arising from core inflation which rose 9bps to 0.84%. According to breakdown from NBS, increases in HWEGF—Housing Water Electricity Gas and other Fuels (+8bps to 0.69%), Clothing & Footwear (+3bps to 0.79%) and Education (+8bps to 0.82%) underpinned the increase in core inflation. Focusing on HWEGF, the increase ensued despite the MoM decline in energy prices—PMS (-5.3%) and diesel (-1.7%)—which reflected in transportation inflation (-3bps to 0.86%). Hence, we think, perhaps, the increase in HWEGF came from higher prices of lubricants and upward reviews to housing rental rates during the month. Similarly, following a brief moderation in the prior month, MoM food inflation rose 5bps to 0.90% which we attribute to higher prices of processed food. Additionally, reflecting the stability in the currency, MoM imported food inflation moderated 4bps to 1.2%.

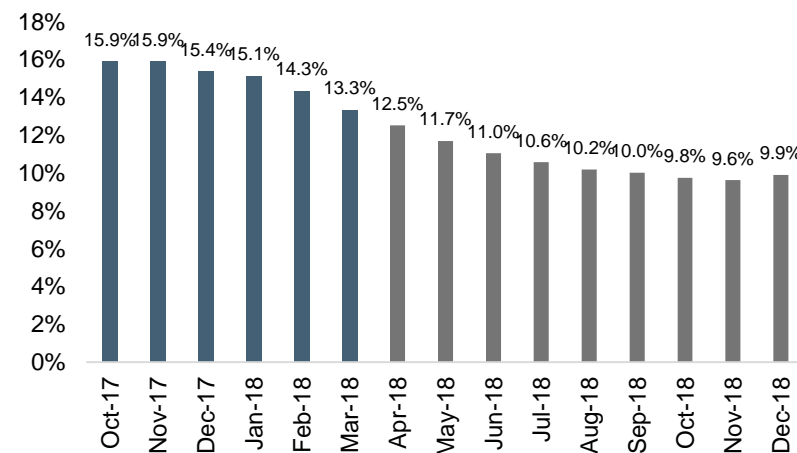
Going forward, base effects from higher food prices should continue to provide benefits to CPI readings. Thus, while higher housing rental rates will inflict pressure on core inflation, we see downward pressure on inflation numbers in the preview month supported by base effects from higher cereal prices in April 2017. This backdrop informs our call for an 81bps MoM moderation in overall headline reading to 12.5% YoY in April.

Figure 6: Inflation rate – Actual and Forecast (YoY)



Source: NBS, ARM Research

Figure 7: : Inflation rate – Actual and Forecast (YoY)



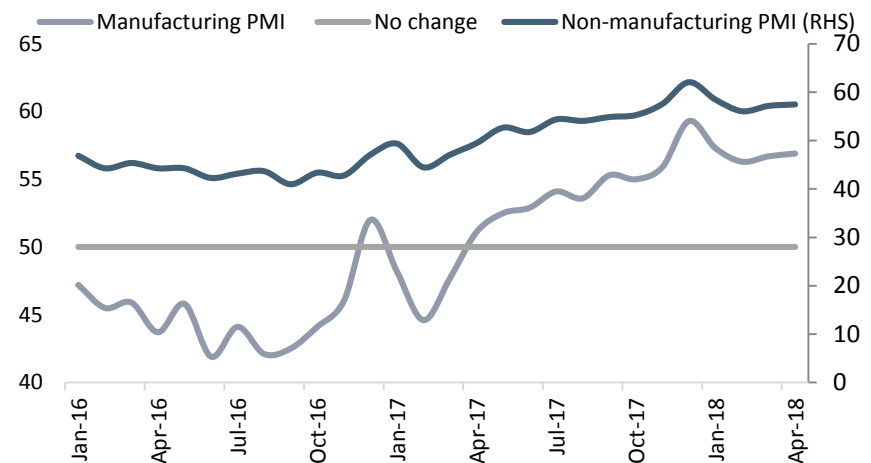
Source: NBS, ARM Research

April PMI: Slow start to Business Activities in Q2 18

In the month of April, Purchasing Manager Index (PMI) survey carried out by the central bank revealed that manufacturing and non-manufacturing (PMI) expanded to 56.9 (March: 56.7) and 57.5 (March: 57.2) index points respectively. On the former, expansion in raw materials inventory, supplier's delivery time and employment level diffusion indices outweighed production level and new orders indices which expanded at a slower rate relative to the prior month. For us, the expansion in raw materials inventory mirrors manufacturers increasing ability to easily source foreign exchange for the importation of materials needed for production. On the other hand, decline in demand explains the slowdown in the pace of expansion for the new order index (55.8 vs 56.1 in March) which most likely fuelled the slower expansion seen in production levels (58.6 index point vs 59.1 in March). On the Non-Manufacturing leg however, we saw improvement across all sub-indices with expansion in inventory level and new orders which in turn drove non-manufacturing business activity as it expanded 57.5 index points (vs 57.2 index point in prior month). Elsewhere, increased use of labour was also mirrored in the employment level index – expanding to 55.3 index point (March: 55.1).

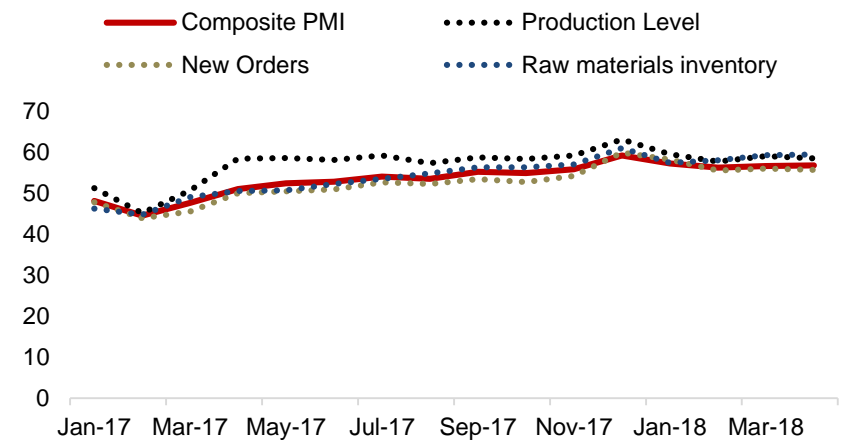
Overall, though headline PMI numbers revealed a general expansion in business activity, a persistent slowdown in demand as indicated by the new orders index guides to a slower expansion in the composite PMI in coming months. For clarity, higher demand translates to an expansion in new orders, production level and indirectly raw materials index which combined accounts for 70% of the overall index. That said, we await the release of Q1 18 GDP figure this month which we forecast to print at 3.1% YoY largely driven by oil.

Figure 8: Historical Movement in Purchasing Manager's Index (PMI)



Source: CBN, ARM Research

Figure 9: Historical Movement in Purchasing Manager's Index (PMI)



Source: CBN, ARM Research