

6 September 2019

## Macro Economic Report | Monthly Update

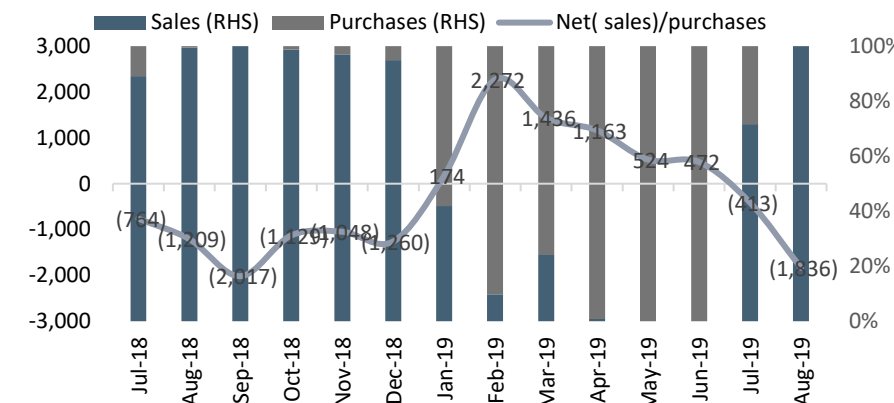
### Macro Economic Update – August 2019

#### *CBN offloading pricey ammunitions*

After six consecutive months of net inflows at the IEW (Ex-CBN), fortune turned in the month of July, with the pressure deepening further in August. Compared to net inflow of \$9.1 billion (average of \$1.5 billion) between January and June, total net outflows summed up to \$2.2 billion dollars between July and August (August standalone of \$1.9 billion). Focusing on August, while inflows during the month declined 17% MoM to \$1.3 billion, outflows expanded at a much faster pace of 68% MoM to \$3.2 billion. With total FI maturity during the month estimated at \$3.3 billion (with foreign holdings of \$1.1 billion), we note that the spate of repatriation largely reflects selloffs during the month. On inflows, it is worth noting that, FPI inflows is at the lowest level since the start of the year, slowing to \$583 million compared to average of \$1.8 billion between January and July.

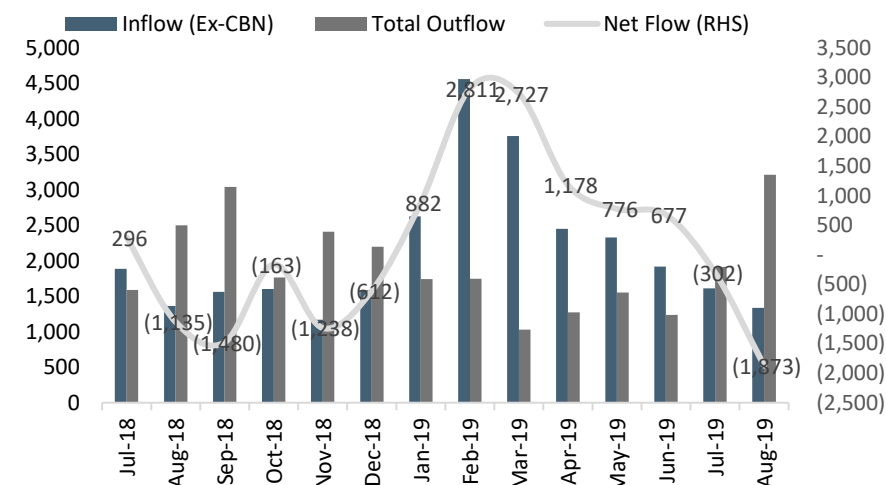
Riding on the rate of net inflows over the first six months, the apex bank net purchased a total of \$6 billion from the IEW. Reflecting the slowing tap at the IEW, the apex bank is now in a position of offloading its pricey ammunitions. In the month of August alone, the CBN intervened to the tune of \$1.8 billion (\$2.2 billion July inclusive) at the IEW. Coupled with series of interventions at other segments, CBN total estimated outflow for the month expanded 74% MoM to \$5.9 billion to exceed our estimate of \$4.9 billion. With inflows to the apex bank shedding over the same period (especially non-oil inflows), the gross external reserve was depleted to the tune of \$1.3 billion (\$1.5 billion July inclusive) to settle at \$43.5 billion.

**Figure 1: CBN Activity at the IEW (\$'000) vs. Balance**



Source: FMDQ, ARM Research

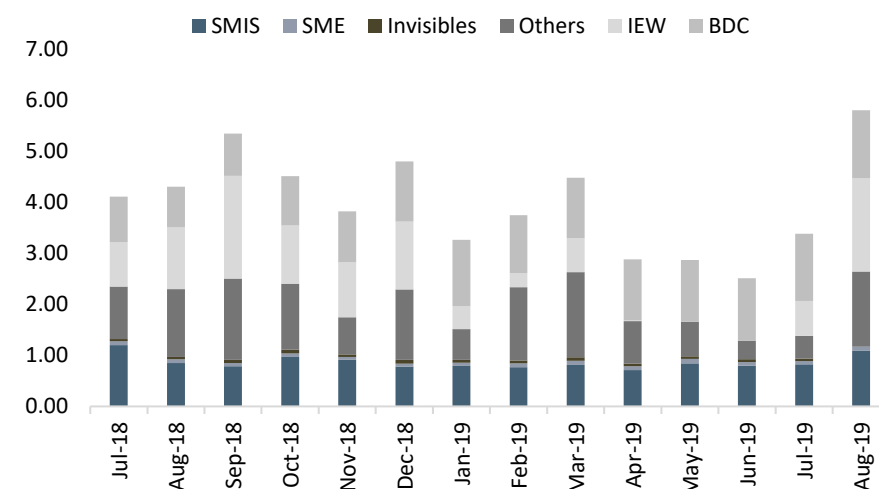
**Figure 2: Foreign Currency flows through the IEW (\$'bn)**



Source: FMDQ, ARM Research

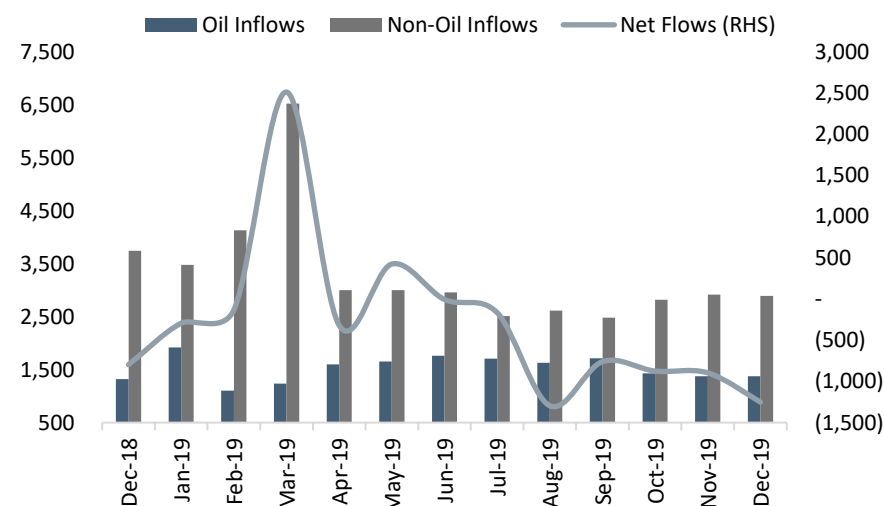
For the rest of the year, while we believe the recent uptick in OMO auction rates are likely to be consoling for investors, we believe the pent up maturity over the last four months of the year will leave CBN coffers negative, given the limited room for any material purchases at the IEW. With cash swap, returned unutilized funds, official receipts, unutilized IMTO funds and third party funds expected to support the non-oil inflows, we lowered our estimate for H2 to \$16.2 billion (previous: \$20.9 billion, H1 19: \$23 billion). With our oil estimates and estimated outflows largely unchanged and our model adjustment for the depletion in August, we see the FX reserves depleting further to \$39.7 billion dollars. Irrespective, we believe the apex bank will keep its hold on the Naira, with short term volatility due to increase demand at the IEW resulting in Naira depreciation between ₦363.0/\$ to ₦366/\$ over H2 19.

**Figure 3: CBN intervention across official FX markets (\$'bn)**



Source: FMDQ, ARM Research

**Figure 4: Foreign currency flows through the CBN (\$'bn)**



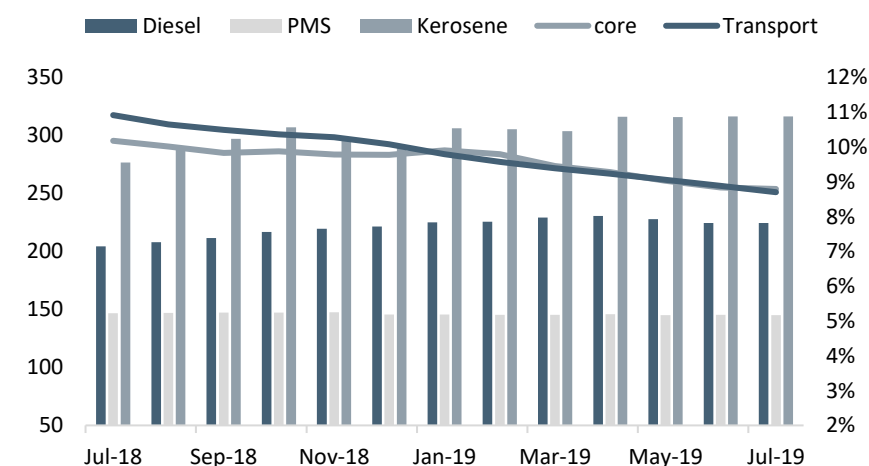
Source: FMDQ, ARM Research

### *Inflation to maintain its downward trajectory.*

Headline inflation took a downward path in the month of July printing at 11.08% YoY (June: 11.22% YoY). The confluence of buoyant market supplies, reduced risk of flooding, curtailed bandit attacks in the North and stable PMS prices steered the downward trend in consumer prices. Precisely, food inflation dipped by 17bps to 13.39% YoY due to decline in prices of farm produce. According to FEWSNET, the ongoing green harvest which came in earlier than usual, further amplified market supply, thereby driving a decline in food prices over the period. Also, Core Inflation further moderated by 4bps to 8.80% YoY reflecting the curtailed nature of PMS prices. Month-on-Month, headline inflation followed a similar pattern, declining by 6bps to 1.01% MoM, due to moderation in food inflation.

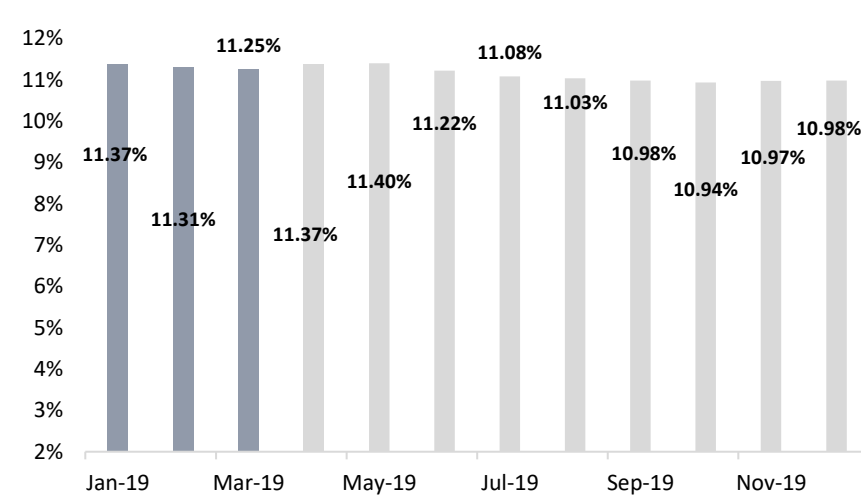
For the month of August, we expect consumer prices to moderate due to improvement in both food and core basket. On food, we expect the downward pressure to persist due to increase in market supplies, favourable weather and reduced bandit attacks. According to FEWSNET, markets remain well supplied to meet the growing lean season demand, leading to either stable or declining food prices. Also, favourable rainfall and increased agricultural implements and technical support helped support the lean planting season – with harvests expected to be above average. In addition, core inflation is expected to follow suit in line with the moderation in energy prices. Aside PMS price which has remained stable at ₦145 per litre since the start of the year, we've seen monthly declines in diesel and kerosene prices following lower crude prices which further supports the case for moderating core inflation. That said, headline inflation for the month of August is expected to print at 11.03% YoY which translates to an average inflation rate of 11.12% YoY (FY 18: 12.2% YoY).

**Figure 5: Avg. energy prices (₦/litre) vs. Core & Transport Inflation (% YoY)**



Source: NBS, ARM Research

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



Source: NBS, ARM Research

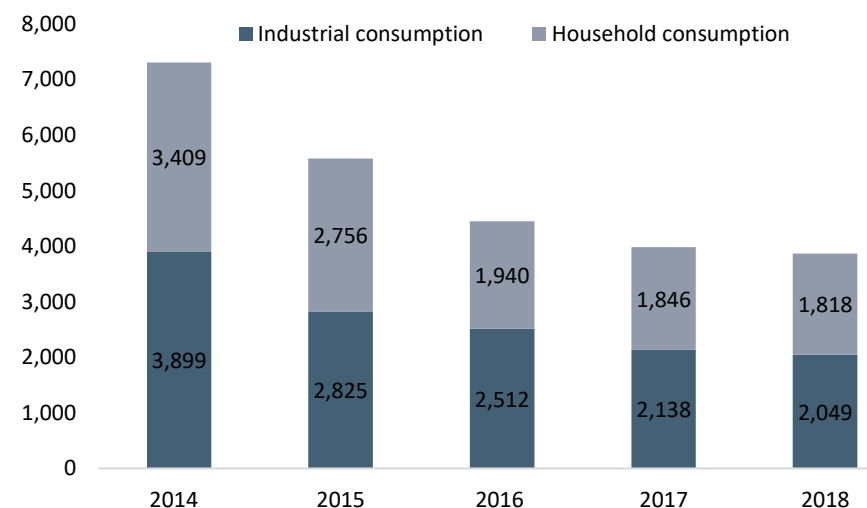
### *Nil impact on trade surplus, but arbitrage at parallel market*

Earlier in the month of August, President Buhari directed the Central Bank of Nigeria to restrict food importers' access to foreign currency in a bid to boost local production and conserve FX reserve. Interestingly, the CBN towed similar path in June 2015, when it restricted access to FX for importation of 41 items which included rice, margarine, meat, and poultry. As a result, compared to the higher levels of \$7.3 billion over 2014, total food imports declined to \$3.8 billion at the end of 2018. With the CBN providing FX for over 60% of these imports, total CBN supply for food imports valid for FX declined from \$5 billion in FY 14 to \$1.5 billion in FY 17 and increased to \$2.3 billion in FY 18.

Beyond the inflationary impact of the move and the signals it sends to the real sector, the impact on trade is minimal given that the NAFEX and parallel market rates are trading at range bound as such demand could explore the parallel market. However, in the event that there exist wider spread between NAFEX and parallel market rate, we could see some impact on the trade surplus if CBN gives a thought to the directive.

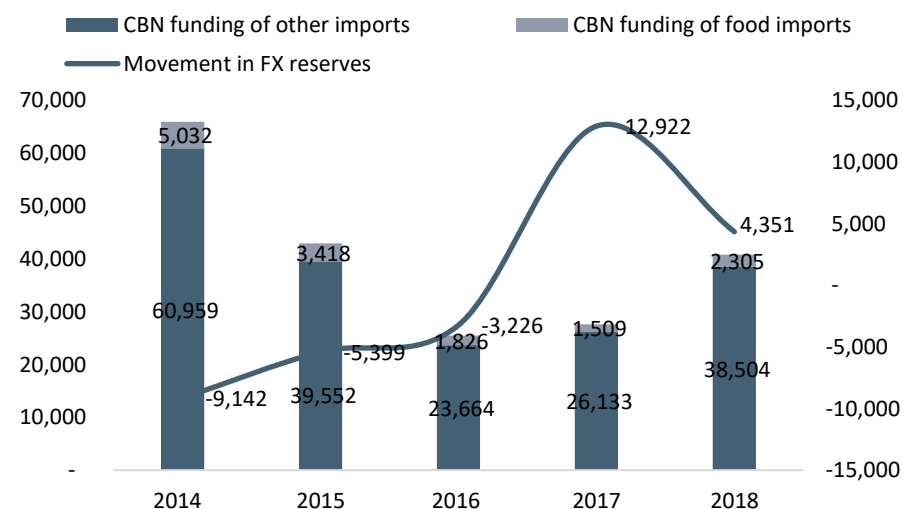
Over 2018, the CBN sold \$2.3 billion to food importers, making up 5.6% of total FX sale for imports (\$40.8 billion). We assumed two scenarios: (1) that the apex bank reduce FX sales for household food imports only, and 2) a reduction in FX sales on both household and industrial food imports. Based on our analysis, we expect savings to the FX reserve by over \$1 billion on an annual basis on our first scenario. On the other hand, the CBN could save over \$2 billion annually with a complete reduction of FX for food imports. As mentioned above, we believe the tradeoff of either of our scenarios will be a corresponding arbitrage opportunities in the parallel market.

**Figure 7: Component of Food imports (\$'million)**



Source: CBN, ARM Research

**Figure 8: Total food imports and CBN funding (\$'million)**



Source: CBN, ARM Research

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