

12 March 2019

Macro Economic Report | Monthly Update

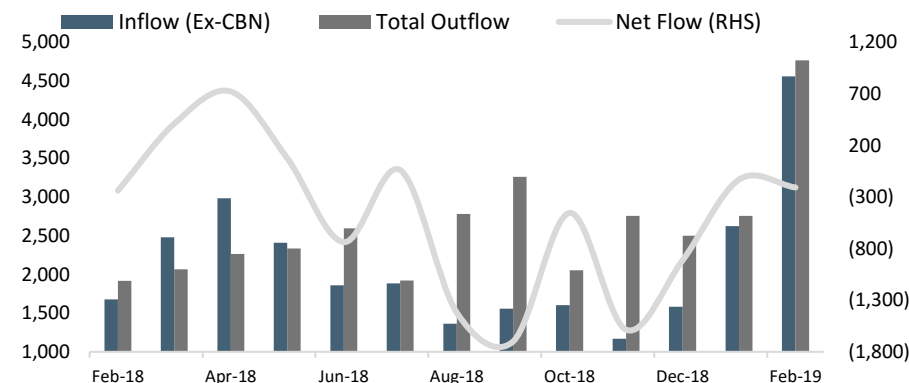
Macro Economic Update – February 2019

Attractive carry-trade propelled growth in FPI flows

Reflecting the calm in the polity and attractive carry-trade breaks in the local fixed income space, inflows (ex-CBN) at the Investors and Exporters Window (IEW) rose 73.6% MoM to \$4.56 in February. Going by breakdown, offshore flows stood at \$3.7 billion (vs. \$1.9 billion in January) driven by FPI flows (+199.3% MoM to \$3.5 billion). While we have no official data to back this claim, recent market performance suggests most of funds flowed to the short end of the fixed income market as evidence by the elevated demands at recent OMO and Treasury bills auctions. However, reflecting higher outflows at the window 72.9% MoM to \$4.76 billion, with unmet demand of \$208 million (Jan: +\$131 million). CBN intervention at the window increased to \$274 million (vs. \$174 million in Jan), while the CBN sold a total of \$3.7 billion (+31% MoM) across other markets with the external reserve depleting by \$207 million to \$42.3 billion.

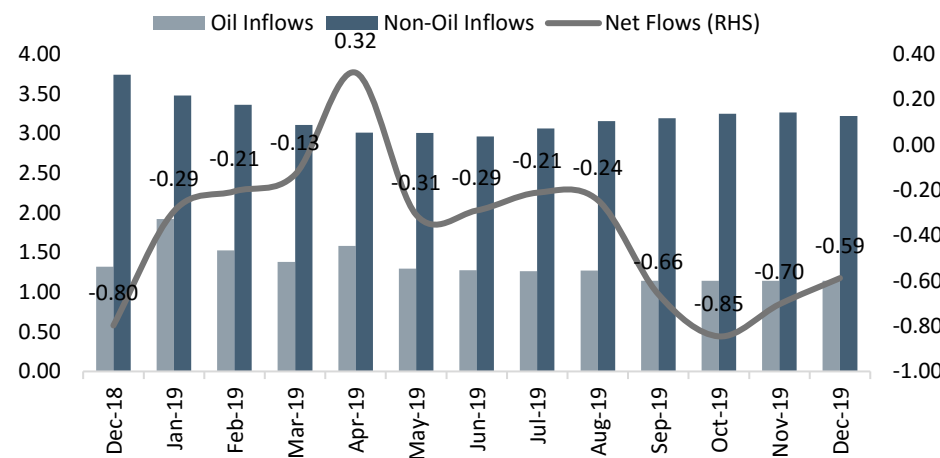
Events in February seems to prop our view of near-term naira stability. First, we forecast average monthly crude oil inflow of \$1.38 billion and \$1.18 billion over H1 19 and H2 19 respectively, with 2019 oil inflow estimated at \$16.08 billion (prev: \$13.83 billion). For non-oil inflow, we are cautious on the sustainability of sizable FPI flows as expectation of lower rates in the short term and less attractive carry-trade informs a slower tap. Irrespective, to reflect the level of non-oil inflows over February, we now expect contraction in non-oil inflows by 13% YoY (previous: 20% YoY) to \$38 billion. On balance, we expect average monthly reserve drawdown of \$367 million over 2019, suggesting cumulative \$3.7 billion depletion in the reserve to \$38.6 billion (excl. proposed Eurobond of \$2.7 billion).

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



Source: FMDQ, ARM Research

Figure 2: Foreign Currency flows through the CBN (\$'Billion)



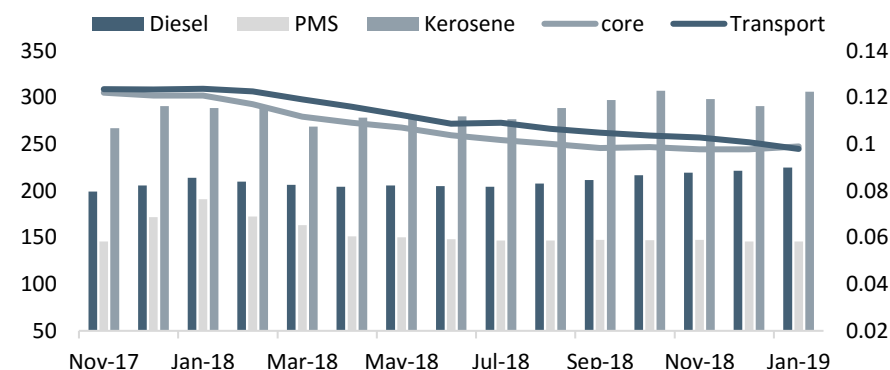
Source: CBN, ARM Research

Inflation remains contained for the month of February

On Consumer prices, inflation rate for the month of January dipped to 11.37%, from 11.44% recorded in the prior month, stemming from a moderation in the food index. Specifically, the food index dropped by 5bps to 13.51% - overshadowing the uptick in the core index (+13bps to 9.91%). Month on month, headline inflation remained flat at 0.74% mirroring the 29bps uptick in core index to 0.8% coupled with the food index which rose by 1bps to 0.83%. On core, we are taken aback, given all the core indices either fell or remained flat relative to the prior month. Specifically, HWEGF, furnishing, health and transport dropped by 2bps while clothing & footwear dropped by 4bps – which together accounts for 76% of the core basket. Food inflation however reflects an uptick in processed food (+386bps to 2.54%) as farm produce inflation moderated by 34bps to 0.67%.

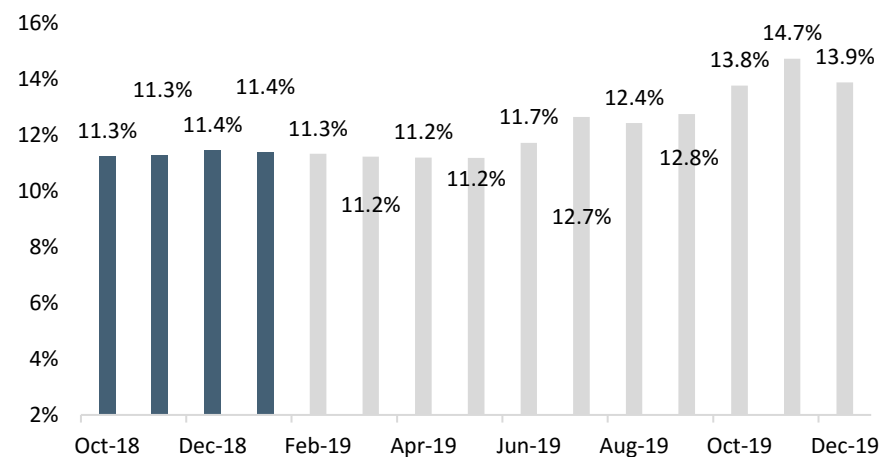
For the month of February, we expect a further decline in inflation to 11.33% YoY as we see no pressure on both food and core inflation. On food, due to ongoing dry season harvest, market supplies trended upwards during the month leading to a decline in food prices. According to FEWSNET, most staple prices have either declined or remained stable relative to the previous month and year, notwithstanding the continued conflict in the north east. Elsewhere, while we still expect diesel and kerosene prices to remain elevated relative to the prior month, lower PMS prices from prior year (-15% YoY) guides our view of a further moderation in core inflation. Overall, our expectation of a moderation in inflation over the first half of the year and increases in the second half borne out of a hike in PMS price and slight naira depreciation remains unchanged, guiding our estimate of an average inflation rate of 12.4% YoY for the year (FY 18: 12.2% YoY).

Figure 3: Avg. energy prices (₦/litre) vs. Core & Transport Inflation (% YoY)



Source: NBS, ARM Research

Figure 4: Inflation rate – Actual and Forecast (YoY)



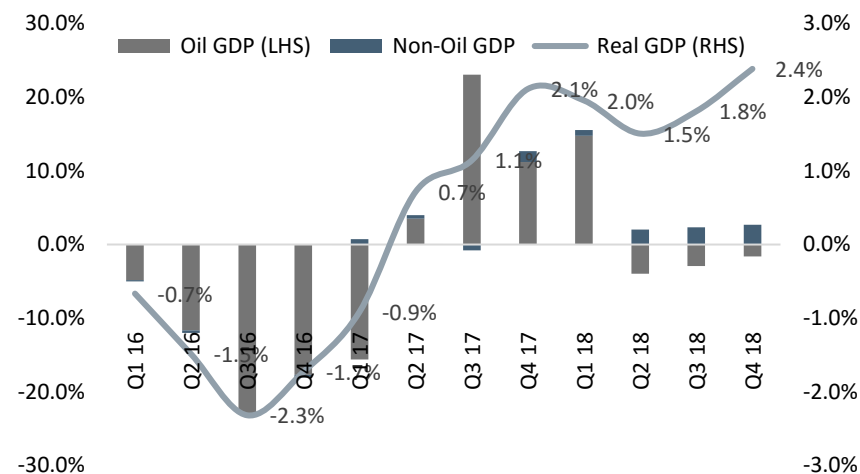
Source: NBS, ARM Research

Economic refuel needed as growth gradually peaks

The Nigerian economy grew by 1.9% in 2018, an improvement from 0.8% recorded in 2017, with the non-oil sector being the fulcrum for the growth picture. Over the last quarter of 2018, the economy recorded a solid growth of 2.4% - with the expansion in the non-oil space (2.7% YoY) taming the contraction observed in the oil sector (-1.6% YoY). Dissecting the components in the non-oil territory, all subsectors expanded, with the services and Agric sector leading the pack. Notably, improvement in the number of active subscribers¹ in ICT subsector coupled with mild support from transport drove the expansion in the services sector (3.8% YoY). Furthermore, while the Agric sector improved by 2.5% in Q4 18, it was disappointing compared to its four-year average of 3.8%. On the flipside, the oil sector dived into recessionary waters buoyed by low crude production (-2.6% to 1.91mbpd).

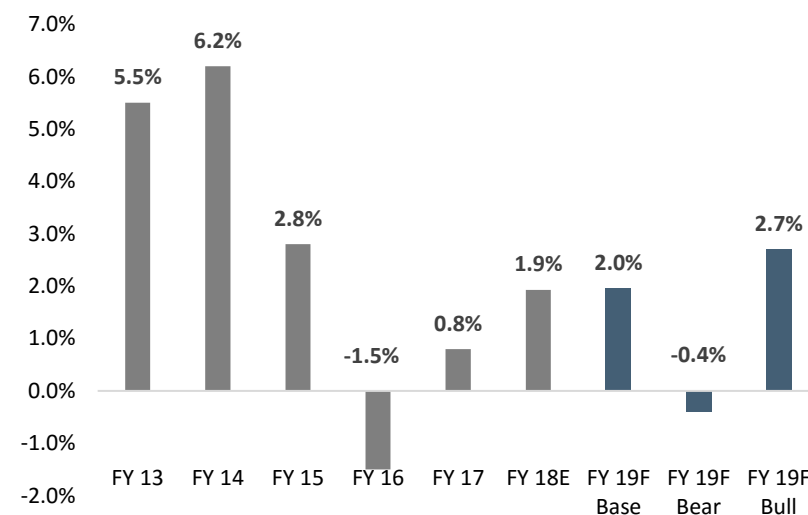
Going forward, we expect resilience in Agric sector and a recovery in the oil sector to be the key driver for growth in non-oil and oil sector accordingly. In the non-oil sector, muted growth in ICT and in turn services as well as weak growth in Manufacturing due to depressed consumer wallet and delay with minimum wage bill, guides to slower growth in the non-oil sector of 1.3% YoY (2018: 2.0% YoY). In the oil space, the additional 200kbpd from the Egina oil field guides our expectation of an expansion in crude production over 2019 (2.06mbpd), albeit capped by OPEC cut. That said we expect growth in the oil sector to print at 7.1% (2018: 1.1%). Overall, we revise our 2019 growth estimate downwards to 1.98% (previously 2.05%), a notch away from 1.93% recorded in 2018. For Q1 19, we expect a slowdown in growth to 1.3% YoY driven by a contraction in the oil sector (-1.1% YoY) and moderation in non-oil sector growth.

Figure 5: Historical movement in Real, Oil and Non oil GDP



Source: NBS, ARM Research

Figure 6: Historical movement in Annual Real, Oil and Non oil GDP



Source: NBS, ARM Research

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