

4 July 2018

Macro Economic Report | Monthly Update

Macro Economic Update – June 2018

FG's Debt Stock: Domestic debt takes a breather

FG's debt stock rose 5.03% QoQ to ₦18 trillion over Q1 2018 with domestic debt accounting for 70% of total debt. The increase in debt stock over Q1 was largely on the back of a \$2.5 billion Eurobond issued in February, which resulted in a 19% QoQ expansion in external debt to \$5.4 billion. Elsewhere, domestic debt stayed flat (-0.1% QoQ) at ₦12.6 trillion on the back of lower Treasury bill stock (-7.5% QoQ to ₦3.3 trillion) which neutered the moderate increase in bonds (+2.9% QoQ to ₦8.9 trillion). Specifically, the FG has net repaid a total of ₦49.7 billion YTD on both T-bills and Bonds reflecting its decision to cut back on domestic debt in favour of offshore funding. Reflecting the current debt stock and elevated borrowing rates over 2017, debt servicing printed at ₦712 billion (+173% QoQ and +39% YoY), with domestic debt service rising to ₦644 billion (+179% QoQ) while external debt service rose \$97 million to \$225 million.

Over 2018, with the support of higher oil receipts, our expectation of a lower fiscal deficit of ₦1.88 trillion (vs. ₦2.36 trillion budgeted in FY 17) guides to lower borrowings YoY with much focus on the external leg. On the domestic leg, we see scope for a slight pick up in borrowings, albeit moderate, given FG's strong imperative to implement the 2018 budget ahead of 2019 elections as well as the fact that FGs borrowing was largely muted in H1 18. On the foreign leg, going with FG's planned fiscal deficit financing plan, we have factored \$2.8 billion foreign borrowings over H2 2018, which in addition to the earlier raised \$2.5 billion translates to total foreign borrowings of \$4.5 billion over 2018 (2017: \$4.8 billion). Thus, FG's aggregate debt stock should expand 6% YoY to ₦20 trillion in 2018. Overall, given our expected total borrowings, we estimate the split between domestic and foreign debt to shift slightly to 69:31 in 2018 from 70:30 in 2017.

Figure 1: Trend in FG domestic and external debt stock (\$'Billion)

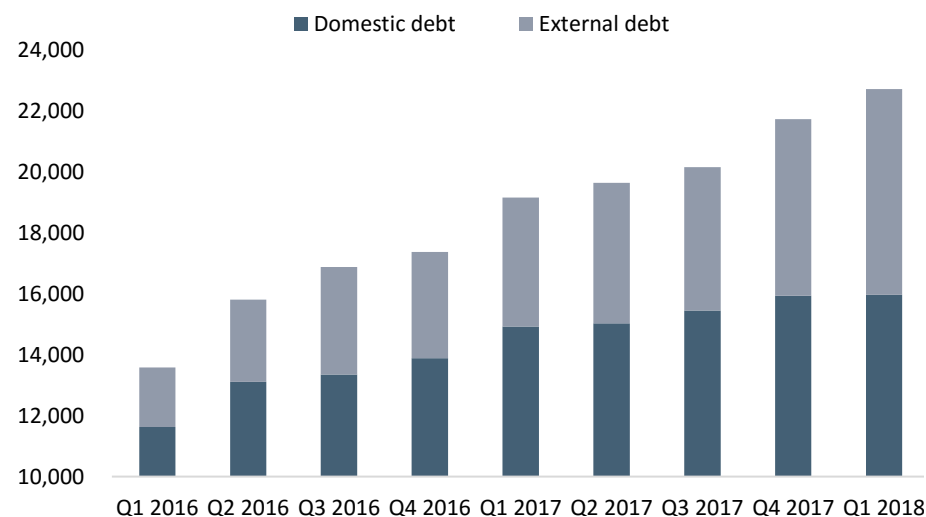
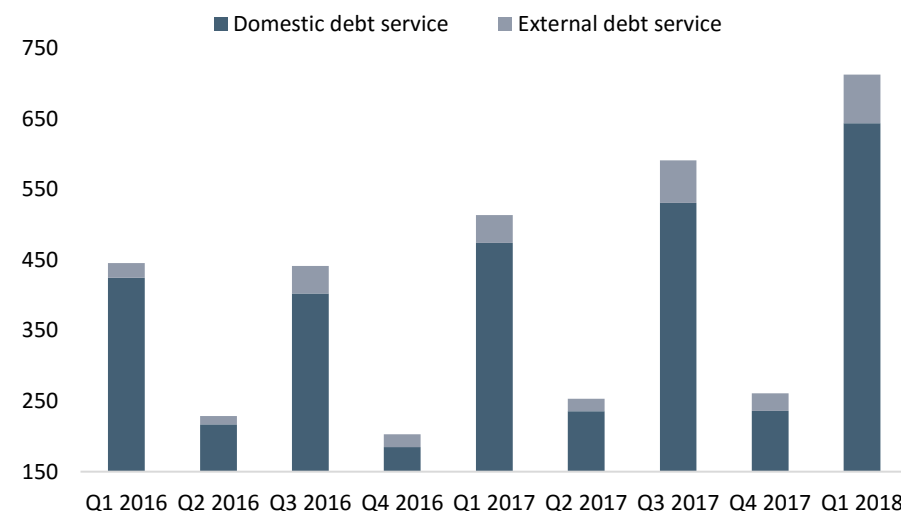


Figure 2: Trend in FG domestic and external debt service



Source: DMO, ARM Research

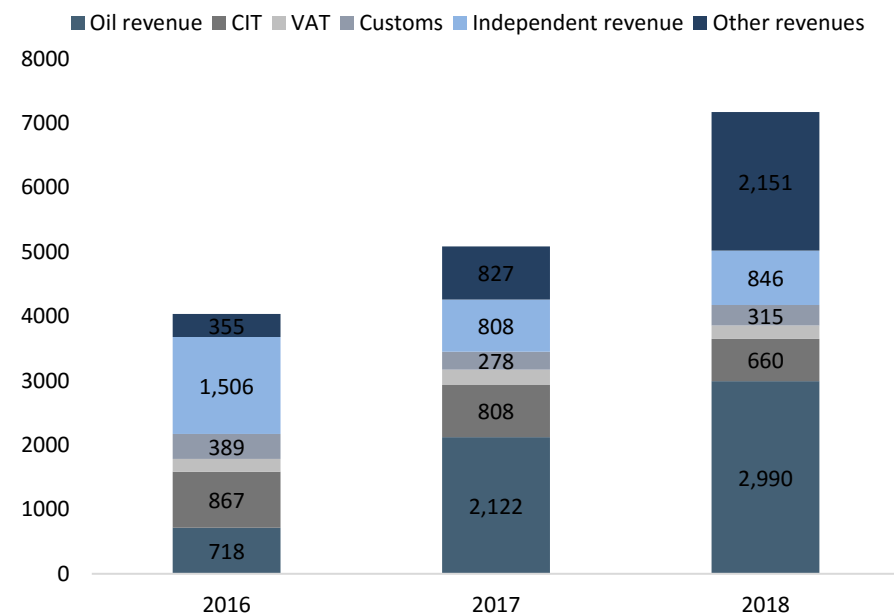
On debt servicing, with the US 10-year benchmark yield currently at 2.87% (vs. 2.46% in January, 2018), we expect higher rates on the proposed \$2.8 billion Eurobond issuance. Going by recent Eurobond issuances across emerging markets, we estimate an increase of between 50bps – 150bps on Nigeria’s Eurobond issuance. On balance, we expect foreign debt service to expand YoY. Elsewhere, we expect tamer domestic debt service cost reflecting lower domestic borrowings and currently low interest rates. That said, we believe external borrowings still looks cheaper in the short term. Particularly, we estimate average foreign borrowing cost to be between 8.5% - 9.0% in 2018 (vs. average domestic borrowing costs of 13.4%).

Fiscal deficit moderates on stronger oil revenue expectation

The budget office released details of the approved 2018 budget following the President’s assent of the appropriation bill. From the details, total federally collected revenue for 2018 is planned at ₦7.17 trillion (vs. ₦6.6 trillion proposed) split into oil revenue (₦2.99 trillion) and non-oil revenue (₦4.18 trillion). Oil revenue estimate (vs. ₦2.4 trillion proposed) is premised on key assumptions of 2.3mbpd, oil price of \$51/bbl. (prior: \$44.50/bbl.) and exchange rate of ₦305/\$. Non-oil revenue estimate of ₦4.18 trillion was unchanged.

On the expenditure leg, the FG planned spending was revised upwards to ₦9.1 trillion (vs. ₦8.6 trillion proposed) with the bulk of the increase allocated to capital expenditure (₦2.8 trillion vs. ₦2.4 trillion proposed). Elsewhere, upward adjustment was made to recurrent expenditure (non-debt) to ₦3.51 trillion (vs. ₦2.99 trillion proposed). Net impact of the revenue and spending projection translates to a fiscal deficit of ₦1.95 trillion (vs. ₦2.0 trillion proposed).

Figure 3: Trend in revenue composition (\$'Billion)



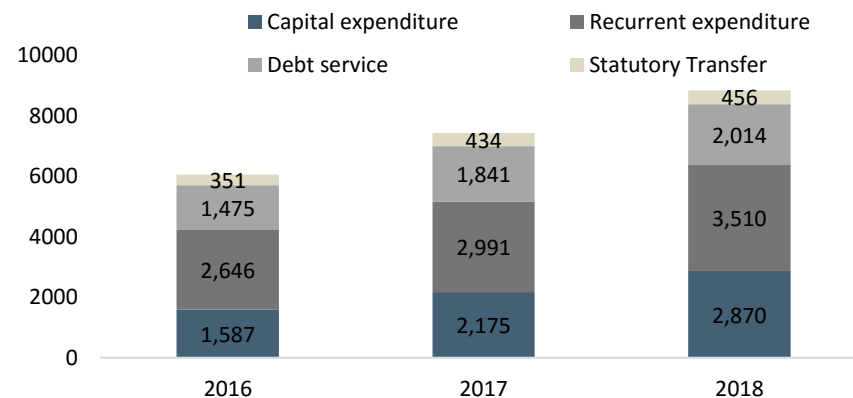
Source: Budget Office, ARM Research

Over 2018, we estimate aggregate revenue to print at ₦5.08 trillion (oil and non-oil estimate of ₦2.88 trillion and ₦2.20 trillion respectively) which covers ~92% of debt and non-debt recurrent expenditure (₦5.5 billion). Given that outlay on recurrent expenditure commences from the beginning of the year while capital expenditure commences following the passage of the budget, we project 100% and 50% implementation of recurrent and capital expenditure respectively. Hence, we forecast aggregate expenditure at ₦6.96 trillion which translates to 75% budget implementation. With our revenue and expenditure forecasts, we estimate fiscal deficit of ₦1.8 trillion over 2018 under our base case scenario.

Base effect offset spike in MoM headline inflation

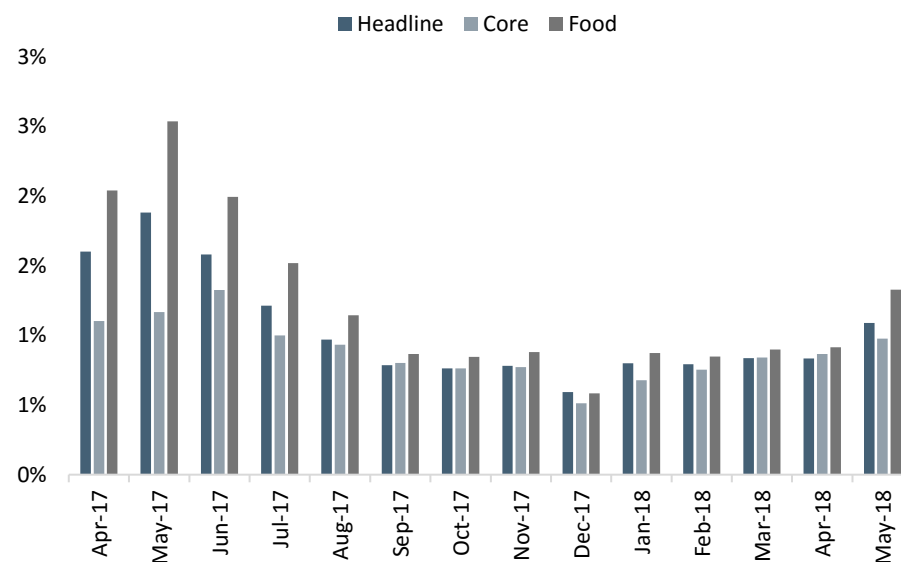
Nigeria's headline inflation continued its descent in the month of May to 11.61% YoY (12.48% YoY in April), largely in line with our forecast of 11.65%. Base effects remained the primary driver, even as MoM headline reading advanced to 1.09% (+26bps MoM) to reach the highest monthly increase since August 2017. Focusing on MoM CPI, the pressure stemmed from the food basket (+41bps to 1.32%) as well as core basket (+11bps to 0.98%). On the former, the seasonality effect of the Ramadan season, wherein demands increases, stoked an upward MoM pressure on food prices. For context, recent data from Famine Early Warning Systems Network (FEWS NET) showed that most grain prices increased compared to the previous month, especially in northern areas due to Ramadan. Elsewhere, the increase in energy prices from Diesel (+0.65% MoM to ₦205.67) and Gas (+0.70% MoM to ₦4,298.72) with attendant impact on Housing, Water, Electricity, Gas, and other Fuel—HWEFG (+10bps to 0.73%) and transport inflation (+5bps to 0.90%) accounted for the upward pressure in the core basket.

Figure 4: Trend in FGN expenditure composition



Source: Budget Office, ARM Research

Figure 5: MoM inflation across sub-components



Source: NBS, ARM Research

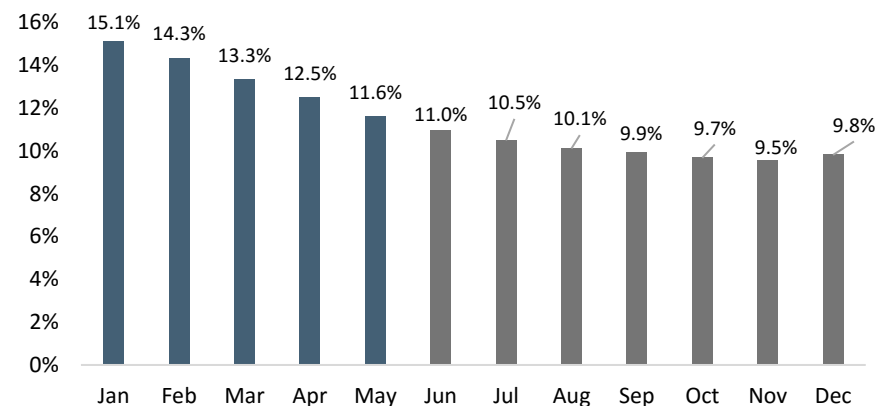
We also believe higher transportation cost from higher diesel prices might have impacted food prices in May.

The onset of the lean season coupled with the spillover of Ramadan into June guides to a sustained increase in market demand relative to supply which invariably would inflict an upward pressure on food prices. Thus, we look for a 1% MoM increase in June's CPI. Notwithstanding, with favorable base effects, we expect June YoY headline inflation to moderate to 11% from 11.61% in the month of May.

OPEC rattles market, stability is the narrative

The run-up to the 174th meeting of OPEC+ was filled with tales and feelers that incited considerable market volatility. On one side of the fence was a push to increase supply, which was greeted by the heavyweights – Saudi Arabia, and Russia. On the other side was a plea to maintain current output, a plea mainly voiced by Iran and Venezuela, reflecting the anticipated supply outage. In justifying the need for an increase in supply, stability was the key consideration. Firstly, players considered the impact of higher oil prices on demand and thus called for the need to maintain stability, in view of the higher compliance of 152%. Also, potential supply outages in Iran over the coming months, due to sanctions, and its impact on market balance supported the need to increase supply. Lastly, global crude oil inventories have declined at an accelerated pace in recent times and now hovers around the 5-year average of ~2.8billion barrels, the target estimate of OPEC for a balanced market. To add, key consumers – China and India, had urged Saudi Arabia to increase supply as prices have hit multi-year highs.

Figure 6: Inflation rate – Actual and Forecast (YoY) over 2018



Source: NBS, ARM Research

President Trump had also put some pressure on Saudi Arabia to increase production and stabilize crude oil prices.

In line with the call for stability and the confluence of factors earlier stated, OPEC+, at its June 22nd meeting, agreed to increase supply to a level that allow 100% compliance to its initial quota, from 152% in May 2018. Based on our analysis, this implies a combined increase of 1mbpd to current output. However, with only the gulf nations having excess capacity to raise production to its initial quote, expected increase in supply sits ~600kbpd.

In terms of impact, we expect to see some stability in prices with average crude oil price hovering around \$75/bbl. for the rest of year, on the back of this decision. First off, we have assumed Iran's supply returns to level of prior sanction at 2.8mbpd, this implies 1mbpd off the market. Thus, the foregoing alongside disruptions in Venezuela and Libya should offset the expected increase from the gulf countries of 600kbpd. Consequently, with demand expected to remain strong over the next 2 quarters and close the year at ~100.5mbpd, the slight market deficit will keep crude oil prices stable for the rest of 2018.

Table 1: OPEC Supply (excl. condensate)

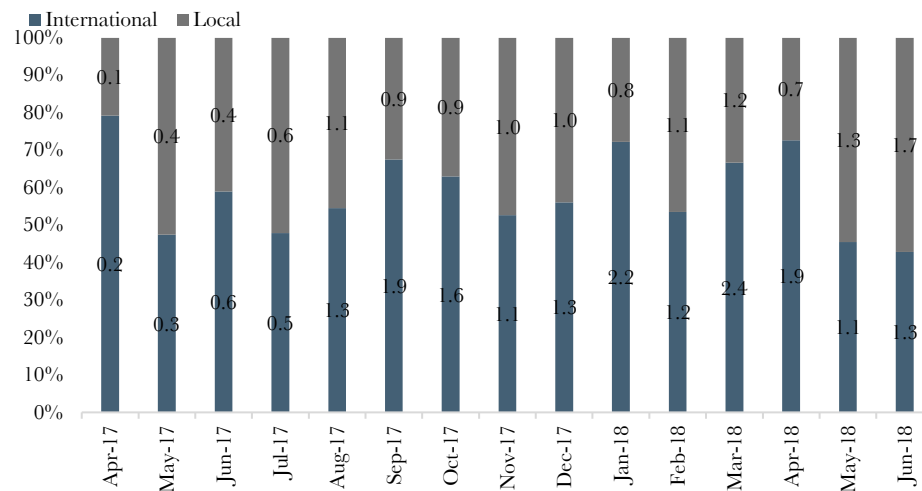
Country	Reference Production level	Adjust ment	Production level effective Jan'17	Q1 17	Q2 17	Q3 17	Q4 17	Q1 18	Q2 18E
Algeria	1.089	(0.05)	1.039	1.04	1.03	1.03	1.00	1.02	1.01
Angola	1.751	(0.09)	1.664	1.64	1.66	1.66	1.63	1.59	1.57
Ecuador	0.548	(0.03)	0.522	0.53	0.53	0.54	0.52	0.52	0.52
Gabon	0.202	(0.01)	0.193	0.19	0.20	0.20	0.20	0.20	0.20
Iran	3.975	0.09	4.065	3.80	3.81	3.83	3.84	3.83	3.82
Iraq	4.561	(0.21)	4.351	4.46	4.44	4.51	4.36	4.46	4.47
Kuwait	2.838	(0.13)	2.707	2.74	2.71	2.72	2.72	2.71	2.71
Libya	0.528	-	0.528	0.65	0.72	0.94	0.95	1.00	1.00
Nigeria	1.628	-	1.628	1.38	1.49	1.68	1.73	1.72	1.58
Qatar	0.648	(0.03)	0.618	0.62	0.61	0.61	0.60	0.61	0.61
Saudi Arabia	10.544	(0.49)	10.058	9.98	10.09	10.18	10.12	10.10	10.09
U.A.E	3.013	(0.14)	2.874	2.92	2.90	2.92	2.90	2.88	2.85
Venezuela	2.067	(0.10)	1.972	1.99	1.97	1.95	1.78	1.57	1.45
	33.39	(1.17)	32.22	31.94	32.18	32.76	32.35	32.21	31.86

Near-term FX stability remains intact

In the month of June, the Investors and Exporters Window (IEW) witnessed a rebound in activities with inflows rising double digit to \$2.98 billion (+20.4% MoM), to more than outweigh outflows (+8.9% MoM to \$2.4 billion). As a result, the market returned to a net flow position of \$240 million. Net of CBN intervention in the market, the market would have booked a net outflow of \$232 million dollars (vs. net outflow of \$354 million in May).

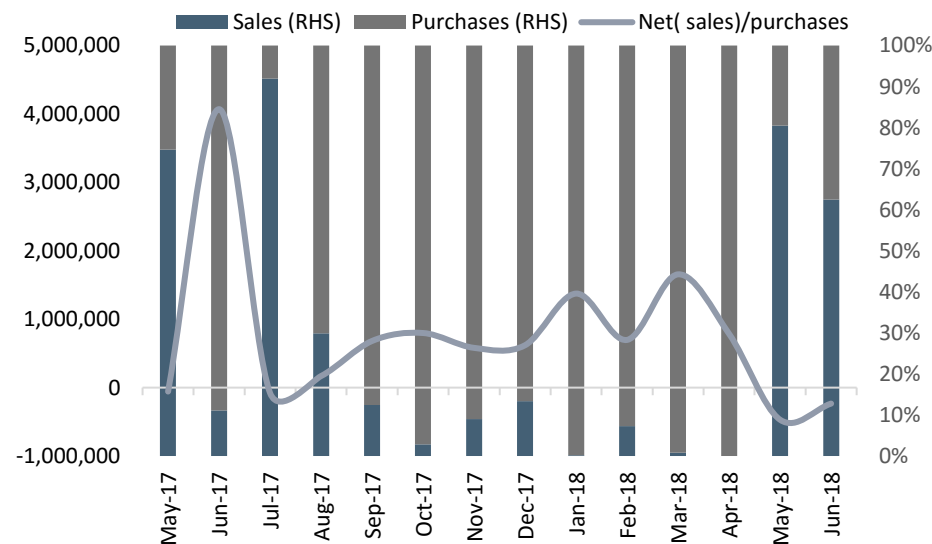
Going by breakdown, offshore inflow rose 13.6% MoM to \$1.3 billion (vs. revised \$1.1 billion in May) following inflows of FPI (+11.8% to \$1.1 billion) which on average accounts for 90% of total foreign inflows. Local flows (ex-CBN sales) was up 71.9% MoM to \$1.2 billion (vs. revised \$714 million in May) largely on the back of increase in Other corporates (92.2% MoM to \$1.2 billion compared to \$607 million in May) to account for 95% (vs. average level of 67%) of total local inflows. Further segregation of transactions revealed that spot transactions rose 28.8% MoM to \$5.6 billion, stemming from increases in both sales (24.9% MoM) and purchases (32.4% MoM) at the window, while forward transactions (-5.0% MoM) recorded a decline which was largely due to the lower maturing opened transactions during the month which limited sales transactions. Reflecting the overall rebound in transactions during the month, specifically offshore inflows, the apex bank inflows into the market declined 25.8% to \$472 million, and with a purchase of \$350 million at the same window, CBN recorded a net-outflow of \$122 million (an improvement from the net-outflow of \$470 million in May).

Figure 7: FX Inflow at the I&E Window (\$'Billion)



Source: FMDQ, ARM Research

Figure 8: CBN Activity at the IEW (\$'000) vs. Balance

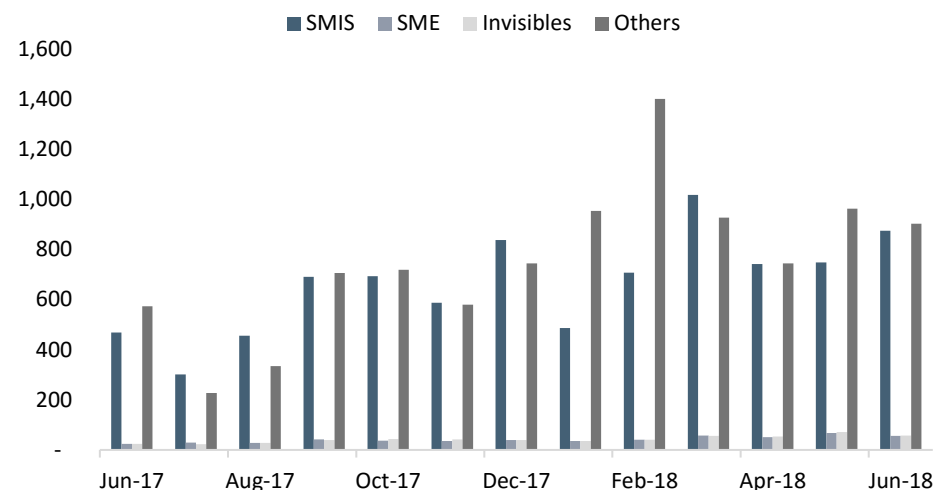


Source: FMDQ, ARM Research

Furthermore, CBN sales at other segments of the market rose slightly (20.2% MoM to \$2.2 billion vs. May: \$1.8 billion). The SMEs (3.9% MoM to \$70 million), SMIS (37.7% MoM to \$1.03 billion) and others (9.3% MoM to \$1.05 billion) segments received larger CBN intervention during the month. Reflecting the increased liquidity, the naira was broadly stable across segments of the market – BDC (₦359.58/\$), parallel (₦360.9/\$), and NAFEX (₦361/\$). Despite the intervention across markets, CBN outflows still declined 1.8% MoM to \$4.5 billion, relative to inflow of \$4.6 billion. Accordingly, the external reserve recorded an accretion of \$183 million during the month after shedding \$991 million between May 10 and June 22.

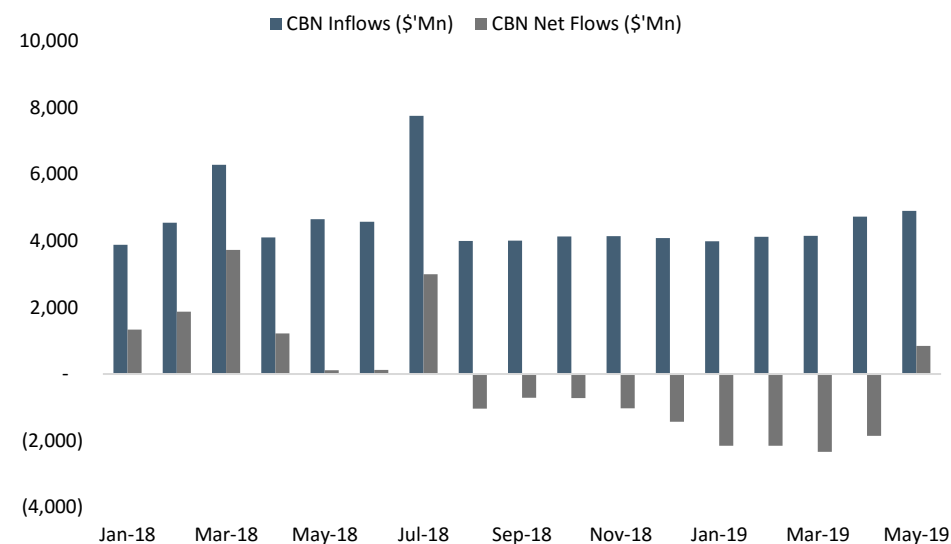
In our earlier estimate of flows to the apex bank during the year, we had estimated Eurobond issuance of \$2.0 billion. However, information from the recently signed budget revealed a higher issuance amounting to \$2.8 billion, with prospects of an additional \$600 million in bilateral borrowings. Coalescing the above adjustments, alongside higher inflows (average monthly of \$4.7 billion for the rest of the year) – with our view of crude oil price stability – and average monthly outflow of \$5 billion, we have raised our end year foreign reserve estimate to \$45.8 billion. Consequently, we are positive on the firmness of the exchange rate at the NAFEX market over the rest of the year, despite concerns over massive FX outflows.

Figure 9: CBN sales at other segments of the market



Source: FMDQ, ARM Research

Figure 10: Foreign Currency flows through the CBN



Source: CBN, ARM Research

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