

5 June 2018

Macro Economic Report | Monthly Update

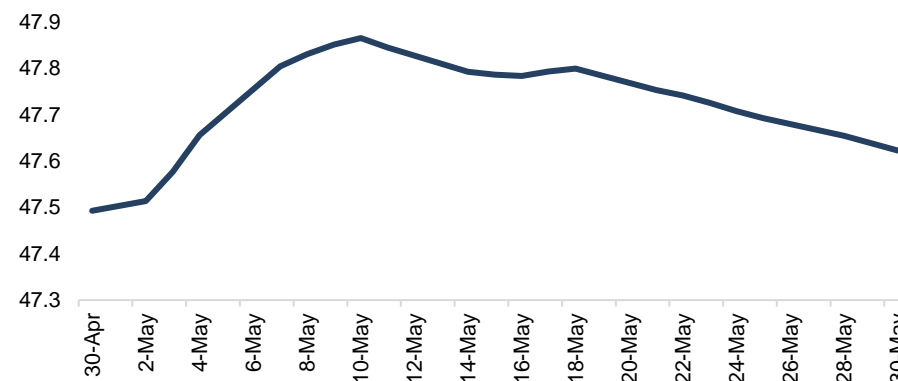
Macro Economic Update – May 2018

Has the FX reserve hit a snag?

After reaching a high of \$47.9 billion on the 10th of May 2018, which is ~\$16 billion accretion from a low of \$31.8 billion in September 2017, recent data from the CBN revealed a gradual drawdown of the reserve. For context, between 10th and 30th of May, the reserve has been drawn-down by \$243 million to \$47.6 billion. The drawdown of the reserve is largely connected with increased sale by the apex bank at the Investor and Exporter Window (IEW). Going by available data, the CBN increased its sales at the IEW window to \$128 million in May from \$65.3 million in April, in a bid to cover the sudden slump in FX inflows at the window.

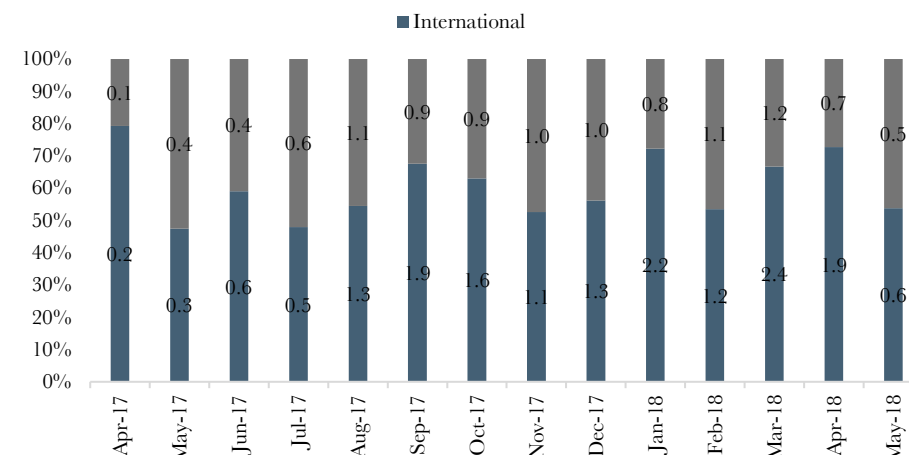
For the first time in 10 months, the IEW recorded a net-demand of \$1 billion from a net-supply of \$328 million in April following a 55% MoM decline in inflows to \$1.2 billion amidst a flat outflow (-3% MoM to \$2.2 billion) during the month. The steep decline in inflow reflected contraction in international flows (-67% MoM). Going by breakdown of offshore inflow, the decline stemmed largely from a 68% MoM decline in FPI flows to \$570 million (vs. \$1.7 billion in April) and a further slow-down in FDI flows by 93% MoM to \$6.6 million (vs. \$94 million in April). Local flows (ex-CBN sales) dipped 36% MoM to \$409 million (vs. \$641 million in April) largely on the back of decline in Other corporates (-36% MoM to \$365 million compared to \$570 million in April) and Exporters (-35% MoM to \$44 million compared to \$68 million in April).

Figure 1: FX Reserve stepping into the drawdown era



Source: CBN, ARM Research

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

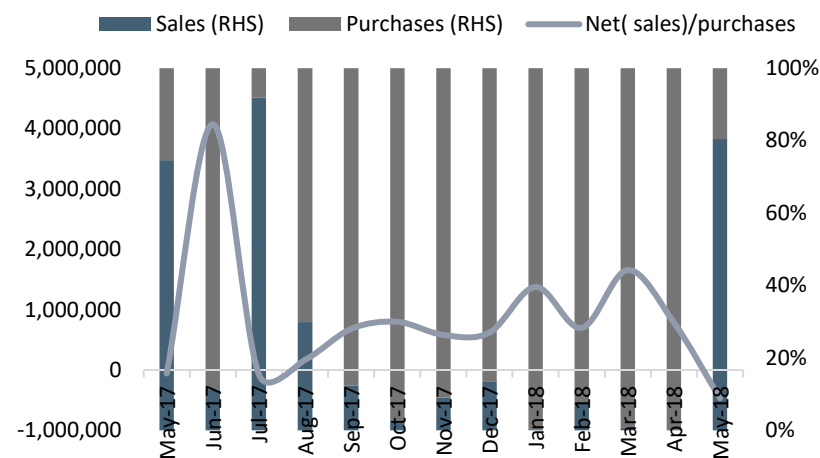


Source: FMDQ, ARM Research

To limit pass-through of pressure at the IEW on the parallel market, the CBN, in a notice released 28th of May, increased its frequency of sales to BDCs to three times weekly (previously twice weekly) and further instructed authorized dealers to continue to provide foreign currencies for invisible transactions over the counter.

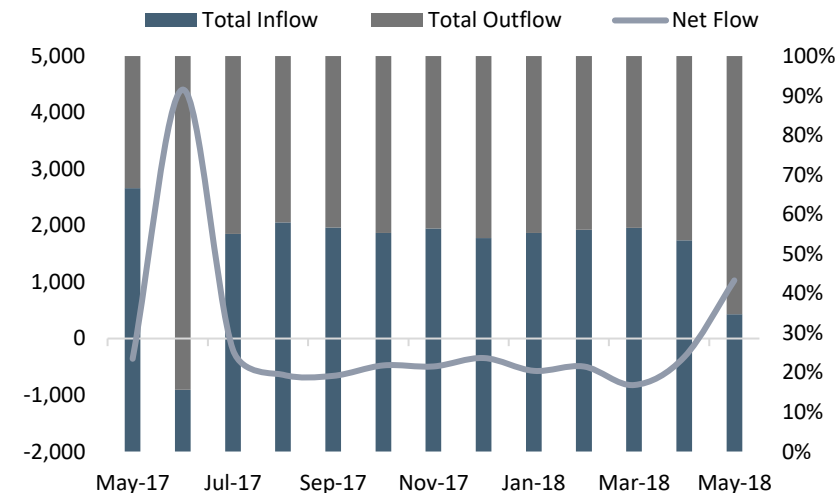
In our pre-MPC note ([MPC Preview: Rate cut delayed, not derailed](#)), we adjusted our outlook on the foreign reserve with a clear thought on how the quantum of capital reversal from maturing fixed income securities might have been downplayed. We assumed a case wherein foreign investors exit 50% of their maturing local fixed income instruments, which we estimate at \$9 billion (30% of \$37 billion – ₦11 trillion). This implies average monthly capital flight of \$697 million which added to our revised mean CBN intervention across other segments of \$4.3 billion brings average monthly outflows from the apex bank to \$4.9 billion. On our expected CBN inflows, we have adjusted our crude oil price projection to average \$70 per barrel for the rest of the year and factored in the \$2 billion Eurobond expected by the fiscal authority for the year, which raised our average monthly CBN inflow to \$4.6 billion. Accordingly, we estimate mean monthly reserve drawdown of \$340 million with an end year balance north of \$44 billion which translates to an import cover of sub 11 months.

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



Source: FMDQ, ARM Research

Figure 4: The balance of flows at the IEW



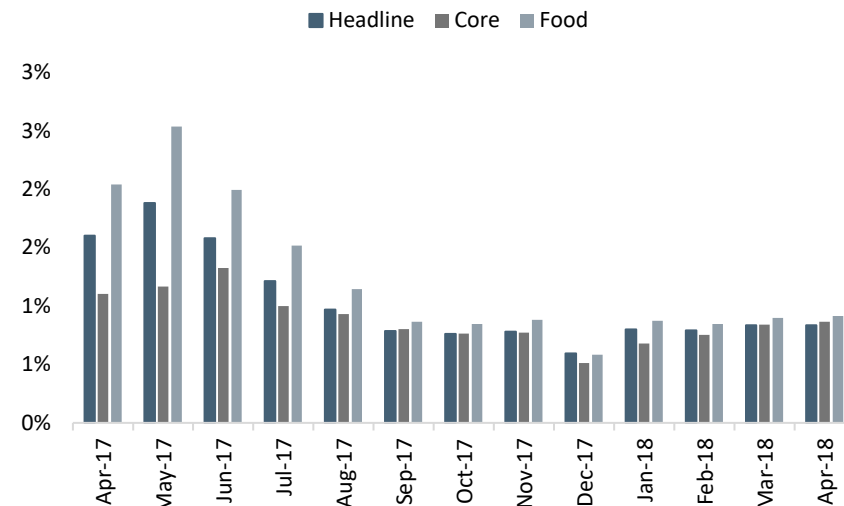
Source: FMDQ, ARM Research

Moderation in headline reading still driven by base effects

The deceleration in inflation rate continued for the fifteenth consecutive month as headline reading for the month of April printed at 12.48% YoY, 85bps lower than 13.34% YoY in the month of March. The decline in inflation continues to reflect the impact of base effects from elevated food and energy prices in the corresponding period of 2017. Disaggregating the sub-components, the decline in inflation largely stemmed from the food basket which dipped 128bps to a 24-month low of 14.80%. Also, core inflation dipped 26bps to 10.92% YoY. April's MoM headline inflation was unchanged at 0.83% driven by a slowdown in price increases in both the food and core baskets. On core, while average prices rose 2bps to 0.87% MoM, we highlight that it was lower than the 9bps jump in the prior month. The slow pace of increase in core inflation stemmed from lower energy prices as Housing, Water, Electricity, Gas and Other Fuels (HWEFG) declined 7bps to 0.62%. Precisely, on a MoM basis, the cost of Premium Motor Spirit (-7.3% to ₦151.4) and Diesel (-1.0% to ₦204.35) moderated with MoM transport inflation printing flat at 0.85%. Food inflation also rose 2bps MoM to 0.91% though, lower when compared to the 5bps increase in the prior month with lower prices of farm produce being the primary driver of the slowdown. Elsewhere, reflecting stability in the currency, MoM imported food inflation extended its moderation to print at 1.16% (-6bps).

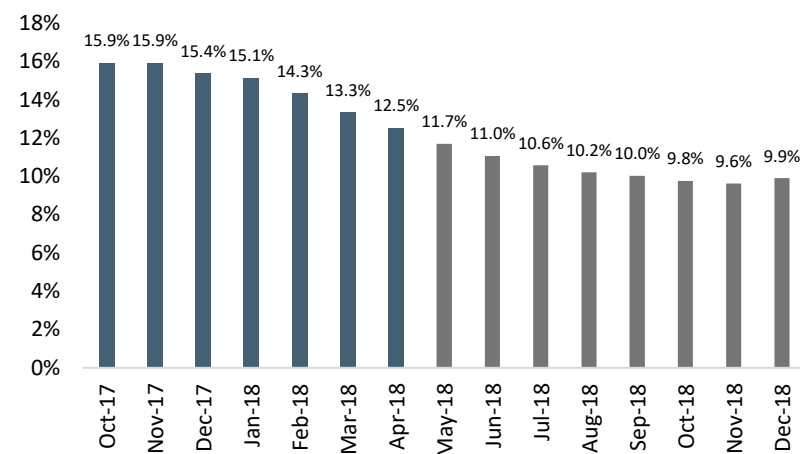
Our outlook for inflation hasn't changed. While the ongoing Ramadan would put pressure on demand with an attendant upward pressure on food prices, we see moderation on the headline reading in the preview month supported by base effects. This backdrop informs our call for an 83bps MoM moderation in overall headline reading to 11.7% YoY in May.

Figure 5: MoM inflation across sub-components



Source: NBS, ARM Research

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



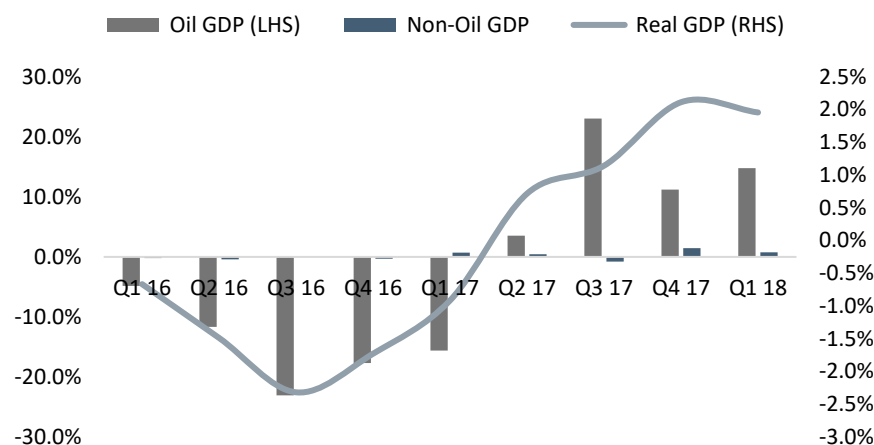
Source: NBS, ARM Research

Q1 18 GDP: Same Oil Story

The Nigerian Economy grew 1.95% YoY in the first quarter of 2018, weaker than 2.11% YoY in Q4 17 (revised from 1.92%). Oil sector was the pilot for growth, as it grew 14.8% YoY underpinned by higher oil production. In the non-oil sector, agriculture (+3.0% YoY) and manufacturing (+3.4% YoY) sectors sustained growth to drive non-oil sector growth of 0.8% YoY in Q1 18.

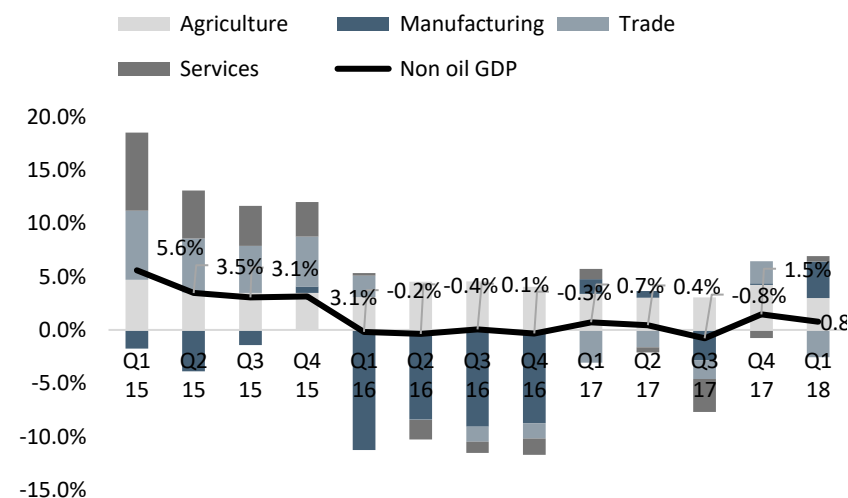
Dissecting the numbers, growth in the oil sector was hinged on higher oil production which printed at 2mbpd (14.3% YoY) while the passthrough of government support programs via cheap credit financing and increased farm inputs led the Agricultural sector to expand 3%. Elsewhere, the 3.4% growth in the manufacturing sector reflected improved dollar liquidity which in turn strengthened output in the Food, Beverage & Tobacco (+5.1% YoY) and Textile, Apparel & Footwear (+1.9% YoY) subsectors. Following three consecutive quarters of negative growth, the services sector returned to a positive terrain with a growth of 0.5% YoY. The performance in the sector reflected improved output in ICT (1.6% YoY) and financial services (13.3% YoY) subsectors. On the former, the telecommunication subsector was the major driver as data services grew 11.2% YoY to 100 million subscribers offsetting the impact of a downturn in voice calls (-3.6% YoY to 148 million active subscribers). On financial services, growth in fee income explained the 13.3% growth recorded. Surprisingly, trade sector which encompasses the process of re-branding and distribution of finished goods produced within and imported into the country, contracted by 2.6% YoY

Figure 7: Historical Movement in Real, Oil and non-oil GDP



Source: NBS, ARM Research

Figure 8: Historical Movement in components of the non-oil

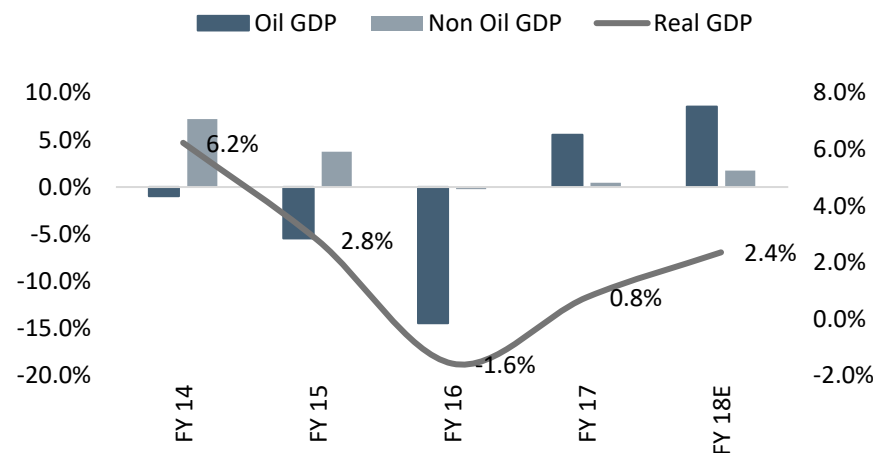


Source: NBS, ARM Research

Oil and Agric sector to drive growth in Q2 18 and FY 18

Going into the second quarter of 2018, while we have left our growth forecasts unchanged for Oil (+8.8% YoY), Services (+0.7% YoY), Agriculture (+3.1% YoY) and manufacturing (+2.5% YoY), we revised our trade forecast lower to 1% YoY (prior estimate: 2% YoY) to capture the slowdown in activities within the subsector. Accordingly, we now forecast an overall growth of 2.1% (revised from 2.2%) in Q2 18. Over the rest of the year, we expect stable and even higher crude oil output which should keep the oil sector in positive territory. On the non-oil front, we expect the rebound in the services sector to be sustained stemming from financial services and telecommunications—with persistent rise in the use of data services expected to douse the decline we foresee in voice calls and drive growth in the ICT and overall services sector. For the Agricultural sector, we believe the unrelenting efforts of the government, directed toward the sector via cheap credit financing, is set to leave the sector in positive territory. Notwithstanding the recent signs of currency pressures in the second quarter, efforts by the CBN to ensure currency stability moderates any cause for concern in the manufacturing sector. Juxtaposing these changes with the actual growth numbers reported in Q1 2018 translates to a full year growth of 2.4% YoY (prior forecast: 2.6% YoY) - with the oil and non-oil sector expected to grow by 8.5% YoY and 1.8% YoY respectively.

Figure 9: Movement in Annual Real GDP, Oil and non-oil GDP



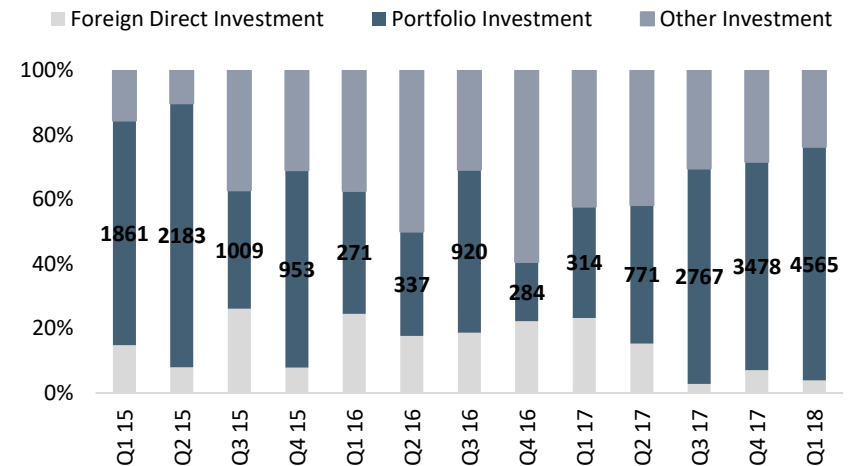
Source: NBS, ARM Research

Capital flows to succumb to push and pull factors

Capital importation for Q1 18 printed at \$6.3 billion (+17% QoQ; +594% YoY), which is almost at par with Q3 14 levels (merely \$240 million short). On a year-on-year basis, we witnessed a significant expansion across all lines on the back of the low base of last year (Q1 17: \$900 million). In line with historical trend, robust capital importation was largely driven by a surge in portfolio flows (+31.3% QoQ to \$4.6 billion) which contributed circa 72% of the total flow into the economy. Breakdown provided revealed that the sharp jump in FPI was on the back of strong flows to money market (61.9% QoQ to \$3.5 billion) which largely neutered the decline in flows to equity market (-29.1% QoQ to \$700 million). We link the sizeable flows to the money market instruments to investors' quest to lock-in on attractive rates relative to other frontier and emerging markets. Elsewhere, FDI and other investment declined for the period shedding 34.8% QoQ and 2.3% QoQ to print at \$246 million and \$1.5 billion respectively.

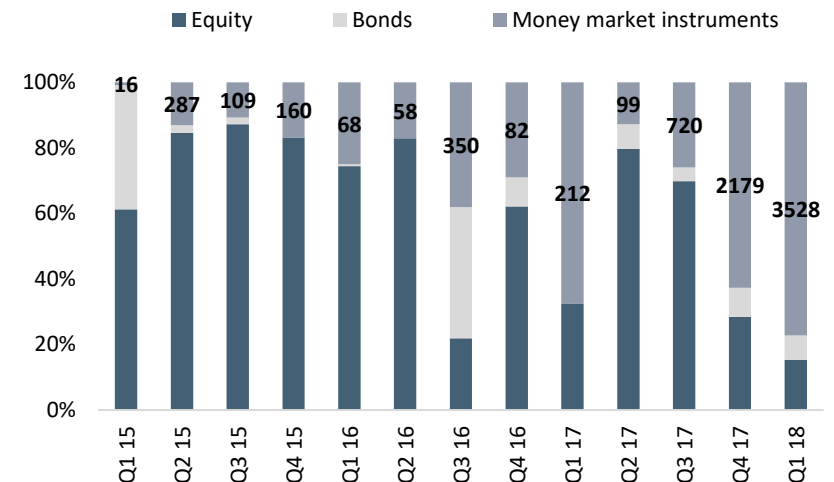
Going into the rest of the year, the duo of policy normalisation in advanced markets and election uncertainties in Nigeria could potentially create foreign investors' aversion towards naira assets and, by extension, reduce capital importation into Nigeria. Already in May, we saw some pressure at the IEW largely due to a slowdown in Foreign Portfolio Inflow with the equities market returning -7.7% MoM (April: -0.6% MoM, March: -4.2% MoM) while average yields in the fixed income market expanded 31 bps MoM in May. Thus, the slowdown of FPI flows at the IEW window points towards a moderation in capital inflow in Q2 18. In the second half of the year, we anticipate significant maturity in the fixed income market (H2 2018: ₦10.5 trillion) with ₦2.2 trillion maturing in December alone.

Figure 10: Capital Importation Composition (\$'mn)



Source: NBS, ARM Research

Figure 11: Foreign Portfolio Flows Composition (\$'mn)



Source: NBS, ARM Research

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