

Macro Economic Report | Monthly Update

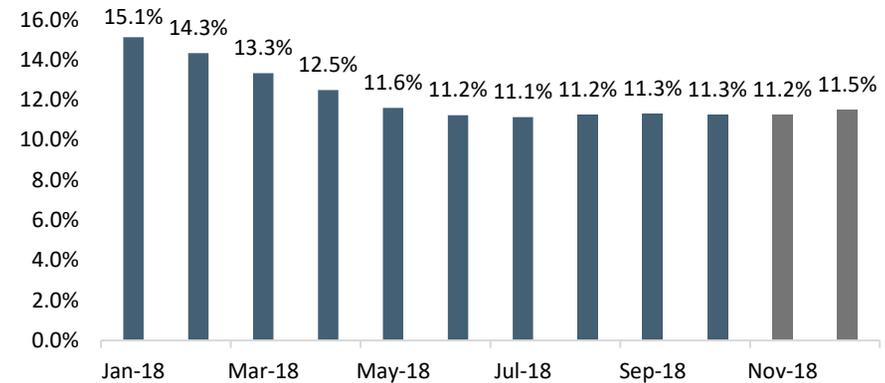
Macro Economic Update – November 2018

Average Inflation for FY 18 to close at 12.1% .

In October, headline inflation came in at 11.26%, slowing from 11.28% in september. The moderation reflects lower food prices which tamed the impact of the surprise uptick in core prices. On a MoM basis, headline inflation moderated by 0.74%, mirroring increased food supplies due to favorable harvest. Consequently, food inflation rose by 0.82% (-18bps MoM). On the flipside, core prices rose by 0.8% (+16bps MoM) – due to higher energy prices. For context, during the month, diesel and cooking gas prices were up by 2.42% and 1.40% MoM respectively. Specifically, price uptick observed across transport, clothing & footwear, household equipment and health outshined the moderation seen in HWEGF (-2bps to 0.48%) and education (-1bps to 0.68%).

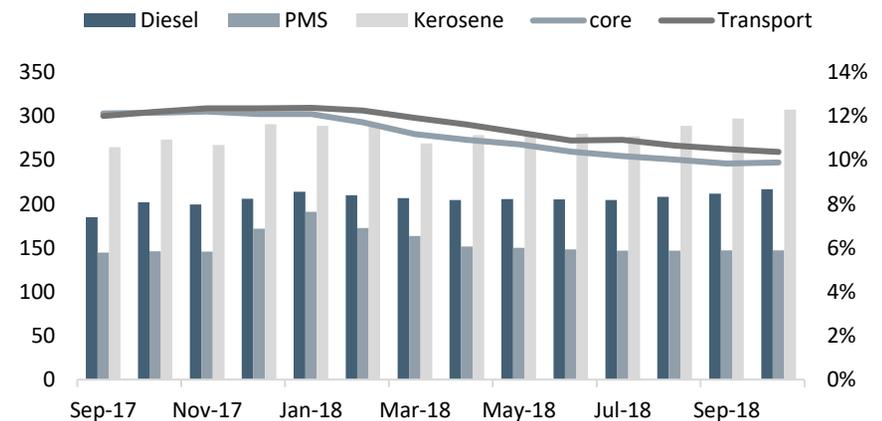
Going forward, while we still expect increased market supplies borne out of the favourable harvest – the seasonal nature of market demand as we approach the festive season is expected to drive food prices slightly higher. However, we expect a moderation in core prices which would support the headline inflation. Our premise on core prices is hinged on the downtrend seen in global crude prices as well as the efforts put in place by the NNPC to ensure supply of petrol and cooking gas throughout the country, both of which signals downtrend in energy prices. That said, we expect inflationary pressures to ease by 1bps to 11.25% in November, but tick higher by 25bps to 11.49% in December, with average inflation rate for the year expected to print at 12.1% (FY 17:16.5%).

Figure 1: Inflation rate – Actual and Forecast (YoY)



Source: NBS, ARM Research

Figure 2: Avg. energy prices (₦/litre) vs. Core & Transport Inflation (% YoY)



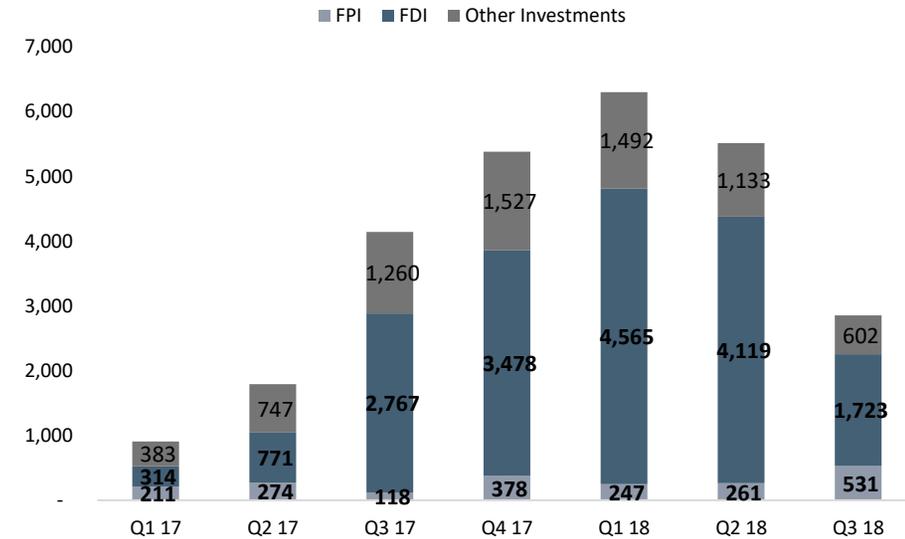
Source: NBS, ARM Research

Flight of no return?

Foreign investors continued to attenuate their investments into the country, with capital importation over Q3 2018 declining by 48.2% QoQ to \$2.9 billion, staggering below a quarterly high of \$6.3 billion in Q1 18. The contraction in flows stemmed from lower portfolio investments (-58.2% QoQ to \$1.7 billion) and Other Investments (-46.9% QoQ to \$602 million). On the former, the lower flows reflected moderation across the three instruments: portfolio investment into stocks (-62% QoQ to \$394 million), bonds (\$37 million) and money market instruments (-51.7% QoQ to \$1.3 billion). Similarly, debt securities, which is the largest component of Other Investments, declined 50% QoQ to \$561 million. Importantly, foreign investors aversion to naira assets continued to reflect higher yields in the US and uncertainties emanating from the coming general election. Meanwhile, Foreign Direct Investment (+103% QoQ to \$531 million) into the country surged over Q3 18 with most of the flows coming in July and August.

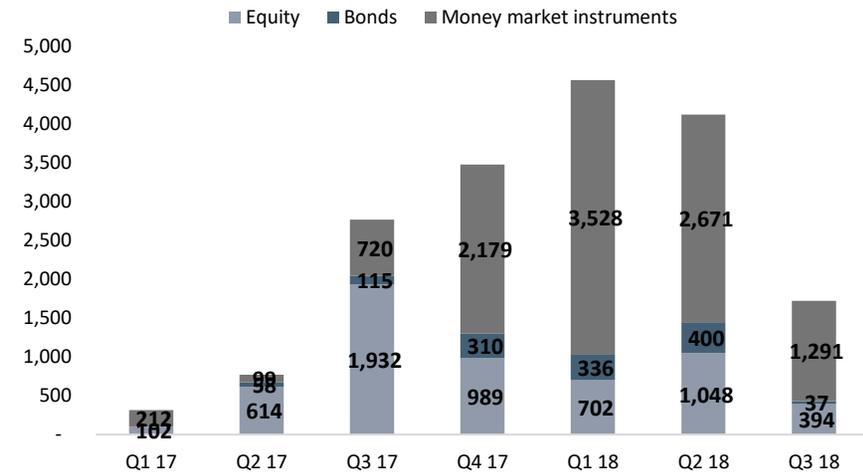
Flows across emerging markets, Nigeria inclusive, have seen significant drawbacks in the last few quarters following policy normalization in the US, amidst strong wage growth across advanced markets. The impact on Nigeria is further amplified by uncertainties preceding the general election which has further exacerbated foreign investors' aversion towards naira assets and, by extension, reduce capital importation. For the first two months in Q4 2018, the IEW has witnessed paucity of FPI inflows. Also, latest data for October showed that capital importation printed at \$818 million relative to monthly averages of \$952 million and \$1.8 billion in Q3 18 and Q2 respectively. According, over the last quarter of the year, we anticipate significant reduction in FPI flows, and overall capital importation into the economy.

Figure 3: Foreign Portfolio Investment (\$'mn)



Source: NBS, ARM Research

Figure 4: Capital Importation into Nigeria (\$'mn)



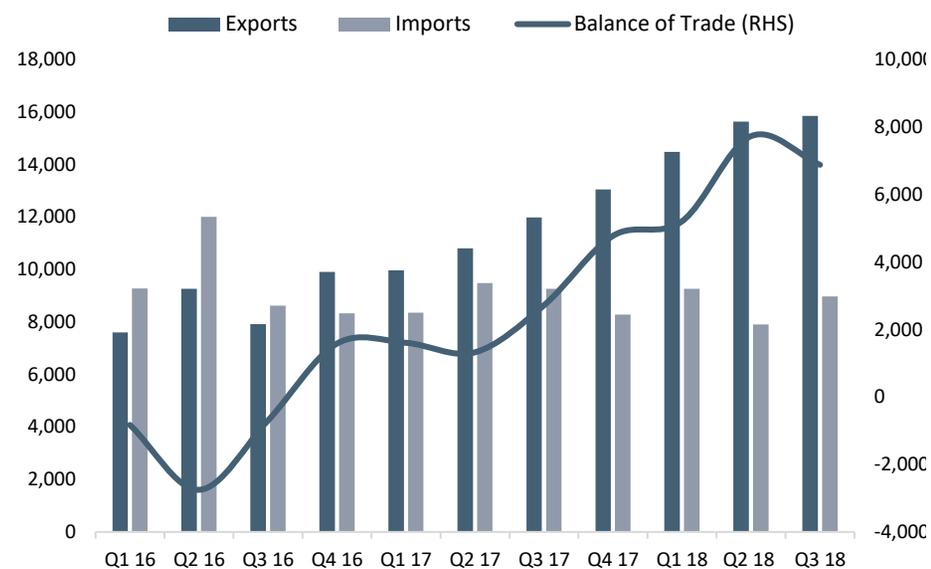
Source: NBS, ARM Research

Poor growth in exports drives dip in trade surplus.

When the books for the year is closed, it will be a pretty good ending for Nigeria trade balance. Over 9M 2018, Nigeria trade balance widened to \$19 billion from a meager \$5.6 billion in 9M 17. Concisely, the expansion emanated from a stronger export during the period which rose 40.3% YoY to \$45.9 billion, while import on the other hand shrank marginally by 3.5% YoY to \$26.1 billion. We note that the significant jump in exports value stemmed from the higher crude oil prices (average price of \$72.73 per barrel relative to \$52.53 in 9M 17) and production (average daily production of 1.72mb/d relative to 1.66mb/d in 9M 17), compared to 9M 17. For import, the slowdown reflects significant reduction in non-oil import (FY 17: 75% of overall import) over the year, which neutered NNPC's increased import of PMS in a bid to pre-empt oil shortages as election period draw closer.

While we expect trade balance will be weak over H2 18 compared to H1 18, as signalled by the contraction in trade balance over Q3 18 by 10.96% QoQ following a jump in import by +13.50% QoQ, which more than outweighed a sluggish growth in export (+1.41% QoQ). Also, data for October showed a drop in trade surplus for October by 92% MoM to \$178.46 million – the lowest monthly balance since the \$21.22 million deficit recorded in June 2017. Furthermore, the global rout in oil prices (QoD: -24.4% to \$61.83) which began at the latter part of Q4 18 is likely to weigh on value of exports. Meanwhile, we expect festive-season-induced increase in consumption, as well as the NNPC's drive for increased PMS imports (in a bid to curb oil scarcity) to boost imports during the period. Irrespective, given the strong outing earlier in the year, we expect the trade balance to close the year buoyant with a 71.8% YoY expansion to \$22.6 billion.

Figure 5: Trend in Trade balance (\$'mn)



Source: NBS, ARM Research

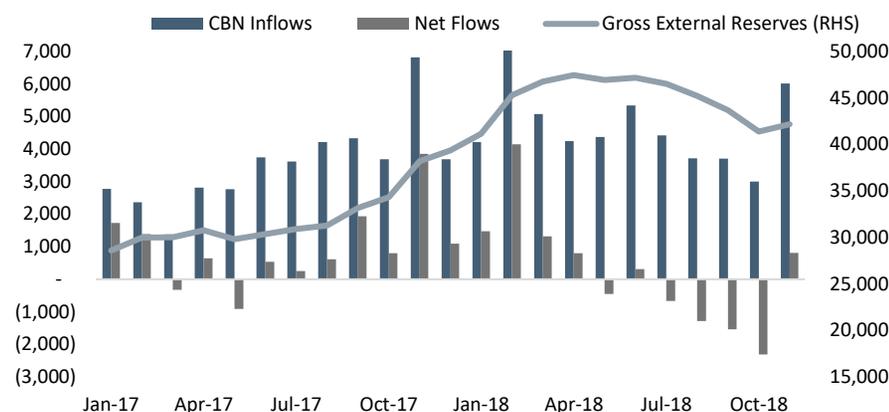
Paucity of flows amplified unmet demand at the IEW

The demand-supply gap at the Investors and Exporters Window (ex-CBN) widened in the month of November with total unmet demand rising 49.3% MoM to \$1.2 billion. The worrisome event largely reflects higher capital repatriation by offshore investors amidst paucity of FPI inflows. On supply, both offshore funds (+19.4% MoM to \$745 million) and local dollar sales – ex-CBN – (49% MoM to \$840 million) came in higher in November due to higher FPI flows (+24% MoM TO \$653 million) and increased local dollar sales by Non-bank financial institutions (+57% MoM to \$692 million). As a result, dollar supply at the IEW (ex-CBN), increased to \$1.6 billion (+33% MoM).

Elsewhere, the repatriation of funds by offshore investors persisted in November with a total outflow of \$2.8 billion (vs. \$2.0 billion in Oct). Notably, we estimate that out of total offshore holdings of maturing fixed income instruments during the month of \$2.1 billion (\$1.4 billion in October), a total of \$1.6 billion (\$1.1 billion in October) was repatriated, with the excess demand largely from foreign Non-bank financial institutions and importers' FX demand demand.

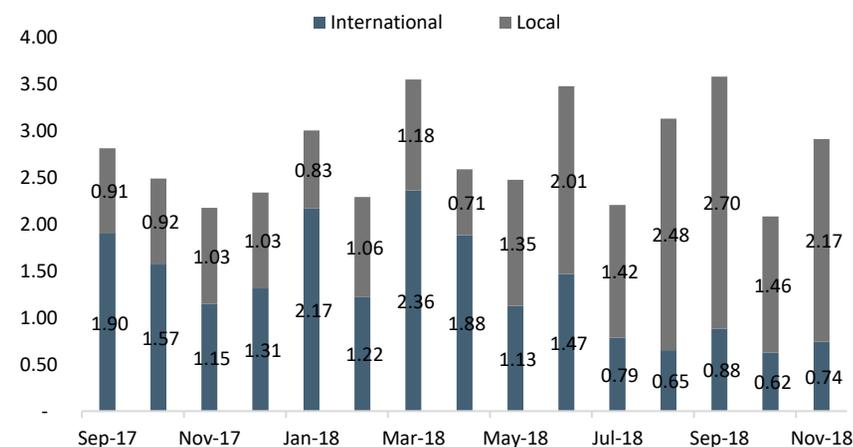
To address the significant gap between supply and demand during the month, the apex bank intervened to the tune of \$1.3 billion (+47.9% MoM) to clear the unmet demand in the market. With the news of the higher unmet demand filtering into the market during the month, we saw depreciation of the NGN at the parallel market ($\text{₦}367.5/1\text{\$}$) and NAFEX ($\text{₦}364.1/1\text{\$}$) market towards the end of the month.

Figure 6: CBN net flow and Gross Reserve position (\$'Million)



Source: CBN, ARM Research

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



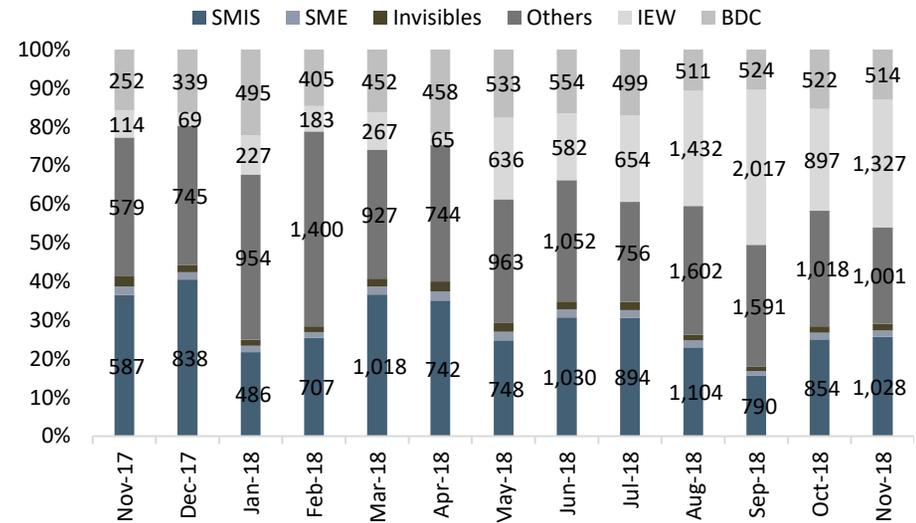
Source: FMDQ, ARM Research

To prevent the undue pressure at the parallel market, with a possible ripple effect at the formal market resulting in undue speculation, the apex bank increased the frequency of dollar sales to BDCs to four times a week (previously Monday, Wednesday and Friday), with an additional \$15,000 sales per BDC on Thursdays. As a result, weekly CBN intervention sales to BDCs per week will now increase to \$60,000 per week from previous \$45,000.

Reflecting the intervention across markets, total intervention by the apex bank came in higher by 17.7% MoM to \$4.0 billion in November. However, the impact on the gross external reserve was unfelt, as the FX reserve for the first time in five months recorded an accretion of \$172 million. Although, we had expected proceeds of the \$2.8 billion Eurobond – given that settlement is carried out within five working days – to hit the reserves in November and support an accretion in the reserve by at least \$500 million, we are yet to see a noticeable trace of it.

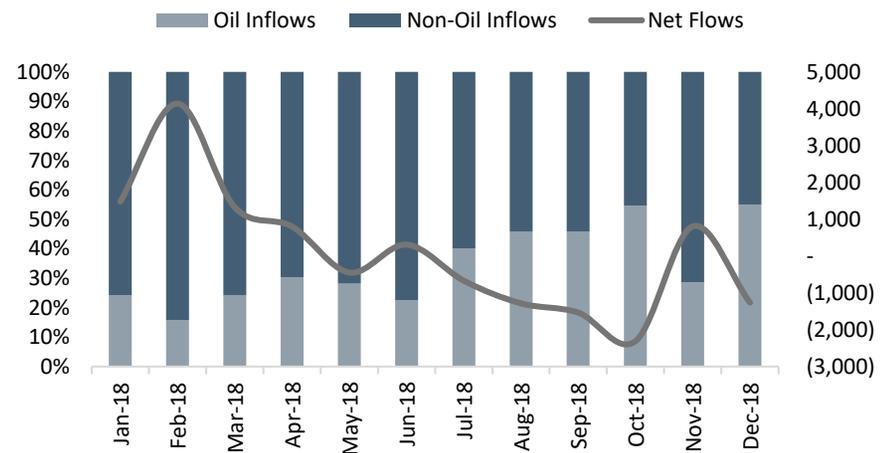
Over the last month of the year, we believe the interplay of persisting repatriation of funds by offshore investors with expected maturity of foreign holdings of fixed income instruments of \$2.3 billion and CBN sales across other segments, we believe overall outflow by the apex bank in December will increase to \$5.8 billion. Despite, gains from oil revenue and non-oil inflows from higher repatriation of funds by Nigerians in diaspora, with overall CBN inflow estimated at \$4.1 billion, we believe the higher outflow will leave the CBN with net outflow of \$1.3 billion in December with the gross external reserve closing the year at \$40.9 billion.

Figure 8: CBN intervention across official FX markets



Source: FMDQ, ARM Research

Figure 9: Foreign Currency flows through the CBN



Source: CBN, ARM Research

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