

**Economic Report | Monthly Update**
**Economic Update – August 2017**
**Economic Snapshot**
**July 2017 Inflation Data/Indices**

	MoM	YoY	Prev YoY
<b>Headline</b>	1.2%	16.1%	16.1%
<b>Food</b>	1.5%	20.3%	19.9%
<b>All Items Less Farm</b>	1.0%	12.2%	12.0%
<b>Imported food</b>	1.1%	14.1%	14.2%
<b>Energy</b>	0.3%	11.6%	14.2%

**Currency Markets**

	Latest	Daily Chg	YTD
<b>USDNGN</b>	363.5	1%	15%
<b>EURNGN</b>	430.7	1%	30%
<b>GBPNGN</b>	470.8	0%	21%
<b>JPYNGN</b>	279.2	0%	22%

**Monetary Aggregates – July 2017**

	(₦'bn)	MoM	YoY
<b>M2</b>	22,200	2.4%	-1.5%
<b>CPS</b>	22,172	0.8%	-1.1%
<b>NCG</b>	4,987	12.7%	66.0%
<b>NFA</b>	8,743	3.3%	15.6%
<b>NDC</b>	27,160	2.9%	6.8%

**External Position**

	Latest	QoQ	YoY
<b>Trade Balance (\$'mn)</b>	185.73	-21.5%	N/A
<b>External Reserves (\$'mn)</b>	31,812	25%	4.8%
<b>Foreign Debt (\$'mn)</b>	13,808	21.1%	23.3%

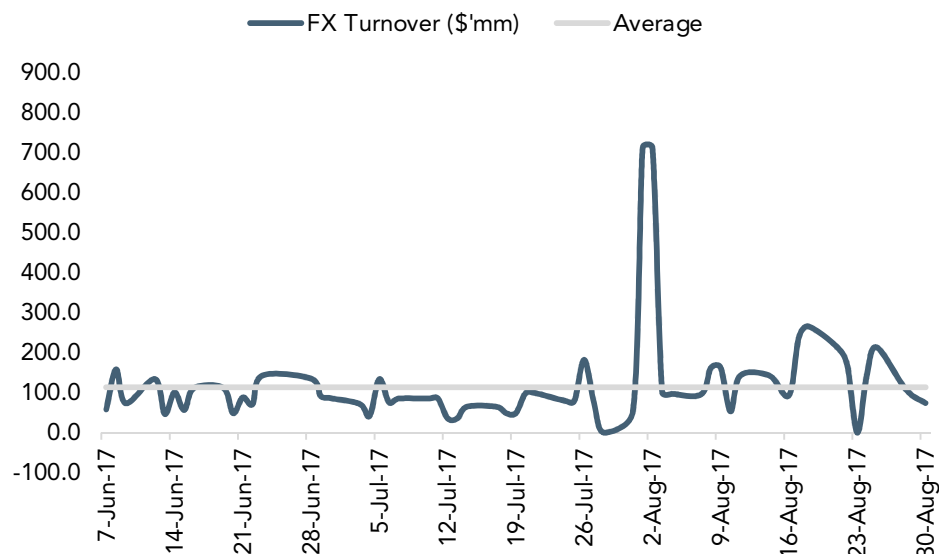
**Growth Data – Q2 2017**

	(₦'bn)	%of total	YoY
<b>Real GDP</b>	16,307	100%	0.5%
<b>Agriculture</b>	3,745	23.0%	3.4%
<b>Oil</b>	1,449	8.9%	1.6%
<b>Services</b>	5,974	36.6%	-0.5%
<b>Wholesale and Trade</b>	2,787	17.1%	-1.6%
<b>Manufacturing</b>	1,529	9.4%	0.6%

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**Naira faces fresh test at parallel end**

In August, the naira rebounded at the IEW (+2% MoM to ₦359.67/\$) with movements at the parallel end moving inversely to close August at ₦368/\$ (-0.82%). At the IEW, gains were largely reflective of further improvements in FX liquidity – turnover (+52% MoM to \$3.4 billion). In our view, sentiment for naira assets were also positively impacted by the regulatory move for banks to quote the floating IEW rate rather than a fixed exchange rate, which was seen by market as a move towards a unified, floating exchange rate. Elsewhere, the depreciation at the parallel market was partly underpinned by increased dollar demand pressures – evidenced by the sizable increase in CBN sales to the BDC over the last two months preceding August. Irrespective, the relatively smaller parallel market USDNGN contraction (-0.82% MoM) by end of August, from -1.9% by 24th August—suggests naira pressures rescinded in the final week of August. For us, this relief was reflective of CBN's directive in August 15, 2017 allowing oil marketers assess dollars at the CBN window for payment of port, maritime administration & safety charges which eased demand pressures at the parallel market.

**Figure 1: Historical movements in FX turnover**



Source: FMDQ, ARM Research

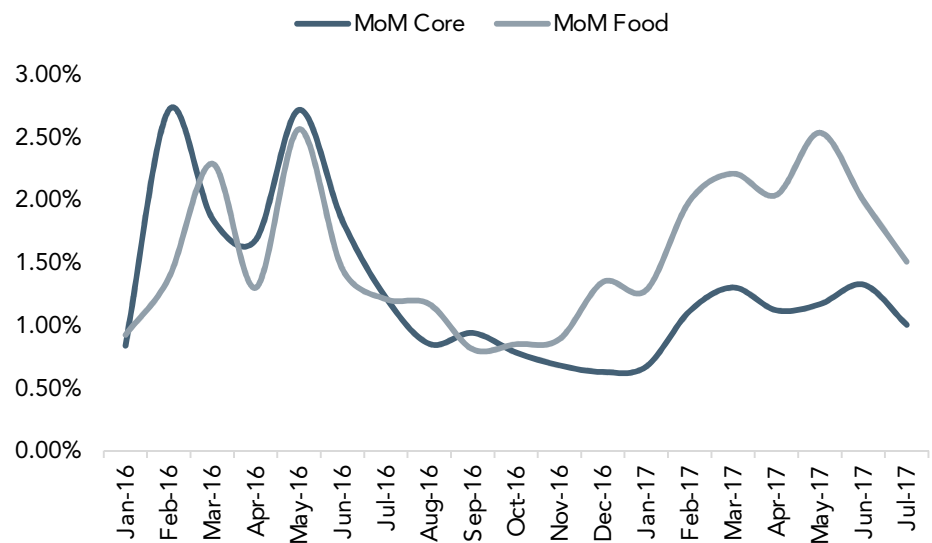
Despite glitches in demand pressures over the review period, we retain our expectation for near term stability of the naira at the different windows with subsisting improvements in fundamentals (Forex reserve: +2.5% MoM to \$31.5 billion; crude production: +14% from April to ~2mbpd in our estimates) providing fresh backing for sustained CBN dollar sales. Beyond this, amidst elevated interest rate and upbeat economic picture, FPI inflows should provide further boost to dollar supply in the coming months.

### ***Food Inflation: what goes up must come down...or not?***

In line with the trend over the past five months, headline inflation declined 5bps from prior reading to 16.05% YoY in July. Whilst the YoY reading was heavily dictated by another moderation in core inflation—consequent on the oft noted dissipation of electricity and PMS price hikes from the sub-basket, the 37bps contraction in MoM headline reading to 1.21% emanated from decelerations in both MoM core (-32bps) and food (-49bps) inflation momentum. The temperance in core inflation was most evident in the HWEGF sub-basket, which experienced its sharpest moderation in 12 quarters in the review month. At the other end, the decline in MoM food inflation—the second in as many months—largely reflected an almost ubiquitous step-down in price momentum in key food segments such as

farm produce (-44bps), imported food (-44bps), and processed food (-106bps) with the latter two possibly indicating some lagged impact of improved dollar supply. While we retain this view on pass-through of currency gains on food inflation, we note that although MoM transport inflation experienced its sharpest moderation in over 11 months in July, it remained sizably higher than trend levels to suggest that cost of food transport was still on the high side. To this end, our correspondence from within the bureau suggests that pressures on the transport front reflected high cost of car/truck maintenance which neutered gains from lower diesel and PMS prices. Beyond this supply-side shock, the intersection of lean seasons in both the Southern and Northern Nigeria was unable to stall the MoM food inflation moderation.

**Figure 2: Historical movements in core and food inflation**



Source: NBS, ARM Research

Going forward, we expect another subdued moderation in transport inflation owing to sustained declines in MoM PMS and diesel prices. This, combined with the end of lean season in the southern part of the country, underpins our expectation for further temperance in food inflation in August. This view is bolstered by continued growth in domestic production of hitherto imported food items following CBN's doggedness in retaining its FX rationing for imports. Elsewhere, we also expect core inflation to decelerate in the absence of supply shocks to the index—with declining inflationary pressures from energy and

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transportation prices bolstering our case. Against this backdrop, we now look for MoM headline reading of 1% for August (July: 1.58% MoM). However, reflecting the high base effects in the earlier part of the year, our projected MoM reading translate to a largely unchanged YoY inflation of 16.04% for August

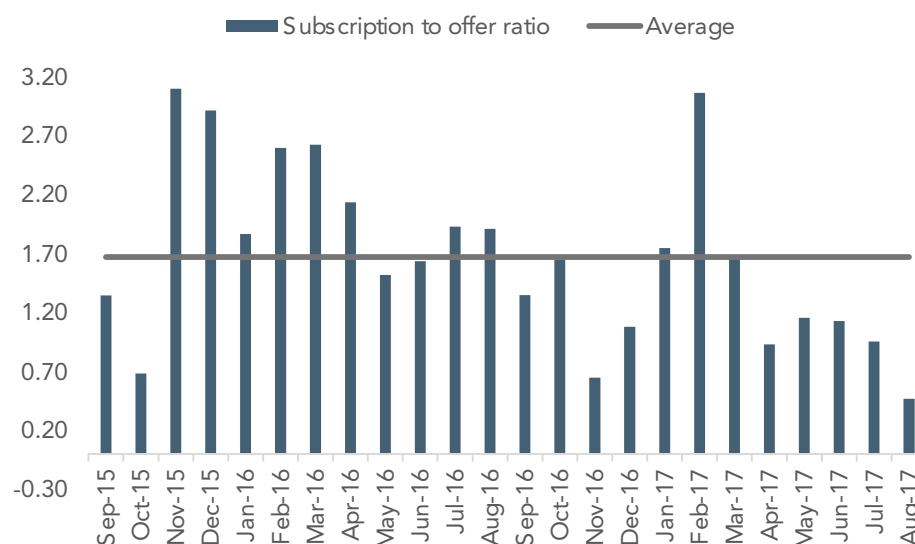
### ***Rising T-Bill demand underpins yield curve tightening***

The naira yield curve extended its contractionary trend (-8bps MoM to 18.40%) for the second consecutive month in August reflecting lower yields on short dated instruments (-35bps MoM) which more than offset upswing in bond yields (+20bps MoM). Akin to July, we believe the decline in T-Bill yields largely reflected increased bank purchases following CBN's issuance of a ₦250 billion stabilization securities on the second of August at below market rate of 17.1%. Elsewhere, after trading flat for most of the month, bond yields climbed 15bps over the last seven trading days of the month as investors reacted to the higher marginal clearing rate (+59bps to a seven month high of 16.83%) at August's bond auction. In contrast to January's auction where aggressive fiscal borrowings underpinned the rise in marginal rates, August's climb reflected lower subscription<sup>1</sup> (-47% MoM to ₦56 billion) which compelled the DMO into allotting only 42% of the ₦135 billion on offer. Given CBN's ₦61 billion OMO issuance in the penultimate bond auction day—highest since the turn of the year—, we believe liquidity constraint as well as investors increased appetite for higher yielding short dated instruments underpinned the decline in the subscription level. Added to this, is the planned issuance of a combined ₦112 billion debt by the Lagos state government, at premia to corresponding sovereign instruments, in the week preceding the auction which we think diverted some of the funds that would ordinarily have been deployed to the FG's auction

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<sup>1</sup> The subscription to offer ratio of 0.47x is the lowest on record

**Figure 3: Trend in Subscription to offer ratio at FG's monthly bond auction**



Source: DMO, ARM Research

**Table 1: Lagos State's bond issuances over August**

Instrument	Tenor (years)	Amount (₦' billion)	Interest rate	Yield on corresponding FG security*
Lagos Bond	7	46.37	16.75%	16.35%
Lagos Bond	10	38.77	17.25%	16.53%
Lagos State Waste management bond	5	27**	17.50%	16.36%
<b>Total</b>		<b>112.14</b>		

Source: Lagos state government, FMDQ, ARM Research \*FG yields were dated 11<sup>th</sup> of August 2017, \*\*- amount on offer

Going forward, we expect concerns over inflation and subsisting worries on the currency front to sustain CBN's contractionary monetary policy. That said, given the prospect of below market rate stabilisation security issuances by the apex bank, we think the deluge of OMO maturity over the rest of the year (₦2.3 trillion) could sustain the buying pressure at the short end of the curve, which should apply downward pressure on T-bill yields. Elsewhere, whilst we expect some moderation in the marginal clearing rate at the bond auctions as liquidity improves, we think investors' preference for higher yielding short dated instrument should keep rates high. Overall, we project a slight decline in the naira yield curve over the near term.

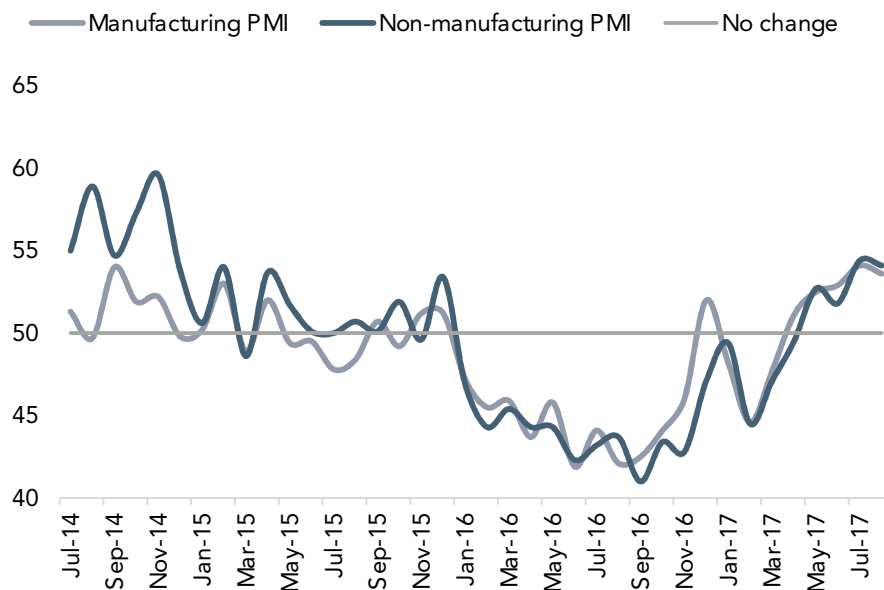
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### *Recovery still on course despite slower PMI reading*

Purchasing Manager's index (PMI) sustained its expansionary trend in August with the manufacturing and non-manufacturing sectors expanding at a slower rate to 53.6 and 54.1 index points respectively. Breakdown revealed that expansion in manufacturing PMI was supported by growth across its five sub-indices - new orders, supply delivery time, employment level, raw material inventory and production levels. Elsewhere, the non-manufacturing PMI, which expanded for the fourth consecutive month in August, was supported by faster growth in employment and inventory level sub-indices. Further breakdowns indicated growth in employment and inventory levels were more conspicuous in construction and accommodation & food services sub sectors. Elsewhere, business activity and new orders grew at a slower rate with most of the draw-back reflective of weaknesses across real estate; construction; arts, entertainment, and recreation; and professional, scientific, and technical services.

As previously communicated, we perceive that the economy is still on track for further recovery in the third quarter of the year on the strength of sustained expansion in PMI readings which have, thus far, coincided with improved dollar liquidity in the country. For us, the improved liquidity has ameliorated pressures from high FX exposure across key manufacturing segments with knock-on effect also evident across their balance sheets. Thus, further aided by improvements in the crude production front following re-opening of Trans Forcados and relative peace in the Niger Delta, we forecast GDP growth forecast of 1.7% YoY for the third quarter of 2017.

**Figure 4: Historical movements in PMI**



Source: CBN, ARM Research

### ***CBN's new non-interest instruments: Are NIFIs approaching take-off stage?***

Towards the close of August, the CBN introduced two new funding instruments (Funding for Liquidity Facility – FfLF and Intra Day Facility – IDF) for licensed non-interest financial institutions. This move, aimed at boosting liquidity, allows licensed Non-Interest Financial Intermediaries (NIFIs) to secure interest-free overnight funding from the CBN, backed by eligible securities<sup>2</sup> worth 1.1x the size of requested facility. Given the scope of NIFIs which exempts them from Treasury bills and OMO securities, the slow deposit growth of these institutions compared to commercial banks continues to push NIFIs to increase market funding to bridge funding gap. Likewise, with government-backed Sukuk listed as eligible securities we expect a successful turn-out for FG Sukuk bond and expect more issuances by FG, states, and corporates.

According to the CBN, the FfLF would operate between 2pm and 3:30pm daily with the apex bank expected to receive back its funding and return collateral to the NIFI upon maturity. Should a NIFI default on its obligation, the provision

<sup>2</sup> Acceptable collateral/securities will be specified by the CBN from time to time with CBN Safe Custody Account (CSCA); CBN Non-Interest Note (CNIN); CBN Asset-Backed Security (CBN ABS); Sukuk with liquidity status from the CBN; Warehouse receipts as approved in the CBN act; and other collateral designated by the bank highlighted as potential securities.

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allows the CBN to rediscount the pledged security at par, recover the facility amount, and return net value to the NIFI. The features of the IDF are also largely like that of the FFLF, with the provisions requiring collection & settlement<sup>3</sup> of funding to occur on the same day. Instructively, whilst both facilities are expected to be extended to NIFIs on a no interest basis, the Market Support Committee (MSC) of the CBN retains the right to impose administrative charge on the transaction if it deems fit. This charge would be dependent on cost borne in providing the facility<sup>4</sup>. Overall, the introduction of the two non-interest instruments reinforces ongoing efforts to enhance liquidity in the broader system with earlier deliberations to license stockbrokers to access CBN's liquidity window already well documented.

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<sup>3</sup> Repayment of the IDF shall be between the hours of 10.00 a.m. and 3.00 p.m. each business day

<sup>4</sup> Communication/correspondence cost; printing/stationary cost; and any other direct and actual cost(s) that do not contravene the principles of non-interest banking as provided in the CBN guidelines.



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