



Economic Research

ARM Research

research@armsecurities.com.ng

+234 1 270 1652

7 July 2014

Economic Report | Monthly update

Economic Update – June 2014

Economic Snapshot

May 2014 Inflation Data/Indices

	MoM	YoY	Prev YoY
Headline	0.8%	8.0%	7.9%
Food	0.8%	9.7%	9.4%
All Items Less Farm	0.6%	7.7%	7.5%
Imported food	0.9%	8.8%	8.0%
Energy	0.9%	4.1%	7.0%

Currency Markets

	Latest	Daily Chg	YTD
USDNGN	162.60	0.34%	-1.4%
EURNGN	221.28	0.74%	-0.5%
GBPNGN	278.93	0.45%	-4.8%
JPYNGN	159.11	0.74%	-4.5%

Monetary Aggregates – May 2014

	(N'bn)	MoM	YoY
M2	15,907	-0.4%	3.1%
CPS	16,769	-1.5%	8.3%
NCG	-1,761	1.6%	-21.7%
NFA	7,693	-0.3%	-18.2%
NDC	15,008	-1.8%	13.4%

External Position

	Latest	QoQ	YoY
Trade Balance (\$'mn)	10,407	15%	5.1%
External Reserves (\$'mn)	36,757	-2.8%	-24.1%
Foreign Debt (\$'mn)	9,166	3.9%	37.4%

Growth Data – Q4 2013

	(N'bn)	%of total	YoY
Real GDP	65,259	100%	7.4%
Agriculture	14,033	21.50%	1.6%
Oil	8,941	13.70%	5.2%
Services	23,546	36.08%	9.5%
Wholesale and Trade	11,134	17.06%	7.8%
Manufacturing	5,163	7.91%	14.6%

Oyekunle Omotayo-Benson

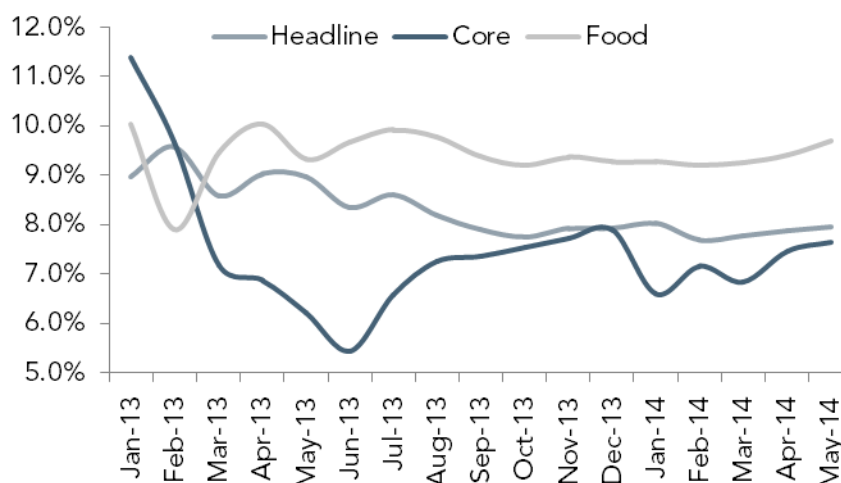
oyekunle.omotayo-benson@arm.com.ng

Inflation nudges higher on 'core' and 'food' pressures

The NBS reports that CPI for May 2014 rose 8% YoY—10bps ahead of the April reading, but behind our estimates by a similar margin. The upswing in YoY headline inflation was underpinned by 20bps and 30bps increases in YoY core and food inflation to 7.7% and 9.7% respectively. MoM, headline inflation of 0.8% was 20bps higher than April reading on the back of a 20bps increment in core inflation to 0.6%, even as food inflation remained flat (0.8%) from the preceding month. The NBS links observed increments in core and food CPI to respective increases in solid/liquid fuels and cereal prices. The uptrend in food inflation corroborate FEWSNET's assertion of an pickup in cereal prices due to higher fuel prices across Northern Nigeria and lower than normal trade flows from North-Eastern Nigeria, due to conflict related market disruptions.

Although, FEWSNET expects better prospects for 2014 harvest given increases in cultivation and favourable rainfall patterns, we continue to see recent escalation in the deadliness and geographical spread of Boko Haram (broadened by pastoralist-farmer conflicts across the north) as posing risks to food outlook, amid potential currency and food-related shocks.

Figure 1: Trends in YoY food, core and headline inflation



Source: NBS, ARM Research

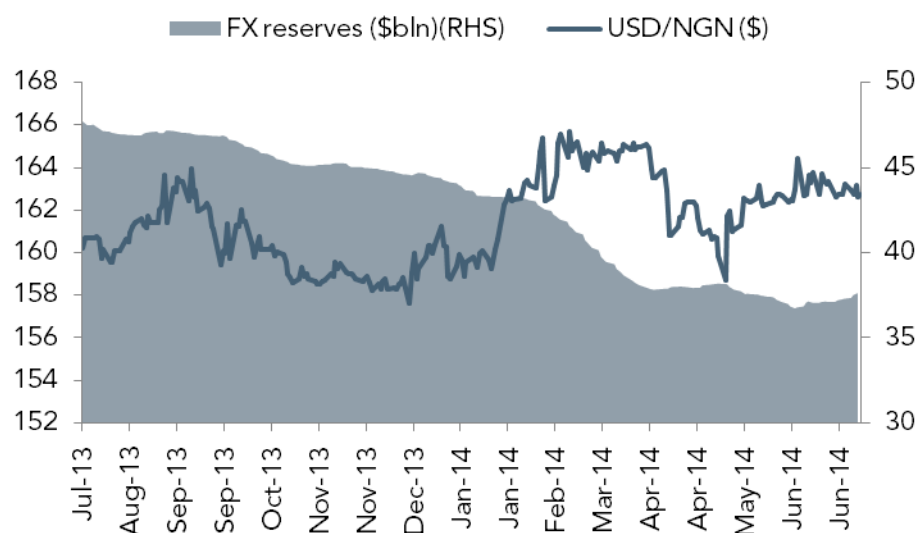
Moderating IOC interbank activity underpins USDNGN weakness

USDNGN weakened further by 0.13% MoM to close June at ₦163/\$. Recent pressures mainly reflect the combined effect of an uptick in demand even as supply to the interbank market improved on net with 6% MoM increase in RDAS sales to \$2.7 billion tempered by continued compression in IOC dollars sales (-21% MoM¹). Nonetheless, overall supply dynamics appear to have been boosted by the rise in oil prices and exports²,--the latter on the heels of removal of the force majeure on major sections of the 850kbpd Trans Forcados pipeline the prior month. Accordingly, despite higher RDAS sales foreign reserves rose 1.4% MoM to \$37.5billion (-3.1 MoM in May 2014).

¹ ARM Research estimates

² Bloomberg loading schedules point to a 7% MoM rise in oil exports

Figure 2: Trends in foreign reserves and USDNGN



Source: Bloomberg, ARM Research

In contrast to May's compression, the spread between parallel and interbank USDNGN rates widened slightly to ~~~₦~~5/\$ following the release of CBN circular that raised minimum capital requirement for BDC operators from ~~₦~~10 million to ~~₦~~35 million with effect from July 15th, 2014. In addition, the CBN measures include an upward review of the mandatory cautionary deposit to ~~₦~~35 million—to be deposited in a non-interest yielding account- and the abolition of the ownership of multiple BDCs. Furthermore, the apex bank also cut its weekly sales to BDCs by ~70% to \$15,000.

Table 1: Spread between Parallel and Interbank Market rates

	January	February	March	April	May	June
BUREAUX-DE-CHANGE	168.5	171.5	171.5	168	167	168
INTER-BANK	162.57	164.85	165	160.7	162.8	163.01
SPREAD	5.93	6.65	6.5	7.3	4.21	4.99

Source: FDHL Analytics, ARM Research

We anticipate continued improvements in reserve accretion despite the *force majeure* declared by Shell on its EA field³ due to technical issues early in June as it is a relatively small field, – a view buttressed by Bloomberg loading schedules which suggest a 6% rise in oil exports to ~2.2mbpd for July regardless. Whilst we expect the uptick in oil revenues to buoy the Naira, recent administrative measures could weigh on currency as most smaller BDCs likely front load FX demand as they attempt to meet the new requirements. This portends some further weakening for the naira at both the interbank and BDC markets in the run up to the July 15th deadline, with spreads likely to widen thereafter.

Loose monetary conditions continue to underpin yield compression

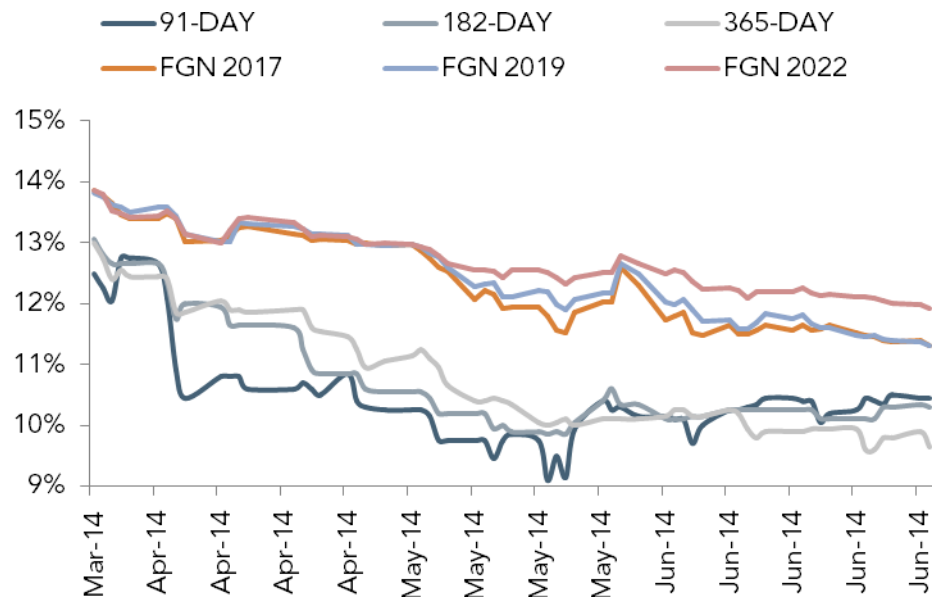
On the heels of a MoM doubling in May, OMO issuance gathered steam in June (+44% MoM to a seven-month high ₦1.1trillion) in response to rising system liquidity. Nonetheless, money markets continued to remain largely loose⁴ on account of higher maturities and FAAC inflows (+17% MoM at ₦684billion). Consequently, on average bond yields compressed 89bps MoM in June to 11.39%, 11.38% and 11.99% for the FGN 2017, 2019 and 2022 respectively. Whilst this downtrend extended to T-bill yields, buying was concentrated on the 364-day paper which declined 20bps MoM to 9.95% whilst the 182-day was flat MoM at 10.35%, even as the 91-day paper rose 30bps MoM to 10.45%. This possibly reflects investor responses to initial near term dovish rate guidance by the new CBN helmsman.

On this note, whilst the new apex bank governor clarified his initial stance by delaying a rate cut till after 2015 elections, we expect elevated liquidity conditions to persist. A further boost could emanate from AMCON repayment of ₦800billion bonds in August, as reported by *Bloomberg*, which underpins scope for further yield compression. On the policy front, with ‘normal’ tools at their limits, we see greater possibility of the apex bank adopting an asymmetric corridor around MPR by adjusting the SDF. Farther out, amid subdued inflation readings and given the new governor’s guidance, prospects of transition to a lower rate environment strengthen.

³ Production capacity at the EA field is estimated at ~40,000mbpd (~2% of total crude production)

⁴ June end ₦433billion vs. ₦357billion as at the end of May 2014

Figure 3: Yield trends in Q2 14



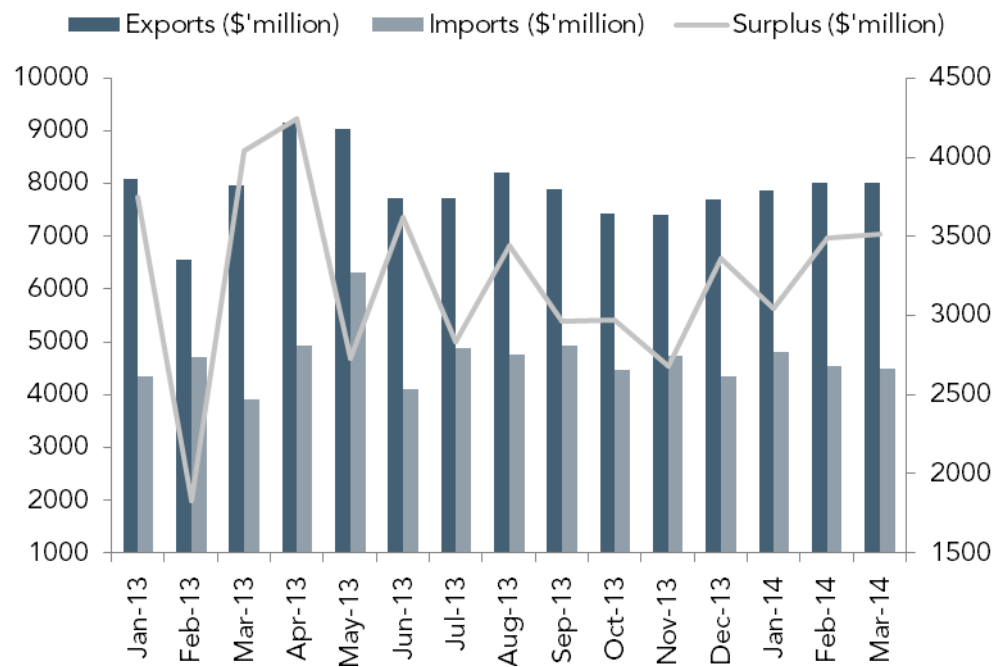
Source: FMDQ, ARM Research

Fresh geopolitical tension to drive trade surplus gain

Developments in Northern Iraq, where Sunni insurgents launched a military campaign on 9 June, 2014 drove Brent crude oil prices to 2014 highs of \$115.06/bbl, before closing the month at \$112.36 (+3.4% MoM). Accordingly, Brent oil price averaged \$111.69/bbl—3.2% higher than May 2014—which together with 7% MoM rise in crude oil exports⁵ to ~2.1mbpd likely buoyed overall exports. On the flip side, we believe imports stayed around current levels, despite 1 month extension in the commencement of the new automotive tariff to 1st July 2014, as main impact of the tariff hike on imports is likely to have occurred prior to the initial February 2014 implementation date. Consequently, we believe trade surplus improved MoM in June.

⁵Based on Bloomberg data on Nigeria's crude oil loading schedules

Figure 4: Monthly Trade Data



Source: CBN, ARM Research

Despite concerns over the insurgency in Iraq, impact on the country's oil production has been mute, as the unrest, in contrast to earlier fears, remains well removed from the southern region where over 70% of oil (3.3mbpd) is produced. This eases the concern of a possibly disruption to supply, which, combined with recent agreement between the central government and militias in Libya—to reopen half of Libya's ~1.2mbpd capacity export terminals—points to some moderation in oil prices. Nonetheless, Nigeria's crude oil exports, which are set to rise a further 6% in July to ~2.2mbpd, should more than offset any impact on overall exports. On the import front, the FG has decided to phase the implementation of the new automotive policy, with the additional 35% tariff on used cars—over 80% of car imports—now set to commence in January 2015. This implies that car imports (~18% of total imports) are unlikely to trend lower in the near-term, though pressures to the upside seems capped by progressively weaker impact of the policy, following multiple extensions. On the balance, we expect stable trends in imports, amidst

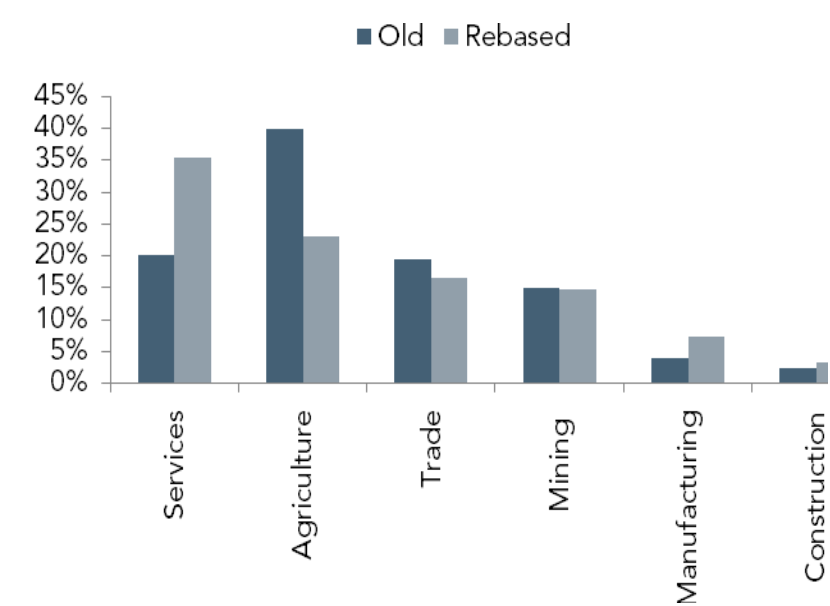
modest gains in oil exports to increase scope for a stronger trade balance.

Rising insecurity pose threat to non-oil GDP

Although the NBS is yet to release GDP figures in quarters post rebasing, the World Bank forecasts a 30bps YoY moderation in output growth to 6.7% for Nigeria, citing negative effects of increased policy uncertainty on private investment due to the onset of the 2015 elections and unrest in the North. On this front, recent attacks that have targeted telephone masts and major shopping centres and the seeming hapless response from the military could weigh negatively on Services sector GDP which now accounts for a sizable share of rebased GDP (~35%). In addition as we hinted in our inflation outlook, increasing Islamist attacks outside the North-East triad of states and rising farming-pastoral conflict in the agricultural Middle Belt could pose problems to crop production (89% of agricultural GDP)⁶. Furthermore, distortions to trade flows on account of population displacement and heightened military response could pressure trade GDP (which now accounts for ~ 17% of overall GDP). Nonetheless, recent improvements in crude oil prices and a recovery in oil production following the completion of repairs along major oil terminals in Q2 14 suggest oil GDP could be set to buck recent weak trend. Whilst the improvement in oil fortunes could help moderate the impact of other developments negative for non-oil GDP, the relatively larger weight of the latter post rebasing suggests greater transmission of shocks therein to overall GDP over the rest of 2014.

⁶ Agric is 20% of total GDP

Figure 5: GDP Composition



Source: NBS, ARM Research

Copyright © 2014 Asset & Resource Management Company Limited (“ARM”).

All rights reserved. Unauthorised use, reproduction, distribution or disclosure of this document is strictly prohibited.

This material has been issued by Asset & Resource Management Company Limited (“ARM”), a Company regulated by the Nigerian Securities and Exchange Commission. The analyst(s) primarily responsible for preparing this research report, in whole or in part, certifies that with respect to each security or issuer covered; all of the views expressed accurately reflect his/her personal views about the subject securities and issuers and no part of his/her compensation was, is, or will be, directly or indirectly, related to the inclusion of specific recommendations or views in the report.

This research report is based on information from sources that ARM and its analysts believe to be reliable. Neither ARM nor any of its research analysts, nor any member of the ARM Group, gives any representation or warranty, express or implied, or undertaking of any kind or assumes responsibility or liability of any kind with respect to the accuracy or completeness of the information set out in this report or any third party’s use (or the results of such use) of such information. This report is provided solely for informational purposes and is not to be construed as providing advice, recommendations, or endorsements of any kind whatsoever. The investments and strategies discussed here may not be suitable for all investors; counsel of investment advisor should be obtained with regard to such investments and or strategies. This research report is not a replacement for advice from an accountant, lawyer, personal finance advisor or other category of investment advisor. The investments discussed in this report may oscillate in price or value. Opinions and information provided are made as of the date of the report issue and are subject to change without notice. This research report is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Reference herein to any specific security or financial instrument does not necessarily constitute or imply its endorsement or recommendation by ARM, its directors, officers, employees or designated agents. Members of ARM may act as broker, advisor or lender, or make a market in any investments or issuers referenced in this report. Further information on any of the securities discussed herein may be obtained upon request to ARM. By accepting this document, you agree to be bound by the foregoing limitations.