

Economic Report | Monthly Update

Economic Update -September 2017

Economic Snapshot

August 2017 Inflation Data/Indices

	MoM	YoY	Prev YoY
Headline	1.0%	16.0%	16.1%
Food	1.1%	20.3%	20.3%
All Items Less Farm	0.9%	12.3%	12.2%
Imported food	1.3%	14.4%	14.1%
Energy	0.4%	10.7%	11.6%

Currency Markets

	Latest	Daily Chg	YTD
USDNGN	360.0	1.4%	14.4%
EURNGN	422.9	-0.1%	30.8%
GBPNGN	472.7	-0.3%	24.5%
JPYNGN	320.0	0.0%	21.7%

Monetary Aggregates – July 2017

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

External Position

	Latest	QoQ	YoY
Trade Balance (\$'mn)	84.76	-9.6%	N/A
External Reserves (\$'mn)	31,883	5.5%	28.0%
Foreign Debt (\$'mn)	13,808	21.1%	23.3%

Growth Data – Q2 2017

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

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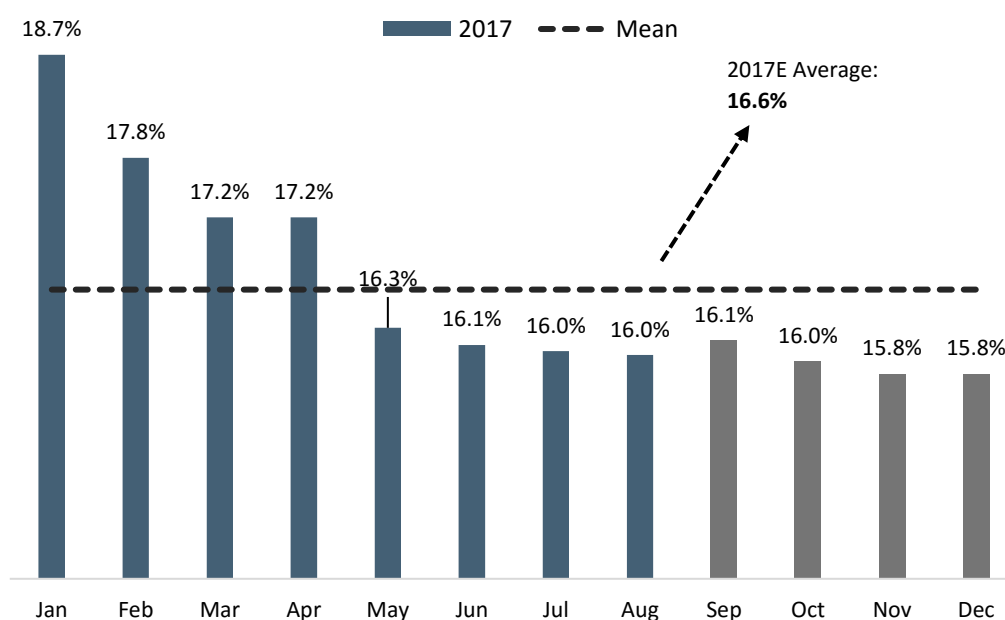
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Flood impact should stir 'dead cat bounce' on inflation

In line with recent trend, headline inflation contracted 4bps from prior reading to 16.01% in August. Going by provided breakdown, this step-down in headline inflation was triggered by a moderation in food inflation, which printed at 20.25% YoY in the period (vs. 20.27% in July). That said, passthrough from moderation in the food basket was more evident on the monthly reading (food inflation: -35bps from prior month to 1.16% MoM), which improved as market edged closer to main harvest season in the south. Elsewhere, core inflation defied retraces in key energy prices (Petrol: -1.9% YoY; Diesel: -0.15% YoY; Kerosene: -7.66% YoY) to print at 12.30% YoY in August. From the details, core pressures reflected sharp increases in prices of processed food, furnishing & household equipment, clothing & footwear, and health divisions—all which account for 37% of the core basket. Irrespective, pressures on the core front failed to prevent another headline moderation in August.

Despite the retrace in food price pressures in August, we still hold the view that the last flooding disrupted harvesting in September, with knock-on effect likely to keep MoM food reading ahead of trend levels. Elsewhere, despite the recent blip, we expect YoY core inflation to resume deceleration in September as gains from monthly improvements in FX liquidity become more telling. However, largely reflecting flood-induced food pressures, we now look for MoM headline reading of 0.95% for September (average in the three years leading to 2016: 0.79% MoM) which translates to a YoY inflation of 16.14% for September.

Figure 1: 2017 Inflation- actual and forecasts



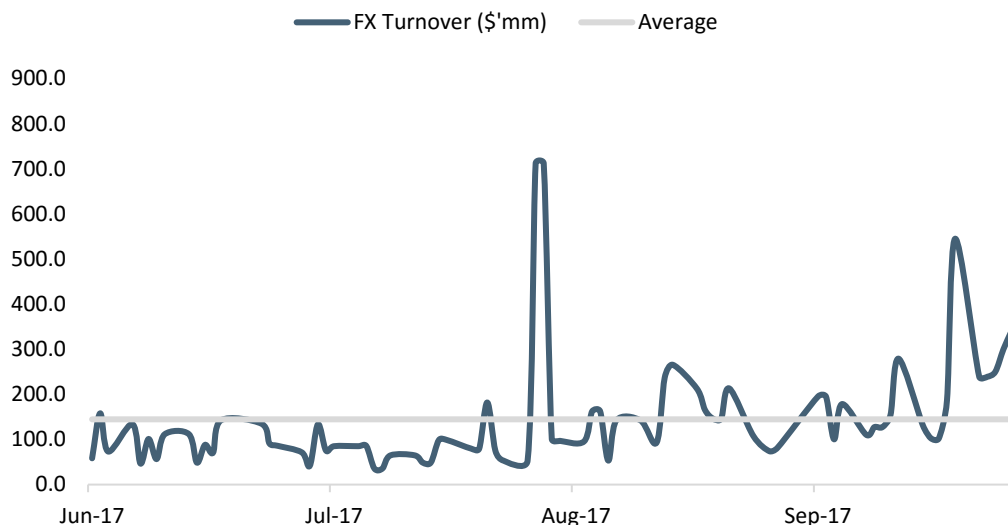
Source: NBS, ARM Research

Expect sustained naira resilience in the near term

In September, the naira appreciated at the interbank market (+0.9% MoM to mean of ₦359.79/\$) with average FX turnover at the I&E window increasing by 5% relative to prior month. We link this naira resilience to CBN's sustained FX sales and regulatory moves to curb speculative activities on the currency. To the latter point, we note that the apex bank continued to mandate DMBs to back forward dollar purchases with naira, with the consequent impact of the directive stoking naira shortages in the month. In passing, we believe that strong net NTB issuance also led to a decline in system liquidity. Elsewhere, impact of continued FX interventions and narrowing system liquidity also filtered through to the parallel market, wherein the naira edged up by 1% MoM to a mean of ₦364.7/\$ in September.

Given the robust size of CBN's reserves (+2% MoM to \$32.5 billion going by the apex bank's latest publication), aggressive dollar sales should continue in the near term with the consequent impact set to leave naira in the green. Furthermore, with sizable foreign flows set to capture the fizzling-out high local interest rate environment, the downside for the naira remains limited, in our view.

Figure 2: Historical movements in FX Turnover at the I&E window



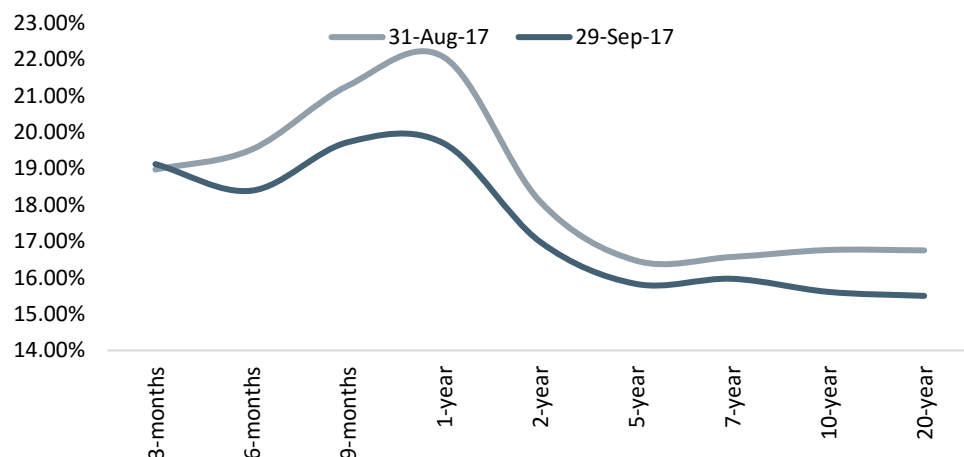
Source: FMDQ, ARM Research

The sword of CBN cuts naira yields

The naira yield curve extended its deceleration to a third consecutive month in September (-93bps MoM to 17.47%) following 111bps and 76bps moderations at both the short and long end respectively. Despite the almost two-fold MoM surge in net NTB issuance to ₦123 billion and a 13% MoM contraction in system liquidity to ₦360 billion, T-bill yields continued to take cue from accommodative signals at the monetary policy end. Specifically, the month of September witnessed net OMO maturities of ₦169 billion (vs. net OMO issuance of ₦118 billion in August) even as the CBN ceased issuance of its one-year OMO bills to drive average stop rates at the auctions lower, shedding 60bps MoM to close at 17.95% in the review month. In addition to the seeming cool-off in the CBN's hawkish policy orientation, we believe banks' increasing purchase of treasuries for fear of forced debits via stabilization securities enforced at below market rates provided further explanation to short end yield declines. At the long-end of the curve, amplified subscription levels at the auction, on the back of declining rates at the PMA, drove a decline in bond yields. Specifically, at the last treasury bills' auction in the month, the stop rate on the one-year paper dropped by 152bps (compared to prior auction) to close at 17.0%. The attendant impact of this has cascaded to a downtrend in secondary market bond rates.

With inflation sustaining its southward momentum and prospects for base effect-induced decelerations very much on the cards for 2018—developments which can induce a more open gravitation towards easing and cheaper borrowing rates in the coming year, FG’s appetite for domestic borrowings continued to retreat with its preference for currently cheaper external borrowings becoming more apparent. Thus, we believe that in view of projected inflation and interest rate moderations and a potential shortage of long-dated domestic treasuries, investors largely opted for a more aggressive purchase of bonds to lock-in rates before the coming downslide. This, in our view, provides further explanation to the contraction in yields observed in the long end. Going forward, despite the MPC’s decision to hold key policy parameters at its last meeting, prospects for below market rate stabilization security issuances by the apex bank and the deluge of OMO maturities (₦1.7 trillion), which are very much in the wings for the remainder of 2017, suggest sustained moderation in T-bill yields in coming months. Similarly, aided by an expectation of further clampdown in inflation and a potential scarcity of FG’s long-dated treasuries, we expect investors to continue to lock-in high rates in the current month with the consequent impact stoking yield downtrend at the long end.

Figure 3: Changes in naira yield curve



Source: FMDQ, ARM Research

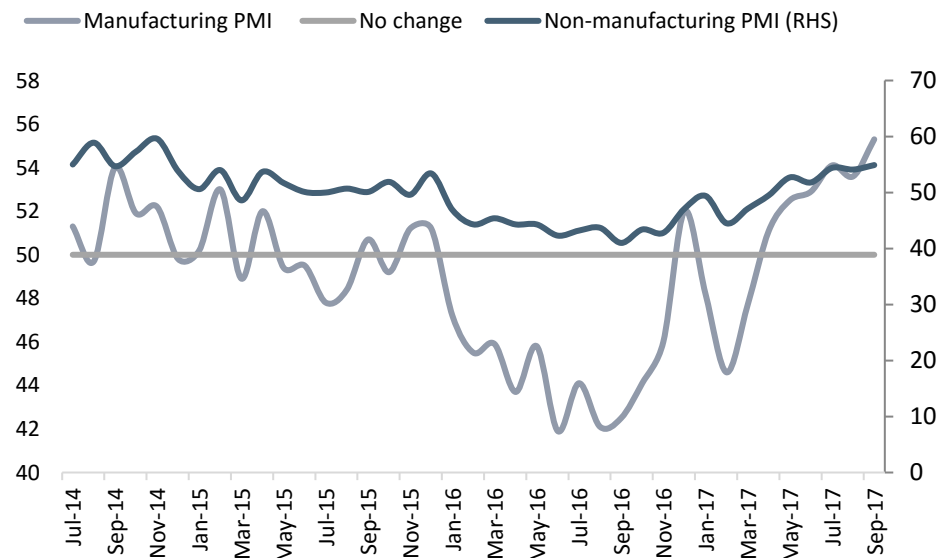
Nigerian PMI: are economic activities hitting new gear?

Going by latest CBN surveys, manufacturing and non-manufacturing activities expanded for the sixth and fifth straight month (respectively) in September. For emphasis, the latest expansion in manufacturing activities is considerably faster than those of the prior five

months with all sub-indices expanding. In addition, upbeat business activities were ubiquitous across fourteen¹ of the sixteen manufacturing subsectors (vs. 12 in August and July), suggesting greater manufacturing strides in the review period. Elsewhere, non-manufacturing segment witnessed expanded activities across fifteen of its eighteen sub-sectors (vs. 15 in prior month) with utilities and agriculture leading the way. Broadly, given the strong correlation between manufacturing outputs and currency movements/consumer discretionary income over the past 28 quarters, we believe the positive momentum observed in manufacturing largely reflects improvements in both availability and cost of foreign exchange. For evidence, we recall that manufacturing PMI bucked its run of three successive contractions in the same month the IEW window was introduced. We believe this was not coincidental. At the other end, non-manufacturing activities have greatly leveraged resilience in sectors such as Agric, the fastest growing non-manufacturing segment in terms of employment level.

Overall, sustained expansion in PMI readings (manufacturing and non-manufacturing) over last few months clearly corroborates our expectation for positive GDP growths for Q3 17 (1.7%) and Q4 17 (1.9%). This expectation looks beyond the projection of further currency-induced gains in manufacturing to potential pass-through from steady increases in domestic crude oil production owing to improved security situation in the Niger Delta.

Figure 4: Historical movements in PMI readings



Source: CBN, ARM Research

¹ The fastest expansion in economic activities were from appliances & components, chemical & pharmaceutical products, electrical equipment, plastics & rubber products sub-sectors over the review period.

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