

Macro Economic Report | Monthly Update

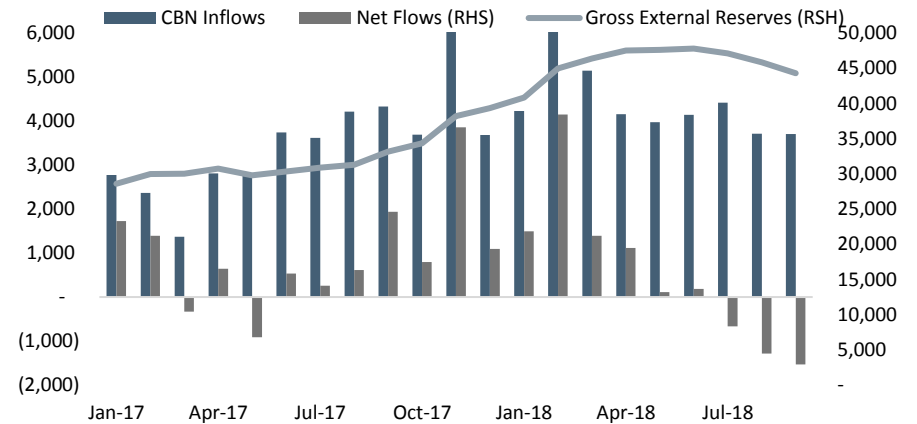
Macro Economic Update – September 2018

Foreign Reserve: reeling under the pressure of capital flow reversal

The hemorrhage in the foreign exchange reserve persisted in September with a \$1.5 billion (August 18: \$1.2 billion) depletion bringing total net outflow from the reserve to \$3.5 billion over Q3 18 compared to accretion of \$1.5 billion in Q2 18. Accordingly, the FX reserve declined to \$44.3 billion at the end of September 2018 as the demand from offshore investors exiting the market created a big deep in the nation’s purse, with the apex bank now sub-aggregating demands before settlement.

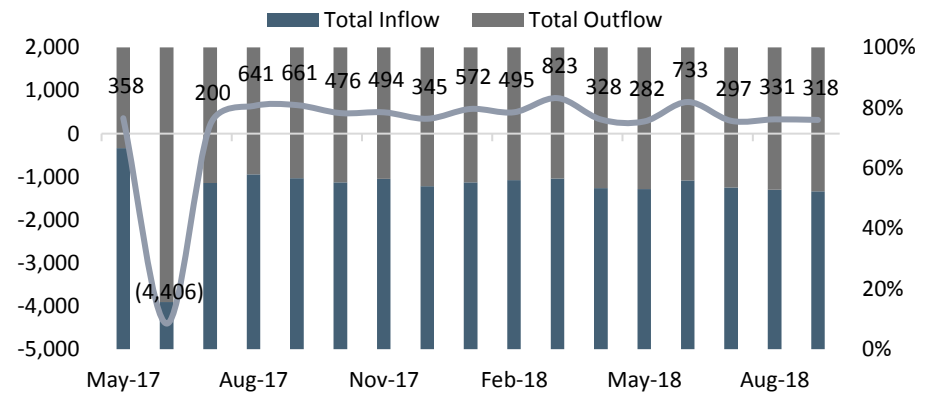
The depletion largely reflected CBN sales across segments of the FX market during the period. Notably, total CBN sales at the IEW increased 40.8% MoM to \$2.0 billion (\$1.4 billion in August) as the apex bank bridged the moderation in offshore inflows. Particularly on offshore inflows, although FPI flows rose to \$785 million (+43.6% MoM) in September, it still lagged the average of \$1.5 billion in Q2 18. For context, total offshore funds through the IEW in Q3 18 was \$2.3 billion, which is significantly lower than the level over Q2 18 of \$4.1 billion. As highlighted earlier, CBN sold a total of \$2.0 billion which supported overall local flows of \$2.7 billion. Ex-CBN, local supply would have settled at \$681 million compared to \$1.0 billion in August. Thus, aggregate inflows totaled \$3.5 billion for the month of August. By our estimate, total outflow by offshore funds in September rose 14% MoM to \$3.3 billion, with the CBN providing \$2.0 billion and the remaining \$1.3 billion settled by inflows from offshore funds and local corporates¹.

Figure 1: CBN inflow, net flow and Gross Reserve position (\$'Million)



Source: CBN, ARM Research

Figure 2: Foreign Currency flows through the IEW

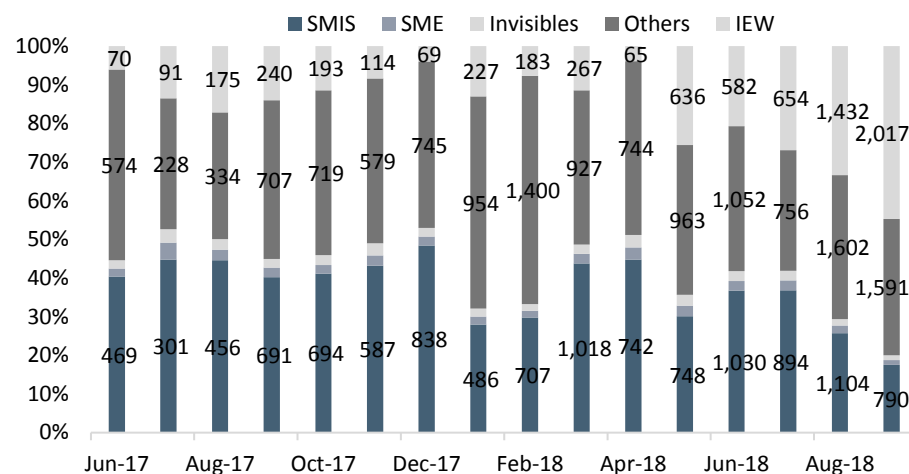


Source: FMDQ, ARM Research

Also, the apex bank stepped up its intervention across other markets, with total sale of \$2.5 billion (13% lower than \$2.9 billion in August). Accordingly, overall apex bank outflow at the IEW and special interventions stood at \$4.5 billion over the same period. Reflecting the increased intervention, the naira firmed at the BDC (₦358.0/\$ vs. ₦358.3/\$ in August) and parallel (₦359.4/\$ vs. ₦359.0/\$ in August) markets. Finally, NIFEX and NAFEX rates converged during the month with the former now closing the month at (₦361.0/\$ vs. ₦357.6/\$ in August). However, the NAFEX rate slipped further to ₦363.1/\$ vs. ₦362.3/\$ in July.

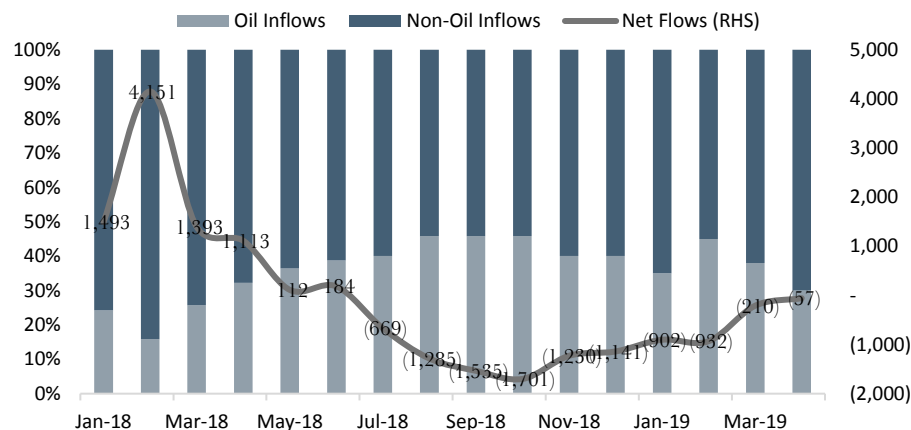
Going by recent data, we estimate a total of \$5.8 billion of maturing foreign holding of local fixed income instruments for the rest of the year. While our conservative assumption of 50% repatriation of the maturing funds resulted in \$366 million differentials between our forecast reserve position and actual, we have decamped our conservatism and now assume a 70% repatriation of the maturing instruments. Accordingly, we expect average monthly outflow from the CBN of \$5.5 billion with average monthly reserve drawdown estimated at \$1.4 billion over the rest of the year, which should pressure a further depletion in the foreign reserve to \$40.2 billion (which adjusted for the Eurobond issuance should rise to \$41.4 billion). Consequently, despite concerns of capital flight and impact on exchange rate, we are of the view that the CBN is in a much more comfortable position to support the Naira and thus expect relative stability in the currency over 2018.

Figure 3: CBN intervention across FX markets (\$'Million)



Source: FMDQ, ARM Research

Figure 4: Foreign Currency flows through the CBN



Source: CBN, ARM Research

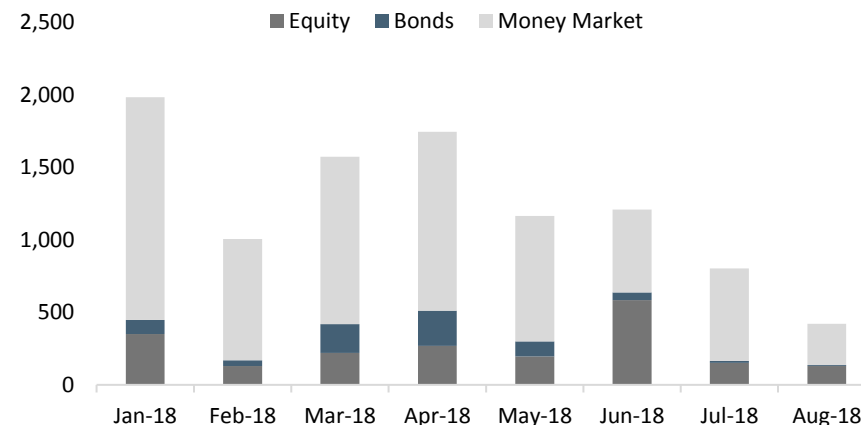
Capital flows hits rock bottom

The downturn in capital flows into Nigeria worsened in the month of August with total capital importation dipping 38% MoM to \$799 million, the lowest flow recorded in 14 months. The lower flows in August reflected sizeable moderation in Foreign Portfolio Investments (-48% MoM to \$421 million) and Foreign Direct Investments into the country (-54% MoM to \$155 million), despite the rally in crude oil price to \$74/bbl. in August (vs. \$64/bbl. in December). Perusing the breakdown of FPI flows, the decline was across board with FPI flows to equity (\$130 million), bonds (\$7.3 million) and money-market instruments (\$283.9 million) moderating 14%, 50% and 56% respectively.

Importantly, foreign investors have continued to stay away from EM risk assets (Nigeria inclusive) in general given higher yields in the US. In addition, we also attribute the lower flows to election uncertainty in Nigeria given the fact that general elections is drawing closer. Additionally, we observed lower FPI flows at the IEW with FPI flows through the window printing at \$650 million, the lowest since July 2017. Elsewhere, Other Investments bucked the negative trend expanding 56% MoM to \$222.9 million mirroring an increase in loans (+58% MoM).

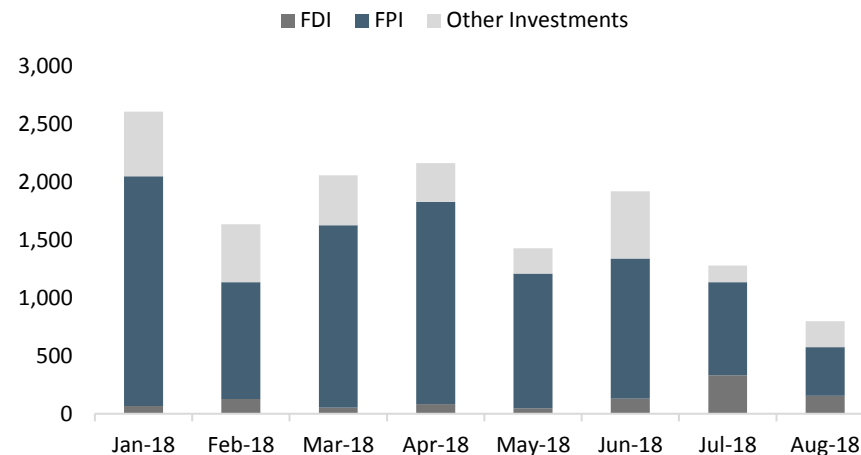
Although FDI flows were lower MoM, there has been renewed interest in long term risk assets in the past three months with FDI flows averaging \$206 million between June and August relative to an average monthly flow of \$85 million between January and May. We believe this is linked to increased optimism on Nigeria's economy growth.

Figure 5: Foreign Portfolio Investment (\$'mn)



Source: CBN, ARM Research

Figure 6: Capital Importation into Nigeria (\$'mn)



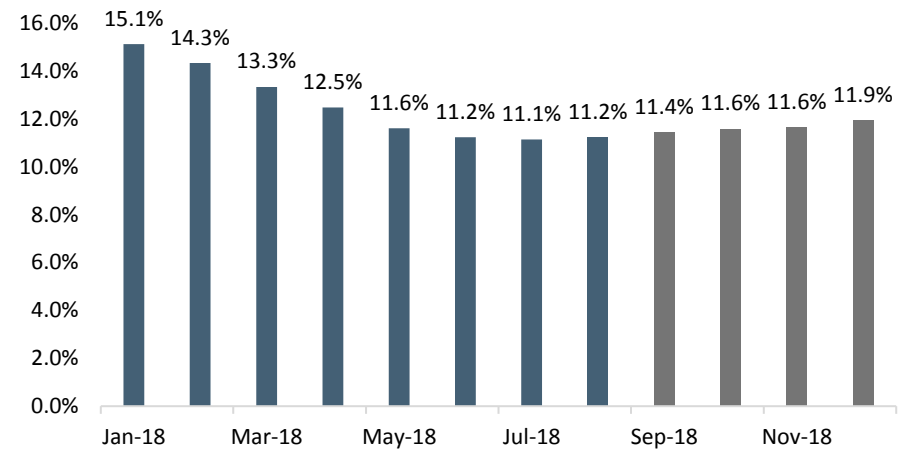
Source: CBN, ARM Research

Headline inflation resumes the uptrend

In the month of August, the CPI index rose for the first time in 18 months to print at 11.23% YoY, 9bps higher than 11.14% in July. The increase was driven by waning base effects coupled with sustained slow deceleration in MoM headline inflation (-8bps to 1.05% vs. 5-year historical August MoM of 0.66%). The pressure point stemmed from food inflation which rose 2bps to 1.40% due to the ongoing lean season alongside the herdsmen and farmers crisis which affected food production in the Middle Belt. On the core sub-index, MoM inflation declined 3bps to 0.78%, reflecting moderation in key sub-components, specifically HWEGF and transport inflation which declined 25bps and 30bps to touch three-year lows of 0.45% and 0.61% respectively, despite a 1.79% MoM increase in the price of Diesel – according to data by the NBS.

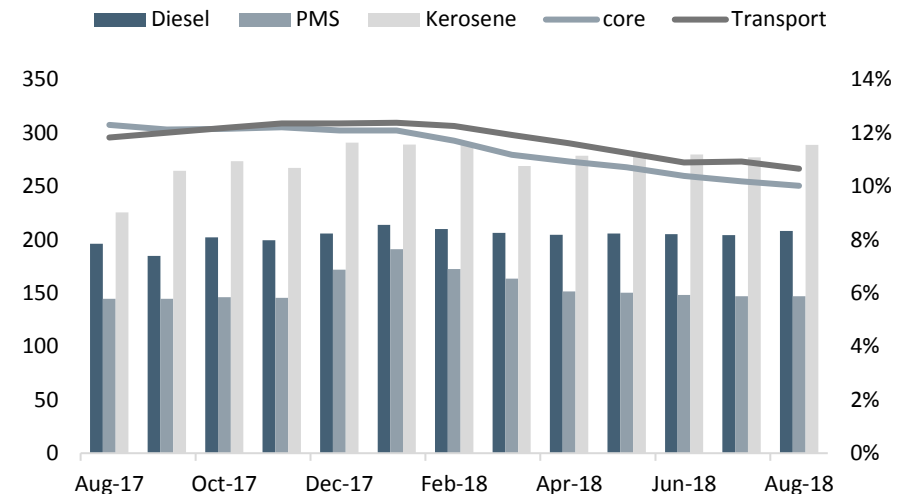
FEWS NET expects food prices to decline from September as harvest activities increase however, we do not envisage a material deceleration as we expect the aftershock of the herdsmen/farmer conflict as well as incidence of flooding in the south-south region of the country to keep food prices above average levels. We also believe there is a lagged impact of the increase in diesel price on HWEGF, transport as well as food inflation which we expect will reflect in the subsequent month. Overall, with dissipating base effects, we expect September headline inflation to print at 11.5% (+ 22bps from 11.23%) with full year 2018 inflation expected to hover around 12.3% (vs. 16.5% in 2017).

Figure 7: Inflation rate – Actual and Forecast (YoY)



Source: NBS, ARM Research

Figure 8: Avg. energy prices (₦/litre) vs. Core & Transport Inflation (% YoY)



Source: NBS, ARM Research

Still oil receipts driving FG's revenue

According to data provided by the budget office, federal retained revenue over 2017 increased by 35.5% to ₦2.4 trillion, although 53% lower than budget revenue of ₦5.1 trillion. Looking through breakdowns, higher federal retained revenue was largely driven by oil revenue (+61% YoY to ₦1.1 billion) stemming from recovery in oil prices (average 2017: \$55/bbl. vs 2016: \$45/bbl.) as well as improved crude production relative to the prior year (2017: 1.9 mb/d vs 2016: 1.8 mb/d). Similarly, non-oil revenue increased 17% to ₦957 billion underpinned by improvements in VAT (+19% YoY to ₦130 billion), custom revenues (+14% YoY to ₦261 billion) and CIT (+19% YoY to ₦543 billion).

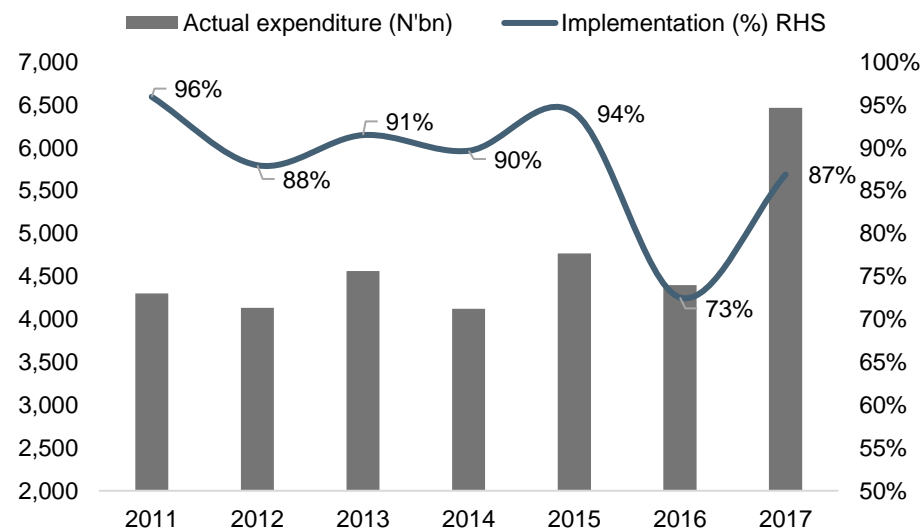
Elsewhere, actual expenditure printed at ₦6.5 trillion, 26% higher than 2016 although, 13% lower than planned budget expenditure of ₦7.4 trillion. In terms of breakdown, recurrent expenditure accounted for the lion share (71%) of government spending directed towards personnel cost and debt service (actual: 99% and 98% of allotted budget respectively). In terms of budget implementation, total recurrent expenditure stood at 95% for the full year period. Elsewhere, capital expenditure for 2017 printed at ₦1.4 trillion (+8.3x YoY), with implementation for 2017 at 66%.

Against this backdrop, the FG's fiscal deficit amounted to ₦3.8 trillion (73% YoY) vs. ₦2.4 trillion allotted in the budget and was largely financed by domestic borrowings (₦1.2 trillion) and foreign borrowings (₦1.3 trillion). Despite the improved revenue picture, the FG failed to fully implement the 2017 budget, with annualized budget implementation at 87%.

Table 1: FGN actual and budget revenue for the fiscal year 2017

	2017 Approved	2017 Actual	2016 Actual
Oil production (mbpd)	2.2	1.89	1.76
Oil price (\$/bbl.)	44.50	54.27	49.47
Exchange rate (₦/\$)	305	305	305
FG Share of oil revenue (₦' billion)	2,122	1,125	699
Total Non-Oil revenue (₦' billion)	2,962	1,533	1,056
FG Total revenue (₦' billion)	5,084	2,658	1,755
FGN Expenditure (₦' billion)	7,441	6,464	4,396
Fiscal deficit (₦' billion)	(2,357)	(3,806)	(2,194)

Figure 9: Historical FG actual expenditure and budget implementation



Source: Budget Office, ARM Research

Our fiscal outlook for 2018 hasn't changed. On FG retained revenue, we expect higher FG's receipts of ₦5.08 trillion (vs. ₦2.4 trillion in FY 17), with much of the support coming from the oil segment (₦2.9 trillion) given the higher oil prices (+36% YoY) and crude production (+2% to 1.9mbpd). On non-oil receipts, while we are positive on improved custom receipts due to the recent upsurge in excise duty rates on alcohol & tobacco and FG's improved ability to collect custom taxes, we believe revenue from other segments – VAT, CIT and independent revenue – will grossly underperform budget due to ambitious targets set by the FG. Owing to this, we forecast non-oil revenue of ₦2.2 trillion, 52% lower than budget non-oil estimate. Our aggregate revenue forecast of ₦5.08 trillion implies a 32% shortfall from budget projections. In 2018, FG's plans an expenditure of ₦9.12 trillion. Assuming 75% budget implementation (100% recurrent & 40% Capex – Jun to Dec 18), and overlaying the forecasted expenditure (₦6.9 trillion) with our revenue expectation, we expect fiscal deficit to print at ₦1.78 trillion for FY 18.

Table 2: Federation budget vs. ARM Estimates

	2018	Estimates		
	Budget	Bear	Base	Bull
<i>Oil production (mbpd)</i>	2.3	2	2	2
<i>Oil price (\$/bbl.)</i>	51	60	70	80
<i>Exchange rate (₦/\$)</i>	305	305	305	305
FG Share of oil revenue (₦' billion)	2,986	2,469	2,880	3,292
Total Non-Oil revenue (₦' billion)	4,180	1,883	2,196	2,906
FG Total revenue (₦' billion)	7,166	4,352	5,077	6,198
FGN Expenditure (₦' billion)	9,120	6,855	6,855	6,855
Source: Budget Office, ARM Research	(1,954)	(2,503)	(1,778)	(657)

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