

Economic Report | Monthly update
Economic Update – June 2017
Economic Snapshot

May 2017 Inflation Data/Indices			
	MoM	YoY	Prev YoY
Headline	1.9%	16.3%	17.3%
Food	2.5%	19.3%	19.3%
All Items Less Farm	1.2%	13.0%	14.8%
Imported food	1.3%	14.9%	16.9%
Energy	1.3%	16.3%	18.8%
Currency Markets			
	Latest	Daily Chg	YTD
USDNGN	305.5	0.00%	-2.99%
EURNGN	347.9	0.58%	-8.46%
GBPNGN	395.5	0.25%	-4.62%
JPYNGN	2.69	0.00%	-2.59%
Monetary Aggregates – April 2017			
	(₦'bn)	MoM	YoY
M2	21,713	-1.4%	4.8%
CPS	21,943	-1.5%	13.2%
NCG	5,592	7.5%	42.2%
NFA	7,262	-4.1%	43.2%
NDC	27,535	0.2%	18.1%
External Position			
	Latest	QoQ	YoY
Trade Balance (\$'mn)	185.73	-21.5%	N/A
External Reserves (\$'mn)	30,323	0.95%	3.68%
Foreign Debt (\$'mn)	13,808	21.1%	23.3%
Growth Data – Q1 2017			
	(₦'bn)	%of total	YoY
Real GDP	15,861	100%	-0.5%
Agriculture	3,385	21.3%	3.4%
Oil	1,411	8.9%	-11.6%
Services	5,975	37.7%	1.0%
Wholesale and Trade	2,819	17.8%	-3.1%
Manufacturing	1,543	9.7%	1.4%

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Budget 2017: Higher financing to trump revenue gain

Acting President, Yemi Osinbajo, signed the 2017 budget into law on the 19th of June. The budget tagged 'Budget of Recovery and Growth' proposed a 23% YoY expansion in aggregate expenditure to ₦7.44trillion split into: non-debt recurrent expenditure (₦2.99trillion), capital expenditure (₦2.17trillion) and debt service (₦1.84trillion) with ₦434.41billion as allocation to Statutory Transfers and ₦177.46billion for Sinking Fund from maturing bonds. In terms of composition, recurrent expenditure consists of 40% of total (2016: 44%) with debt service and capital expenditure accounting for 25% and 29% respectively (vs. 22% and 30% in 2016). On the revenue leg, crude oil price projection was raised to \$44.50/bbl. while production was retained at 2.2mbpd to bring oil revenue to ₦1.99trillion. Non-oil revenue of ₦3.0trillion comprises of non-oil (₦1.4trillion), Independent revenue (₦807billion) and other revenue (₦776billion). Overall, FG's retained revenues of ₦5.08trillion is 32% higher than in 2016 budget.

Given our expectation for crude production of 2mbpd over 2017 and our revised crude price forecast of \$45/bbl., we estimate FG's share of oil revenue at ₦1.9trillion. The foregoing, combined with non-oil revenue estimate of ₦1.6trillion suggest an FGN retained revenue of ₦3.5trillion (31% lower than in the proposed budget). Also, the continued reliance on more expensive local borrowing suggests that debt service is likely to exceed government's target for the second year running. Indeed, on annualizing current run rate of 2017 debt service and adjusting for higher interest rates over H1 17,

actual debt service looks set to exceed FG's expectation by at least ₦600 billion. Overall, we estimate a fiscal deficit of ₦3.9trillion (₦1.6trillion higher than proposed).

Table 1: 2017 Federation revenue budget vs ARM revised estimate

	2017		Estimates	
	Budget	Bear	Base	Bull
Oil production (mbpd)	2.20	1.00	2.00	2.20
Oil price (\$/bbl)	44.50	30.00	45.00	60.00
Exchange rate (N/\$)	305.00	305.00	305.00	450.00
Oil and gas receipts (N' billion)	5,080.00	1,478.25	4,508.66	9,756.45
Deductions	-	-	-	-
JV Cash calls (N' billion)	-	369.56	-	-
13% derivation (N' billion)	660.40	144.13	586.13	1,268.34
Net Oil Revenue (N' billion)	4,419.60	964.56	3,922.54	8,488.11
FG Share of oil revenue (N' billion)	2,143.51	467.81	1,902.43	4,116.73
FG share of non-Oil revenue (N' billion)	1,370.00	729.28	825.46	921.65
FG independent revenue (N' billion)	807.57	213.24	323.37	404.00
Other revenue (N' billion)	776.00	355.90	453.80	776.00
FG Total revenue (N' billion)	5,097.08	1,766.23	3,505.06	6,218.38
FGN Expenditure (N' billion)	7,444.00	7,444.00	7,444.00	7,444.00
Fiscal deficit (N' billion)	(2,347)	(5,678)	(3,939)	(1,226)

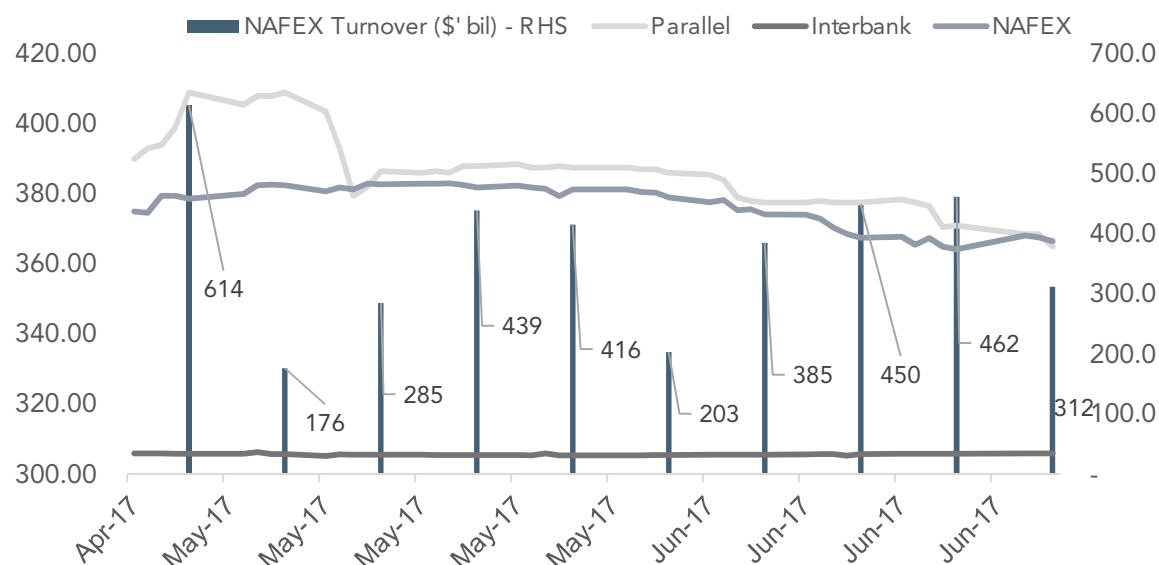
Source: ARM Research, Budget Office

Naira Renaissance, short-term outlook remains stable

Extending the gains from the turn of the year, the naira appreciated 2.3% MoM to ₦366/\$ at the parallel market in June. The currency appreciation continues to reflect improved liquidity at the currency market stemming from sustained FX sales by the CBN (June 2017: \$1.6billion based on our estimate) and sustained influx of portfolio flows. In particular, CBN's directive at the start of the month (June 05) for Deposit Monetary Banks (DMBs) to trade FX positions among each other without seeking its prior approval as was previously required, boosted liquidity with FX turnover at the Investors and Exporters FX window (IEW) surging 38% MoM to \$1.8 billion in June. Unsurprisingly, naira closing rate at the IEW also appreciated 3.7% MoM to ₦366.44\$ in the review month. Overall, reflecting increased dollar sales as well as positive effect of the liberalization of the

FX market which has boosted liquidity, the once scary premium between the parallel and interbank (70% in February 2017) has contracted to a more reasonable reading of 20% at the end of H1 17.

Figure 1: Historical Interbank, NAFEX and Parallel market rate vs. NAFEX turnover (Weekly)



Source: FMDQ, ARM Research

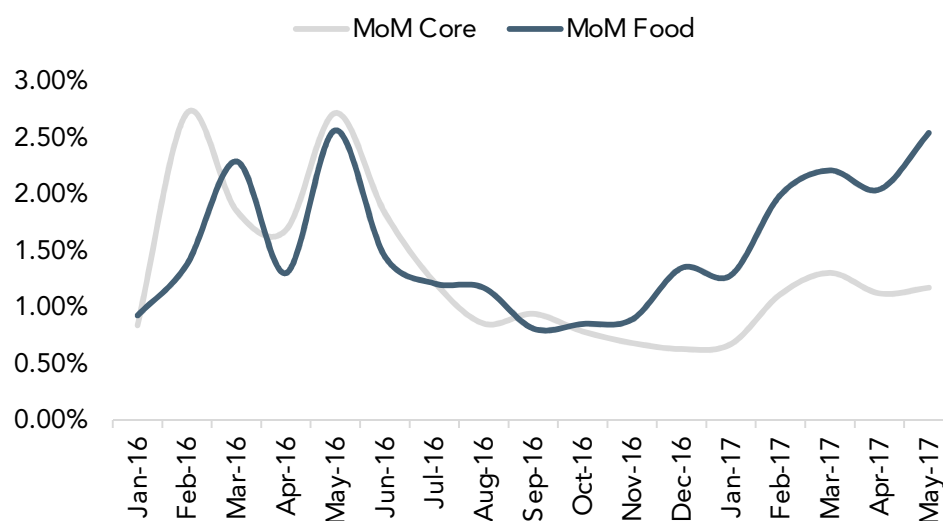
Given the still robust FX reserves (\$30.3 billion) which should be boosted by the recently issued diaspora bond (\$300million), we expect the CBN to maintain its aggressive dollar sales. Furthermore, amidst elevated interest rate and upbeat economic picture, we expect sustained influx of portfolio flows, which together with CBN’s dollar sales should keep exchange rate at the FX markets relatively stable.

Inflation uptrend to resume as base effect bows

According to the National Bureau of Statistics (NBS), headline inflation continued its descent to 16.25% YoY in May (-99bps from prior reading)—the fourth consecutive deceleration in 2017—on the back of sizable moderation in core inflation owing to impact of high base effect from 2016. Disaggregating the sub-components, core inflation fell sharply (-173bps from prior reading to 13% YoY)

even as food inflation was unchanged from prior reading at 19.3% YoY). Focusing on the former, breakdowns provided revealed that declines in HWEGF (-314bps to 13% YoY) and other energy-related sub-core components were central to the downswing in core inflation. To buttress, PMS prices have been subdued (+0.3% YoY to ₦150.70 per litre)—relative to the steep rise in the prior year. On food inflation, though largely unchanged, MoM reading printed at its highest level in 12 months (+2.54% MoM) with the NBS noting highest increases in prices of bread and cereals, meat, fish, tubers, and vegetables. To be clear, increased demand for cereals—especially in the predominantly Muslim north—in the bloom of the Ramadan season buoyed the price pressure in May. In addition to this, pressures on food prices were further worsened by a quickening in transport inflation to its highest level in 9 months in May (+1.2% MoM) despite reported decline in diesel prices (-5.7% MoM to ₦216.30). This pressure from transport largely reflects follow-through from recent price hikes by major transport associations across the country in response to the sharp jump in Diesel prices in December.

Figure 2: Trend in MoM Core and Food Inflation



Source: NBS, ARM Research

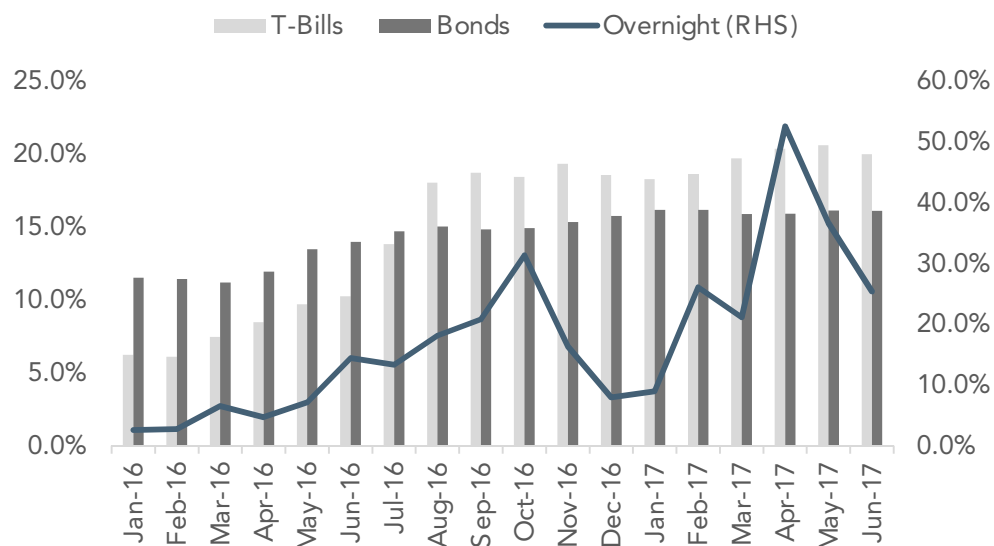
In framing our views on headline inflation, we focus on the directions of the sub-components. On the food side of things, we expect pressures to subsist due to the impact of the just-concluded Ramadan season, which extended into June, and relentless surge in cost of transportation. Elsewhere, we project sustained

downtrend in core inflation largely owing to recent declines in diesel prices (-42% MoM in June) which we expect to impact the Housing, Water, Electricity, Gas and Other Fuel (HWEGF) core division. Overlaying, our expectations for the food and core baskets, we project an unchanged headline inflation reading of 16.25% YoY (+/-20bps) in June 2017.

Sustained tightening and increased borrowing guides to elevated yield

Similar to the prior month, the naira yield curve expanded 7bps MoM to 18.28% as a surge in Treasury Bill rates (+21bps MoM to 20.47%) more than offset modest declines at the long end of the curve (-6bps MoM to 16.09%). Given improved system liquidity—as average interbank overnight rate moderated in the period (-6.4pps MoM to 5.5%)—which stemmed from net OMO maturities in the period (N203billion) as well as higher FAAC inflows (+10.3% MoM to N462billion), we believe yield expansion at the short end of the curve reflected reduction in OMO clearing rates which touched 17.9% in the period to drive a shift in sentiment towards bond instruments. At the long end of the curve, mean marginal clearing rates declined 10bps MoM to 16.19% at the June auction despite maximum bid rates tracking higher 1.9pps MoM to 19.7%. Pertinently, given FG's posture on lowering yields at the auction, the successful diaspora issuance created scope for restrained domestic borrowing to drive a cut back on DMO's planned offer (-29% to N99billion).

Figure 3: Trend in average monthly rates



Source: FMDQ, ARM Research

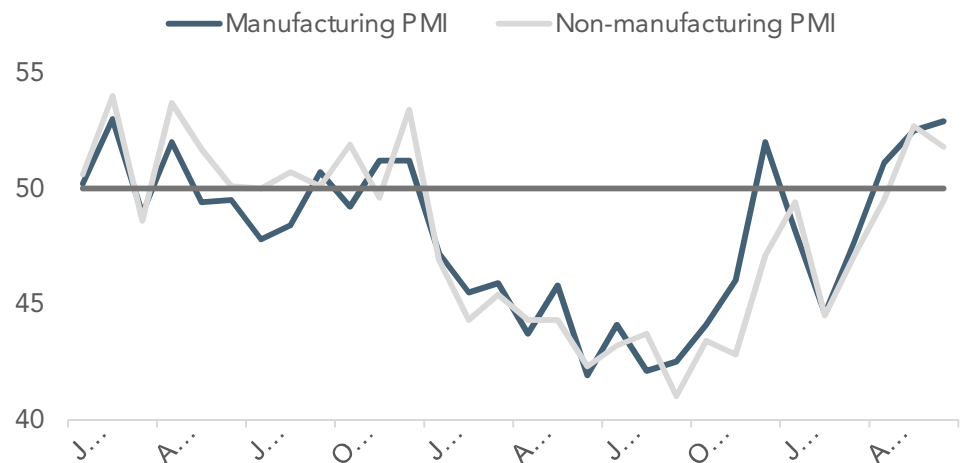
Going forward, activities in the currency market and inflationary trend is expected to dictate the direction of monetary policy. On the latter, as base effect on the CPI takes a bow, lean season-aggravated rise in food prices points to an uptick in headline inflation.

On currency, the apex bank's drive to attract portfolio flows and curb speculation is expected to maintain the drive in FX stability. Thus, we are of the view that ongoing monetary tightening would be sustained over the near term. Elsewhere, while we think the FG has almost maxed out on its foreign borrowing leg having raised \$2.4billion (c. ₦800billion) coupled with about c. ₦850billion raised in the domestic space—which is about 44% of our projected deficit of ₦3.9trillion—we expect heightened issuance by the FG in coming months, assuming a minimum budget implementation of 80%. Given the greater implementation of the budget so far in the year (annualized spending is only 5% short of budget vs. 13% on average over the last 4 years), it appears the FG is intent on executing its expansionary policy for the year. Bringing it all together, we expect the apex bank to sustain its liquidity mopping measures (OMO sales and FX supply) which should keep short term interest rate elevated. At the long end of the curve, despite DMO's sensitivity to higher borrowing cost, ramp up in borrowings supported by political to implement the budget should keep bond yields at elevated levels.

Sturdy PMI readings raises scope for recovery over Q2 17 GDP

In line with the pattern of recovery in macroeconomic data, the CBN reported that both manufacturing (52.9) and non-manufacturing (51.8) Purchasing Managers Index (PMI) extended its expansionary trend into the 2nd consecutive month in June. In our view, the improved liquidity picture in the FX market alongside increased gas supply sustained growth in manufacturing activities. A further parse through the report also revealed positive readings (above 50) in key sub-indices such as Production Level (58.2), New Orders (51.0), Raw Materials/WIP Inventories (52.3) and Employment Level (51.1).

Figure 4: Historical PMI readings



Source: CBN; ARM Research

Given that the PMI is a leading indicator, the expansionary reading, which should mirror trends in the manufacturing sector, points to a recovery in the economy in the second quarter of 2017 and beyond. Consequently, the foregoing, combined with recovery in Oil GDP and continued growth of other non-oil segment, supports our view of a positive 0.1% quarterly YoY growth in Q2 17 GDP.

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