

## Economic Report | Monthly Update

## Economic Update -October 2017

### Economic Snapshot

#### September 2017 Inflation Data/Indices

	MoM	YoY	Prev YoY
<b>Headline</b>	0.8%	16.0%	16.1%
<b>Food</b>	0.9%	20.3%	20.3%
<b>All Items Less Farm</b>	0.8%	12.1%	12.3%
<b>Imported food</b>	1.3%	14.9%	10.7%
<b>Energy</b>	0.7%	9.84%	11.6%

#### Currency Markets

	Latest	Daily Chg	YTD
<b>USDNGN</b>	360.3	-0.02%	14.5%
<b>EURNNGN</b>	416.2	-0.27%	25.2%
<b>GBPNGN</b>	473.2	-0.07%	24.6%
<b>JPYNGN</b>	315.0	-0.32%	19.8%

#### Monetary Aggregates – August 2017

	(₦bn)	MoM	YoY
<b>M2</b>	21,851	-1.6%	-0.9%
<b>CPS</b>	21,997	-0.8%	-3.6%
<b>NCG</b>	4,824	-17.8%	35.9%
<b>NFA</b>	9,733	11.3%	32.4%
<b>NDC</b>	26,821	-4.3%	1.8%

#### External Position

	Latest	QoQ	YoY
<b>Trade Balance (\$'mn)</b>	84.8	-9.6%	N/A
<b>External Reserves (\$'mn)</b>	31,112	0.95%	3.68%
<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%

### Will Inflation durably converge at CBN's target?

September's inflation reading reflected our views, albeit lower, of a one-off flood-induced concern on the food basket despite sustained decline in the core basket. On the actual numbers, though headline inflation printed at 15.98% YoY, 30bps lower than prior month, the finer details showed an 8bps YoY increase in the food basket offset by a 16bps decline in the core basket. Specifically, September's MoM food inflation of 0.87% was at its highest level since 2012<sup>1</sup> due to pressures from flooding activities across key food producing states. However, gains from decelerating pressures from transport inflation<sup>2</sup>— a fall-out of subdued energy pressures moderated the momentum of inflationary pressures on the food front<sup>3</sup>. On the core basket, subdued pace of price increases in education and energy was the driver.

Going forward, we hold the view that inflation will sustain its downtrend to end the year at 15.6% with 2017 average of 16.5%. First off, gains from the ongoing harvest season and further moderations in transport inflation should further ease pressures on the food front. On other fronts, deceleration in diesel and transport inflation look set to sustain core trajectory in the coming period as pass-through from improvements in FX liquidity becomes increasingly obvious.

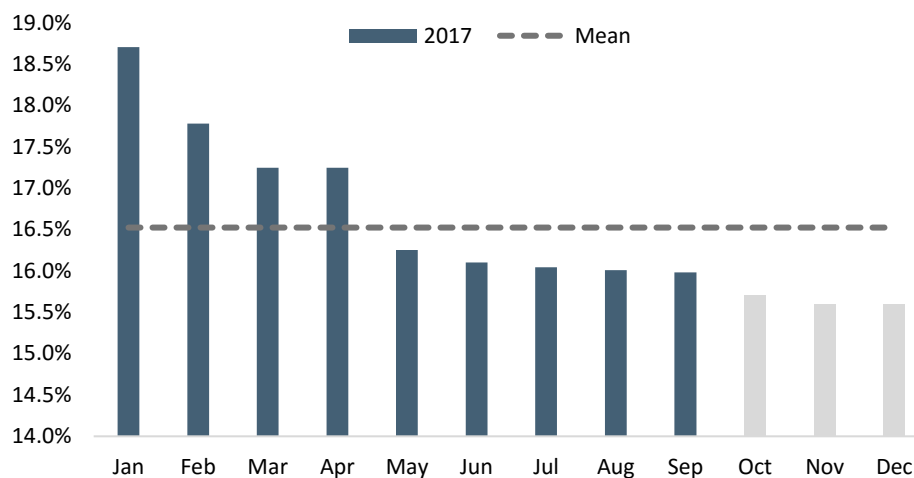
<sup>1</sup> According to NBS data, September inflation over the prior four years has averaged 0.71

<sup>2</sup> Transport inflation touched its lowest level in ten months (0.8% MoM) in September after remaining sticky in the prior two months

<sup>3</sup> While we had expected flood-induced pressures and sticky transport inflation to propel September's MoM food reading to 0.95%, actual reading came in at 0.87%.

To add, given no expected supply—side shocks, especially on the energy front, the downtrend looks certain. Against this backdrop, we forecast a 30bps decline in October’s inflation to 15.7% YoY. Precisely, we expect the coming October food reading (0.6% MoM in our forecast) to be in line with historical levels (0.58%) as the harvest season reaches its peak, while we project MoM headline reading of 0.6%, with the implied YoY reading expected to come in at 15.7% YoY.

**Figure 1: 2017 Inflation- actual and forecasts**



Source: NBS, ARM Research

Going into 2018, we see little scope for substantial shocks on headline inflation. Precisely, against the 2019 elections and what looks set to be, a tough electioneering campaign, we expect PMS and electricity prices to remain relatively stable. Therefore, with no inflationary shocks in sight in the near term therefore, we see scope for substantial deceleration in headline inflation in 2018 owing largely to high base effects from 2017. Overall, we expect headline inflation to average 12.4% over H1 18. Consequently, the argument in favor elevated rates to keep real return positive should gradually lose support over H1 18 as high base effect and the absence of significant price shock eases the current momentum of price increases.

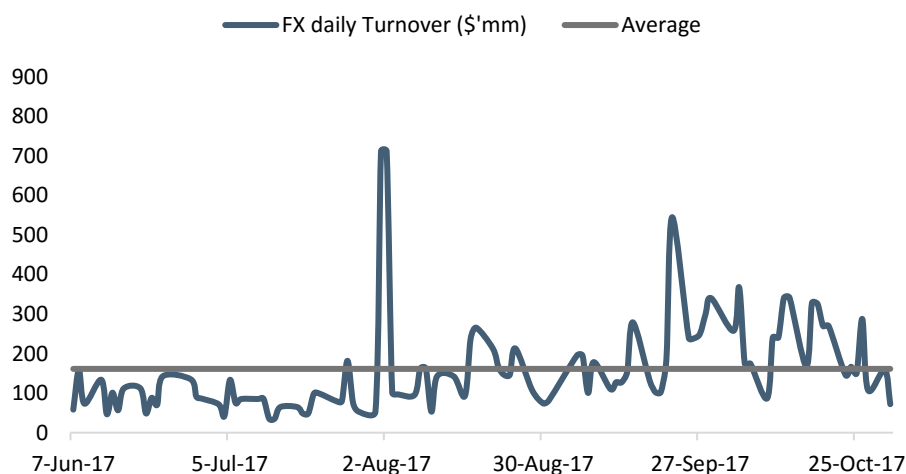
***The party continues for the Naira***

The naira (NGN) continued to show relative stability at the I&E window (IEW) as well as the parallel market. Average daily turnover at the IEW in October remained sturdy at \$215 million, 46% higher than average turnover since the introduction of the window (\$147 million), though 2.8% lower than September’s turnover. At the parallel market, feedback

reveals that the CBN sustained its elevated sales to that segment with supply muting demand pressure at the parallel market. Consequently, the naira extended gains at the parallel market closing at ₦362/\$ (+0.8% MoM) in October while the NAFEX rates was relatively flat, closing at ₦360.83/\$ which is lower by -0.1% from September's closing rate.

Going forward, we think there are grounds for expecting the naira to sustain gains in the near term and possibly into the first quarter of 2018. Given the robust size of CBN's reserves (+3.9% MoM to \$33 billion) as well as the sustained rally in crude oil prices (3.8% MoM to \$57.65/bbl.), the CBN looks to be in a better position to maintain aggressive dollar sales should demand pressures resurface. Furthermore, with sizable foreign flows set to capture fizzling-out high local interest rates, the downside for the naira remains limited.

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



Source: FMDQ, ARM Research

***MTEF: More red ink ahead but debt strategy will change gear***

Last month, the Buhari administration presented the 2018-2020 medium term expenditure framework (MTEF) and the fiscal strategy paper (FSP) to the legislative arm as part of preliminary preparations for the presentation of the 2018 appropriation bill. With respect to the 2018 fiscal year, the administration is requesting a 15% increase in outlays relative to 2017 while expecting revenues to rise at a slower pace of 11% in 2018.

---

In terms of outlays, the framework is proposing higher allocation to recurrent expenditure with proportion of non-debt recurrent and debt service expected to rise to 41% and 26% in 2018 respectively (2017: 40% and 25% accordingly) while capital expenditure prints at 28% of expenditure (2017: 29%). Included in the non-debt expenditure is a provision of ₦194.3 billion for the power sector reform programme and ₦315 billion for restructuring FGN power assets and DISCO Debts. In the details, the FG stated its intention to allocate at least 30% of its outlays to capital projects but noted the challenges in reducing the proportion of recurrent expenditure, particularly personnel cost which currently accounts for about 30% of recurrent outlays.

On the revenue side, the FG's projects oil revenue of ₦2.4 trillion (+15.1% YoY), other revenues of ₦1.8 trillion (+14.5% YoY) and a modest increase in non-oil revenue to ₦1.4 trillion (+0.9%YoY). Underlying the FG's projected oil revenue in 2018 is projected crude oil production of 2.3mbpd (+4.6% YoY) and benchmark oil price of \$45/bbl. (+1.1% YoY) while exchange rate was left unchanged at ₦305/\$. Overall, proposed outlay of ₦8.6 trillion and revenue of ₦5.6 trillion translates to a fiscal deficit of ₦2.949 trillion relative to ₦2.4 trillion in 2017 budget. Fiscal deficit at 2.6% of GDP (2017: 2.2%) remains below the maximum (3% of GDP) stipulated in the Fiscal Responsibility Act of 2007, though higher than the erstwhile projection in the ERGP of 1.96%.

One of the most important aspects of any set of budget projections is the underlying assumptions used. While assumptions for crude oil prices are roughly consistent in the near term, the administration's crude oil production assumption is much higher than our forecast and guides to an overly optimistic projection for oil revenue. Furthermore, the FG's projection for non-oil revenue is overly ambitious in our view. For context, government could only achieve about 51% of budgeted non-oil revenue in H1 17 on a prorated basis. While we believe that improved FX liquidity should provide support for imports and custom revenues, we note that imports activities still significantly lag 2014 and 2015 levels<sup>4</sup>. Consequently, despite the FG plans to raise the VAT rate for luxury items from 5% to 15% from 2018, we think non-oil revenue will be shy from projections with 2018 fiscal deficit expected to come in higher than FG projections. That said, given the FG's preference for longer term external financing to form a sizable part of its debt portfolio<sup>5</sup>, we expect a

---

<sup>4</sup> 2014 avg: \$15.5 billion, 2015 avg: \$13.3 billion, 2016-2017 avg: \$8.6 billion

<sup>5</sup> FG intends to increase the proportionate share of foreign financing from 28% to 72% in 2020.

somewhat subdued pressure on the domestic debt market. As the budget process moves forward, we will continue to update our readers on key fiscal policy developments as they occur.

**Table 1: Budget breakdown of FG's 2018 budget**

	2018 Budget	2017 Budget	change (%)	2017 Budget Pro rata (Jan – Jun)	2017 Actual Pro rata (Jan – Jun)
<i>₦</i> Billions					
Budget Oil Production	2.3 mbpd	2.2 mbpd	15.00	2.2 mbpd	1.8 mbpd
Benchmark oil price	\$45	\$44.5	1.12	\$45	\$53
Exchange rate	\$305/₦	\$305/₦	0	\$305/₦	\$305.78/₦
<b>Federal Retained revenues</b>	<b>5,646.89</b>	<b>5,084.40</b>	<b>11.06</b>	<b>2,542.20</b>	<b>2,429.65</b>
<b>Oil Revenue</b>	<b>2,441.56</b>	<b>2,122.18</b>	<b>15.05</b>	<b>1,061.09</b>	<b>960.87</b>
<b>Non-Oil Revenue</b>	<b>1,385.28</b>	<b>1,379.84</b>	<b>0.88</b>	<b>689.92</b>	<b>352.88</b>
<b>Other Revenues</b>	<b>1,820.04</b>	<b>1589.00</b>	<b>14.54</b>	<b>791.18</b>	<b>1115.9</b>
<b>FGN Expenditure</b>	<b>8,595.67</b>	<b>7,441.18</b>	<b>15.51</b>	<b>3,720.59</b>	<b>3,101.33</b>
Statutory Transfers	451.46	434.41	3.92	217.21	209.02
Recurrent Expenditure	5,767.13	4,832.27	19.35	2,416.13	2,892.31
Non-debt Recurrent Expenditure	3,519.12	2,990.92	17.66	1,495.46	1,947.57
Debt Service	2,248.01	1,841.35	22.08	920.67	927.74
Capital Expenditure	2,377.08	2,174.50	9.32	1,087.25	0
<b>Fiscal Deficit</b>	<b>2,948.78</b>	<b>2,356.77</b>	<b>25.12</b>	<b>1,178.59</b>	<b>671.98</b>

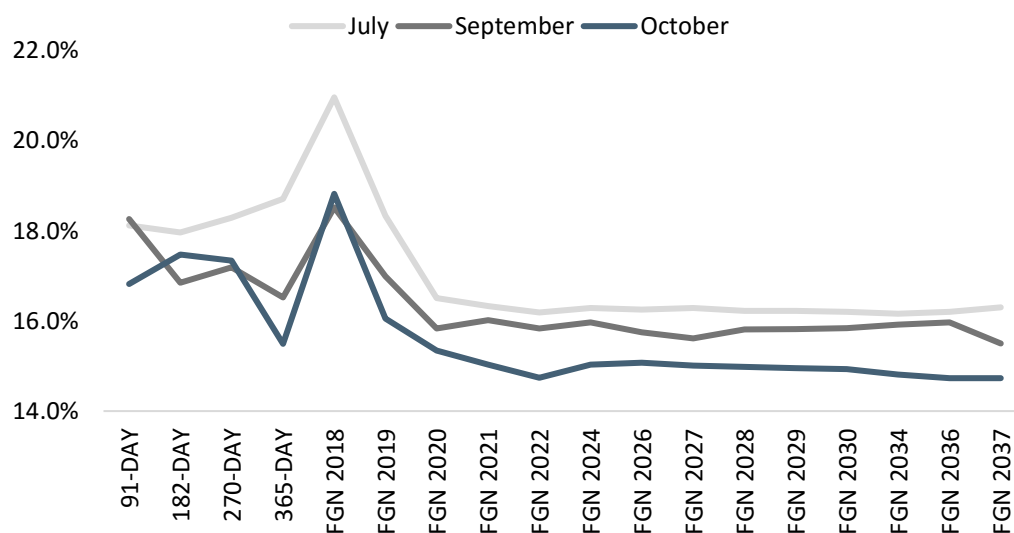
Source: Budget office, ARM Research

### *Market forces drive down yield curve*

Following the 93bps decline in the prior month, the yield curve dipped further by ~54bps to average 16.9% in October, largely driven by the long-dated bonds, on falling inflation and lower supply. The foregoing enriched valuation in the belly of the curve versus the long end, and thus for tactical purposes we hold a relative preference for medium-term instruments. The extended dip in the yield curve was on the back of lower treasury and bond issuances as well as stronger appetite for longer term bonds trailing the release of the

FG's 2018 borrowing framework which supports a tilt towards higher external borrowing. At the short end of the curve, net maturity at the treasury bills market of ₦182.8 billion as well as FAAC inflows of ₦558 billion trumped impact of net OMO issuance of ₦56.5 billion to drive a downtrend in yields (-21bps MoM to 18.87%). At the long end of the curve, despite the tamer bid-ask ratio of 1.7x (vs. 3x in September), average marginal clearing rates dipped for the second consecutive month (-94bps to 15%). In October, the FG ceased issuance of the 20-yr paper and simultaneously lowered the amount on offer to ₦100 billion with an overall issuance of ₦121 billion at the auction (₦100 billion sold and non-competitive bids of ₦21 billion). The foregoing combined with expected monetary easing on the back of falling inflation stoked concerns on re-investment risk and supported the 86bps decline in bond yields to 15%.

**Figure 3: Changes in naira yield curve**



Source: FMDQ, ARM Research

With inflation sustaining its southward momentum and prospects for base effect-induced decelerations very much on the cards for 2018—developments which support more open gravitation towards easing and cheaper borrowing rates in the coming year, FG's appetite for domestic borrowings has continued to retreat with its preference for currently cheaper external borrowings becoming more apparent. 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. Thus, we recommend that, investors intensify aggressive bond purchases to lock-in rates against the impending downside in yields.

### ***October PMI: Tentative signs of further recovery***

Purchasing Managers Index published by the CBN sustained an expansionary trend in October. The details of the report show that manufacturing and non-manufacturing activities expanded to 55.0 and 55.3 points respectively. On the manufacturing leg, the outturn more closely mirrored the firming in business sentiment and continues to point to a more upbeat pace of activity in the manufacturing sector. The breakdown show that new orders continue to expand with lagged impact driving higher production and inventory levels. To meet the increase in activity, the pace of hiring further expanded. This dynamic suggest that capacity pressures continue to build.

Similarly, non-manufacturing PMI continued its pace of acceleration with improvement evident across all the four sub-indices (business activities, new orders, level of employment, inventory), as well as all the constituent sub-sectors. In line with events in the prior month, fifteen of the eighteen sub-sectors domiciled in the index expanded in October with utilities and agriculture retaining the lead role. According to commentary provided by the CBN, the strength of non-manufacturing activities over the past six months can be largely attributed to the tenacity of the Agriculture and Finance & Insurance sectors with the former being the fastest growing non-manufacturing segment in terms of business activities.

As usual, given the weight of manufacturing (9.4%) and Agriculture (23.0%) to Nigeria's economic activity, we are of the view that overall growth over Q3 and Q4 will be driven by the resilience of these sectors as well as growth in the oil sector to offset a less upbeat picture on the services sector. However, taking the manufacturing and non-manufacturing readings together, the October composite PMI marginal retreated to 55.0, down from 55.1 in September, a consequence of slowing non-oil activities. Thus, oil sector growth – a reflection of higher production and prices, should play a critical role in our overall GDP

---

growth forecast for Q3 and Q4 2017 of 1.1% and 2.0% respectively. Consequently, 2017 GDP growth should print at 0.7% YoY.



---

Copyright © 2017 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.