

3 September 2020

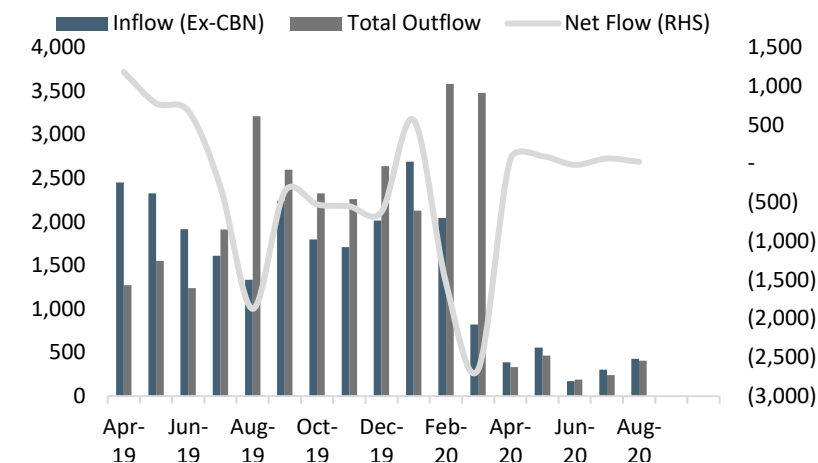
**FX sales to ease pressure on parallel market**

The paucity of flows at the IEW continued into August as foreign investors sentiment remained soured. Uncertainties surrounding Nigeria’s economic growth and FX policy continued to keep investors at bay. Precisely, offshore inflows so far in August currently prints at a meagre \$65 million (-21% MoM). Meanwhile, inflows from local corporates continued to hold steady printing at \$312 million (+62% MoM). Overall, inflows (ex CBN) currently prints at \$429 million (+41% MoM). On the other hand, outflows expanded by 69% MoM to \$407 million, but still remains low compared to historical period. On balance, balance of flows printed at a net inflow of \$21 million compared to a net outflow of \$64 million in July. Furthermore, the CBN made no sale at the IEW for the fifth consecutive month. Reflecting the paucity of flows (oil and non-oil inflow) together with FX sales at other segments, the reserves depleted by \$214.9 million to \$35.7billion. Meanwhile, rates at both the IEW and parallel market recorded some gains over the month, appreciating by 0.82% MoM and 2.5% MoM respectively.

Last week, the CBN announced resumption of FX sale to BDCs following expected resumption of international flights on September 5. Consequently, sales to BDCs is expected to resume on September 7. In addition, the CBN placed a maximum limit of ₦386/\$ from BDCs to end users. The apex bank will be making sales only on Mondays and Wednesdays (previously Monday, Wednesday and Friday) at the outset and \$20,000 per BDC each week (previously: \$75,000). Unsurprisingly, the naira started to appreciate at the parallel market ahead of the resumption of sales. Between the date of announcement and now, the naira gained 9.1% at the parallel market.

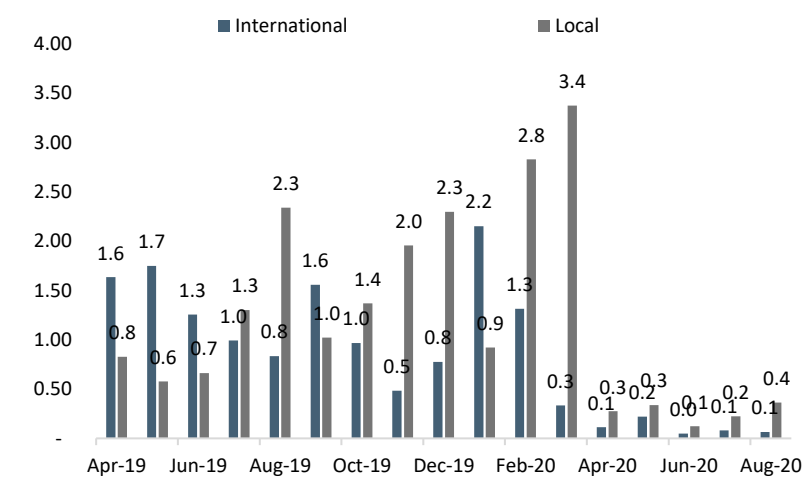
Going forward, with the recent update of lower FX sales to BDCs, we have modelled FX sales to BDCs amounting to \$240 million in September and October respectively while we expect a pickup to \$600 million on average in November and December. This adjustment takes our reserve expectation to \$32.4 billion (previously \$29 billion) by year end excluding inflow from World Bank. Given our expected level of reserve relative to CBN’s proclaimed comfort level of \$30 billion, we see limited downside in FX rates over the rest of the year. We expect rate at the NAFEX to close the year between ₦380/\$1 – ₦400/\$1 while rates at the parallel close the year between ₦400/\$1 – ₦450/\$1 as resumption of sales to BDCs ease the pressure in the parallel market.

**Figure 1: Foreign Currency flows through the IEW (\$'mn)**



Source: FMDQ, ARM Research

**Figure 2: Trend in offshore and local inflow at the IEW (\$'bn)**



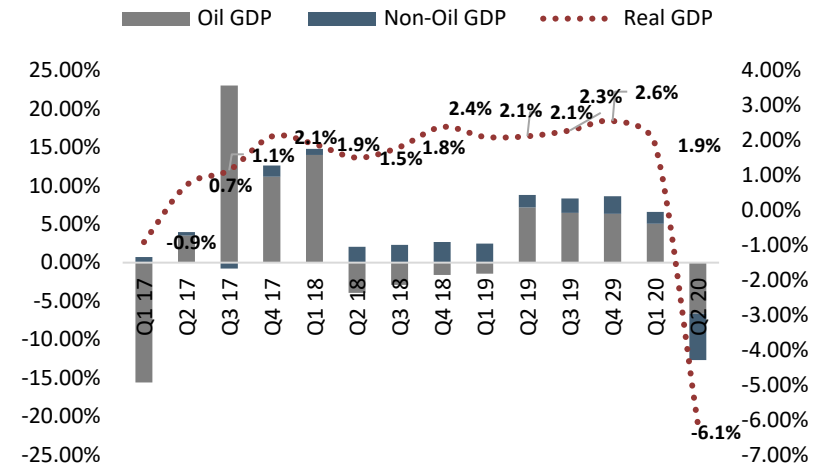
Source: FMDQ, ARM Research

**2020 GDP: The storm may be over, but the rubbles remain**

The Nigerian economy recorded the steepest contraction in over 9 years with Q2 2020 GDP printing at -6.10% YoY. This was driven by contractions in both oil and non-oil sector. The oil sector contracted by 6.6% YoY relative to 5.1% growth in Q1 2020, owing to a moderation in crude oil production which printed at 1.81mbpd (vs Q1 2020 crude oil production of 2.07mbpd). Meanwhile, the non-oil sector declined by 6.1% YoY (vs Q1 2020: 1.5% YoY). Dissecting the components in the non-oil sector revealed all sectors contracted save the Agric sector which expanded by 1.58% YoY (Q1 2020: 2.2% YoY). We believe movement restrictions and below-average access to inputs, amongst other factors curtailed growth in agricultural activities during the period under review. On the other hand, disruption in production value chain - a fall out of the pandemic – as well as devaluation of the Naira, weighed heavily across the manufacturing (Q2 2020: -8.8% YoY vs Q1 2020: 0.4% YoY) and Trade (Q2 2020: -16.6% YoY vs Q1 2020: -2.8% YoY) sectors. Elsewhere, services sector contracted by 2.61% YoY for the first time since Q4 17 as declines in Transport (-49.2% YoY), Real Estate (-22% YoY) and other services subsectors more than outweighed growth in ICT (+18.1% YoY) – the highest in over 9 years and Finance (+18.5% YoY) subsectors. Notably, increased use of internet services during and after the lockdown spurred growth in ICT.

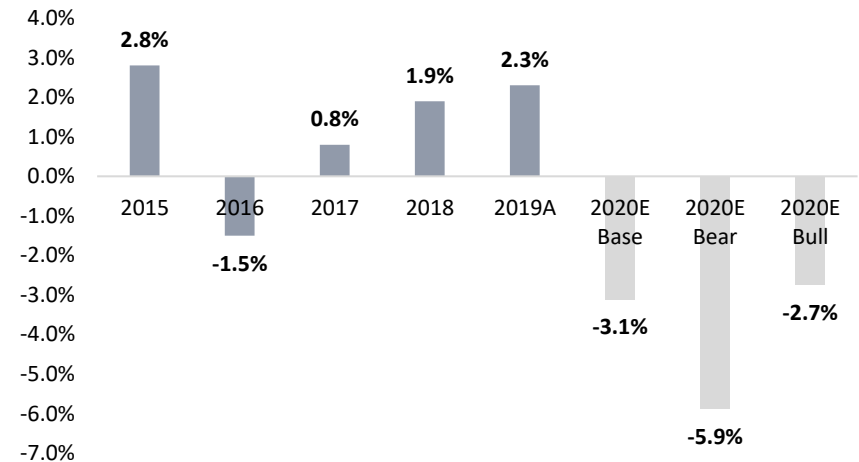
Going further into the year, while we believe the worst may be over, we expect Nigeria to test the recessionary waters in 2020 as we mentioned in our H2 2020 NSR report (***Gross Domestic Product H2 2020 – A Recession Looms***). Since the gradual reopening of the economy, economic activities have shown signs of improvement. The PMI data which tracks the level of business activities showed an improvement compared to the prior months. Manufacturing PMI for August printed at 48.9pts (July 2020: 44.9pts) while the Non-manufacturing PMI printed at 44.7pts (vs 43.3 pts in July 2020).

**Figure 3: Historical movement in Real, Oil and Non oil GDP**



Source: NBS, ARM Research

**Figure 4: Historical movement in Annual Real GDP & Forecast**



Source: NBS, ARM Research

Albeit, we expect a contraction in the oil and non-oil sector relative to 2019. Starting off with the oil sector, we expect an average crude oil production of 1.82mbpd over FY 2020 (FY 19: 2.01mbpd) hinged on a higher level of compliance in 2020. Although, the agreed production cuts was reduced to 7.7mbpd in August from 9.7mbpd in May, Nigeria is expected to compensate for lack of full compliance with the previous limit. That said, the oil sector is expected to contract by 9.57% YoY over FY 2020. In the non-oil sector, except for the Agric sector, our expectation of contractions in the Manufacturing, Trade, Services and Construction sectors guides to an overall contraction of 2.5% YoY for FY 2020 (FY 19: 2.1% YoY). For the Agric sector, we expect the continuation of farming activities to drive growth, albeit at a slower pace relative to FY 19 as engagement in agriculture activities is generally below normal across the country.

Meanwhile, in the manufacturing sector, although activities have picked up relative to H1 2020, we still expect lower output on an annual basis. Furthermore, given the susceptibility of the manufacturing and Trade sectors to foreign exchange, the technical devaluation across all windows by the CBN late Q1 2020 is expected to be detrimental to the sectors' performance. For services, while ICT and finance are expected to record growth, we expect Real estate, Education, accommodation and food services to drag the overall services sector southward. Overall, we revise our FY 2020 growth estimate downwards to a 3.05% YoY contraction (previously -1.6% YoY). Albeit, our estimate is less pessimistic than the IMF forecast of -5.4% contraction. In H1 2020 where we had the lockdown, the economy contracted by 2.12% YoY. To meetup with IMF's GDP forecast of -5.4%, the economy will have to contract by -8.68% in H2 2020 which we believe has a low probability of occurring due to pick up in economic activities. For Q3 2020, we expect a contraction in GDP to -5.42% YoY driven by a contraction in the oil sector (-21.6% YoY with crude oil production estimate of 1.6mbpd including condensates) and shrinkage in non-oil sector by 3.7% YoY.

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