

Macro Economic Report | Monthly Update

Macro Economic Update – February 2020

Burst after burst!!!

The crude oil market witnessed an unprecedented plunge in prices over the past few weeks. First, the widespread Coronavirus, which unlike January has spread rapidly outside China, raised concerns on the potential impact on crude oil consumption. This was largely responsible for the \$8/bbl. decline in average Brent oil prices over the month of February to average \$53/bbl.

However, in a comical twist of events, outcome of the OPEC+ meeting over the weekend, led to a 30% plunge in oil prices in market open to a 2016-low of \$33/barrel. This marked the largest single-day drop since the 1991 Gulf war. This followed Russia’s refusal to agree with the rest of the producers, and especially the cartel *de facto* leader, Saudi Arabia, in taking additional 1.5mbpd production cut to the existing 1.7mbpd voluntary cut. The increased cut was aimed at balancing the market in view of the impending shortfalls in demand caused by the Coronavirus. This severed the partnership between OPEC and its allies which began in 2016.

In response, Saudi Aramco declared an all-out price war after it slashed price of its Arab crude blends by \$6-8/bbl. in competition with Ural and Shale oil. Saudi Arabia is expected let its production tap loose as it fights to regain market share from Russia and the US, which could potentially increase supply by another 2mbpd from its current production of ~9mbpd. While the Saudis are known to have the lowest cost of production (~\$9/bbl.), compared to Russia (~\$19) and the US shale (~\$23), it faces risk of a wider budget deficit which has been pegged at \$80.

Figure 1: Oil price movement (\$/bbl.)

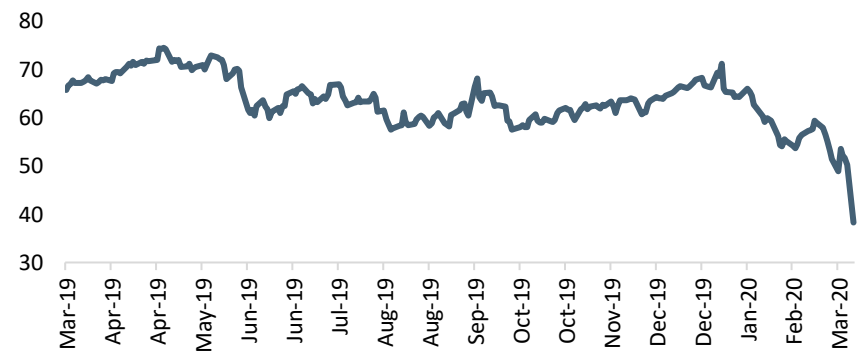
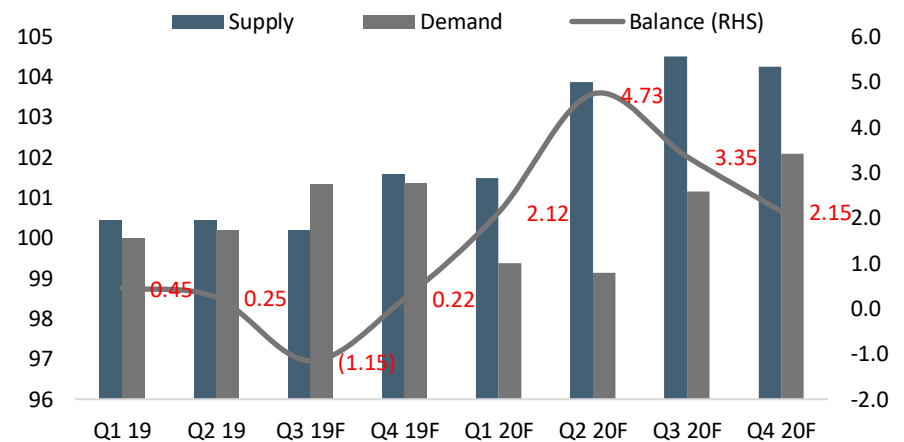


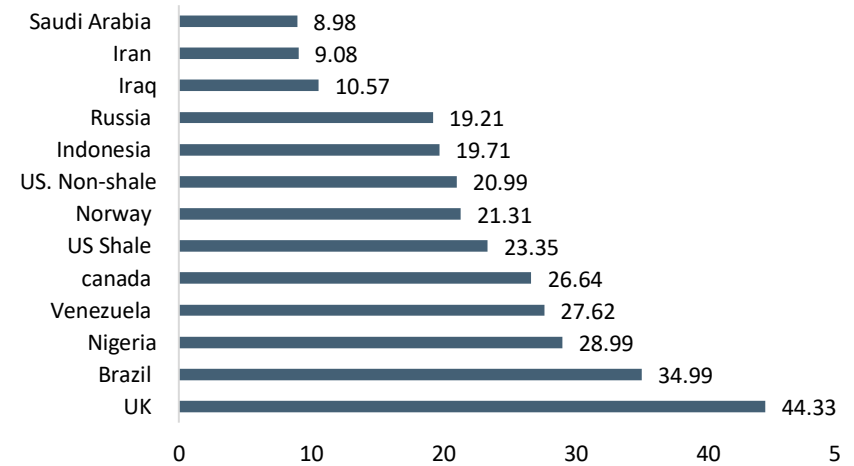
Figure 2: Global Oil Demand and Supply



Source: Bloomberg, ARM Research

Going forward, we have adjusted our oil price forecast for the rest of the year to \$47.5 from previous forecast of \$61.3/bbl. and \$64/bbl. in previous year. This is based on an interpolation of our expectation of market balance, which we now expect will print at a net surplus of 3.09mbpd over 2020 (previously: 0.14mbpd). On the demand leg, we project lower consumption growth in China, Europe and the US will put global demand growth lower by 0.28mbpd YoY in 2020. We expect some recovery in demand in H2 (vs H1), as impact of the Coronavirus gradually fades. On the supply leg, we project higher outflows from OPEC, with Saudi increasing outflows by ~1.5mbpd while other member countries and Russia remain increase outflows. However, we still expect involuntary shut-offs in Libya, Iran and Venezuela will keep the increased supply at bay. Upside to our forecasts reside in a Saudi-Russia reconciliation, which could bring production cuts talks back on the table to stabilise oil market and prices.

Figure 3: Breakeven oil production cost (\$/bbl.) - 2016



Source: Wall Street Journal, Rystad Energy

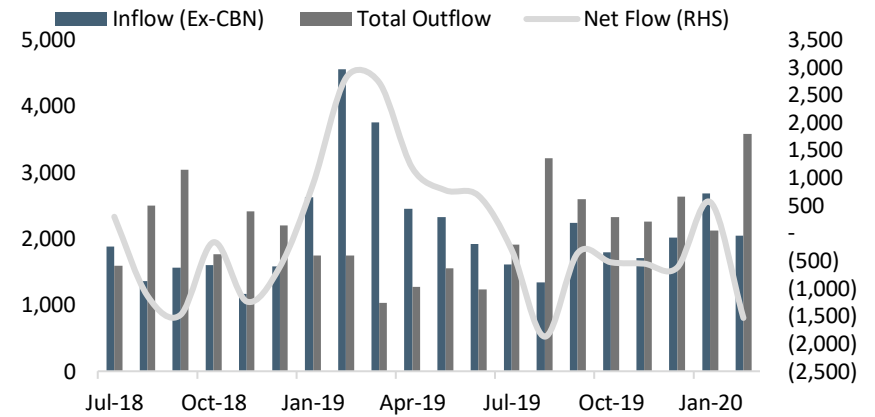
Is a naira doom in the offing?

Following a breather in net outflows at the IEW in January, balance of flows once again printed at a net outflow of \$1.5 billion in February (vs. a net inflow of \$561 million in January). This time, the net outflow was driven by a combination of lower inflows (ex CBN): -24% MoM and a surge in outflows (+68% MoM). Repatriation of FPI funds was evidently higher, amplified by the significant FI maturity totalling (\$7.2 billion) over the month. On inflows, offshore inflows eased by -39% MoM to \$1.3 billion over the month, obscuring a modest increase in local inflows (ex-CBN).

Reflective of increased outflows, the CBN returned to supplying the window with dollar liquidity to the tune of \$2.1 billion (4.4x MoM). Overall, with a total net inflow of \$563 million (inclusive of CBN's sale), we believe all demands were matched with adequate supply at the IEW. Elsewhere, CBN's interventions at other windows also increased significantly by 35% MoM to \$3.8 billion. The increase likely reflected a higher one-off FX sale apportioned for developmental projects. Consequently, the gross reserve (unadjusted) depleted by \$1.7 billion to close the month at \$36.3 billion.

Going into coming months, while FI maturity levels is expected to come in lower relative to the past two months, we however note our concern on the Corona virus, price war on oil prices and in turn plausible significant repatriation of foreign flows. Therefore, we played various scenarios assuming different levels of oil price and FPI repatriation rate. For a base case, we assume oil price to average the year at \$47.5/bbl while forecasting a 50% repatriation of foreign funds (2-year historical average : 40%) as investors scamper to safe haven assets. Ex-Eurobond issuance, we see the FX reserve touching CBN's comfort level of \$30 billion by the end of September. For us, we believe the CBN will utilize all possible administrative tools to keep the naira stable (i.e increasing OMO rates) before opting for a devaluation. However, should concerns on corona virus persist, no Eurobond issuance and oil price maintain its current momentum, we see the possibility of a devaluation by Q3 2020.

Figure 4: Foreign Currency flows through the IEW (\$'bn)



Source: FMDQ, ARM Research

Table 1: Scenario analysis of CBN's FX reserve (\$'bn) by YE 20

		FPI repatriation rate		
		Bear case (70%)	Base case (50%)	Bull case (40%)
Oil price forecast	Bear case \$40/bbl	24.9	26.8	27.8
	Base case \$47.5/bbl.	25.5	27.4	28.4
	Bull case \$55/bbl	26.9	28.8	29.7

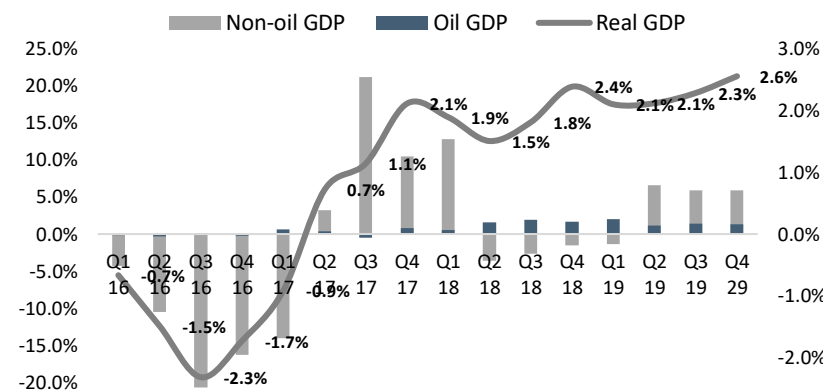
Source: FMDQ, ARM Research

GDP to remain unaltered

The Nigerian economy grew by 2.3% YoY over FY 19, an improvement from 1.9% in 2018, with both the oil driving the growth. In the last quarter of 2019, the economy recorded a sturdy growth of 2.55% - buoyed by expansion in the non-oil sector (2.3% YoY) while oil sector tapered slightly to 6.4% YoY). A deeper look at the non-oil space revealed expansion across all sectors while the Trade sector saw a slower contraction during the period (-0.6% vs -1.5% in Q3 19). Specifically, the Services and Manufacturing sector led the pack, while Agric sector growth flatlined. Notably, the financial service segment which expanded by 20.2% YoY - the highest recorded over five years, as well as continuous growth in ICT segment drove expansion in services sector (4.01% YoY). We believe growth in financial services mirrors the banking sector's drive to meet the 65% LDR requirement. According to CBN data, a total of ₦937 billion worth of loans was created by Deposit Money Banks over Q4 19. Furthermore, we witnessed improvement in the manufacturing sector which expanded by 1.2% YoY, reflecting a recovery in Textile, Apparel and Footwear subsectors. On the flipside, activities in the oil sector moderated slightly to 6.4% from 6.5% YoY recorded in Q3 19, following reduced crude oil production recorded during the period. In Q4 19, crude oil production printed at 2.00mbpd relative to 2.04mbpd in Q3 19.

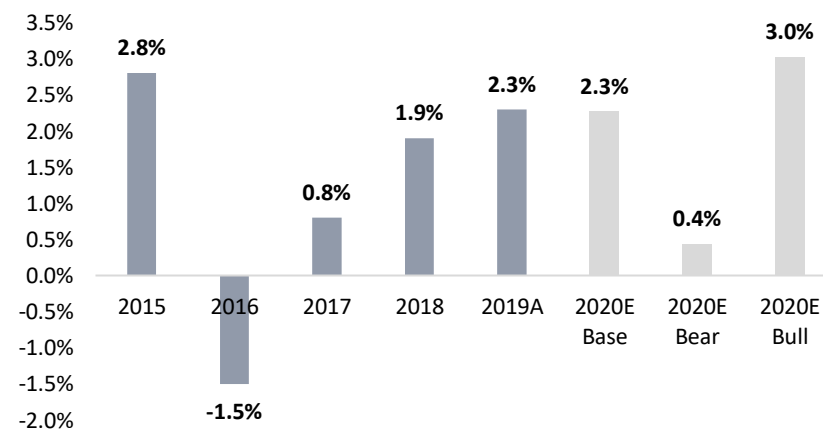
For FY 2020, we expect growth over 2020 to flatline at 2.3% which is our base case. On oil sector, we expect growth to slow and expect production to print at 2.1mbpd. On the other hand, growth in the non-oil sector is expected to persist hinged on a sturdy growth in services, manufacturing and agricultural sector. On the former, while the momentum in ICT segment maintained, improvement in financial services due to increased lending to the real economy provides additional support to services sector. Meanwhile, in the manufacturing sector, while competition from imported goods would persist – the absence of election driven slowdown we saw in Q1 19 coupled with sturdy output in the cement space supports our stance for regained momentum over 2020. On agriculture, reduced flooding risk and improved output forms our basis for an improvement in Agric sector.

Figure 5: Historical movement in Real, Oil and Non oil GDP



Source: NBS, ARM Research

Figure 6: Historical movement in Annual Real GDP and Forecast



Source: NBS, ARM Research

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