

**Macro Economic Report | Monthly Update**

**Macro Economic Update – March 2020**

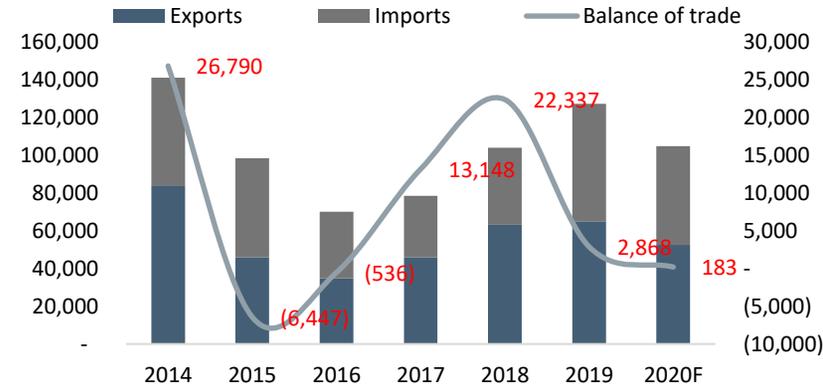
*Nigeria Current Account: The Boiling Frog*

Nigeria’s current account balance was in the worst position ever on record in 2019. We posted a \$17 billion current account deficit over the period from a surplus of \$5 billion in FY 18, with all four quarters of the year closing in deficits. This also printed higher than the \$15 billion deficit posted back in 2015 – the year leading up to the devaluation of the naira in 2016. However, unlike the deficit in 2015 where pressure had stemmed from thinned out oil receipts owing to pressures on oil prices and production; the pressure this time around stemmed from the wound-up purchase of foreign goods (imports) and services (spendings on BTA and PTA). For context, imports jumped by 52% YoY to \$62 billion in 2019, while exports rose 3% YoY to \$65 billion – oil: -7% YoY, non-oil: +123% YoY. As a result, the trade surplus shrunk 87% on the year to \$2.9 billion. There was also a surge in BTA and PTA spending as well as increased payments for foreign professional and technical services, all of which mounted pressures on the services deficit (+30% YoY to \$34 billion). These spikes in spending offset the 9% YoY increase in current transfers to \$26 billion, comprising workers’ remittances and government transfers.

In our FY 2020 outlook (released earlier in January) we estimated that, save for an administrative intervention by the CBN to curb foreign spending, the current account deficit could print at \$17 billion by the end of 2020. However, following the global break out of the Corona Virus, there has been a virtual halt to global economic operations and travelling. This has necessitated a revision to our estimates as this is likely to reduce (1) the extent of imports this year and (2) travelling expenses as well as on PTA and BTA spending.

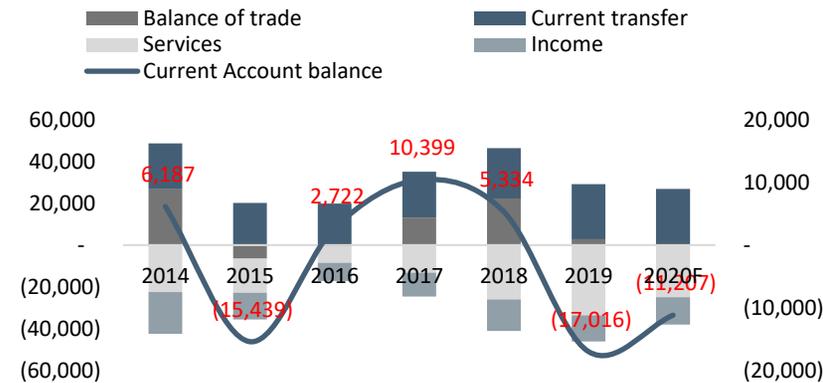
It is worth stating that in addition to the pull back in the demand for foreign goods and services, recent policies by the CBN – such as the halted sale of FX to the BDCs and the adjustments (technically, a devaluation) – are bound to dissuade foreign spending and thus, further ease the pressure on the current accounts.

**Figure 1: Historical and Forecast Trade Balance**



Source: NBS, ARM Research

**Figure 2: Historical and Forecast Current Account Components (\$'million)**



Source: NBS, ARM Research

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Consequently, we revised our estimates for imports and services deficit lower to \$52 billion and \$25 billion, from \$60 billion and \$36 billion respectively. We have also incorporated our downwardly revised FY 2020 oil price forecast of \$47.5/barrel (previously \$61) as well as reduced estimates for exports. These resulted in a downward revision in exports to \$52 billion from \$65 billion.

Overall, following the downward revision to imports and services deficit – which outweigh our reduced exports forecast – we revised our FY 2020 current account deficit estimate lower to \$11 billion from \$17 billion. It is worth stating that should the COVID-19 pandemic continue to halt global operations longer than we envisage (beyond Q2 19), and the CBN go ahead with tougher FX restrictions and FX

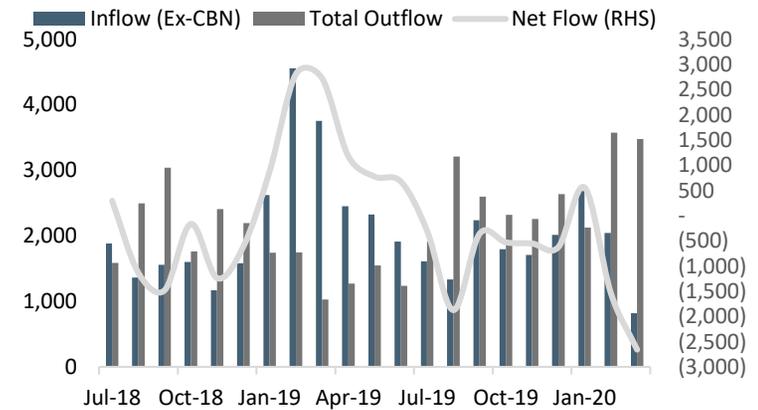
## Déjà vu all over again

Events over the past few weeks have made us reminence almost similar events in 2016/2017. Oil price has remained low, averaging \$34.1 over March, lowest since January 2016. Just four years ago, the CBN was forced to devalue the naira following an oil price crash and lower oil receipts and now, face similar quandary. Further adding to present lower oil price predicament, the FX market has not been spared from a FX flow crunch due to the Covid-19 epidemic. Over the month of March, inflows (ex CBN) into the IEW has moderated by 59.9% MoM to \$819 million. Together with an outflow of \$3.5 billion (-2.8% MoM), net outflow currently prints at \$2.7 billion, the highest since the commencement of the IEW in 2017. In turn, the CBN intervened to the tune of \$2.9 billion over the month. CBN's intervention at other windows continued to remain on the high side (\$3.9 billion). Consequently, the gross reserve (unadjusted) was depleted to the tune of \$1.1 billion to close at \$35.2 billion, largely mirroring higher outflows relative to inflows.

Reflective of the pressure on its reserve, the CBN devalued the official exchange rate from ₦306/\$1 to ₦360/\$1. In addition, rates for different users at the IEW were adjusted from prevailing rates of ₦360/\$1 – ₦365/\$1. The rate was adjusted to ₦376/\$1 from IMTOs to Banks, ₦377/\$1 from Banks to CBN, ₦378/\$1 from CBN to BDCs and maximum of ₦380/\$1 from BDCs to end-users. The CBN also took to administrative control in order to limit the pressure on its reserve. Specifically, FX sales to BDCs was suspended, due to the border closure and travel restrictions across the world which is expected to reduce FX demand.

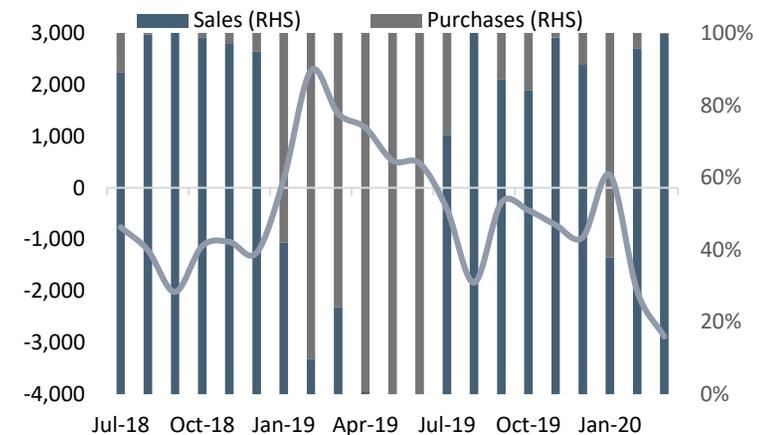
Overall, the pressure on CBN's reserve is quite evident. It is therefore pertinent to determine if CBN has reached its breaking limit or can still manage further. Firstly, due to the restriction of activities globally and domestically, we see potential for savings on the CBN's FX reserve. Particularly, we see scope for reduced FX demands relating to imports and travels. Following the suspension of FX sales to BDCs, we expect a saving of about \$2.2 billion over a two month period using average monthly sale to BDCs over the past one-year. We assume borders will remain closed and CBN sticks to its No Sale to BDCs for the next two months.

Figure 3: Foreign Currency flows through the IEW (\$'bn)



Source: FMDQ, ARM Research

Figure 4: CBN Sales/Purchase (\$'million)

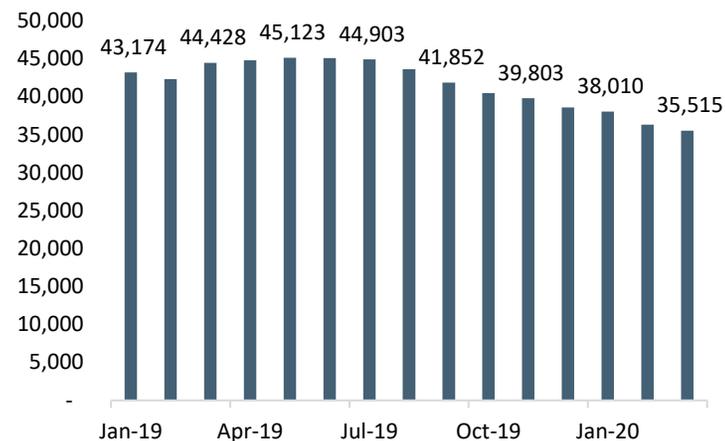


Source: FMDQ, ARM Research

In addition, we forecast a 10% decline in FX sales at SMIS, SME and Wholesale Forwards window. Elsewhere, we maintain our projection of a 50% repatriation of foreign flows over the rest of the year. This brings total outflow to \$51.3 billion over 2020. That said, we maintain our oil price forecast of \$47.5 and oil production of 2.07mbpd over 2020. Together with non-oil inflows of \$31.4 billion, we expect total inflows of \$42.6 billion over the year. On balance, our adjustments places the FX reserve at \$29.4 billion by year end.

Although CBN's professed comfort level of \$30 billion is still some months away, its recent actions typically denote a sense of jittery. Precisely, aside the adjustment of FX rates, our sources have revealed backlogs of FX demands at different windows. These all suggests CBN way of managing the increasing demand at the IEW. With the \$3 billion Eurobond issuance delayed till further notice, we expect the CBN to maintain its use of administrative tools in managing the FX reserves. That said, in the coming months, we expect the lower maturity profile to provide some respite and limit further depreciation of FX rates at the IEW. Meanwhile, we expect rates at the parallel market to continue trading at a premium to NAFEX rate as panic buying persists.

**Figure 5: CBN FX Reserve (\$'million)**



Source: CBN, ARM Research

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### *Lots of moving parts but deficit picture still intact*

Desperate times like this calls for desperate measures. The FG is currently embattled with lower oil prices (average: -39% MoM) and reduced economic activities – a fallout of the covid-19 epidemic which birthed the oil price war, and poses a big threat to the 2020 fiscal budget. In response, the FG made a couple of revisions to the budget. First, the oil benchmark was revised lower to \$30/bbl (previously \$57/bbl) and the dollar interbank rate was increased from ₦306/\$1 to ₦360/\$1. In addition, the FG plans to cut its recurrent and capital expenditure by 25% (₦1.21trillion) and 20% (₦556.7 billion) respectively. These adjustments alone should reduce the budget deficit by 42% or ₦772 billion to ₦1.08trillion. However, we see scope for a higher budget deficit on the back of a much steeper fall in non-oil revenue given FG's overly ambitious estimates and impact of current lock down on economic activities.

To start with, given the current lockdown and subsequent drop in economic activities, we expect revenues from VAT, CIT and customs to print lower. We assume the slow economic activity persists for the next two months. Contrary to the FG's more conservative expectation for oil price, we project oil price to average \$47.5/bbl over the year, as demand starts to return and OPEC eventually agrees on a cut, while we project a daily oil production of 2.1mbpd compared to the government's assumption of 2.18 mbps. Overall, we expect oil revenue to print at ₦1.48 trillion (budget: ₦2.64 trillion). Combining our expectation for oil revenue with our projected non-oil revenue of ₦1.14 trillion (budget: ₦1.81 trillion) and other revenue of ₦1.34 trillion (budget: ₦3.42 trillion), we project a total revenue of ₦3.96 trillion (budget: ₦7.87trillion) over 2020.

On the other hand, we have reduced both capital and recurrent expenditure in line with the government's guidance. Additionally, we cut our capex implementation rate from 45% to 35% and recurrent implementation from 89% to 80%. This gives us a total expenditure of ₦7.34 trillion (budget: ₦9.71trillion). On balance, we expect budget deficit to come in at ₦3.38 trillion.

An important aspect of the budget revision the FG is yet to shed any light on, is how they intend to fund it. Initial borrowing plans entailed borrowing ₦745 billion domestically and another ₦850 billion via foreign sources, including a new Eurobond issuance. However, the drop-in oil prices have raised Nigeria's risk profile and culminated in Fitch downgrading Nigeria's credit rating to negative. In addition, sentiments across markets is not looking favourable due to the impact of the Covid-19. This increases borrowing costs and led to the FG shelving its Eurobond plans indefinitely. Barring any last minute change, we expect increased domestic borrowings to meet up for the shortfall. As a matter of fact, the Q2 2020 bond issuance calendar makes mention of the FG seeking approval to raise the ₦850 billion from the domestic market as an alternative to the planned Eurobond. Overall, we could be looking at a total of ₦1.59 trillion in domestic borrowings in order to fund the budget.

**Table 1: Budget Estimates**

	2020 Budget	2020 Revised Budget	2020 Estimates		
(N' billion)			Bear	Base	Bull
<b>Oil production (mbpd)</b>	<b>2.18</b>	<b>2.18</b>	<b>1.78</b>	<b>2.10</b>	<b>2.18</b>
<b>Oil price (\$/bbl)</b>	<b>57.00</b>	<b>30.00</b>	<b>30.00</b>	<b>47.50</b>	<b>68.50</b>
<b>Exchange rate (N/\$)</b>	<b>305</b>	<b>360</b>	<b>360</b>	<b>360</b>	<b>360</b>
FG Share of oil revenue	2,637	1,336	793	1,482	2,773
Non-Oil revenue	1,805	1,805	1,104	1,138	1,358
Other revenue	3,423	3,423	1,022	1,341	1,835
<b>FG Total revenue</b>	<b>7,865</b>	<b>6,564</b>	<b>2,919</b>	<b>3,961</b>	<b>5,966</b>
FGN Expenditure	9,713	7,640	8,455	7,343	8,862
<b>Fiscal deficit</b>	<b>(1,848)</b>	<b>(1,076)</b>	<b>(5,536)</b>	<b>(3,382)</b>	<b>(2,896)</b>

Source: Budget Office, ARM Research

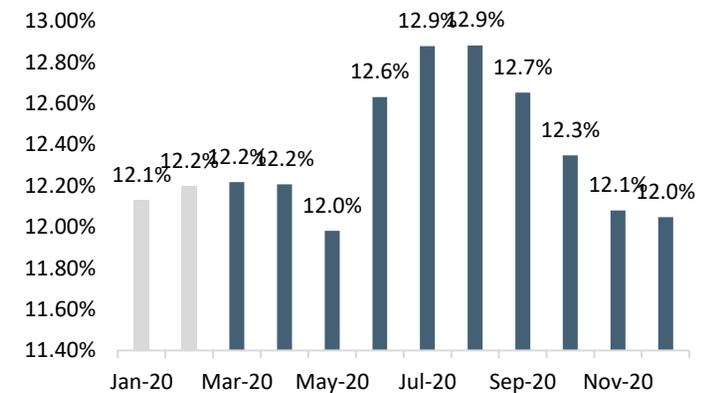
## Differing policies to leave consumer prices elevated

Headline inflation came in lower than expected for the month of February as inflation ticked 7bps higher to 12.20%. Notably, core inflation accounted for bulk of the hike in inflation rising by 9bps to 9.43% YoY, while food inflation rose 6bps to 14.9% YoY. On the former, the uptick was driven by increases across sub-indices including HWEGF (+3bps to 7.81%), Furnishing (+16bps to 9.39%), Health (+16bps to 9.39%) and Transport (+8bps to 9.43%), amongst others. Meanwhile, the driver for the latter was a 4bps expansion in both farm and imported food inflation to 15.39% and 16.14% YoY respectively. While the unfavorable base effect remained the anchor of the expansion, we believe the buoyant supply from carryover stocks from the previous harvest season helped taper the pace of increase. According to FEWSNET, save for imported rice, market remained copious across the country as staple cereals including maize, millet, sorghum, tubers as well as the cassava harvest kept market in a surplus position.

As opposed to the YoY numbers, Month-on-month numbers dipped 9bps to 0.79% MoM hinged on declines in both core and food inflation. Core inflation tanked 9bps to 0.73% MoM reflecting moderation in HWEGF, Clothing, Health and Transport sub-indices. Similarly, food inflation declined 12bps to 0.87% MoM mirroring 7bps and 60bps decline in farm produce and processed food to 0.86% and 0.99% respectively.

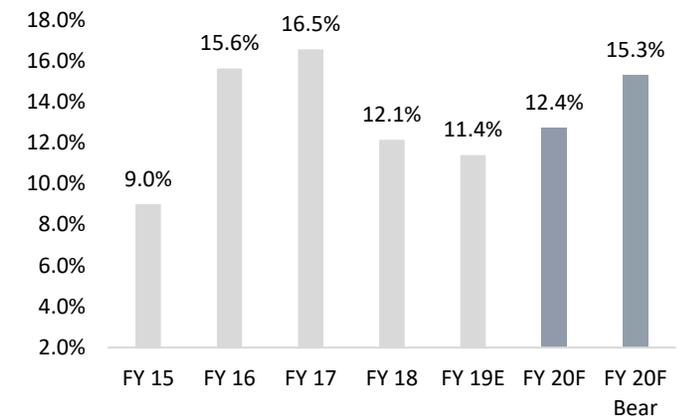
Going forward, contrary to previous months where the increases in consumer prices largely reflects base effects from the boarder closure which kicked off last year, recent policies implemented to combat the impact of COVID-19 on the economy are expected to be the key determinants in coming months. To begin, the FG implemented a cut in petrol pump price from N145/litre to N125/litre in March, CBN announced a technical devaluation of the naira to N380/\$ on 20<sup>th</sup> march 2020 and FG implemented a 14-day lockdown which led to an artificial increase in food prices. While the reduction in petrol pump price should drive a decline in consumer prices, we believe the last two policies will limit its impact on overall consumer prices. That said, we therefore expect an uptick in inflation for the month of March to 12.2% YoY. However, the adjustment to our numbers to reflect the 3-month delay in the implementation of an electricity tariff hike (previously expected to kick off in April) necessitated a downward adjustment to our FY 20E to 12.4% YoY (previously: 13% YoY).

Figure 6: YoY movement in headline



Source: NBS, ARM Research

Figure 7: Annual Inflation numbers (% YoY)



Source: NBS, ARM Research

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