

July 9, 2020



# Nigeria Strategy Report

H2 2020

Domestic Economy and Markets

## Balance of Payment: A Dire Outlook

### Executive Summary

Nigeria's current account position continued to face pressure owing to the fast pace rise in the demand for foreign goods and services. In Q1 20, Nigeria recorded its fifth consecutive quarter of current account deficit totaling \$5 billion, which marks the longest chain of quarterly deficits since 2015. This came in higher than we had estimated for the quarter at \$4 billion. On capital flows, coming into the year, our view on the direction for flows in 2020 was tainted with a lot of uncertainties owing to juxtaposing factors at play as at the end of 2019. Interestingly, at the start of the year, we saw flows increase over the first two months of the year, as total capital flows were already 38% higher than the entire Q4 19, at \$5 billion. However, the tides turned from March as conflicts in OPEC and impact of COVID 19 led to a plunge in global oil and invariably foreign portfolio flows.

Going into the rest of the year, we have a more dire projection for the H2 20 current account balance than we initially estimated in the previous outlook report. We expect a worse-off trade balance and a lower current transfer surplus to push the current account deficit higher than we initially estimated to \$25 billion. On capital flows, we do not think flows would come in higher in H2 20 than in the first half. With FPI flows supporting Q1 20, and multilateral loans supporting Q2 20, it is unlikely we see any surge in inflows which could beat H1. Although our OMO rate remains relatively competitive (despite the recent cuts) compared to advanced markets, and even some peers in EM, the risk on FX and subsisting concerns on repatriation is unlikely to encourage more flows this year.

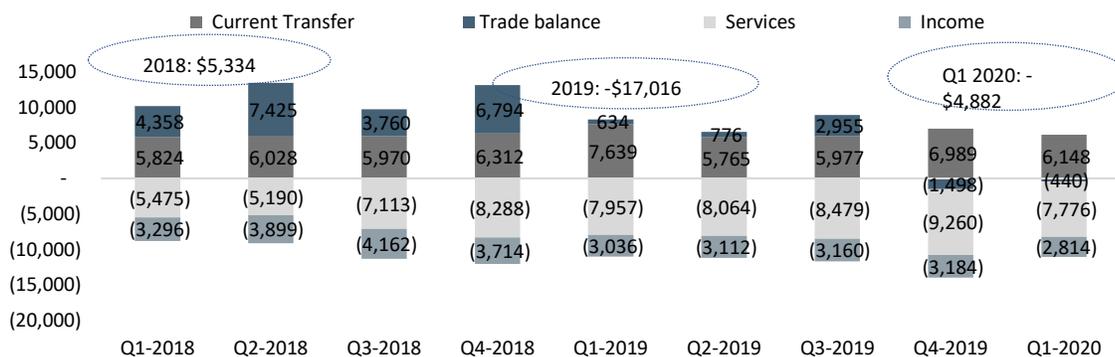
*In this report, we focus on development in the Domestic environment, highlighting our views on the Nigeria's current and financial accounts position.*

**Current account goes further downhill**

Nigeria’s current account position continued to face pressure owing to the fast pace rise in the demand for foreign goods and services. Meanwhile, inflows into the current account have remained primarily reliant on dollar oil earnings and remittances from citizens in the diaspora. In Q1 20, Nigeria recorded its fifth consecutive quarter of current account deficit totaling \$5 billion, which marks the longest chain of quarterly deficits since 2015. This came in higher than we had estimated for the quarter at \$4 billion. In our last outlook report, we had projected that Nigeria’s current account position would remain pressured in 2020, estimating a \$17 billion deficit for FY 20, same as in FY 19.

The deficit in the quarter, although lower than Q4 19, was still higher than the quarterly average of \$4.3 billion in 2019 and our estimate. The QoQ decline mirrored the one-off import of an electro-diagnostic apparatus which is estimated at \$2.8 billion and which thrusts the trade balance to the first deficit since 2016. Excluding the one-off purchase, Q4 19 would have recorded a trade surplus and a lower current account deficit of \$1.3 billion and -\$4.2 billion, respectively.

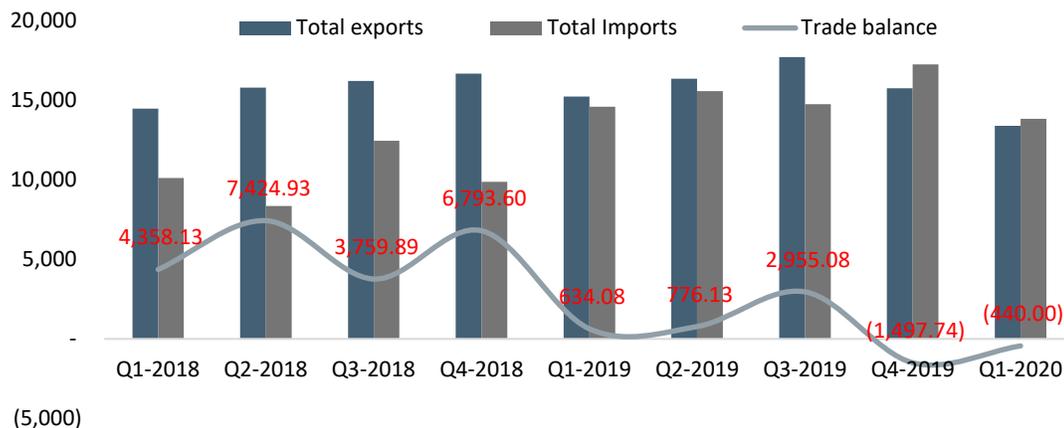
**Figure 1: Current Account Balance (\$’million)**



Source: CBN, ARM Research

Nonetheless, in Q1 20, the plunge in global oil prices (bonny light: -16% QoQ to \$52) sealed off a second consecutive quarter of trade deficit printing at \$440 million, albeit lower than previous quarter. Oil exports dropped 17% QoQ to \$11 billion, driving the value of total exports down by 15% in the quarter to \$13.4 billion. Non-oil export was relatively flat at \$2 billion, as the increased sale of agricultural goods and raw materials offset the drop in sale of manufactured goods. Meanwhile, total imports dropped 20% QoQ to \$13.8 billion. Clearly, the high base of imports in Q4 19 was the major reason for the sharp drop in imports. However, we believe early impacts of the global lockdown could have added pressure to the drop in imports. For clarity, excluding the impact of the one-off purchase, import was still down 4% QoQ.

Figure 2: Trade balance (\$'million)



Source: CBN, ARM Research

The services deficit was also down 16% on the quarter to \$7.8 billion, owing largely to a 24% decline in demand for foreign professional and technical services. There was also reduced spend on cargo transports (-19% QoQ) while passenger transport was relatively flat at \$87 million (+1% QoQ). Meanwhile, demand for BTA and PTA remained pent up in the quarter, increasing by 10% QoQ to \$3 billion.

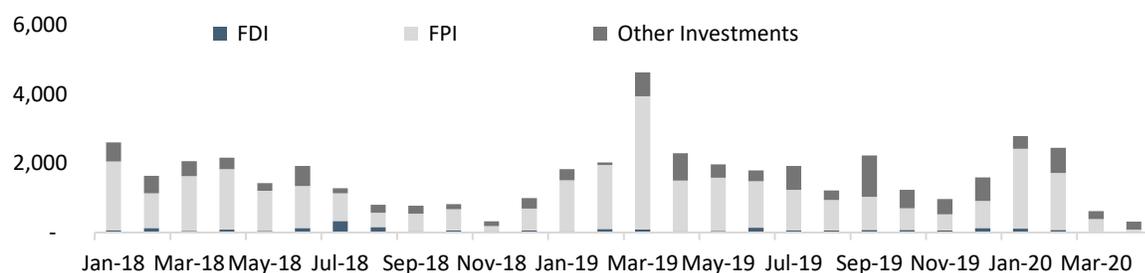
On another front, there was a 12% QoQ and 5% YoY decline in remittances by Nigerians in the diaspora to \$5.6 billion in the quarter. Again, we believe this highlights impact of the global shut down which had begun to have more significant impact in some countries during the quarter. Meanwhile, foreign investors repatriated lower returns on investments during the quarter, as income deficit contracted 12% QoQ to \$3 billion in Q1 20. This mirrored performance in the Nigerian financial market, especially the equities market which lost 21% over Q1 20, while average fixed income yields contracted in the quarter by 8bps to 7.6%, following on from the declines in Q4 19.

Overall, the persisting deficit in the current account balance further contributed to the immense pressure in the foreign reserves, particularly in Q1 20 where reserves depleted by \$3.4 billion to \$35 billion.

*Hopes for flows dashed by COVID 19 and oil price woes*

Coming into the year, our view on the direction for capital flows in 2020 was tainted with a lot of uncertainties owing to juxtaposing factors at play as at the end of 2019. On one hand, the (1) resolution of the US-China rift meant toned-down risk-off sentiments and improved flows to EM market and (2) our competitive OMO rates<sup>2</sup> meant Nigeria could secure a competitive edge for influx of flows -- at least better than the receding flows we saw in H2 19. On the other hand, foreign investors' concerns over the CBN's policy restricting domestic participation in OMO market which translated to a less-liquid OMO market, coupled with increased concerns over the rate of depletion of the FX reserves tugged at our optimism for any recovery in flows over H1 20.

**Figure 3: Capital importation (\$'million)**



Source: CBN, ARM Research

Interestingly, at the start of the year, we saw flows sway to our first scenario over the first two months of the year, as total capital flows was already 38% higher than the entire Q4 19, at \$5 billion. This was solely due to the increase in FPI flows (+110% to \$4 billion). Meanwhile FDI and other investments (particularly loans) were down 27% and 34% to \$188 million and \$1.1 billion, respectively, compared to Q4 19. The higher FPI flows over 2M 20 was driven by the tamed EM risk-off sentiments, investors' adaptation to the CBN's unorthodox policy as well as the still competitive OMO rates. There were increases across all the asset classes, compared to Q4 19, with money market instruments (+112% to \$3 billion) bearing 80% of the total FPI increase. Flows to bonds (+388%) and equities (+63%) were also up over the 2M period. It is worth stating, that although flows started to drop in March, the total flows in Q1 20 printed at the highest since Q2 2019.

However, the tides turned in March as conflicts in OPEC led to plunge in global oil prices (-55% MoM to \$23). As a result, investors got jittery, and FPI dropped 78% MoM to \$361 million, while total capital flow was down 75% MoM to \$615 million. As impact of the COVID-19 global lockdown began to weigh even more on oil prices in April (causing prices to drop to an 18-year low

<sup>2</sup> As opposed to decreasing rates in peer markets at the time (Eg in Turkey, Egypt)

of \$19.33) FPI nose-dived even further to a meagre \$68 million while total flows dropped to \$317 million. These were the lowest levels last seen before the introduction of the Investor and Exporter Window (IEW) in March 2017.

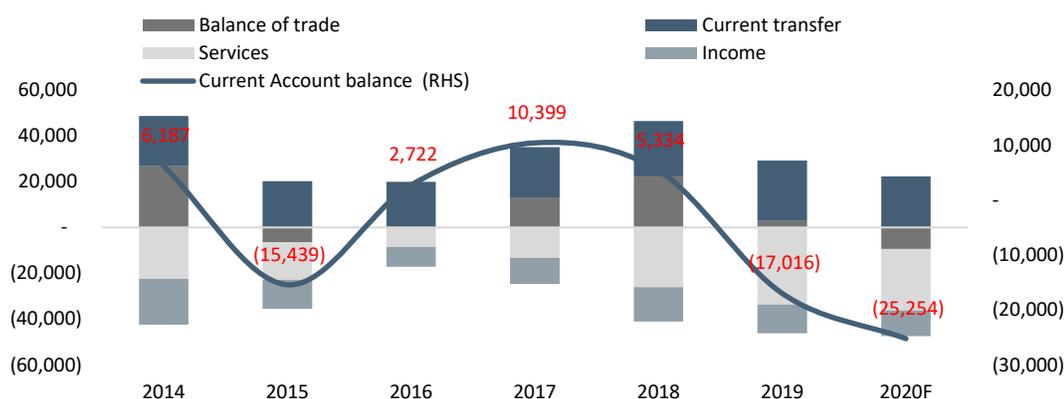
For context, compared to the peak in January, FPI, FDI and other investments (loans) were down 85%, 97%, and 38% to \$17 million, \$68 million and \$232 million, respectively, in April. In fact, among the FPI's asset classes, only equities (\$19 million) and money market instruments (\$49 million) got flows in April, while bond was nil in both March and April. Asides the jitters from oil prices, we believe investors' sentiments were also smeared by the increased repatriation risk faced over those periods. Many hot monies were trapped in Nigeria, as CBN failed to meet investors' demands to exit the market.

While we await data for the last two months of H1 20, we think the increased multilateral loans which began to troop in from May, could swing inflows into the financial accounts up. A total of \$5 billion is to be raised via multilateral loans from the IMF, World Bank, AfDB and Islamic Development Bank, of which \$3.4 billion has been raised so far in May and June.

**Outlook for H2 20 current account is dire**

Going into the rest of the year, we anticipate a worse outlook for the H2 20 current account balance relative to our previous projection (See previous outlook: [Edge of the Cliff](#)). Previously, we had estimated a current account deficit of \$17 billion over FY 20, which was largely unchanged from FY 19. This was expected to stem from subsisting pressures in the services deficit and trade balance. However, while we now expect pressures from the services deficit to ease off this year, we expect a worse-off trade balance and a lower current transfer surplus to push the current account deficit higher than we initially estimated. Our FY 20 current account deficit forecast now prints at \$25 billion.

**Figure 4: Current account forecast (\$'million)**



Source: CBN, ARM Research

Over FY 20, we forecast a trade deficit of -\$9.4 billion compared to a trade surplus of \$3 billion in FY 19<sup>6</sup> and our previous estimate of \$5 billion surplus. The key pressure on the trade balance stems from the downward revision to our oil exports estimate by 36% to \$34 billion (FY 19: \$54 billion). This reflects the revision to our oil price forecast for the year to \$40 (previously \$61) and our projection for crude oil production to 1.8mbpd<sup>7</sup> (previously 2.1 mbpd).

Meanwhile, impact of the global lockdown is expected to ease the pressure from imports of goods. Hence, we have revised FY 20 imports down to \$52 billion from \$59 billion (FY 19: \$62 billion<sup>8</sup>). It is worth stating that back in March<sup>9</sup>, we had projected the declining trend in FX reserves could prompt the CBN to adopt some administrative restrictive measures<sup>10</sup>. However, following the deluge of multilateral loans which have given the much-needed buffer to the reserves, we now think it is less likely the CBN goes ahead with enforcing such strict administrative policies.

Similar to imports, we also project the services deficit to print lower than we initially estimated at the start of the year. Clearly, we expect the global lockdown to reduce spend on travel expenses and BTA and PTA demands, and also lower demands for professional and technical services. Thus, we have revised our services deficit estimate for FY 20 to \$27 billion from \$36 billion (FY 19: \$34 billion).

### ***Capital Flows to stay aloof***

Central banks around the world have taken on expansionary mode to boost growth post-COVID. The US now runs on a 0-0.25% Fed fund rate, while other advanced economies in Europe and Asia span from a negative interest rate to 0%. Emerging economies are also not left out, the likes of Egypt, Turkey, South Africa, Kenya, Ghana and even Nigeria, among other others, have taken on significant cuts in their respective benchmark interest rates. Nigeria's MPR has been cut only 100 bps so far this year to 12.5% -- a lower rate of decline compared to peers.

However, bringing it home where FPIs are concerned, the CBN, in June, cut the long-dated OMO rate (1-year bills) to single digit for the first time since 2015. In our view, we think the CBN's flex shows how much comfort the apex bank has gotten from the deluge of multilateral loans.

Overall, we do not think capital flows would come in higher in H2 20 than in the first half. With FPI flows supporting Q1 20, and multilateral loans supporting Q2 20, it is unlikely we see any surge in

<sup>6</sup> Ex the one-off imports of heavy machineries in Q1 and Q4 19, FY 19 trade surplus would have printed at \$7 billion

<sup>7</sup> Based on our expectation for increased compliance to OPEC+ production cut

<sup>8</sup> \$58 billion, ex one-off purchases.

<sup>9</sup> In our monthly report: March 2020 - [Nigeria Current Account: The Boiling Frog](#)

<sup>10</sup> similar to the 41 banned list items in 2015

inflows which could beat H1. Although, OMO rate remains relatively competitive (despite the recent cuts) compared to advanced markets, and even some peers in EM<sup>11</sup>, the risk on FX and subsisting concerns on repatriation is unlikely to encourage more flows this year. Besides, with the CBN now soothed with multilateral loans, the apex bank faces less pressure to appease FPIs and could rather focus on winding down the cost of financing its balance sheet. Thus, further cutting the OMO rate which could chip off the premium in carry trades and make our market less attractive compared to peers.

---

<sup>11</sup> Peers such as Kenya (7.8%), (Brazil (2.513%) and Turkey (9.195%) have their 1-year bill rates print lower/close to our OMO 1-year of 9%. However, it is worth stating that the likes of Kazakhstan (10.7%), Egypt (13.5%), and even Ghana (16.9%) have higher rates

**ARM Securities Contact**

Research	234 (1) 2701653	<a href="mailto:research@armsecurities.com.ng"><b>research@armsecurities.com.ng</b></a>
Institutional Sales & Trading	234 (1) 448 8833	<a href="mailto:trading@armsecurities.com.ng"><b>trading@armsecurities.com.ng</b></a>
Customer Service	234 (1) 4488282	<a href="mailto:customerservice@armsecurities.com.ng"><b>customerservice@armsecurities.com.ng</b></a>

Copyright © 2020 Asset & Resource Management Company Limited (“ARM”).

All rights reserved. Unauthorized 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.

