

Economic Report | Monthly update
Economic Update – February 2017
Economic Snapshot
January 2017 Inflation Data/Indices

	MoM	YoY	Prev YoY
Headline	1.0%	18.7%	18.6%
Food	1.3%	17.8%	17.4%
All Items Less Farm	0.7%	17.9%	18.1%
Imported food	0.9%	21.0%	21.1%
Energy	0.8%	31.1%	31.3%

Currency Markets

	Latest	Daily Chg	YTD
USDNGN	305.7	-0.4%	0.15%
EURNGN	333.7	-0.4%	-0.61%
GBPNGN	386.0	-0.1%	1.30%
JPYNGN	275.0	0.4%	-2.20%

Monetary Aggregates –December 2016

	(₦'bn)	MoM	YoY
M2	23,840	6.5%	11.7%
CPS	22,375	-2.9%	23.1%
NCG	4,596	20.8%	31.4%
NFA	9,354	17.0%	41.4%
NDC	26,970	0.5%	24.2%

External Position

	Latest	QoQ	YoY
Trade Balance (\$'mn)	185.73	-21.5%	N/A
External Reserves (\$'mn)	29,967	20.0%	7.5%
Foreign Debt (\$'mn)	10,718	0.9%	10.4%

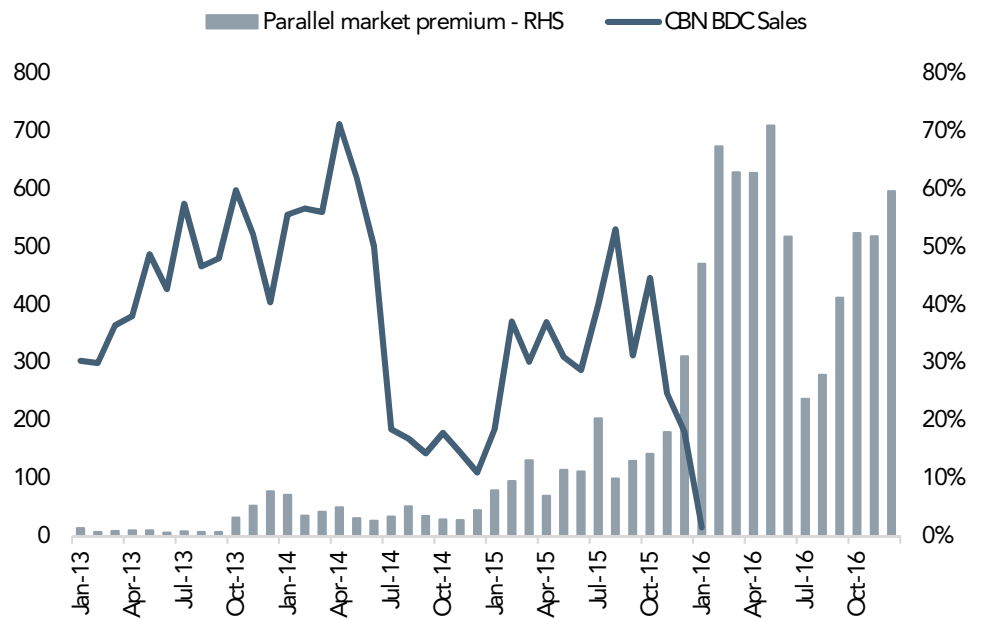
Growth Data – Q4 2016

	(₦'bn)	%of total	YoY
Real GDP	18,292	100%	-1.3%
Agriculture	4,662	25.5%	4.0%
Oil	1,338	7.2%	-12.4%
Services	6,865	37.5%	-1.6%
Wholesale and Trade	3,046	16.7%	-1.4%
Manufacturing	1,757	9.6%	-2.5%

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CBN's new FX policy: a change of heart?

In February 2017, the CBN announced a raft of FX policy measures which led to its commencement of dollar sales for personal and business travel allowances as well as foreign education and medical fees upon fulfilment of basic documentary requirements at a rate not exceeding 20% of the interbank rate. In addition, the CBN announced the relaxation of the 60:40 FX allocation rule in favour of manufacturing companies, and reduced the tenor on its currency forwards to 60-days (vs 180-days previously) even as it signalled a desire for greater intervention to clear unfilled orders in the interbank FX market. The policy move is a marked turnaround from 2016, when in response to shocks to oil receipts, the CBN placed emphasis on dollar demand management which resulted in a cutback in official FX supply to the interbank and parallel markets. To put in context, CBN dollar sales to the interbank and BDC operators plunged 74% and 99% YoY to \$6.3 billion and \$55 million respectively to drive parallel market premium to a seven-month peak of 60% by the end of 2016.

Figure 1: Historical BDC sales and parallel market premium



Source: FMDQ, CBN, ARM Research

The timing of the policy pronouncement, which came on the heels of the directive from the National Economic Council, a largely advisory but politically strong body, mandating the apex bank to take actions to stem widening parallel market premiums, hints at a shift in policy orientation at the top. Importantly, the CBN shift follows the transfer of more executive powers to the Vice President, Professor Yemi Osinbajo, a supporter of greater NGN flexibility relative to the absent President Buhari who have long opposed naira weakness and advocated for dollar demand curtailment. Beyond the fiscal urging, we think improved FX reserves, which climbed to an over 15-month high of \$29.9 billion in February 2017 on the back of increased oil prices and production and successful Eurobond issue, provided legroom for CBN to raise dollar supply.

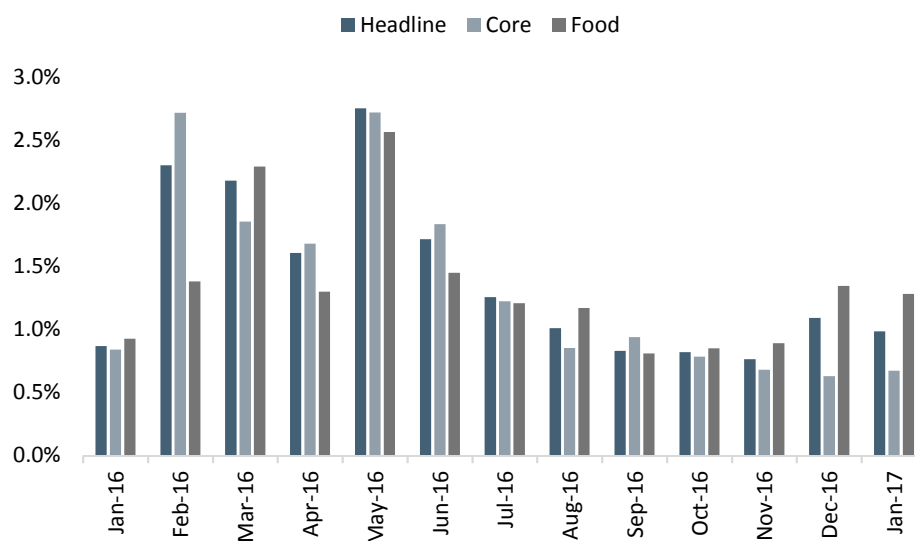
Following increased CBN activity via Secondary Market Intervention Sales (SMIS) of ~\$500 million over the rest of the month, NGN appreciated at the parallel market with premiums shrinking 14pps MoM to 49%. Going forward, we think, facing a better reserve inflow picture, the CBN is unlikely to entertain conversations around shifting the naira peg in the near term while it continues its

interbank interventions in a bid to shrink parallel market premiums. Farther out, we see the upper rate limit on CBN's intervention sales (i.e. the 20% band around the interbank peg of ₦305/\$) as the next level for the USD/NGN.

Inflation: Base effects come into view

Headline inflation printed at 18.7% YoY in January 2017 (+14bps from prior reading) while the MoM number moderated to 1.0% (vs. 1.2% previously). In line with the pattern in the last three months, pressures in the food basket largely accounted for the uptick in headline inflation as thinning domestic grain supply, a fallout of higher exports owing to over six months of currency-induced demand pressures, pushed Nigerian cereal prices over 132% higher YoY. On other fronts, despite broadly higher energy prices (Kerosene: +87.1% MoM, LPG: +39.4% MoM, Diesel: +22.6% MoM and PMS: +1.4% MoM), core inflation slid for the second consecutive month (-19bps MoM to 17.85%) in January. The cutback in core inflation reflects offsetting impact of declines across Education (-58bps), Restaurants and Hotels (-56bps), Alcoholic Beverage, Tobacco, and Kola (-47bps) as well as Health (-31bps) divisions which tilted the sub-index southwards.

Figure 2: Trend in MoM headline, core, and food inflation



Source: NBS, ARM Research

Going forward, base effects from the 45% hike in electricity tariffs in February 2017 pose hurdles to CPI readings. Thus, while naira weakness should continue to stoke higher food prices, we see downward pressure on inflation numbers from the elision of the 2.3% MoM base effects from electricity tariff increase in February 2016. This backdrop informs our call for a 153bps MoM moderation in overall headline reading to 17.2% YoY (+/- 50bps) in February.

Fallout from FX interventions halt bullish run on the naira yield curve

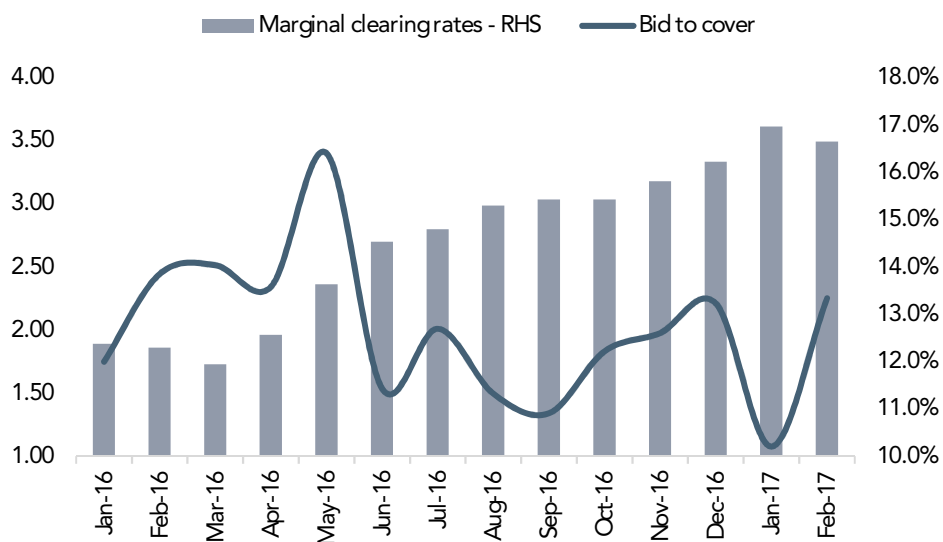
The naira yield curve trended higher in February (+16bps MoM to 17.31%) as system liquidity tightened following CBN's Secondary Market Intervention Sales (SMIS) which drove overnight money market rate to a peak of 133.3% (from 6.9% at the end of January). The SMIS helped offset impact of lower paper supply (as the CBN net issued ₦92 billion in OMO paper in February vs ₦701 billion in January 2017) which had resulted in the mounting liquidity at the short end that drove bullish sentiment in the T-bill market over the first few weeks of the month. The liquidity draining impact of the FX sales drove a 39bps average increment in Treasury bill yields to 14.61%, 19.10%, and 21.85% across 91, 182, and 364 day instruments respectively.

At the longer end of the naira curve, after reaching low of 15.86% on February 20, 2016, bond yields similarly recovered to 16.10% by February end to leave the naira curve humped at the short end for the umpteenth month. Notably, the initial temperance in bond yield followed lower average marginal clearing rates at the February bond auction (-32bps MoM to 16.64%) when bid to cover rose more than double MoM to 2.25x. Specifically, prospect of fiscal authorities raising its ₦1.0 trillion budgeted external borrowings may have calmed investors' sentiment.

Ahead of the March 2017 MPC meeting, our views regarding potential declines in inflation raise scope for an end to current hawkish monetary policy stance. That said, CBN's move to raise FX supply, which has been accompanied by increased liquidity mop-ups, could yet drive "a no change decision" at the meeting. Taking a cue from the July 2016 hike, the apex bank could leave MPR unchanged and lower the clearing rates at its OMO auctions to lower the naira yield curve. Given

limited clarity on the emerging FX policy, we see strong scope for the CBN to adopt this position. Farther out (i.e. in Q2 17), base effects from fuel price hikes in May 2017 raises stronger prospect for some easing at May 2017 MPC, though we note that an already bulging liquidity profile, with the maturity of the ₦479 billion FGN 2017 bond in April, bolsters prospects for yield declines in Q2 17.

Figure 3: Historical bond marginal clearing rates



Source: DMO, ARM Research

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