

Economic Report | Monthly update
Economic Update –May 2017
Economic Snapshot
April 2017 Inflation Data/Indices

	MoM	YoY	Prev YoY
Headline	1.6%	17.2%	17.3%
Food	2.0%	19.3%	18.4%
All Items Less Farm	1.1%	14.8%	15.4%
Imported food	1.5%	18.1%	18.1%
Energy	1.4%	22.5%	22.5%

Currency Markets

	Latest	Daily Chg	YTD
USDNGN	324.7	0.00%	-2.99%
EURNGN	353.6	3.19%	-8.04%
GBPNGN	407.3	3.15%	-5.81%
JPYNGN	286.0	3.38%	-7.21%

Monetary Aggregates –April 2017

	(₦'bn)	MoM	YoY
M2	21,713	-1.4%	4.8%
CPS	21,943	-1.5%	13.2%
NGC	5,592	7.5%	42.2%
NFA	7,262	-4.1%	43.2%
NDC	27,535	0.2%	18.1%

External Position

	Latest	QoQ	YoY
Trade Balance (\$'mn)	185.73	-21.5%	N/A
External Reserves (\$'mn)	30,289	0.95%	3.68%
Foreign Debt (\$'mn)	13,808	21.1%	23.3%

Growth Data – Q1 2017

	(₦'bn)	%of total	YoY
Real GDP	15,861	100%	-0.5%
Agriculture	3,385	21.3%	3.4%
Oil	1,411	8.9%	-11.6%
Services	5,975	37.7%	1.0%
Wholesale and Trade	2,819	17.8%	-3.1%
Manufacturing	1,543	9.7%	1.4%

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Nigeria's FX market: springing back to life?

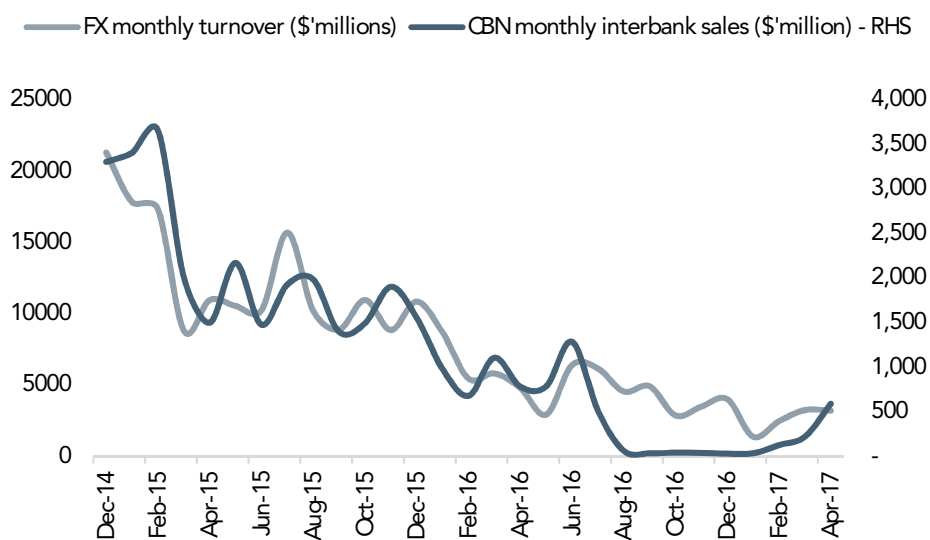
The naira maintained its stable trend at the interbank (+0.15% MoM to ₦305.40/\$) and parallel market (+2.1% MoM to ₦382/\$) with premium between both contracting to 25.1% vs. 62% at the beginning of the year. The stability in the FX market largely reflects improved dollar supply stemming from the apex bank deliberate actions as well as recent influx of portfolio flows. Focusing on the latter, following the introduction of the market-driven “Investors and Exporters window” (IEW), whose closing price of ₦380.50 mirrored that of the parallel market, foreign investors who were once shy of naira assets returned to stoke the biggest dollar supply at the IEW, which recorded total turnover of \$2.13 billion over the six weeks ended 2nd of June 2017. Added to this, the CBN, buoyed by higher FX reserves (+17.2% YTD to \$30.3 billion) also maintained its elevated dollar sales (\$1.7 billion in May based on our estimate) leaving the currency market with improved supply to drive stability.

Furthermore, in a bid to improve liquidity in the IEW, the CBN recently directed DMBs to trade FX positions among each other without seeking its prior approval as was previously required, though subject to a maximum spread of ₦1/trade which is less attractive to the ₦3/trade obtainable at the Invisibles window¹. Irrespective, the measures implemented to enhance the IEW should be a precursor

¹ FX window that cater for BTAs/PTAs, medical, school fees etc.

for further portfolio flows supported by the improving economic picture and high interest rate environment. Elsewhere, given prospects for higher crude oil proceeds and external borrowings, we see scope for continued dollar sales by the CBN over the rest of the year. This speaks to possibilities of adequate dollar supply at FX markets (BDCs, parallel market and Interbank Spot and Forward). Against this backdrop, as well as sustained naira appreciation at both the parallel market (+3.6% MTD to ₦368/\$) and the IEW (+0.5% MTD to ₦378.67/\$), we expect FX rates to converge to around the ₦360/\$ benchmark set for the invisibles market.

Figure 1: FX turnover and CBN interbank sales



Source: FMDQ, ARM Research

Base effect to drive steep inflation decline

The National Bureau of Statistics (NBS) reported that headline inflation flattened at 17.2% YoY in April, missing Bloomberg consensus for a 50bps decline to 16.9%YoY in the review month. Disaggregating the sub-components, food inflation surged to an eight-year peak of 19.95% YoY (87bps higher than the March reading) to offset the moderation seen in the core basket (-64bps from prior reading to an eleven-month low of 14.75%). Focusing on the former, despite the onset of the dry season harvest in April as well as sustained currency gains at the

parallel market, both of which should have moderated excess demand pressures, food prices generally tracked higher with the biggest increase witnessed in Tinned Milk, Eggs, and Garri². In our view, parallel market naira appreciation is yet to reach levels that would materially discourage rising food demand pressures from neighbouring West Africa countries.³ Whilst this continues to underpin pressures on farm produce (+73bps from prior reading to an eight year high of 20.13% in April) on the one hand, producers' sustained increases in output prices—evidenced by sustained expansions in related PMI sub-index⁴—provide explanation for the jump in processed food prices (+2.3pps from March reading to 10.5% YoY) recorded in the period. On the core basket, declines largely stemmed from the Housing, Water, Electricity, Gas, and Other Fuel (HWEGF)⁵ division which mirrored movements in MoM energy prices (Kerosene: -9.9%, PMS: -1.2%, LPG: -2.6%, Diesel: -2.3%).

We expect MoM inflation to remain elevated over the month of May (+1.6%) due to the onset of the Ramadan season, which typically bolsters demand for cereals. However, given the impact of high base effect from the May 2016 PMS surge, we project a 130bps cutback in the YoY reading to 15.9% (+/-20bps).

Sustained monetary tightening keeps yield curve elevated

In contrast to the prior month, the naira yield curve expanded 9bps MoM to 18.21% largely reflecting yield uptrend at the long end of the curve (+16bps MoM to 16.15%) and a modest uptick on T-Bill rates (+3bps MoM to 20.27%). The yield uptick reflected CBN's aggressive policies which have come in form of sustained OMO issuances and FX dollar sales. For us, these efforts have left banking systems relatively illiquid with average interbank overnight rate remaining high over the month of May at 36.59%. At the long end of the curve, mean marginal clearing rate also rose for the first time in four months (+14bps MoM to 16.30%) despite FG's cut back of planned borrowings (-21.4% to ₦110 billion), reflecting current liquidity mop-ups by the apex bank which pushed maximum bid rates 44bps higher MoM to 18% in May.

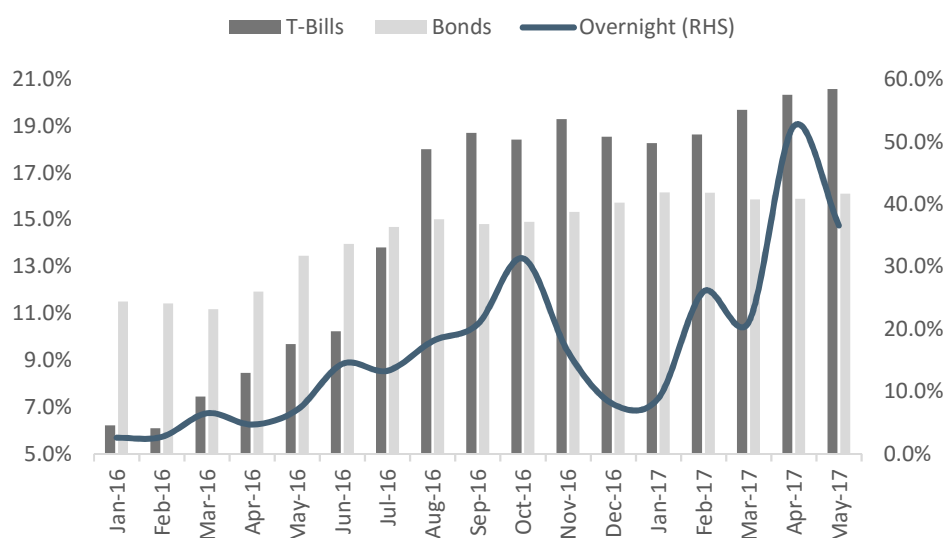
² Tinned Milk (MoM: +11.4%, YoY: +40%), Eggs (MoM: +5.2%, YoY: +28.7%), and Garri (MoM: +6.3%, YoY: +72%).

³ In passing, we note that food demand pressures emerged as a set-back to food prices when naira at the parallel market deteriorated to ₦305/\$ in January 2016.

⁴ According to the manufacturing PMI, output prices have been on an expansionary trend since January 2016, with the latest reading in May printing at 61.3

⁵ 31% of the core basket

Figure 3: Trend in average monthly rates



Source: FMDQ, ARM Research

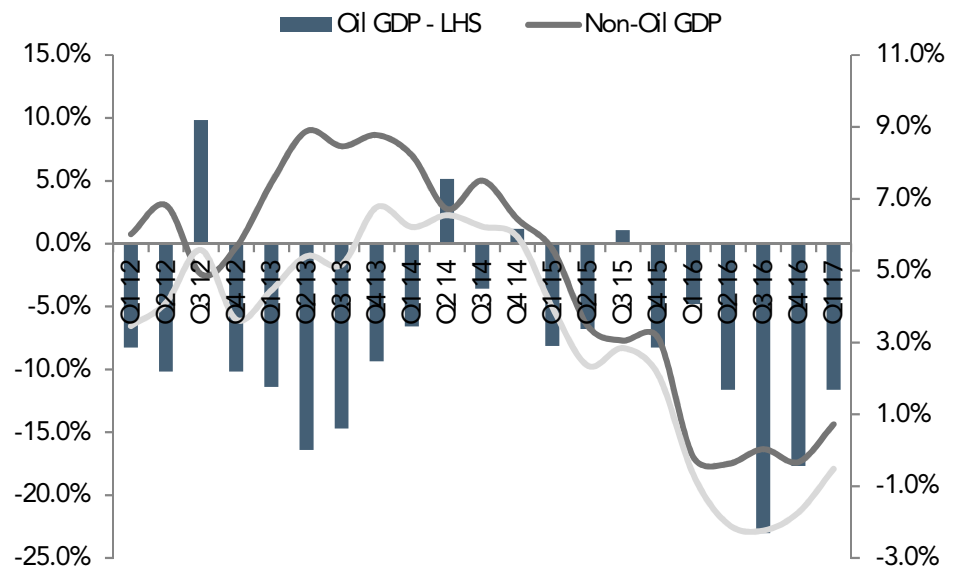
Going forward, amidst improving economic picture (with both manufacturing and non-manufacturing PMI expanding in May 2017—the first time since 2015) and a still elevated inflation reading, we believe activities in the FX market would remain crucial in determining rate direction over the near term. On this wise, given the downside risk implied in a rate cut (dissuading portfolio flows and encouraging currency speculators), we are of the view that ongoing monetary tightening would be sustained over the near term. Farther out however, as headline inflation drops closer to the Monetary policy rate of 14% with the currency market increasingly functional, we see scope for temperance in ongoing monetary tightening.

Q1 17 GDP: harbinger of hope?

In line with our estimate, the National Bureau of Statistics (NBS) reported that Nigeria's economy contracted (-0.5% YoY in Q1 17) at its slowest pace since the commencement of recession in Q1 16. The improved economic picture stemmed from both oil and non-oil GDP, with the latter recording its first growth in three quarters. Buoying the non-oil segment is the rebound in Manufacturing (+1.4% YoY) and Services (+1.0% YoY) GDP as well as resilience in Agriculture output

(+3.4% YoY), which continues to benefit from favourable government policies, attractive prices, and high export demand. On manufacturing, the improved FX supply which aided the importation of critical raw materials underpinned growth in that segment, while recovery in Services, after three consecutive quarters of contraction, largely emanated from the ICT sub-sector (+2.7%). Elsewhere, though Oil GDP remained stuck in the negative territory, Q1 17 average crude production of 1.83mbpd was higher than that of the prior three quarters. The improvement largely reflected the lifting of the force majeure on Brass terminal which had positive impact of economic activities in the Niger Delta creeks. To add, there was lower pipeline vandalism in the period as FG's reconciliatory efforts calmed Niger-Delta militants, who are also set to receive higher amnesty payments going by the 2017 budgeted sum (over two-fold YoY to ₦65 billion).

Figure 4: Trend in oil, non-oil, and real GDP



Source: NBS, ARM Research

Over the rest of the year, we expect the positive impact of improved FX and gas supply to sustain growth in the manufacturing sector while higher YoY mobile subscription base should maintain the positive trend in the telecommunications segment and, by extension, the Services sector. In addition, amidst continued FG's support and favourable pricing environment, we expect farmers to remain

incentivized into raising their cultivation activities, which buoys outlook for the agriculture sector. On balance, despite the impact of high interest rate environment and weak consumer income on output, our projection is for sustained growth in the non-oil segment. For oil, FG's continued negotiations with host communities to ensure security and protection of oil and gas infrastructure, temporal nature of the closure of major pipelines (Nembe Creek Trunk Line and Qua Iboe) and reopening of the Forcados pipeline (220kbpd) should further bolster the oil outlook. Against this backdrop, we project an average 2mbpd crude oil production over 2017, which translate to a 10.6% YoY growth from 2016 average of 1.81mbpd. In summary, given the expected rebound in Oil GDP and the prospect for continued growth in the non-oil segment, we expect the economy to rise 1.8% YoY (prior estimate: +0.3% YoY) over the year, with the first quarterly YoY growth expected in Q2 17.

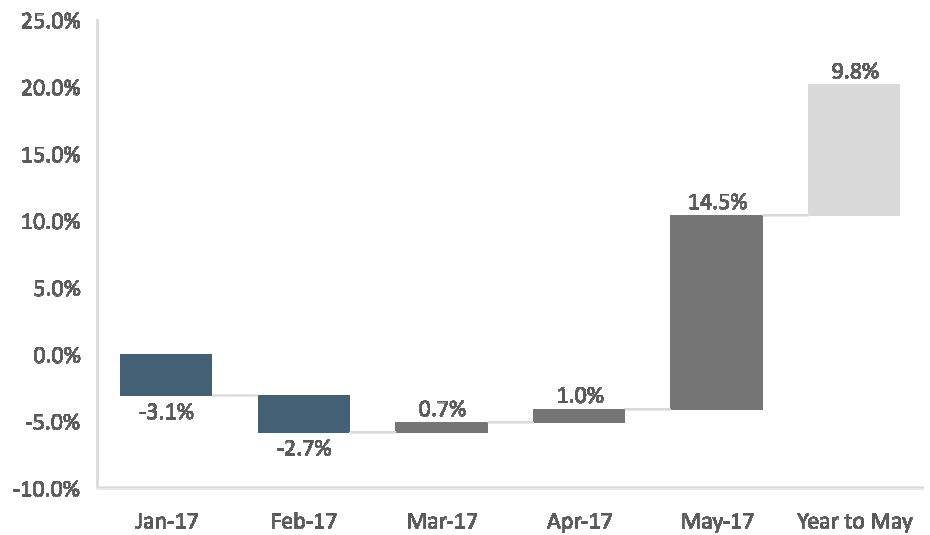
Nigeria equities on a roller Coaster

The Nigerian Equities market (NSEASI) recorded its highest monthly return (+14.5%) in eight years and its third highest on record in May 2017. In our view, the improved sentiment towards the Nigerian bourse reflected influx of FPI flows on the back of accessibility to a market determined FX market, lowering the much-feared currency risk implied by the interbank-parallel market FX premium. Amidst political worries in South Africa, and expensive stock market (implied by the higher than historical P/E ratio⁶) in Kenya as well as limited upside in post currency floatation Egyptian bourse⁷, we think the new FX window in Nigeria provided a fresh platform for African-focused equity funds to invest in. Also, the upbeat economic picture ^[1], passage of the Petroleum Industrial Governance Bill (PIGB) by the senate, and review of the Pension investment guideline which among other things now permit PFAs to purchase stocks of holding companies were other positives. Against this backdrop, the average monthly traded value in the Nigeria's stock market surged to a two year high of ₦4.7 billion (2017 average: ₦2.5 billion).

⁶ P/E of 20.0x at the end of May is significantly higher than the 13.7x trend average for the Nairobi Stock Exchange

⁷ The EGX 30 had gained 51% since Egypt floated its currency in November 2016

Figure 5: 2017 NSEASI performance



Source: NSE, ARM Research

With South Africa now entrenched in recession, Nigeria's tilt towards recovery and the raising of NSEASI weighting in MSCI Frontier Index (+1.4 pps to 7.9%) leaves scope for a sustenance of recent rally in the country's stock market.

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