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Economic Report | Monthly Update

Economic Update-November 2017

Economic Snapshot

October 2017 Inflation Data/Indices	MoM	YoY	Prev YoY
Headline	0.8%	15.9%	16.0%
Food	0.8%	20.3%	20.3%
All Items Less Farm	0.8%	12.1%	12.1%
Imported food	1.3%	15.3%	15.0%
Energy	0.7%	9.86%	9.74%

Currency Markets	Latest	Daily Chg	YTD
USDNGN	360.0	-0.01%	14.2%
EURNGN	427.0	-0.31%	28.8%
GBPNGN	482.6	-0.46%	18.1%
JPYNGN	320.0	-0.31%	19.0%

Monetary Aggregates – August 2017	(₦'bn)	MoM	YoY
M2	21,851	-1.6%	-0.9%
CPS	21,997	-0.8%	-3.6%
NCG	4,824	-17.8%	35.9%
NFA	9,733	11.3%	32.4%
NDC	26,821	-4.3%	1.8%

External Position	Latest	QoQ	YoY
Trade Balance ($'mn)	84.8	-9.6%	N/A
External Reserves ($'mn)	34,816	7.2%	33.4%
Foreign Debt ($'mn)	13,808	21.1%	23.3%

Growth Data – Q3 2017	(₦'bn)	%of total	YoY
Real GDP	17,800	100%	1.4%
Agriculture	5,189	29.2%	3.1%
Oil	1,787	10.0%	25.9%
Services	5,765	32.4%	-3.1%
Wholesale and Trade	2,829	15.9%	-1.7%
Manufacturing	1,568	8.8%	-2.9%

Capital flows riding the ranges

Capital importation to Nigeria sustained its strong growth for the second consecutive quarter in Q3 2017, with combined flows of $4.1 billion over the quarter being two-fold higher QoQ and YoY, according to data from the NBS. In sync with trend, the strong capital flows emerged from portfolio flows which printed at $2.8 billion, an increase of 260% and 200% QoQ and YoY respectively, even as 'other investment' sustained the positive momentum, rising 69% QoQ (125% YoY) to $1.3 billion largely on account of loans. That said, foreign direct investment (FDI) printed at an 11-quarter low of $117 million. Amidst improved fundamentals of companies and attractive valuation relative to peers combined with FX liberalisation, portfolio flows largely flooded the equities market which contributed nearly half (48%) of the total flows and the highest in the last 11 quarters of $1.9 billion ***($1.3 billion excluding one-off transaction in Dangote cement and Mobil).*** Furthermore, amidst elevated interest rate environment and falling YoY headline inflation, foreign capital was upbeat to short term debt instrument (+630% QoQ) and bonds (+100% QoQ). The strong appetite for naira assets, which is mainly pull driven, largely reflected the combined impact of the liberalisation of the currency market in late April, higher crude oil proceeds and external reserve, improved FX liquidity as well as the thirst to lock-in on higher interest rate in the domestic market.

Figure 1: Capital Importation Composition

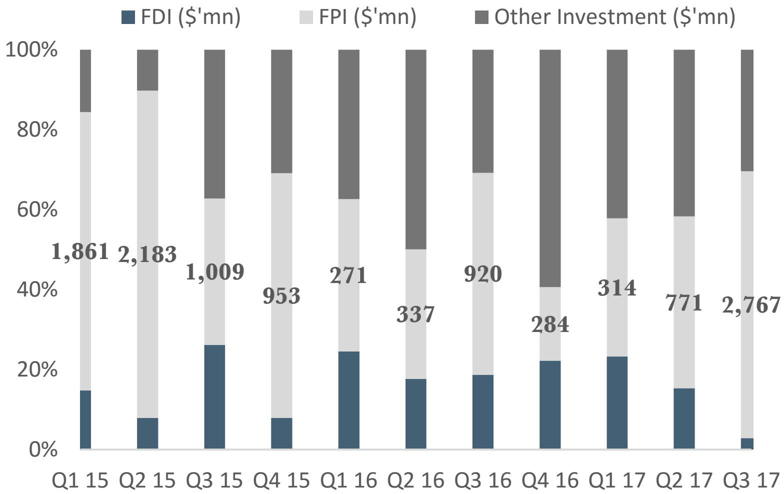
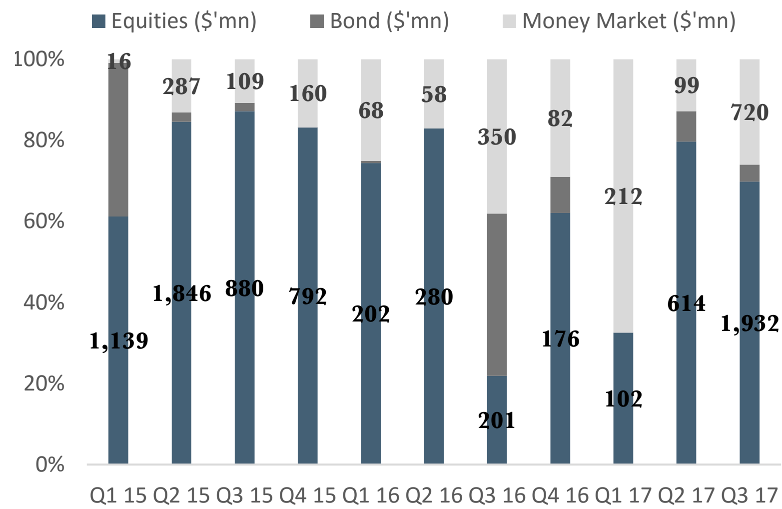


Figure 2: Foreign Portfolio Flows Composition



Source: NBS, ARM Research

Going into the next 2 quarters, while we see positive appetite for naira assets (mainly equities), we are of the view that capital flows will moderate. On the global front, baring accommodative monetary policy in Japan, hawkish environment in other developed economies suggests reduced portfolio flows to the Nigerian market. On the domestic front, given our expectation of lower yield environment as well as political risk gearing towards the election, we think flows to short-term debt instrument as well as bonds will likely cool off in coming quarters. On equities, while valuations remain attractive relative to peers, the high base in Q3 2017, largely due to one-offs and immediate reaction to FX liberalization, implies slower flows to equities in coming quarters. We estimate a base case scenario of $9.8 billion for FY 17 (9M 17: $6.8 billion) and forecast $5 billion for FY 18. However, higher crude oil proceeds and accretion of the external reserve (+33.4% YTD to $34.8 billion) is expected to moderate inherent risk in naira assets. On balance, our expectation of a depressed outlook on flows will have a lesser impact on the currency market given accretion in CBN's war chest to sustain liquidity.

Eurobond Issuance: dovish outlook for FI Yields

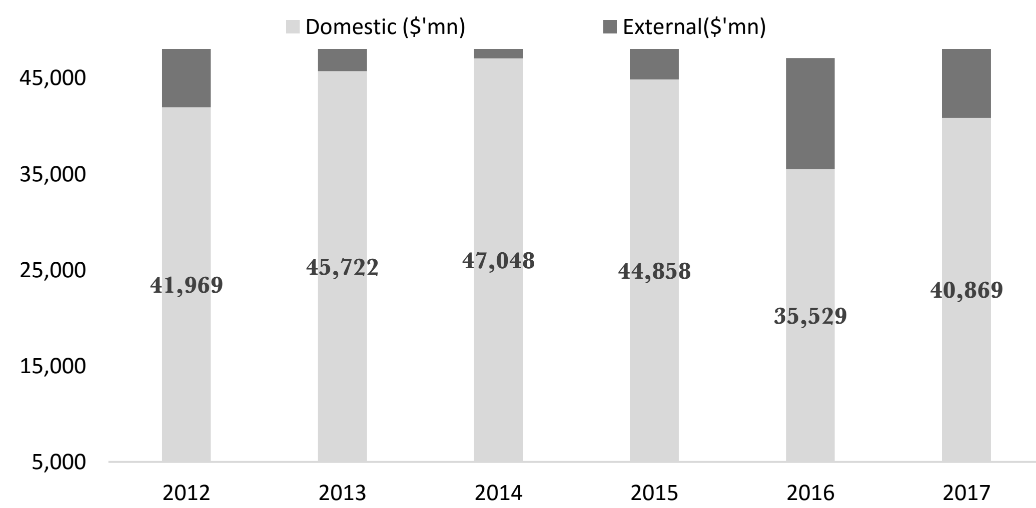
Late November, Nigeria accessed the global debt market for the 4th time[1] raising $3 billion her largest single issuance on record. The issuance was split into the 10-year and 30-year series of $1.5 billion apiece bearing coupon of 6.5% and 7.625% respectively. Notwithstanding the recent ratings downgrade by Moody and interest normalization in the

[1] Previous issuances were done in 2011, 2013 (two series) and earlier in 2017

US, the offer was oversubscribed with orders in excess of $11.4 billion (bid-cover of 3.8x). The general confidence of the market reflects more comfort with Nigerian dollar risk because of improving oil prices even as the economy continue to show signs of stability[2], as well as investors preference for high yield emerging market risk assets. Comparing the cost with recent issuances especially that of Egypt's 10-year and 30-year bond at rates of 6.65% and 7.95% respectively, the issue looks relatively favorable.

So far in 2017, the FG has net-issued ~₦1.36 trillion (over 100% of budgeted domestic borrowing), split between net T-bill issuance: ₦379 billion, and net bond issuance: ₦985.2 billion). Hence, the successful Eurobond issuance of $3 billion, of which $2.3 billion is targeted at deficit financing, as well as the $300 million diaspora bond raised earlier in the year, displaces the need for domestic borrowings. On balance, this would mean moderated domestic borrowings for the remainder of the year and, by extension, sustained yield downtrend at the long end. Tying it all together, we see a subsisting downtrend in the level and slope of the naira yield curve over the next six months with dovish monetary policy, lower domestic borrowings, and perhaps some form of coordination with monetary policy to ease financing costs to drive yields lower. In terms of FX impact, the proceeds from the issuance should provide additional support for the FX reserve (up to $37 billion) and firmly supports the stability of the naira over the near term.

Figure 3: FGN Domestic and External Debt



Source: DMO, ARM Research

[2] Q3 17 GDP increased by 1.4% compared to 0.72% in the previous quarter.

Budget 2018: Still a long stretch

President Buhari presented the proposed federal budget for 2018 tagged ***"the Budget of Consolidation"*** to the National assembly with FGN proposing a 15.7% YoY expansion in aggregate expenditure to ₦8.61 trillion splits into: non-debt recurrent expenditure of ₦3.5 trillion (+32% YoY), capital expenditure of ₦2.4 trillion (+11.7% YoY), debt service of ₦2 trillion (+21% YoY) and statutory transfers of ₦457 billion (+5.1% YoY). To implement the proposed 2018 fiscal outlay, the FGN projects retained revenues of ₦6.6 trillion (+30% YoY) largely underpinned by higher oil receipts (+15% YoY to ₦2.4 trillion) and a 40% YoY jump in non-oil revenues to ₦4.2 trillion. On non-oil, while the 2018 budget assumes higher estimates for Independent and other revenues (+80% YoY to ₦2.84 trillion), it projects a 3% slide in non-oil receipts to ₦1.33 trillion. Consequently, fiscal deficit is expected to print at ₦2.01 trillion, albeit lower YoY by 14.5%. In terms of deficit financing, the FG plans to raise ₦306 billion from sale of non-oil assets with a tilt towards higher external borrowing (50% apiece for domestic and external borrowing) which implies borrowing of $2.8 billion offshore in 2018.

On oil assumptions, while assumption for crude oil price is roughly consistent in the near term, the pitfall remains FG's overly optimistic stance on crude oil production which is 15% higher than our forecast and guides to an overly optimistic projection for oil revenue. Elsewhere, we are of the view that FG's projection for non-oil revenue is overly ambitious. For context, government could only achieve about 51% of budgeted non-oil revenue in H1 17 on a prorated basis. While we believe that improved FX liquidity should provide support for imports and custom revenues, we note that imports activities still significantly lag 2014 and 2015 levels. Consequently, despite the FG plans to raise the VAT rate for luxury items from 5% to 15% from 2018, we think non-oil revenue will be shy from projections with 2018 fiscal deficit expected to come in higher than FG's projections. Overall, as in the 2017 budget, we see enough downside across both revenue segments and therefore remain unconvinced of FGN's estimates. We have assumed budget implementation of 90%. Overall, we project fiscal deficit at ₦2.7 trillion - 41% greater than government projection. Thus, we see scope for elevated borrowing though tilting towards external sources.

Table 1: FGN Budget Estimates vs ARM Estimates

	2018 Budget	Estimates		
		Bear	Base	Bull
Oil production (mbpd)	***2.3***	***1.6***	***2.0***	***2.3***
Oil price ($/bbl.)	***45***	***30***	***50***	***60***
Exchange rate (N/$)	***305***	***305***	***305***	***305***
Oil and gas receipts (N' billion)	6,387	2,789	5,989	7,989
Net Oil Revenue (N' billion)	6,387	2,789	5,989	7,989
FG Share of oil revenue (N' billion)	2,442	1,060	2,276	3,036
Non-Oil revenue (N' billion)	1385	504	1,096	1100
FG independent revenue (N' billion)	847.9	213	743	800
Other revenue (N' billion)	1476	356	967	1250
FG Total revenue (N' billion)	**6,607**	**2,133**	**5,081**	**6,186**
FGN Expenditure (N' billion)	8,612	7,750	7,750	7,750
Fiscal deficit (N' billion)	**-2,005**	**-5,617**	**- 2,669**	**-1,564**

Source: Budget Office, ARM Research

Q3 17 GDP: Oil led growth mask deceleration in non-oil

Nigeria's economy grew by 1.4% YoY in Q3 2017, which is in sync with our estimate of 1.1%. Much of the growth came through a sustained boom in the oil sector which grew by 25.9% YoY on the back of higher oil production to 2.03mbpd (+8.9% YoY). Also, Agriculture sector sustained its resilience for the 8th consecutive quarter, recording a growth of 3.06% YoY to help moderate the weak numbers from the non-oil leg. However, not all data in this release was positive. Aside from Agriculture, other notable sub-sectors in the non-oil segment recorded deceleration in the review quarter. Consequently, non-oil GDP decelerated by 0.76% YoY, after two consecutive quarters of growth. The services sector, the largest component of the non-oil GDP sustained its decline for the second consecutive quarter (-2.7% YoY) on the backdrop of a slowdown in the 1CT subsector (-4.5%) which continues to reflect the deceleration in active subscribers (-8.2% YoY to 139 million). Real estate sub-sector also contracted by 4.1%. Elsewhere, the manufacturing sector declined for the first time this year by 2.9% YoY largely due to to 45% and 5% YoY deceleration in oil refining and cement even as Food, Beverage, & Tobacco, and Textile, Apparel & Footwear sub-segments recorded slower growth. Trade sector extended its contractionary trend since Q3 16 printing at -1.7% YoY. To put in perspective, the three sectors contributes a total of 63% to the non-oil segment.

For the last quarter of 2017, we forecast crude oil production of 2.05mbpd (16.4% YoY) and thus estimate oil GDP growth of 48.1% YoY. On the non-oil leg, we forecast a 3.2% YoY growth in Agriculture on the back of the ongoing harvest season which is expected to boost crop production. On the other side, we estimate a 4.7% YoY contraction in Services underpinned by ICT and real estate. Given our view on lower voice calls, the largest contributor to ICT, we expect a further contraction in the third quarter on ICT even as slower activities in luxury real estate should sustain the deceleration in the real estate sector. Furthermore, supressed demand from 2015 levels and the high base from currency impact is expected to further depress Manufacturing and Trade sectors, a contraction of 1.8% and 2.8% accordingly. Consequently, we forecast non-oil GDP of -2.3% YoY. Tying our views on oil and non-oil guides to Q4 2017 GDP growth of 1.1% YoY which brings FY 2017 GDP to 0.5% YoY.

Inflation: Soft Headline, but MoM is firming

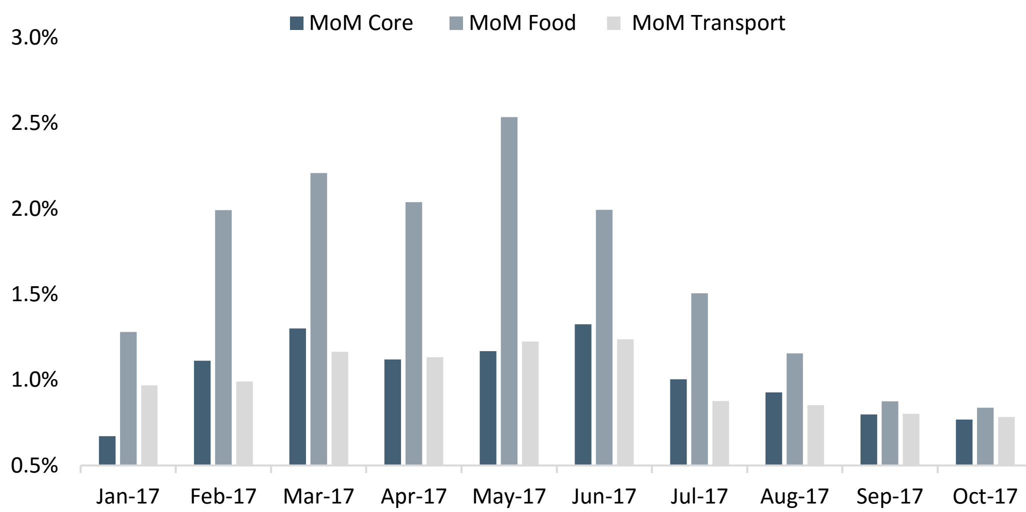
In the month of October, Nigeria's consumer price index sustained its moderation, to a 17-month low of 15.91% YoY, as modest gains from food offset a slight increase in the core basket. The latter increased by an annual rate of 12.14%, 2bps higher than September's reading, largely underpinned by subsisting inflationary pressures across key sub-sectors[3]. Elsewhere, while food inflation attuned to the impact of harvest season on food prices, the scale of moderation expected was capped by pressures in processed food and imported food segments. Consequently, food inflation moderated slightly by 1ppt to an annual rate of 20.31%. From a MoM perspective, inflation declined by 3bps, largely reflecting pressures in both the food and core component. For food, while we had anticipated gains from the ongoing harvest season and further decline in transport inflation, energy induced pressure on transport—driven by increased diesel prices—sticky farm produce (+0.75% MoM) and processed food inflation (+1.79% MoM) tamed moderation in food inflation against our expectation. Food inflation came in lower by 0.28pps to 0.85% which trumped prior five-year October average forecast of 0.71%.

Going forward, given the conclusion of the main harvest in October, we now expect firming MoM headline inflation to be evident in the month of November underpinned by an uptick in food inflation which should offset gains from subdued core inflation reading. Our expectation for elevated MoM food inflation is largely reflective of sticky transport inflation

[3] energy, processed food, restaurants, and furnishings & household equipment maintenance divisions.

supported by higher diesel prices as well as ramp-up in the demand for cereals and other food produce against the imminent approach of the December festive period. On the core front, we expect MoM reading to sustain its deceleration into November against the backdrop of fading supply shocks. On balance, we now look for MoM headline inflation reading of 0.88% in November 2017 with the implied YoY reading expected to come in at 16% YoY. In December, we expect MoM headline inflation to remain elevated on the back of inflationary pressures emanating from the food side –a fallout of the festive season - while sustained FX liquidity continues to drive moderation in MoM core inflation. Overall, we look for December and 2017 mean YoY headline inflation of 16% and 16.61% respectively.

Figure 4: MoM Core, Food, and Transport



Source: NBS, ARM Research

Going into next year, our views on inflation remains unchanged as we see little room for a significant shock to headline inflation reading, especially from energy prices where we think political considerations will be key factor. Consequently, on the back of a high base in 2017, we forecast headline inflation to hover around 13.3% over H1 18. The consequent of the foregoing will neuter any argument for positive real return.

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