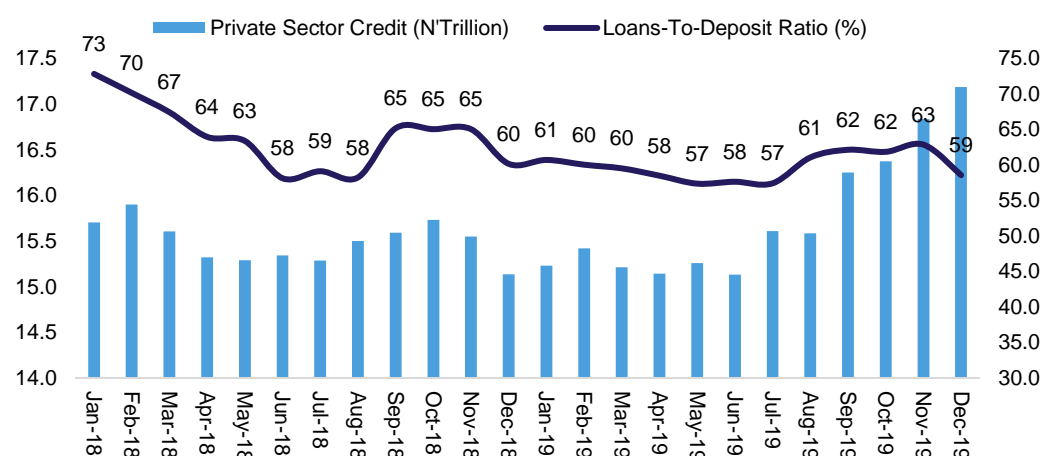


Monthly Economic Insights

New Loans... Old Customers

Compared to the level at the end of 2018, aggregate private sector credit increased by N2.05 trillion over H2 2019 to end December 2019 at N17.19 trillion. The increase largely reflects the CBN's implementation of a minimum loan to deposit ratio (LDR) in July 2019, which mandated deposit money banks (DMBs) to deploy 60% of total funding as loans by September 30, 2019 and an eventual upward review to 65% with a deadline of 31 December 2019. However, given the increase in funding base over the same period, the banking sector LDR ended the year at 58.56%, compared to the regulatory minimum of 65%. Accordingly, we estimate that the apex bank sterilized about ~N945 billion from the banking system since the policy began, representing 50% of the shortfall of the loan to funding requirement. Largely reflecting loan growth in our view, banking sector NPL improved to 6.1% at the end of December from 11.68% in December 2018.

Figure 1: Trend in Banking Sector Credit and Loan to Deposit Ratio (%)



Source: CBN, NOVA Research

To further strengthen the policy, the CBN in a circular distributed to banks earlier in January adjusted the LDR compliance calculation to an average daily figure from a spot figure previously adopted. Accordingly, for DMBs to be excluded from the 50% sterilization of a shortfall, the LDR limit must consistently be above or constant at the prescribed level to meet the 65% level at the time of assessment, which CBN guided could be on or before 31 March 2020. Going by available DMB funding at the end of 2019, we estimate that the banking system will have to create additional N1.89 trillion in credit to avoid further sterilization of funds at the end of the first quarter. With banks scouting for credible obligors, we believe a capital market debt instrument issue by either state governments or corporates will be largely favored by banks, as this applies in the calculation of the total credit created.

The Month's Key Points

- [New Loans... Old Customers](#)
- [Temporary or Sustained Relief at the IEW?](#)
- [Federating Unit's Revenue to Receive a Boost from VAT Increase](#)

Other Readings

[MPC Increased Cash Reserve Ratio by 500bps to 27.5%](#), 24 January

[MPC Preview: Dovish stance but hawkish actions](#), 22 January

[Month-on-month inflation expands at a slower pace in December](#), 17 January

[NOVA Economic Outlook \(NEO\) H1 2020](#), 17 January

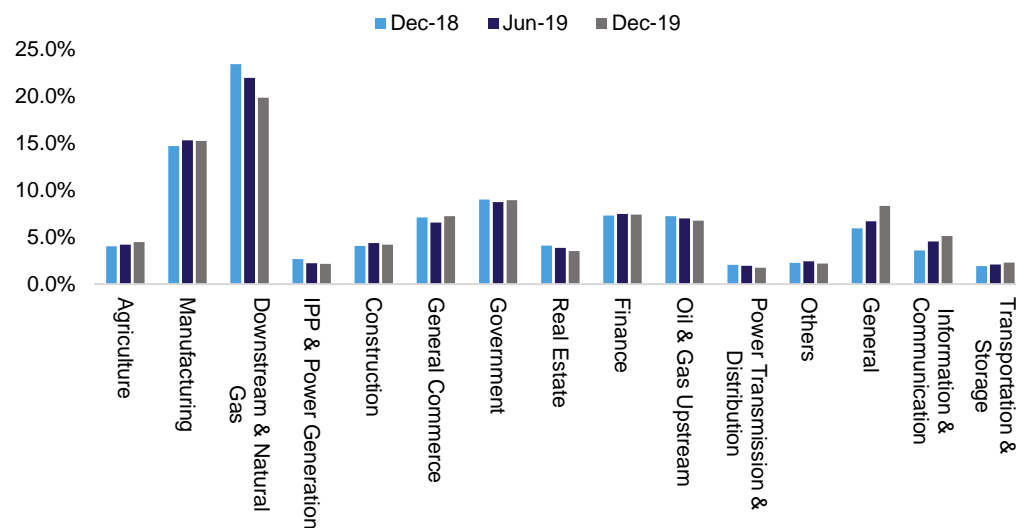
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As such, while the recent increase in CRR could result in kneejerk reactions in the fixed income market, we believe lending rate will remain depressed in the medium term.

Figure 2: Private credit distribution by sectors (%)

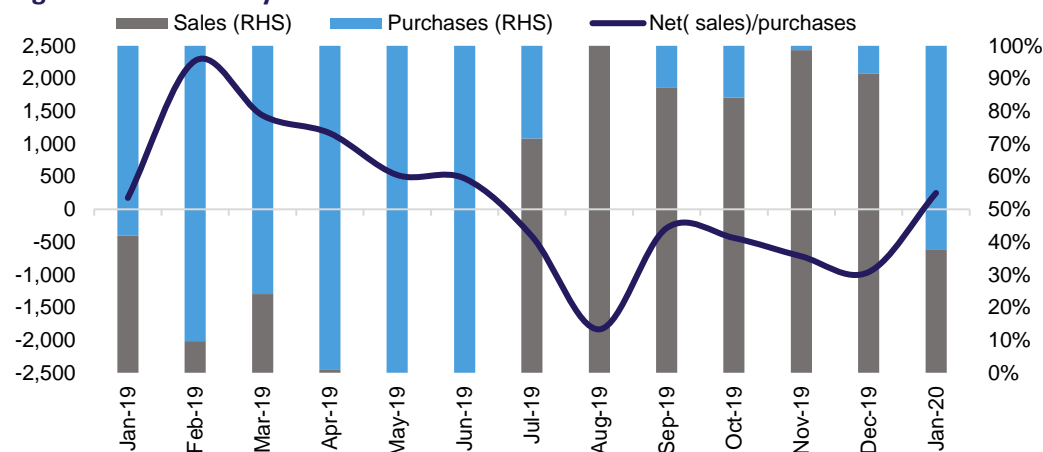


Source: CBN, NOVA Research

Temporary or Sustained Relief at the IEW?

Compared to the last six months wherein the Central Bank of Nigeria (CBN) was a net seller at the Investors and Exporters Window (I&EW), improved activities in the month of January resulted in the CBN being a net buyer to the tune of \$250 million following a 12% decline in outflows compared to a 41% increase in inflows. Interestingly, compared to the support provided by local suppliers of FX (exporters, individuals and non-bank financial institutions) in the month of December, overall local sales declined 54% to \$535 million, with foreign flows providing most of the support in January. Notably, the sturdy foreign inflows at the IEW was driven largely by a rebound in foreign portfolio investment (FPI) which increased more than 3x MoM to \$1.99 billion. Foreign direct investment and inflows from foreign non-bank financial institutions also increased by 77% and 108% MoM to \$51 million and \$105 million respectively. On outflows, the decline in January largely reflected the lower rate of FPI repatriation of funds by foreign investors.

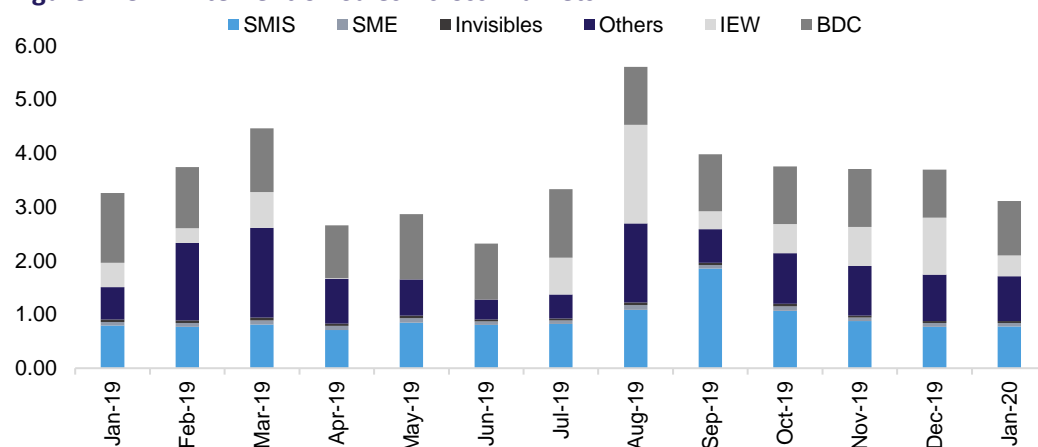
Figure 3: CBN Activity at the IEW



Source: CBN, FMDQ, NOVA Research

Outside the IEW, the CBN maintained active sales, albeit with a moderate increase to \$2.73 billion compared to \$2.64 billion in December. Sales to the SMEs, Invisibles and SMIS (retail) windows was largely same as December at \$877 million, a development we attribute to CBN rationing of dollar sales and debiting of banks. However, non-auction and BDC sales increased 5%MoM to \$1.85 billion. Surprisingly, despite the broadly lower total CBN intervention sales of \$3.11 billion compared to December sales of \$3.69 billion, the gross external reserve still declined by \$585 million to adjusted level of \$37.51 billion. We believe the decline largely reflects lower oil inflows and increased official sales by the apex bank.

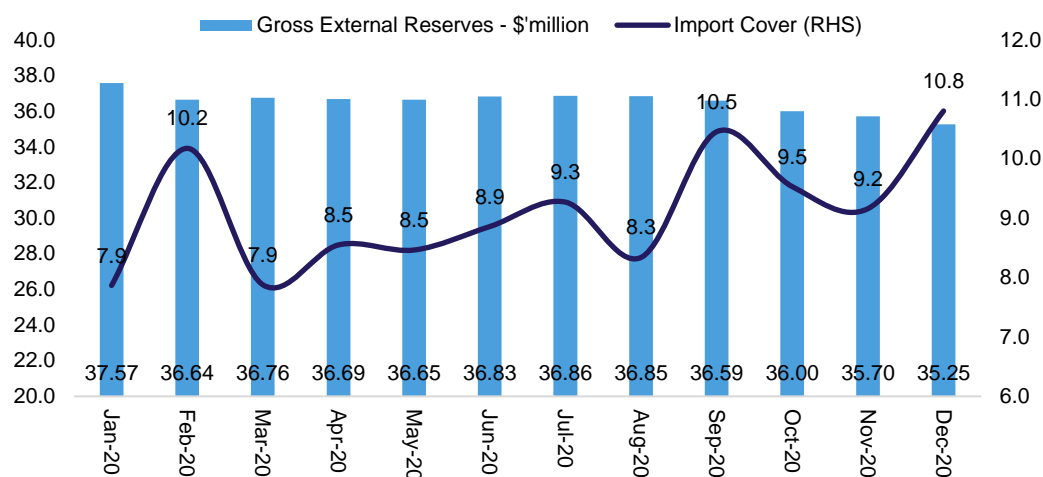
Figure 4: CBN Intervention Sales Across Markets



Source: CBN, FMDQ, NOVA Research

In our NOVA Economic Outlook (NEO) H1 2020 (See report: [NOVA Economic Outlook H1 2020](#)), we had estimated our modelled assumptions oil inflows to the CBN on benchmark oil price of \$60.3 /barrel and average production of 2.0 million barrels). Despite the upward review average Brent crude price for the year by the U.S. Energy Information Administration (EIA), we maintained our earlier forecast as a base case with a scenario on the impact a prolonged disturbance in demand due to the Coronavirus could have on oil prices and CBN reserves. On our base case, we estimated decline in total CBN inflow by 15% to \$47 billion (with average monthly inflow of \$3.9 billion, compared to 2019 average \$4.6 billion). Also, we modelled CBN outflows of \$50 billion (monthly average of \$4.2 billion) in 2020, with average reserve drawdown of \$371 million (compared to 2019 average \$424 million) with gross reserve settling at \$33.1 billion (excluding possible foreign borrowings). However, adjusting our model for a prolonged lower crude oil prices for the rest of H1 2020 with average of \$59.45/barrel. Coupled with a possible escalation of the rate of repatriation, we estimate that the gross reserve could decline to as low as \$32.3 billion at the end of the year. Notwithstanding our fundamental based purchasing power parity suggesting 12% overvaluation of the Naira, we expect the CBN to keep the Naira dollar rate stable over 2020 between the range of N363-368.

Figure 5: Forecast Gross External Reserves and Import Cover

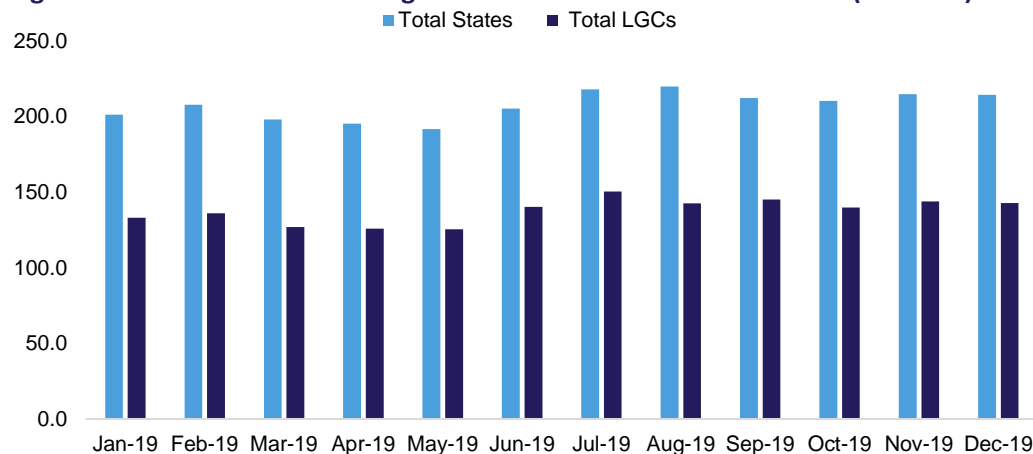


Source: CBN, NOVA Research

Federating Unit's Revenue to Receive a Boost from VAT Increase

The statutory allocation to the federating units (state and local governments) declined marginally over 2019 by less than 2% YoY to N4.14 trillion, reflecting lower allocations from the federation account even as the share of the VAT pool increased over 2019. Going by provided breakdown, allocation to states (including FCT) declined by ~3% YoY, while allocation to local government councils declined less than 1%. Elsewhere, annualized internally generated revenue (IGR) across the federating units increased 16% YoY to N1.32 trillion, with Zamfara and Ekiti states recording over 100% increases when compared to the prior year. Across the federating units, the actual revenue allocation and IGR accounted for only 48% of cumulative budget of the federating units, a development we attribute to aggressive budgets projections by most federating units.

Figure 6: Allocation to Federating Units from the Federation Account (N'Billion)



Source: CBN, NBS, NOVA Research

Over 2020, we believe the major catalyst for the federating units' revenue will largely stem from the increase in VAT rates from 5% to 7.5% starting February 2020. By our estimate, the increase in the VAT rate will accrue additional revenue of ~N500 billion to the federation account. Given that the FG share of the VAT pool is just 15%, the states and local governments are essentially the major beneficiaries of the increase in VAT rate.

On our base case (in the Figure 2 below), we estimate increase in federating unit's total revenue by 4% to N6.34 trillion in 2020. However, we expect the increase in the revenue to be muted by the implementation of the higher minimum wage.

Figure 7: Historical and Forecast Federating Unit's Revenue

	Actual		2020 Estimates		
	2018	2019	Bear	Base	Bull
(N' billion)					
<i>Oil production (mbpd)</i>	<i>1.96</i>	<i>2.01</i>	<i>1.94</i>	<i>2.05</i>	<i>2.18</i>
<i>Oil price (\$/bbl)</i>	<i>71.30</i>	<i>63.93</i>	<i>57.69</i>	<i>64.80</i>	<i>67.00</i>
<i>Exchange rate (N/\$)</i>	<i>305.95</i>	<i>306.92</i>	<i>306.92</i>	<i>306.92</i>	<i>306.92</i>
Oil and Gas Receipts	4,084	5,546	4,495	5,359	5,882
Net Non-oil Revenue	3,064	3,508	3,507	3,891	4,171
VAT	1,047	1,127	1,395	1,627	1,743
CIT	1,373	1,650	1,349	1,477	1,606
Customs/Excise	612	731	764	786	822
States and LGs Share of Oil Revenue	2,686	2,622	1,937	2,309	2,534
States and LGs Share of Non-Oil Revenue	1,939	2,180	2,245	2,521	2,703
Internally Generated Revenue	1,169	1,315	1,381	1,512	1,644
States and LGs Total revenue	5,794	6,117	5,563	6,342	6,881

Source: NOVA Research calculations based on NBS and BOF Data

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