NOVA

NEW THINKING. NEW OPPORTUNITIES.

March 5, 2020

Economic Research

Monthly Economic Insights

COVID-19 Economic Disruption Going Viral?

The outbreak of COVID-19 disrupted economic activities in China, with sources and recent PMI data suggesting material impact on growth. However, the escalation of the virus to countries other than China is already having a reverberating effect on the outlook for the global economy in Q1 and even the rest of the year. The impact of the virus has been more evident on the movement in commodities prices, especially crude oil which has lost 25% year to date. In response to the domino effect of possible escalation of the virus, monetary authorities have started implementing measures to assuage the impact. Firstly, the People's Bank of China reduced the 10-year loan prime rate by 10bps and the 5-year rate by 5bps earlier in February. The US Federal Open Market Committee (FOMC) and Bank of Canada both lowered benchmark rates by 50bps each in the first week of March. The FOMC action was unusual, coming ahead of the regularly scheduled meeting on March 18. In the statement that announced the rate cut, the FOMC reiterated its earlier view that the fundamentals of the U.S. economy remain strong but cited that the ravaging coronavirus poses evolving risks to economic activity. Also, the Bank of England governor recently signaled that that bank's Monetary Policy Committee would be prepared to cut interest rates and allow banks to use "rainy day" funds to soften the impact of the coronavirus outbreak on the UK economy.

While we maintain our view that the Nigerian economy will grow by 2.4% YoY in 2020 pending fundamental driven adjustments, the risks to our view is now skewed to the downside due to the COVID-19 outbreak. Beyond limited casualties in Nigeria, the escalation in other key economies portends major risk to Nigeria's fiscal and external balances. On fiscal balance, recall the 2020 fiscal act is based on a benchmarked average monthly crude oil price of $57/bbl. While crude oil prices averaged $63.54/bbl in January, it declined to $55.24/bbl in February, with crude oil prices trading at a low of $49.67/bbl (-13% MoM) at the end of February. On our modelled 2020 federation account revenue, adjusting for a persisting escalation of COVID 19 with crude oil prices averaging $59.45/bbl (which reflects possible actions by OPEC+ to support price and an end to the pandemic earlier in Q2) for the rest of the year, we reckon that oil revenue to the federation account could fall short by N23.9 billion monthly on our base case, with oil and gas receipt declining by 12% YoY and 8% relative to our prior estimate. Accordingly, on the part of the Federal Government, we estimate that lower revenue could result in fiscal deficit increasing to N3.96 trillion (+11% YoY), much ahead of the approved budget deficit of N1.8 trillion.

The Month's Key Points

Other Readings

Q4 19 GDP – Positive Surprise, But Sustainable?, 24 February

Headline Inflation Ticked Up by 15bps to 12.13% YoY in January, 18 February

Monthly Oil Market Update – February 2020, 13 February

Monthly Economic Insights – February 2020, 07 February

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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Figure 1: Historical and Forecast FGN Revenue and Deficit

	2018	2019 Annualised	2020 Budget	2020 Estimates		
(N' billion)				Bear	Base	Bull
Oil production (mbpd)	***1.96***	***2.01***	***2.18***	***1.94***	***2.05***	***2.18***
Oil price ($/bbl)	***71.30***	***63.93***	***57.00***	***52.34***	***59.45***	***66.56***
Exchange rate (N/$)	***305.95***	***306.92***	***305.00***	***306.92***	***306.92***	***306.92***
Oil and Gas Receipts	5,546	5,583	9,096	4,078	4,917	5,843
Net Oil Revenue after 13% Derivation	4,043	3,820	5,899	2,645	3,188	3,789
FG Share of Oil Revenue	1,961	1,852	2,638	1,283	1,546	1,838
FG Share of Non-Oil Revenue	1,125	1,143	1,805	1,262	1,370	1,468
Other Revenue	386	620	2,573	527	651	682
Independent Revenue	395	507	850	456	583	633
FG Total revenue	**3,866**	**4,122**	**7,866**	**3,528**	**4,150**	**4,622**
FGN Expenditure	7,404	7,705	9,714	7,263	8,108	8,911
Fiscal deficit	**-3,538**	**-3,583**	**-1,848**	**-3,736**	**-3,958**	**-4,289**

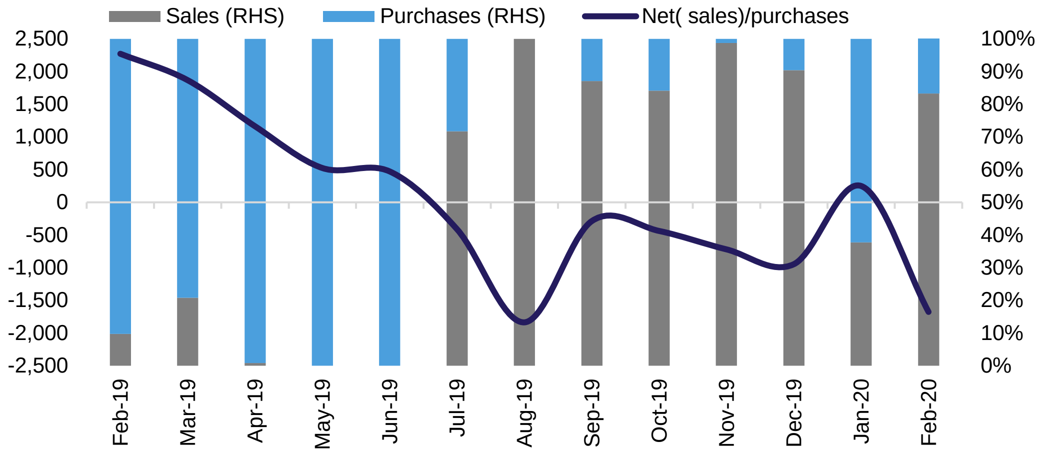
Source: Budget Office, NOVA Research Estimates

On external balance, beyond lower oil receipt to the gross reserves, the precarious fiscal picture could also propel sudden shift in investors' interest which could result in higher than expected foreign portfolio repatriation (See FX note below). We believe a prolonged impact of the virus is inimical to both the current account and domestic growth. Specifically, rising number of countries that have been adversely affected by the outbreak could exert pressure on both the level of exports and imports. For context, China (accounting for 28% standalone), Japan, USA and the 4 largest economies in the Euro Area (Italy, Germany, France and Spain) who are recording increasing number of COVID-19 cases accounted for 48% Nigeria's total imports in 2019. In the event of an escalation, we believe the closure of factories in the above-mentioned countries could lead to supply chain disruptions resulting in material downshift of manufacturing activities in Nigeria and result in temporary higher prices due to feedthrough from scarce imported commodities. For export, while we reckon that crude oil and gas accounts for ~79% of total exports, Nigeria's export exposure to the above countries which sums to 32%, portends great risk for exporters of agricultural products and even demand for Nigeria's crude oil. In all, while we are yet to fundamentally assess the impact on key components of GDP (see Q4 2019 GDP report), we believe a downshift might be necessary if the pandemic escalates.

Double Whammy as FPI Hit on Both Sides

After taking a breather in January, the rate of FPI repatriation surged in the month of February amidst decline in foreign inflows. While the higher FPI inflows in January had limited the quantum of CBN sales at the Investors and Exporters Window (IEW), the decline in inflows magnified CBN sales with the apex bank becoming a net seller. Compared to January wherein outflows declined MoM, it surged 68% MoM in February to $3.6 billion. We believe the higher repatriation during the month, in part, reflects global risk-off sentiment occasioned by COVID-19 and lower domestic paper issuance. In February, total fixed income maturity amounted to $7.19 billion (with our estimate suggesting 30% is held by foreign portfolio investors) compared to total paper issuance of $3.75 billion (total subscription of $5.67 billion). January and February combined witnessed maturity of $14.99 billion and subscriptions at fixed income auctions at $15.56 billion, while total paper issuance amounted to $9.34 billion. On the other hand, foreign inflows declined 39% MoM to $1.3 billion driven largely by a drop in FPI inflows to $1.0 billion (-48% MoM). Although, local dollar sales (ex-CBN) increased to $730 million (+36.5% MoM), when combined with the foreign inflows, it still fell short of the outflows during the month resulting in a net deficit of $1.54 billion (compared to surplus of $556 million in January). Accordingly, the apex bank stepped up intervention at the window to the tune of $2.0 billion in February, compared to net purchase of $250 million in January.

Figure 2: CBN activity at the IEW

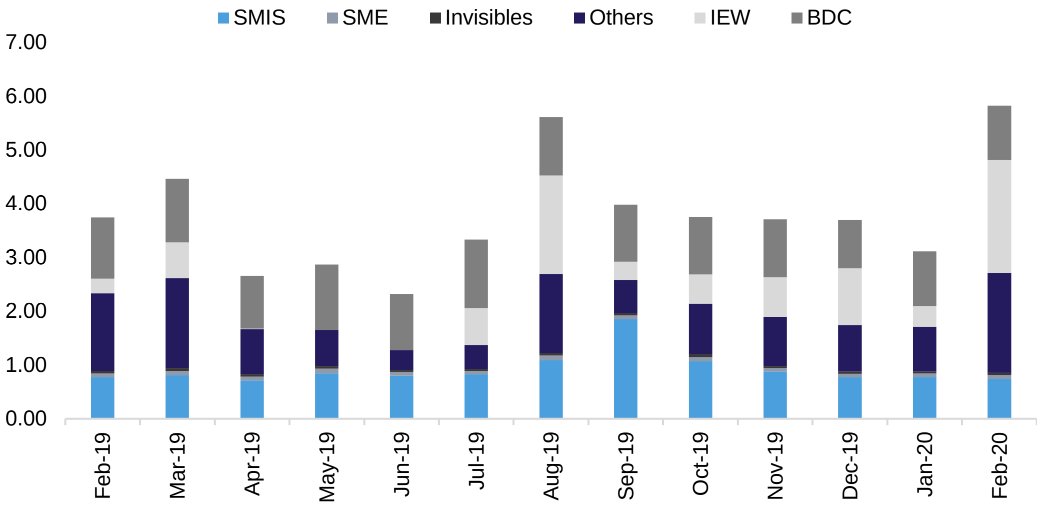


Source: CBN, FMDQ, NOVA Research

At other segments, the CBN sales increased by 37% MoM to $3.72 billion compared to $2.73 billion in January. Sales to the SMEs, Invisibles and SMIS (retail and wholesale) windows declined marginally to $855 million (-2.5% MoM) largely reflecting the CBN's rationing of dollars and DMBs lowering bids to avoid unusual debits by CBN for bidding excessively at SMIS auctions. However, non-auction and BDC sales increased by 55% MoM to $2.87 billion. Overall, CBN intervention sales across windows surged by $87 MoM to $5.82 billion. Reflecting the increased sales, the gross external reserve depleted by $1.71 billion to adjusted level of $35.80 billion at the end of February.

In our January Economic Insight, we had modelled a scenario of prolonged lower crude oil prices for the rest of H1 2020, with year average of $59.45/barrel (which reflects possible actions by OPEC+ to support price and a possible end to the pandemic earlier in Q2). Also, coupled with a possible escalation of the rate of repatriation, we estimated that the gross reserve could decline to as low as $32.3 billion at the end of the year. With a faster escalation of the COVID-19, we see room to adopt the scenario going forward.

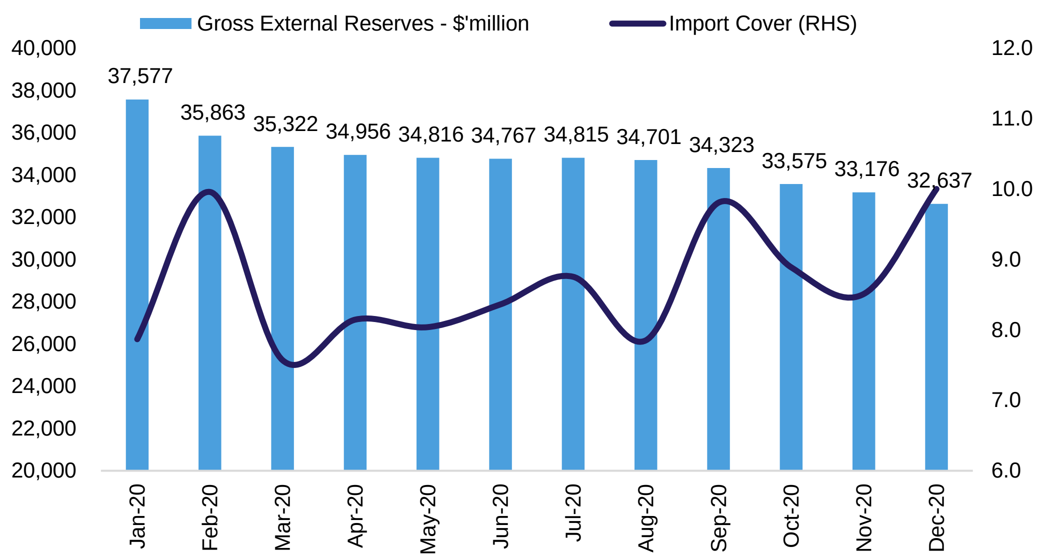
Figure 3: CBN intervention sales across markets



Source: CBN, FMDQ, NOVA Research

Notwithstanding recent monetary policy actions in advanced economies, we believe the FX risk adjusted returns will limit any sizeable foreign inflows into the country, with prospect for a faster repatriation (although fixed income maturity is minimal over the rest of H1 20) as the outlook for the gross external reserves dims further. However, adjusting the reserve level for foreign borrowings of $3.3 billion, the reserve could be supported to close at $36 billion at the end of the year. While the worsening reserve picture begs the question of when the foreign exchange rate will reflect fundamentals, we believe the apex bank would first adopt some administrative measures, roll out further unorthodox policies or reversal of some of the policies implemented in 2019 to curb further dwindling of the reserves before necessarily succumbing to adjusting the FX rates. On our fundamental based purchasing power parity, we believe the Naira is 12% overvalued, and a likely adjustment could see the exchange rate weaken to ~N405/$, but we expect the Naira to trade between the range of N363-368 at the IEW in the interim.

Figure 4: Forecast Gross External Reserves and Import Cover

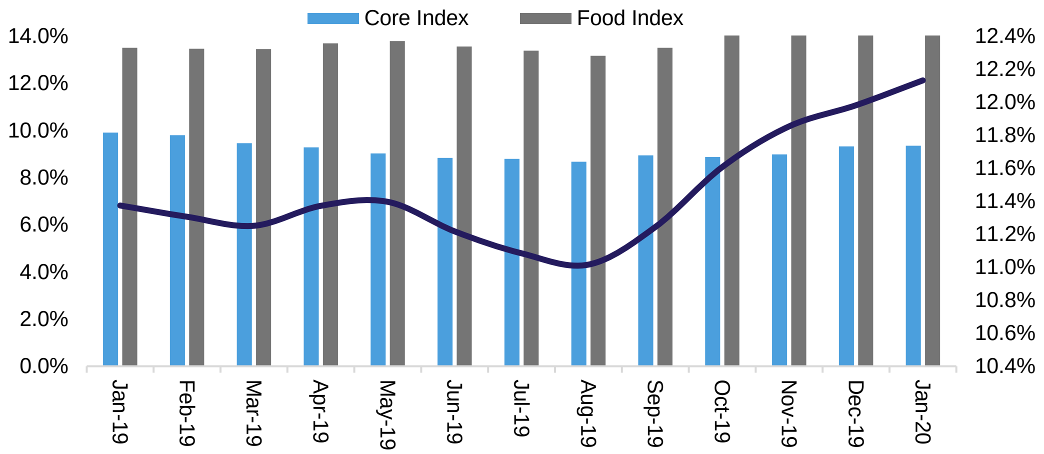


Source: CBN, NOVA Research Estimates

Inflation Continues its March Upwards

Not so farfetched from our expectation, inflation rate for the month of January rose to 12.13% YoY from 11.98% in December 2019. Much of the expansion emanated from faster increase in the food index (+18bps to 14.85% YoY) which more than outweighed moderate growth in the core index (+2bps to 9.35% YoY). The YoY expansion in the food index largely reflects the low base of the prior year, which was further espoused by the feedthrough of the land border closure on food prices. Relative to the same period in the prior year, the food index is 134bps higher than January 2019 level of 13.51% YoY while the growth in the core index moderated by 56bps from 9.91% YoY in January 2019.

Figure 5: YoY Trend in Headline, Core and Food Inflation Trend



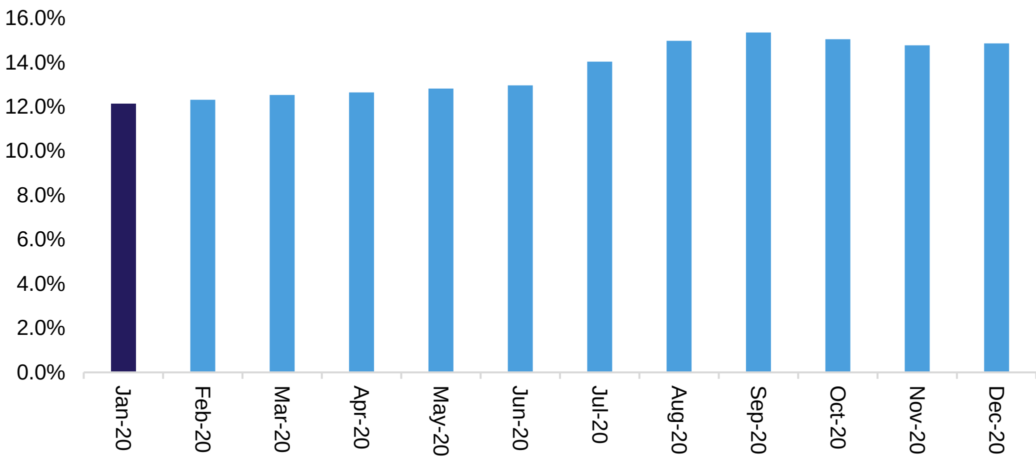
Source: NBS, NOVA Research

Surprisingly, the month-on-month movement of the consumer price index remained stubborn in January, expanding 0.87% MoM compared to 0.85% MoM in December and our forecast of a moderation to 0.83% MoM change. The increase compared to the prior month largely mirrored 1bps MoM increase in both the food and core index to 0.98% and 0.82% MoM respectively. We believe the still accelerating MoM growth in the food index reflects transitory impact of the border closure, as update from the Famine Early Warning Systems Network (FEWS NET) revealed that market supplies of tubers, millet, rice, and maize remain buoyant despite the conclusion of the main harvest season. For the core index, the increase reflects MoM increases in average prices of premium motor spirit, diesel, kerosene and prices by 0.01%, 0.93% and 0.02% to N145.37/litre, N323.46/litre and N2,019.10/5kg cylinder respectively.

As stated in our NOVA Economic Outlook (NEO) H1 2020 (See report: NOVA Economic Outlook H1 2020), the confluence of higher electricity tariff, VAT increase, persisting border closure and FX depreciation will determine the inflationary trend over 2020. Notwithstanding recent media update suggesting likely implementation of 50% tariff increase starting in April 2020, our channel checks guided to absence of a directive from NERC regarding such increase. As such, we believe the aforementioned triggers will materialize over the second half of the year (especially the electricity tariff hike and currency depreciation).

For the first half of the year, we maintain our view that inflation trend will be dictated by the restriction on imports through the land border and feedthrough impact of the VAT increase (albeit minimal). However, with the impact of the border closure fading much faster than our expectation on the month on month numbers, we have adjusted our expectation for the rest of H1. In the interim, we do not rule out feedthrough of global shocks on imported inputs. Overall, we expect the consumer price index to improve by 0.90% MoM, with headline YoY expanding to 12.32% YoY in February. Accordingly, we revised average inflation rate for 2020 to settle at 13.7% on our base case.

Figure 6: Forecast 2020 inflation trend



Source: NBS, NOVA Research

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