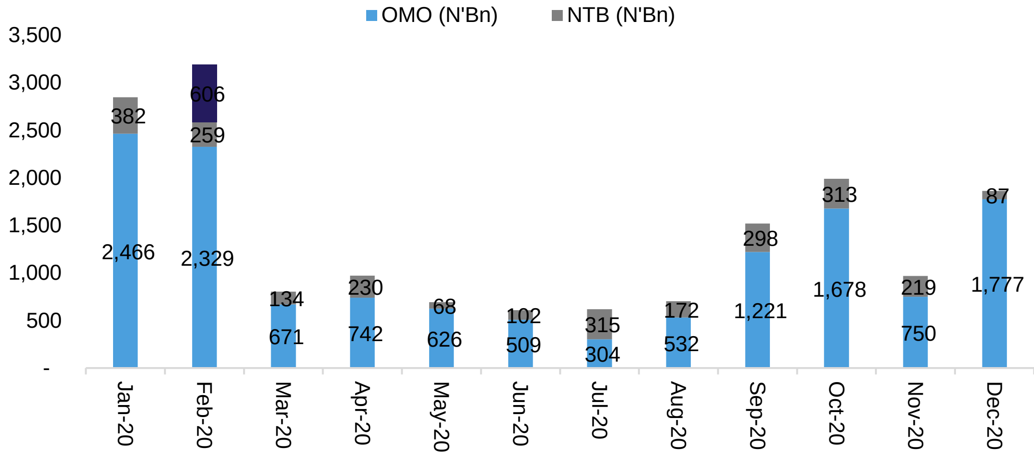
Monthly Economic Insights

Liquidity Pressure to Moderate Impact of Higher Borrowings

In our recently published report on the fiscal position, we concluded that the expected borrowing of $6.9 billion and the $150 million drawdown from NSIA will unlock about N2.5 trillion for the federation account to augment shortfalls from both oil revenue, lower customs and VAT revenue. Irrespective, we stated that the 2020 budget will still have a N2.6 trillion gap given our modelled budget deficit of N5.1 trillion. Assuming the only planned foreign borrowing for the 2020 fiscal year is the $6.9 billion from IMF, World Bank and AfDB, we believe the options available to the FGN to finance the gap are domestic borrowings, CBN overdrafts and drawdown from existing deposits held in accounts of extra-budgetary funds (like the stabilization fund). The total balance in the stabilization fund at the end of 2019 was $351 million, as such with the withdrawal of the planned $150 million, the excess in the account even if totally drawdown will only provide N72 billion in funding, which will be shared with states and local governments. Accordingly, we believe the most viable option available to the FGN in funding the gap is domestic borrowings and CBN overdrafts.

Figure 1: Fixed Income Maturities Over 2020



Source: FMDQ, NOVA Research

On borrowings, compared to the approved budget which allocated N744 billion in new domestic borrowings and N850 billion external borrowings, the DMO recently received approval of the Senate to source the planned external borrowings from the domestic market, bringing total planned domestic borrowings to N1.6 trillion. With expected total NTB and Bond maturity of N3.5 trillion over 2020, we reckon that total paper issuance by the FGN will have to sum up to N5.1 trillion during the year. Between January and April, the FGN issued total securities of N2.0 trillion (of which N1.2 trillion is NTBs and the rest N817 billion in bonds), with total maturity over the same period of N1.73 trillion (the sole

The Month's Key Points

- Liquidity Pressure to Moderate Impact of Higher Borrowings
- Rising Reserves Pressure Could Result in More Stringent Policies
- FX Depreciation and Social Distancing to Ignite More Pressure on Prices

Other Readings

Delayed Transmission Softens Inflation Expansion in March, 21 April

Great Lockdown Necessitates Further Downgrade to GDP, 16 April

Oil Supply Deal: Market Stability Desired, 14 April

Monthly Oil Market Update, 08 April

Fiscal Position: Still Critical but Temporary Panacea in Sight, 07 April

Monthly Economic Insights, 03 April

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bond maturity for the year was in February, N606.4 billion). As such, to meet up with the planned domestic borrowing, the FG will have to issue a total of N3.1 trillion between May and December, which we believe the domestic market can sufficiently supply given the run rate over the first months of the year.

However, given that the 2019 budget deficit was largely financed by the Central Bank of Nigeria (CBN) to the tune of about N2.9 trillion through drawdown on ways and means, we do not rule out the FGN adopting same approach over 2020. As such, on a preferred scenario, we see the FG actual new domestic borrowings summing up to N1.24 trillion with the CBN financing the excess of the gap of N1.24 trillion.

Figure 2: FGN 2020 Budget Deficit Financing Scenario

N'billion	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Projected Deficit	**5,092**	**5,092**	**5,092**	**5,092**	**5,092**
Privatisation Proceeds	252	252	0	0	0
Foreign Borrowings	2,484	2,484	2,484	0	0
Stabilization Fund Drawdown	126	126	126	126	126
Net Deficit/Surplus	***2,230***	***2,230***	***2,482***	***4,966***	***4,966***
CBN ways and Means	2,230	1,115	1,241	2,230	2,483
Domestic Capital Market Borrowings	***0***	***1,115***	***1,241***	***2,736***	***2,483***
2017 Net issuance	1,283	1,283	1,283	1,283	1,283
2018 Net issuance	193	193	193	193	193
2019 Net issuance	863	863	863	863	863
Total Borrowing in 2020	***2,484***	***3,599***	***3,725***	***2,736***	***2,483***

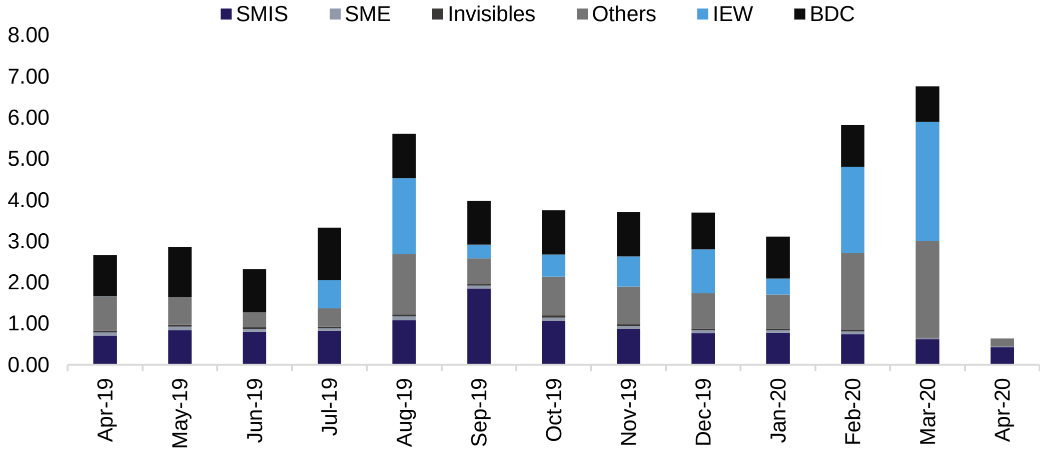
Source: NOVA Research Estimates

On pricing of the borrowings, out of the OMO holdings prior to the restriction of corporates and individuals from participating in OMO (effective 23 October 2019), a total of N9.83 trillion is due for maturity in 2020 with about N4.2 trillion of the maturity being held by corporates and individuals. With the maturities largely dominating the NTB, Bond and corporate instruments, we see limited upside for stop rates from NTB and bond current levels of 2.73% and 11.2% on average respectively. While our outlook for the gross reserve favors upward adjustment to the OMO rates in H2 2020 to make it more attractive for foreign portfolio investors, we expect the divergence between the OMO and NTB rates to persist over 2020.

Rising Reserves Pressure Could Result in More Stringent Policies

The gross external reserves depleted at a much faster rate of $1.64 billion (March depletion $1.14 billion) in the month of April to adjusted level of $32.24 billion. While CBN was largely absent at the Investors and Exports Window (IEW) amidst lower intervention sales across other segments, we reckon that the rate of depletion is not unrelated to matured swap positions, external debt service, drawings on LCs, other official payments, funds returned to remitters and 3rd party MDA transfers. Sales across other segments was meagre following the lockdown implemented for most of the month. Particularly, CBN sales to the SMEs, Invisibles and SMIS (retail and wholesale) windows declined 32% MoM to $451 million as CBN rationing of dollars and DMBs lowering of bids to avoid unusual debits by CBN persists. Non-auction sales also declined to just $192 million from $2.3 billion in March, while no sale was recorded for BDCs following the suspension of sales in April. Even with the dollar rationing at the interbank and SMIS, it is our understanding that the apex bank is yet to deliver on some sales in March and April.

Figure 3: CBN intervention sales across markets

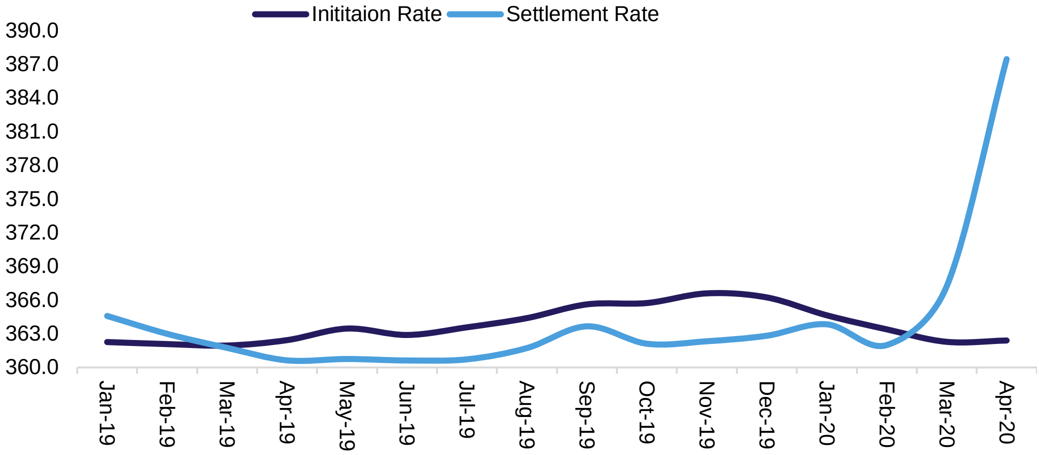


Source: FMDQ, CBN, NOVA Research

On the positive, despite the lackluster activities in April, foreign inflows totaled $163 million compared to $335 million in March, while local supplies (ex-CBN) also declined to $360 million (March: $819 million). With the absence of CBN intervention at the IEW, only DMBs activities with clients were recorded. DMBs sold a total of $492 million during the month compared to purchases from clients of $465 million.

OTC FX futures market activity also slowed in the month of April, with total value traded declining to $1.99 billion compared to $4.95 billion in March (with total number of transactions declining to 246 in April from 755 in March). Notably, a total of $1.52 billion contracts matured on April 29. Compared to the rate at initiation of N362.4/$, the NAFEX rate on the settlement date averaged N387.5/$, indicating the apex bank closed the position with a loss of N37.9 billion compared to N6.3 billion loss on the March settlement. Reflecting the widening loss position, the FMDQ today announced upward revision for all new contracts, with the 6 months, 1 year and longest tenor moved up by N11.8, N26.93 and N156.33 to N402.9/$, N421.2/$ and N569.69/$ respectively.

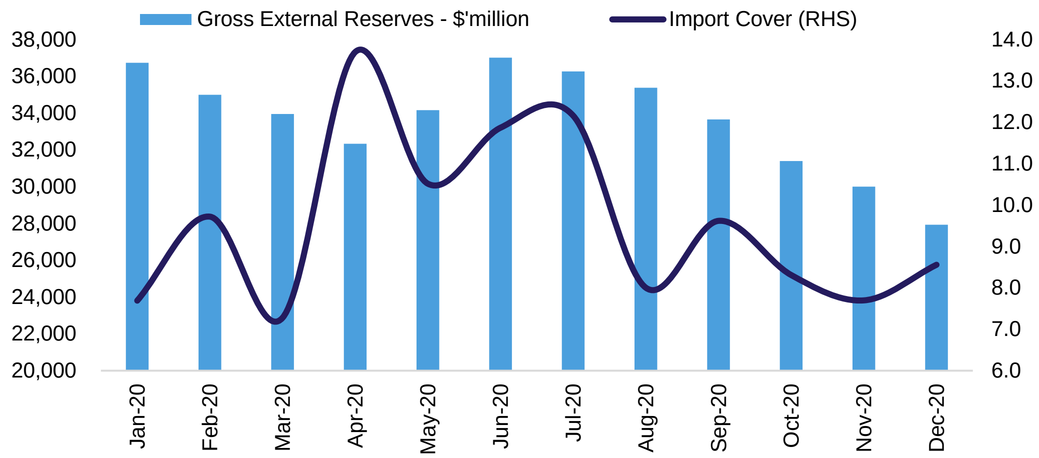
Figure 4: OTC FX Futures Contracts



Source: FMDQ, NOVA Research

In our April Economic Insight, we stated that with limited inflows in sight and reduced avenues to control outflows, we do not see the recent price adjustments to the NAFEX and BDC rates having any material impact on the reserves. As such, we concluded that the only option that will have any meaningful impact on the reserve is an outright floating of the exchange rate with intermittent intervention to avoid unnecessary speculative attacks. In modelling the reserve position over the rest of the year, we have adjusted expected oil inflows to reflect the depressed oil price and production cap due to compliance to OPEC+ cuts. Also, we expect paucity of FPI inflows to persist for the rest of the year, while we also adjusted outflows for the resumption of sales to BDC in May, albeit lower than average of January to March. With the minimal activity at the IEW in April, we believe the portion of offshore holdings of maturing fixed income ($10.6 billion between April and December) for the month of April (estimated at $1.02 billion) is yet to be repatriated, as such we rolled it over to the rest of the year.

Figure 5: Forecast Gross External Reserves and Import Cover



Source: CBN, NOVA Research Estimates

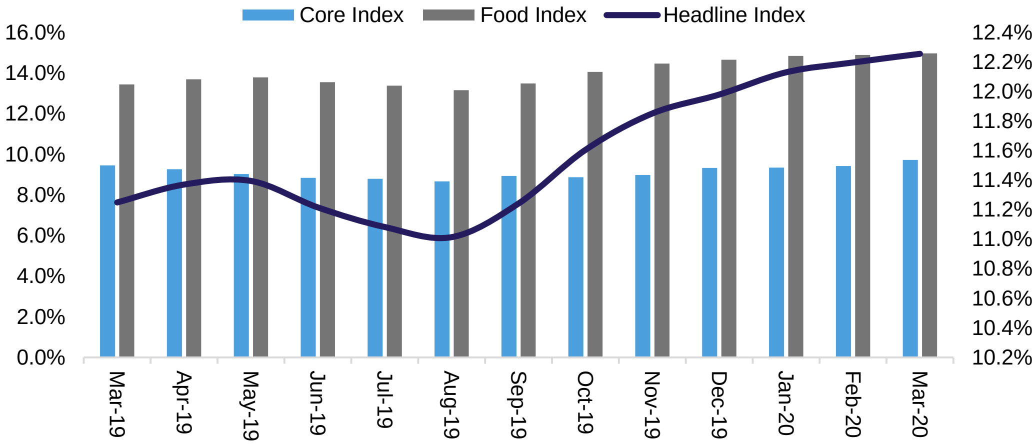
Still assuming a worst case scenario that 100% of the offshore holdings are repatriated, resumption of sales to BDC in May amidst import and services demand, the gross external reserves could end the year at $20.6 billion. Adjusting our modelled reserve level for the inflow of IMF facility and other official receipts, we see support for the reserve to

$24.4 billion at year end. Furthermore, if adjusted for the remaining expected World Bank and AfDB borrowings of $3.5 billion, we estimate a year end reserve position of $27.9 billion, with our model suggesting further weakening of the NAFEX rate to N410/$. On the offshore holdings, given the scale of fixed income sales by offshore investors prior to maturity, the timing of the repatriation might defer from our monthly expectations based on the maturity profile. And also, we do not rule out the introduction of capital controls, either in form of sizeable currency adjustment or other administrative measures, to limit the scale of the offshore repatriation.

FX Depreciation and Social Distancing to Ignite More Pressure on Prices

Events over the last two weeks in March to a large extent changed our view of price movement over the rest of the year. However, given delayed transmission of the disruption in supply chains and the tacit exchange rate adjustment, month-on-month inflation expanded by 0.84% coming above 0.79% MoM in February, but below our forecast of 0.93% MoM change. The increase compared to the prior month largely mirrored 7bps MoM increase in both the food and core index to 0.94% and 0.80% respectively. Going by the breakdown of the food index, the increase emanated from a slower expansion in farm produce (+2bps to 0.88% MoM), which neutered increase in processed foods (+62bps to 1.6% MoM). On the core index, Transport sub-index firmed 1bps MoM, while Clothing & Footwear (+3bps to 0.78% MoM), Health (+1bp to 0.81% MoM) and Housing, Water, Gas, Electricity, and other Fuel (+5bps to 0.60% MoM) recorded increases.

Figure 6: YoY Trend in Headline, Core and Food Inflation Trend

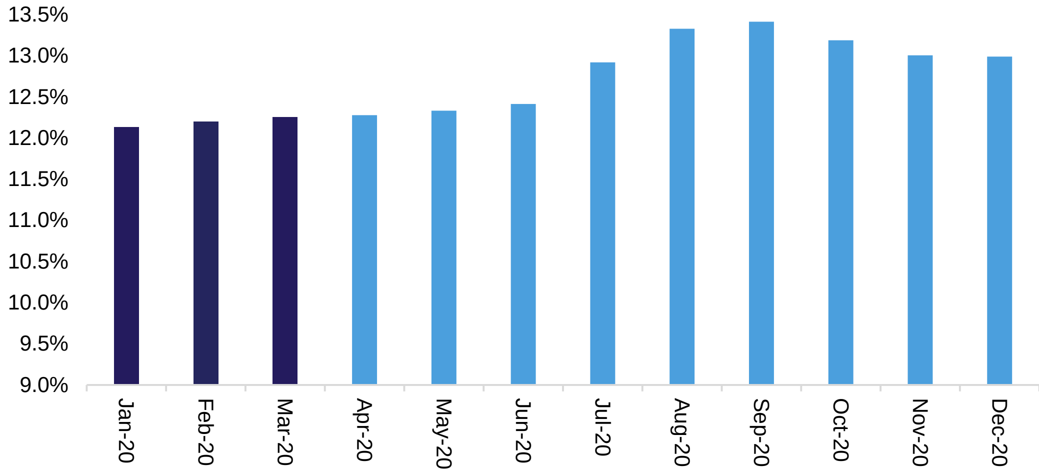


Source: NBS, NOVA Research

Despite gradually fading, the impact of the border closure continued to take its toll on the price level, when compared to the prior year. Specifically, food prices remained elevated with the YoY number expanding 7bps to 14.98% reflecting increases in prices of imported food (+6bps to 16.2% YoY) and processed food (+320bps to 12.9% YoY), which more than outweighed gains from bountiful harvest with farm produce declining 22bps to 15.2% YoY. Solidifying the pace in the prior month, the core index surged 30bps to 9.73% YoY, following increases in Furnishing (+12bps to 9.50%), Transport (+6bps to 9.49% YoY), Health (+5bps to 9.99% YoY) amongst others. Overall, the headline inflation expanded by 12.26% in the month of March, coming ahead of February level of 12.20%. Relative to same period in the prior year, the food index is 153bps higher than the March 2019 level of 13.45% YoY while the core index increased by 27bps from 9.46% YoY in March 2019.

We believe the impact of the disruptive impact of a breakup in the supply chains (with transmission to scarce imported commodities and higher demand for local substitutes), the abrupt adjustment to the exchange rate and jump in prices of essential items (due to the lockdown) were largely evident in the month of April. All told, we expect the consumer price index to expand by 0.96% MoM, with headline YoY expanding to 12.28% YoY in April. While we still allow our model to reflect the likely implementation of the higher electricity tariff in July, we acknowledge recent communication between Nigeria and IMF suggesting a likely implementation starting 2021 due to the economic cost of the Covid-19 outbreak on consumers. We maintain our expectation of persistent Naira weakness, elevated transportation cost due to social distancing policy and higher prices of essential items due to the partial lockdown. All told, we expect average inflation rate for 2020 to settle at 12.7% on our base case.

Figure 7: Forecast 2020 inflation trend



Source: NBS, NOVA Research Estimates