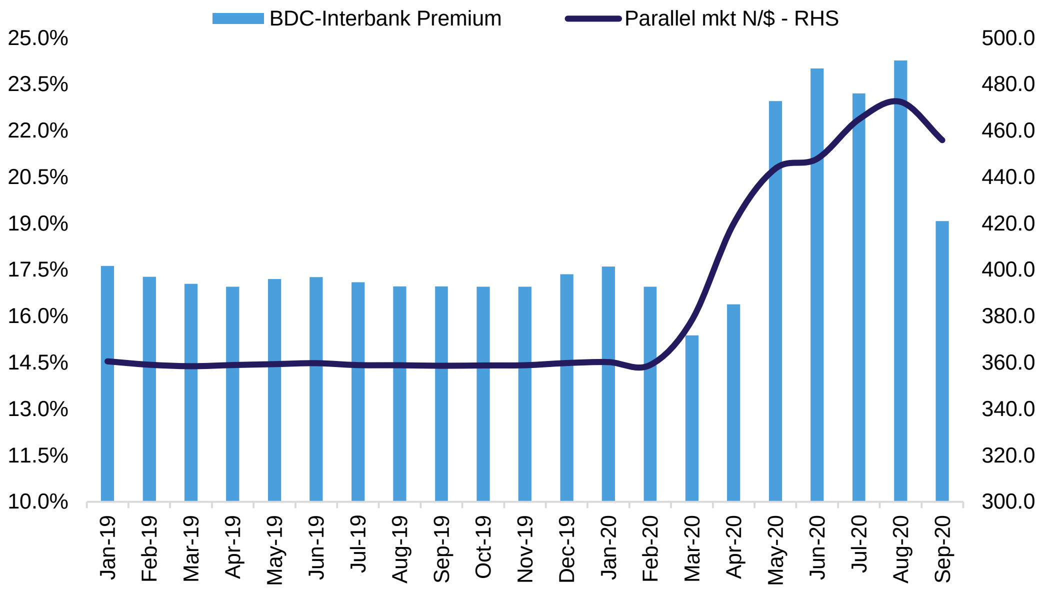
# Monthly Economic Insights

## CBN Partially Relaxed Lockdown at the IEW and BDC Segments

The Apex bank partially relaxed lockdown on FX sales at the IEW and to BDC operators in September. The apex intervened at the IEW to the tune of $435 million, with estimated sales to BDCs of $295 million. Following the resumption of sales, the BDC-Interbank premium narrowed to 19% (from 24% at the end of August) with the parallel market exchange rate appreciating to N455.9/$ (average for September from N472.4/$ in August). Over Q3 2020, foreign inflows summed to $272 million, while outflows summed to $1.94 billion. Local FX supply (excluding CBN) provided much of the support over Q3, with cumulative FX supply by Exporters/Importers, Individuals, and Non-bank FIs of $1.23 billion.

**Figure 1: BDC-Interbank Premium and Parallel Market Rate**




Source: CBN, Aboki FX, NOVA Research

In the month of September, CBN sales to the SMEs, Invisibles and SMIS (retail and wholesale) segments totaled $400 million compared to $457 million in August. Non-auction sales increased to $407 million compared to $143 million in August. Foreign inflow was just $90 million compared to $65 million in August, while local supplies (ex-CBN) increased to $412 million (August: $364 million), following higher FCY sales by exporters/importers. Despite CBN sales across segments increasing 149% MoM to $1.54 billion relative to the level of inflows (both oil and FPI), the gross external reserves increased by $61 million (August depletion $215 million) in the month of September to adjusted level of $35.30 billion following inflow of some official funds.

### The Month's Key Points

- CBN Partially Relaxed Lockdown at the IEW and BDC Segments
- Growing Reserve Requirements Will Offset Moderation in Deposit Rates

### Other Readings

*Low Liquidity Expected to Dampen Impact of Lower Rates*, September 23

*MPC Preview: Balancing FX Stability and Moderating Economic Contraction*, September 21

*Renewed Jump in Core Inflation Compound Pressure on The Headline Index*, September 15

*Monthly Oil Market Update – September 2020*, September 11

*Monthly Economic Insights – September 2020*, September 04

*NOVA Economic Outlook H2 2020 – A Contraction Like Never Before*, July 16

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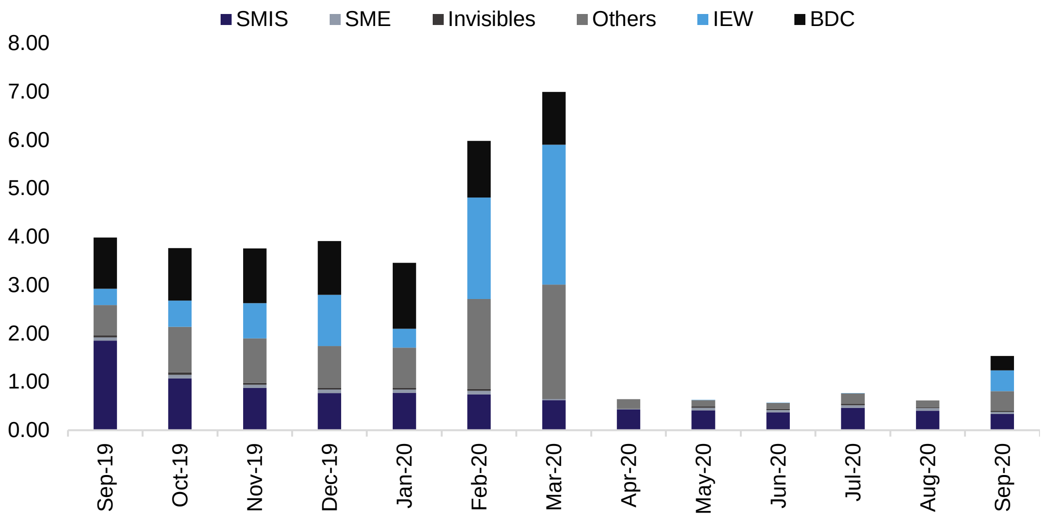
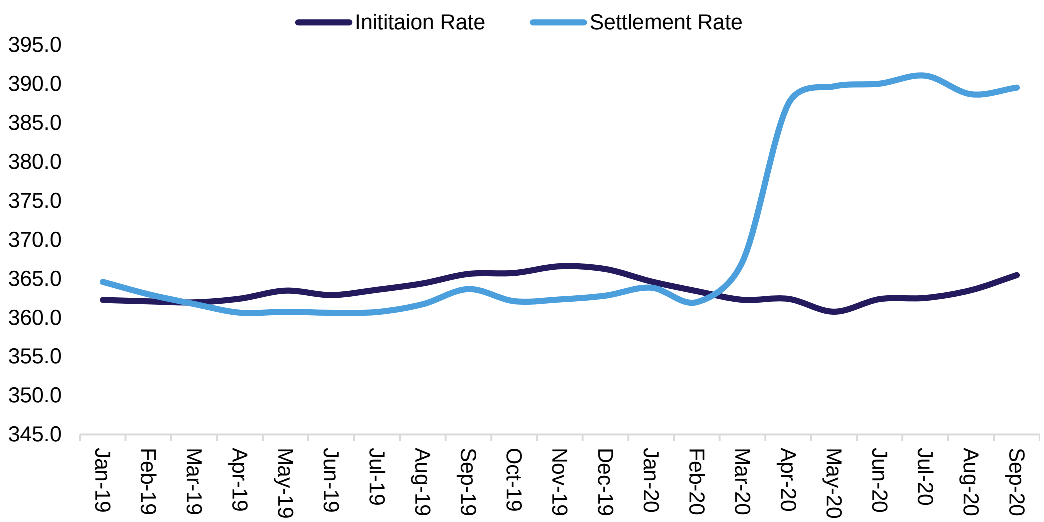
**Figure 2: CBN intervention sales across markets**




Source: CBN, FMDQ, NOVA Research

OTC FX futures market activity slowed in the month of August, with total value traded reducing to $393.58 million compared to $1.29 billion in August. Futures contract worth $1.54 billion matured on September 30. Compared to the rate at initiation of N365.5/$, the NAFEX rate on the settlement date averaged N389.5/$ with a total counterparty settlement gain/loss of N37 billion.

**Figure 3: OTC FX Futures Contracts**

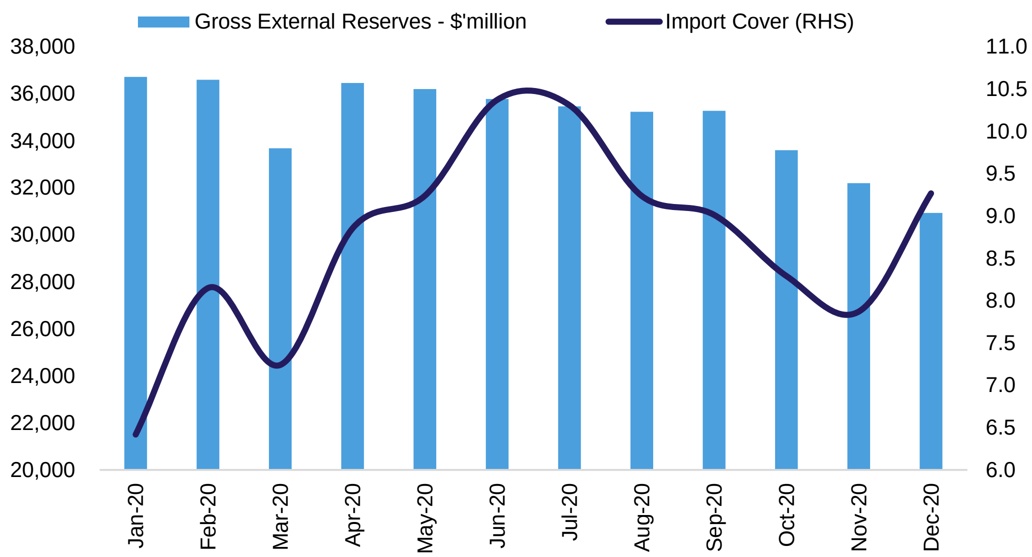



Source: FMDQ, NOVA Research

With foreign portfolio inflows expected to remain meagre for the rest of the year, amidst still low crude oil prices, we expect the CBN to continue to manage its dollar supply. Particularly, we expect the FX supply for FPI repatriation to remain lower than the required demand with such funds continually dominating demand at primary market fixed income auctions. Going from the above, we now expect a base-case FX supply for FPI repatriation to average 25% of the backlog and maturing offshore holdings between October and December, which by our estimate should sum up to $5.35 billion. Assuming 15% repatriation of backlog and maturing offshore holdings between October and December, cumulative sale should amount to $3.52 billion. Coupled with our modelled

FX sales to BDC operators of $1.1 billion over Q4 and sales across other segments, we expect the gross foreign exchange reserve to close the year at $30.9 billion on our base scenario and $32.8 billion on our best-case scenario. Adjusting the reserve position for expected foreign borrowing of $2.11 billion, could result in a corresponding increase in both our base and best-case scenarios. With further moderation in interest rate and rising inflation, our modelled interest rate-inflation differential increased in favour of the U.S, expanding the Naira overvaluation. Overlaying the widening inflation-interest rates differential on our purchasing power parity model, the fundamental value of naira lies between N420/$ and $432/$ (8% – 11% overvaluation from current NAFEX rate of N386.30/$). Notwithstanding our fundamental assessment of the optimum exchanger rate, we believe an outright floating of the exchange rate with intermittent intervention to avoid unnecessary speculative attacks will have more meaningful impact.

**Figure 4: Forecast Gross External Reserves and Import Cover (Base Case)**

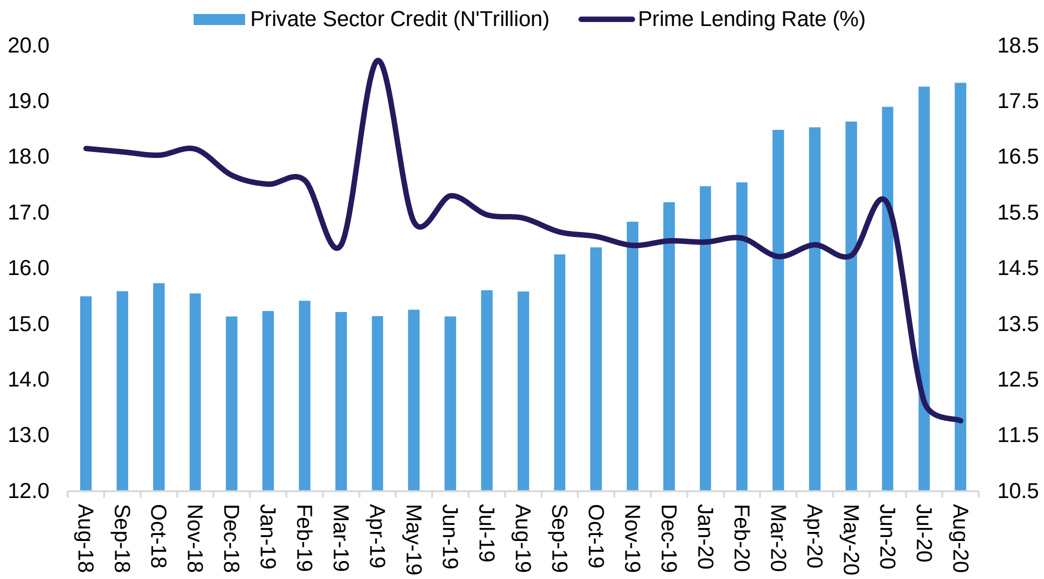



Source: CBN, NOVA Research Estimates

## Growing Reserve Requirements Will Offset Moderation in Deposit Rates

Compared to the level at the end of 2019, aggregate private sector credit increased by N2.14 trillion over the first eight months of 2020 to end August 2020 at N19.33 trillion. The loan growth was accompanied by moderation in the prime lending rate. Beyond doubt, the LDR policy has proven to be more potent in driving real sector lending and at the same time moderating the cost of borrowing due to the increased competition for corporate names. Compared to overall gross credit of the banking system in June 2019 before the introduction of the minimum LDR on July 3rd, 2019, the overall private sector credit has grown by N4.2 trillion. Over the same period, the prime lending rate declined 4.04% to end August 2020 at 11.8% compared to 15.80% as at June 2019, with a year to date contraction by 3.23%. Notwithstanding the success of the LDR policy in driving credit creation and moderating lending rates, the distribution of loans continues to favour largely the prime sectors and borrowers, with limited transmission to the CBN's preferred sectors of SMEs, retail, mortgage, and consumer lending as banks are more concerned about credit risk with current conditions.

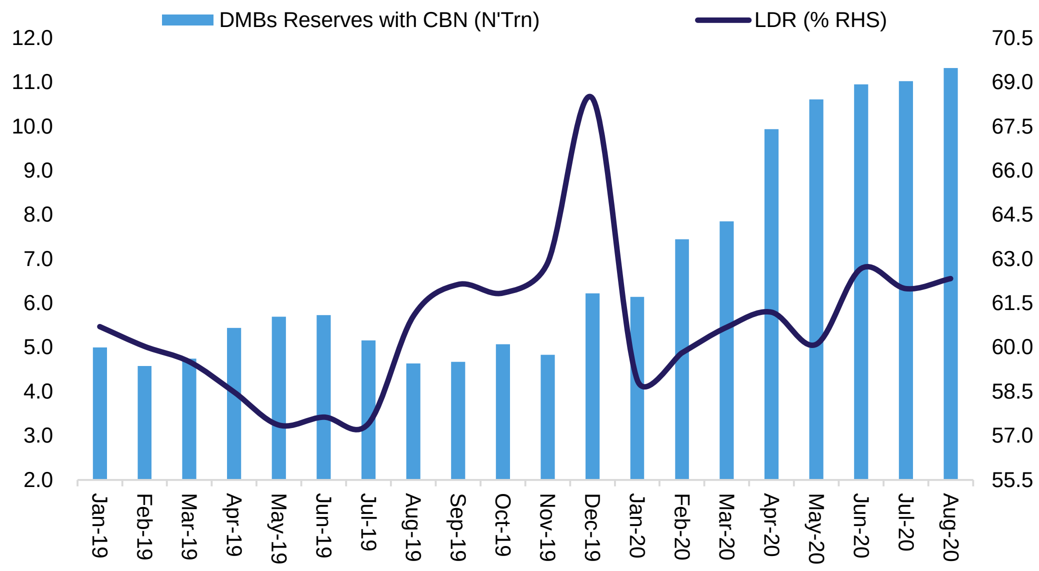
**Figure 5: Trend in Banking Sector Credit and Prime Lending Rate (%)**




Source: CBN, NOVA Research

Since the first punitive debits for LDR in September 2019, the rates of debits have spiked even beyond the LDR punitive measures. After raising the CRR by 500bps to 27.5% at the January MPC meeting in a bid to reduce the cost of liquidity mop-up within the banking system and combat possible foreign currency speculation induced by the impending liquidity, the apex bank also initiated series of unusual debits. Between September 2019 and August 2020, the volume of banks' reserve sterilized with the CBN has grown by N6.64 trillion, with the increase over 2020 alone amounting to N5.1 trillion to settle at N11.3 trillion at the end of August. Beyond any doubt, the series of debits have to a large extent increased the effective cost of funds across the banking system, with such increases largely passed on to the mid and small-scale borrowers.

**Figure 6: Trend in DMBs Reserves with CBN and Loan-to-Deposit Ratio**




Source: CBN, Nova Research

Reflecting the huge system liquidity occasioned by the exclusion of nonbank financial institutions and individuals from investing in OMO and minimal government securities to mop-up such funds, the level of deposit in the banking system has been on a consistent increase, with impact on the banking system funding base. Post the end of Q2 2020 debit of ~N341 billion, the funding base in the banking system has grown by N854 billion to N31 trillion at the end of August with LDR over the same period at 62.34%. Assuming a best-case scenario of 3% increase in the LDR to 65.34% at the end of September, average over the quarter would still fall below CBN preferred daily average of 65% at 63.23%. Accordingly, we estimate that the apex bank could sterilize about ~N280 billion from the banking system at the end of September as LDR punitive measure. The constrained liquidity in the banking system occasioned by the series of debits is resulting in increases in the effective cost of funds across the banking system, with the recent moderation in savings rate and falling interest rate on term deposits just moderating the impact. Beyond doubt, we believe a gradual refund of excess CRR will have more positive impact on overall lending rates, spur credit demand and support the productive sectors of the economy.