MERISTEM

Macroeconomic Update

MPC Monitor | November 2020

MPC Leaves All Parameters Unchanged

The Monetary Policy Committee (MPC) held its last meeting for the year on the 23rd and 24th of November 2020. The committee voted to leave all parameters unchanged, in line with our expectation.

In reaching its decision, the committee took into cognizance the continuing impact of COVID-19 across several economies. The MPC noted the improving albeit, weak outlook of the global economy in view of the progress recorded so far in the development of COVID-19 vaccines.

On the domestic front, the committee noted the second consecutive contraction in output growth, indicating that the country officially entered a recession in Q3:2020. The MPC was however optimistic that the economy would return to the growth path in Q4:2020 on the back of improving PMIs and real sector credit growth.

Another key decision variable for the MPC was the unabating inflationary pressures, which the committee noted as due to the lingering insecurities and structural deficiencies affecting logistics around the country. The committee further stated that inflationary pressures were exacerbated by falling output and hence, expressed confidence that the expected improvement in Q1:2021 GDP would lead to a moderation in headline inflation.

The decision is void of a definitive stance against monetary inflation induced by high system liquidity, thus, we do not expect a slow-down in inflation rate over the near term. Although domestic production is showing signs of a recovery, the loss of consumer purchasing power and high real cost of production may impede recovery process. Also, we do not anticipate an improvement in fixed income assets yield over the short-term.

Committee's Considerations

The Committee noted with concern the challenges exerting pressure on the general price level and output growth. It noted that the spike in inflation has been driven by supply-side factors arising from the COVID-19 pandemic. The committee stressed the need to address the structural issues which have been a bane to cost management within the economy, while also advising the Federal Government to prioritize the acquisition of vaccines in order to contain the public health problems constituted by Coronavirus.

The committee noted that the economic contraction recorded in Q3:2020 (-3.62%) had bottomed out from the Q2:2020 position (-6.10%) following improvement in economic activities. This follows the proactive measures employed by both the fiscal and monetary sides of the economy.

The Committee took note of the improvements in the performance of the equities market in recent times, taking it as a signal of medium-term macro-economic

recovery. Also, the increase in credit to real sectors in the economy was noted, while also encouraging more credit support to employment stimulating sectors to hasten output growth and improve employment among the youths.

The Committee appraised the regulatory surveillance of the CBN in the banking sector and suggests improvements in order to keep Non-Performing Loan (NPL) at low levels.

The Committee noted that the need to resuscitate the economy, after the recent slide into recession has become paramount. It highlighted that while tightening the benchmark rate would moderate inflationary pressures, its position to expand credit to the real sector would be countered. On the other hand, a decision to ease would spur liquidity in the system and energize existing spike in price levels. On this note, the Committee voted to hold the benchmark rate and keep other parameters unchanged.

Key Decisions
Retained the MPR at 11.50%
Retained CRR at 27.50%
Retained liquidity ratio at 30.00%
Retained the asymmetric corridor at +100bps/-700bps around the MPR.

Anticipated Impacts

The Banking Sector: Margins to Remain Pressured

The reduction of the MPR to at the last MPC meeting exerted significant downward pressure on risk assets yield, which was consistent with our expectations. Prime and maximum lending rates in the banking sector fell to 11.31% and 28.36% in October, from 11.55% and 28.45% in September respectively. The decline in interbank call rate to near 0% in October from 2.00% in September is also indicative of high liquidity of the sector and consequently lower yield. Nevertheless, banks have managed to stay resilient by playing the volume game and supporting performance with non-interest income lines such as trading and FX gains.

Today, our views remain unchanged, especially as the MPC has decided to maintain status quo. **We continue to hold that growth in interest income will increasingly depend on the capacity of banks to sufficiently grow loan book even as macroeconomic conditions do not favor loan growth due to the potential negative impact on asset quality over the short-to-medium term. Banks will therefore have to continually make the tradeoff decision between achieving higher margins and maintaining asset quality**. Recent developments such as the creation of a special tribunal for loan recovery by the newly signed BOFIA 2020; Global Standing Instruction; and penal charge on failed direct debit transactions from an unfunded account; are however expected to help reduce non-performing loans in the sector.

The Real Sector: MPC Decision to have Negligible Effect

GDP figures according to the National Bureau of Statistics shows the economy slipped into a recession in Q3:2020. Although eased lockdown conditions and COVID-19 interventions by the CBN helped taper the extent of contraction in the non-oil sector, low oil production and low prices impacted the oil economy heavily. Going by November PMI statistics, the contraction in manufacturing activities witnessed since May has been halted, driven by expansions seen in sectors such as consumer goods, non-metallic mineral products, cement, textile, and transport equipment. However, activities in the petroleum and coal, chemical and pharmaceuticals, electrical equipment, primary metals, Paper products and Fabricated metal products sectors remain subdued.

While the MPC sees a rate hike as counter-growth and a cut as inflation inducing, we expect the MPC's stance to keep all parameters unchanged to have little or no effect on the level of real sector output

The Fixed Income Market: Here Come Negative Nominal Rates

The fixed income space has continued to record robust patronage as investors seem to prioritize liquidity management over attractive returns. This buying pressure, in the past week, pressed average treasury bills yield in the secondary market to a negative 0.03% as at the 20th of November 2020. The bond market has also seen further compression in yields as system liquidity remains elevated amid limited attractive alternatives.

We do not expect this decision to alter the course of the market, as we expect yields to taper further through the year amid sustained demand. More so, with negative returns on the horizon, investing in short term treasuries may begin to take the back seat as investors explore other capital preservation alternatives at this time.

The Equities Market: Muted Impact on Equities

prevailing positive sentiments in the equities market. The market has continued to benefit from robust participation from both retail and institutional players, due to depressed fixed-income yields. The NSEASI has gained c. 33.86% since the committee last met in September, crossing the 30,000pts. support level to settle at 34,340.56pts. The momentous gain in the prior week which triggered the NSE's circuit breaker mechanism is also noteworthy.

Third-quarter performances have also been broadly impressive across most sectors, particularly when viewed in light of the gloomy macroeconomic realities. As the year winds down, we opine that the equities market would close positive, supported by the hunt for attractive returns and liquidity in the financial system. From a valuation standpoint also, the Nigerian equities market, trading at a PE of 12.6x, remains fairly attractive, relative to the South African market (26.2x), frontier (21.2x) and emerging market (22.9x) indices respectively.

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