MERISTEM

Ahead of MPC

May 2021

MPC Slated to Hold its Third Meeting of the Year

… Key Parameters to Remain Unchanged

The Monetary Policy Committee (**MPC**) is set to meet for the third time this year on the 24th and 25th of May 2021. There have been a number of key global and domestic developments since the Committee last convened in March. We expect these to feature in the Committee's deliberations, and ultimately feed into its decision. The Committee is expected to consider the position of monetary authorities across the world, and the US Fed in particular as inflation gradually picks up in America. Also, the Committee should appraise the pace of vaccination globally and the fight against the coronavirus, particularly in India, which is one of the country's major trading partners.

On the domestic scene, as the National Bureau of Statistics (**NBS**) is yet to release Q1:2021 GDP figures, the Committee may be unable to fully assess the impact of its erstwhile policy stance on economic growth. On the other hand, disinflation reported in April (18.12%YoY vs. 18.17%YoY in the prior month), thanks to a slowdown in food inflation would count as a win in the Committee's books.

After carefully considering what we deem relevant to the Committee at this time, we think the final decision would be to keep all the policy parameters unchanged.

International Economies and Developments

IMF Revises Global GDP Projection

In April, the IMF revised upwards its global growth projection by 50bps to 6.00% in 2021 (vs. initial projection of 5.5%). The decision was influenced by the increasing rate of vaccinations across developed countries, coupled with the expected effectiveness of economic policies in battling the after effect of the COVID-19 pandemic. Monetary authorities across nations, continue to maintain an accommodative posture in a bid to provide support to their respective economies. In its most recent meeting, the Federal Open Market Committee in the US, maintained its target range for the federal funds rate at 0.00% - 0.25% till it meets its employment and inflation objective. Likewise, the Bank of England in its most recent meeting voted to maintain the bank rate at 0.1% and continue its program of UK government bond purchases.

Historic Inflationary Surge in Developed Economies

In Europe, inflation rose to its peak since the outbreak of the pandemic. The harmonized index of consumer prices in the 19 countries increased to 1.3% in March from 0.9% in the previous month. The increase in inflation rate was attributed to one-off items such as the reversal of a German Value Added Tax reduction at the start of the year, increasing energy costs and changes to the weighting of products used for inflation computation. In the US, the CPI grew by 4.2% YoY in April from 2.6% in the prior month, the highest in about 13 years. The jump in inflation was due largely to the rapid reopening of the US economy, and the low base effect from last year. Other factors include monetary stimulus from the USD1.9trn economic relief bill signed by President Joe Biden in March.

New wave of the COVID-19 pandemic hits India

India is currently battling a second wave of the COVID-19 pandemic, reporting c. 400,000 daily cases and more than 250,000 deaths. The second wave was triggered by the relaxation of lockdowns, resumption of public gatherings such as political rallies and religious festivals, following the Prime Minister's announcement of a steady decline in cases in January. A new variant of the Coronavirus has been identified in India B.1.617- and the World Health Organization has classified it as a variant of concern with a possibility of increased transmissibility. India comes behind many countries in terms of per capita vaccination with just about 2.52% of its population fully vaccinated according to data from John Hopkins University.

The COVID-19 crisis in India poses a threat to global economic growth, considering the size of the Indian economy. The knock-off effects are evident in the decline in the nation's demand for oil, being the third-largest oil consumer worldwide. Countries across the world have begun imposing travel bans on India, delaying reopening of borders. In addition, India is the world's largest vaccine manufacturer and accounts for about 20% of global export of generic drugs. A clampdown on Indian exports may leave other countries vulnerable to a new wave of the virus, delaying efforts geared at restarting the global economy.

Muted Israeli-Palestine War Reawakens

There has been a reawakening of the Israeli-Palestine war, after an attempt to evict Palestinian families in East Jerusalem, and an Israeli police raid on Palestine worshippers in Al Aqsa mosque in Jerusalem during the Islamic fasting. The situation degenerated into a war between Israel and Hamas (a Palestine militant and nationalist organization). The violence escalated and has prompted an exchange of rockets and airstrikes between Hamas and Israel and is one of the worst cases of violence between both countries in the last seven years, with a death toll of about 200 people. While the United Nations has been actively engaging both sides towards a ceasefire, we note the damaging impact the conflict

could have on both economies as official statistics reveal that Israel's economy already contracted by 6.5% in Q1:2021.

Taking into consideration all of the above, we expect the MPC to prioritize its goal of stimulating the domestic economic growth considering the recent deceleration in inflation rate and policy stance of its counterparts.

Higher Oil Prices Poses Inflationary Risk

The rebound in economic activities especially for advanced countries has recently triggered a significant improvement in global oil demand. In the US, the EIA (Energy Information Administration) reported a decline in gasoline inventory by 2 million barrels week-on-week following a strong uptick in transportation data, which is now nearing pre-COVID levels. Similarly, in the Eurozone, the UK in April logged a 1mbpd increase in crude oil imports. This stems from the recent easing of lockdown measures which was initiated at the beginning of the year to curb the spread of the virus. The aviation sector has also gained momentum in these regions especially as the summer period draws near.

Sadly, the crude market is not completely out of the woods, given that the fresh outbreak of the virus in India and Brazil poses a significant threat to fuel demand. A spotlight on oil prices reveals prices are still range bound, with Brent crude hovering between USD65 to USD70 per barrel. Nevertheless, this comes as an improvement relative to March when the MPC last met.

OPEC+ undeterred by events in India, reaffirmed its demand growth stance by rolling out 1.2mbpd into the market, effective over the next three months starting in May. For Nigeria, this would mean an increment in production quota by 64,000 bpd to 1.59mbpd, excluding condensates. However, the impact of this new development to economic growth remains muted, given the marginal increase in allotment and sector contribution to GDP - which currently sits at c. 10%.

A more pressing concern is the resurgence in oil prices which poses a huge downside risk on retail petrol prices. Pump prices are still benchmarked around NGN163 - NGN168 per litre - which based on current parameters, is no reflection of current market trends.

As the outlook for crude prices remains positive, we anticipate this would pressure an upward revision of petrol prices in the near-term. Therefore, we expect the committee to consider the ripple effect this might have on inflation.

Domestic Macros

Committee Should Remain Keen on Supporting Growth

Since the country's exit from recession in Q4:2020, economic activities have gone on unhindered by heavy COVID-19 restrictions. According to the National Bureau of Statistics COVID-19 impact monitoring report in February, there were far fewer restrictions on movement and economic activities within the country compared to the previous quarter. In our view, this is related to vaccination efforts which kicked into gear in Q1:2021, and the drop in the daily infection rates. It is on this basis that we expect stronger domestic demand over Q1:2021 with notably better private consumption. However, on a sectoral basis, prospects for the oil economy is tainted by the relatively lower oil output (average of 1.68mbpd in Q1:2020 vs. 1.54mbpd quota by OPEC), while the non-oil sector can be expected to remain on the path of expansion. We recall that in Q4:2020, the ICT and agriculture sectors were key growth drivers of the non-oil sector, while other key sectors like manufacturing (-1.51%YoY), accommodation and food services (-15.03%YoY) and transportation (-5.95%YoY) remained in the region of contraction. Given our appraisal of the economic environment, we expect improvement in trade and manufacturing over Q1:2021.

So far, oil prices have proved supportive, averaging USD62.32pb between January and April 2021 (vs. USD44.84pb in the corresponding period last year). Although this bodes well for government earnings, we expect the overarching desire of the committee to be the need stimulate sustainable growth.

First Inflation Decline in 20 months

In April 2021, the National Bureau of Statistics (NBS) reported a slower pace of increase in the domestic inflation rate. The headline inflation rose by 18.12% YoY, representing a 5bps decrease (the first since August 2019) from 18.17% recorded in March 2021. The slight moderation was influenced by the slowdown in food inflation which ticked up by 22.72% vs. 22.95% in March. In a bid to further confront the spiralling inflationary pressure, we acknowledge the CBN's effort in supporting the increase in the supply of maize and providing facilities to farmers through its Anchor Borrowers' Programme. However, we expect pressure on food prices to persist in the near term considering the magnitude of existing structural issues, and security challenges ravaging the country's agriculture belt. The CBN's recent announcement of its intention to add both Sugar and Wheat to its FX restriction list also signals a potential surge in food prices in the short run.

Core inflation rose by +7bps YoY to 12.74% despite the relatively stable exchange rate observed at the I&E window in the past month. Foreign exchange illiquidity, however, continues to contribute to the increase in production costs, triggering the pressure on core inflation. Import dependent items (such as pharmaceutical products, motor cars, and

vehicle spare parts) specifically influenced the uptrend in core inflation. The upcoming review of electricity tariff is expected to further contribute to the existing pressures on the price index.

In its next meeting, we opine that the MPC's considerations would be largely tilted towards spurring economic activities, considering the recent decline in inflation.

Government Revenues Still Under Pressure

The higher oil price environment witnessed this year has meant more revenue from oil sales to the government on one hand and increasing burden of under recovery for the Nigerian National Petroleum Corporation (**NNPC**) on the other. Recently, the NNPC announced that it would be unable to make remittances to the FAAC account for the month of May 2021 as it reels under the weight of subsidy payments. This would further weaken revenue accruing to State Governments.

Meanwhile, the Federal Government has sought approval from the National Assembly for fresh borrowing (to the tune of USD6.18bn) to part finance the 2021 budget deficit. According to the Federal Government, the amount, which was pre-approved during the budget approval process, is expected to be sourced from both domestic and International (via a possible Eurobond issuance) capital market. Assuming the entire amount is raised, this would drive up total external debt to USD39.45bn (from USD33.34bn as at year end 2020) – exerting additional pressure on debt service costs and government revenue.

Although a successful issuance would support government spending in the interim, we also identify the likely impact on inflation. We therefore expect the Committee to weigh the impact of increased government spending on inflation and economic growth.

Insecurity Continues to Plague the Nation.

From insurgency in the North-East; banditry in the North-West, and secessionist agitations in the South-East and South-West, growing insecurity challenges remain a threat to the country's economy. This has disrupted economic activities, particularly in the agricultural sector, eventually contributing to the lingering hike in food prices.

On the political scene, the forum of Southern Governors banned open grazing across all 17 southern states to arrest the growing menace of herders' crisis creeping into the region. This may further stoke already existing tensions which could lead to escalation of violence. The Governors also renewed calls for restructuring, seeking devolution of power and greater control of policing in their respective regions.

We expect the Committee's focus to be on the implication of insecurity challenges in the country on food supply and inflation.

Monetary Policy

Money Supply and Credit

In contrast to the Year-to-Date (YtD) growth (2.88%) recorded in Q1:2020, broad money supply (M3) declined by 0.41% (NGN168.14bn) YtD to NGN38.46trn in Q1:2021. This was off the back of a 5.11% decline in Net Foreign Assets over the same period. Net Domestic Assets however maintained its uptrend, growing by 0.66% YtD to NGN31.50tn in Q1:2021. We note that CBN's monetary expansion drive via various intervention loans and minimum Loans-to-Deposits ratio policy have been instrumental to overall Net Domestic Credit and GDP growth. However, recent monetary aggregates data suggest that the CBN is becoming less aggressive on monetary expansion. Net Domestic Credit (NDC) advanced by only 1.71% (NGN728.46bn) YtD in Q1:2021, compared to 6.23% (NGN2.25tn) in Q1:2020. In our view, the cautious expansion is an attempt to mitigate the heightened inflationary pressure although the MPC in the past has stressed the fact that inflation in Nigeria is a structural (rather than monetary) phenomenon. In view of the recent moderation in inflation rate, we expect sustained albeit modest growth in Net Domestic Credit and money supply over the near term.

Exchange Rate (Official) Stable Amid Low FX Liquidity

Ever since peaking at c. USD36bn in January 2021, Nigeria's external reserves have continued to trend downwards. Year-to-Date, the external reserve balance has declined by -2.81% to USD34.38bn. This is in spite of oil prices being firmly above USD60pb for the most part of the year so far. While we note that crude oil earnings (which are an important source of FX inflows to external reserves) have improved as a result of higher oil prices, demand for FX has also trended upward. For instance, higher crude oil prices also mean higher landing costs of refined petroleum products, most of which have to be imported to Nigeria. FX market turnover in Q1:2021 reflects subdued supply of FX to the market as it declined sharply by 71.74% YoY to USD12.42bn. The CBN on its part aims to improve diaspora remittance inflows (which declined by about 28% YoY in 2020) through the "Naira 4 Dollar" scheme which rewards recipients of remittances for FX received via official channels.

Meanwhile, exchange rates across official channels have remained largely stable with the official rate at NGN379/USD and the I&E window rate between NGN410/USD and NGN420/USD. Recently however, the CBN removed the official rate from its website and although there has not been an official explanation, the move is generally thought to be a further attempt at unification of FX rates. The MPC is expected to assess current FX liquidity (which declined significantly in Q1:2021 relative to Q1:2020 relative) and its impact on economic growth. We are of the view, however that the link between

the key policy rate and FX inflows is rather weak as capital controls are a major hindrance to FPI inflows. Also, the CBN is often keen to rely on unconventional tools (such as OMO bills) to attract FX inflows.

Fixed Income: Real Rates of Return Still in Negative Territory

Fixed income yields have generally maintained an uptrend so far this year with average T-bills and bond yields in the secondary market climbing from 0.44% and 6.04% as at the last trading day of 2020 (December 29th, 2020) to 5.13% and 12.38% as at May 19th, 2021. Yields in the secondary market have generally moved in tandem with rates offered at primary market auctions, which have in turn been influenced by investors' demand for higher rates to compensate for elevated inflation risks.

However, despite the increase in yields, real returns have remained firmly in the negative territory due to high inflation rate. The outlook for fixed income yields over the near term remains positive, driven by the renewed focus on the domestic debt market by the government (per the new debt management strategy) and persistent inflationary pressures. While higher yields will improve the real rate of return for fixed income investors, they are counterproductive to output growth as cost of borrowing for real sector investments also increases. In any case, it is our view that the MPR has to be significantly altered before it can have any material impact on fixed income yields.

Equities Market Performance and Outlook

So far this year, the key highlight of the equities market has been the release of financial scorecards for 2020FY and Q1:2021, with mixed performance observed across sectors. Notwithstanding, investor sentiments have remained predominantly bearish. Our assessment is that the gradual retracing of yields in the money market, as well as the anticipated market correction following the rally observed in Q4:2020, have played a part in the general selloffs in the equities market. We also recognize that mark-downs for 2020FY dividends has contributed to the negative returns on the All Share Index. Overall, we do not think that the equities market performance would have any significant bearing on the committee's decisions.

On a Balance of Factors…

Ultimately, we expect the Committee to:

- **Retain the MPR at its current level of 12.50%**
- **Retain liquidity ratio at 30%**
- **Retain the asymmetric corridor at +200bps/-500bps**
- **Retain the CRR at 27.50%**

Contact Information

Brokerage and Retail Services

topeoludimu@meristemng.com (+234 905 569 0627)
olatunjifaniyi@meristemng.com (+234 803 4463118)
contact@meristemng.com

Investment Banking/Corporate Finance

rasakisalawu@meristemng.com (+234 806 022 9889)
seunlijofi@meristemng.com (+234 808 536 5766)

Wealth Management

funmilolaadekola-daramola@meristemng.com (+234 805 498 4522)
crmwealth@meristemng.com
Tel : +234 01 738 9948

Registrars

muboolasoko@meristemregistrars.com (+234 803 324 7996)
martinaosague@meristemregistrars.com (+234 802 303 1783)
www.meristemregistrars.com
Tel: +23401-280 9250

Group Business Development

saheedbashir@mersitemng.com (+234 802 454 6575)
ifeomaogalue@meristemng.com (+234 802 394 2967)
info@meristemng.com

Client Services

adefemitaiwo@meristemng.com (+234 803 694 3034)
blessingogwuche@meristemng.com (+234 706 896 5173)
car@meristemng.com

Investment Research

ahmedjinad@meristemng.com (+234 809 183 9487)
research@meristemng.com

Corporate websites: www.meristemng.com www.meristemwealth.com www.meristemregistrars.com

Meristem Research can also be accessed on the following platforms:
Meristem Research portal: meristem.com.ng/rhub
Bloomberg: MERI <GO>
Capital IQ: www.capitaliq.com
ISI Emerging Markets: www.securities.com/ch.html?pc=NG
Reuters: www.thomsonreuters.com
FactSet: www.factset.com