Ahead of MPC

Committee Set to Hold its Fifth Meeting in 2021

…Key Parameters to remain unchanged

The Monetary Policy Committee (**MPC**) is scheduled to hold its fifth meeting of the year on the 16th and 17th of September 2021. An appraisal of key developments in the global and domestic environment is expected to feature in the Committee's considerations and ultimately feed into its decision.

A key consideration should be the economic rebound witnessed in advanced economies (like the Eurozone and the U.S) and the implication of the Fed's deliberation to ease its Asset Purchase Program gradually. We also expect the Committee to take note of the rising inflation on the global scene and the role of rising energy prices. High energy demand, rollback of production cuts by OPEC+ and recently, Hurricane Ida in Louisiana have all contributed to the uptick in oil prices. In the domestic scene, however, the oil sector has remained subdued due to lower oil production volumes when compared to the corresponding period in 2020.

Nonetheless, the general economic recovery witnessed so far should be a major discussion point and a key consideration for the Committee while noting the downside risk posed by the Delta variant to the country's economic outlook. On the other hand, we posit that the disinflation recorded since April should quell fears of mounting inflationary pressure and thus give the Committee more room to allow the existing policy to permeate the economy.

Thus, we expect the Committee to keep all policy parameters unchanged.

International Economies and Developments

Economic Recovery at a Cost

Some economies continue to recover from the impact of COVID-19, especially as vaccination effort gains traction. GDP in some advanced economies like the US and EU advanced by 12.26%YoY and 1.9%YoY respectively in Q2:2021. This could be attributed to the broad-based economic recovery supported by accommodative monetary policies and fiscal stimulus packages. However, the rise in COVID-19 cases globally continues to threaten a continued economic growth. In China, new lockdown measures adopted in July and mid-August impacted both manufacturing and service PMI, which declined to 49.2pts and 46.7pts, respectively in August (vs. 50.3pts and 54.9pts respectively recorded in July). The manufacturing PMI is the lowest figure recorded since April 2020.

Rising prices of goods and services have also been a major point of discussion. In the US and Eurozone, inflation figures have shot past the 2% target (US- 5.3%, Eurozone- 3.0%)

set by monetary authorities. Also, energy prices (especially electricity) have peaked in the past months owing to higher commodity prices. In the Eurozone, electricity prices were up by 15.4%YoY in August as natural gas prices used in electricity generation reached an all-time high.

Notwithstanding, monetary authorities have tagged these factors as transitory and are looking to taper down on asset purchase program as a better approach to moderating inflation as against raising the interest rate. In the meeting held by the European Central Bank (ECB) last week, the committee agreed to maintain interest rate at 0% to 0.25% but opted for a slower pace of net asset purchases under the Pandemic Emergency Purchase Program (PEPP) than in the previous two quarters.

Demand-Supply Mismatch Pushes Oil Prices Upward.

While OPEC continues to post an upward revision to its oil demand forecast for 2021, now at 96.68mbpd *(unchanged from last month's revision*), oil supply has been revised downward due to production challenges experienced in the US. In addition, the hurricane incident, which occurred at the tail end of August (*Gulf of Mexico*), impacted the major oil-producing states pushing down oil production in the month. Consequently, this has triggered an increased oil supply deficit, translating to the rally in oil prices in the market.

Though this comes as great news for oil-producing countries, it has sparked global energy prices. However, OPEC+, in their meeting held in August, signaled it would ease production cut, thus supporting rising demand. For Nigeria, we expect the oil quota increase and the enactment of the petroleum industry act to pose as an incentive to oil producers, thereby improving the nation's production volume. The combined effect of increased production and higher oil prices bodes well for FX accretion, thus, neutralizing any potential impact of a likely exchange rate hike.

While the industry praises the final passing of the Petroleum Industry Bill (now Act) by the President after a two-decade wait, from a welfare perspective, we note the provision that states a likely deregulation of the downstream sector which can potentially raise PMS pump prices for consumers. We expect this to be a consideration for the committee.

Domestic Macros

Domestic Economy Sustains Growth Trajectory

Domestic output has continued to improve since the economy recovered from the COVID-19 induced recession in Q4:2020 (+0.11%YoY). The latest GDP report reveals an expansion of 5.10%YoY in Q2:2021 output, representing the third consecutive quarter of positive growth. We beam the spotlight on the non-oil sector, which recovered to pre-pandemic levels with an expansion of 6.74%YoY in the period. The recovery was led by continued growth in the Information & Communication (+5.50%YoY), Agriculture (+1.30%YoY), Manufacturing (+3.49%YoY), and Real Estate (+3.85%YoY) sectors. While these reflected the broad-based economic recovery, it also reflects in part the growth effects of targeted interventions (especially to the agriculture and manufacturing sectors). We also note that the Trade sector expanded by 22.59%YoY in Q2:2021 – the first positive growth since Q2:2019. This could be attributed to the reopened land borders and the improved business operating environment in the period. Although manufacturing activities have improved moderately, as signaled by a better PMI reading in July (46.60pts vs. June – 45.50pts), the spate of new COVID-19 cases, occasioned by the emergence of the delta variant stands as a downside risk.

The oil sector remains subdued by lower oil production in Q2:2021 (1.61mbpd), compared to 1.81mbpd in Q2:2020. However, the recent decision by OPEC+ to increase oil production by 400,000 bpd every month from August 2021 should translate to a higher oil production quota for Nigeria over the rest of the year. Based on this, we hold a positive outlook for the oil sector in Q3:2021.

While we acknowledge that the improvement in economic growth would be a key consideration for the committee, our expectation is that the committee would maintain the status quo, favoring its pro-growth stance.

Inflation Continues to Trend Downward

The National Bureau of Statistics reported an increase of 17.01%YoY in consumer prices for August 2021 (vs. 17.38%YoY in July 2021), marking the fifth consecutive instance of slower growth in the headline inflation rate. The moderation was a result of a deceleration in both the food and core index for the month. Although the country's food-producing regions remain plagued by security challenges, the slower growth in food inflation (August – 20.30%YoY from July – 21.03%YoY) is mainly attributable to a high 2020 base and the positive effect of post-harvest supplies.

Core inflation also increased at a slower pace (13.41%YoY in August vs. 13.72%YoY in July), driven by the increase in prices of footwear, household textile, and motor cars. We note that the I&E exchange rate and PMS price have remained largely unchanged since the Committee last met, contributing to the moderation in core inflation in August.

The decelerating inflation rate will be a major consideration for the Committee. In our opinion, this should buy more time for the Committee to allow the existing policy to permeate the economy.

Fiscal Policy

Since the Monetary Policy Committee (**MPC**) last met in July 2021, some developments have occurred. The Petroleum Industry Act (PIA) was officially signed into law by the President on August 16th, 2021. While this move has been applauded considering its benefits to the oil and gas sector, it has also been critiqued on timeliness and provision for host communities.

Recently, the tax war which ensued between some states and the Federal Government has been a major highlight of the quarter. A few states are seeking to be in charge of VAT collections in their states. We, however, note the potential inefficiencies and complexities that may arise as a result.

Nonetheless, there have been heightened concerns surrounding fiscal spending. The fiscal deficit position remains elevated, with a deficit of NGN3.96trn in June 2021 (vs. NGN3.20trn in April 2021). Regardless, the President is proposing an additional external loan of USD4.05bn and EUR710mn. This was presented to the National Assembly for approval on August 24th, 2021. The borrowing plan, which is expected to be financed through sovereign loans from the World Bank, and other sources, is to fund federal and state governments' projects. This is in addition to the forthcoming Eurobond issue to raise an additional borrowing of NGN2.34trn to partly finance the government's deficit. As of last month, the FG already selected its international bookrunners to facilitate this move. Its main aim is to moderate debt servicing costs by accessing relatively cheaper funds abroad as global rates look attractive. **In its upcoming meeting, we expect the Committee to consider the recent developments in the fiscal space and the country's debt sustainability.**

Politics and Insecurity

Since the last MPC meeting, there have been several reports concerning banditry in the North-West, Farmers and Herder clashes in the North-Central, and kidnapping and vandalism in the South-East. Notable cases include the recent abduction of persons from the College of Agriculture and Animal Science, Bakura, and from the Government Day Secondary School, Kaya, Zamfara state. The unabating incidence of insecurity in Zamfara state prompted the Nigerian Communication Commission to order the shutdown of telecommunication services in the state to inhibit information leakage to bandits. The shutdown was effective on September 3rd and is expected to span a period of two weeks. **The ugly events have continued to strain the food supply chain, thereby resulting in inflated food prices. We expect the Committee to note the most recent incidences of insecurity (especially in the country's food belt) and its dire consequence on inflation.**

Monetary Policy

Uptrend in External Reserve as Exchange Rate Remain Relatively Stable

An improvement in crude oil export in H1:2021 coupled with relatively higher Brent Crude prices (above USD70pb) supported the nation's external reserves. As a result, increased accretion propped the reserves from USD33.40bn in July to USD35.11bn on September 13th, 2021. As a positive, the Special Drawing Rights (SDR) inflow of NGN3.3bn from the IMF helped shore up the foreign reserves. Coupled with the scheduled Eurobond Issuance of USD6.2bn in October, these factors posit stability in the foreign reserves in the near term. However, the demand for oil globally and the direction of oil prices depend considerably on the prevalence of the Coronavirus outbreak. By implication, the imposition of lockdowns and social restrictions would pressure oil demand downwards, to the disadvantage of oil-revenue-dependent nations.

Since the last meeting, the exchange rate has hovered between NGN411.45/USD and NGN412/USD in the I&E FX Window. However, following the CBN's suspension of the sale of FX to BDC operators in July, rates in the parallel market have maintained a northward posture- up to NGN549/USD on September 13th from NGN505/USD on July 27th, 2021.

The CBN's effort is geared towards curbing the BDC operators' malpractices and ensuring the Naira's stability in the FX market. However, we are of the view that the nexus between the policy and near-term exchange rate stability is rather weak given the play-out in recent times. Hence, we project a continued weakening of the Naira in the near term.

Fixed Income Environment and Outlook

Buying pressure has continued to dominate the secondary market for fixed income instruments, resulting in lower yields. Thus, average T-Bills and FGN Bond yields declined to 4.90% and 10.46%, respectively, as of 13th September 2021, from 5.76% and 11.38% as of 27th July 2021.

At the most recent primary market auction (PMA) for T-Bills, stop rates on the 91days and 182days remained constant at 2.50% and 3.50%, respectively. However, the rate on the 364days instrument, which continues to attract the highest investor patronage, reversed its downtrend, rising to 7.20% (vs. 6.80% in the penultimate auction). This came on the heels of an increase in investors' bid range. Similarly, concerns for elevated debt service to revenue ratio continue to contribute to the downward pressure on yield in the primary market for FGN Bonds. Consequently, the average yield declined to 10.39% (at the PMA held in August) from 12.92% at the auction held in July.

With respect to the fixed income market, we expect two counteracting factors to influence the Committee's decision: the borrowing need of the Federal Government to finance the 2021 budget towards economic expansion and the need to lower the burden of debt service on the Federal Government. Striking a balance between these factors means that it is more likely for the Committee to maintain the status quo on the policy rate than to alter the MPR in either direction.

Meanwhile, a few private corporate entities – including United Capital Plc and Coronation Merchant Bank Ltd - tapped into the money market with new commercial paper issuances since the last MPC meeting. On the other hand, there was no new corporate bond issuance within the period.

Equities Market Performance and Outlook

The Nigerian equities market has continued to witness mixed sentiments since the last MPC meeting. The broad market index gained 1.74% in August, and the Year-to-Date losses have moderated to -3.35% as of 13th of September 2021 (vs. -3.67% as of 27th of July). The release of H1:2021 financial results had negligible impacts on the index's performance, as the market continued to trade sideways despite announcements of interim dividends and impressive financial results by most companies.

The bourse witnessed a decline in total value traded to NGN357.89bn in Q2:2021 (vs. NGN676.53bn in Q1:2021 and NGN831.95bn in Q4:2020) – a reflection of the dampening investors' confidence. In a similar vein, foreign participation made up a paltry 17.30% of the total value traded on the exchange (vs. 23.24% in the previous month and 33.51% in July 2020). In absolute terms, this represents a decline of NGN31.99bn from NGN47.52bn in January.

On a sectoral basis, the Oil and Gas Index currently leads the gainers' chart, returning 62.99% year-to-date on the back of buying interest on **SEPLAT** (+88.84% YtD) and **TOTAL** (+53.23% YtD). On the flip side, the **NGXBNK** index has shed 4.93% YtD following selloffs on **GTCO** (-16.23% YtD) and **STANBIC** (-11.69% YtD).

Relative to its African peers, Nigerian equities YtD return (-3.35%) continues to trail behind other markets in the region – Ghana: 44.89% YtD, Egypt: 2.72% YtD, Kenya: 18.53% YtD and South Africa: 8.80% YtD. Also, the Nigerian equities market appears undervalued with a PE of 10.41x- a significant discount to its regional market peers: average PE of 12.38x.

For the near term, we expect activities in the market to remain muted, barring any significant corporate actions or economic development.

On a Balance of Factors…

Ultimately, we expect the Committee to:

- **Retain the MPR at its current level of 11.50%**
- **Retain liquidity ratio at 30%**
- **Retain the asymmetric corridor at +100bps/-700bps**
- **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)
issaconaolapo@meristemng.com	(+234 803 2348 275)
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

IMPORTANT INFORMATION: DISCLAIMER

Meristem Securities Limited (''Meristem'') equity reports and its attendant recommendations are prepared based on publicly available information and are meant for general information purposes only and it may not be reproduced or distributed to any other person. All reasonable care has been taken to ensure that the information contained herein is not misleading or untrue at the time of publication; **Meristem** can neither guarantee its accuracy nor completeness as they are an expression of our analysts' views and opinions.

Meristem and any of its associated or subsidiary companies or the employees thereof cannot be held responsible for any loss suffered by relying on the said information as this information as earlier stated, is based on publicly available information, analysts' estimates and opinions and is meant for general information purposes and should not be construed as an offer to buy or sell or a solicitation of an offer to buy or sell securities or any financial instruments. The value of any investment is subject to fluctuations, i.e. may fall and rise. Past performance is no guide to the future. The rate of exchange between currencies may cause the value of investment to increase or diminish. Hence investors may not get back the full value of their original investment. Meristem Securities is registered with the Securities and Exchange (SEC) and is also a member of The Nigerian Stock Exchange (The NSE). Meristem Securities' registered office is at 124 Norman Williams Street, Southwest, Ikoyi, Lagos, Nigeria. Website: www.meristemng.com; Email: research@meristemng.com.