MERISTEM

Macroeconomic Update

MPC Monitor | November 2021

MPC Retains Policy Parameters at Current Levels

The Monetary Policy Committee (MPC) held its last meeting of the year on the 22nd and 23rd of November 2021 where it unanimously voted to hold all parameters constant.

In reaching its decision, the Committee acknowledged being faced with a policy dilemma. However, it maintained that its existing accommodative stance in the past has supported economic growth – *GDP grew by 4.03%YoY vs 5.01%YoY in Q2:2021*. Headline inflation also moderated further (to 15.99% vs 16.63% in September). While the Committee noted that the sustained interventions by the Apex bank should propel growth in the short to medium term, it recognizes the presence of key downside risks to growth – *especially insecurity in key food producing areas and its effect on agriculture output.*

Given that the inflation rate has moderated for seven consecutive months, the Committee expressed optimism that food inflation should drop significantly following a successful harvest in September/October. It therefore expects its decision to support an environment for sustained economic growth.

While a combination of post-harvest supply and the high 2020 base is expected to sustain disinflation in the short-term, positive real rate of return on fixed income instruments is not yet in sight given the current nominal rate environment.

Committee's Considerations

The Committee applauded the sustained support of the CBN through various intervention programs, which has contributed to the improved output growth witnessed so far in 2021. The Committee also hinted at new CBN intervention programs to support sustainable economic development and accelerate structural transformation. One of such programs the 100 for 100 production policy and productivity (PPP) geared towards the support of private sector companies to improve non-oil export and foreign exchange availability. However, it highlighted the continued security challenges in major food-producing areas as a critical downside risk to the nation's recovery.

The Committee noted the gradual diversification of the economy with the increased contribution of the non-oil sector to government revenue and called for more support to increase non-oil export as a potential source of foreign exchange to the economy. In addition, the Committee noted the impact of the poor infrastructure on rising domestic price levels, urging the Federal Government to prioritize investment in public utilities to improve the business environment.

In appraising the equities market, the MPC highlighted the continued investors' confidence in the Nigerian economy and urged the monetary and fiscal authorities to build on this sustained confidence to attract more foreign direct investment into Nigeria. It also noted the resilience of the banking sector amidst the severe shock to both the domestic and global economy. The Committee commended the bank's management for maintaining overall stability in the banking system. Also, it advised the bank to continue pushing for increased intermediation as the way forward to reduce unemployment, enhance production and improve aggregate demand to strengthen the economic recovery.

Furthermore, the Committee expressed confidence in the ongoing policies of both the fiscal and monetary and called on both authorities to look beyond the current economic position and plan towards achieving sustainable investment flow into Nigeria.

Key Decisions

- Retain the MPR at 11.50%
- Retain CRR at 27.50%
- Retain liquidity ratio at 30.00%
- Retain the asymmetric corridor at +100bps/-700bps around the MPR

Anticipated Impacts

The Banking Sector: MPC's Decision to Keep Net Interest Margin Stable

Between August and October 2021, Credit to the Private Sector increased by 3.19%. Within the same period, prime lending rate remained stable at 11.61% while the maximum lending rate declined by 90bps to 27.1%. Cumulatively, the average lending rate reduced to 19.36% in October from 19.81% in August. While we note the continuous tilt towards low-cost funding in the banking sector, we are mindful of the lingering tight system liquidity position which could marginally affect the smaller players within the sector. Summarily, we expect Net Interest Margin to remain stable given the potentially lower asset yield as the Committee maintains status quo.

Non-Performing Loan (NPL) ratio continued its downtrend, slowing to 5.29% in October 2021 (vs. 5.40% in August 2021). This renders support for further credit creation amidst economic expansion. Also, we maintain our position that there is more scope for non-funded income to sustain its uptrend given the expected increase in both credit- and non-credit related banking activities on digital channels.

The Real Sector: Policy Interventions to Improve Real Economy

GDP figures from the National Bureau of Statistics revealed that the economy expanded by 4.03%YoY in Q3:2021, (vs. 5.01%YoY in Q2:2021) marking the fourth quarter of expansion since recovery from the recession in Q4:2020. This growth was driven by the expansion in the non-oil sector (+5.44%YoY), as the agricultural (+1.22%), manufacturing (4.29%) and ICT (9.66%) sectors all expanded considerably. We view the continued targeted credit interventions by the CBN (to the agricultural, healthcare, manufacturing, and energy sector(s), amongst others) as a major catalyst of growth for the real economy.

We note the improvement in Purchasing Managers' Index (PMI) which rose to 47.3pts in October (from 46.6pts in September). Although still considerably below the 50pts benchmark, the improvement in the PMI supports the growth witnessed in manufacturing GDP and signals the positive impact of the continued support from fiscal and monetary authorities to the economy.

From the decisions reached at the MPC meeting, we clearly see that the Committee is satisfied with the continued moderation in headline inflation (15.99% in October vs. 16.63% in September). We expect the continuous interventions and extension of credit facility to the real sector to continue supporting growth. The incessant cases of insecurity, especially in the food producing regions of the country, however, pose a significant downside risk to this growth expectation.

The Fixed Income Market: Yields to Hover Around Current Levels

The fixed income market has continued to witness a downward trend in yields since the last MPC meeting. Stop rates at the primary market auction (PMA) for treasury bills have remained mostly flat at 2.50% and 3.50% on the short and medium end of the curve. Despite the Federal Government's preference for the long-term instrument, rates on the long end of the curve have however declined from 7.20% to 6.50%. Similarly, Average T-Bills and FGN Bond yields have declined to 4.62% and 10.71% as of 22nd November 2021 (from 5.13% and 10.73%, as at the last MPC meeting), respectively. We note that the decline in yields is mainly due to the FGN's increased appetite for external loans. Moreso, the FGN has raised more than its target for domestic debt to fund its budget deficit for 2021FY and is thus not under pressure to increase its domestic debt for the rest of the year.

Going forward, we do not envisage any significant movement in yields in the near term as inflation expectations point to further moderation. Thus, the MPC's decision is not expected to alter the course of the fixed income market.

The Equities Market: Profit Taking Activities to Dominate in the Near Term

Since the last MPC meeting, the mood in the Nigerian equities market has been largely positive, closing up 7 out of 8 weeks. There has been an improvement (*+11.18%*) in the All share Index, moving up to 43,255.14 on 23rd of November 2021 (from 38,906.87 as at the last MPC meeting). Similarly, the market PE inched higher to 10.60x, putting it ahead of peer average (9.65x) with performance attributed to intense buying interest which dominated the market in the period. We also note the improvement in activity level in the market as total value of transactions in October reached NGN213.07bn (the highest in seven months). In addition, the level of foreign participation in the market increased to NGN42.42bn in October (vs. monthly average of NGN32.96bn).

We however do not expect the Committee's decision to have any substantial impact on the market bearing, as we expect profit taking activities to dominate the market in the near term. This is in view of the present price levels.

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