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Macroeconomic Update | Monetary Policy Committee Report

MPC Guidance | Q2:2022

MPC's Upcoming Meeting

We Expect Key Parameters to Remain Unchanged

In the first quarter of the year, the Monetary Policy Committee held two meetings (24th-25th of January and 21st-22nd of March 2022), where it voted to keep all policy parameters unchanged. The Committee's decision to retain rates highlights its commitment to sustain economic growth amidst heightened inflationary pressures.

The Monetary Policy Committee is scheduled to meet again in the second quarter of the year (23rd-24th of May 2022). We expect the rising inflationary pressures on the global scene, the impact of the Russian-Ukraine crisis on global output, Nigeria's sustained economic growth, spiraling inflation in the domestic space as well as developments in the financial markets to feature in the Committee's discourse.

On the global front, heightened inflationary pressures across the globe further exacerbated by the geopolitical tensions between Russia and Ukraine has triggered the decision to hike key policy rates in most economies, such as the US and UK. The Committee considers the risk of capital flight from Nigeria minimal. As such, we do not expect the rate hike in advanced economies to weigh in on the Committee's decision.

On the domestic scene, inflation has persistently trended upwards, with the pressure points being imported and food inflation components. Consequently, real rate of returns remain depressed.

In our opinion, after carefully considering the aforementioned, we expect the Committee to keep policy parameters unchanged.

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International Economies and Developments:

Rising Inflation: A Major Concern for Monetary Authorities

The International Monetary Fund, in its recent world economic outlook downgraded its growth forecast to 3.60% for both 2022 and 2023 (from 4.40% and 3.80% respectively in its January 2022 forecast). This projection was an offshoot of the ongoing tension between Russia and Ukraine as well as the sanctions placed on Russia. Following the downgrade, the Bureau of Economic Analysis reported that the U.S economy contracted by 1.40% YoY in Q1: 2022, (from 6.90% in Q4: 2021). This decline in output was due to reduced inventory, huge trade deficit and declined defense spending, fueling concerns about a future recession in the country.

The ongoing political tensions have also resulted in a significant spike in the prices of commodities such as food, metals, and energy, resulting in higher inflation rate across the global economy. Inflation in the Euro zone rose to 7.5% in April (from 7.4% in March), representing the sixth consecutive month of record high inflation in the region. Similarly, inflation in the United States came in at 8.30% in April 2022, (from 7.50% in January).

In response, global monetary authorities have opted to tighten their key policy rates. Notably, the Bank of England has raised its monetary policy rate four consecutive times - currently, at 1.00% following the last meeting held in May. Similarly, the US Fed has also hiked its interest rate twice this year - with the latest hike being the highest rate increase since 2000. The target range for its federal funds rate was increased by 50bps to 0.75%-1.00% (from 0.25%-0,50%) This is also in addition to the Bank's decision to continue reducing asset holdings on its balance sheet and roll back its asset purchase programme .

The European central bank has also towed the line of asset purchase reduction to EUR20bn, however opting to keep its monetary policy rate at current levels. Nevertheless, we believe a rate hike is imminent especially if prices continues to spiral after the Bank ends its asset purchase program in the third quarter of the year.

For emerging economies, the case was dissimilar across board. China recorded an increase in headline inflation for the first time since November 2021 (to 1.49% from 0.90% in January), though still below the target band of 3.00%. Hence, the People's Bank of China (PBOC) has kept its interest rate unchanged to ease the economic pressures borne by the surging COVID-19 cases.

On the other hand, Russia's inflation rate climbed to 17.60% in April 2022 from 8.50% at the start of the year. Its ongoing war which ushered in economic sanctions have significantly impacted its monetary environment. Consequently, the central bank of Russia raised rate to 20.00% to attract capital inflow. However, this was later reduced to 14.00% in April.

Generally, there has been a mismatch between demand and supply in the global economy. Hence, given Nigeria's high exposure to these economies in terms of import and foreign investment inflows, this would be a key consideration for the monetary policy authorities in the coming meeting.

Sub-Saharan Africa:

A Patchy Road for Sub-Saharan Africa as Inflation Engulfs the Region

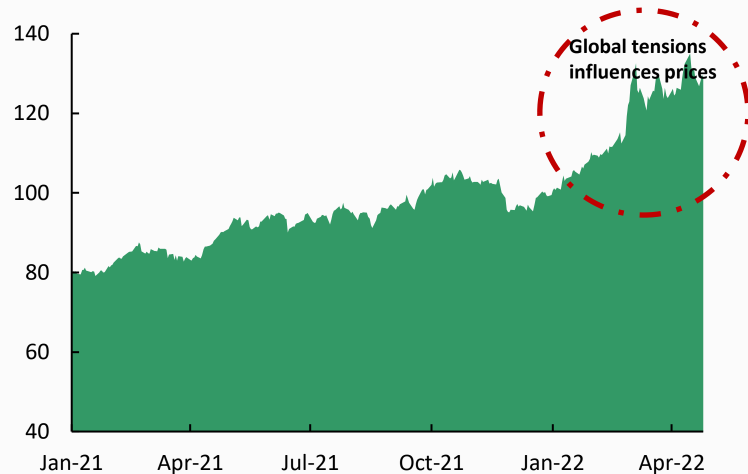
Majority of economies in the Sub-Saharan African (SSA) region have been on the path of economic recovery following the pandemic-induced recession that the region suffered in 2020. According to the International Monetary Fund (IMF), the SSA region recorded a GDP growth rate of 4.50%YoY in 2021 (vs. -1.70%YoY in 2020), largely influenced by the acceleration in vaccine development and distribution compared to 2020, higher export commodities prices, slower spread of the virus and recovery in global trade. However, the Russian-Ukraine conflict jeopardized the growth momentum as this has further widened the demand-supply mismatch. Due to Russia and Ukraine's position as major exporters of commodities consumed by SSA countries (like energy, wheat, fertilizers etc.), the tensions have led to a significant increase in the prices of these commodities and have also increased the volatility in the financial market for these SSA economies.

Commodity exporters such as Angola (crude oil), and Ghana (gold and diamonds), stand to benefit from the increase in commodity prices. Therefore, hinged on its brighter prospect for commodity exporters, the IMF- in its World Economic Outlook for April, revised its growth forecast for the region up to 3.8% (from 3.7% forecasted in January 2022). However, ongoing political instability, low oil production levels, reduced demand from key trading partners, food security concerns, rising inflationary pressures, and import dependency on Russia, Europe, and Ukraine remain the major downsides to the growth projection for the region.

Although there have been inflationary pressures in the region prior to the political tension in Russia and Ukraine, the war has further exacerbated its effect. The IMF projects that the inflation rate in 2022 will remain elevated at 12.20% (vs 11.00% in 2021) due to higher food and energy prices globally.

An assessment of the region's largest economies reveals that the effect has been mixed across several countries. Countries with heavy reliance on food and energy imports – like Ghana, Nigeria, and Egypt – have faced a significant uptick in prices as well as exchange rate depreciation.

Chart 1: Trend of Global Commodity Prices (using Bloomberg Commodity Index)



Source: Bloomberg, Meristem Research

The Egyptian Pounds was devalued in April by (-17.00%), further increasing the price of import commodities as its inflation rate ticked up to 10.50% in March (from 7.30% in January 2022). Ghana also recorded a significant rise in inflation in March 2022 (19.40%) from 13.90% in January 2022, with the rise in prices of food, non-alcoholic beverages, and transport being the key drivers. South Africa and Rwanda also witnessed similar upticks as their inflation rates averaged 5.77% and 5.87% in Q1:2022 (from 5.47% and 1.17% in Q4:2021).

Countries like Angola and Mozambique, however, reported a sustained disinflation with inflation at 27.00% and 6.67% in March 2022 (from 27.66% and 6.84%, respectively reported in January 2022). This is due to the Angola Government's suspension of some import tariffs, which positively impacted import prices, while Mozambique's disinflation is a result of the 2021 hike in the Interbank Money Market Rate.

Sub-Saharan Africa:

Tightening the Policy Screws

In response to the rising inflation figures, some SSA monetary authorities have opted to adopt a more hawkish tone. The Bank of Ghana increased its primary lending rate by 250bps to 17.00% in March 2022 (from 14.50%), marking the highest rate hike in the country since November 2018. It also banned the use of USD to make payments for goods and services in the country in a bid to reduce demand for dollars and alleviate pressure on Ghanaian Cedis. Likewise, South African Reserve Bank (SARB) increased its benchmark repurchase rates by 25bps for the third consecutive time to 4.25% due to the increasing impact of the Russia-Ukraine conflict. Elsewhere, Egypt raised its overnight deposit rate, overnight lending rate, and the monetary policy rate by 100 bps across board to 9.25%, 10.25%, and 9.75%, respectively, in March 2022.

Fiscal authorities in the region are also faced with an increasingly challenging and complex policy environment. Challenges such as development expenditure needs, and difficulty with improving its tax revenues, have significantly impacted fiscal balance. Countries in the region (like Ghana, Kenya, and Rwanda) are also faced with a sustained negative outlook on debt due to increasing debt stock and a high-interest burden on Government revenue.

For context, South Africa's debt to GDP is expected to still remain high at 69.50% for the 2022 fiscal year vs. 70.70% in 2021. The high-interest burden in the region is also set to increase due to the rise in Eurobond yields.

We expect inflation in the SSA region to continue its uptrend, given its exposure to price fluctuations in the global economy. However, we envisage that the various aforementioned policy actions would curtail the impact to a certain extent. Furthermore, we expect the hawkish tone to spread across other SSA economies (Nigeria inclusive) later in the year, to reduce inflationary pressures. The shift to a tighter policy stance by the US Fed would also necessitate rate hikes in the region as authorities scramble to avoid significant capital repatriation in 2022.

Domestic Macros:

Policy Stance Supports Economic Growth

While Growth Outlook is Positive…

To support the domestic economy, the Monetary Policy Committee (MPC) has maintained the Monetary Policy Rate (MPR) at 11.50% since September 2020. This, in addition to other policy supports, has proven helpful in sustaining the Nigerian economy. According to the Q4:2021 GDP report released by the National Bureau of Statistics (NBS); the economy has fully recovered from the effect of the pandemic. According to the report, Nigeria's real Gross Domestic Product (GDP) stood at NGN72.40trn representing a 3.40% YoY growth. The non-oil sector remained the major growth catalysts as the trade, information and communication sector (ICT), manufacturing and agricultural sectors expanded by 8.62%, 6.55%, 3.35% and 2.13%, respectively. Despite oil prices being supportive for the larger part of 2021 the gains were lost on oil GDP due to production losses. Output in the sector contracted by 8.30%YoY in 2021 (vs. -8.89% YoY in 2020).

The IMF revised its 2022 growth forecast for Nigeria upwards to 3.40% from 2.70%, citing the increased crude oil prices a positive for growth in the country. We however view the continued inability to meet up with OPEC+ production quota as a significant deterrent to economic growth. However, the Purchasing Managers' Index for March 2022 suggests that output in the manufacturing sector remains strong (at 54.10pts, albeit lower than 57.30pts in February).

With the monetary policy pro-growth stance complemented by fiscal measures, Nigeria's growth outlook remains positive. The crisis in Eastern Europe should lead to higher demand for Nigeria's crude oil. However, production challenges could hamper the ability to reap the full benefits.

…Inflation is Still on the Rise

As the Nigeria economy sustains its growth momentum, the country's double-digit inflation figure has remained worrisome. In Q1:2022, inflation rate averaged 15.74% (as against 17.32% in Q1:2021). The pain points remain rising food inflation (17.20% vs. 17.13% in January 2022) due to a general increase in the prices of imported food items like wheat. Insecurity in the country (especially in the northern region) has also impacted farming and logistics activities.

In Q1:2022, prices of gas, liquid fuels and lubricants for personal transport increased significantly due to the ongoing geopolitical tensions. The withdrawal of adulterated fuel in February, also resulted in a country-wide fuel scarcity, further exerting pressure on prices. Hence, Core inflation in the period ticked up to 13.91% (vs 12.67% in Q1:2021),

In our opinion, the MPC would be more drawn to favour its pro-growth stance over price stability in the quarter. However, we do not rule out the possibility of a rate hie in the near future as the economic growth becomes more stable.

Fiscal Policy Actions

In April, The Revenue Mobilization Allocation and Fiscal Allocation Committee (RMAFC) recommended a change in the FAAC revenue sharing agreement to 49.35% for Federal Government, 29.79% for State Government, 21.04% for the Local Governments (previously 52.68%, 26.72%, and 20.60% respectively). This move is expected to strengthen fiscal federalism and support revenue source for sub-national governments. Furthermore, the Federal Ministry of Finance announced that a sum of USD1.50bn had been disbursed to 24 State Governments under the State Fiscal Transparency, Accountability and Sustainability (SFTAS) programme-for-results scheme. The scheme is a World Bank-assisted programme aimed at strengthening fiscal transparency, domestic revenue mobilization, , debt transparency and sustainability. **We envisage that these policy initiatives to increase revenue generating abilities for the state and local governments. We expect the MPC to also factor in these developments and the impact on inflation when considering policy actions.**

Domestic Macros:

Political and Security Landscape

Nigeria's political landscape has been gradually heating up following announcements by several political aspirants ahead of the 2023 general elections. With the steadily rising chatters on the political front, the pervasive insecurity risks in the country remains heightened. In addition to the violent clashes between nomadic herdsmen and crop farmers in the South, reports of banditry, incessant kidnappings and terrorism continue to plague the security landscape. In the same breath, the national electricity grid has collapsed three times so far this year – mainly attributable to vandalism.

In Q2:2022, we expect the rising food prices to be a key consideration for the monetary committee given the persistent farmer-herder clashes across the country's agricultural belt. We also expect the committee to consider the need to bolster capital inflows thereby easing the imported component of headline inflation.

Monetary Policy: External Reserves and FX

Following the current geopolitical tension between Russia and Ukraine, oil prices have been trending upward since the tail end of February, peaking at USD127.98pb in March 2022. Nigeria’s low production volumes have however made it difficult to benefit from the oil price rally.

As a result, the movement in Nigeria's FX reserve has largely been unstable (despite the issuance of USD1.25bn Eurobond). As of May 9th, 2022, the external reserve balance stood at USD39.17bn, resulting in a year-to-date return of -3.34%. In a bid to boost the external reserve and strengthen the exchange rate, the CBN has introduced several initiatives. One of such initiatives include extending the "Naira-for-Dollar scheme" indefinitely. The CBN asserts that the initiative has contributed significantly to lifting the country's remittance from an average of USD6.00mn weekly to c. USD100.00mn weekly as of February 2022.

The CBN also launched the RT200 foreign exchange programme, which aims to increase foreign exchange inflow to USD200bn over the next 3-5 years, mainly from non-oil export earnings. The scheme offers a rebate of NGN65.00 to exporters for every USD1.00 remitted at the I&E foreign exchange window.

While the policy's impact is yet to be ascertained, it is hoped that the CBN will be able to achieve its goal of increasing remittances to the country via this program and other existing initiatives. In light of this, we expect a marginal improvement in the FX reserve, coupled with the expectation of the Federal Government to tap into the Eurobond market again during the year.

Monetary Policy: Money Supply

A bond maturity of NGN605.31bn, coupon payments, periodic FAAC allocations, and maturities of other short-term treasury instruments gave money supply a significant boost in Q1:2022. As at end of the period, broad Money Supply (M3) increased by 4.19% (compared to December 2021) to NGN45.65trn. Similarly, net domestic credit (to both the Government and the private sector) expanded by 8.59%. Consequently, money market rates reduced; average T-bills and maximum lending rates dropped to 1.75% and 26.61%, from 2.49% and 27.58% in December 2021, respectively.

We believe that money supply should only expand marginally in Q2:2022, given the lower level of expected inflows of funds. Moreover, we expect the CBN to employ its regulatory apparatus in ensuring that money supply does not expand at a rate that exerts further pressure on inflation.

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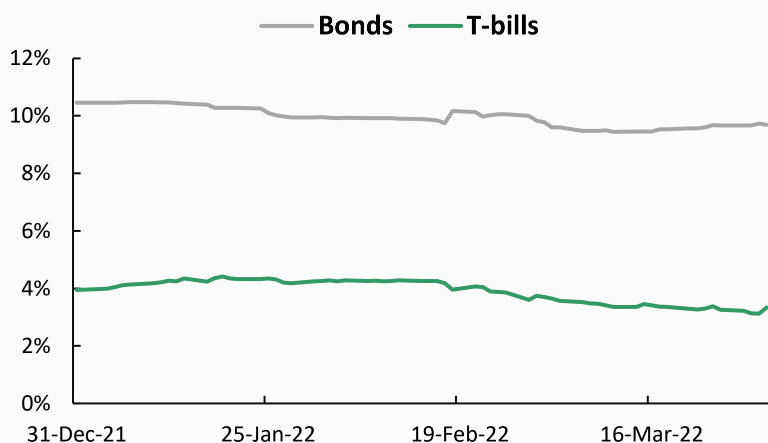
Domestic Fixed Income Market:

Yields Projected to Rise in Q2:2022

In Q1:2022, the mood in the fixed income secondary market was predominantly bullish due to the high level of liquidity in the market. The liquidity was due mainly to OMO maturities c. NGN1.24trn and coupon payments witnessed in the first quarter of the year. Thus, average bond and T-bills yields declined from 10.24% and 3.99% to 9.69% and 3.33% respectively during the period under review.

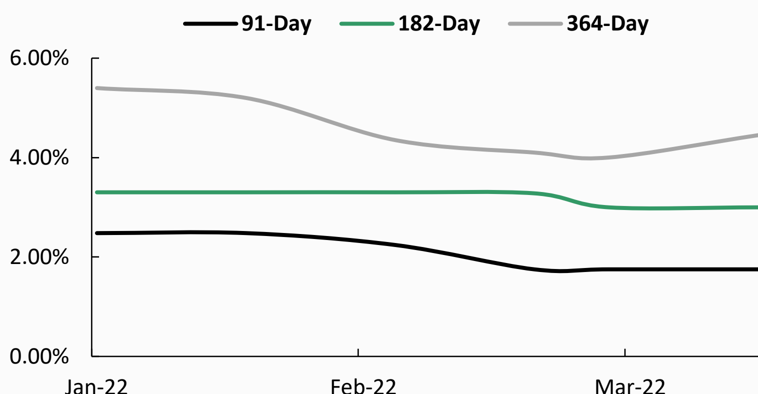
Chart 2: YTD Bonds and T-bills Yield Curve



Source: FMDQ, Meristem Research

At the primary market auctions (bonds and Treasury bills), stop rates declined across board during the period as the Federal Government leveraged on the high system liquidity in the market as well as the CBN financing window to keep stop rates low at primary market auctions.

Chart 3: Treasury Bills Stop Rates



Source: CBN, DMO, Meristem Research

Also, the corporate debt market recorded influx of corporate issuances in Q1:2022 as companies took advantage of the low yield environment. However, we note that towards the end of the quarter, investors began to demand for higher yields from corporate issuers. Case in point was the upward revision of rates on the **MTNN** commercial paper issuance despite its' AAA (GCR) and Aa (Agusto) ratings.

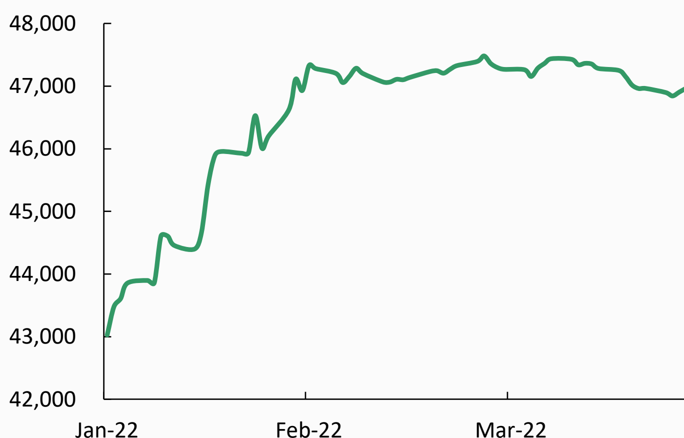
In Q2: 2022, we expect an uptrend in yields given the general expectation of a lower level of system liquidity in Q2:2022 relative to Q1:2022 and the increased amount on offer at the coming auctions in the quarter. However, we note that the Government has already raised c. 47% of total planned domestic borrowing as of Q1:2022. Also, the low level of rate in the global market could incentivize more capital raise in the Eurobonds market (ahead of any significant hike in global monetary policy rates) as indicated by the recent issuance of USD1.25bn. Similarly, the CBN Ways and Means of financing is another factor that can keep rates low in Q2.

Domestic Equities Market:

All-Share Index Records Highest First Quarter Returns in 9 Years

Positive sentiments dominated the local bourse at the start of the year, as the All-Share Index advanced all through the weeks in January. Thus, the All-Share Index settled at 46,624.67 pts by the end of January, implying a Year-to-date return of 9.15%. The mood in the market remained largely bullish throughout the first quarter of the year, driven by price appreciation on heavyweight tickers such as **SEPLAT** (+43.08%), **AIRTELAFRI** (+31.98%), **MTNN** (+8.63%), **DANGCEM** (+6.42%), **BUACEMENT** (+5.52%). Impressive corporate performances and 2021FY dividend declarations further contributed to the positive mood in the market. By the end of the Q1:2022, the Year-to-Date return settled at 9.95%.

Chart 4: NGXASI Trend

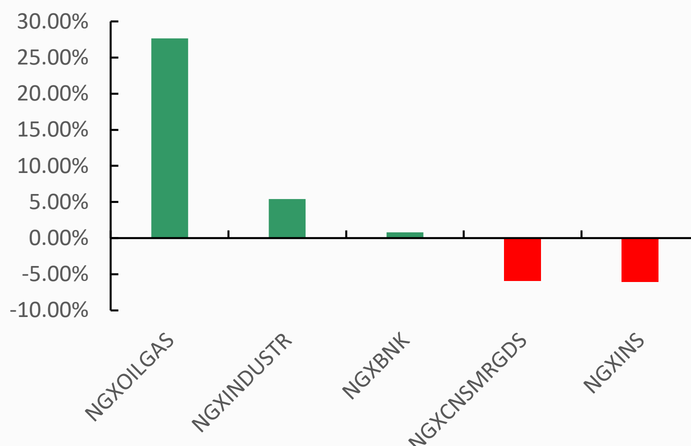


Source: NGXASI, Meristem Research

Corporate actions during the quarter also contributed to the bullish sentiment witnessed in the market. These include the listing of **BUAFOODS**, **DANGCEM**'s share buy-back programme, **SEPLAT**'s proposed acquisition of Mobil Producing Nigeria Unlimited (**MNPU**) and **WEMABANK**'s share reconstruction. The activities in the market remained dominated by domestic investors, who accounted for 79.56% of the total activities in the market during the first quarter of the year.

Keeping up its momentum from last year, the Oil and Gas index (**NGXOILGAS**) was the top-performing sectoral index during the quarter, with a return of 27.66%. The Industrial Goods and Banking indices (**NGXINDUSTR** and **NGXBNK**) also advanced during the quarter by 5.39% and 0.79% respectively. On the flip side, the Insurance and Consumer Goods indices lagged, returning negative 6.03% and 5.96% respectively.

Chart 5: NGXASI Trend



Source: Bloomberg, Meristem Research

With a PE ratio of 10.00x, the Nigerian equities market traded at a premium vis-à-vis many of its African counterparts in Q1:2022 (Ghana: 7.00x, Egypt: 8.40x, Kenya: 8.90x). The PE ratio however remained below the South African equities market (11.30x) and the emerging, frontier and developed equities markets, indicating room for capital appreciation.

We expect the mood in the equities market to remain largely positive in the near term, as decent upside still exists on stocks across sectors. We also expect positive corporate performances, and we note the possibility for other corporate action announcements triggering buying interest on specific tickers.

On a Balance of Factors:

Keep Parameters Unchanged

At the last meeting in March 2022, the MPC retained Monetary Policy Rate at 11.50%, citing the need to consolidate on the output growth and solidify gains achieved so far. The Committee stated that a contraction could be inimical to expansion in output while loosening may exacerbate inflationary and exchange rate pressures.

Thus, we posit that the MPC will maintain rates at the next meeting, as it would not want to mount inflationary pressures by adopting a dovish stance. Also, adopting a hawkish stance would discourage economic growth. However, taking cues from the divided opinions at the last meeting (where 4 members voted for a rate hike by at least 25bps), we envisage that a hike in rates is not off the radar later in the year. Our expectation is also anchored on the bleak prospects for a decline in the inflation rate.

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%**

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