Ahead of MPC

Committee Set to Hold its Sixth Meeting in 2022

Inflation to remain the primary focus: we expect a 50bps hike in MPR

The Monetary Policy Committee (**MPC**) is set to hold its sixth meeting for the year on the 21st and 22nd of November 2022. In reaching a decision, the Committee will in its usual way, consider developments in both the global and domestic economies.

On the global scene, the major issues to be considered by the Committee are: heightened inflationary pressure, sustained hawkish stance of monetary authorities in advanced economies together with the consequent capital flight; rising oil prices as the OPEC+'s supply cut by 2mbpd will keep oil prices elevated in the short to medium term; and supply chain bottlenecks.

On the domestic front, while Q3:2022 GDP report is yet to be released, preliminary indicators indicate a slowdown in economic activities. The Purchasing Managers' Index (PMI) data from the CBN showed two consecutive declines below the 50pts marks to 47.20pts in August 2022. In addition, the continuous upswing in the general price level propelled by the prevailing structural challenges in the economy has kept the real rate of return in the negative territory. Hence, in our view, the Committee will still prioritize reining in inflation in its upcoming meeting.

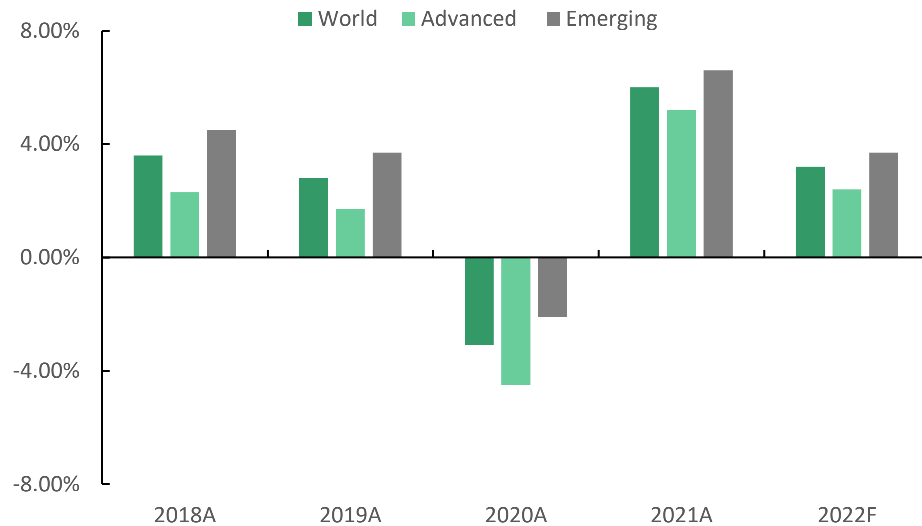
Overall, we expect the Committee to sustain its contractionary stance through a 50bps hike in the Monetary Policy Rate, while keeping other parameters unchanged.

International Economies and Developments

Heightened Geopolitical Tension Holds Economic Growth to Ransom

According to the IMF's October 2022 World Economic Outlook (WEO) report, the estimated global economic growth for 2022 was retained at 3.20%, with more than a third of economies globally likely to experience a recession this year or the following year. The key factors considered by the agency in its projection include Russia's invasion of Ukraine, multidecade high inflation rates, an unrelenting hawkish monetary posture, and the slowdown in economic activities in China. The Russian invasion of Ukraine has triggered substantial adverse effects on the global economy, particularly in Europe, due to the region's high exposure and reliance on Russian oil and gas supplies. However, the UN-brokered deal with Russia, which allows Ukraine to export grains from the black sea, has incessantly moderated commodity prices since the commencement of the operation in August.

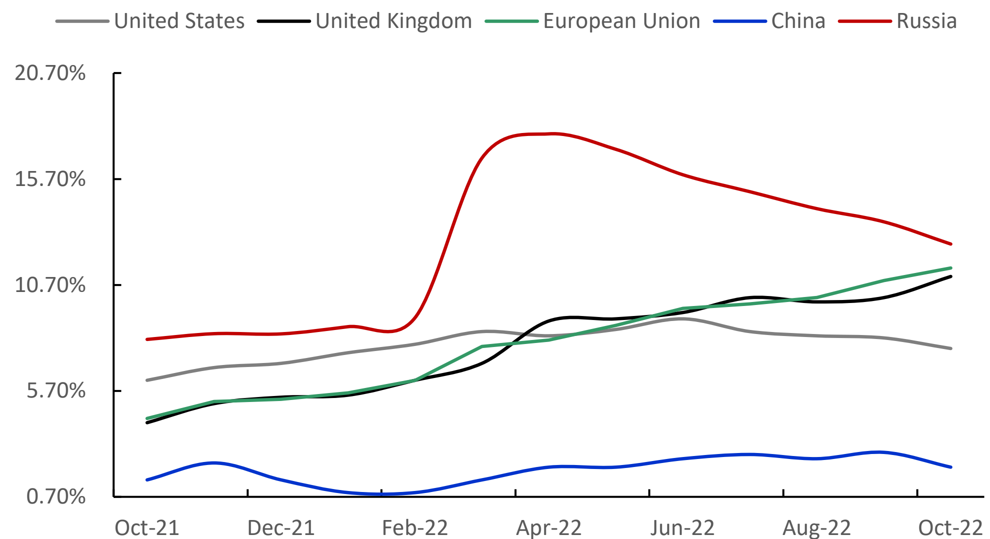
Chart 1: Real GDP Growth Rates of Major Regions



***Source**: International Monetary Fund, Meristem Research*

With the current uncertainties clouding the global macroeconomic environment, inflation in advanced and emerging economies skyrocketed to a record high. For instance, the Eurozone and UK posted inflation rates of 10.60% YoY (the highest in over four decades) and 11.10% YoY in October (vs 9.90% YoY and 10.10% YoY in September), respectively. This decade-high inflation rate prompted most central banks to adopt restrictive monetary policies. As such, some economies now experience disinflation, though inflation rates still stay above their target bands. Notably, the United States recorded its fourth consecutive disinflation in October at 7.70% (vs 8.20% in September), attributable to the successive rate hikes - a cumulative of 375bps so far in 2022 - and the oil release from its strategic reserve.

Chart 2: Inflation Rate of Selected Advanced and Emerging Economies



***Source**: Bloomberg, Meristem Research*

As anticipated, the tighter monetary policy and dwindling consumers' purchasing power have resulted in a slowdown in production and economic activities. Particularly, the Purchasing Manager's Index (PMI) for the United States and China (the two largest economies in the world) declined to 48.20pts and 48.30pts in October (vs 49.50pts and 48.50pts in September, respectively). As such, global recessionary fears have heightened.

In the forthcoming meeting, we expect the Monetary Policy Committee (MPC) to consider the hawkish monetary policies implemented by the advanced economies. As reiterated by the CBN governor in the September meeting, the consistent rate hikes in the advanced economies triggered capital flight from the domestic economy. As such, we envisage this will support the Committee's decision to maintain its hawkish stance.

OPEC+ Production Cut Continues to Pressure Oil Prices

Given the current macroeconomic headwinds surrounding the global oil market outlook, the OPEC+ group implemented its most significant production cut (2.00mbpd) - the highest since 2020 - to achieve long-term oil market stability and spur the recovery of global oil prices. Since the announcement of the decision on October 5, Brent crude price has stayed at an average of USD94.33pb as of November 16. We expect the cartel's move to tighten the global oil supply further.

Alongside the headline oil production cut, OPEC+ revised the global oil demand growth forecast downward by 0.10mbpd to 2.50mbpd in 2022, marking the fifth reduction since April. We attribute this to the enormous economic uncertainty that still exists globally, notably China's strict adherence to its zero-COVID-19 strategy, relentless geopolitical tensions, and the slowdown of economic activities. Overall, we expect global oil prices to remain elevated in the short to medium term, hinged on continued production shortfall. Higher oil prices are expected to bode well for FX accretion in the domestic economy. We, however, do not rule out the possibility of oil prices trending below OPEC's price limit of USD90pd due to a likely shortfall in demand from China (the world's top oil importer) and further release from US oil reserves.

Sub-Saharan Africa

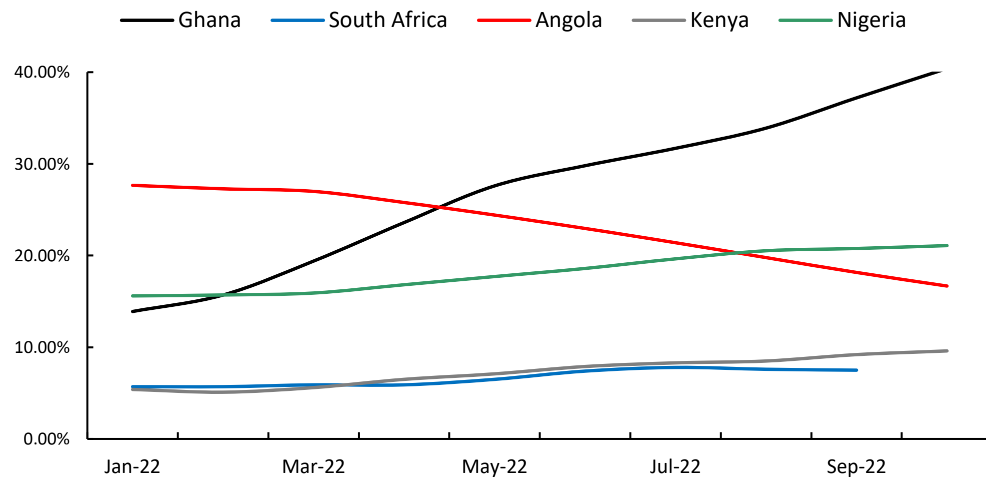
Rising Inflation Shapes Policy Orientation

Following the pandemic, economic recovery in the SSA region has been derailed by multiple economic shocks, including rising inflation, global economic slowdown, and tightening financial conditions globally. As a result, policymakers have been preoccupied with balancing price stability and economic growth. However, the worrying pace of inflation has led to a firmer stance on price stability.

Geopolitical imbalances have disrupted supply chains. As a result, energy, agriculture, and consumer goods prices have risen, devastatingly impacting the SSA region due to the region's reliance on imported food and energy products.

However, the inflation dynamics were not uniform across the countries in the SSA region. Countries that are net importers generally battle higher price levels. For context, Ghana reported an inflation rate of 40.40% YoY in October (vs 13.90% YoY in January). A similar trend was observed in Kenya; October's inflation was 9.60% YoY (vs 5.40% YoY in January). Contrastingly, inflation decelerated in Angola (a net exporter) to 16.68% YoY in October (vs 27.66% YoY in January). Angolan economy benefitted from high oil prices, improved production, and non-oil sector growth. On the other hand, the high inflation in the region reflects the persistent high energy prices, transport costs, food price pressures and currency depreciation.

Chart 3: Inflation Rate Among Selected SSA Countries



***Source**: Bloomberg, Meristem Research*

Furthermore, adverse weather conditions in the East African region have added to inflationary pressures in the region. Five straight seasons with little rainfall led to the most significant drought in four decades, with about 22 million people facing starvation across Kenya, Somalia, Ethiopia, and Sudan, according to the UN's World Food Programme (WFP).

The persistence of factors fueling global inflation indicates inflation remaining elevated in the near term. Firstly, the possibility of Russia pulling out of grain agreements due to the war heightens the risks to the food supply. Additionally, OPEC+'s reduction of oil production is expected to sustain high energy prices throughout the medium term. The broad depreciation of most SSA countries' currencies is expected to persist, considering the continuous hike in interest rates in advanced economies, which has redirected capital flows.

Slowing Economic Activities

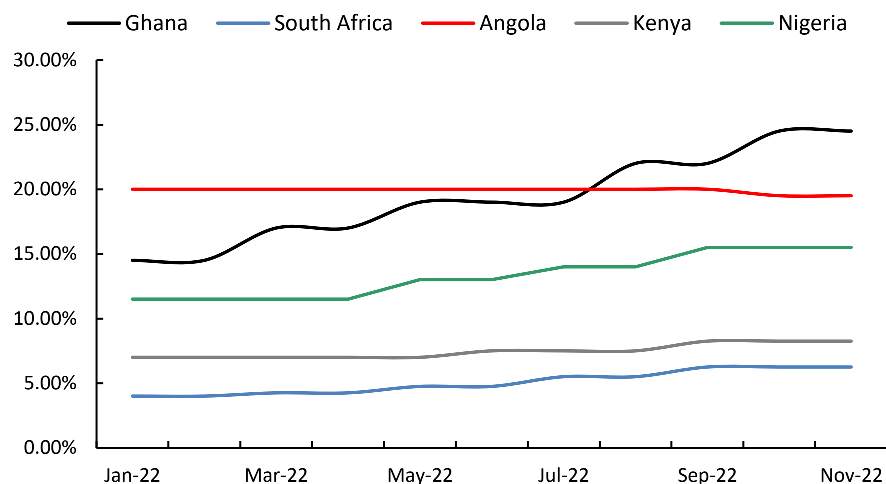
Economic activities continue to slow down as central banks across the region pursue tighter monetary policies to rein in inflation. In October, the IMF revised its economic growth projection for the SSA region to 3.30% in 2022 (vs 3.60% projected in April 2022). Compared to the 4.10% recorded in 2021, the 2022 GDP projection is lower, which reflects the slowdown in SSA GDP growth precipitated by global economic uncertainties, high inflation levels, and hawkish policy. **The risks to the economic outlook for the SSA region are tilted to the downside. The ongoing Russia - Ukraine war will keep food and energy prices high. Furthermore, China**

has significant trade and financial connections with the SSA region; thus, a slowdown in the Chinese economy will drag the region's growth. Internal risks include the high borrowing cost, which has constrained capacity for fiscal stimulation, and the adverse weather conditions as a threat to food security.

Monetary Policy

Confronted by the threats of slowing economic growth and rising inflation, central banks across the region face the puzzle of either supporting economic growth or controlling inflation. However, with inflation edging higher, policymakers have had to shift focus to inflation. This has led them to tighten financial conditions through policy rate hikes.

Chart 4: Trend of Monetary Policy Rate Across Selected SSA Countries in 2022



***Source**: Bloomberg, Meristem Research*

Higher interest rates have raised borrowing costs due to investors' search for high yields. This has caused debt service costs to rise and heightened credit risks. Eritrea (234.9%), Sudan (183.8%), Cabo Verde (147.7%%), Ghana (104.6%), and Mozambique (102.6%) are among the nations with significant public debt relative to their GDPs according to the October IMF Africa Pulse report. However, some countries have already approached multilateral financial organizations for funding support. For example, Ghana is in talks with the IMF for loan assistance of USD3.00bn, and Zambia has already received approval for a USD1.3bn extended credit facility.

Although the current monetary policy stance of central banks across the region vis a vis inflation raises recessionary risks for countries in the region, we expect central banks to maintain a hawkish stance in the near term until inflation falls to acceptable levels.

Domestic Macros

Macroeconomic Headwinds to Decelerate Growth

Manufacturing activities in Nigeria have continued to trend downwards, as signalled by the composite Purchasing Managers' Index (PMI), which declined to 47.20pts in August 2022 (vs 50.40pts and 51.1pts in July and June 2022, respectively). This reflects the adverse impact of the previous rate hikes by the Monetary Policy Committee (MPC), which started in May 2022, on economic activities and business conditions. We note that Q2:2022 GDP grew by 3.54% YoY (vs. 3.11% YoY in Q1:2022) mainly driven by the non-oil sector. This is attributable to the several intervention programmes implemented by the Federal Government in the non-oil sector. However, we expect the prevailing headwinds - the high cost of borrowing, lingering insecurity challenge, high cost of input, and lower consumer real disposable income - to slow the growth of the Agricultural and Manufacturing sectors. Thus, Nigeria is likely to record only moderate growth in the non-oil sector, as the agricultural and manufacturing sectors are critical drivers of economic growth.

For the oil sector, the actual production of oil has remained lower than the quota set by the Organization of the Petroleum Exporting Countries (OPEC) of 1.80mbpd. However, oil production increased to 1.01mbpd in October 2022, following two consecutive months of decline. Hence, we project an improvement in the oil sector.

Overall, we envisage a slowdown in economic growth hinged on the heightened inflationary pressures, low purchasing power, and challenges in procuring foreign exchange by manufacturers.

Inflation Continues to Trend Upward

Sustaining its uptrend, Nigeria's inflation spiked to a 17-year high of 21.09% YoY in October 2022. The uptick in both the food and core indices drove the headline inflation. However, the structural challenges of poor transportation and storage facilities, the high cost of agricultural inputs, and the unabating security challenge in the food-producing states of the economy remain significant catalysts for the acceleration in food inflation. In the same vein, core inflation trended northwards on the back of higher prices of gas, solid and liquid fuels, and transportation costs. Additionally, the depreciation of the naira at the I&E window and the parallel market continues to pose an upside risk to inflation.

In the near term, food inflation is projected to remain elevated, hinged on the recent flooding in the agricultural hubs of the economy, which has resulted in post-harvest losses. In addition, as the festive season approaches, we foresee increased demand for food items to keep food prices elevated. Similarly, core inflation is expected to remain

tilted towards the upside on the back of OPEC+ planned supply cut by 2mbpd. This is anticipated to put pressure on crude oil prices, translating into higher transportation costs. Furthermore, exchange rate devaluation should keep prices of import-dependent items like household textiles, motor cars, and footwear high. Overall, we envisage the general price level to keep moving northwards.

Politics and Insecurity

Since the last MPC meeting, the political scene has witnessed heightened tension as the stage is gradually getting set for the 2023 elections. Campaign activities, rallies and the release of manifestoes by major presidential candidates have been the primary drivers of the political environment in recent times. From our prognosis of the manifestoes released by the major presidential candidates, we gleaned that while some candidates focus on promoting national security, others have prioritized improving the economy (both market and private sector), and restructuring of the country. Nevertheless, we expect all these electioneering activities to lead to increased spending, further exacerbating inflationary pressures. Similarly, the insecurity situation of the nation remains unabated, with kidnappings, banditry and terrorist activities steadily increasing. This has impacted commuters and the transportation/distribution of goods and services, especially agriculture. Thus, the prices of essential commodities, especially agricultural produce, have increased. **As such, we expect this to be a key consideration for the Committee as the lingering insecurity challenges continue to strain the supply chain of goods and services, and electioneering activities further fuel inflation.**

Monetary Policy

External Reserve Maintains its Downward Trend

So far in Q4:2022, the external reserve has declined by 2.78% to settle at USD37.88bn as of November 16, 2022. The decline is attributable to underwhelming oil production and low foreign inflows. The various policy measures to attract inflow of foreign exchange have had negligible impact on accretion of foreign exchange and external reserve.

Based on the latest report on capital importation (Q2:2022), Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) declined by 5.04% QoQ and 20.91% QoQ, respectively, which signifies lower investor confidence. Furthermore, the downgrade of Nigeria's rating by Moody's Investor Service and Fitch Ratings is anticipated to impact investors' confidence adversely, resulting in lower foreign inflows.

High FX illiquidity due to supply-demand imbalance has led to the depreciation of the naira by 2.37 % on the I&E window from the last meeting to date. In addition, the central bank's redesigning of the naira notes is expected to put more pressure on the exchange rate as speculative activities increase.

Given the government's efforts to improve oil production and the expected commencement of crude oil export from the Bonny terminal and Forcardos oil terminal, we expect oil production and revenue to improve. However, this is dependent on the ability of the government to intensify efforts to combat challenges within the oil and gas industry. Nonetheless, in the near term, we project a continued weakening of the naira.

Fixed Income Environment and Outlook

Since the monetary policy committee (MPC) hiked the rate in May 2022, investors have remained upbeat about the fixed-income market and sustained the momentum following other rate hikes. As a result, the average stop rate on treasury bills' primary market auction has improved to 9.52% (as at the last auction on November 9) from 4.12% as at the last auction in May. Similarly, the average stop rate at the bond auction improved to 15.38% in November (vs 11.82% in May). Conversely, in the secondary markets, the sentiment has been predominantly bearish, as average T-bills and bond yields increased to 12.71% and 14.49% as of November 15 (from 7.27% and 12.90% as of September 26), respectively. This sentiment has been mainly propelled by investors' demand for higher rates as real returns remain firmly sited in the negative region. Also, investors' interest has been primarily skewed towards the primary market auctions.

However, since the last MPC meeting in September, we have observed lower subscriptions across treasury bills and bond primary market auctions. This was primarily driven by tighter system liquidity (increased CRR to 32.50%). For context, in October's T-bills PMA, total subscriptions hit a year low of NGN248.90bn, with total subscription-to-offer declining to 0.58x vs 1.68x in September. Also, so far in Q4:2022, the corporate debt market has witnessed lower issuances of corporate instruments compared to the second and third quarters of the year. Again, this is attributed to the high-interest rate environment, with yields on issued commercial papers rising to c. 24%.

We opine that a further rate hike would sustain the northward direction of yields in the fixed-income space. We expect the current market dynamics to remain till the end of the year. This expectation is premised on lower subscription levels, given the relatively tighter system liquidity. Also, the Federal Government's interest in financing its remaining budget deficit through domestic borrowings, having already financed c.93% of its deficit from the domestic debt market, would call the market direction.

Equities Market Performance and Outlook

Sentiments on the broad market have remained negative since the last MPC in September. In October, the local bourse recorded the biggest monthly loss since March 2020 as the **NGXASI** declined by 10.58% MoM. The sell-off on the domestic market lowered the return of the **NGXASI** to +4.16% YtD (vs +15.09% YtD as at the September MPC meeting). In addition, despite the broadly positive corporate performances and dividend announcements, bearish sentiments persist in the equities market.

On a sectoral basis, performance has been broadly negative since the last MPC meeting. The **NGXOILGAS** (-11.45%), **NGXINS** (-8.68%), **NGXCNSMRGDS** (-8.38) edged lower, while **NGXINDUSTR** (+12.69%) and **NGXBNK** (+1.37%) appreciated. We attribute the negative performance of the market to profit-taking activities on heavyweight tickers, including **AIRTELAFRI** (-36.50%), **NB** (-14.77%), **SEPLAT** (-12.89%), **NESTLE** (-10.00%), **DANGCEM** (-2.65%).

Relative to its African peers, Nigeria equities YtD return (4.16%) trails only the Egyptian exchange (4.74% YtD). Other regional markets recorded negative returns – Kenya: -22.49% YtD, Ghana: -11.82% YtD, and South Africa: -1.15% YtD. Also, with a PE of 6.15x, the domestic market trades at a discount relative to its regional peers: average PE of 7.49x.

We expect the negative sentiments dominating the local bourse to persist as the current economic headwinds remain and investors continue to price in the increased market and political risk. Also, we expect higher yields on fixed-income instruments hinged on

higher policy rates. This will increase investors' preference for fixed-income instruments compared to risk assets.

Ultimately…

We expect the Committee to:

- **Raise the MPR by 50ps to 16.00%**
- **Retain liquidity ratio at 30%**
- **Retain the asymmetric corridor at +100bps/-700bps**
- **Retain the CRR at 32.50%**

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