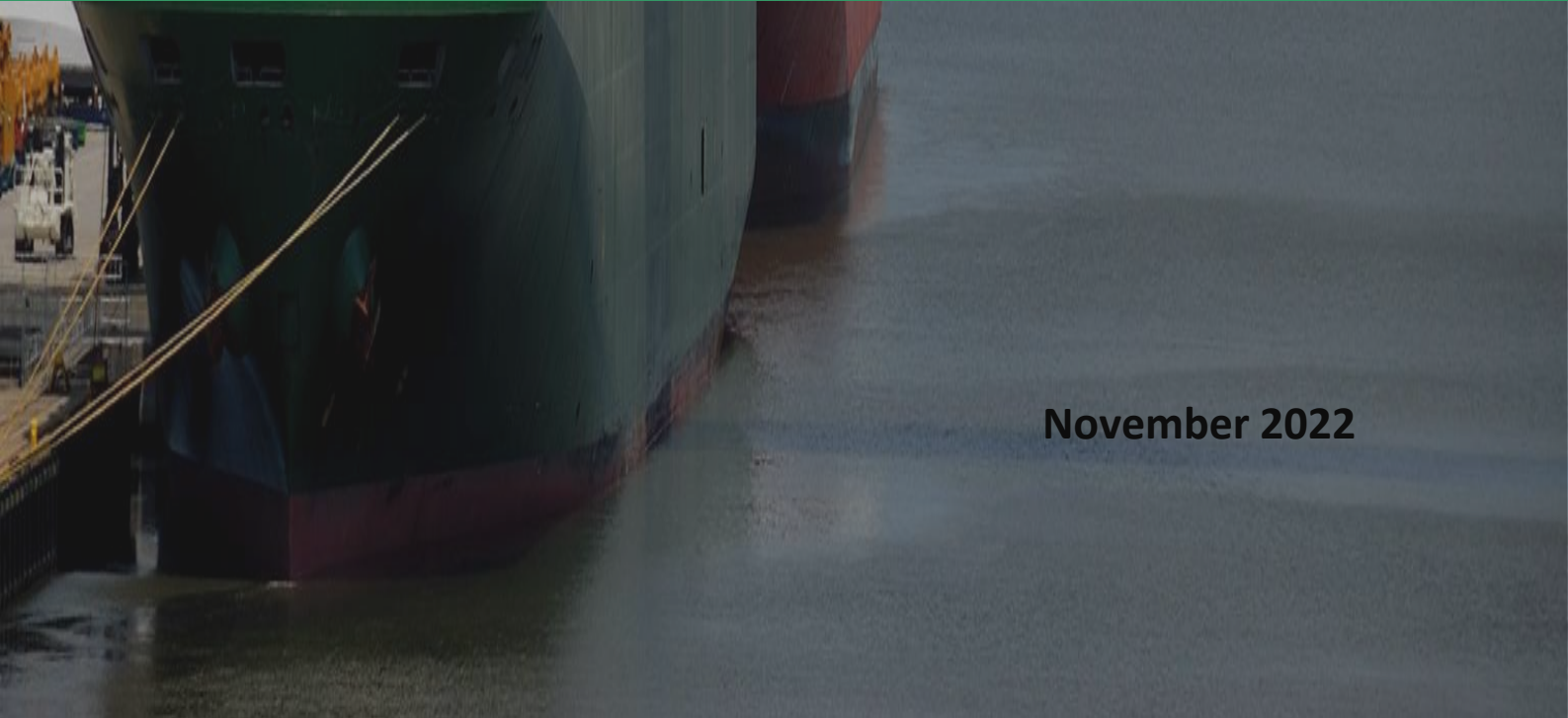




Monetary Policies and Global Trade Conditions Drive Currency Movement

..... Macroeconomic Commentary



November 2022

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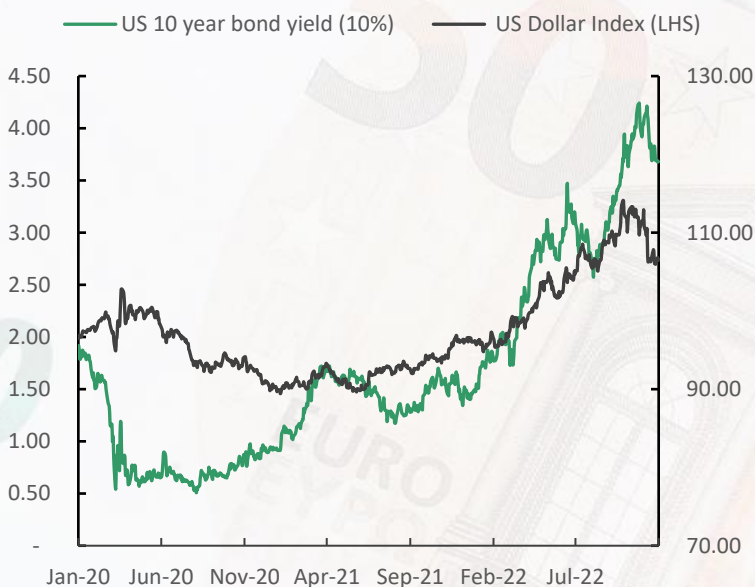
Dollar Rally Pressures Global Economy

Nearly all global currencies have seen significant depreciation/devaluation in 2022 against the USD. Being a year fraught with challenges for global trade, lingering COVID-19 cases, decade-high inflationary pressures, and geopolitical crises, only countries with strong value propositions have been able to limit the impact of the crisis and retain a relatively strong medium of exchange.

As we highlighted in our [2021 Macroeconomic commentary](#), the COVID-19 pandemic had a significant impact on global trade. The Russian-Ukraine crisis which began on February 24th, 2022, added extra layer of pressure, causing a slowdown in global trade recovery. According to the United Nations Conference on Trade and Development (UNCTAD), the world trade volumes grew by 3.90% YoY in Q2:2022 (vs 22.74% YoY in Q2:2021), implying a slowdown in the growth of trading activities. This also represents the slowest growth since the recovery from the pandemic in Q1:2021 (5.32% YoY).

As the supply chain conditions became tighter, general price levels continued to rise triggering a significant broad-based shift in monetary policy stance across global economies. The Fed has hiked its benchmark rate by 375bps so far this year, making investment in US risk-free assets more attractive. Thus, the USD's appreciation against other currencies appears to be mostly driven by both the tighter monetary policy action and the energy crisis in the global economy. Considering the dollar's dominant role in global trade, the improvement in trade conditions for other economies is largely dependent on the resolution of the geopolitical tension, and less aggressive monetary policy actions to combat inflation.

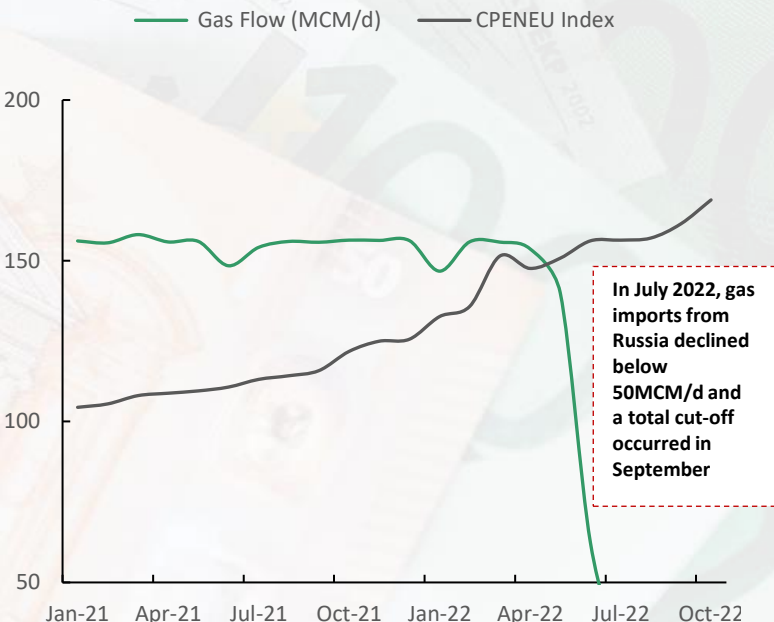
Chart 1: US Dollar Index and the US 10-year Bond yield(%)



Source: Bloomberg, Meristem Research

*USD index tracks international values of the USD, benchmarked against other major trading currencies

Chart 2: Relationship Between Gas import from Russia by the Eurozone and Domestic Gas Price

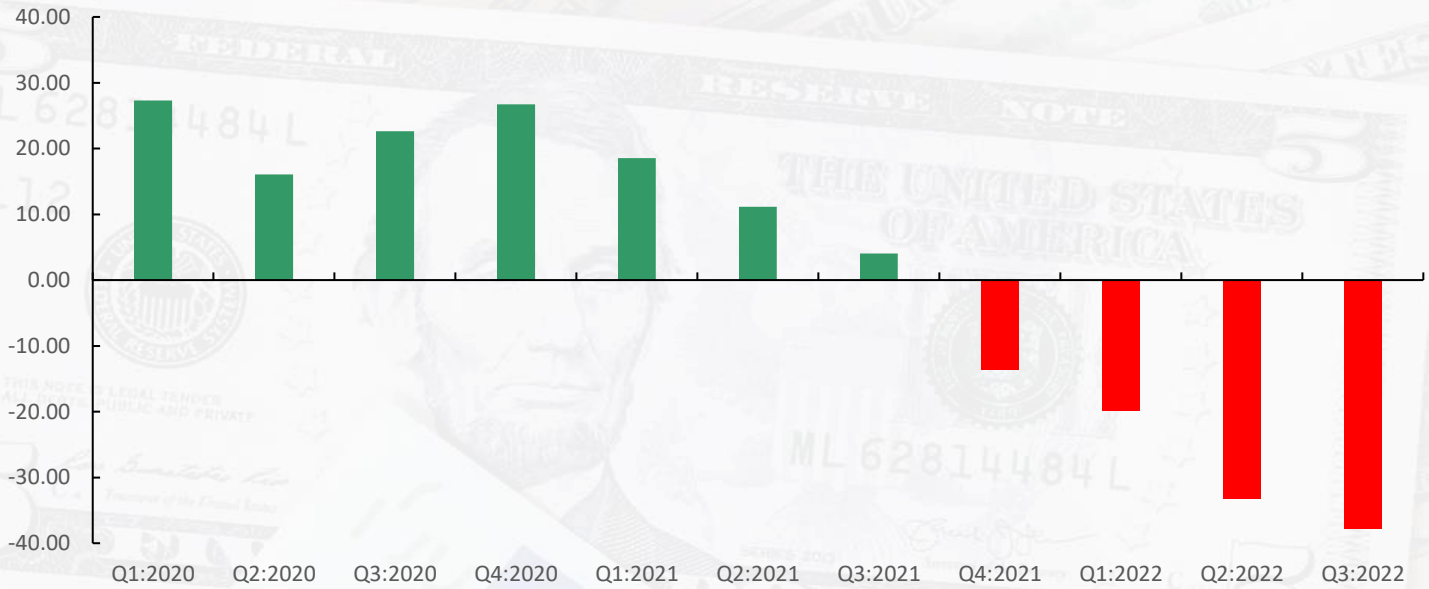


In July 2022, gas imports from Russia declined below 50MCM/d and a total cut-off occurred in September

Source: Eurostat, Meristem Research

On the contrary, the Euro-zone's dependence on energy imports from Russia, and the latter's subsequent decision to suspend gas exports to Europe triggered energy price shocks in the region as concerns for energy supply worsened. For the first time in 19 years, the EUR began trading at a discount to the USD, unable to withstand the myriad of issues affecting its stability as a legal tender for trade. As of September 2022, the Euro area recorded a trade deficit of EUR37.71bn as soaring energy prices and depreciated currency inflated its imports bills.

Chart 3: Eurozone Trade Balance (EUR'bn)



Source: Eurostat, Meristem Research

Chart 4: The movement of the Euro against the US Dollar

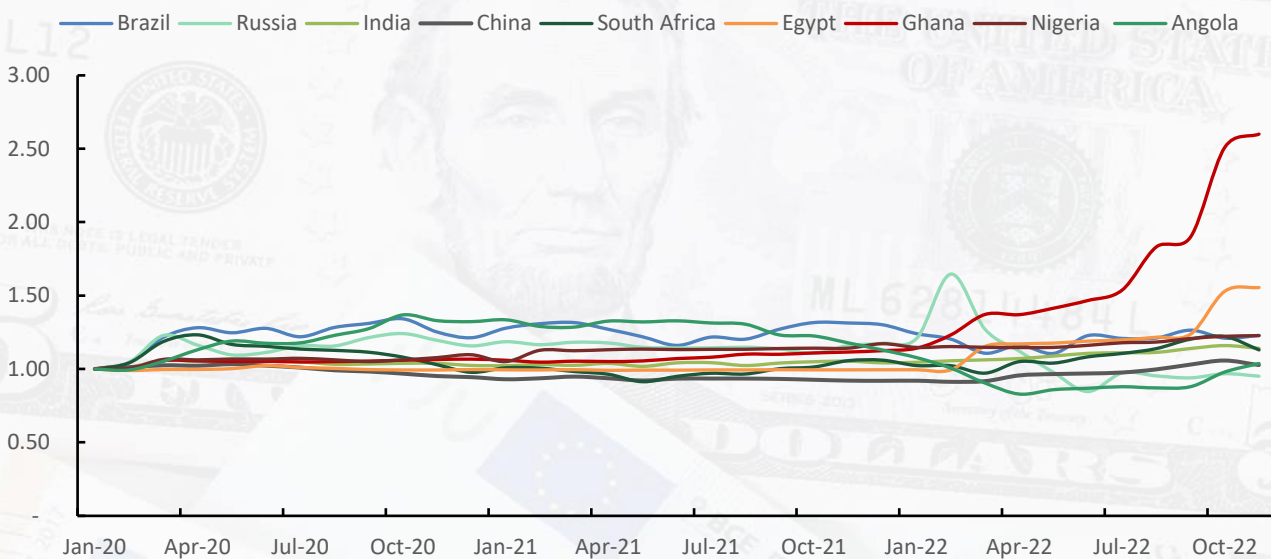


Source: Bloomberg, Meristem Research

Emerging Markets Face Significant Currency depreciation to USD

The rising inflationary challenges which prompted global monetary authorities to begin an aggressive series of monetary policy rate hikes triggered a reversal of capital flows out from Emerging and Developing economies (EMDEs) into safer havens. Foreign investors began reducing their exposure to these markets and currencies weakened significantly vis-à-vis the USD. The Fed's rate hike is also expected to have dire consequences for external debt sustainability and ability of fiscal authorities to raise external financing on the back of higher borrowing costs. While the 2022 capital flight seems more orderly than that of the taper tantrum event of 2013 and 2014, we posit that it is underway and would likely persist till the first half of 2023

Chart 5: Index Movement of Selected Emerging and Developing Market Currencies Against the Dollar



Source: Bloomberg, Meristem Research

Chart 6: Bloomberg Emerging Market Capital Flow Index



Source: Bloomberg, Meristem Research

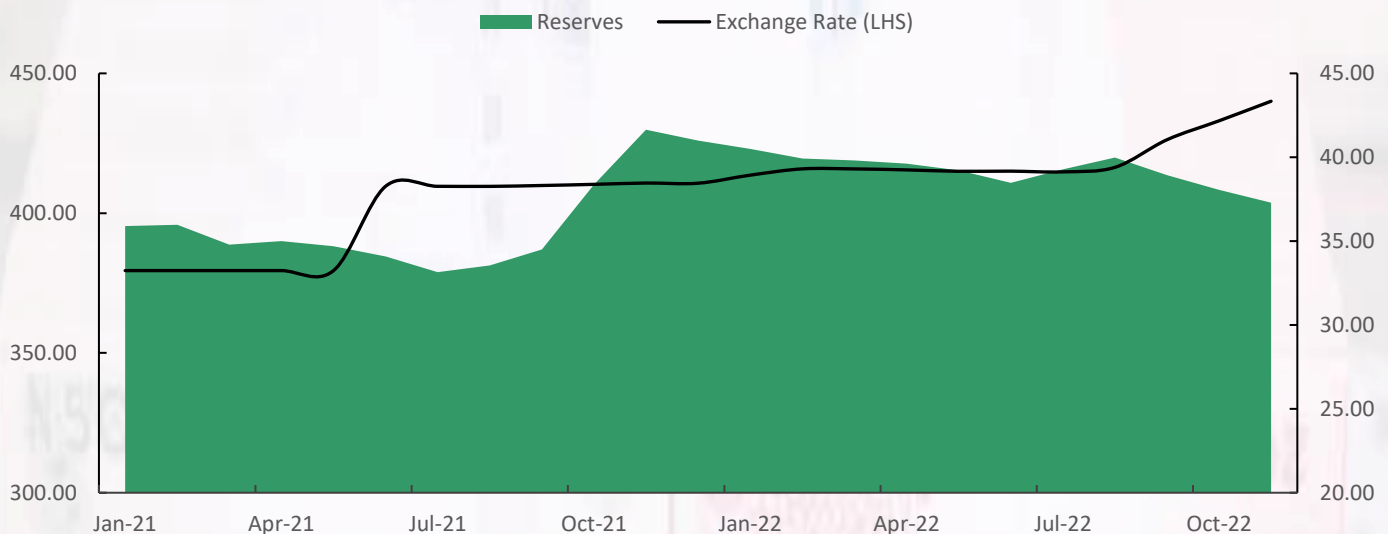
Nigeria

A Possibility of Naira Devaluation

The reality in Nigeria is not so different from what is obtainable in other emerging and developing markets. So far in 2022, the monetary policy committee has raised the Monetary Policy Rate (500 bps) and Cash reserve requirement (500bps) to control the spate of rising inflation and attract foreign capital flows into the country. Added concerns of political uncertainty, FX illiquidity, and volatile government policies have also contributed to foreign investor apprehension in the country. The difficulties associated with foreign repatriation of funds have been evident in recent months as some international airline operators have at different points this year announced plans to suspend flights to and from Nigeria due to unrepatriated earnings trapped in the country. Furthermore, the IMF estimates the trapped foreign funds in Nigeria are unable to be repatriated at about USD1.70bn as of November 2022.

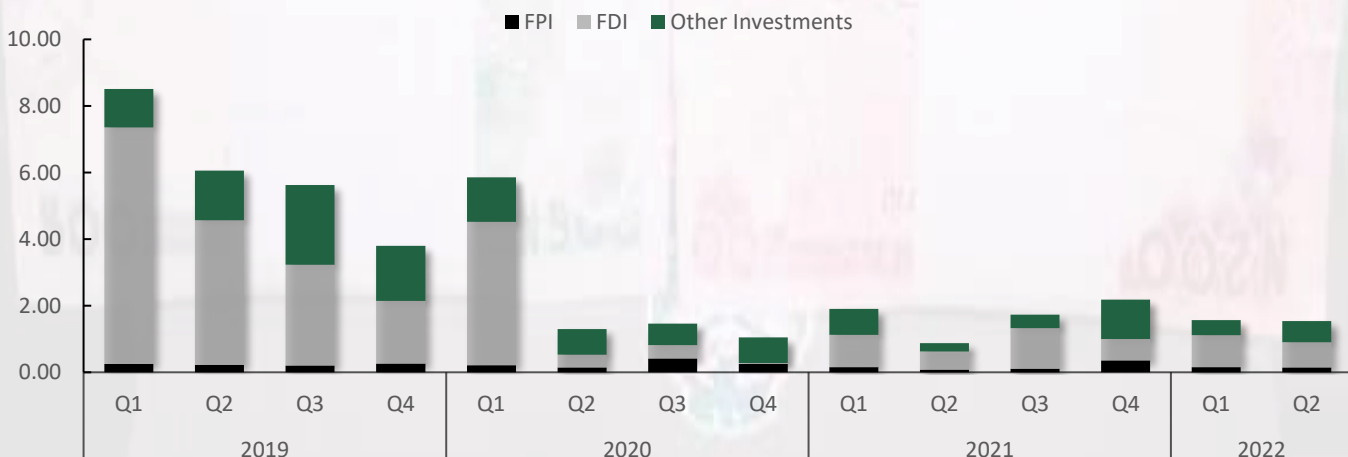
The FX repatriation woes have mostly been driven by the inadequacy of FX inflows into the country. Unlike some of its other African counterparts (Angola and Libya), the gains from higher crude oil prices have been mostly lost on Nigeria's external reserve owing to the high petrol subsidy bill and lower oil production volumes. This has significantly reduced the CBN's ability to defend the Naira, leading the official exchange rate lower in the I&E window. While the official market has remained relatively stable so far in the year, the significant volatility in the parallel exchange rate has kept the greenback rate at a significant premium over the official rates (72.92%).

Chart 7: Exchange rate (NGN/USD) and Foreign Reserve (USD'bn) Movement



Source: Central Bank of Nigeria, FMDQ, Meristem Research

Chart 8: Foreign Direct, Foreign Portfolio, and Other Investments (USD'bn)



Source: National Bureau of Statistics, Meristem Research

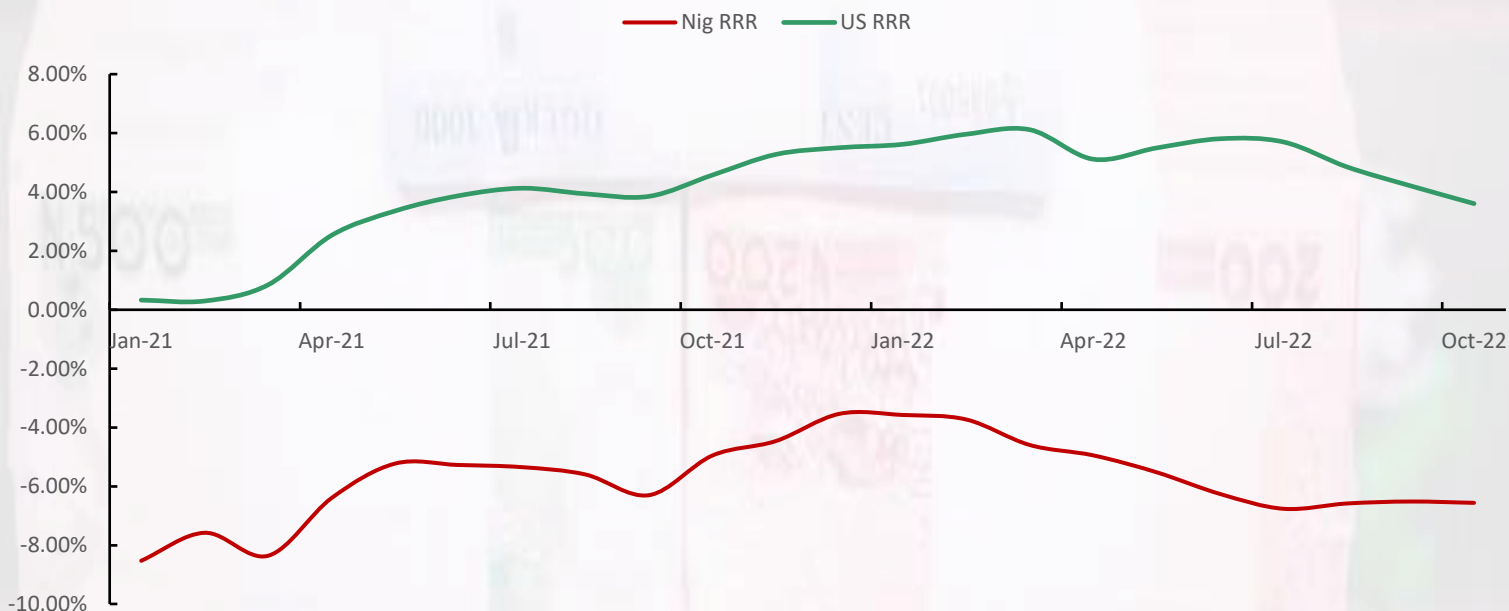
Expectations going forward...

In a bid to improve foreign inflows into the economy and strengthen the Naira, the CBN has implemented different policies such as the RT200 Non-Oil Export Rebate Scheme aimed at growing earnings from non-oil exports to USD200bn over the next 3 to 5 years. New Naira notes have also been unveiled as a means of controlling the money supply and inflationary pressures. The adoption of tighter monetary policy is also expected to attract more foreign investors, especially into the bonds market as yields have been rising steadily since the series of rate hikes. However, there is only so much that these policies can achieve in shoring up the external reserve balance and maintaining the exchange rate as the country's major FX sources have been embattled.

As the CBN governor attested in November 2022, there has been no accretion into the foreign reserve from oil sources in recent months. Also, we expect foreign investors to continue considering challenges with FX repatriation when making investment decisions into Nigeria.

Furthermore, in a bid to allow the exchange rate to reflect current realities, we do not rule out the possibility of another Naira devaluation next year. FX supply is likely to be constricted over the coming year given the aforementioned factors and the expected election-related increase in demand for the USD.

Chart 9: Real Rate of Return (RRR) on Nigeria average bond yield and the US 10 year bond yield



Source: FMDQ, Bloomberg, NBS, Meristem Research

**compared to real rate of return in safer havens, the real rate of return on average bond yields for Nigeria remains entrenched in negative territory*

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