Macroeconomic Update

MPC Monitor | January 2023

MPC Tightens Policy Parameters

In its first meeting for the year concluded on 24th January 2023, the Monetary Policy Committee (MPC) **raised the Monetary Policy Rate (MPR) by 100bps to 17.50% from 16.50% while holding other parameters constant,** in line with our expectation. We note that all members of the Committee opted for a rate hike although at different magnitudes: 1 member voted 150bps, 7 members voted 100bps and 4 members voted 50bps.

In reaching its decision, the Committee took cognizance of the adverse impact of the lingering tension in Europe, the resurgence of COVID-19 cases in China, the hawkish stance by monetary authorities globally and its negative effect on global supply chain. These factors are expected to keep inflation broadly elevated. On growth, the Committee expressed concern on a potential recession in advanced economies.

For Nigeria, while the Committee expects a continuation of the output growth trend in 2023 on the back of sustained CBN Interventions, it projects that the growth will be slower. The Committee also stated that the decline in headline inflation as of December 2022 is not enough reason to alter its monetary tone as inflation remained elevated on a month-on-month basis.

We envisage that the rate hike would further add pressure to the cost of borrowing and thereby translate to lower production activities. Fixed income yields are expected to rise thus, we advise investors to position in short-duration and high yield fixed income instruments. For the equities market, we note that investors have likely priced in the rate hikes and therefore does not pose a significant risk to performance.

Committee's Considerations

The Committee raised concerns of the possibility of a global recession in 2023 due to the resurgence of Covid-19 pandemic in China, unresolved geopolitical tension between Russia and Ukraine, disruptions in the energy market, lingering supply bottlenecks, among other factors. The MPC also cited the downward review of global economic growth forecast by IMF and World Bank as a cause for concern.

On global inflation, while the Committee considered the disinflation witnessed in most advanced economies, it noted that inflation remained significantly above the target band of those countries. The Committee also noted that global inflation is expected to remain elevated for the most part of 2023, majorly due to high price of food and energy, robust liquidity and possibility of Russia pulling out of the Black Sea grain deal.

On the domestic scene, the Committee noted the positive impact of the sustained supports from both the Central Bank of Nigeria (CBN) and fiscal authority which have helped in keeping real Gross Domestic Product (GDP) growth positive in the last eight quarters. The continued support also raises optimism of further growth in subsequent periods in the Committee's view.

Furthermore, the Committee welcomed the disinflation witnessed in December 2022 and attributed that to its previous rate hikes. The MPC however noted that despite this disinflation, the country's current inflation rate of 21.34% is a threat to economic growth. Also, it enumerated some factors considered to be major headwinds to price stability, including the upcoming general election, recurrent scarcity of Premium Motor Spirit (PMS), increased prices of other products like diesel and gasoline, exchange rate pressures and the lingering insecurity issues. On the flip side, the Committee considered the current Naira redesign and cash withdrawal limit as factors that could keep inflation in check.

Key Decisions:

- Raise the MPR by 100bps to 17.50%
- Retain CRR at 32.50%
- Retain liquidity ratio at 30.00%
- Retain the asymmetric corridor at +100bps/-700bps around the MPR

Anticipated Impacts

The Banking Sector:

Further MPR Hike Presents Net Positive Outlook

In 2022, the consolidated effect of the multiple rate hikes was net positive for Nigerian banks. Broadly, banks benefitted from the high interest rate environment via upward loan repricing and higher yields on investment securities. For context, compared to their levels as of December 2021, average lending rate, treasury bills rate, and bonds yield all edged higher by 186bps to 21.49%, 172bps to 5.71%, and 148bps to 13.04% in 2022, respectively. These translated to higher interest income (by +31.25% YoY for our coverage banks as at 9M:2022) which overshadowed the increase in the MPR-anchored interest expenses. Thus, the industry reported improved profitability metrics.

In line with our 2023 expectation for the sector, the Committee's decision to increase the MPR by 100bps portends a sustenance of the positive outlook for banks' interest income. In our opinion, the higher policy rate will leave a wide grin on banks' faces. While yield on treasury instruments - a significant revenue stream - has been moderating since mid-November 2022, higher MPR coupled with higher amount on offer in the coming bonds auction point to the likelihood of higher investment securities yields.

The Committee also highlighted the notable improvement in the industry's critical metrics despite earlier concerns that the deteriorating macroeconomic conditions could adversely impact them. Remarkably, Non-Performing Loans (NPL) ratio improved to 4.20% as of December 2022 (vs 4.85% in December 2021). Likewise, the Liquidity Ratio (44.10% as of December 2022) and Capital Adequacy Ratio remained above the regulatory benchmark of 30.00% and 10.00%, respectively.

Overall, the higher MPR offers a net positive outlook for the banking industry's financial performance. Likewise, we expect further improvements in key regulatory metrics.

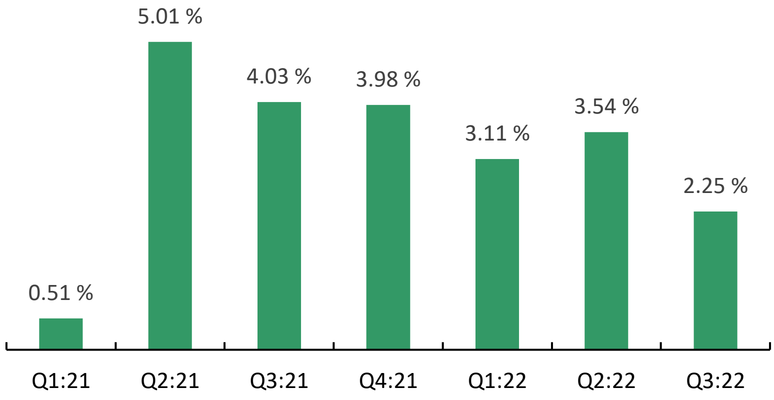
The Real Sector

MPC Decision to Decelerate Growth

The latest GDP report released by the National Bureau of Statistics (NBS) reveals that domestic output maintained a positive – *but slower growth* – trajectory for the 8th consecutive quarter (2.25% YoY in Q3:2022 vs. 3.54% and 4.03% YoY in Q2:2022 and Q3:2021, respectively). This performance was mainly driven by the non-oil sector, led by the Information and Communication (+10.50% YoY), trade (+5.08% YoY), and agriculture (+1.34% YoY) sectors. However, we note a contraction in the manufacturing sector's GDP (-1.91% YoY vs. 3.00% YoY in Q2:2022) reflecting the adverse impact of higher borrowing costs (owing to the cumulative rate hikes) on production activities. On the other hand, the performance of the oil sector remained subdued due to continuous shortfall in oil production (1.20mbpd in Q3:2022 vs. 1.57mbpd in Q3:2021). The Committee's decision to hike MPR highlights its commitment to rein in inflation (21.34% YoY in December 2022 vs. 15.63% YoY in December 2021) despite slower output growth.

In our opinion, the retention of the MPC's aggressive stance will have a negative effect on the real sector productivity through reduced new investments as borrowing cost climbs higher. This would further result to slower economic growth. Nonetheless, the sustained targeted intervention programmes by both the fiscal and monetary authorities should provide some level of respite.

Chart 1: Nigeria's Real GDP Growth Rate



Source: *NBS, Meristem Research*

The Fixed Income Market:

Yields Poised to Rise Gradually

Since the last MPC meeting, the Nigerian fixed income market has been recording a rather bullish note as the average treasury and bond yields declined to 3.71% and 13.40% as of January 23, 2023 (vs 12.58% and 14.36% as at the previous MPC meeting). Similarly, at the treasury bills primary market auction (PMA) held so far in January 2023, average stop rates across the trio instruments declined to 4.54% (vs 9.80% at the last auction in November 2022), a continuation of the downward trend witnessed at the PMAs in December 2022. Factors responsible for this include the improvement in system liquidity, to NGN71.64bn as of January 23, 2023 (from a negative of NGN115.64bn as at the previous MPC meeting in November), and the drastically lower amount-on-offer (NGN56.93bn vs NGN213.43bn at the last auction in November 2022). As a result, subscription significantly outweighed amount-on-offer by 5.20x, with investors rotating to the secondary market to fill unmet demands at the PMA.

Notwithstanding, in the short-to-medium term, we posit that the odds are still in favour of a gradual rise in yields at the upcoming PMAs, especially with the significant increase in amounts-on-offer (Bonds NGN360bn and T-bills NGN220.53bn), as the Government looks to plug its deficit from the domestic debt market. Also, the sustenance of the hawkish monetary policy stance and the high demand for a positive real rate of return amid surging inflation further makes a case for an uptick in stop rates at the PMAs and a rise in yields in the secondary market.

The Equities Market:

Rate Hike Meets Index at a Crucial Level

The MPC decision to hike rate in November 2022 had a low impact on investors sentiments as the decision had been largely anticipated by investors. Hence, the local bourse gained in the last 2 months (+8.72% and +7.53% in November and December 2022, respectively). This positive sentiment carried on into 2023, with the All-Share Index closing positive in two out of three trading weeks so far, and a Year-to-Date (YtD) return of 2.66% as of 24th January 2022.

From a valuation standpoint, the Nigerian equities market (Price-to-Earnings, PE ratio of 12.47x) currently trades at a premium to its peers: South Africa (10.49x), Egypt (9.84x), Kenya (6.33x), Ghana (5.16x) and emerging markets (11.50x). Specifically, the Relative Strength Index (RSI) is above 70.00, this implies that the market is currently overbought. We also draw attention to the potential double-top pattern that appears after the trendline was breached, as shown on the chart. This is a signal for a potential market reversal from its current positive mood.

Chart 2: NGX-ASI Trend (Pts)

Source: Bloomberg, NGX, Meristem research

The positive sentiments on the local bourse can last beyond expectations especially as corporate financial performance for 2022 are released (which might further spur positive sentiments). Nevertheless, we see a couple of downside risks ahead including expectations of higher yields in the fixed income markets, and political risk which could spur demand for higher risk premium.

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