Macroeconomic Update

MPC Monitor | May 2023

MPC Further Hikes Policy Rates

The Monetary Policy Committee held its third meeting for the year held on the 23rd and 24th of May 2023. In line with our expectation ahead of the meeting, the Committee voted to raise the policy rate by 50bps to 18.50% while keeping other parameters constant. While all members of the Committee agreed that a rate hike was necessary, 10 members voted for 50bps and 1 member opted for 25bps. The Committee's decision represents the seventh consecutive rate hike (700bps cumulatively) in the cycle which began in May 2022.

In reaching its decision, the Committee continues to consider the contagion risk arising from the banking crisis in the US, sustained Eastern Europe crisis, volatility in the global oil markets and decline in global trade as key risks impacting the global economy. These factors constitute key downside risks to global growth prospects and have led to mixed economic performance across economies.

The Committee also discussed developments on the domestic front. These include positive output growth in Q1:2023, improvement in Composite Purchasing Manager's Index (PMI) to 51.10 points in April 2023 (from 42.60 points in March 2023), continued uptrend in inflation, and high public debt. Going forward, the Committee expects this moderate output recovery to continue despite legacy and emerging shocks, including insecurity in food-producing areas and high energy costs.

The rate hike is reflective of the Committee's commitment to ensuring price stability in the economy. Given that the increase in rates was widely anticipated we do not expect the Committee's decision to have a significant impact on asset prices. Structural factors impacting inflation remain unabating, thus the decision is not likely to lower inflationary pressures in the near term.

Committee's Considerations

The Committee noted the moderate and subdued growth recovery in the global economy as it highlighted the IMF's downgrade of the global output growth forecast for 2023 (to 2.80% vs. its January forecast of 2.90%). Additionally, it considered the broadly elevated level of inflation, with inflation figures remaining well above target despite concerted efforts by central banks to tame it. Moreover, the Committee mentioned the effect of the global banks' crisis and the lingering effects of the Russia-Ukraine conflict on global economic recovery.

On the domestic front, the Committee expressed concerns over the decline in output growth as real Gross Domestic Product (GDP) growth slowed down to 2.31% YoY in Q1:2023 (vs. 3.11% in Q1:2022). Also, the Committee noted the persistent rise in headline inflation due to a myriad of factors outside the control of the central bank. These include the perennial scarcity of Premium Motor Spirit (PMS), escalating costs of energy, and other headwinds facing the food supply chain. Additionally, it noted that the economy continues to be weighed down by high import bills, resulting in higher pressures on foreign exchange and price level.

Furthermore, the Central Bank of Nigeria (CBN) Governor highlighted that empirical evidence from the research and monetary policy department shows the efficacy of previous rate hikes. It stated that the cumulative effects of previous hikes have successfully limited the rise in inflation by c. 800 bps over the last year. The Committee expressed optimism that the continuous progress made on the RT200, and other policies targeted at attracting trade and diaspora remittances would continue to support accretion to reserves and improve liquidity in the foreign exchange market. However, the Committee stressed the need for the fiscal authority to explore other avenues to expand its safety net in a bid to improve its ability to absorb emerging shocks to the economy.

Key Decisions

Overall, the decisions of the MPC were to:

- Raise the MPR by 50bps to 18.50%.
- Retain the Cash Reserve Ratio at 32.50%.
- Retain Liquidity Ratio at 30.00%.
- Retain the Asymmetric Corridor at +100bps/-700bps around the MPR.

Anticipated Impacts

The Banking Sector:

Higher MPR to Leave Banks with Net Positive Impact

Until the most recent 50bps hike, the Nigerian banking sector has experienced a notable positive impact due to the cumulative increase of 650bps in the MPR since May 2022. Moreso, despite various macroeconomic challenges, key banking sector indicators point to sustained resilience. In April 2023, the industry Non-Performing Loans (NPL) was 4.40%, below the regulatory target of 5.00%. Additionally, the industry Capital Adequacy Ratio (CAR) and Liquidity Ratio (LR) remained robust at 12.80% and 45.30% respectively, surpassing the regulatory minimum of 10.00% and 30.00%. While acknowledging the persistent risk of global financial contagion, the MPC emphasized the adoption of vigilant measures to shield the banking sector from potential spillover effects.

It is anticipated that the banking sector will continue to derive benefits from the higher MPR, primarily through higher lending rates. According to data from the CBN, both prime and maximum lending rates have risen by 221bps and 122bps since May 2022 to 14.05% and 28.59%, respectively in April 2023. The higher lending rates translate into higher interest income on customer loans, subsequently boosting industry interest income. Q1:2023 earnings releases provide continuing evidence of this trend from 2022FY, with our coverage banks recording an average YoY increase of 27.87% in interest income. Additionally, banks stand to benefit from relatively higher yields on investment securities, including treasury bills and bonds. Notably, the average treasury bill rate has risen by 216bps since May 2022, reaching 6.13% in May 2023, while the average bond yield has increased by 220bps to 13.30% in the same period.

On the flip side, however, the elevation in MPR implies a higher cost of funds for banks. Notably, the average deposit rate has jumped by 336bps since May 2022, reaching 7.57% in April 2023. More so, the interbank call rate has nearly doubled within the same period, reaching 15.80%. We expect this trend to continue to translate into higher interest expenses for banks.

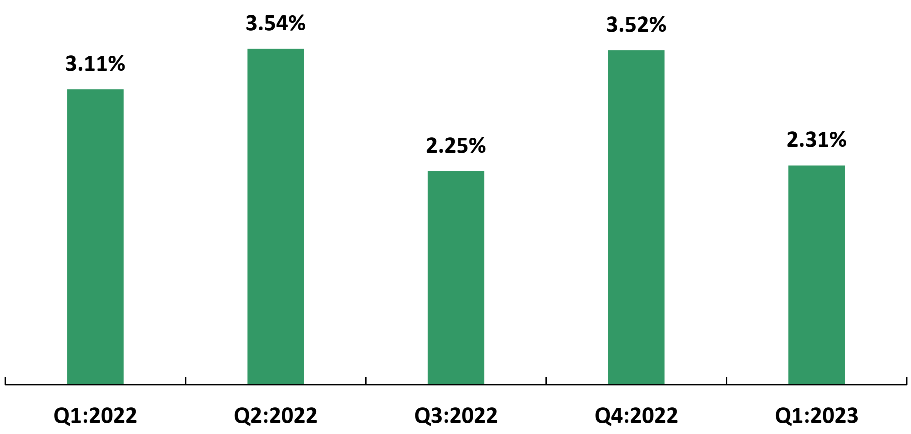
However, we expect that the increase in interest income will outweigh the increase in interest expense for banks. This is due to banks having a significant proportion of low-cost deposits and a high spread between their lending and deposit rates. Therefore, we expect to see an improvement in banks' net interest margin (NIM) in their 2023FY financial results.

The Real Sector
Outlook On Growth Remains Dim

As referenced by the Committee, Nigeria's Gross Domestic Product (GDP) expanded by 2.31% YoY in Q1:2023 (vs. 3.11% YoY in Q1:2022), marking the tenth consecutive quarter of growth since Q4:2020. This performance was buoyed by the non-oil sector, as the financial institutions (+24.96% YoY), information and communication (+10.32% YoY), manufacturing (+1.61% YoY), and trade (+1.31% YoY) sectors all expanded. The oil sector, on the other hand, remained in the region of contraction (-4.21% YoY), as oil production volumes declined by 1.57% YoY in the period according to data from the Nigerian Upstream Petroleum Regulatory Commission (NUPRC).

Furthermore, we observed that the real sector grew at a slower pace in Q1:2023 – the manufacturing, trade, and real estate sectors expanded YoY by 1.61%, 1.31%, and 1.70% (vs. 5.89%, 6.54%, and 4.44% in Q1:2022), respectively, while the agricultural sector contracted by 0.90% (vs. +3.16% in Q1:2022). This is attributable to the adverse impact of the cash crunch resulting from the Naira Redesign Policy. In addition, higher borrowing costs hinged on the aggressive stance of the Committee, as well as other prevailing macroeconomic headwinds such as higher costs of inputs contributed to the deceleration. Similarly, on a quarter-on-quarter QoQ basis, Nigeria's real GDP contracted by 15.65% in Q1:2023 (vs. +10.99% in Q4:2022).

Chart 1: Nigeria's Real GDP Growth Rate (YoY)



Source: *NBS, Meristem Research*

The Committee's decision clearly points to a focus on reining in inflation, which is at its highest level (22.22% YoY as of April) since September 2005. This sustained hike action by the Committee is expected to further push borrowing costs higher, thereby posing downside risks to output growth.

The Fixed Income Market:

System Liquidity Sways Yields Direction

So far, high system liquidity has continued to dictate the direction of the fixed-income market, triggering high investors' demand for instruments at Primary Market Auctions (PMAs). Specifically, the market has witnessed a decline in stop rates at the treasury bills PMAs, with average stop rates across the trio instruments dropping to 5.09% (vs. 9.58% in March when the MPC held its previous meeting). Robust system liquidity (NGN382.74trn from a negative of NGN522.43trn as at the last MPC meeting) displayed by increased subscription levels (with an average subscription-to-offer of 4.50x vs. 1.50x as at the last auction in March) has driven the activities at the PMAs.

Meanwhile, the sentiment has been mixed in the secondary market. The mood in the treasury bills market has been relatively bullish (average treasury yield declined to 6.13% as of May 23, 2023, vs. 6.67% as at the previous MPC meeting). However, the bonds market has been somewhat bearish with average bond yields increasing to 13.30% in May (from 13.20% as at the previous MPC meeting) with notable sell-offs witnessed across the yield curve.

The general expectation is for a marginal uptrend in yields. Essentially, the recent MPR hike could prompt investors to demand higher rates in a bid to narrow the negative real returns caused by the persistent inflationary pressures. However, we opine that system liquidity would continue to call the direction of the fixed income market in the near to medium term especially with the expected Eurobonds maturity (USD500.00mn) in July 2023.

The Equities Market:

Equity Market to Remain Positive

The MPC's decision to maintain a hawkish stance in its March meeting had a negligible impact on activities in the equities market as investors anticipated the successive rate hikes. Nonetheless, the equities market started Q2:2023 on a negative note, due to profit-taking activities across sectors. Specifically, five of the seven sectors we track declined in April, with only the Consumer Goods Index (+4.75% MoM) and Insurance Index (+3.87% MoM) recording gains. Overall, the All-Share Index lost 4.47% MoM in April to settle at 52,403.51. So far in May, the mood in the market has been slightly bullish, with the All-Share Index recording a marginal gain of 0.80% Mtd (as of 25th of May). Furthermore, four of the seven sectoral indices have recorded gains, and 88 stocks recorded gains, while 22 stocks declined (implying a market breadth of 3.73x vs. 0.86x in April).

The recently released Foreign Portfolio Investment report by the NGX revealed that foreign participation on the local bourse hit a new low of NGN8.47bn (4.43% of market activity) in April 2023. The continued deterioration in foreign portfolio investment reflects the foreign investor's apathy towards the Nigerian bourse.
In the near term, we expect the market to remain positive, due to buying interest on tickers that still have attractive valuations. The major downside to this is the possibility of selloffs on stocks that have recently recorded gains.

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