Ahead of MPC

September 2023

Committee Set to Hold its Fifth Meeting in 2023

…All eyes on the new administration

The Monetary Policy Committee (MPC) is expected to meet for the fifth time this year in coming weeks. We expect the Committee to assess both global and domestic events in deciding its next monetary policy direction. We also consider the possibility of this being the first Committee meeting of the new ship-steerers' at the Apex bank.

We expect key considerations at the meeting to include inflation patterns in advanced economies, global monetary authorities consideration, the recent surge in oil prices driven by voluntary cuts by major producers like UAE and Russia, and the possible ripple effects of China's housing crisis and its slower demand on the global stage.

On the domestic scene, the continued uptrend in headline inflation, stemming from higher energy and food prices, remains a focal point for the Committee's considerations. Additionally, factors poised to shape the Committee's decision include system liquidity and ongoing fluctuations in the foreign exchange market.

Given that inflationary pressures remain persistent and are expected to rise further, we expect the Committee to raise the policy rate by another 25bps to 19.00%, while holding other policy parameters unchanged.
However, while we maintain that a HOLD stance is not appropriate at this time, we opine that the Committee's decision could swing between a decision to hold and utilise other monetary policy tools, or to increase the MPR further.

International Economies and Developments

The Enduring Fight Against Obstinate Inflation

Global monetary authorities have largely stayed committed to curtailing inflationary pressures through rate hikes for most of 2023. However, this commitment appears to be waning despite inflation remaining above the target band for most economies as of August 2023 (US- 3.70% YoY, Eurozone- 5.30% YoY, UK- 5.90% YoY, Canada- 4.00% YoY). In its latest meeting, the US Fed held its Fed funds rate constant for the second time this year, having accessed the current economic position and expectation of further decline in inflation rates. However, the Fed also considered the possibility of further rate hikes in its subsequent meetings if inflationary pressures rise further. Also, the Bank of Canada held its key policy rate constant in its September meeting, citing weaker economic growth as a concern. On the contrary, following its 25bps rate hike at its last September meeting, the European Central Bank (ECB) expects inflationary pressures to increase further and stated that monetary policy will remain restrictive for as long as necessary.

Elsewhere in China, policymakers grapple with the delayed and sluggish post-pandemic recovery. Despite improvements in the manufacturing sector and consumer spending, the persistent property market issues and demographic concerns impede overall economic expansion. Notably, property investment has declined for the 18th consecutive month, by 1.30% MoM, marking a significant setback to -19.10%. Consequently, the People's Bank of China declared its intention to lower the cash reserve requirements for banks, for the second time this year. This decision is part of a comprehensive strategy that includes relaxing restrictions on home purchases in specific cities, all aimed at revitalizing growth in the property sector and, by extension, the broader economy.

On the emerging market front, the BRICS summit, which held in South Africa in August, has remained a top burner as we consider the implications for member countries' monetary authorities. The primary focus of the summit was on strengthening economic cooperation among the member countries and exploring opportunities for expanding the group's membership. While we think that achievement of a BRICS currency dominance relative to the US dollar is not likely in the near term, we opine that its introduction would impact trade and monetary policy actions by member countries.

Higher Prices, Strong Demand Amid Crude Supply Cuts

In its September report, the Organization of Petroleum Exporting Countries (OPEC+) forecasts a 2.40 million barrels per day (mbpd) increase in global crude oil demand to 102.21mbpd for the remainder of 2023. The expected growth is attributed to the ongoing economic recovery in countries like Japan, India, Brazil, and Russia. In addition, China's crude imports, which surged to 12.4 million barrels per day (mbpd) in August, is anticipated to increase further due to the implementation of expanded fiscal and monetary stimulus measures to promote economic growth. In addition, China's crude imports, which surged to 12.40mbpd in August, is anticipated to increase further due to the country’s implementation of expanded fiscal and monetary stimulus measures to promote economic growth. On the price side, Saudi Arabia and Russia, the world's largest crude oil exporters, have extended voluntary production cuts by 1.00mbpd and 0.30mbpd, respectively. As a result, Brent crude price surged to USD95.09 per barrel, marking its highest level since November 2022. **In the near term, we anticipate that oil prices will remain elevated, potentially impacting energy prices and stoke inflationary pressure across global economies. Thus, we expect the Committee to prioritize its price stability mandate in the upcoming meeting.**

Domestic Macros

Domestic Economy Sustains Growth Trajectory

In Q2:2023, the domestic economy's Gross Domestic Product (GDP) expanded by 2.51% YoY, rebounding from the adverse effects of Q1:2023's currency crisis (2.31% YoY) GDP growth. Nevertheless, output growth remained below 2022 levels - 3.54% YoY in Q2:2022. The decelerated output growth is mainly hinged on the oil sector's subdued performance during the quarter, compounded by prevailing macroeconomic challenges such as the foreign exchange (FX) shortage and the continued depreciation of the Naira.

Output growth in the oil sector contracted by 13.43% YoY, mainly owing to the disruptive impact of the Petroleum and Natural Gas Senior Staff Association of Nigeria (PENGASSAN) strike in April and production losses experienced on major terminals (Bonny, Forcados and Escravos), which led to lower crude oil production volumes (1.22mbpd vs 1.43mbpd in Q2:2022). The non-oil sector, which remained the highest contributor to total GDP, grew by 3.58% YoY, driven by robust growth in the information and telecommunications (+8.60% YoY), trade (+2.41% YoY), financial services (+26.84% YoY), and manufacturing (+2.20% YoY) sectors.

Furthermore, in Q2:2023, Nigeria's overall foreign trade contracted by 7.60% YoY to NGN12.74trn. Nonetheless, the trade surplus increased by +27.40% YoY to NGN1.29trn as imports (-10.40 YoY) decelerated faster than exports (-5.20 YoY) primarily on the back of FX scarcity and illiquidity, which hampered import activities during the quarter. Going forward, we expect the trade surplus to be sustained, given that crude oil receipts are projected to be higher (*due to higher production volume, global crude oil prices, and devalued exchange rate*). Also, lingering FX illiquidity poses a notable risk to importation and may dampen manufacturing activities in the near term. **Thus, we posit that the Monetary Policy Committee will be wary of policy actions that might significantly hurt the country's economic growth prospects and sustain its less aggressive pace of rate hikes.**

Inflation Maintains Upward Trajectory

According to National Bureau of Statistics (NBS), Nigeria’s headline inflation rate for August 2023 increased for the eighth consecutive month to 25.80% YoY (from 24.08% YoY in July 2023). This significant surge can be primarily attributed to the sharp rise in food prices, substantial increase in transportation costs stemming from higher Premium Motor Spirits (PMS) pump prices, lingering security issues in food-producing regions, and increased logistics costs for food items. Thus, the food and core inflation indices increased to 29.34% and 21.15%, respectively, from 26.98% and 20.47% in July 2023. In our opinion, the significant acceleration in the headline inflation rate since that last MPC meeting is not expected to dissipate in the near term. **Consequently, we expect the Committee to be concerned about the further impact of recent policy actions (FX devaluation and removal of fuel subsidy) on the inflationary environment and maintain the previous momentum of policy rate hikes in its upcoming monetary policy meeting.**

Fiscal Policy

Maximizing the Potentials of Revenue Generation

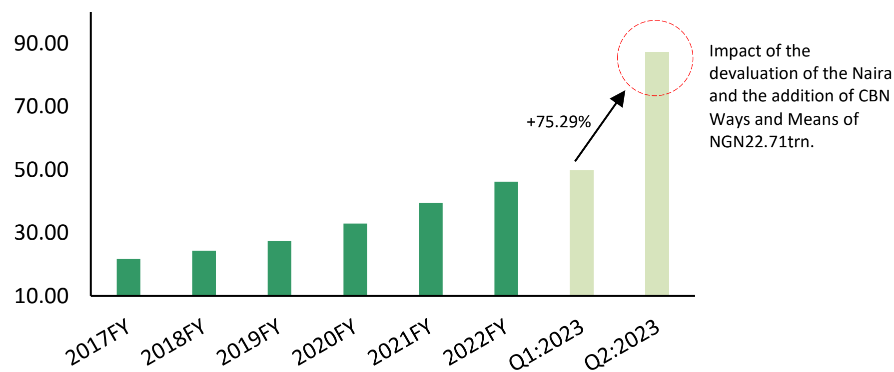
From the last Monetary Policy Committee (MPC) meeting in July, notable developments have emerged in the fiscal policy landscape. These include the inauguration of a tax Committee, a substantial increase in the national debt stock, and an optimistic projection for oil revenues (based on an upswing in global oil prices and FX devaluation). Recently, the President inaugurated the Committee on Fiscal Policy and Tax Reforms

(PCFPTR), whose objectives encompass achieving a tax-to-GDP ratio of 18%, expanding the tax base, standardizing tax structures across different levels, and ultimately enhancing government tax revenue collection. While the short-term effects of these measures may not be readily apparent, we anticipate that the Government will gradually begin to reap the benefits of enhanced revenue collection in the medium term, thus positively contributing to the Government's fiscal position.

Deeper Implications for the Country's Fiscal Health

According to the Debt Management Office (DMO), Nigeria's debt stock surged significantly by 75.29% to NGN87.38trn as of June 2023 (vs. NGN49.85trn as of March 2023). This increase is attributed to two main factors: the inclusion of securitized Ways and Means advances at the CBN (NGN22.70trn) and the devaluation of Naira (with exchange rates soaring to NGN841.00/USD1.00 on the I&E window as of June 30, 2023), thus, raising further concerns about the country's debt-to-GDP ratio– *expected at c.41% in 2023*, potentially leading to a higher debt service burden for the Government. Consequently, an uptick in the policy rate could result in elevated debt costs for the Government, prompting discussions about the country's debt sustainability.

Chart 1: Nigeria's Total Debt Stock (NGN'trn)



***Source**: DMO, Meristem Research*

Monetary Policy

Liquidity Management Takes Centre Stage for MPC

Since the last meeting, monetary authorities have continued to undertake numerous measures to stabilize the exchange rate, including consolidating various foreign exchange windows. These strategies have however been unable to sufficiently address the FX volatility prompted by the supply-demand mismatch and existing FX backlogs. As of 20th September, the value of the Naira against the greenback has depreciated by 32.08%YtD to NGN770.71/USD (vs NGN461.00/USD at the start of the year) at the official window. Moreover, the parallel market's premium over official rates widened further as rates at the informal market settled at NGN980.00/USD as of 20th September

(vs NGN870.00/USD as at the last MPC meeting). The external reserve has also been on a free fall shedding 10.22%YtD to USD33.28bn as of 19th September 2023 (from USD37.07bn at the start of the year), reflecting the twin challenges of low crude oil production volumes and dwindling capital inflows despite favorable crude oil prices.

Furthermore, to curb inflationary pressure, the MPC at its last meeting underscored the importance of liquidity management, opting to narrow the asymmetric corridor to +100/-300bps from +100/-700bps. Also, the CBN issued Open Market Operation (OMO) bills worth NGN150bn in August for the first time in 2023. Due to these liquidity tightening measures, system liquidity worsened, evinced by the increase in both Open Buy Back (OPR) and Overnight (O/N) rates to 23.50% and 23.75% (from 14.00% and 14.86% as at the last MPC meeting). **Looking forward, short-term prospects for accretion to the external reserve appear bleak. The nation still operates below its optimal capacity in terms of oil production, despite its recent production increase in August (1.30mbpd).**

Fixed Income Environment and Outlook

The mood in the fixed-income market has been predominantly bearish since the last MPC meeting. As expected, interbank liquidity continued to dictate the direction of yields on treasury instruments. This has been primarily influenced by measures taken by the CBN to tighten system liquidity during the period - the Open Market Operation bills issued in August and CRR debits. In fact, since the last MPC meeting in July, interbank liquidity has been largely volatile, declining by 70.72% to NGN230.96bn as of September 20.

Consequently, at the Primary Market Auctions (PMA) for T-Bills in August, the average stop rate increased by 495bps to 9.05% compared to the auction before the July meeting (July 12). Similarly, the average marginal rate at the FGN bond PMA increased to 15.44% in September (vs. 13.63% in July). Also, the secondary market mirrored the activities of the primary market as average bonds and T-Bills yield rose by 172bps and 450bps to 14.42% and 8.30%, respectively, as of September 20.

While the margin between treasury yields and the inflation rate widens, investors remain cautious about their investment options. Thus, investors demand higher yields to compensate for the deteriorating macroeconomic conditions. In addition, the Government is keen to support the monetary authorities in ensuring that Treasury rates reflect macroeconomic realities. Thus, we consider the aforementioned factors necessary for consideration in the forthcoming meeting.

Equities Market Performance and Outlook

The Nigerian equities market has displayed a predominantly mixed trend since the last MPC meeting. The All-Share Index (**NGX-ASI**) has gained 3.46% since the last meeting, settling at 68,271.14pts as of September 21. Notably, there has been a pullback from investors as they remain cautious about the health of corporates in the country. This is evident in the reduced activities in the market during the review period. In August, the

volume and value traded declined by 50.51% MoM and 62.26% MoM to 9.13bn units and NGN132.84bn, respectively, while market breadth weakened to 0.84x from 1.40x. Notwithstanding, the **NGXASI** gained 3.44% MoM, while five of the seven sectoral indices we track recorded month-on-month gains.

Some of the significant factors that influenced the market performance during the period include the H1:2023 earnings releases, subsequent dividend declarations and corporate actions by companies. As a result, there were notable buying activities on tickers that outperformed, while we noticed selloffs on some stocks that reported lower-than-expected earnings. In addition, an update on the proposed merger between **NASCON** and **DANGSUGAR** caused a positive ripple effect in the consumer goods sector. Meanwhile, **PZ** announced that its majority shareholder (PZ Cussons Holding Limited) has offered to purchase all shares held by minority shareholders in **PZ** and thereafter delist from the Nigerian Exchange. Similarly, after 51 years of operations in Nigeria, **GLAXOSMITH** announced plans to exit the Nigerian market, ceasing the commercialization of its prescription medicines and vaccines in Nigeria and transition into a third-party distribution model.

Furthermore, FTSE Rusell's (a primary provider of global market benchmarks and indices) downgrade of Nigeria's classification from a frontier market to an unclassified market – *owing to the uncertainties regarding Nigeria's macroeconomic landscape*, also impacted market direction during the period. The downgrade led to selloffs as the All-Share Index (ASI) shed 1.24% on September 11. While this is expected to reduce foreign inflows into the Nigerian equities market, we posit that the impact will be minimal in the short term due to relatively low foreign participation in the local market (5.77% in July).

Overall, we emphasize that the impact of previous monetary policy hikes has remained subdued in the equities market as the MPC decision has been largely in line with market expectations. **We do not expect the MPC decision to significantly impact market direction following the MPC meeting. Sentiments in the market should remain mixed, barring any significant corporate actions or economic development.**

On a Balance of Factors…

We expect the Committee to:

- **Raise the MPR by 25bps to 19.00%**
- **Retain liquidity ratio at 30%**
- **Retain the asymmetric corridor at +100bps/-300bps**
- **Retain the CRR at 32.50%**

Contact Information

Brokerage and Retail Services

topeoludimu@meristemng.com	(+234 905 569 0627)
adaezeonyemachi@meristemng.com	(+234 808 369 0213)
contact@meristemng.com	

Investment Banking/Corporate Finance

rasakisalawu@meristemng.com	(+234 806 022 9889)
davidadu@meristemng.com	(+234 810 940 4836)

Wealth Management

funmilolaadekola-daramola@meristemng.com	(+234 805 498 4522)
crmwealth@meristemng.com	
Tel: +234 01 738 9948	

Registrars

oluseyiowoturo@meristemregistrars.com	(+234 802 321 0561)
www.meristemregistrars.com	
Tel: +23401-280 9250	

Trust Services

damilolahassan@meristemng.com	(+234 803 613 9123)
trustees@meristemng.com	

Finance

olasokomubo@meristemfinance.com	(+234 803 324 7996)
matthewawotundun@meristemfinance.com	(+234 802 390 6249)

Group Business Development

sulaimanadedokun@mersitemng.com	(+234 803 301 3331)
ifeomaanyanwu@meristemng.com	(+234 802 394 2967)
info@meristemng.com	

Client Services

adefemitaiwo@meristemng.com	(+234 803 694 3034)
brandandcomms@meristemng.com	

Investment Research

damilareojo@meristemng.com	(+234 816 890 2771)
praiseihansekhien@meristemng.com	(+234 817 007 1512)
research@meristemng.com	

Corporate websites: www.meristemng.com www.meristemwealth.com www.meristemregistrars.com

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