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Nigeria | Macroeconomics

Ahead Of MPC Report

March 2024

Committee Set to Hold its Second Meeting in 2024

Previewing the Upcoming MPC Meeting: A Hawkish Stance with a focus on Inflation and Naira Stability

The Nigerian Monetary Policy Committee (MPC) is set to convene for its second meeting of the year on March 25th and 26th, 2024. As with every MPC meeting, stabilizing prices and curbing inflation will be paramount on their agenda.

The committee will likely consider recent trends in developed economies. Disinflationary trends could offer insights into potential future developments in Nigeria. They will also monitor the measures other central banks around the world are implementing to combat inflation.

Nigeria is currently facing a significant surge in inflation with food inflation (37.90%) being a major contributor, accounting for over 50% of the total inflation (31.70%) figure reported in February 2024. Furthermore, the depreciation of the naira is putting additional upward pressure on domestic prices.

Given the urgency of addressing inflation, the MPC is expected to prioritize policies aimed at curbing it. An increase in the Monetary Policy Rate (MPR) by 200bps to 24.75% is anticipated. While a rate hike is likely, the MPC might choose to maintain other policy parameters, such as the Cash Reserve Ratio (CRR). This would reflect a cautious approach towards managing system liquidity while prioritizing naira stability. We also support this by the CBN's actions towards increasing FPIs to further support the exchange rate.

Overall, we expect the committee to prioritize curbing inflation through a potential rate hike, while maintaining a balanced approach towards managing system liquidity and exchange rate stability.

Committee's Expected Decision

On a Balance of Factors…

We expect the Committee to:

- **Raise the MPR by 200bps to 24.75%**
- **Retain Liquidity Ratio at 30%**
- **Retain the Asymmetric Corridor at +100bps/-700bps around the MPR.**
- **Maintain the CRR at 45.00%**

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International Economies and Developments

Inflation and Monetary Policy

Global Inflation Continues to Decline

On the global stage, inflationary pressures have shown signs of easing across major economies, largely driven by lower food and energy prices resulting from improvements in supply chains. In February 2024, headline inflation in the UK and Euro Area decelerated to 3.40% and 2.60%, respectively, compared to 4.00% and 2.80% in the previous month. However, the US headline inflation in the US ticked up unexpectedly to 3.20% from 3.10% in January, attributed to increases in gasoline and shelter costs. Despite inflation levels being above the 2% target, major monetary authorities such as the US Fed, ECB, and BOE opted to maintain their primary interest rates unchanged at their March meetings, aiming to strike a delicate balance between curbing inflation and supporting economic growth. Conversely, the Bank of Japan (BOJ) made a significant move by ending its eight-year-long negative interest rate policy, increasing its policy rate to the range of 0% to 0.10% for the first time in 17 years. This decision comes as inflation remains well above its target range for over a year, indicating the possibility of further planned rate hikes.

Global Growth

Diverse Growth Outcomes Prevail Across Regions

In our previous report, we largely highlighted the recent developments in the global economy. However, recent data reports a notable upturn in China's trade surplus, reaching USD125.16bn in January 2024 compared to USD75.03bn in December. This better-than-expected growth is attributed to several factors, including the gradual recovery in global trade, favorable base effect, and Chinese manufacturers reducing prices to secure more orders, leading to increased exports. Additionally, imports surged due to heightened crude oil imports, driven by refineries aiming to meet domestic demand for oil during the Lunar New Year holiday. While this development is positive for the Chinese economy amidst the ongoing property sector crisis, we remain cautious about sustained growth in trade due to subdued domestic demand. Furthermore, PMI data suggests a slight improvement in global growth prospects, improving to 52.10pts in February from 51.80pts in January 2024, above the 50pts benchmark. For the rest of the year, expectations to global growth hinges greatly on various economic policies leading up to the polls and a significant improve in China's property sector.

Oil Prices Soar Amid Tension Fears

Recently, we've seen more escalations from the Israel-Hamas and its impact on the rest of the world. The attacks by the Houthi rebels (allies with Palestine in the war) continue to stifle trade activities along the red sea trade shipping lanes coupled with major damages to underwater cables which have disrupted internet connectivity across Africa, Asia, and parts of Europe. In response to this uprising, the oil market jolted as global Brent crude oil prices rose to USD84.71pbl from USD81.18pbl at the end of February. During the month, the International Energy Organization (IEA) raised its global oil demand forecasts to 1.31mbpd compared to its earlier forecast of 1.20mbpd in February, citing the increased demand for bunker fuel owing to trade disruptions at the red sea. Therefore, we anticipate that the Monetary Policy Committee (MPC) will take into account the developments in the global scene and happenings in the oil market during its upcoming meeting.

Domestic Macros

Economic Growth

Rate Hike Impacts: Opportunities and Challenges for Economic Growth

The Nigerian economy recorded a 3.46% YoY expansion in Q4:2023, as reported by the National Bureau of Statistics (NBS), slightly lower than the 3.52% YoY increase in Q4:2022. This growth was primarily driven by improvements in oil output, which returned to growth in line with our expectation (+ 3.20% YoY). Additionally, the non-oil sector demonstrated continuous resilience, posting a 3.04% YoY growth. Overall, the economy expanded by 2.74% YoY growth in 2023FY.

Looking ahead, we anticipate a sustained positive momentum in the country's oil and gas sector, particularly with increasing interest and investments in the sector. However, we highlight the possibility of occasional downturns in oil production volumes due to prevalent issues such as oil theft and arbitrage activities along oil infrastructures. This concern is reflected in the oil production figures for February 2024, which declined to 1.54 million barrels per day (mbpd) from 1.64 mbpd in January 2024, according to Nigerian Upstream Petroleum regulatory Commission.

Furthermore, we acknowledge that the recent decision by the Monetary Policy Committee (MPC) to hike rates in its previous sitting acts as a double-edged sword. On one hand, it enhances the outlook for sectors like financial and insurance services, which stand to benefit from higher interest rates. On the other hand, it presents a challenge for the real economy as credit to private sector is expected to reduce, introducing uncertainties regarding the performance of certain sub-sectors in the non-oil sector like the manufacturing, agricultural and services sector. The latest S&P Purchasing Managers' Index (PMI) readings further underscores this outlook as PMI declined to 51.00pts in February 2024 (from 54.50pts in January), marking a three-month low.

Overall, we anticipate that the potential impact of higher interest rates on economic growth will be a significant consideration for the MPC in its upcoming meeting and thus, expect the committee to adopt a less aggressive stance compared to the previous meeting.

Inflation

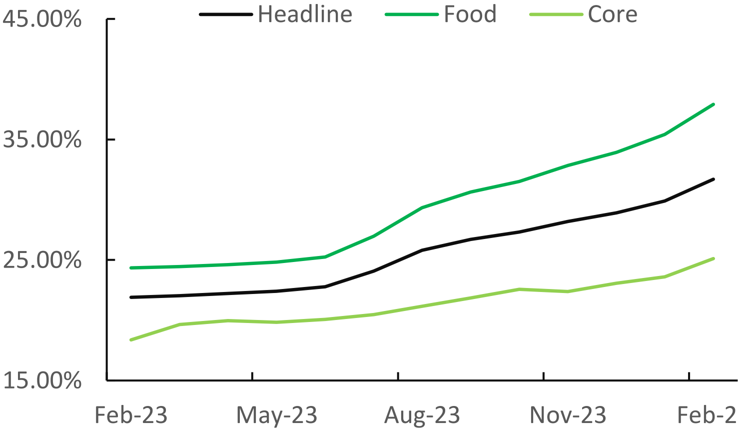
Inflation Maintains Unwavering Uptrend

In February 2024, Nigerian's headline inflation rate continued its northward trend, surging to 31.70% YoY, up from 29.90% in the previous month and 21.91% in February 2023. This was propelled by significant upticks in the food and core indices to 37.90% and 25.34%, respectively. The persistent rise in food prices can be linked to poor road networks, inadequate storage facilities, and high transportation costs amongst other bottlenecks in the country's food sector. Additionally, the increase in the core index was primarily driven by the passthrough effect of the depreciation of the Naira on the prices of other goods and services.

In the near term, we anticipate further increases in inflation, driven by the challenges mentioned above. Furthermore, we anticipate that reduced output resulting from the ongoing planting season and fasting will further contribute to the escalation of food prices.

Given the monetary policy authority's focus on combating inflation and its objective to attain a target inflation rate of 21.40% by December 2024, we anticipate that the Committee will adopt contractionary measures to stabilize price levels. The persistence of inflationary trends despite prior rate adjustments further reinforces this expectation.

Chart 1: Headline, Food and Core Inflation Trend



Source: NBS, Meristem Research

Monetary Policy

Monetary Policy in Focus

At the last MPC meeting, the Committee made adjustments to three out of the four monetary policy tools – MPR ⬆ 22.75% (vs 18.75%), asymmetric corridor ⬆ +100/-300 (vs +100/-700), and CRR ⬆ 45.00% (vs 32.50%). However, the liquidity ratio remained unchanged at 30.00%. These adjustments signal the aggressive stance of the monetary authorities in their efforts to curb persistent inflationary pressures, exchange rate pressures amid ongoing structural challenges shortages, and the need to effectively anchor expectations within the economy. In response to these changes, average fixed income rates, particularly those on Treasury bills (18.91%), FGN bonds (20.13%) and OMO bills (20.00%) rose to levels-high at their respective auctions. This move aims to make rates more attractive to foreign investors, thereby reinforcing efforts to attract investment into the Nigerian market. Consequently, the external reserves experienced a 1.93% accretion, rising from USD33.67bn at the last meeting to USD34.32bn as of March 20th, 2024. While we acknowledge that inflation is a lagging indicator, there remains a pressing need to maintain an aggressive stance and sustain an attractive yield environment for investors. This is crucial for facilitating continued appreciation of the Naira, which has already appreciated by 9.76% to NGN1453.28/USD as of 21st March, 2024. We have also seen sustained convergence between the official and parallel markets, with occasional instances of the parallel market rate dipping below the official rate.

Although the adjustment of the asymmetric corridor has muted impact on the CBN deposit rate, we see the Standing Lending Facility (SLF) remain significantly higher than the Standing Deposit Facility (SDF) NGN20.46trn vs NGN98.62bn, mirroring tight system liquidity (down to NGN47.67bn from NGN136.16bn as of the last meeting), which is in line with the monetary authority's objective of liquidity management. Consequently, both the Open Buy Back (OPR) and Overnight (O/N) rates surged to 24.50% and 25.42%, respectively, up from 14.00% and 14.86% observed at the last meeting. In addition to

Chart 2: Assessment of Impact of CBN Circulars (Year-to-Date)

CBN Circulars	Impact
Guidelines on Operations of Bank Accounts for Virtual Assets Service Providers (VASPs)	✅
Financial Markets Price Transparency	✅
Harmonisation of Reporting Requirements on Foreign Currency Exposures of Banks	↗↙
Reviewed Guidelines of International Money Transfer Services in Nigeria	↗↙
Cash Reserve Requirement (CRR) Framework Implementation Guidelines	✅
Removal of the spread on Foreign Exchange Transaction	✅
Allowable Channels for Payout of PTA and BTA	↗↙
Allowable Deviation Limit on The Price Verification System	✅
Requirements for Foreign Currency Cash Pooling on behalf of IOCs	✅
Revised guidelines for Bureau de change operations	✅
Foreign exchange rates for import duty assessment	↗↙
Sales of FX to bureau de change operators to meet retail demand	✅
Harmonisation of reporting requirement of foreign currency exposure of bank	✅
Mandatory reporting of FX transactions	✅

Legend:
- ✅ Significant Impact
- ↗↙ Minimal Impact

Source: CBN, Meristem Research

reviewing the policy tools, we also evaluate the effects of previous circulars issued by the CBN and their intended implications for maintaining overall price stability. While many of these measures have initially positively influenced the exchange rate upon announcement, sustained impacts or correlations with price stability remain elusive. Thus, aligning with the sentiments expressed by the monetary policy committee, we anticipate that the MPC will maintain elevated rates given the persistent inflationary pressures.

Markets

Fixed Income Market

Treasury Yields to Remain Focal Point

The fixed income market has predominantly displayed a bearish sentiment since the last Monetary Policy Committee (MPC) meeting. Notably, the 400 basis points (bps) hike in the Monetary Policy Rate (MPR) to 22.75% at the meeting stimulated an uptrend in treasury yields. Following this, at the Open Market Operations (OMO) auction held after the meeting, the stop rate on the 361-day instrument reached a peak of 21.50%. Similarly, stop rates at the Primary Market Auction (PMA) for Treasury Bills increased due to heightened investor demand, with the average stop rate rising to 18.91%, (from 17.83% previously). Additionally, marginal rates on the MAR 2027, FEB 2031 and FEB 2034 bonds issued during the period came in at 19.94%, 20.00%, and 20.45%, reflecting the upbeat mood.

In the same vein, the secondary market mirrored the primary market activities, as the average T-Bills and bond yields increased to 18.69% and 18.94% (vs. 16.79% and 16.80% at the last meeting). In our view, the high interest rate environment underscores the monetary authority's commitment to liquidity management, attracting foreign investors, and ensuring that treasury rates accurately reflect market conditions. This strategy is anticipated to bolster foreign exchange (FX) inflows and support currency appreciation. However, we note that the real rate of return on treasury instruments has remained negative due to persistent inflationary pressure.

On the other hand, we have observed a notable decline in corporate entities' participation in the debt market, as evinced by the absence of new commercial paper listings on the FMDQ since the last meeting. We attribute this to the increased borrowing costs, and crowding out effect, which may have dissuaded corporates from raising short-term debt. In light of these factors, we expect that the direction of treasury yields will remain the focus of the MPC committee, alongside evaluating strategies for effective debt management.

Equities Market

Local Bourse Rides Both Ends

Sell-offs in the Nigerian Equities market, which began in February was exacerbated by the MPC's unprecedented 400bps hike in the MPR. In addition, the underwhelming financial performance from tickers like **MTNN** and **NESTLE** during the period also spurred substantial selloffs (**MTNN** declined to a 3-yr low of NGN183.00 per share). While the sentiment remained subdued in early March, the listing of Transcorp Power Plc (**TRANSPOWER**) on the exchange upturned the broad market performance. Being a heavy-weight (listed at NGN1.80trn), the buying interests on the ticker (+59.58% MtD) overshadowed the existing dampened mood in the market.

Subsequently, the market performance has been mixed but tilted towards the negatives as investors continue to take profit on sizeable gains as well as cautiously bargain-hunt on fundamentally strong tickers. The All-Share Index (**NGX-ASI**) has returned 4.41% MtD to reach 104,387.47bpts as of 21st March, 2024. Thus, the year-to-date return stayed strong at 39.60%, outperforming its African peers like Egypt (16.71%YtD), Ghana (13.03%YtD), Kenya (0.40%YtD) and South Africa (5.82%YtD).

Across sectorial indices, performance has varied as four out of seven indices under our coverage recorded positive month-to-date returns except **NGXINDUSTR** (-1.14%), **NGXOILGAS** (-0.67%), and **MERI-AGRIC** (-0.34%) in the red zone. The bargain hunting on banking sector (+17.20% MtD) is attributed to investors' optimism ahead of the release of banks' 2023FY and Q1:2024 financials and expectations of attractive dividend declarations.

We posit that the likely further rate hike of 200bps is largely anticipated by investors and thus is not likely to spur significant reaction from equity investors post announcement. However, any unexpected decision by the MPC could significantly impact market direction, reflecting the sensitivity of market sentiment to monetary policy decisions.

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