MERISTEM

Nigeria | Macroeconomics

Ahead Of MPC Report

February 2024

Committee Set to Hold its First Meeting in 2024

Expected MPR Hike: MPC Expected to Take Policy Directions Aimed at Combating Inflationary Pressure

The Monetary Policy Committee (MPC) is scheduled to convene for its first session of the year on February 26th and 27th 2024.

During the upcoming meeting, we anticipate that the monetary policy committee will focus on several key considerations. These include evaluating the disinflation trends observed in advanced economies and monitoring the measures implemented by global monetary authorities. Additionally, we expect the committee to assess the deceleration in oil price fluctuations and analyze the potential repercussions of the UK and Japan's economic downturns on global economic growth.

In the domestic landscape, the persistent rise in headline inflation, attributed to escalating food prices and the depreciation of the Naira, continues to pose a major concern for the Committee. Furthermore, factors such as money supply and the continuous free fall of the Naira are expected to influence the Committee's deliberations.

Considering the sustained inflationary pressures and the anticipation of a continued uptrend, we foresee the Committee raising the policy rate by 100bps to 19.75%. Moreover, we anticipate an increase in the Cash Reserve Ratio (CRR) by 250bps to 35.00%, with other policy parameters remaining unchanged. Additionally, considering the necessity of aligning the monetary policy rate with prevailing market interest rates, we opine that a 'HOLD' stance is unlikely.

International Economies and Developments

Inflation and Monetary Policy

Global Inflation Continues to Decline

Across major advanced economies, inflationary pressures have continued to ease since Q3:2023, primarily due to a downtrend in food and energy prices. In January 2024, headline inflation in the United States and the Euro Area decelerated to 3.10% and 2.80% from 3.40% and 2.90% in December 2023, respectively while the UK's inflation rate remained unchanged at 4.00%. In response to these disinflationary trends, major monetary authorities, including the US Federal Reserve, European Central Bank and Bank of England kept rates constant in their last meeting. We expect these monetary authorities to retain this stance while monitoring underlying factors that threaten price stability, such as labor market trends and supply chain disruptions stemming from the ongoing geopolitical tensions. Consequently, we foresee the likelihood of rate cuts in the later part of the year.

Global Growth

Diverse Growth Outcomes Prevail Across Regions

The International Monetary Fund (IMF), in its January World Economic Outlook report, revised its 2024 projection for global growth to 3.10% from the initial 2.90% in October 2023. The upward adjustment is chiefly hinged on the US economy's greater-than-expected resilience which expanded by 3.30% YoY in the Q4:2024. However, other advanced economies report different growth outcomes – the Euro area GDP remained flat at 0.1% YoY in Q4:2024, and the Office for National Statistics (ONS) reported that the UK economy has entered a recession for the first time since 2020. The UK economy contraction of 0.30% YoY in Q4:2024 is primarily owed to reduced consumption due to prevailing high prices and the cumulative impact of elevated interest rates on business activities. In 2024, we expect a slowdown in economic growth as existing and new challenges continue to hinder expansion. However, with 2024 being an election year for the major economies (US, UK amongst others), there are likely to be more expansionary fiscal policies in form of increased government spending and tax cuts for businesses. Additionally, the continuation of accommodative monetary policy by the central banks will play a major role in supporting economic growth in the near term.

In the Asian region, Japan's economy slipped into a recession after recording a second consecutive quarter of negative GDP growth of 0.40% YoY in Q4:2023. Despite various fiscal stimulus measures by the Japanese government, continuous weak domestic demand and weak currency continued to impede growth and this is expected to persist in the near term as there are no positive triggers in sight. For China, the nation continues to face challenges in its property market and subdued consumer spending. In January 2024, a Hong Kong court issued an order for the liquidation of China's property giant Evergrande Group following the company's prolonged debt crisis that created an adverse ripple effect in the Chinese property sector and economy at large. While this may weaken confidence in the property sector, we expect this to bring some clarity to recovery plans and prompt a more structured revitalization effort by the Chinese government.

Given the impact of global monetary and fiscal activities on interest rates in the global economy, we expect the Monetary Policy Committee's decision to be influenced by these factors.

Oil Prices Remain Stable Despite Shock Triggers

The escalation of the Israel-Hamas war and the ensuing attacks by Houthi rebels along the Red sea trade route have led to paused shipments and longer shipping routes for vessels, thus, raising the possibility of a shock to global crude supply. Nonetheless, crude prices have remained relatively stable in recent months (USD81.99/bl as of 21st February 2024 compared to a peak of USD96.66/bl in Q3:2023). The Organization of Petroleum Exporting Countries (OPEC+) proactive supply cuts influenced price stability as it adequately offset the negative impact of subdued global demands, particularly from Asia.

The OPEC+ in its February 2024 report, has maintained its outlook for global crude demand at 2.20mb/d as the expectations of strong demand from the US was balanced out by the slower demand prospects from Europe and Asia. Finally, with demand stable coupled with the reduced attack of shipments in the red sea, we posit that crude oil prices will be less volatile in the near term.

As such, we expect the Monetary Policy Committee to consider the balance in the oil market at its meeting as price remains stable and there are no shocks to global oil market.

Domestic Macros

Economic Growth

Oil Sector to Return to Growth in Q4:2023

In Q3:2023, data reported by the National Bureau of Statistics (NBS) indicated that Nigeria's economy expanded by 2.54% YoY, compared to 2.25% YoY in Q3:2022 and 2.51% YoY in the preceding quarter. This growth marks the 12th consecutive quarter of economic expansion and was driven by a significant recovery in the oil sector, which recorded a lesser contraction of 0.85% YoY (compared to 22.67% YoY in Q3:2022). Meanwhile, the non-oil sector remained resilient, growing by 2.75% YoY, albeit slower than Q3:2022 and Q2:2023 (4.27% and 3.58%, respectively).

For Q4:2023 GDP report (expected to be released on February 26, 2024), we project improved growth in the oil sector, driven by expectations of higher oil outputs. Also, oil production data which averaged 1.53mbpd as of Q4:2023, up from 1.43mbpd in Q3:2023 further supports this outlook. Hence, we envisage the oil sector to return to growth in Q4:2023. We however anticipate a further decline in output growth from the non-oil sector in Q4:2023, due to lower performance of the agricultural, trade, manufacturing and transportation sectors. Moreso, S&P Global PMI readings for Q4:2023 depict that manufacturing activities fell to 49.93pts (from 51.00pts in Q3:2023) further substantiating our outlook.

In 2024FY, we project an increase in oil production to 1.55mbpd (from 1.46mbpd in 2023), driven by various government initiatives aimed at enhancing oil output. Moreover, we anticipate a resurgence in business activity as the impact of economic reforms fades. The possibility of a GDP basket rebasing during the year to include sectors not previously accounted for in the 2009 framework is another positive factor for improved economic growth. We project a 2024FY GDP growth of 3.42% premised on these factors.

However, we expect the Committee to be concerned about the rapid pace of Naira depreciation in recent times amid FX market volatility and its impacts business activities which poses a downside projection to our growth expectation. Thus, efforts aimed at improving the strength of the Naira are likely to influence the MPC's decision.

Inflation

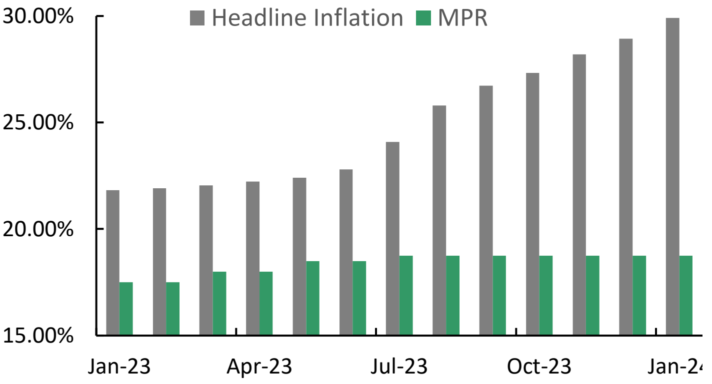
Nigeria's Headline Inflation Hits 28-Year High at 29.90% YoY

In January 2024, the National Bureau of Statistics (NBS) reported that Nigeria experienced its highest headline inflation in 28 years, reaching 29.90% YoY compared to 28.92% and 21.82% in December and January 2023, respectively. The upswing was propelled by simultaneous spikes in the food and core indices, hitting 35.41% YoY and 23.59%, respectively. The persistent uptick in food inflation is attributed to reduced productivity in Nigeria's agricultural sector due to infrastructure deficiencies, deteriorating security conditions in vital food-producing regions, and a general upsurge in the cost of living. Furthermore, the uptick in the core index is linked to the ongoing depreciation of the Naira, impacting items dependent on imports.

Looking ahead, we anticipate sustained inflationary trends, particularly in food prices, given the government's plans to restrict food imports, potentially intensifying the upward trajectory in the near term. Additionally, recent developments such as the Central Bank of Nigeria's (CBN) decision to increase the exchange rate for import duties and the potential elimination of electricity subsidies could further increase the core inflation rate.

Considering the priority of price stability in the Committee's mandate and the expected release of its inflation-targeting framework, we expect the Committee to implement contractionary measures to help stabilize price levels in the country.

Chart 1: Nigeria's Inflation and MPR Trend



Source: *NBS, CBN, Meristem Research*

MERISTEM

Monetary and Fiscal Policy

Monetary Policy

Monetary Authorities Race to Tame Currency Storm

Since resuming office, the new monetary authorities at the Apex bank have intensified efforts to combat currency fluctuations and manage financial system liquidity. Notably, the Central Bank of Nigeria (CBN) intervened in the foreign exchange market after a five-month hiatus, aiming to inject stability and quell speculative pressures. Additionally, twelve circulars have been issued since January 2024, introducing new measures mainly aimed at reducing FX demand. These measures include the cessation of daily debits of Cash Reserve Ratio (CRR) to boost liquidity, restriction of banks' net open positions to mitigate excessive foreign exchange exposure, and the requirement for foreign currency cash pooling on behalf of International Oil Companies in Nigeria (IOCs) to ensure repatriation does not negatively impact liquidity. Despite this, the naira depreciated by 49.02% and 47.28% to NGN1,542.58 and NGN1,760 at the official and parallel market, respectively so far this year. The external reserve has also remained low at USD33.39bn as of 19th February 2024 (vs USD33.95bn at the last meeting). This further points to the need to boost FX supply and attract inflows apart from oil receipts

More so, we observe a signaling effect between monetary policy decisions and fixed income rates. Since August 2023, the continuous issuance of Open Market Operations (OMO) alongside record-high treasury bill and bond allocations of NGN2.88trn and NGN1.92trn, respectively, have exerted upward pressure on fixed income rates, aligning with the direction of the monetary policy rate. These liquidity-tightening measures have resulted in a decline in system liquidity, which fell from NGN218.46bn in December 2023 to NGN120.72bn and NGN198.79bn in January and February 2024, respectively. 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.

Despite these tightening measures, CBN data on money aggregates reveals an increase in broad money supply (M3) to NGN93.72bn in January, +19.02% from NGN78.74bn in December 2023, propelled by growth in Net domestic credit (+17.59%) and net domestic assets (+21.75%). We expect the MPC at its next meeting to reconsider the Apex bank's stance on further M3 growth. This is due to significant and persistent inflationary pressure which continues to erode consumer purchasing power; and which proves counterproductive to the goal of reducing inflation and maintaining price stability.

Chart 2: Trend of Monetary Policy Tools

	MPR (%)	Asymmetric Corridor	CRR (%)	Liquidity Ratio (%)
Nov-22	11.50	+100/-700	27.50	30.00
Jan-22	11.50	+100/-700	27.50	30.00
Mar-22	11.50	+100/-700	27.50	30.00
May-22	13.00	+100/-700	27.50	30.00
Jul-22	14.00	+100/-700	27.50	30.00
Sep-22	15.50	+100/-700	32.50	30.00
Nov-22	16.50	+100/-700	32.50	30.00
Jan-23	17.50	+100/-700	32.50	30.00
Mar-23	18.00	+100/-700	32.50	30.00
May-23	18.50	+100/-700	32.50	30.00
Jul-23	18.75	+100/-300	32.50	30.00

Source: CBN, Meristem Research

Fiscal Policy

Crippling Economic Fundamentals Underline Increased Borrowing Needs

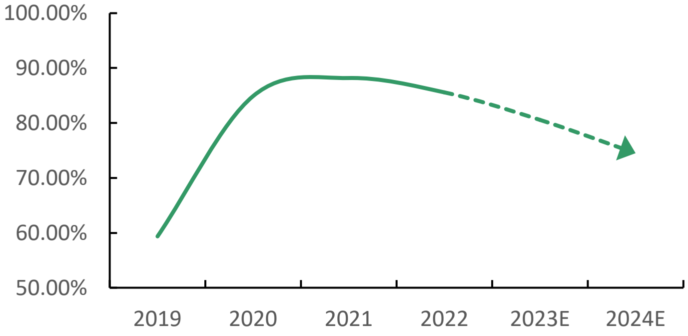
Since our last Ahead of MPC report in November 2023, several significant developments have unfolded in the country's fiscal landscape, which remain key to shaping the direction of monetary policy at the upcoming committee meeting. Notably, the Senate approved the fiscal budget for 2024, raising the budget size by c. 5% to NGN28.66trn from the initial NGN27.50trn proposed by the Presidency. Additionally, adjustments were made to the underlying assumptions, with an upward revision to the estimated oil price to USD77.96pb, and the exchange rate set at NGN800/USD. Meanwhile, the inflation rate and estimated oil output remained unchanged at 21.40% and 1.78mbpd, respectively.

With a revenue projection of NGN19.52bn, the budget deficit soared to NGN9.18trn, indicating a heightened reliance on debt financing from both domestic and international sources, as well as multilateral funding avenues, potentially including access to the Ways and Means facility.

Monetary and Fiscal Policy

In a recent development, the CBN governor hinted the likely cease in further grants to the Federal Government (FGN) of the Ways and Means facility until outstanding debts are settled. Although this is a positive initiative which could potentially reduce debt sourcing through this means. However, the continued depreciation of the Naira against the dollar and increased borrowing needs signal a rise in debt levels. With an average cost of debt standing at around 9% based on debt service of NGN5.79trn in 9M:2023 and a burgeoning total debt balance, the government faces mounting debt burdens. To finance the budget deficit, the government must resort to additional borrowings, alongside the NGN1.55trn raised in T-bills and NGN1.61trn in bonds so far this year. However, this deepens the country's debt situation, with an estimated debt service of NGN8.27trn, as outlined in the budget.

Chart 3: Federal Government's Debt Service to Revenue (2019 – 2024E)



Source: DMO, Budget Office, Meristem Research

Oil revenue has faced challenges due to persistent issues of oil theft and bunkering, resulting in production levels remaining below pre-pandemic levels (2.01mbpd). NBS data indicated an average decline in oil production to 1.55mbpd in 2023 (vs 1.42mbpd in the previous year). Additionally, the recent pledge of crude oil output as collateral for a pre-export loan facility from AFREXIM Bank, amounting to c.90,000bpd over the next five years, is anticipated to further impact government oil revenue in the near term. Given this underwhelming revenue performance, restrictions on accessing the Ways and Means facility, and higher funding requirement (with the return in subsidy payments by the FGN), it is likely that the government will turn to the international market for funding.

In 2024, Cote d'Ivoire and Benin Republic turned to the international debt market to access funding from Eurobonds issuances. At the auctions earlier in this year, a total of USD2.60bn at 8.50%, and USD750mn at 8.38% were raised for Cote d'Ivoire and Benin Republic, respectively. Furthermore, the auctions in Cote d'Ivoire and Benin Republic saw remarkable over-subscription, with demand exceeding the amount offered by three and seven times, respectively. This signals a strong and growing investor appetite for African Eurobonds market. Thus, based on this, and as monetary authorities across major economies shift to take a dovish stance on policy rates by the next half of 2024, we might likely see Nigeria resort to the Eurobonds market to access funding.

Polity and Insecurity

Unsettling Hardships Cause a Rise in Insecurity

In contrast to previous periods when incidents of banditry and kidnappings were concentrated mainly in the North-Central region of Nigeria, recent occurrences have seen these security challenges spreading to the Western states. Areas such as Ondo, Oyo, and Ekiti states, and along the Lagos-Ibadan expressway, have witnessed a surge in cases involving banditry, violence, and abductions. This escalation poses a significant threat not only to the affected regions' economic activities but also raises concerns about the potential for these disruptions to extend to other productive areas across the country. The recent proposition surrounding the introduction of state police commands in Nigeria underscores the necessity of a framework that facilitates allows for a localized control in addressing security concerns across different regions of the country.

Also, as the cost-of-living crisis worsens, the Nigerian Labour Congress (NLC) has issued a statement announcing the commencement of strike actions over the state of country and economic hardships faced by the populace. Against this backdrop, we note that it is imperative for the MPC to carefully assess the implications of these security challenges on the economy.

Fixed Income Market and Outlook

Treasury Yields Chart Upward Course

Since the last MPC meeting in July 2023, the fixed income market has encountered occasional swings characterized by elevated Treasury yields. Since then, the stop rates of the 91-day, 182-day, and 364-day instruments have spiked significantly by 1124bps, 1000bps, and 685bps to 17.24%, 18.00%, and 19.00%, respectively as at the last auction in February 2024. Likewise, the rates on the FGN bonds issued at the primary market auctions (PMAs) have followed similar trajectory. These activities have been chiefly driven by the active liquidity management strategy of the CBN (occasional Open Market Operations (OMO) bills issuances and CRR debits on banks) as well as the increased borrowing needs of the Government (displayed by the NGN1trn and NGN2.50trn offered at the T-bills and bond PMAs in February.

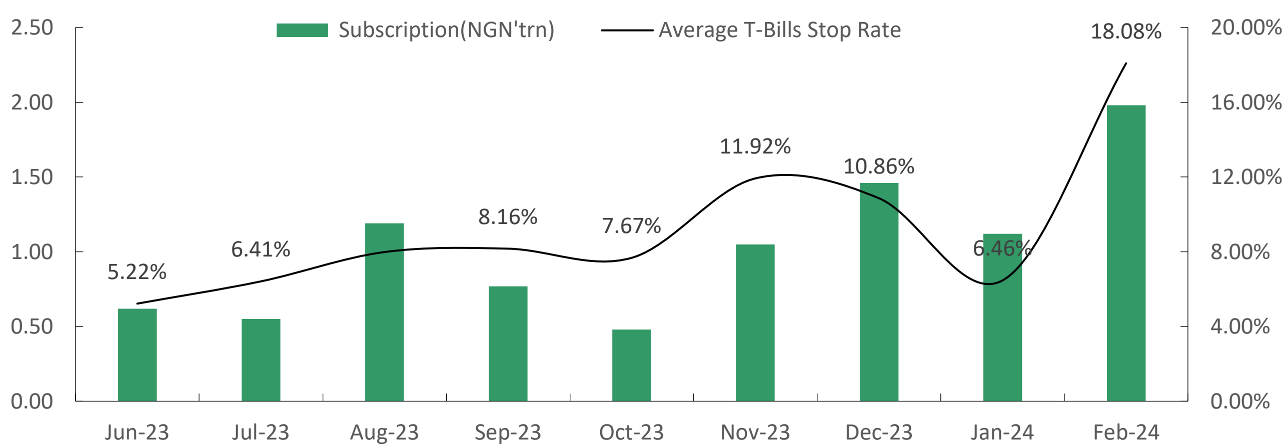
Also, the sentiment in the secondary market has largely mirrored that of the PMAs as the market has been predominantly bearish since the last meeting. Selloffs across the curve drove yields higher during the period. As a result, the average T-Bills and bond yields increased to 16.93% and 16.09% as of February 19, 2024 (vs. 10.53% and 12.73% as at the last meeting), respectively.

Despite the uptrend in Treasury yields at both the primary and secondary markets, the real rate of return has remained negative owing to the continuous increase in the country's inflation figures. This remains a focal discussion topic for investors interested in locking their funds in the Nigerian local currency denominated Sovereign debt instruments.

The expectation of an elevated inflation rate in the immediate term which could further widen the negative real rate of return remains the core mandate to be addressed by the Committee. Thus, we envisage that the Committee will consider the direction of Treasury yields in the forthcoming meeting in its decision. In addition, we expect the central bank to continue the issuance of OMO bills as a supporting tool to manage system liquidity.

On the other hand, the Government's increasing debt profile will also be considered in the Committee's decision. Overall, key indicators to be considered within the fixed-income space make a case for a rate hike at the forthcoming MPC meeting.

Chart 4: Average subscription and T-Bills PMA rate (Jun 2023- Feb 2024)



***Source:* CBN, Meristem Research**

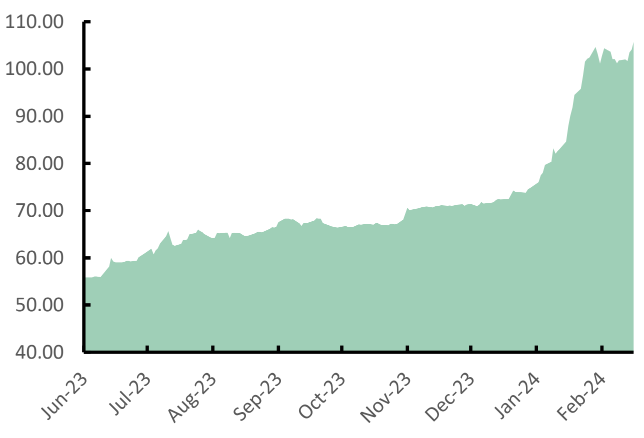
Equities Market and Outlook

Crippling Hurdles Slow the Bulls Relentless Run

The Nigerian equities market returned +45.90% in 2023FY as various factors influenced broad positive sentiment. These factors include earnings releases, key reforms, corporate actions, proposed mergers, premium buyout prices from de-listings, and new listings. This strong positive momentum continued in January 2024 as the market crossed 100,000pts and recorded a 35.53% increase in market capitalization to NGN55.46trn (vs NGN40.92trn on December 31, 2023). As a result of the gains in January and significant activities on bellwether tickers, the Year-to-Date return reached +35.56% as of February 21, 2024. Notably, seven (7) out of eight (8) indices in our radar have positive year-to-date returns, with only NGXBNK (-2.40% YtD) in the red zone.

Relative to its African peers in terms of returns, the Nigerian bourse (+35.56% YtD) is significantly outperforming its African peers – Ghana (+1.95% YtD), South Africa (-5.38% YtD), Kenya (+0.40% YtD), and Egypt (+17.67% YtD).

Chart 5: Trend in NGXASI points (Jun 2023- Feb 2024) '000



***Source:* Bloomberg, Meristem Research**

However, the market's performance in February has majorly been driven by bellwether tickers that surged to record-high levels, thus overriding the negative undertone in the market.

For context, as of Feb 21, the seven most capitalized stocks, which account for c.70% of total market capitalization have all recorded ample year-to-date returns this year – DANGCEM (+114.66%), AIRTELAFRI (+16.59%), BUAFOODS (+84.85%), BUACEMENT (+54.64%), GEREGU (+146.87%), and SEPLAT (+45.89%).

Notwithstanding the stellar market performance in 2023, foreign investors remained hesitant to invest in the Nigerian equities market due to the lingering concerns about funds repatriation amid the country's foreign exchange crisis. Data from the NGX revealed that foreign investors' participation fell to 11.48% in 2023 (vs 16.32% in 2022 and 22.88% in 2021). In addition, total foreign outflow for the year (NGN235.82bn) outpaced total foreign inflow (NGN174.80bn) by 1.29x. We expect this to persist in H1:2024 as the existing issues around repatriation remain unsolved.

Furthermore, profit-taking activities have largely reigned in the equities market for the past xx weeks as fixed-income rates become increasingly attractive for investors while macroeconomic conditions continue to deteriorate. Also, we note that although there has been a significant reduction in activity levels in the equities markets, outflow of funds from equities to the fixed income market appears to be muted as NGXASI has only shed 0.73% since yields surged on Feb 7th. This is also despite the significant subscriptions to Treasury bills and bonds auctions, underscoring the presence of sufficient system liquidity. We expect the MPC to conclude that the equities market remains resilient to happenings in the fixed income market and thus are not likely to place emphasis on considering policy directions that will boost growth in equities asset prices. We highlight that the impact of previous monetary policy hikes has remained subdued in the equities market as investors largely anticipated the decisions. Nevertheless, investors are keen on the outcome of this meeting to aid clarity of policy direction being the first convene of the new leadership. As such, an unexpected decision by the MPC may trigger a negative reaction from investors.

Committee's Expected Decision

On a Balance of Factors…

We expect the Committee to:

- **Raise the MPR by 100bps to 19.75%**
- **Retain Liquidity Ratio at 30%**
- **Retain the Asymmetric Corridor at +100bps/-300bps around the MPR.**
- **Raise the CRR by 250bps to 35.00%**

MERISTEM

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 (+234 803 355 0008)
crmwealth@meristemng.com (+234 01 738 9948)

Registrars
nkechinyeluokoye@meristemng.com (+234 803 526 1801)
www.meristemregistrars.com (+234 01 280 9250)

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

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

Investment Research
praiseihansekhien@meristemng.com (+234 817 007 1512)
research@meristemng.com

Client Services
adefemitaiwo@meristemng.com (+234 803 798 3762)
Brandandcomms@meristemng.com (+234 01 280 9250)

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

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

Meristem Research can also be accessed on the following platforms:

Meristem Research Portal: research.meristemng.com
Bloomberg: MERI <GO>
Capital IQ: www.capitaliq.com
Reuters: www.thomsonreuters.com
ISI Emerging Markets: www.securities.com/ch.html?pc=NG
FactSet: www.factset.com