Nigeria | Macroeconomics

Ahead Of MPC Report

May 2024

Committee Set to Hold its Third Meeting in 2024

MPC Expected to Hike Rate to Curb Rising Inflation

The Nigerian Monetary Policy Committee (MPC) is scheduled to hold its third meeting of the year on May 20th and 21st, 2024, with its primary focus on price stability.

During the meeting, we expect the committee to deliberate on disinflationary trends observed in advanced economies, as well as the sustained "high for longer" interest rate stance employed by monetary authorities to effectively combat inflation in these economies. Furthermore, we anticipate the committee will assess the economic growth trajectories of these economies and their potential spillover effects on the domestic economy. Moreover, consideration may be given to potential escalations in geopolitical tensions and their probable impact on global oil prices.

In the domestic economy, Nigeria’s inflation rate came in lower than expected in April 2024, rising to 33.69% from 33.20% in the previous month (marking the sixteenth consecutive month of inflation uptrend). This uptick is primarily attributed to increases in both the food and core indexes, driven by higher food prices and the continued depreciation of the Naira. However, inflation moderated on a month-on-month basis, with headline, food, and core inflation showing slower upticks of 2.29%, 2.50%, and 2.20%, respectively, compared to 3.02%, 3.62%, and 2.54% in March.

Given the committee's commitment to a contractionary stance and the monetary authority's mandate to ensure price stability, we anticipate a 100 basis points hike in the monetary policy rate to 25.75%, while maintaining other parameters at their current levels. However, we acknowledge the possibility of a HOLD stance due to the moderation in month-on-month inflation figures and our expectation of a disinflationary trend in the coming months.

Ultimately, we expect the committee to give priority to controlling inflation and attracting Foreign Portfolio Investments (in order to achieve a stable exchange rate system), through the implementation of a rate hike.

Committee's Expected Decision

On a Balance of Factors…

We expect the Committee to:

- **Raise the MPR by 100bps to 25.75%**
- **Retain Liquidity Ratio at 30%**
- **Retain the Asymmetric Corridor at +100bps/-700bps around the MPR.**
- **Maintain the CRR at 45.00%**

International Economies and Developments

Inflation and Monetary Policy

Unified Downtrend Across Major Economies

Global inflation pressures continue to ease across regions. In the United States, the inflation rate slowed to 3.40% in April, compared to 3.50% in March, after two consecutive months of increase. This is attributed to the decline in the price of new vehicles, non-alcoholic beverages, food costs, and household furnishings. Similarly, the Eurozone inflation remained stable at 2.40% YoY in April. Prices declined in fifteen member countries with Lithuania, Finland, and Denmark reporting the lowest decline. Also, the United Kingdom's inflation rate decreased to 3.20% in March, down from 3.40% in February, primarily due to a reduction in food prices. These highlight the dynamic nature of global inflation trends, with varying factors influencing rates across different regions. Major monetary authorities such as the US Fed, ECB, and the BOE have opted to keep their primary interest rates unchanged at their April meetings, seeking to navigate a careful balance between controlling inflation and fostering economic growth as inflation is still above the 2% target.

Global Growth

Growth Momentum Builds….

Recently released data reveals a notable slowdown in the US economy, which expanded by 1.60% YoY in Q1:2024, lower than 2.20% in Q1:2023 and 3.40% in Q4:2023. This deceleration was driven by reductions in consumer spending, exports, and government expenditure. In contrast, the Euro area experienced its strongest growth since Q3:2022, with a 0.30% QoQ expansion in Q1:2024. This upswing was primarily spurred by a rebound in Germany, the region's largest economy, which grew by 0.20% after contracting by 0.50% in Q4:2023. Additionally, marginal expansions in production and fixed asset investments contributed to the Euro area's growth. We expect marginal improvement in global growth hinged on higher government spending amid upcoming elections and as monetary authorities begin to ease off from their contractionary stance.

In Asia, despite the housing sector crisis which has grounded its outlook in recent quarters, China's economy continued its upward trajectory in Q1:2024, expanding by 5.30% YoY (compared to 4.50% and 5.20% in Q1:2023 and Q4:2023, respectively). This is driven by expansions in industrial production, increased fixed asset investments, and heightened government spending targeted at providing low-cost houses to ease pressure in the housing sector.

Prolonged Tension Push Crude Oil Price Up

Since the last MPC meeting, the Israel-Hamas conflict has taken a dire turn, with escalating tensions and far-reaching consequences for the globe. As fears of regional escalation mount, Iran launched its first direct attack on Israel, while Houthi rebels – allies of Palestine in the war, continue to disrupt trade activities along the critical Red Sea shipping route. Israel's refusal to accept a ceasefire agreement, intended to alleviate the crisis, has heightened concerns. The oil market reacted sharply to these tensions, as global Brent crude oil prices rose to USD87.25 per barrel (pb) in April from USD86.11pb at the end of March. Furthermore, the International Energy Organization (IEA) revised its global oil demand forecasts downward to 1.11 million barrels per day (mbpd) in May, a significant decrease from previous estimates of 1.30mbpd. This revision was driven by reduced deliveries, low industrial activities, and a decline in the number of diesel cars in Europe.

As these warring tensions stay abated, prolonged conflicts could worsen inflationary pressures through energy cost passthroughs, thus, compelling monetary authorities to maintain elevated policy rates for an extended duration.

As such, we expect that the Monetary Policy Committee (MPC) will carefully evaluate the direction of monetary policy and developments in the global space in its upcoming meeting.

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Domestic Macros

Economic Growth

Oil Production Decline to Stall Q1:2024 Growth

In Q1:2024, oil production had t consecutive declines, with the average daily production dropping to 1.33mbpd, down from 1.55mbpd in Q4:2023 and 1.51mbpd in Q1:2023. This decline can be attributed to persistent issues related to oil theft and vandalism activities along oil infrastructures (particularly the Trans-Niger pipeline), as well as maintenance activities at certain oil terminals during this period. As such, we opine that this reduction in oil production volumes may weigh on the growth of the oil sector in Q1:2024. and negatively impact its contribution to total GDP.

Looking forward, we foresee enhancements in oil production driven by several factors. The recent resumption of operations at the Awoba terminal (which could potentially contribute around 360,000 barrels of oil per month) , as well as the commencement of production at terminals where maintenance activities were conducted in the first quarter of the year, are expected to bolster oil production figures for the country. Moreover, the recent introduction of fiscal incentives by the Federal Government to reinvigorate Nigeria's oil and gas sector and attract around NGN10.00bn in investments over the next 12 to 18 months holds promise for medium to long-term gains.

For the non-oil sector, the sustained high-interest rate environment (which limits credit access to the private sector) introduces uncertainties regarding the performance of certain subsectors, such as manufacturing, and poses challenges to its output. The S&P Purchasing Managers' Index (PMI), which held steady at 51.00pts in March 2024, reinforces this outlook. However, we anticipate enhanced performance in sectors like financial services to support overall output in the non-oil sector. Additionally, we expect growth in the agricultural sector due to recent reforms aimed at improving productivity and the low base effect from last year's contraction of 0.90%.

Overall, we project an economic expansion of 3.29% YoY in Q1:2024 (vs 2.31% and 3.46% in Q1:2023 and Q4:2023 respectively). This is expected to significantly influence the MPC's decision, likely prompting a less aggressive stance compared to previous sessions.

Inflation

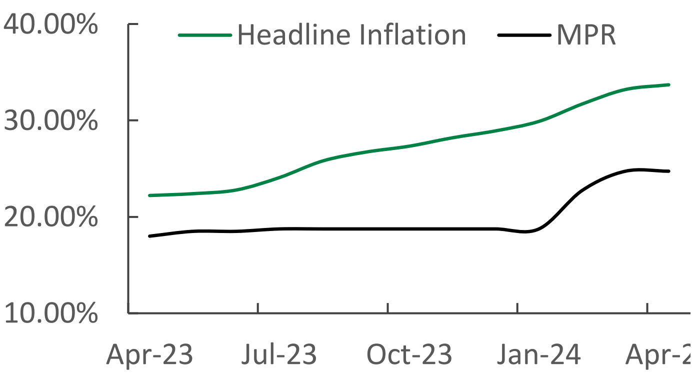
Stabilising Naira Slows Month-on-Month Inflation Figures

Nigeria's headline inflation rose for the sixteenth consecutive month, reaching 33.69% in April from 33.20% in the previous month. This increase is attributed to the simultaneous uptrend in both the core and food indexes, which increased to 26.84% and 40.53%, respectively. The rise in the food index is due to higher prices of major food items amid ongoing cost pressures in the food sector, while the core index rose owing to the depreciation of the Naira (5.86% MoM), and the electricity tariff hike implemented during the month. However, for the second time in six months, headline, food, and core inflation experienced slower month-on-month upticks in April 2024 to 2.29%, 2.50%, and 2.20%, respectively (vs. 3.02%, 3.62%, and 2.54% in March 2024).

In the near term, we anticipate a further rise in general prices due to continued inflation drivers, such as the NERC's upward revision of the electricity tariff to NGN206/kWh and other governmental initiatives targeted at improving the standard of living. However, we note the likelihood of a moderation in inflation figures in the coming months due to the high base effect from last year.

Given the monetary authority's inflation target of 21.40% by December 2024, we anticipate that the Committee will maintain its contractionary stance to stabilise price levels. Nonetheless, our projection of a likely moderation in inflation figures makes the case for a less aggressive rate hike.

Chart 1: Headline Inflation and MPR



Source: NBS, CBN, Meristem Research

Monetary

Monetary Policy

Will the MPC Act Decisively?

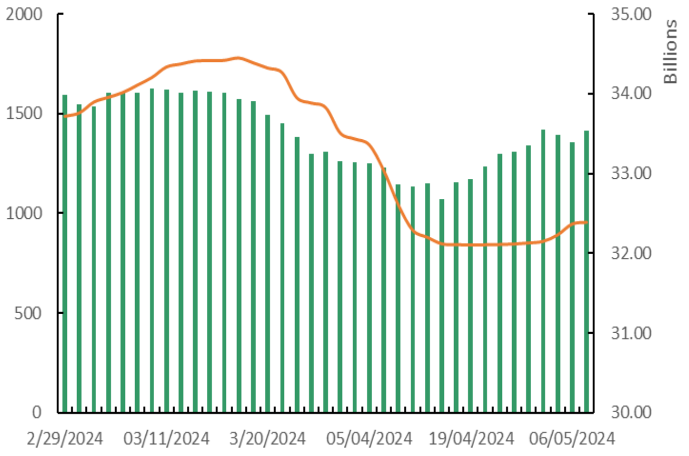
Despite the CBN's efforts to strengthen the naira, it depreciated by 6.03% to NGN1,533.99/USD since the last meeting. We highlight the impact of foreign capital inflow on the exchange rate, as evidenced by the sustained depreciation of the naira against the USD causing the spread between the parallel market rate and the official market rate to further widen to NGN55/USD as at May 16, 2024, reversing the convergence seen earlier in the year. On the back of this, we opine that the pressure on the Naira will remain intense in the short to medium term, thus, MPC may consider further tightening measures to ease improve FX inflows.

The foreign reserves has been on a steady decline – (-3.17% since the last MPC meeting and -1.24% YtD). We expect this to be at the forefront of the MPC's considerations. While crude oil prices (Brent as proxy) are currently trading high at USD84.22pb, we opine that reserves will remain pressured, as the CBN continues its interventions at the foreign exchange market, amidst staggered oil production, weak US Dollar inflows from oil receipts, and low FPI and FDI inflows.

While the recent adjustments to the asymmetric corridor had muted impact on the CBN deposit rate, it is important to note the significant spread between the Standing Lending Facility (SLF) at **NGN17.47trn** and the Standing Deposit Facility (SDF) at **NGN795.47bn**. This indicates the CBN's intention to tighten monetary policy and incentivise banks to lend less and hold more reserves. Also, liquidity has declined to -**NGN427.25bn** from -**NGN16.28bn** observed at the last meeting. Consequently, this led to a 357bps and 369bps increase in the Open Buy Back (OPR) and Overnight (O/N) rates to **29.86%** and **30.65%** respectively, (vs 26.29% and 26.96% observed at the previous meeting). The CRR at 45.00% has also contributed to this liquidity tightening, as banks hold a higher portion of customer deposits as reserves, reducing the amount of readily available funds for lending in the interbank market.

Moreover, we highlight the relative non-responsiveness of the fixed income rates to adjustments in the MPR across all instruments, including T-Bills, Bonds and even OMO rates. For context, OMO rates has been mixed at an average of 21.31% for the last two auctions (vs 21.50% before the meeting). Asides being cautious of borrowing cost, we believe this might be a foreshadow of a less aggressive stance at the next MPC meeting.

Chart 2: Foreign Reserve in USD (RHS) and Exchange Rate in NGN/USD1 (LHS) Movements



Source: CBN, Meristem Research.

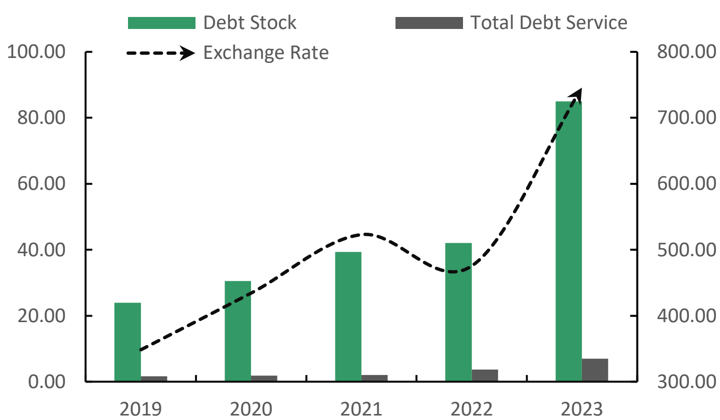
Fiscal Policy

Fiscal Policy

FX volatility Pushes External Debt Service

Since the last MPC meeting in March, significant fiscal policy developments have emerged. The Debt Management Office (DMO) reported a surge in national debt to NGN97.34trn for 2023FY, up from NGN46.25trn in 2022FY. Also, the Central Bank of Nigeria (CBN) announced a 45.65% YoY increase in external debt service costs, reaching USD3.50bn. The increase in debt levels and debt service was driven partly by new domestic borrowings to finance fiscal deficits, compounded by the impact of Naira depreciation, and high global borrowing costs. Additionally, the Federal Government recently secured a 1%, 40-year USD2.25bn facility from the World Bank with a 10-year moratorium. These developments underscore the country's escalating borrowing needs and fiscal stability challenges, despite efforts to diversify revenue sources and reduce debt reliance.

Chart 3: Debt Stock, Debt Service (NGN'trn) and NAFEM Rate (RHS) (%)



Source: NBS, CBN, Meristem Research

Reforms to Stretch Government Spending

To ease the impact of high inflation, the FGN approved a 25-35% salary increase for civil servants across six salary structures and a 20-28% raise for pensioners under the defined benefits scheme. Additionally, the government launched the consumer credit scheme via CREDICORP to enhance credit reporting and expand access to consumer credit, beginning with civil servants and aiming to cover 50% of employed Nigerians by 2030. There is a risk of potential strikes and rallies as negotiations with the Nigerian labour Congress (NLC) – demanding a significant minimum wage hike to NGN615,000 – remain stalled. We anticipate the potential impact of increased deficits given the approved salary increase for civil servants, from higher government expenditure on personnel costs. However, stalled negotiations with the NLC over a minimum wage hike pose a risk of industrial action, which could disrupt economic activity.

Security Concerns Pose Threat to the Food Sector

As the government implements measures to create a safer environment for investments, recent events have raised concerns. An even worthy of mention is the recent attack on Okomu Oil Palm Plc's plantation by militant groups in the South-East which caused significant damage to production facilities and personnel. Additionally, ongoing bandit attacks in the North continue to threaten activities in the country's food value chain.

We expect the MPC to consider recent attacks as potential factors contributing to inflationary pressures, as these disruptions could have significant implications for economic stability and policy decisions.

Markets

Fixed Income Market

Treasury Yields Maintain Prevailing Levels

Since the last MPC meeting, the mood in the fixed-income market has been chiefly influenced by the Monetary authority's liquidity management strategy, evinced by tighter system liquidity during the period (reaching a low of NGN1.43bn - as of April 18, 2024). Also, the OMO auction held during the period witnessed a slight uptick, with average rate settling at 21.5% (vs. 21.13% at the last meeting).

Meanwhile, the rates at the Primary Market Auctions for T-Bills and Bonds during the period did not reflect the uptick in MPR. For context, the stop rates on the 91-day, 182-da and 364-day instruments at the T-Bills PMA remained unchanged at 16.24%, 17.00%, and 20.70% since the last meeting. Conversely, the average marginal rates at the bonds PMA declined to 19.64% (vs. 20.13% at the last meeting). In our view, the lower offer amount and subscription level at the auctions during the period, lessened the incentive for an uptick in stop rates despite the higher MPR. Thus, underscoring the Monetary authority's effective debt management strategy during the period.

Meanwhile, a blend of sentiments characterised the secondary market since the last meeting, as the average T-Bills yields rose to 20.16% (vs. 17.67% as at the last meeting) while the average bonds yields declined to 18.68% (vs. 19.29% as at the last meeting). We anticipate a burgeoning investors' demand for higher rates at upcoming auctions as the real rate of return across fixed income instruments continues to widen due to the persistent inflationary pressure.

Overall, we expect that the MPC's decision will centre around making rates attractive enough to reflect macroeconomic realities and effective debt management.

Equities Market

Bearish Sentiment Weighs on Local Bourse

Since the MPC meeting held at the end of Q1:2024, sentiment in the domestic equities market has remained largely in the red zone. The All-share index (**NGX-ASI**) has shed 6.86% QtD, to settle at 97,709.38pts, while the YtD performance dwindled to 30.24% YtD as of 15th May, 2024. Nonetheless, the Nigerian bourse outperformed its African peers – Ghana (+19.62% YtD), Egypt (+1.69% YtD), Kenya (+0.40% YtD) and South Africa (+3.31% YtD).

Sector wise, performance was predominantly negative as **NGXBNK** (-21.57% QtD), **NGXCNSMRGDS** (-5.17% QtD), **NGXOILGAS** (-8.42% QtD), **NGXINS** (-8.02% QtD), **NGXINDSTR** (-3.08% QtD), and **MERITELCO** (-9.24 QtD) lost while **MERIAGRIC** (+9.96% QtD) closed in the green zone. This overall downturn was influenced by several factors including Q1:2024 earnings releases and prolonged profit-taking activities in the banking sector due to dilution concerns amid the recapitalisation exercise. While strong profitability from the Agric sector (+9.96 QtD) drove buying interests in **PRESCO** (+15.42% QtD) and **OKOMUOIL** (+5.23% QtD), poor scorecards from other sectors further dampened investors' mood. In addition, uncertainties around corporate actions during the period contributed to the bearish reign. Specifically, suspension of the merger between **NASCON** (-45.97% QtD), **DANGSUGAR** (-28.40 QtD) & Dangote Rice Limited as well as **TRANSCORP's** (-18.83% QtD) plan to reduce its share capital.

Moreover, the fixed income market remain an attractive alternative to investors than equity assets amid elevated yields, thus, impeding new inflows. Nonetheless, data from NGX reported that foreign inflow into the equities market in March surged to its highest in 5 years at NGN52.26bn (c. 30% of 2023FY inflow). This reflects increased optimism on overall macroeconomic outlook and repatriation.

Ultimately, given the consistent broad-based negativity in the local bourse, we posit that the performance of the equities market is unlikely to influence the committees' decision in its upcoming meeting.

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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:
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