Nigeria | Macroeconomics

Ahead Of MPC Report

July 2024

Committee Set to Hold its Fourth Meeting in 2024

MPC to Remain Hawkish in the Face of Persistent Inflationary Pressures

The Nigerian Monetary Policy Committee (MPC) is set to hold its fourth meeting of the year on July 22nd and 23rd, 2024, with price stability as its main objective.

During the meeting, we expect the committee to assess the prevailing disinflationary trends in advanced economies and the prospect of additional rate cuts by monetary authorities in these economies. Additionally, we anticipate that the committee will evaluate the economic growth outlook for these economies and potential downside risks to this outlook. Moreover, the committee may consider the potential fallouts of intensification in existing geopolitical tensions on global oil prices, global inflation and their possible pass-through effect on the domestic economy.

Nigeria's inflation rate maintained its ascent in June 2024, inching up to 34.19% from 33.95% in May 2024, marking the eighteenth consecutive month of inflation uptrend. The uptick was primarily driven by increases in both food and core indexes, fueled by rising food prices and the continued depreciation of the Naira. Following a three-month streak of consecutive declines, all indices reversed their trend and resumed their upward trajectory in June 2024 as the headline, food, and core indices rose by 2.31% MoM, 2.55% MoM, and 2.06% MoM, respectively (compared to 2.14%, 2.28%, and 2.01% in May 2024).

Considering the committee's objectives of maintaining price stability, and ensuring stability in the country's foreign exchange market, we expect a 100 basis point increase in the monetary policy rate to 27.25% while likely keeping other parameters unchanged.

Overall, we anticipate that the committee will prioritize inflation control and capital inflow sustainability, crucial for maintaining a stable exchange rate system, and accordingly, implement a rate hike to achieve these objectives.

Committee’s Expected Decision

On a Balance of Factors…

We expect the Committee to:

- **Raise the MPR by 100bps to 27.25%**
- **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

Disinflation Trend to Continue Across Major Economies

Inflation in global economies continued to decrease in June 2024. In the US, inflation dropped for the third consecutive month, reaching 3.00% in June, down from 3.30% in May 2024. Similarly, in the Eurozone, inflation fell to 2.40% in June from 2.60% in May 2024, following a slight increase in the previous month. In the UK, the inflation rate gradually decreased to its target rate of 2.00% in June 2024, compared to 4.00% at the beginning of the year. This downward trend is attributed to falling food prices and lower gas prices due to improved supply conditions and reduced fuel demand.

However, while the US labour market slowed down in June, concerns about the pace of wage growth persist in the UK and Eurozone. Notably, the European Central Bank (ECB) led the rate-cut scene among major economies, implementing a 25bps cut in its interest rate to 4.25% in its June 2024 meeting. On the other hand, the Federal Reserve and the Bank of England opted to maintain rates at their current levels, choosing to monitor economic indicators to ensure inflation is under control in these economies.

Based on our expectation of a continued disinflation trend for the remainder of the year in these economies, we believe that the Feds and BOE are likely to follow suit, implementing at least one interest rate cut each in the second half of 2024.

Global Growth

Global Economies Find Their Footing

Global economies are on track for a soft landing, driven by easing inflation and improving trade conditions. Furthermore, rising consumer spending and targeted fiscal stimulus in economies with upcoming elections in 2024 are expected to provide additional tailwinds, boosting economic activities.

However, in Asia, China's economic growth decelerated to 4.70% YoY in Q2:2024, down from 5.30% in Q1:2024, marking the slowest expansion since Q1:2023. This slowdown occurred despite expansionary fiscal policies, as the economy faced headwinds from a prolonged property market downturn, subdued domestic demand and a depreciating Yuan.

Despite China’s slower expansion, the International Monetary Fund (IMF) maintained its global growth projection for 2024 at 3.20% in July 2024, underpinned by robust consumption and increased investment, driven by improving financing conditions and a gradual easing of monetary policy for the remainder of the year.

Oil Prices Remain High Amidst Global Tensions

OPEC+ has reaffirmed its substantial production cuts and indicated that these reductions would likely extend into Q3:2025, with additional cuts of up to 2.20 million barrels per day (mbd) planned from the end of 2024, which could potentially keep prices elevated in the near term. This move aims to stabilize global oil prices amidst ongoing uncertainties in demand. In June, global crude oil prices averaged USD82.99bbl, reflecting a tight oil market. The market is being influenced by weakening global demand, particularly from China, and geopolitical tensions, such as the recent attack on an oil tanker by Yemen’s Houthis. However, these risks are somewhat mitigated by a ceasefire in Gaza. Thus, the International Energy Agency (IEA) has kept its global demand forecast steady at 1.11mbpd.

Given these developments, we expect the Monetary Policy Committee (MPC) to consider the current global trends and the state of the oil market in their forthcoming meeting.

Domestic Macros

Economic Growth

A Glimmer of Hope for Nigeria's Oil Sector

Nigeria's oil production saw consecutive monthly increases in Q2:2024, averaging 1.47mbpd (+5.61% YoY), with June output leading the quarter's performance at 1.50mbpd. This uptick is attributed to higher output from major terminals like Bonny & Forcados and the resumption of production at previously non-operational terminals like Okono. However, Q2:2024 figures remain below Q1:2024 levels due to ongoing challenges like oil theft and vandalism. Moreover, production still lags behind the revised OPEC+ quota of 1.50mbpd, currently averaging 1.27mbpd in Q2:2024.

Looking ahead, we expect improvements in oil production driven by rising investments in the sector, prompted by government measures to boost output. Additionally, the resumption of activities at newly acquired terminals and the revival of dormant oil wells could lead to positive gains in the second half of the year.

In Q2:2024, the trifecta of high interest rates, inflationary pressures, and FX depreciation continued to impact performance in certain non-oil subsectors, including manufacturing and telecommunications. The S&P Purchasing Managers' Index (PMI) clearly indicates a drag in economic momentum, as it fell to an average of 51.10pts in Q2:2024, a decline from 52.20pts in Q1:2024. Notably, the index reached a seven-month low in June 2024, dropping to 50.10pts reflecting a further slowdown in economic activities.

Moving forward, we expect this trend to persist, with the non-oil sector's growth remaining tempered as the challenges remain unresolved. However, other sectors like Financial Services and Mining & Quarrying are expected to maintain strong outputs due to high yields and increased stakeholder activities.

Consequently, we revise our 2024FY GDP forecast to 3.14%. The IMF's recent adjustment of its growth forecast for Nigeria to 3.10% from 3.30% aligns with our outlook. Thus, we anticipate that the country's economic growth trajectory will influence the MPC's decision in its upcoming meeting, leading to a less aggressive stance compared to previous meetings.

Inflation

Disinflation Trend in H2:2024?

Nigeria's headline inflation rate continued to rise in June 2024, marking the 18th consecutive month of increase, with a rate of 34.19% compared to 33.95% in May 2024. This surge was primarily driven by significant increases in food and core inflation, which reached 40.87% and 27.40%, respectively, up from 40.66% and 27.04% in May 2024.

The food inflation uptick is attributed to structural challenges in the food sector and heightened demand during the Eid-el-Kabir celebration, which led to price increases for food items in June 2024. Meanwhile, the rise in core inflation is linked to higher energy costs and the Naira's depreciation, resulting in increased commodity prices across the economy.

After three months of consecutive decline, all indices resumed their upward trend in June 2024, with the headline, food, and core indices rising by 2.31% MoM, 2.55% MoM, and 2.06% MoM, respectively (from 2.14%, 2.28% and 2.01% in May 2024).

While we anticipate continued inflationary pressures due to existing challenges, we expect a moderation in inflation rates in the coming months. This outlook is fueled by initiatives such as the federal government's distribution of fertilizers, suspension of import duties on food items, and the year-round farming program, which could boost agricultural yields in the near to mid-term. Additionally, our expectation of a relatively stable exchange rate in H2:2024 and the high base effect from the corresponding period last year suggest a potential disinflation trend in H2:2024.

Considering the MPC's primary objective of maintaining price stability and its inflation target of 21.40% by December 2024, we anticipate the MPC will likely retain its hawkish stance at its upcoming meeting. However, our forecast of a probable easing in inflation rates suggests that a less aggressive interest rate hike may be warranted.

Fiscal Policy

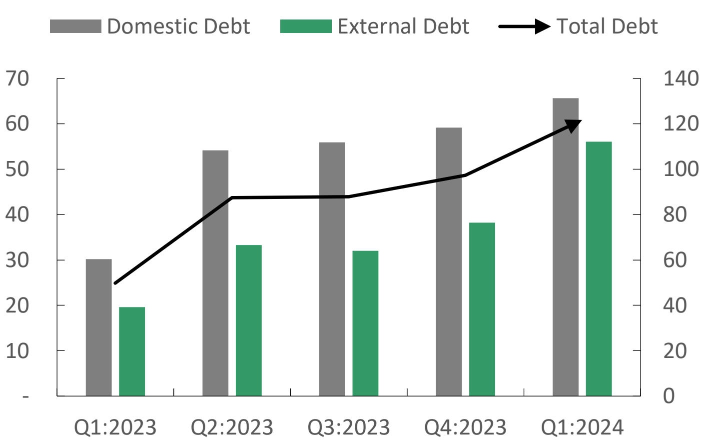
Fiscal Policy

Worsening Debt Concerns

Following the latest MPC meeting, significant changes have been observed in Nigeria's fiscal policy landscape. The Debt Management Office (DMO) reported a substantial 25.12% increase in the country's debt stock, which reached NGN121.67trn in Q1:2024 (compared to NGN97.34trn as at 2023FY). This surge was primarily driven by the devaluation of the Naira, resulting in a 45.92% increase in the value of external debt. Furthermore, the government's reliance on domestic borrowing to repay a portion of the Ways and Means debt (NGN7.30trn) owed to the Central Bank of Nigeria (CBN) also contributed to the rising debt levels.

Looking forward, debt levels are projected to escalate further due to anticipated increases in external debt. This includes a USD1.00bn oil-backed loan from the AFREXIM bank and the potential issuance of a Eurobond later in the year. Additionally, domestic borrowing is expected to rise, driven by the need to finance a projected supplementary budget, recent minimum wage increases, and other government expenditure requirements.

Chart 2: Trend in Nigeria's Debt Stock (NGN'trn)



Source: DMO, Meristem Research

Policy Actions: A Balance for Progress

The fiscal authority has implemented various guidelines and measures aimed at boosting government revenue and reducing its reliance on debt. Notably, tax credits, the suspension of import duties and VAT on certain items and agricultural produce (easing the strain on food prices), and a recent 50% windfall tax on FX revaluation gains recorded by banks in 2023FY.

However, a review of the Accelerated Stabilisation and Advancement Plan (ASAP) presented by the Minister of Finance reveals some concerning projections. Expenditure on fuel subsidies is expected to reach NGN5.40trn in 2024, undermining the anticipated benefits from the fuel subsidy removal announced in 2023. Additionally, the draft plan outlines a potential supplementary budget of up to NGN6.65trn. which aims to fund a 133.33% increase in the minimum wage to NGN70,000, among other expenditures. These developments could lead to increased government spending, higher debt levels, inflationary pressures, and further fiscal challenges in the near term.

We anticipate a significant rise in government expenditure due to ongoing payments for PMS and electricity subsidies, expansionary fiscal measures aimed at improving living standards, and increased debt service costs. Despite initiatives to enhance tax revenue collection and planned increases in VAT, the tax relief measures recently implemented are expected to reduce overall government revenue.

Monetary

Monetary Policy

How much more Impactful can it be?

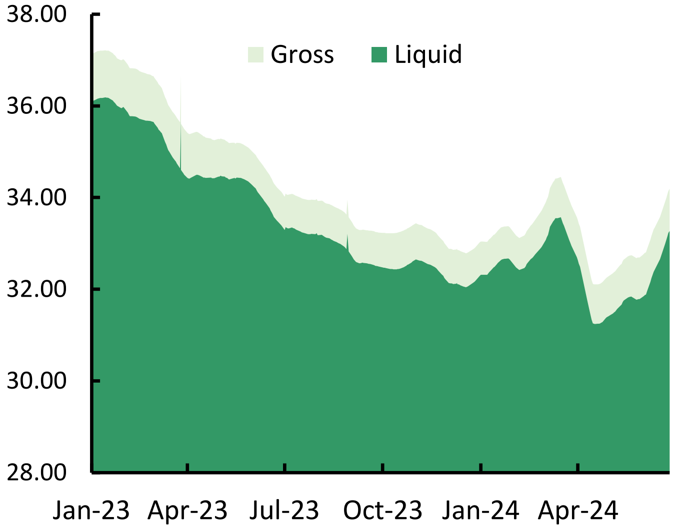
Since the last MPC meeting, Nigeria's external reserves have shown significant improvement, reaching USD35.93bn as of July 19, 2024 - the highest level since March 2023. This USD3.25bn increase can be attributed to several factors, including reduced intervention in the foreign exchange market by monetary authorities and improved oil receipts. The latter stems from higher Brent Crude prices and increased oil production, which rose to 1.25mbpd. Additionally, the country received USD925mn from the USD3.30bn crude oil-backed prepayment facility, saw increased remittances, and benefited from a USD751.88mn loan disbursement from the World Bank under the Development Policy Financing Program (DPF) project.

Despite this positive trend in reserves, the exchange rate experienced depreciation in both official and parallel markets. The official window saw a 7.55% depreciation to NGN1,596.92/USD, while the parallel market depreciated by 11.93% to USD1,595.00/USD. However, it's worth noting that exchange rates showed relative stability during this period, hovering around the NGN1,500 level. Notably, there was a convergence between the official and parallel market rates, indicating a potential narrowing of the gap between these two markets.

The monetary authorities have maintained strict liquidity management, evidenced by negative system liquidity in 21 out of 37 days. This approach has led to a slight increase in short-term interest rates, with the Open Buy Back and Overnight rates rising to 31.39% and 32.02% (vs 31.32% and 32.00%). Additionally, the authorities continued to issue OMO bills during the period. However, despite the liquidity management, broad money supply (M3) continues to be on the rise as it rose to its highest level ever – NGN99.24trn at the end of May driven largely by growth across Net Domestic Assets (+22.93%), Net Domestic Credit (10.55%) and Credit to Government (+42.04%).

Looking ahead, we anticipate that the monetary authorities will maintain a hawkish stance, though somewhat moderated, to curb inflationary pressures, manage money supply issues, and attract foreign capital inflows.

Chart 1: External Reserves Balance (USD'bn)



Source: CBN, Meristem Research

Markets

Fixed Income Market

Treasury Tug-of-War: Costs vs. Monetary Control

The fixed-income market has maintained the same dynamics since the last MPC meeting, with system liquidity remaining tight, reaching a low of NGN1.49bn as of July 18, 2024. We attribute this to the CBN's continued liquidity management measures during the period. For context, the CBN allotted a total of NGN3.16trn in OMO bills since the last meeting. However, the average stop rate printed slightly lower at 20.89% (vs. 21.50% as at the last meeting).

Meanwhile, in the T-Bills and Bonds Primary market, rates remained mostly unchanged during the period (16.30% and 17.44% on the 91-day and 182-day bills, respectively). However, at the last auction, the stop rate on the 364-day bill increased by 56bps to 21.24%. Also, the average marginal rates at the bonds PMA advanced to 20.44% (vs. 19.64% at the last meeting). The higher subscription and allotment amount (NGN551.33bn and NGN380.76bn vs NGN305.26bn and NGN297.01bn as at the last meeting) spurred the slight uptick in the bond auction stop rates.

Unsurprisingly, bearish sentiment dominated the secondary market since the last meeting, as the average T-Bills yields rose to 23.28% (vs. 20.16% as at the last meeting) while the average bonds yields increased to 19.29% (vs. 18.68% as at the last meeting).

In our view, the elevated yield levels remain crucial to maintaining foreign inflows to the fixed-income market. Moreover, the uptick in inflation has widened the real rate of return on treasury instruments. We expect this to influence the MPC to maintain its hawkish stance in its forthcoming meeting. However, we note that managing government borrowing costs might spur the incentive for an accommodative stance.

Equities Market

Upbeat Mood Sprouts Amid Wavering Bias

Since the last MPC meeting, the market has traded on a mixed note with a slightly bullish tilt. In June 2024, the NGX-ASI returned 0.77% MoM (vs. -1.33% MoM in May 2024), bringing the half-year return to 33.80%, settling at 100,032.32pts. Similarly, the local bourse has been bullish in July, returning 0.48% MoM as of 19th July.

In the same vein, the performance across sectoral indices has been predominantly bullish, as all indices under our coverage closed in positive territory. The NGXBNK (+11.45%), NGXCNSMRGDS (+1.79%), NGXOILGAS (+27.41%), NGXINS (+8.44%), NGXINDSTR (+0.42%), and MERI-AGRIC (+32.22%) indices all recorded positive returns, except for MERI-TELCO (-4.23%), which closed in the red zone. We attribute the upbeat sentiment to strong buying interest in banking stocks, as banking tickers like ACCESSCORP (+13.82%), FIDELITYBK (+26.47%), and GTCO (+19.74%) seek to raise funds in the equities market to meet the earlier bank recapitalisation exercise required by CBN, thus spurring buying activities within the period. Also, we observed positive investors' reactions to some companies announcing interim dividend and bonus issues - UCAP (+104.51%). However, we witnessed sell-offs on telecoms tickers in anticipation of lacklustre earnings releases, notably AIRTELAFRI (-2.33%) and MTNN (-14.92%).

As we anticipated, the broadly muted direction of fixed-income yields during the period gradually reignited investors' appeal towards equities assets. Moreso, we believe that investors have already factored in another hawkish MPC stance at the forthcoming meeting. As such, we are of the view that the equities market's activities will have a minimal impact on the committee's decision in its next meeting.

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