

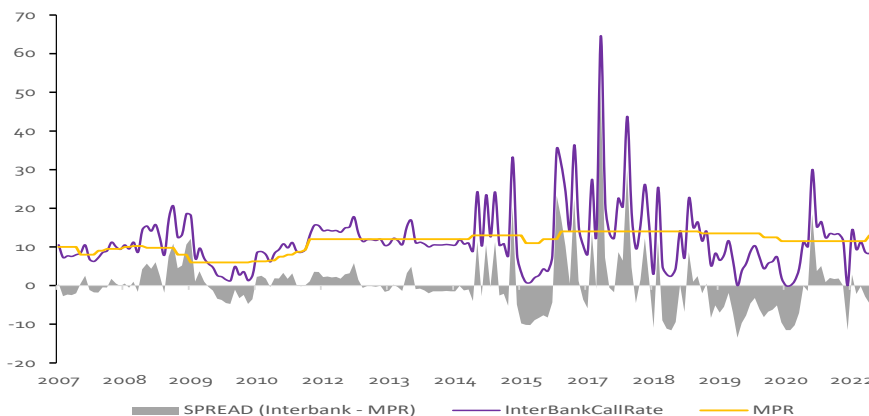
MPC Review: Another 100bps increase

- At yesterday's MPC meeting, the authorities further raised the Monetary Policy Rate (MPR) by 100bps to 14.0% from 13.0%. The major consideration was the faster rise in inflation despite a prior 150bps hike.
- The further rise in the MPR, if it translates to an increase in market rates will narrow the interest rate gap and make Naira bonds more attractive, which may be negative for the stock market. The NGX ASI, declined by 0.02% yesterday when the news broke.
- We retain our view that a continuous hike in rate will likely constrain the country's fragile growth while achieving very little in terms of combating inflation and attracting foreign inflows.

In our last MPC review note in May 2022, we noted that the direction of the MPR at the next MPC meeting in July would highly depend on the turn of events in the local and global space. Since our update, pressure on consumer prices have remained unrelenting as the headline inflation has risen at a faster pace. The Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) unanimously raised the MPR from 13.0% to 14.0%, the second consecutive hike and a cumulative 250bps increase within three months.

With the current narrative on inflation, the Committee was of the view that neither holding nor loosening the policy parameters was an option, given the impact of the rising inflationary pressures which may begin to erode the moderate gains achieved in improving consumer purchasing power. According to the committee, a hold stance would mean that the CBN was not responding sufficiently to the global and domestic price developments. In their view, the decision to tighten signals strong determination by the bank to address its price stability mandate and portray the MPC's sensitivity to the impact of inflation on the vulnerable households.

Interbank versus MPR



Source: CBN, CSL Research

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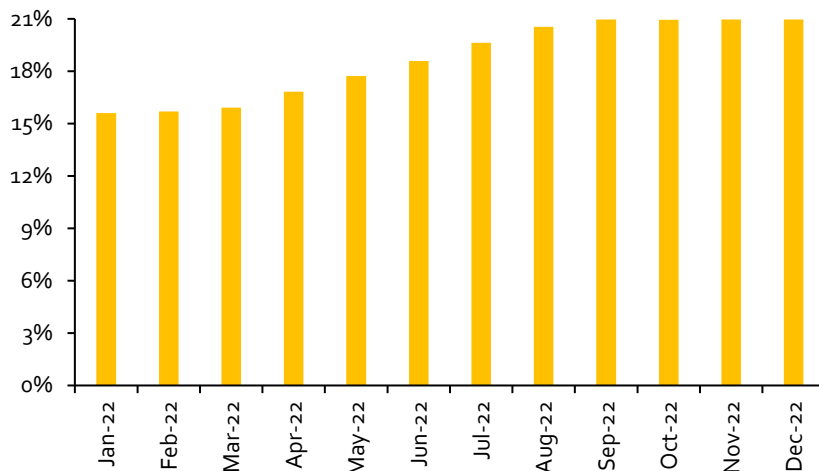
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Inflation at 18.6% was a major driver: Nigeria’s annual inflation rate accelerated for the fifth consecutive month to 18.62% in June 2022, from 17.71% in the prior month and this was flagged as a major consideration, in line with our view that maintaining a hawkish move was imperative. While the MPC agreed that several supply-side factors, which cannot be abated by a rate hike, were responsible for the inflationary pressure, they also noted that emerging evidence showed that money demand pressure is on the rise. The committee Members assessed the impact of the continued upsurge in money supply resulting from the increased demand for money, associated with election spending

In our view, the rate hike will at best only help control inflation minimally since the supply-side factors remain dominant. We forecast inflation would worsen, stemming majorly from supply side triggers. Though, we anticipate a mild respite to increasing food prices when the harvest season begins in September. We expect the impact of the Russian-Ukraine war on the prices of commodities like wheat and oil to continue to pressure food inflation. Again, pass-through effect from rising transport cost will continue to add another layer of pressure amidst the worsening insecurity situation. Speculations making the headline yesterday that the Nigerian National Petroleum Company (NNPC) limited approved an upward review in the pump price of Premium Motor Spirit (PMS) from N165/litre to N179/litre. Also, there is a chance that another MYTO review will occur before the year end, which means more discos would be allowed to raise electricity tariffs to cushion the impact of the worsened macroeconomic pressures. All these point to pressure on core inflation. Overall, we expect headline inflation to average 20.67% in H2 compared with 16.72% in H1 and we expect headline inflation to close the year at 20.97% in December 2022.

Inflation rate (July – December are forecasts)



Source: NBS, CSL Research

Capital flow: On capital flows reversal, the CBN noted that the global central banks have remained aggressive in interest rate normalisation, and this has largely been responsible for the bearish trend in the capital market. Global central banks turned hawkish after their prolonged covid stimulus packages to ease the impact on the economy began to have a ripple effect on inflation. The committee noted in its communique that tightening would moderate the speed of capital flow reversal and provide incentives for foreign capital inflows, with its complementary impact on exchange rate stability. In our view, the policy shift, if followed up with a rise in market interest rates, would have a fair chance of attracting domestic banks into the bonds market, and of attracting domestic pension funds, but foreign investors would

likely remain sceptical of both FX liquidity and the exchange rate and we see very little impact on capital inflows. That said, it may be successful in preventing capital reversals and help retain what is left of foreign capital.

Economic Growth: Like we posited, the committee expressed the likelihood of subdued output growth in the year. Nigeria's Gross Domestic Product (GDP) grew by 3.11% y/y in real terms in the first quarter of 2022, down from 3.98% in Q4 2021. The CBN governor noted that while it may seem contradictory to raise rates in the face of fragile growth, not curtailing inflation could erode the moderate gains achieved in improving consumer purchasing power and push many below the poverty line. According to the CBN governor, reining in inflation is more urgent in the sequence of policy objectives. We reiterate our view that the factors driving inflation remain largely supply driven. Though we acknowledge the rising money supply through increased election spending, we believe the CBN can explore other measures to curb money supply. We retain our view that a continuous hike in rate will likely constrain the country's fragile growth while achieving very little in terms of combating inflation and attracting foreign inflows. We expect GDP growth to soften in the second half of 2022 based on the following assumptions.

- The oil sector is forecast to continue to contract. Production has been declining steadily since the beginning of the year. Nigeria has been unable to maximize the surge in oil prices, as crude oil production has remained perpetually below the OPEC benchmark due to terminal shutdowns resulting from dilapidating infrastructure, oil theft and we do not expect an improvement to the current situation in H2. New production from new fields will not do much to reduce the overall drop in output in our view. We project average crude oil production (including condensates) of 1.38mbpd in H2 compared with 1.48mbpd in H1.
- Elsewhere, we had expected the completion of Dangote's refinery to boost refined petroleum exports while simultaneously offering structural tailwinds to FX liquidity but that is looking impossible to happen before year end.
- Increasing focus on the elections, will likely dampen growth in the non-oil sectors. The rising cost of diesel, FX illiquidity and increased borrowing cost is expected to put further pressure on the manufacturing and services sectors. Also, the continuous decline in consumer purchasing power will most likely dampen output growth.
- We also expect growth in the agricultural sector to remain subdued due to the escalating insecurity in the food producing regions.

Stock Market: It appears the local bourse negatively reacted to the news as the benchmark equity index, NGX ASI, declined by 0.02% yesterday, after a gain at the previous trading day (Monday; +0.20%). Meanwhile, while the news of improved rates was negative for the stock market, banks should benefit from better yields on their investment securities portfolio. Hence, we see renewed investors' interest in the banking universe, especially for companies that relatively have cheap valuations. Besides, with the expectation of seeing more activities in the fixed income market, investors would only focus on fundamentally sound stocks.

Conclusion: The MPC is at a crossroad in our view. Despite the initial 150bps hike in MPR in May to combat inflation, inflation rose faster in June and is showing no sign of abating. The current 14% rate is the maximum rate the CBN has reached since 2006 when the Bank replaced MRR with MPR. Looking ahead, inflation is not likely to slow

down in the coming months while economic growth will likely remain fragile, and there is only a limit to the fragile economy's ability to withstand the aggressive rate hike. Judging by the MPC's posture at yesterday's meeting, the CBN is more likely to stick on the path of a rate hike, especially at a time when election spending is partially fuelling add-on inflationary pressures. While the MPR at 14% is the highest level the CBN has ever gotten to in the past decade, the current realities suggest that the apex bank may be caught between a rock and a hard place. At a time when the global space is grappling with inflationary pressures, igniting aggressive interest lift-off, we do not rule out the possibility of another hike by the CBN in the last two meetings of the year. However, if the MPR is retained till year-end, there is the possibility of adjustments to other policy parameters such as the CRR, liquidity ratio or asymmetric corridor.

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