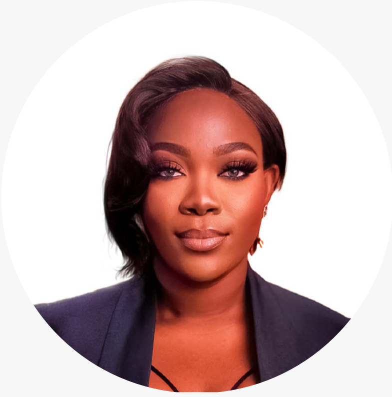
MACROECONOMIC UPDATE | NIGERIA

FUNDAMENTALS

21 JULY 2022

IN PURSUIT OF THE HOLY GRAIL



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IN BRIEF

- A wind of change is blowing in the Central Bank of Nigeria (CBN) as it is unwavering in its commitment to its price stability mandate.
- The monetary policy committee (MPC) once again reached for its hatchet, raising its monetary policy rate (MPR) by 100bps to 14% at the July meeting in its quest to bring inflation to the heel.
- Central bankers globally move in a herd led by a ringmaster, the United States (US) Federal Reserve Bank (Fed).
- While global central banks are taking only baby steps to tighten policy, the CBN's policy trade-off is still high as price risks continue to dominate the inflation outlook.
- Inflation is the chief woe that can exacerbate Nigeria's macroeconomic strains.
- However, one monetary glove fitting all 11 members' hands increases the odds of reining it in more promptly.
- But for how long will the central bank keep up with its unbending anti-inflation stance?
- And will it be willing to sacrifice the current economic growth bright spot?
- I do not envy the choices facing the CBN as it navigates the shoals ahead.
- But for the sake of Nigeria's economy, I wish them good luck. Or should I say *"bonne chance"?*

As inflation continues to be a source of angst, Sub-Saharan Africa's rates lift-off continued with the Central Bank of Nigeria (CBN) delivering a hawkish 100bps rate hike in its monetary policy rate (MPR) to 14%. In response to higher price pressures, the CBN has raised the MPR by a cumulative of 250bps in 2022.

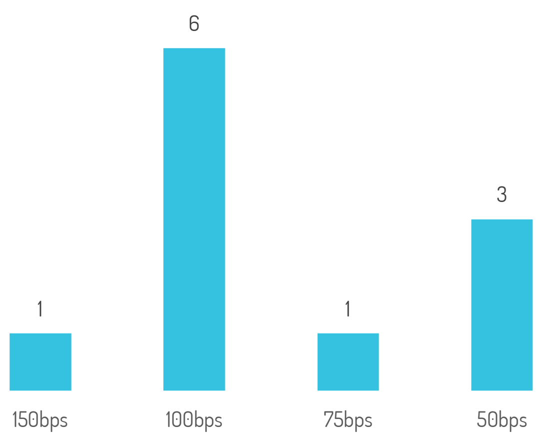
The monetary policy committee (MPC) minutes confirmed the increasingly hawkish tone of members of the MPC and their "unrelenting resolve" to restore price stability, amid the bandwagon of monetary policy normalisation. As the European war protracts and continues to underpin food and energy prices, the risks to Nigeria's inflation outlook are clearly skewed to the upside. This will not only stoke economic growth but also perturb the bonds market.

CBN hawks showing their colours

The CBN is likely to maintain its hawkish rhetoric if consumer prices continue to accelerate both globally and locally. In June inflation reached an eye-popping 18.6% y/y, driven principally by food prices - up a whopping 20.6% y/y in June - along with energy prices (17.7% y/y).

There was no cacophony among the voices making up the 11-member MPC as they unanimously agreed that higher and persistent inflation is an imminent threat to price stability – the central bank's holy grail. However, the MPC's split on the degree of needed tightening highlights the widespread economic uncertainties. Six of the 11-person committee voted for a 100bps increase, three for 50bps, while 75bps and 150bps got one vote each.

HOW THE MPC MEMBERS VOTED



SOURCE: CENTRAL BANK OF NIGERIA (CBN)

Although the CBN's communication was clear-cut, changes signalled through wording and nuances suggest that its rhetoric has grown increasingly hawkish as Nigeria's headline inflation continued to surge.

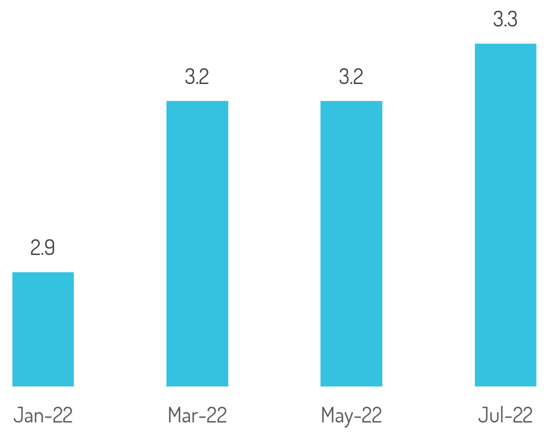
Can the CBN nail a soft landing?

Borrowing the words of Norman Vincent Peale – an American authour –, the CBN may land among the stars while shooting for the moon. By raising interest rates, the CBN may not cancel Nigeria's economic growth Christmas, but credit standards will be tightened for firms and households – invariably slowing the growth trajectory.

There is no gainsaying that Nigeria entered the recent wave of global uncertainties with a bright output position. The economy expanded by 3.1% y/y in the first quarter of the year. However, high-frequency indicators (i.e. the purchasing managers' index) are suggesting that economic activities have been slowing in recent months. This trend may continue in the face of rate hikes – that currently look probable.

The CBN seems quite optimistic about the country's growth outturn though, in the face of global and domestic headwinds. As global economic storms are gathering, the CBN sees a brighter outlook for Nigeria's economy as it raised its 2022 economic growth projection for Nigeria to 3.3% y/y from 3.2% y/y communicated at the last meeting. But its projection still falls shy of the International Monetary Fund's (IMF) 3.4% y/y, and the Federal government's 4.2% y/y.

PROGRESSION OF THE CBN'S GDP PROJECTIONS (%)



SOURCE: CENTRAL BANK OF NIGERIA (CBN)

The CBN may be looking to achieve a soft landing – i.e. raising interest rates just enough to slow down the economy - without triggering a recession -, and taper off inflation. Its success or failure however will depend on the impact of geopolitical events on global supply chains.

The current rate hikes have an element of unwinding pandemic support while ensuring that the liquidity conditions are sufficient to meet the credit growth requirements for growing Nigeria's economy. Hopefully, robust agriculture output and deeper technology penetration will help to achieve a healthy growth outturn, but global events are likely to be a bigger influence on the growth outcome.

Bonds to buckle under hawkish bets

Nigeria's bonds are poised to be unsettled by increasing global hawkish bets that prompt capital reversals from emerging and frontier markets. Inflation in advanced economies running at four times their central banks' targets can push them to undertake large rate hikes too quickly - potentially transmitting shocks to emerging markets.

Conclusion

Considering the likely trajectory of inflation and interest rate hikes in advanced economies and the pass-through impact on consumer prices in developing economies like Nigeria, it is quite likely that we will see more rate hikes by the CBN over the next few MPC meetings. There are many sticky elements to the current inflation spiral, which will take some time to resolve.

As the European war protracts, the CBN finds itself at fundamental crossroads as higher food and fuel prices continue to bedevil Nigeria's price stability. In fact, it faces tougher balancing decisions than the United States (US) Federal Reserve Bank (Fed) as it tries to balance higher inflation prints, Naira volatility, and the strong downside risks to economic growth.

Going by its current communication, the CBN's hawkish stance is likely to persist to prevent more painful tightening later. But can interest rate hikes defeat inflation? Maybe not in its entirety, because the spurt in inflation is driven to a large extent by supply-side global events. However, monetary policy has to ensure that the inflationary effect of such supply shocks is not amplified through higher inflation expectations. Therefore, further tightening can tamp down demand-side pressures that may be adding to the overall pressure on consumer prices, through the attrition of over-ample liquidity.

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