NIGERIA | MACROECONOMIC UPDATE | MONETARY POLICY | INSIGHTS

FUNDAMENTALS

NIGERIA MPC UPDATE: JUGGLING FROGS

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IN BRIEF

- At its March 2023 meeting, Nigeria's Monetary Policy Committee (MPC) voted by a majority decision to increase the monetary policy rate by 50 basis points to 18.0%, citing continued upside risk to headline inflation.

- The authorities noted that the policy on Naira redesign and cash withdrawal limit have significantly reduced the currency-outside-banks, with an expected improvement in the effectiveness of monetary policy.

- While we view the main drivers of Nigeria's inflation as non-monetary, the MPC continues to believe in the power of rising interest rates to control inflation. We think the Committee's preference for rate hikes, albeit still below the headline inflation, is motivated by the need to curb the second-round effect of the structural and cost-push drivers of Nigeria's inflation.

- We expect the headline inflation to remain sticky above 20% in the near-term as a new government (to be inaugurated in May 2023) considers the removal of fuel subsidies. This outlook suggests that the MPC will remain hawkish in the near-term as the Committee will seek to counter the price shocks from the expected subsidy removal, potentially by late-2023.

Monetary policy decision

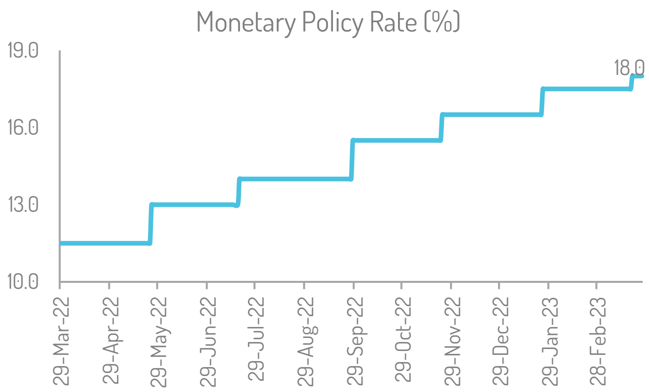
The MPC continues to believe in the power of rising rate

At its March 2023 meeting, Nigeria's Monetary Policy Committee (MPC) voted by a majority decision to increase the monetary policy rate by 50 basis points to 18.0%. The MPC cited the continued upward risk to inflation arising from expectations on the removal of fuel subsidy, rising prices of other energy sources, exchange rate pressures, and the uncertain climatic conditions for food production.

The Committee retained the other tools of monetary policy at their current levels with the Cash Reserve Ratio and the Liquidity Ratio maintained at 32.5% and 30.0%, respectively. The authorities noted that the policy on Naira redesign and cash withdrawal limit have significantly reduced the currency-outside-banks, with an expected improvement in the effectiveness of monetary policy.

While we view the main drivers of Nigeria's inflation as non-monetary, the MPC continues to believe in the power of rising interest rates to control inflation. We think the Committee's preference for rate hikes, albeit still below the headline inflation, is motivated by the need to curb the second-round effect of the structural and cost-push drivers of Nigeria's inflation. However, an improved security situation in agrarian zones and strong fiscal adjustment measures will offer a more sustainable route to lower inflation in Nigeria. This makes the heavy reliance on monetary policy to control structurally-induced price shocks appear like an attempt to juggle frogs.

Path of Monetary Policy Rate in Nigeria (%)



Source: National Bureau of Statistics

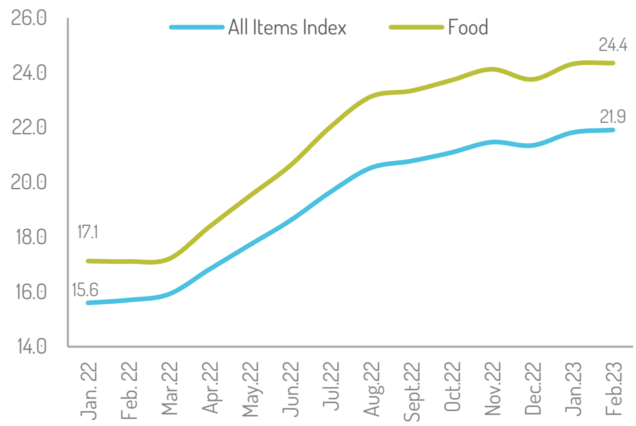
Inflation situation

Inflation will remain sticky above 20% in the near-term

After eleven (11) successive increases, headline inflation ticked lower by 13bps in December 2022 to close the year at 21.34%. However, we observed a resurgence in inflation at the start of 2023 as the headline rate rose in the first 2-months to 21.91% in February 2023, the highest level since 2005.

Despite the cumulative hike of 650bps in the policy rate since May 2022, Nigeria's inflation rate has gained further upward momentum with ≃600bps surge over the same period and remains sticky above 20% since July 2022. The restrictions on cash withdrawal and the Naira swap policies will support the effectiveness of monetary policy in curbing the second-round effect of price shocks. However, we expect Nigeria's inflation rate to remain sticky above the 20% mark in the near-term as a new government (to be inaugurated in May 2023) considers the removal of fuel subsidies. This outlook suggests that the MPC will remain hawkish in the near-term as the Committee will seek to counter the price shocks from the expected subsidy removal, potentially by late-2023.

Composite Consumer Price Index, Year-on change (%)



Source: National Bureau of Statistics

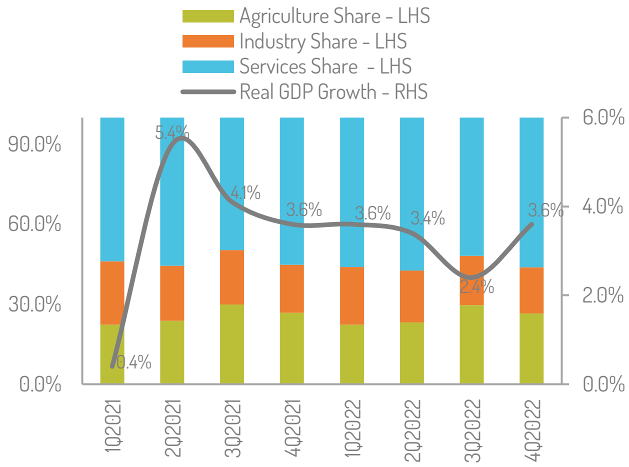
Real Sector

Growth momentum will remain flat with marginal risk to the downside.

The Central Bank appears slightly less bullish on Nigeria's 2023 growth outlook compared to the Federal Government and the International Monetary Fund (IMF). Although the monetary authorities forecast FY2023 growth at 3.0%, the Federal Government and the IMF projects 2023 growth at 3.4% and 3.2%, respectively.

While we view the difference in growth forecasts by the Central Bank and the Federal Government as suggesting a lack of policy coherence, we also note the potentially flat growth momentum in 2023. Nigeria's overall real GDP grew by 3.1% in 2022, slowing by 50bps compared to the 2021 level. We, thus, view the 2023 growth forecasts as reflecting tailwinds from higher hydrocarbon production with government interventions in the non-oil sector offset by headwinds from cost pressures, worsening fiscal position, and lingering security issues in agrarian zones.

Distribution of Nigeria's GDP and Real Growth Rate (%)



Source: National Bureau of Statistics

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