FUNDAMENTALS

NIGERIA MPC UPDATE: A SYMBOLIC HIKE

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IN BRIEF

- At its May 2023 Monetary Policy Committee (MPC) meeting, the Central Bank of Nigeria (CBN) raised the Monetary Policy Rate (MPR) by 50bps to 18.5%, representing the seventh consecutive increase since May 2022.

- The Committee, however, 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 Committee confirmed our longstanding view that Nigeria's inflation was largely due to non-monetary factors but opted for a moderate hike in the policy rate to symbolize its commitment to restore price stability

- We expect the Central Bank to continue on the path of monetary tightening as Nigeria's new President, Bola Tinubu, confirmed the removal of fuel subsidy amidst a potential devaluation of the Naira.

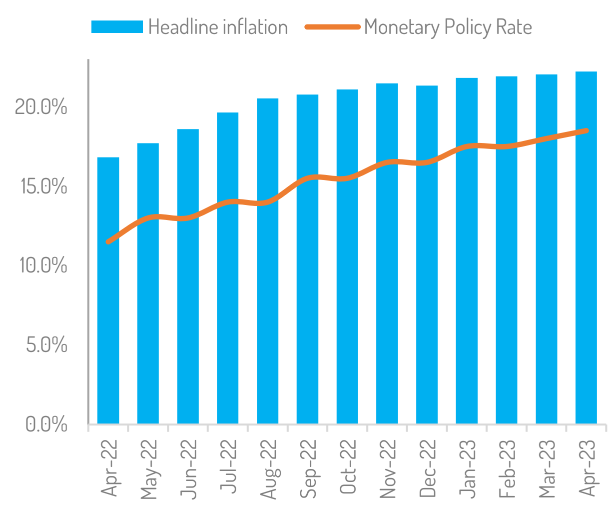
- Within the backdrop of continued restrictive monetary policy and a broken food supply chain, we anticipate downside risk to real GDP growth in FY2023.

Rate hike with a symbolic feel

At its May 2023 Monetary Policy Committee (MPC) meeting, the Central Bank of Nigeria (CBN) raised the Monetary Policy Rate (MPR) by 50bps to 18.5%, representing the seventh consecutive increase since May 2022. The MPC, however 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.

In line with our longstanding view, the Committee partly attributed the sustained increase in headline inflation to non-monetary factors such as energy prices and persistent issues with food supply chains. However, the monetary authorities opted for a moderate hike to symbolize its commitment to restore price stability. Despite concerns of deploying monetary policy tools against non-monetary drivers of inflation, the MPC justified the rate hike by providing a counterfactual situation where inflation would have been 30.5% in April 2023 without the continued policy rate hikes.

Inflation and Policy Rate Path since 2022



Source: Central Bank & National Bureau of Statistics

Additional hikes could be warranted

Given the recent legislative approval to increase Central Bank financing of the Treasury from 5% to 15% of previous year's revenue, the MPC appeared visibly concerned about fiscal dominance in the outlook. Although the MPC called for improved fiscal revenue collection, ostensibly to limit the fiscal dominance of monetary policy, we foresee continued fiscal push to inflation in the short-term.

Additionally, Nigeria's newly inaugurated President, Bola Tinubu, emphatically declared the cessation of the current fuel subsidy regime given its fiscal burden. While this policy signal aligns with our expectation for Nigeria's new administration to withdraw fuel subsidy, it appears the new fuel pricing policy favours an immediate removal rather than our expectation of a gradual withdrawal of subsidies. This will elevate the non-monetary push to inflation in the near-term and potentially keep the MPC on the path of policy rate hikes.

The new President also called for the unification of Nigeria's multiple exchange rates, as broadly anticipated by the market. While this will ultimately revive investor confidence with an ex-post capital flow to Nigeria, we foresee a near-term devaluation of the official FX rate as a prior action to achieve a unified FX rate. We expect the resultant exchange rate pass-through to fuel inflationary pressure, keeping the MPC on a restrictive policy path in the near-term.

Downside risk to real GDP growth in FY2023

Nigeria's economy expanded by 2.3% y/y in 1Q2023, a slower growth compared to 1Q2022 (3.1%) and 4Q2022 (3.5%). The MPC expectedly attributed the slowdown partly to the continued tightening of monetary policy stance since May 2022, raising concerns of further downside risk ahead. Against the backdrop of tighter monetary policy stance with expected uptick in cost pressures from higher fuel prices, we foresee sluggish growth prospect in FY2023, markedly below the medium-term target of 6.0% indicated by the new administration.

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