NIGERIA | MACROECONOMIC UPDATE | MONETARY POLICY | INSIGHTS

FUNDAMENTALS

NIGERIA MPC UPDATE: A BALANCING ACT

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IN BRIEF

- At the end of its fourth meeting in 2023, and the first meeting under Nigeria's new administration, the Monetary Policy Committee (MPC) delivered a token hike of 25bps in its Monetary Policy Rate (MPR) to 18.75% as we anticipated. The MPC also narrowed the asymmetric interest rate corridor to +100bps/-300bps around the MPR (vs +100bps/-700bps previously).

- The MPC justified its decision to implement a token hike in the MPR by citing the elevated upside risk to inflation against a wait-and-see position amidst the surprised modest uptick in the June 2023 inflation rate. Furthermore, we perceive the token hike as reflecting the Committee's desire to play a balancing act between curbing inflation and promoting economic growth, making it difficult to envisage aggressive policy tightening in the MPC meetings ahead.

- On the tightening of the asymmetric interest rate corridor, the monetary authorities aim to encourage deposits from commercial banks and steadily reduce the excess Naira liquidity in the system as broad money supply grew strongly YTD in June 2023.

- In our opinion, the perennial structural issues remain a major driver of price pressures in Nigeria via the shocks to supply and distribution channels. We believe a correction of these structural issues would be required in addition to the ongoing policy adjustments to lower inflation.

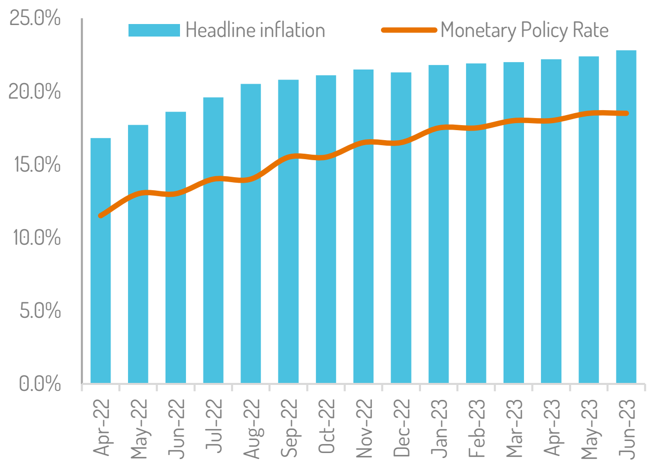
A token hike with a major step

At the end of its fourth meeting in 2023, and the first under Nigeria's new administration, the Monetary Policy Committee (MPC) delivered a token hike of 25bps in its Monetary Policy Rate (MPR) to 18.75% as we anticipated.

This decision was underpinned by concerns of elevated upside risk to inflation after fiscal policy measures by the new administration heightened the price expectations. In particular, zero fuel subsidy and the loosening of exchange rate controls culminated in spikes in transport cost and food prices. Despite the slower-than-expected uptick in headline and core inflation to 22.8% and 20.3%, respectively in June 2023, the MPC appeared cautious on the inflation outlook against the backdrop of ongoing reforms.

Furthermore, we perceive the token hike as reflecting the Committee's desire to leave a window of support for the real sector given the potential impact of cost pressures on economic activity.

Inflation and policy rate path since 2022



Source: Central Bank & National Bureau of Statistics

Given the surprisingly modest uptick in the June inflation rate amidst the reforms-induced spike in cost pressures, the MPC's token hike was in line with our expectations and the consensus forecast. In our view, the posture of the MPC could be more complex for the next meetings as the extent of pass-through of reforms to inflation remains uncertain. Also, we think the MPC continues to play a balancing act between curbing inflation and promoting economic growth, making it difficult to envisage aggressive policy tightening in the MPC meetings ahead.

A major step to curb the liquidity overhang

With regard to the other instruments of monetary policy, the Committee made the first change to the asymmetric interest rate corridor since September 2020, narrowing the band from +100/-700 basis points to +100/-300 basis points around the MPR. This measure aims to encourage deposits from commercial banks and reduce the excess Naira liquidity in the system as broad money supply (M3) grew strongly by 24.4% YTD in June 2023 compared to 6.7% YTD in May. The Cash Reserve Ratio (CRR) and the liquidity Ratio were however retained at 32.5% and 30.0%, respectively.

On foreign exchange developments, the MPC appears confident that the recent FX reforms will increase market transparency and encourage foreign capital inflows. While we align with this view, we however believe that the authorities' capacity to clear the existing backlog of FX demand will be a crucial determinant in reviving foreign capital inflows. We expect the spread between the parallel market rates and the official rate to widen in the short term, in the absence of policies to secure dollar supplies.

Structural reforms are inevitable

Notwithstanding the MPC's attempt to curb demand-pull inflation, structural constraints to supply amidst disrupted supply chains continue to undermine the effectiveness of monetary policy decisions. We believe the MPC's call for sustained collaboration between the fiscal and monetary authorities reflects the Central Bank's concerns about the structural constraints to monetary policy effectiveness.

Consequently, we believe a correction of these structural issues would be required in addition to the ongoing monetary policy adjustments to achieve a lower inflation.

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