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Ahead of MPC

MPC to Maintain Accommodative Stance

… to Balance Extant and Emerging Risks

The Monetary Policy Committee (MPC) will hold its penultimate meeting for the year on September 19 and 20, 2019. This is the fifth meeting for the year and will afford the committee an opportunity to critically evaluate the quality of its previous decisions vis-à-vis the state of the Nigerian economy.

We expect that the Committee will consider current conditions in the global economy, principally the accommodative posture adopted by monetary authorities in advanced economies to catalyze weakening growth. We also envisage that the Committee will consider the ongoing trade tensions, geopolitical pressures and oil price cum demand-supply dynamics.

On the local front, we expect that the MPC will assess the impact of its various initiatives at stimulating business and economic expansion. It will also be imperative that the Committee considers current inflationary pressures and the risks recent restrictions (such as the closure of land borders) pose to the single-digit inflationary target.

After due consideration of the aforementioned factors, we envisage that the committee will favour maintenance of the status quo.

International Economies and Developments

Weakened International Trade Spurs Monetary Easing

Weakened growth remains the overarching theme for the global economy as we near the end of the third quarter of 2019. The escalation of trade tensions between the U.S and China continues to dominate headlines, dampening the outlook for international trade and oil prices, and causing disruptions to the global supply chain. However, both countries have attempted to defuse tensions with delay in tariff implementations and tariff exemptions for some U.S goods, ahead of negotiations in September. Nevertheless, global manufacturing has continued to bear the brunt of weakened trade. Global Manufacturing PMI data for August reveal a fourth consecutive monthly slowdown to 49.5, with Germany among the countries recording the steepest PMI readings.

In the advanced economies, the European Central Bank (ECB) announced a 10bps cut in deposit rate from -0.4% to -0.5% in September while signaling its intention to restart its quantitative easing program. This has become pertinent as the E.U continues to battle slow growth and low inflation due to weakened international trade, structural challenges in some member countries and the lingering Brexit conundrum. Also, the Fed is widely expected to follow in the steps of the ECB and cut rates in its next meeting in September, in order to provide support to the US economy amidst the weak global economic backdrop. Elsewhere in China, recently released data shows that GDP slowed to 6.2% in Q2:2019, its lowest level in recent years, as the Orient nation continues to writhe under the impact of the trade tensions. This has prompted the People's Bank of China (PBOC) to also adopt easing policies to cushion the effect of the trade dispute on its economy.

Monetary easing has been a recurring theme across most major economies, with the declining yield environment spurring capital outflows to most emerging and frontier markets. These factors provide a good case for a rate cut by the MPC, however, other risk factors inherent in the economy such as unstable oil prices and the ongoing P&ID dispute might prevent this decision. Hence, we expect the MPC to maintain status quo at the next meeting.

Geopolitical Tensions Provide Much-needed Buffers for Oil Prices

Since the start of the second half of 2019, oil prices have trended further downwards, averaging USD60.90pb since the last MPC meeting. Concerns about the unresolved trade war and its implication for oil demand are mounting and have subdued any positive triggers for prices. OPEC+ has maintained its production adjustments, with output reaching a new 5-year low of 29.61MMbpd in July, led by Saudi Arabia's aggressive cuts. Meanwhile, the political impasse in Venezuela and the sanctions on Iran continue to artificially constrain supply from these two sources of heavy oil. There have also been sizeable inventory drawdowns in the US, even as geopolitical strife in the Persian Gulf has persisted. All of these do not seem to count for much, as international agencies including the Organization for Petroleum Exporting Countries (OPEC), the International Energy Agency (IEA) and the Energy and Information Administration (EIA) have consistently adjusted demand outlook downwards; the IEA revised oil demand growth for 2019 to only 1.1MMbpd from the 1.5MMbpd projected at the beginning of the year and expects even slower growth in 2020. In August, oil prices averaged only USD59.50pb, as the market was awash with a flurry of negative regards regarding the trade war. However, on 14th September, Houthi rebels from Yemen attacked two of Saudi-Arabia's key facilities, the *Abqaiq* – which is the world's largest crude oil processing facility and the *Khurais*, its second largest oilfield. The drone strikes shut in at least 5.7MMbpd, equivalent to 58.13% of Saudi's August production and 5.7% of global supply. The attack are

unprecedented in the oil markets, and immediately hurled prices at least 20% upwards to c. USD71.95pb on fears that Saudi might be unable to promptly recover from the disruption. This incident has introduced a new dynamic that might provide some support for prices in the coming months.

In the domestic space, production numbers have seen some progress in the last 3 months, aided by relative calm in producing areas. However, early in September, the Nembe Creek Trunk Line was placed under Force Majeure for undisclosed reasons. Further, there have been no major policy announcements in the sector since Q2 when the National Assembly passed the redrafted PIGB to the President for assent. Oil production (including condensates) have averaged 1.98MMbpd in 2019 but remains well below the budget benchmark of 2.3MMbpd. With the recent incident, we expect OPEC to deemphasize the production cuts for a while, to allow Saudi Arabia some scope to recover from the attack. This, alongside the fact that Brent prices should remain above the support level of USD60pb, are positives for Nigeria, triggering accretion to foreign reserves from oil exports. However, higher under-recovery costs on refined products could temper reserve growth.

In the near term, we expect Brent crude to trade between USD60pb – USD70pb, which augurs well for fiscal spending. The MPC should consider the impact of this on oil receipts and Nigeria's external reserves, as well as its influence on the CBN's ability to support the Naira in its decision to hold MPR at 13.50%.

Domestic Macros

GDP grew by 1.94% YoY As Oil Production dipped slightly

In the period under review, the Nigerian Bureau of Statistics (NBS) released the GDP report for the second quarter which showed a 1.94% YoY growth. While this was an improvement over the corresponding quarter (Q2:2018; 1.50%), it fell short of the 2.10% YoY growth recorded in Q1:2019. Expansion in the industrial (+2.10%) and agricultural sector (+1.79%) were the main drivers of growth during the period as both contributed 23.21% and 22.82% to GDP respectively. Contribution of the non-oil sector to the nation's revenue improved to 91.18%, while the oil sector contributed lower at 8.82%. There was a slight reduction in oil production volumes, however, the elevated oil prices during the period suppressed the effect, resulting in a 5.15% increase in oil sector growth during the period.

The Composite PMI report also indicated a slight uptick in expansion for the Manufacturing sector and Non-manufacturing sector as the PMI for both sectors inched up slightly in August 2019. The manufacturing PMI was reported at 57.9 index points (vs. 57.6 pts in July 2019), implying expansion in the manufacturing sector for twenty-nine straight months. Notable increases in the Raw materials inventory and

Employment level triggered the upswing in the manufacturing growth. Non-manufacturing PMI also came in at 58.8pts (vs. 58.7 pts in July 2019), with contraction in New order and New employment levels.

The economic outlook remains modest due to the combined effect of the US-China trade war on global oil price and the cap on Nigeria's oil production level which are both expected to hamper oil revenue in the near term. For the non-oil sector, we expect moderate growth in the space, driven by sustained FX liquidity and a marginal increase in business funding in the year.

Headline Inflation Declines for the Third Consecutive Month

Despite several pronouncements regarding FX restriction on some food items, inflation declined for the third consecutive month in August 2019 to 11.02% from 11.08% in July 2019. The cost-push pressure from the proportion of goods restricted from FX access was not significant to trigger a jolt in the food index, owing to the small basket size of the restricted food items.

Also, to tighten the nation's security, the Nigerian borders were closed, partially, from the 20th of August. While this drove up the prices of some food products, the price decline at the start of the month outweighed the increase at the tail-end (11days).

Consequently, food inflation slowed to 13.17% from 13.39% in July, following the improved availability of food products. Given the relative stability in the FX market, core inflation continued its downward trend, settling at 8.68% from 8.80% in July 2019.

In the coming months, we expect inflation to inch up, slightly, owing to the pressure point surrounding food prices. Notwithstanding, with the MPC's focus on growth, we expect the Committee to maintain rates at current levels.

USD9.6bn Fine Award Against Nigeria Spurs Concerns on Forex Stability

In a recent court ruling, the United Kingdom-based tribunal issued a USD9.6bn fine against the Federal Government of Nigeria for breaching its agreement in a gas-supply contract with the Process and Industrial Development Company, P&ID. This has triggered worries as the fine awarded is about 20% of the country's foreign reserve. If the country is compelled to pay the fine immediately, this will intensify the pressure on the foreign reserve balance, which has served as an instrument by the CBN in maintaining FX stability.

The Federal Government also proposed an increase in Value Added Tax rate from 5% to 7.2%, to increase the inflows of non-oil revenue. While the increase in the VAT

rate is essential for closing the gap between the rising government expenditure and its relatively low revenue, it is also a crucialstep needed to reduce the overdependence of the nation on oil revenue. However, the increase in the VAT could impair consumer spending and in turn demand for business services and product.

The committee has consistently called on government executives to institute fiscal policies to support their strategies for stimulating growth. However, the increase in VAT and pending debt, go the opposite way and may work against the current direction of the committee. Hence, we expect the committee to hold the MPR and retain its accommodative stance, still fiscal policies move towards supporting growth.

Politics and Security

Certainty Returning to the Polity

Since the last MPC meeting, we have seen the appointment of the Nigerian ministers and the assignment of their portfolios by President Buhari for his second term in office. The number of ministers were increased to forty-three (43) from thirty-six (36) in the last tenure, with several appointees reinstated in their previous positions. With focus on implementing appropriate policies within the domestic macroeconomy space, an eight-member Economic Advisory Council (EAC) was created by the Presidency, to replace the current Economic Management Team (EMT). This Council would provide advisory to the President on fiscal policies that would drive economic growth while considering external factors and the global economies at large.

On the other hand, the Presidential election tribunal has dismissed the petition filed by the PDP Presidential candidate, Atiku Abubakar. The court ruled that there was no admissible evidence on record to support the allegations of non-compliance to the electoral act.

On the security front, the xenophobic attacks on Nigerians in South Africa and the reprisal attacks that ensued, have been the major concerns in the country. However, efforts have been made to contain this menace as the Presidency called for a voluntary evacuation of Nigerians in South Africa following the envoy despatched to South Africa's President, Cyril Ramaphosa.

A clear direction of the nation's policy stance and reforms seem to be emanating following the swearing-in of the Presidential cabinet. However, there has not been much optimism regarding efforts to drive economic growth. Thus, we expect the MPC to maintain the rates at the upcoming meeting, while they await more forward-looking fiscal stimuli from the government.

Monetary Policy

Credit to the Private Sector Moderates

In July 2019, Broad money supply advanced by 1.35% MoM, following an increase in demand deposit (+3.33%) and quasi money (+0.60%). In comparison with the same period a year ago, Broad money supply (M2) is up by 13.21% resulting from strong growth across demand deposit (+6.80%) and quasi money (+17.69%). Credit to the private sector (-1.93%) contracted for the third consecutive month, however, credit to the government grew by 20.53%, resulting in a 3.34% increase in Net domestic credit.

The CBN's initiatives intended at boosting private sector lending, as well as the expectation that the Debt Management Office (DMO) in line with its debt management strategy will tap into the international capital market towards the end of the year is expected to create room for growth in private sector lending.

MPR vs. MMM rates

Since the last MPC meeting, the OBB and the OVN rates both increased by 17.15% and 18.50% respectively, leaving the average money market rate to settle higher at 35.11% on the 16th of September 2019. Similarly, the Nigerian Interbank Rate (NIBOR) increased across all the tenors, with the average NIBOR rate settling at 18.05%.

We expect the CBN to continue to intervene in the market to moderate and maintain system liquidity when required. In the absence of any shock to system liquidity, we expect the CBN to hold all rates while it continues to intervene in the money market when the need arises.

External Reserves and FOREX

Despite the increased level of oil production and relatively stable currency, since the last MPC meeting, external reserves declined by 4.88% to USD42.84 as at the 16th of September 2019 owing to lower oil prices.

The naira was relatively stable owing to the consistent market intervention by the CBN. At the interbank and parallel FX market, naira settled at NGN306.90 and NGN360.00 as at the 16th of September 2019.

Currently, the threats to capital outflow are moderate, as advanced economies maintain an accommodative monetary stance. However, the USD9.6bn judgement debt awarded against the Federal government, in favour of the Process and Industrial Development (P&ID) Company, could result to a significant strain on the

external reserve levels and the strength of the naira, upon enforcement. The judgement debt, which constitutes c. 22.41% of external reserves at the current level, arose due to an alleged breach by the FGN of a gas plant-construction contract. Pending the enforcement of the judgement debt, we expect continued FX stability and liquidity as the CBN continues its market intervention.

Fixed Income Environment and Outlook

Since the last MPC meeting, bearish sentiment dominated the secondary market for Treasury bills as average T-Bills yield inched up by 2.56% to 13.27% as at 16th of September 2019. We observed less preference for the 12M instrument as it recorded the highest uptick in yield (-3.26%). More preference for the 6M instrument was also observed as it recorded the lowest advancement in yield (-1.82%). In the primary market for T-Bills, we noted consistent declines in rates across tenors. A gradual reversal was, however, observed due to the need to retain existing investors and attract new investors into the market.

Similarly, the secondary market for bonds registered bearish sentiment as average bond yield advanced by 0.86% to 14.18% as at 16th of September 2019. Although short-dated instruments registered significant selling pressure, mild buying pressure was observed on long-dated instruments as investors sought to mitigate short-term uncertainties. In the primary market for bonds, low investor participation was observed as the bond auctions recorded undersubscriptions across offers since the last MPC meeting. This resulted in the conduct of a private auction to fill bids not subscribed to.

With the decline in investor participation, we envisage that a rate cut would suppress the yield in the fixed income space and further reduce the attractiveness of fixed income instruments. We, thus, posit that the MPC would vote to hold rate at 13.50%.

Equities Market Performance and Outlook

The market maintained its historical trend of poor performances in the month of August. Since the last MPC meeting in July, the NSEASI has lost 1.83%, declining from 28,088.74pts to 27,574.32pts. This has dragged the Year to date return further to -12.27%. Weak economic growth and the lack of lucid policies in the fiscal space to boost investors' confidence further intensified the stillness in the market. The release of financial results and interim dividend declarations by some of the tickers did little to stimulate gains. Although the market is currently underperforming, it is relatively trading at a discount to its peers, with a PE of 7.10x weighed against the frontier market (10.79x), emerging markets (13.64x) and developed markets (16.74x). In the absence of fundamental triggers, corporate actions such as Ignite Investment

acquisition of FO shares, have been the key driver of market rallies for specific counters.

Given the improvement in fixed income yields and slow economic growth, we expect the bearish investors' sentiment towards the market to persist. The Economic Advisory Council newly constituted by the President however may change this narrative and boost investor confidence given the pro market pedigree of members of the team.

On a Balance of Factors…

The committee, at the last MPC meeting, emphasized the need for a cautious and well-balanced policy amidst fragile recovery, especially as growth is below potential. The committee referenced the moderation in inflation which justifies the need for non-drastic action, as further tightening may not elicit desired outcome.

The Committee also emphasized that the full effects of the CBN's initiatives and measures aimed at re-focusing the deposit money banks on their primary responsibility of financial intermediation, especially lending to the private sector, are yet to be ascertained. Therefore, any adjustments in rates could destabilise the expected result of past policies and culminate to indeterminate outcomes. Ultimately, we do not envisage a deviation from the existing monetary policy stance at the next meeting. Thus, we expect the MPC to make the following decisions:

- **Retain the MPR at its current level of 13.50%**
- **Retain liquidity ratio at 30%**
- **Retain the asymmetric corridor at +200bps/-500bps**
- **Retain the CRR at 22.5%**

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