

January 22, 2021



# Nigeria Strategy Report

H1 2021

Domestic Economy and Markets

## Monetary Policy: Prioritizing Economic Growth

### Executive Summary

The Monetary policy authorities in H2:2020 maintained its accommodative stance, as it considered the lingering impacts of the twin shocks of the COVID-19 pandemic and low oil prices on the Nigerian economy. Inflationary pressures stemming from the prevalence of insecurity in the nation's food producing states, hike in the price of petroleum products, and adjustments in exchange rates tilted the Monetary Policy Committee (MPC) to stand with its pro-growth viewpoint. Consequently, benchmark rates were adjusted in the second half of 2020, as MPR in September was cut to 11.50% (vs. 12.50% at the end of H1:2020), and Asymmetric corridor was adjusted to +100/700bps (vs. +200bps/-500bps at the end of H1:2020).

Inflation is poised to maintain its upward trend in the near term. Prevailing factors such as insecurity in food producing nations and higher energy costs are expected to contributor to the rising inflation. Considering this, we do not see the MPC lower interest rates further, as it could stifle achieving non-inflationary economic growth. We do however expect the MPC will maintain its accommodative stance to support the growth and recovery of the domestic economy. The apex bank's pro-growth attitude should see increased sector-targeted interventions and encourage lending to the real sector. Considering this, we see yields remaining low and negative real rates of return widening, as authorities encourage cheap credit to lift the economy out of its depressed state.

We anticipate total maturity of ₦14.84 trillion in 2021 from Bonds, T-bills and OMO. However, we expect that the CBN continues to manage the expected money supply via CRR debits on the apex bank's disposition. On the back of this, we expect effective CRR to remain high in 2021. At the OMO auctions in 2021, we envisage that the low stop rates would be sustained. We expect the CBN will seek to maintain a lower cost in managing liquidity, especially as expected inflows World Bank and would give more headroom to maintain low rates.

*In this report, we focus on developments in the Monetary space over H2 20 and delineate our outlook for monetary policy direction for 2021.*

### *Prioritizing Economic Growth*

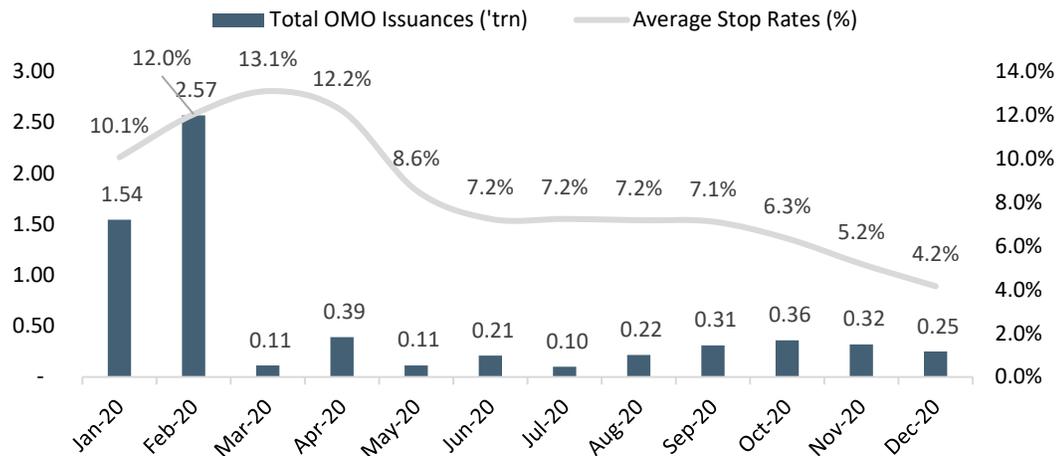
The Monetary policy authorities in H2:2020 maintained its accommodative stance, as it considered the lingering impacts of the twin shocks of the COVID-19 pandemic and low oil prices on the Nigerian economy. Inflationary pressures stemming from the prevalence of insecurity in the nation's food producing states, hike in the price of petroleum products, and adjustments in exchange rates tilted the Monetary Policy Committee (MPC) to stand with its pro-growth viewpoint. Consequently, benchmark rates were adjusted in the second half of 2020, as MPR in September was cut to 11.50% (vs. 12.50% at the end of H1:2020), and Asymmetric corridor was adjusted to +100/700bps (vs. +200bps/-500bps at the end of H1:2020). In light of the northward trend in inflation, this reflects an attempt to balance a stimulation of economic activity by boosting credit to the real sector and managing liquidity levels. Also, with low levels of foreign inflow considering the global economic predicament, the FX reserves were at risk and the CBN's ability to maintain FX stability was hit. In H2:2020, the CBN consequently adjusted the official rate to ₦379/\$ from ₦360/\$. In addition, rates at the IEW were revised from closing rates of ₦361.84 – ₦392.18/\$ in H1:2020 to ₦384.80 – ₦410.25/\$ in H2:2020.

As the MPC continued to maintain low interest rates and carry out real sector interventions via sector targeted funds, Money supply (M3) advanced by 5.21% during 2020 to close at ₦36.59 trillion in November, while Net domestic credit rose by 10.90% during 2020 to ₦40.12 trillion. In addition, Manufacturing PMI in December 2020 advanced to 49.6pts (vs. 41.1pts at the end of H1:2020), while Non-Manufacturing PMI advanced further to 45.7pts (vs. 35.7pts at the end of H1:2020), reflecting the gradual recovery in domestic economic activity.

### *CBN Moves to Lower Cost of Liquidity Management*

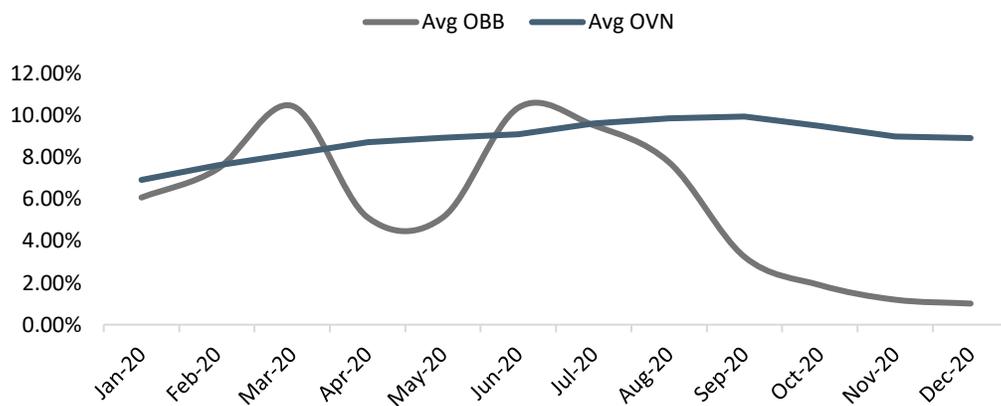
Despite the low levels of FX inflows, the CBN had cut stop rates in the second quarter of 2020 to as low as 4.95% on 82-DAY OMO instruments. This was to help in lowering the cost of managing the already buoyant system liquidity. Highlighting this was the drop-in rates at the money market as OVN1 rate went from 16.00% in June 2020, to 0.53% in December. Interbank OBB2 rates also fell to a range of 0.03% – 2.00% from a range of 13.00% - 16.00% at the end of H1:2020. Total issuance by the end of H2:2020 came in at N1.56 trillion for the year (vs. ₦4.94 trillion in H1:2020 and ₦5.96 trillion in H2:2019 when rates were higher). At the end of H2:2020, the one-year stop rate went to 5.9% from 8.99% at the end of H1:2020. In addition, the external inflows from IMF in form of a loan facility allowed more headroom for the CBN to cut rates at the OMO market. Whilst H2:2020 subscription (₦5.90 trillion) remained buoyant, the CBN sold ₦1.56 trillion – ₦24.87 billion less than what it offered (₦1.58 trillion).

**Figure 1: OMO issuances and stop rates [CBN]**



Source: CBN, ARM Research

**Figure 2: Trend in interbank rates in 2020**



Source: FMDQ, ARM Research

**Improving Conditions for FX Stability**

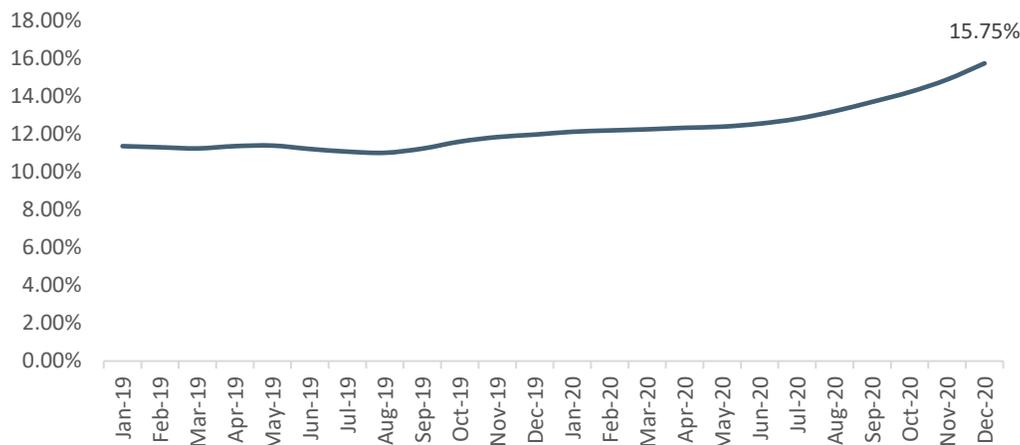
We expect that the CBN exerts efforts, even amidst the low levels of foreign inflows to the economy to keep the Naira relatively stable. The CBN has expressed an unwavering stance on maintaining the currency even amidst depleting reserves. We recall that despite FX reserves falling by \$4.52bn in 2019, the average monthly rate of the Naira stayed within ₦306.85 – ₦306.95 /\$. The apex bank’s arm was however twisted in 2020 as the shock that is the COVID-19 pandemic hit the global economy, alongside depressed oil prices that reached as low as \$19.33pb in April. Consequently, we saw the official rate adjusted twice to close at ₦379 /\$ by the end of H2:2020.

A positive outlook for the global oil market, and buffers to the reserves via external loans should allow the CBN get back on course in defending the Naira. The CBN restrained outflows in 2020 as it suspended FX sales to the IEW as well as BDCs, but we expect this to be relaxed during 2021. In addition, an expected pick-up in economic activity should lead to increased FX demand for travel purposes and imports. On the inflow side, expectations are that global crude oil market would fare better in 2021 than in 2020 – this is considering eases in lockdowns and OPEC’s sustained commitment to curb supply. Subsequently, we project improved oil receipts for Nigeria. In addition, the reserves are expected to still be supported by swaps and external financing in the form of loans. On the balance of factors, we estimate gross revenue to close at \$28.79 billion by the year’s end. Considering the proclaimed comfort level of \$30 billion in the past, the reserves currently at ₦36.45 billion gravitates our opinion for the Naira to be maintained within the range of ₦379 – ₦410 / \$ in 2021.

### *Despite Surging Inflation...*

Inflation is poised to maintain its upward trend in the near term. Prevailing factors such as insecurity in food producing nations cap policy/intervention effect and stifle food supply – thereby leading to food inflation. Pharmaceutical products, in light of fears for a second wave of the COVID-19 pandemic would cause already its already hiked prices sticky downwards. Higher landing costs for petroleum products importation should translate to higher energy costs as well – subsequently leading to higher transportation costs. Having analyzed the contributors to the rising inflation, it is fair to say structural issues, more so than monetary issues are to be focused on to manage it. Consumer Price Index YoY printed at 15.75% in December 2020 (vs. 11.98% in December 2019). Despite the reopening of the land borders, we do not expect to see significant lowering in food inflation as the government still limits importation of selected food items. Considering this, we do not see the MPC lower interest rates further, as it could stifle achieving non-inflationary economic growth.

**Figure 3: Inflation Trend**

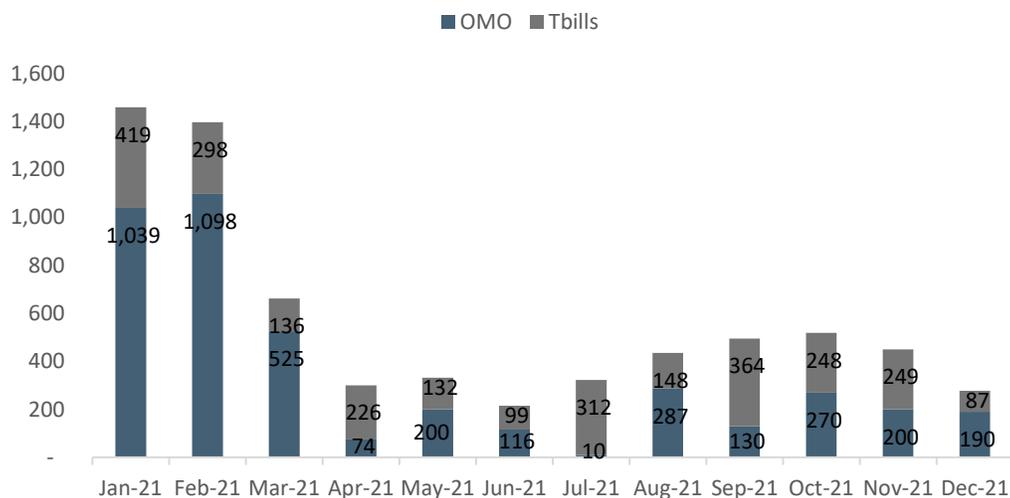


**...It Will Be Tolerated for Now**

We expect the MPC will maintain its accommodative stance to support the growth and recovery of the domestic economy. The apex bank’s pro-growth attitude should see increased sector-targeted interventions and encourage lending to the real sector. Considering this, we see yields remaining low and negative real rates of return widening, as authorities encourage cheap credit to lift the economy out of its depressed state.

We anticipate total maturity of ₦14.84 trillion in 2021 from Bonds, T-bills and OMO. However, we expect that the CBN continues to manage the expected money supply via CRR debits on the apex bank’s disposition. On the back of this, we expect effective CRR to remain high in 2021.

**Figure 4: Maturity Profile FY 2021 (₦'billion)**



Source: FMDQ, ARM Research

At the OMO auctions in 2021, we envisage that the low stop rates would be sustained. We expect the CBN will seek to maintain a lower cost in managing liquidity, especially as expected inflows from the World Bank and would give more headroom to maintain low rates.

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