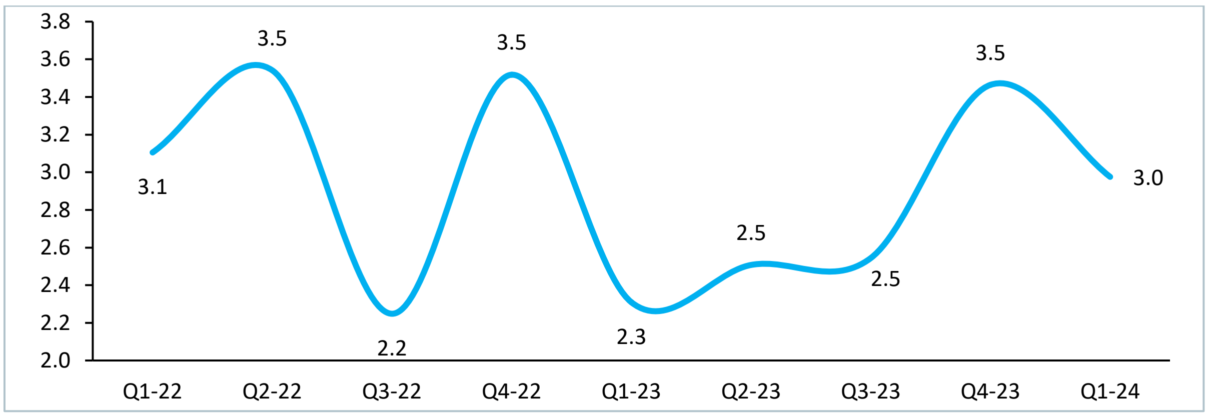
10 June 2024

FSDH Economic Note - June 2024

Economic growth in the last two quarters has been supported by the recovery of crude oil

President Tinubu assumed office in May 2023 with a vision of achieving an annual real Gross Domestic Product (GDP) growth of over 6%. In the last two quarters of 2023, GDP growth averaged 3%, while annual growth for 2023 was 2.74%, according to National Bureau of Statistics data. The Nigerian economy continued its growth performance in the first quarter of 2024. Real GDP grew by 2.98% in Q1 2024, higher than 2.3% in the corresponding quarter of 2023. However, growth decelerated by 0.48 percentage points compared to the previous quarter. As with previous growth episodes, the services sector was instrumental in driving GDP growth in Q1 2024 with an expansion of 4.32%, slightly down from 4.35% in Q4 2023. The financial sector largely drove this growth, which saw a significant increase of 31.24% during the quarter. This is unsurprising following the impressive performance of several financial institutions in the quarter, supported by high interest rates, among other factors.

Figure 1: Real GDP Growth (%)



Source: NBS

Additionally, the information and communication sector recorded a positive growth of 5.43% in the quarter, although this was lower than the impressive 10.3% growth in the corresponding quarter of 2023. Key sectors such as telecoms, broadcasting, publishing and motion pictures grew but at a slower pace compared to Q1 2023. Transportation and storage returned to positive growth after declining for three consecutive quarters triggered by a post-election slowdown and an increase in fuel price following the President's announcement of subsidy removal in May 2023. Among the transport subsectors, road transportation was the most affected by the subsidy removal.

Table 1: GDP Growth of Key Sectors

	Q1 2023	Q4 2023	Q1 2024
Agriculture	-0.90	2.10	0.18
Industry	0.31	3.86	2.19
Services	4.35	3.98	4.32
GDP	**2.31**	**3.46**	**2.98**

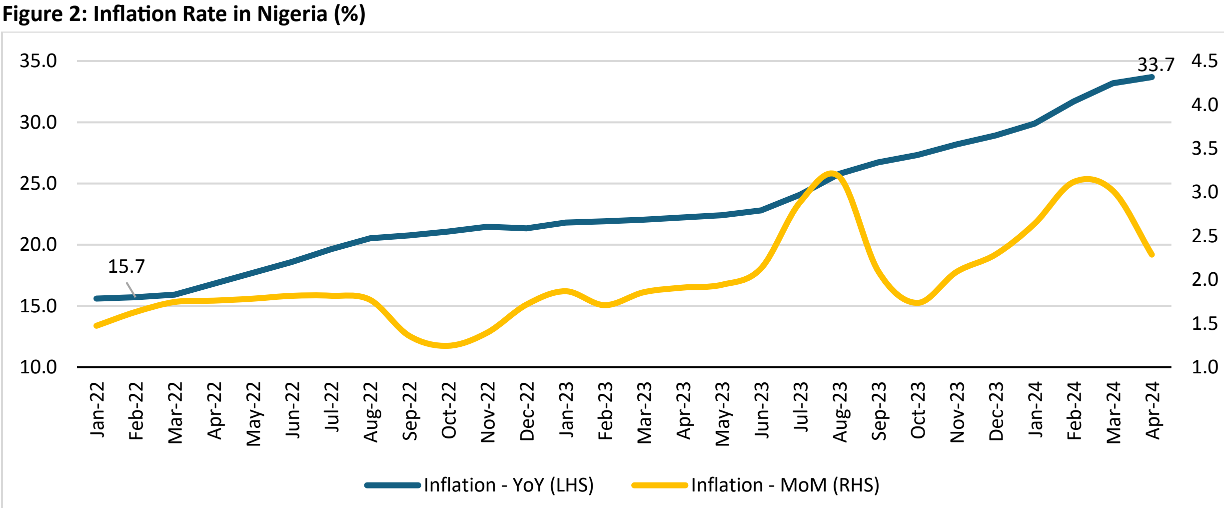
Source: NBS

One noticeable trend since the President assumed office is the consistent increase in crude oil production since the third quarter of 2023. After 14 quarters of consecutive decline, the oil sector expanded by 12.1% in Q4 2023. In Q1 2024, the sector continued its expansion, growing by 5.7%, a significant improvement from -1.4% in Q1 2023. This impressive performance was motivated by a consistent increase in oil production over the past four consecutive quarters, from 1.22 million barrels per day (mbpd) in Q2 2023 to 1.57mbpd in Q1 2024. It shows that the President's efforts to combat oil theft yielded positive results. In the agriculture sector, although growth in Q1 2024 (0.18%) was better than the corresponding quarter in 2023 (-0.9%), the sector still performed poorly. Persistent challenges of insecurity, low productivity, wastage and inadequate infrastructure continue to limit the sector's growth. The manufacturing sector's performance remains tepid, growing by 1.49% in Q1 2024 from 1.61% in Q1 2023.

Economic Growth was accompanied by heightened inflationary pressure

In the first year of President Bola Tinubu's administration, inflation emerged as one of the most significant economic challenges for households and businesses. In April 2024, Nigeria's headline inflation rate surged to 33.69%, up from 22.8% in June 2023, just a month into the new administration. This increase in April represents the 16th consecutive month of rising inflation in the country. Food and core inflation rates accelerated sharply to 40.5% and 26.8%, respectively, in April 2024. Key drivers of inflation include the enduring and compounding adverse impacts of fuel subsidy removal, exchange rate depreciation, and other structural issues such as poor power supply, insecurity and infrastructural deficiencies. Despite the overall rising trend, there was a slight improvement in the monthly inflation trend. Month-on-month inflation rate fell for the second consecutive month, from 3.12% in February 2024 to 2.29% in April 2024. With shocks emanating from renewed security threats and the hike in electricity tariffs, inflationary pressure may extend into the second half of the year unless efforts are implemented by the government to ameliorate the situation.

Figure 2: Inflation Rate in Nigeria (%)

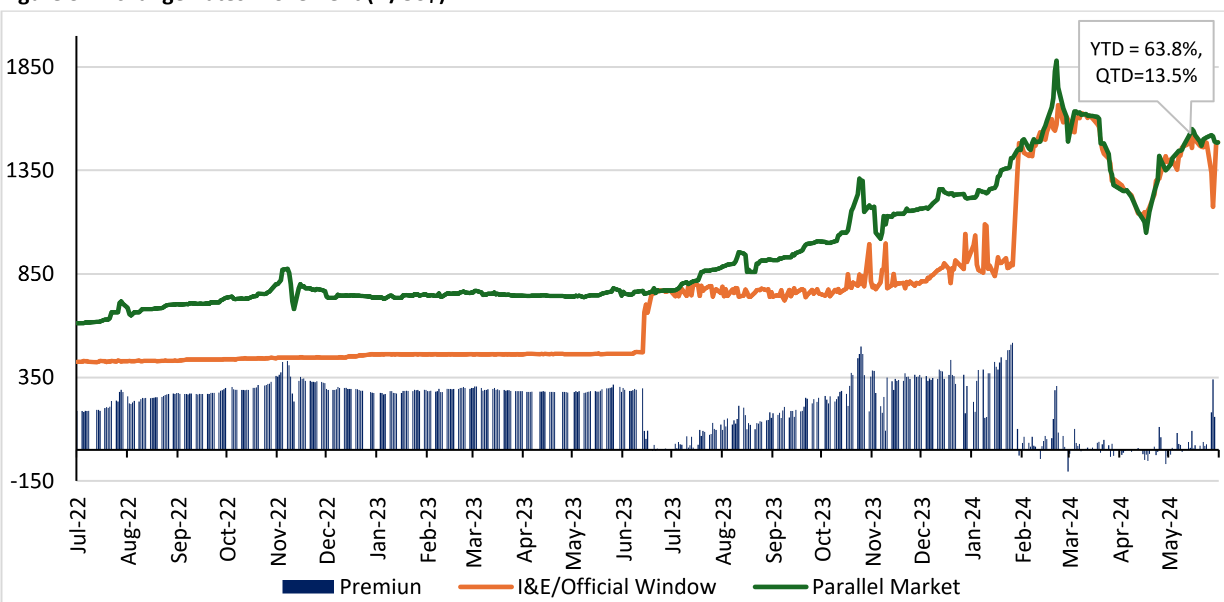


Source: NBS

Depreciation and volatility of the Naira marked the first year of President Tinubu's administration

At the start of the current administration, the exchange rate was N461 to a US Dollar. The policy shift by the Central Bank of Nigeria (CBN) to return to a willing buyer-willing seller arrangement led to a significant currency depreciation since June 2023. By December 2023, the currency had lost 95% of its value, closing the month at N899.4 per US Dollar. In 2024, the exchange rate showed mixed performance. The Naira was volatile in the first five months of the year, depreciating by 81% until the end of February and appreciating by 29% thereafter until late April. This appreciation was a departure from the trend in H2 2023. To achieve this, the CBN embarked on a series of interventions and reforms, such as clearing forex backlogs, raising the monetary policy rate, reforming the Bureau de Change segment, etc. However, by the end of May 2024, the Naira depreciated by 29% to N1,483/US$, raising concerns about the sustainability of these reforms. This situation emphasises the importance of structural reforms and efforts to sustainably increase crude oil production and non-oil exports to complement the CBN's actions. While the exchange rate remains relatively stable compared with H2 2023, the price discovery process is expected to continue into the second half of the year, albeit with less volatility than experienced in H1. We expect the exchange rate to hover around N1,500 per US$ in H2 2024.

Figure 3: Exchange Rates Movement (N/US$)



Source: FMDQ, Nairametrics

Monetary Policy: the return of the orthodox approach to inflation targeting

In the first year of President Tinubu's administration, the Central Bank of Nigeria (CBN), under Yemi Cardoso's leadership, has demonstrated a strong commitment to pursuing an inflation-targeting framework and ensuring exchange rate stability. Cardoso's first Monetary Policy Committee (MPC) was held in February 2024 following the postponement of two meetings in September and November 2023. So far in 2024, the CBN MPC has met three times and raised the Monetary Policy Rate (MPR) on each occasion. In February 2024, the MPC raised the MPR by 400 basis points to 22.75% from 18.75% and tightened the CRR to 45% from 32.5%. Subsequently, in March and May 2024, the Committee raised the MPR by 200 and 150 basis points, respectively, to 24.75% and 26.25%. These continuous and unprecedented rate hikes highlight the CBN's commitment to its inflation-targeting framework aimed at achieving price stability.

Table 2: Recent Monetary Policy Reforms in 2024 (January to May 2024)

S/N	Policy Parameters	Policy Changes/Actions		
		First Meeting (February 2024)	Second Meeting (March 2024)	Third Meeting (May 2024)
1.	**Monetary Policy Rate (MPR)**	Raised the MPR by 400 basis points from 18.75% to 22.75%.	Raised the MPR by 200 basis points from 22.75% to 24.75%.	Raised the MPR by 150 basis points from 24.75% to 26.25%.
2	**Asymmetric Corridor**	Adjusted the asymmetric corridor around the MPR from +100/-300 to +100/-700.	Reversed the asymmetric corridor to +100/-300.	Retained the asymmetric corridor at +100/-300.
3.	**Cash Reserve Ratio (CRR)**	Raised the CRR of commercial banks from 32.5% to 45.0%.	Raised the CRR of merchant banks from 10% to 14%.	Retained the CRR of commercial banks at 45% and merchant banks at 14%.
4.	**Liquidity Ratio**	Retained the Liquidity Ratio at 30%	Retained the Liquidity Ratio at 30%	Retained the Liquidity Ratio at 30%
5.	**Open Market Operations (OMO)**	Sold OMO instruments worth N3.28 trillion in the primary auction market in the first five months of 2024, compared with N728 billion in 2023, to mop up liquidity.		
6.	**Loan-to-Deposit Ratio (LDR)**	Revised the banks' LDR from 65% to 50%		

Source: CBN, FMDQ

Regarding the impact of these rate hikes, the CBN Governor previously announced an inflation target of 21.4% for 2024. However, the inflation rate has continued its upward trend, increasing from 28.8% in December 2023 to 33.7% in April 2024. Although the month-on-month inflation rate has declined for two consecutive months, it is still too early to attribute this decline to the hikes in the MPR. This indicates that the CBN is still far from achieving its target of 21.4% for the year. Clearly, the drivers of inflation in Nigeria include non-monetary elements, suggesting that monetary policy actions alone are insufficient. These actions must be complemented by fiscal and trade measures to reduce inflation effectively.

Beyond inflation, the rate hikes have resulted in higher interest rates and yields on financial instruments. As of May 2024, yields on one-year treasury bills hovered around 20%, while those of commercial papers fell between 21% and 24%. This reflects the broader impact of the MPC's rate hike on the financial market, influencing both government and corporate debt instruments. On the government side, these rate hikes are expected to significantly increase government debt servicing costs, adding immense pressure on public finances. For investors, while higher interest rates are expected to attract foreign portfolio investment (FPI) into Nigeria as investors seek higher returns on their investments, evidence from the movement of the external reserves does not suggest a significant increase in FPIs. Year-to-date (June 6), external reserves had lost 0.6% of its value, at US$32.8 billion, although the recent trend indicates an upward movement. Overall, it appears that the recent rate hikes are not a silver bullet in addressing inflation, exchange rate volatility and low foreign investment in Nigeria. The experience suggests that investors are not only focused on returns on investment but also on the safety of their investment, especially considering exchange rate fluctuations and a challenging business environment. Ultimately, fiscal authorities must intensify efforts to address low food production, low productivity in the agricultural sector, insecurity and infrastructure/logistics bottlenecks.

Figure 4: Money Supply and Credit to Private Sector (N'trn)

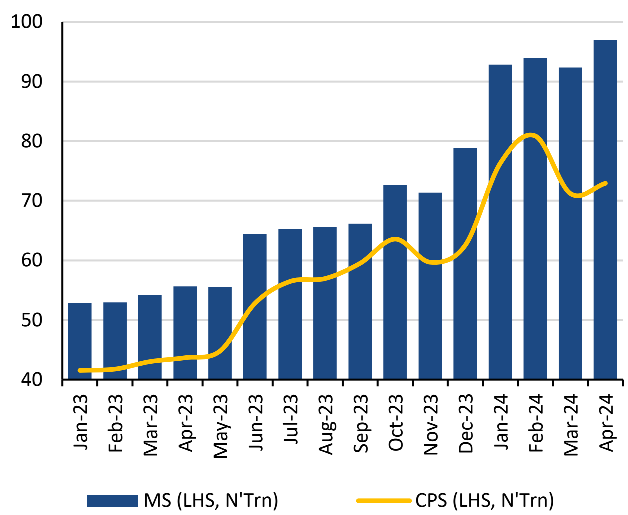
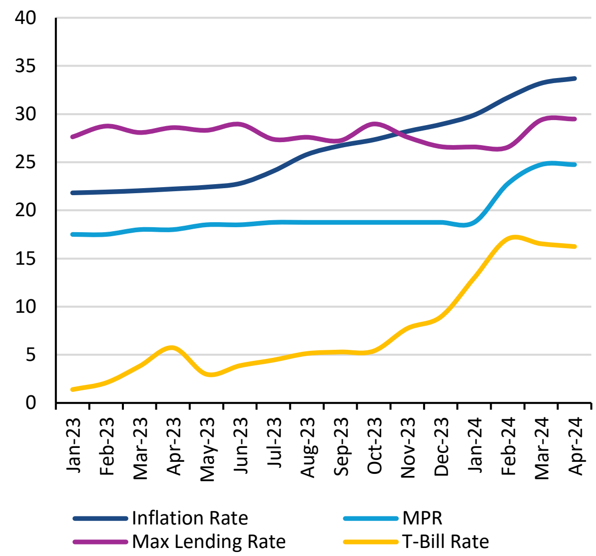


Figure 5: Interest rates in the Financial Market (%)



Source: CBN

While the recent rake hikes may have adversely affected the real sector in the form of high lending rates, the financial sector has experienced an impressive performance. The dramatic increase in interest rates and yields in the fixed-income market has increased the interest income of financial institutions. In addition, a weaker currency had a net positive impact on the book balance of the foreign currency-denominated portfolios, even as earnings from such assets were amplified. Consequently, financial institutions such as Access Holdings, FBN Holdings, GTCO and Stanbic IBTC, among other banks, recorded 121.85%, 315.61%, 685.90% and 58.13% increases in profit (year-on-year), respectively, in Q1 2024.

We do not completely rule out the role of monetary policy in supporting exchange rate stability and reducing inflation in Nigeria. The experiences of advanced economies, such as the United States and the United Kingdom, which have more effective monetary policy transmission mechanisms, show that time is crucial for monetary policy to have the desired effect. Therefore, while the immediate results may not be evident, well-coordinated monetary and fiscal policy actions can contribute significantly to economic stability over time.

Outlook - What to expect in H2 2024

Our estimation of real GDP growth for 2024 remains at 2.98%, an improvement over the 2.74% achieved in 2023. This optimism stems from sustained efforts by policymakers, especially the monetary authorities, to ensure a stable exchange rate and restore investors' confidence in the economy. We expect the Naira to remain around N1,500/US$, supported by increased oil output and intermittent interventions by the CBN in the foreign exchange market. A stable exchange rate, coupled with initiatives such as dry-season farming, will positively impact inflation. Therefore, we maintain our previous views that the inflation rate will decline in H2 2024 as households and businesses adjust to the FX and subsidy reforms. However, we do not expect the CBN to achieve its inflation target of 21.4% in 2024. Our projection for the inflation rate stands at 27.1% for the year. Key risks to our projection include continued insecurity, infrastructure deficit, supply chain bottlenecks, and the impact of the electricity tariff hike.

On monetary policy, we believe that the CBN's MPC will likely pause the rate hike in subsequent meetings to assess the impact of previous hikes. In the last few months, credit growth to the private sector has slowed while lending rates remained high, at around 30%. While an aggressive rate hike might be useful for exchange rate stability, its impact on economic growth must be carefully considered. On a final note, one area of concern is the Ways and Means advances, which involve the Federal Government borrowing from the Central Bank. Under the previous administration, these advances increased significantly to over N26 trillion[1], way above the statutory limit of 5% of the previous year's revenue as contained in the CBN Act. This raised several concerns, particularly in aspects of transparency, accountability and the independence of the Central Bank. Since the new administration took office, Ways and Means advances trended upward in the last six months of 2023, rising from N4.2 trillion in June to N8.2 trillion in December 2023. While the CBN is yet to publish data on Ways and Means up to May 2024, an increase in CBN lending to the federal government could be counter-intuitive, especially in an era where the CBN MPC has raised interest rates and reduced money supply to control inflation. As highlighted in our previous notes, a temporary halt of Ways and Means lending is required to enhance the efficacy of monetary policy in Nigeria.

[1] CBN Statistical Bulletin puts Ways and Means at N26.95 trillion in May 2023. The National Assembly approved the securitization of the Ways and Means which was transferred to the Debt Management Office (DMO).