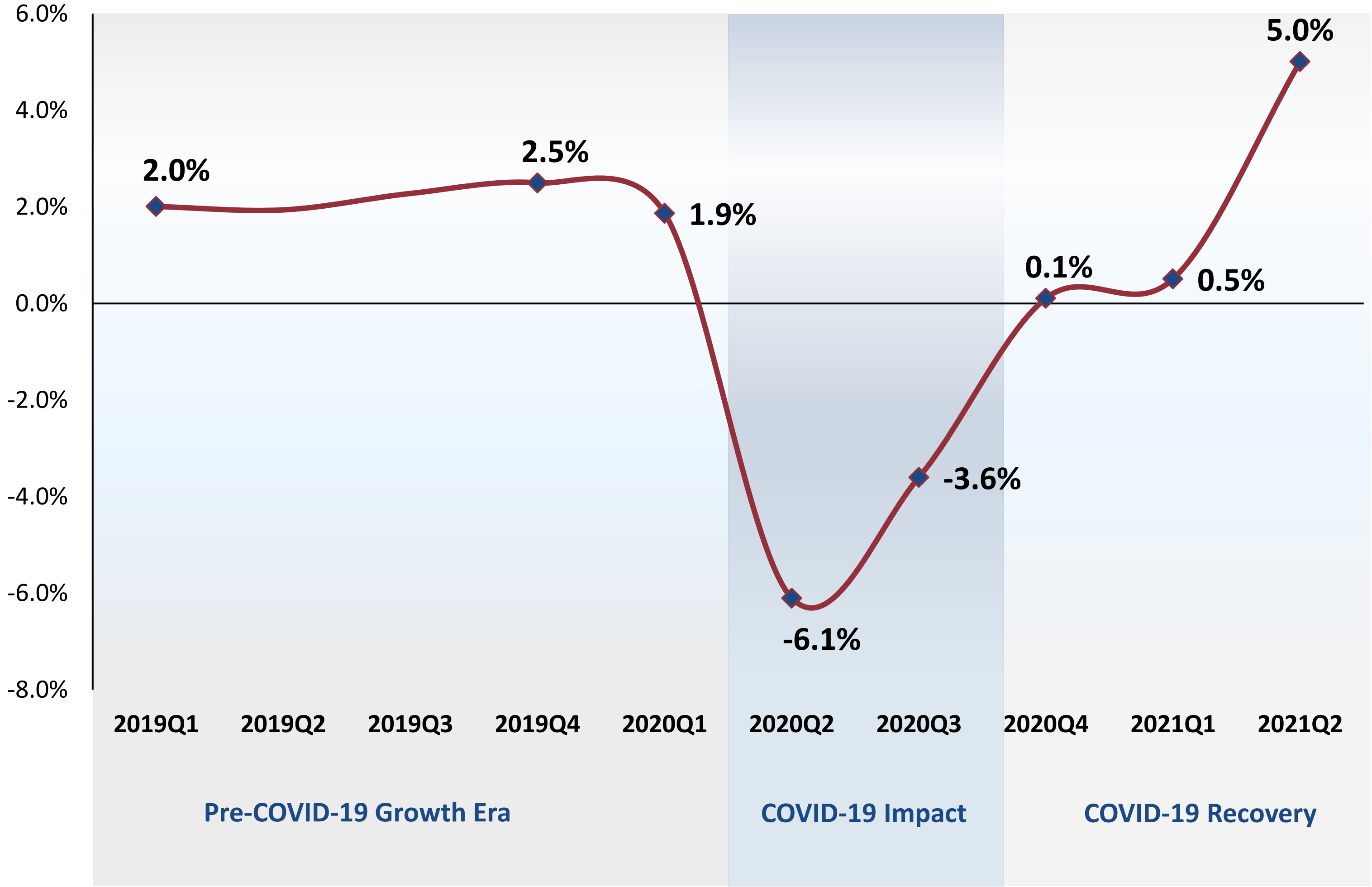
GDP, Inflation and MPC Note

September 2021

Nigeria’s GDP grew by 5% in 2021Q2 mainly due to the base effect

Nigeria’s Real GDP growth

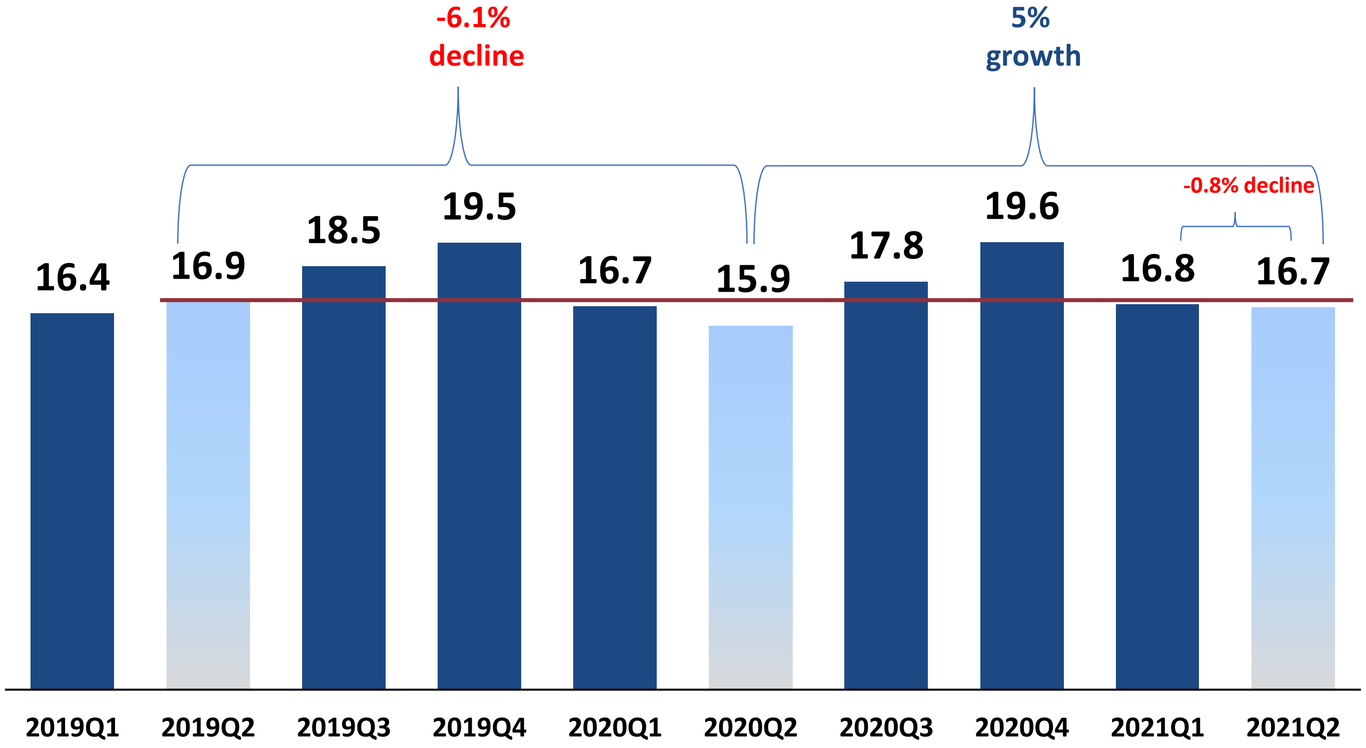


- In the second quarter of 2021, the Nigerian economy grew by 5% on a year on year basis. This represents the third consecutive positive quarterly growth since the third quarter of 2020.
- As stated in our previous Macroeconomic report, “specifically for the second quarter of 2021, economies that recorded deeper GDP contractions in the second quarter of 2020 due to lockdowns will emerge with significant growth in the corresponding quarter of 2021. This is mainly due to the base effect”.
- Growth in Q2 was driven by the non-oil sector, particularly transportation & storage, trade, information & communication and manufacturing.
- In the first half of the 2021, the economy grew by 2.76%.

Data Source: National Bureau of Statistics

Quarter on Quarter GDP declined by 0.8%

Nigeria's Real GDP value in Trillion Naira



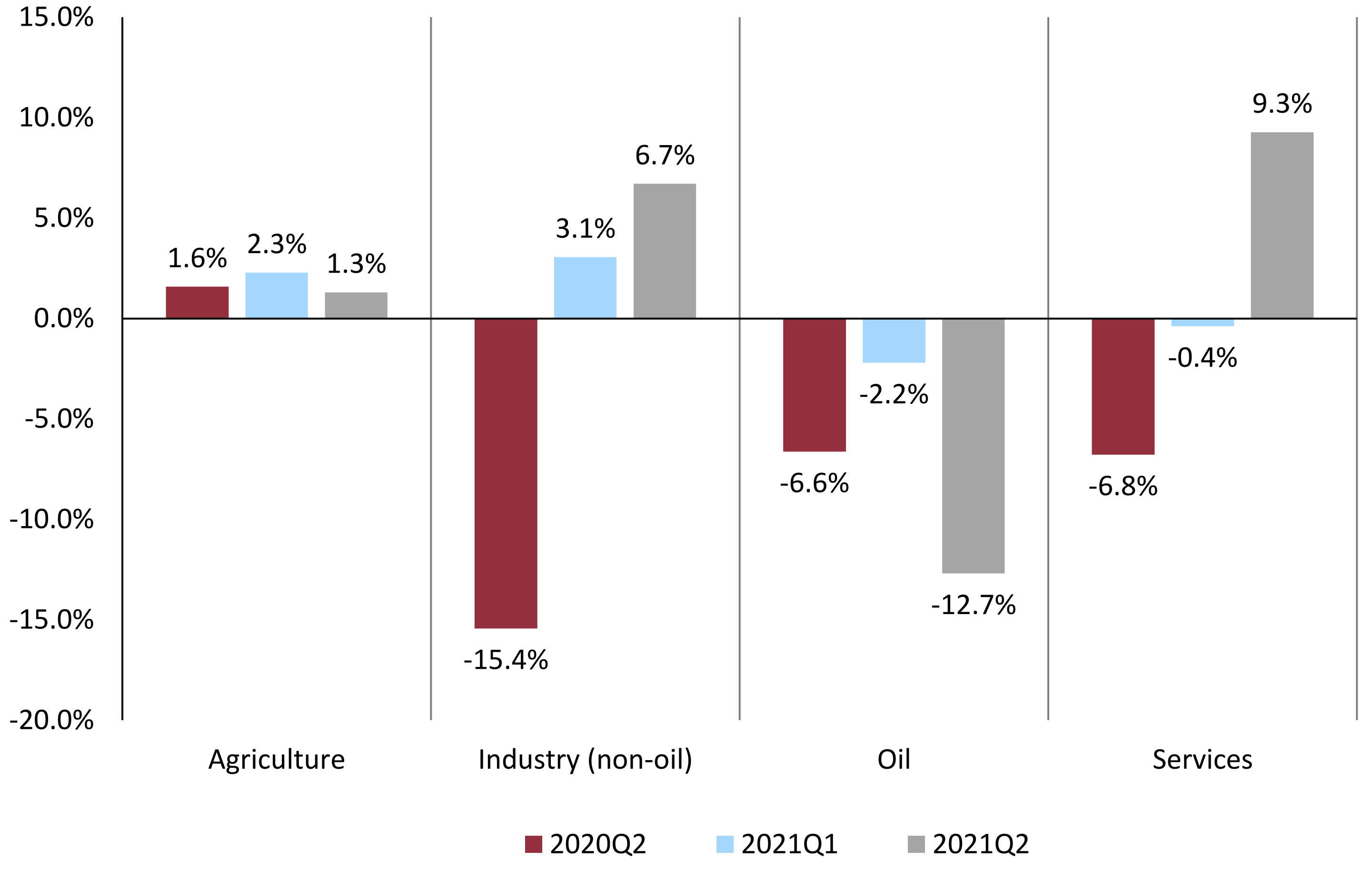
- Despite the impressive year on year growth performance, quarter on quarter GDP declined by 0.8% in 2021Q2.
- Historically, the value of real GDP in Q2 is usually higher than the value in Q1. This is mainly because the first quarter of the year is characterized by lower spending activities relative to other quarters.
- But for the second time* since 2003, the value of real GDP in the first quarter in 2021 (N16.83 trillion) was higher than that of the second quarter (N16.7 trillion).
- This suggests that economic recovery is fragile and factors that hinder economic growth are prevalent.
- Going forward, the 5% year on year growth recorded in Q2 will be the highest growth rate in the year.
- We expect slower growth figures in Q3 and Q4 as the base effect fades.

Data Source: National Bureau of Statistics

**The first time this happened since 2003 was in 2020 due to the implementation of lockdown in 2020Q2.*

Oil & Gas sector continued to perform poorly, Services sector grew faster

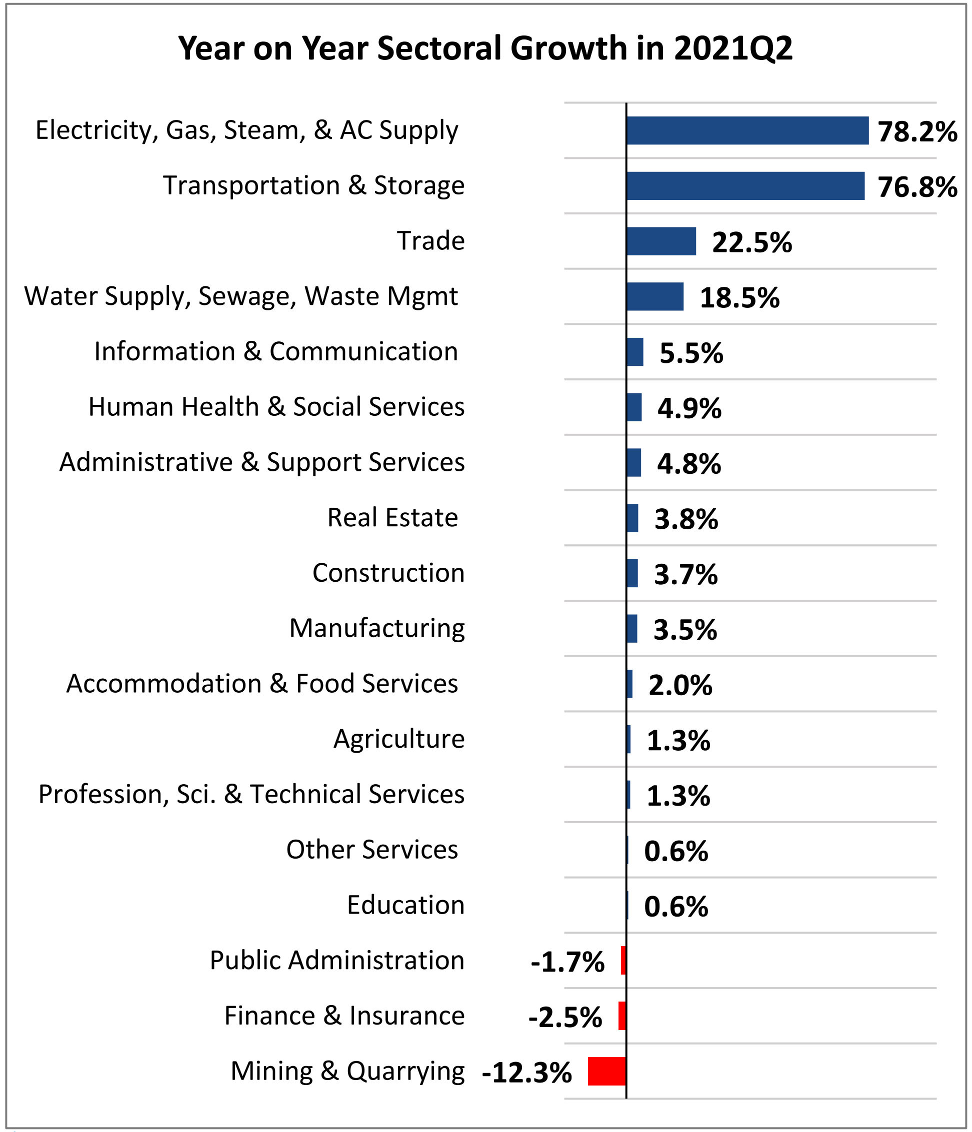
Real GDP growth of major sectors

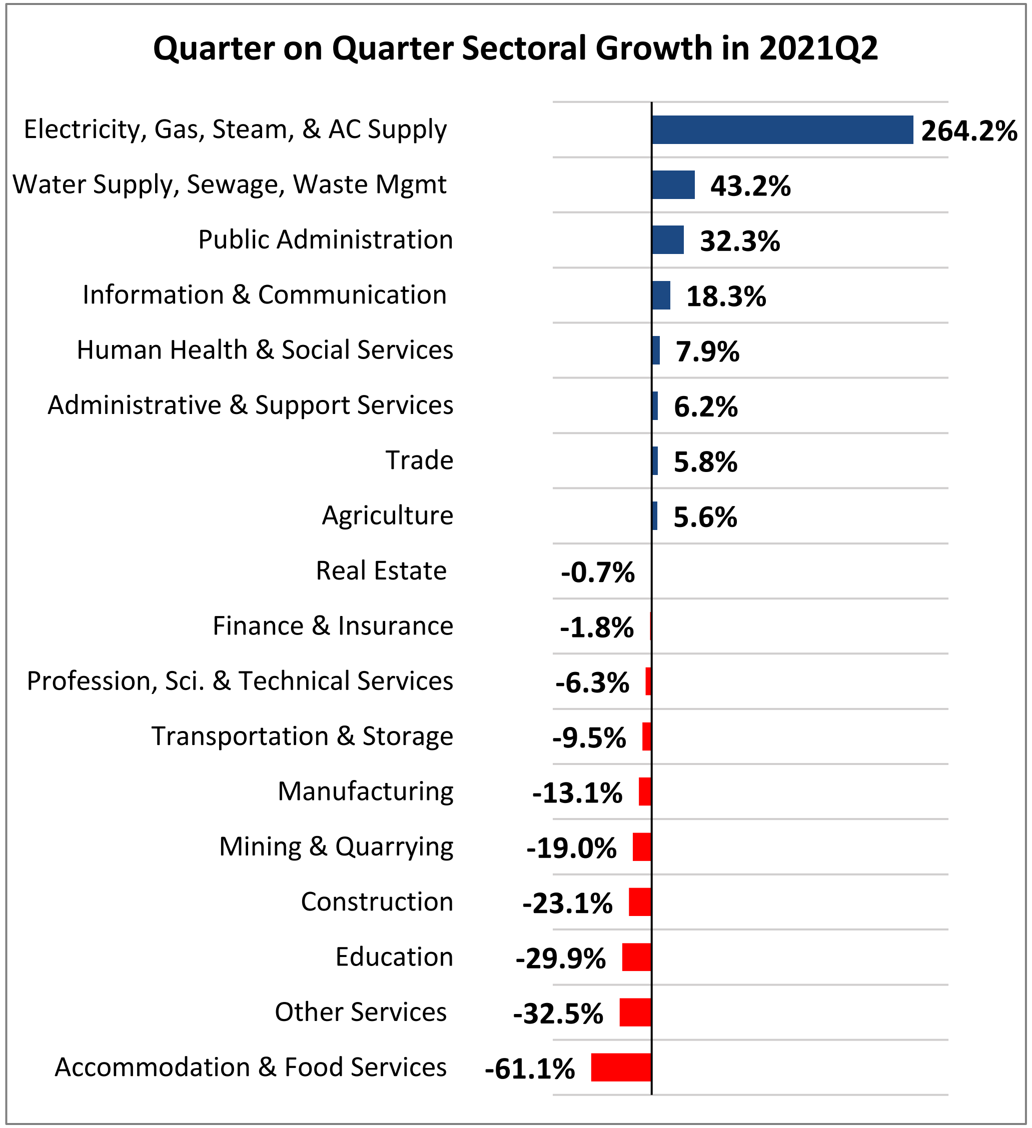


- The performance of broad sectors in 2021Q2 confirmed the narrative that sectors (apart from Oil & Gas) that were severely affected by the lockdown in 2020Q2, experienced strong growth in 2021Q2.
- The Services sector recorded a strong positive growth of 9.3% in the second quarter of 2021.
- Growth in Services was driven by Transportation and Storage subsector which grew by 77%. Recall that this subsector was among the most affected during the COVID-19 induced lockdown in 2020.
- The contraction in the Oil and Gas sector was triggered by the fall in oil production volumes to 1.61 million barrels per day (mbpd) in 2021Q2 from 1.72mbpd in 2021Q1 and 1.81mbpd in 2020Q2.
- For agriculture, insecurity, seasonal factors and high prices continue to affect output in the year.

Data Source: National Bureau of Statistics

The Base Effect: Only 3 sectors declined in 2021Q2 on a year-on-year basis

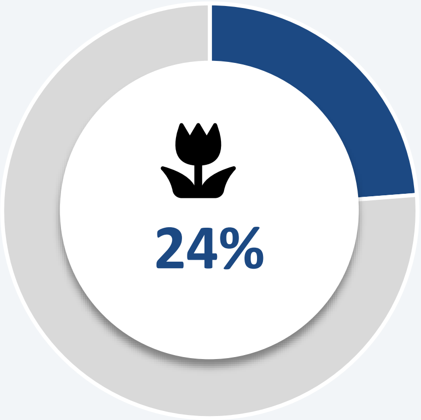




- The base effect influenced performance across sectors.
- On a year-on-year basis, only 3 sectors declined in Q2.
- The output of 10 sectors declined when compared with the previous quarter.

Data Source: National Bureau of Statistics

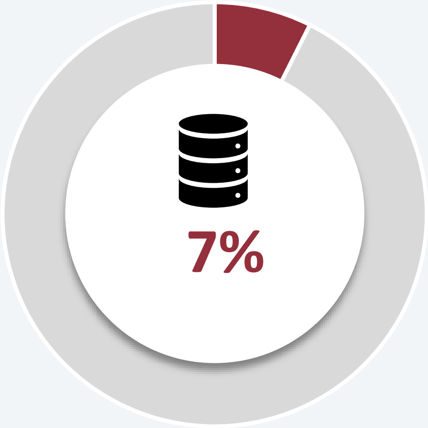
Share of Services sector in GDP increased, Crude Oil declined



Agriculture

—

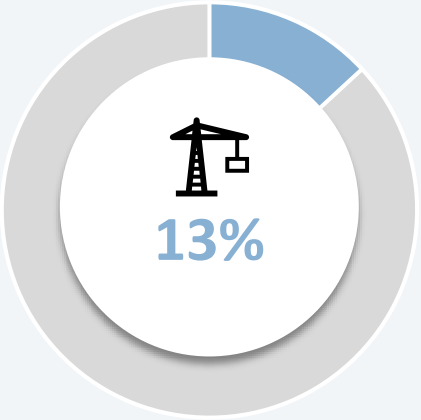
Agriculture contributed 24% to GDP in the second quarter of 2021. Of the four major subsectors of agriculture, crop production had the highest share of 89% of agricultural output in the quarter.



Crude Oil & Gas

—

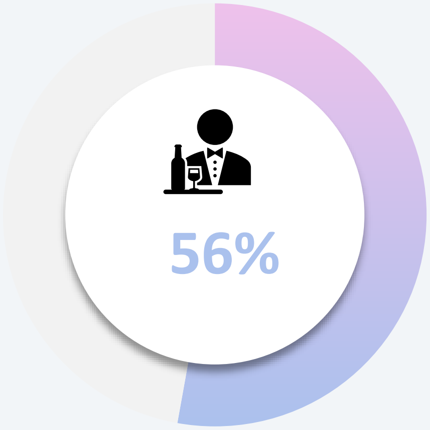
The decline in the value of output in the oil and gas sector led to a reduction in the sector's share in overall GDP in 2021Q2. The sector still remains in recession due to low crude oil production volumes.



Industry (Non-Oil)

—

The industrial sector's share of GDP declined to 13% in 2021Q2 from 15% in the previous quarter. Manufacturing and construction sectors accounted for 66% and 24% respectively, of the industrial (non-oil) sector's output in Q2.



Services

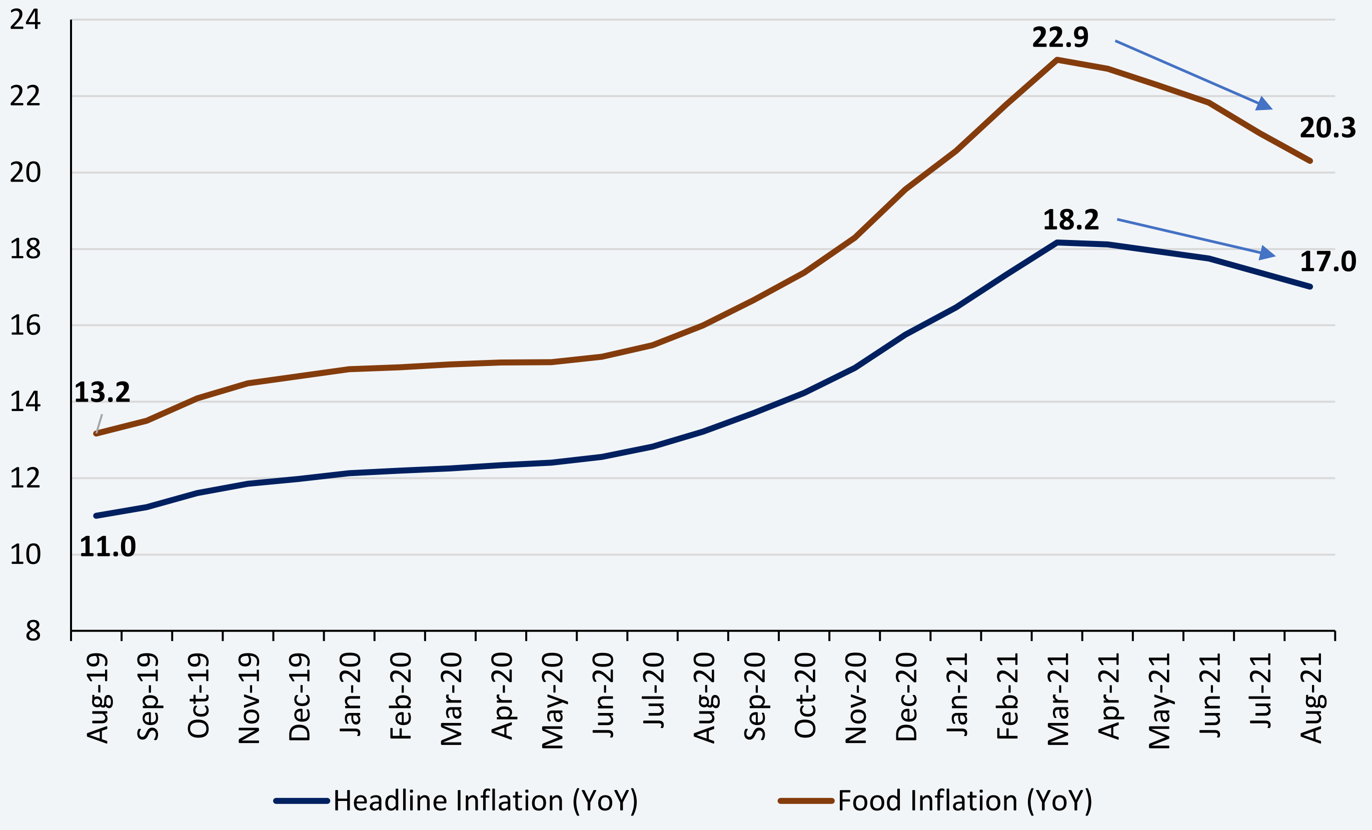
—

The share of services sector in total GDP increased in the quarter to 56%. In Q2, information and communication emerged as the largest subsector in Services with a share of 33%, surpassing Trade (30%).

Data Source: National Bureau of Statistics

Inflation: Inflation rate has fallen for 5 consecutive months to 17% in August 2021

Nigeria's Inflation Rate (%)



- Headline inflation rate fell from a peak of 18.2% in March 2021 to 17.4% in July 2021. It further contracted to 17.01% in August 2021*.
- This represents the fifth consecutive month of slowdown in the rate of increase in prices of goods and services in the country since April 2021.
- The declining inflation rate was driven by persistent decline of food inflation.
- Food inflation for the months of July and August stood at 21.03% and 20.30% respectively from 21.83% in June 2021. Core inflation on the other hand increased to 13.7% in July 2021 from 13.1% in June 2021. It, however, declined to 13.4% in August 2021.
- Month-on-month, inflation rate declined to 0.93% in July 2021 and increased afterward to 1.02% in August 2021.

Data Source: National Bureau of Statistics

**A fall in inflation rate does not mean prices of goods and services have fallen. In the current context, it means the rate of price increase has slowed. In August 2021, average prices rose by 17% (yoy). In March prices rose by 18.2%.*

Food and Non-Alcoholic bev. recorded the highest increase in prices year on year

Food & Non Alcoholic Beverages

Inflation Rate
August 2020: 15.9%
August 2021: 20.2%

The inflation rate of food & non alcoholic beverages increased to 20.2% in August 2021 from 15.9% in August 2020. The ban on importation of some food items, exchange rate depreciation and insecurity are responsible for this increase.

Transport

Inflation Rate
August 2020: 11.2%
August 2021: 15.0%

The inflation rate of transport increased to 15.0% in August 2021 from 11.2% in August 2020. This is on the back of increase in fuel prices, insecurity, among other factors.

Clothing and Footwear

Inflation Rate
August 2020: 10.8%
August 2021: 14.4%

Exchange rate depreciation coupled with increase in the prices of intermediate materials in the production of textiles contributed to the rise in the price of clothing & footwear.

Furnishings & Household Equipment Maintenance

Inflation Rate
August 2020: 10.2%
August 2021: 13.7%

The inflation rate on furnishing and household equipment maintenance increased to 13.7% in August 2021 from 10.2% in August 2020. This was as a result of exchange rate depreciation as many of the inputs are imported.

Health

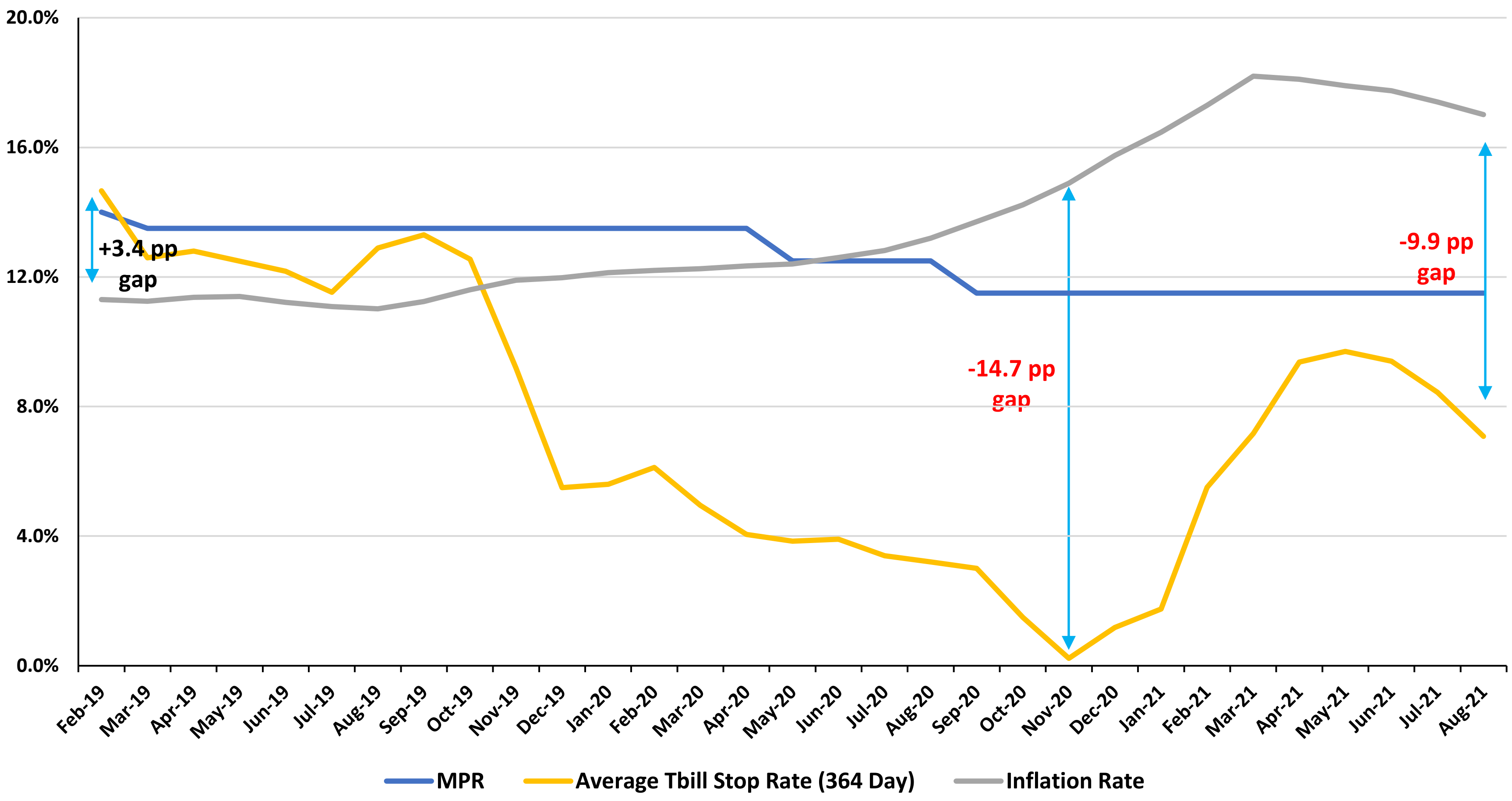
Inflation Rate
August 2020: 12.1%
August 2021: 15.5%

On the back of increased demand for health care following the outbreak of COVID-19, health inflation rate increased to 15.5% in August 2021 from 12.1% in August 2020.

Data Source: National Bureau of Statistics

Real Interest Rate under pressure as Treasury Bills Rates declined

Real Interest Rate: MPR, 364-Day Treasury Bill Average Stop Rate vs Inflation Rate



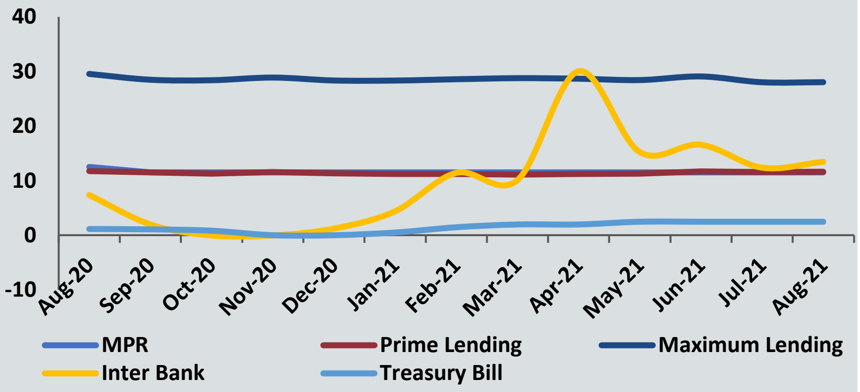
*pp - percentage points

- The gap between interest rate and inflation rate widened in the months of June, July and August, despite the consistent drop in inflation rate.
- From June to August, average Tbills stop rate fell, mainly due to high buying interests from investors.
- Going forward, we expect the interest rate-inflation rate gap to narrow as moderation of inflation rate will continue. Interest rate on the other hand will stabilize on the back of more debt issuance by the Debt Management Office.

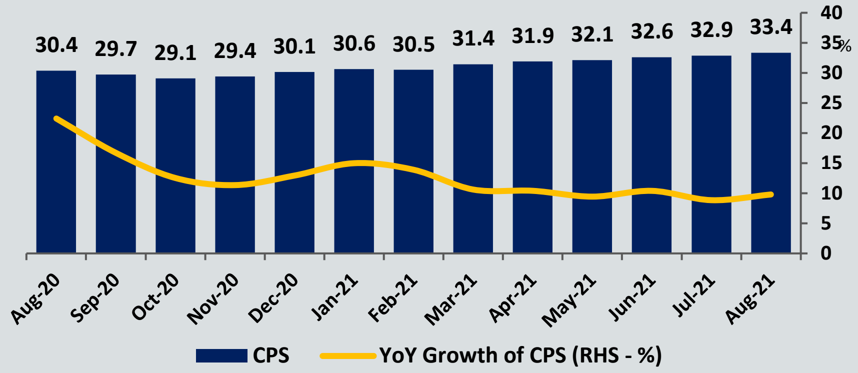
Data Source: National Bureau of Statistics & Central Bank of Nigeria

Monetary Policy: Key Charts

Lending Rate (%)



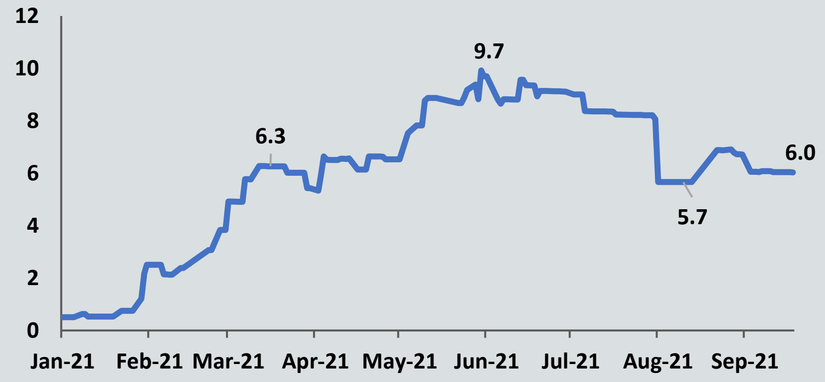
Credit to Private Sector (N'Trillion)



Financial Deepening Indicators (%)

	Dec-20	Jan-21	Mar-21	Jun-21	Jul-21	Aug-21
Currency/M2	7.71	7.5	7.35	7.07	7.08	6.82
Currency/GDP	1.91	1.86	1.84	1.80	1.85	1.82
M2/GDP	24.75	24.78	25.09	25.45	26.08	26.75
CPS/GDP	19.79	20.12	20.64	21.43	21.57	21.90
Stock Market Capitalization/ GDP	13.56	15.38	14.17	12.97	13.18	13.37

CBN Special Bill Yield (%)



Data Source: Central Bank of Nigeria

Monetary Policy: MPC retains key Monetary Parameters

The CBN Monetary Policy Committee (MPC) held its fifth meeting of 2021 in September and the Committee maintained its previous policy stance for the sixth consecutive meetings. The MPC decided as follows:

- *Retain the MPR at 11.5%;*
- *Retain the Asymmetric Corridor at +100/-700 basis points around the MPR;*
- *Retain Cash Reserve Ratio (CRR) at 27.5 percent; and*
- *Retain the Liquidity Ratio at 30 percent.*

Key factors that influenced monetary policy decisions at the MPC meeting included:

- Recovery in output growth
- Increasing level of insecurity in some parts of the country
- Moderating inflation rate
- Progressive decline in the non-performing loans ratio
- Growth of credit to key sectors
- Sustaining current level of system liquidity
- Foreign exchange demand

Outlook and expectations

- The MPC meeting held at a time when Nigeria reported a significant GDP growth of 5% in the second quarter of 2021. It also held at a period of intense exchange rate pressure especially in the parallel market, falling inflation rate and lower investment inflows in the second quarter of 2021.
- The decision to hold rate was based on the premise that tightening of monetary policy will raise the cost of credit to the private sector while loosening will compromise the downward movement of inflation rate leading to a widening of negative real interest rate.
- Our outlook for inflation is moderate while we believe GDP growth rate will slow down in H2 as the base effect fades. We believe that these two factors will play a signiicant role in influencing the decision of the MPC in subsequent meetings.
- Consequently, we expect key monetary parameters to remain unchanged, in a bid to strike a balance between economic recovery and high inflation.

Analyst Views on GDP Growth, Inflation and Monetary Policy

GDP Growth

- The year on year real GDP growth of 5% recorded in the second quarter of 2021 was impressive and is the highest growth rate since the fourth quarter of 2014.
- While the base effect was instrumental in influencing GDP outcomes, we believe that this 5% growth will be the highest quarterly growth rate in the year. This implies that growth in Q3 and Q4 will be lower than 5% especially as the base effect fades away.
- Real GDP performance on a quarter on quarter basis showed a decline of 0.8% in 2021Q2, suggesting that the value of real output in the first quarter was higher than what was recorded in the second quarter.
- A lower real GDP in the second quarter (relative to the first) is rare and the last time it occurred in Nigeria was in 2020 due to COVID-19 and in 2003. This performance suggests a weak economic recovery and it should be a major source of concern for policymakers.
- For the second consecutive quarter, agricultural growth has declined (from 3.4% in 2020Q4 to 2.3% in 2021Q1 and 1.3 in 2021Q2). The sector remains Nigeria's largest employer of labour and is a major source of intermediate input for the manufacturing sector. We believe concerted efforts are required from stakeholders to improve productivity of the sector and also in addressing insecurity in different parts of the country.

Inflation and Monetary Policy

- The downward trend in inflation rate in the last five months has been driven by moderation in food inflation rate. Although this is a good development for the economy, inflation rate is still very high and it has a negative impact on investments and income of citizens. The World Bank estimated that in 2020, 7 million Nigerians fell into poverty due to falling purchasing power.
- Urgent efforts are therefore required to address challenges such as insecurity, high logistics costs, exchange rate depreciation, infrastructure deficits, among other factors, which are drivers of inflation in Nigeria.
- Following the declining inflation rate and high GDP growth figures, we believe that monetary policy rate and other parameters will be held constant in the last MPC meeting of the year.
- With the approval of the $3.35 billion Special Drawing Rights (SDRs) by the International Monetary Fund (IMF) in August 2021, Nigeria's external reserves have been trending upwards. As at September 28, reserves stood at US$36.4 billion.
- The improvement of reserves is expected to ease pressure on rates in the I&E window but this is largely dependent on how the CBN is able to meet dollar demands and clear Forex backlogs in coming months. We believe the CBN will continue to implement Forex restrictions to manage demand pressures in the official window.

Macroeconomic Projection for 2021

Macroeconomic Scenario for 2021

Scenario	Assumptions	Possible Outcome
Best Case (Economy opens up and government fully implements interventions to stimulate the economy)	• Oil price rises significantly above US$53 per barrel • Demand for Nigerian crude improves as economies recover- Nigeria produces 1.9 million barrels per day • Government capital spending at N1.7 trillion • Full implementation of sectoral support interventions	• GDP Growth at 2.3% • Inflation Rate at 14.5% • External Reserves at US$38bn • Exchange Rate at N380/US$
Moderate Case (the economy recovers moderately and embraces the new normal)	• Oil price averages US$45 per barrel • Gradual re-opening of cities, schools, airports, businesses, etc. • Crude oil production at 1.6 million barrels per day • Government capital spending at N1.4 trillion • Partial implementation of sectoral support interventions	• GDP Growth at 1.3% • Inflation Rate at 16.6% • External Reserves at US$34 billion • Average Exchange Rate at N430/US$
Worst Case (Death toll from COVID-19 increases rapidly, weak implementation of business support initiatives)	• Oil price below US$30 pb • Another wave of COVID-19 infections results in lock down of schools and restriction of gathering, etc. • Lower crude oil production- Nigeria produces 1.2 million barrels per day • Government capital spending at N700 billion • Weak implementation of sectoral support interventions • Civil unrests/protests disruptions productive activities	• GDP Growth at -2% • Inflation Rate at 19% • External Reserves at US$28 billion • Exchange Rate at N460/US$

fsdh RESEARCH

Macroeconomic Projection for 2021

	2017	2018	2019	2020	2021f*
Real GDP Growth	0.8%	1.9%	2.3%	-1.9%	1.3%
Inflation rate	16.5%	12.1%	11.4%	13.2%	16.6%
Average Exchange rate (N/US$)	365.58	361.97	361.93	382.07	430
Investment as a % of GDP (nominal)	14.7%	19.0%	24.6%	28.6%	23.0%
Monetary Policy Rate	14.0%	14.0%	13.5%	11.5%	11.0%
External Reserves (Average, US$ Billion)	31.3	44.6	43.0	35.9	34.0

**Please note that there is still a high degree of uncertainty around the forecast for 2021. Actual figures could exceed or fall below these forecasts. A lot depends on the path of COVID-19, vaccine effectiveness, oil price movement and possible disruptions in the local economy.*

FSDH Merchant Bank

www.research@fsdhgroup.com