Post MPC Monitor

May 2020

MPR Reduced to 12.5%… as MPC Aims to Stimulate Aggregate Demand

The Monetary Policy Committee (MPC) held its third meeting for the year on the 28th of May 2020, where they voted to cut MPR by 100bps to 12.50%. All other key parameters remain unchanged; Asymmetric Corridor at +200bps/-500bps around the MPR; Cash Reserve Ratio (CRR) at 27.50% and Liquidity ratio at 30%.

In arriving at its decision, the Committee assessed the damaging impact of the COVID-19 pandemic on both the global and domestic environment. They considered the adverse effect of the pandemic on oil prices and the disruptions to global supply chains – a result of the lockdowns put in place by various countries to contain the spread of the virus. The Committee also noted the stock market crashes, rising levels of debts and unemployment, as well as capital flow reversals.

In the domestic space, the Committee noted the expansion of real GDP by 1.87% in Q1:2020 (vs. 2.55% in Q4:2019 and 2.10% in Q1:2019), while anticipating a slowdown in economic growth in the coming quarters. The Committee also commended the banks' efforts to mitigate economic shocks while expressing support for the sustenance of broad-based stimulus and liquidity facilities

While we acknowledge the Committee's accommodative stance to stimulate economic growth, we posit that the impact of this move on credit delivery to the real sector will be negligible. We also expect the rate cut to have minimal impact on bank lending and loan book expansion given the observed relative insensitivity of lending rates to the MPR. In the fixed income space, we expect yields to sustain its downward trend while activities in the equities market are likely to remain unchanged, as we do not expect the rate cut to alter investors' sentiment.

Committee's Considerations

- The Committee, before arriving at its decision, reviewed the impact of the coronavirus pandemic on both the global and domestic economies over the past five months. The Committee identified disruption to supply chains, stock market crashes, exchange rate volatilities, rising corporate and public debt, rising levels of unemployment, capital flow reversals and negative shocks to commodity prices as resultant effects of the novel virus.

- On the global front, the Committee noted the extensive implementation of monetary and fiscal measures to avert economic crisis and the impending recession. The

Committee also stated that inflation in most advanced economies remained largely below their long-run targets. This, it noted has been supported by suppressed aggregate demand; a consequence of widespread lockdowns and uncertainty regarding future income which has directed spending towards essential goods and services. Despite the accommodative stance adopted by monetary authorities, the committee identified portfolio reversals from emerging and developing economies as a signal of general rebalancing of portfolios by investors towards safer assets. This has resulted in renewed pressures on exchange rates in these economies with a likely passthrough effect on domestic prices.

- In the domestic space, the Committee noted the expansion of real GDP by 1.87% in Q1:2020 (vs. 2.55% in Q4:2019 and 2.10% in Q1:2019). This was supported by a 5.06% expansion in the oil sector and 1.55% in the non-oil sector. The committee expects the sluggish growth recorded in Q1:2020 to dip slightly in the coming quarters but restated its commitment to supporting the economy to avoid slipping into a recession. In May 2020, the manufacturing and non-manufacturing PMI contracted significantly to 42.4 and 25.3 index pts respectively (vs. 51.1 and 49.2 index pts. in March 2020). The decline in manufacturing PMI was notable as it followed 36 months of expansion while the non-manufacturing PMI contracted for the second consecutive month. This was attributed to slower growth in production, new orders, employment level, raw materials and input prices.

- The Committee commended the banks for their efforts towards curbing the shocks to the economy, expressing support for the sustenance of broad based stimulus and liquidity facilities by the banks. The Committee, however, expressed concern over the sustained uptick in inflation for the eighth consecutive month to 12.34% in April from 12.26 in March 2020. This reflected the rise in both the food and core components of the CPI which the committee attributed to the disruption in supply chains (flowing from restrictions on interstate travel), reduced domestic supply of foreign exchange, continued impact of deteriorating infrastructure amongst others. Against this backdrop, the committee emphasized the need to sustain measures put in place to maintain price stability following the reopening of the economy.

- The Committee reviewed the impact of the oil price shocks witnessed in April and the short to medium term consequences on the domestic economy. The Committee also noted the slow recovery of oil prices and resumption of accretion to external reserves, while also commending the stability in the banking system. The committee applauded the Federal Government for maintaining the core of its spending plans for 2020 while revising the oil price benchmark downwards to reflect the current

realities. The committee, however, reiterated the need for the government to improve tax collection via a gradual diversification of the country's revenue base.

- The Committee unanimously voted to reduce the Monetary rate by 100 basis points. Although it cited the possible impact this may have on inflationary pressure, the Committee expressed confidence that given the slow rate of acceleration of inflation, its accommodative stance will stimulate aggregate demand and supply in the short-term.

- **Key Decisions**
  - Reduce MPR by 100bps to 12.5% from 13.5%
  - Maintain CRR at 27.5%
  - Retain liquidity ratio at 30.00%
  - Retain asymmetric corridor at +200 and -500bps around MPR

Anticipated Impacts

Yields to Maintain Downtrend

Since the last monetary policy committee (MPC) meeting, activities in the fixed income space have been bullish. This is evidenced in the decline in average T-Bills and Bond yields to 2.64% and 10.32% respectively (vs. 3.57% and 11.15% as at 23rd March 2020). Despite real rate of returns deep in the negative territory, investors' participation at the Primary Market Auctions (PMA) have remained solid, owing to the excess liquidity in the system flowing from maturing OMO bills.

Given the MPC's decision to cut MPR by 100bps to 12.50%, we envisage sustained bullish momentum in the fixed income market which will result to lower yields. More so, given the excess liquidity in the system with incoming OMO maturities worth NGN812.69bn in the next two months, we expect demand for fixed income instruments to remain strong.

Reduction in Policy Rate to Have Minimal Impact on Bank Lending

The outlook for the Nigerian banking sector in 2020 remains challenging in view of heightened regulatory risks and the impact of the COVID-19 pandemic. Most of the banks under our coverage recorded a spike in impairment charges in Q1:2020 as a result of factors such as: lower recoveries, devaluation of impaired dollar-denominated assets, and a general reassessment of risk levels associated with vulnerable obligors (especially those in Oil and Gas, Manufacturing and Agriculture).

Also, liquidity conditions were noticeably strained by increased mandatory reserves held with CBN.

In our opinion, the Committee's decision to maintain CRR at 27.5% (effective CRR estimated to be as high as 40%) implies that bank liquidity will remain stifled with a resultant increase in funding costs (particularly for banks with low liquidity levels) and consequently, an impaired appetite to create risk assets. **We do not expect the cut in MPR to 12.50% to have a significant impact on lending rates and loan book expansion given the observed relative insensitivity of lending rates to the MPR**. Moreover, the CBN's use of the Loan to Deposit Ratio (LDR) policy and its various direct interventions in specific sectors have so far proved effective in stimulating real sector credit.

We therefore maintain that margins will remain tight across the banking sector, with a continued deterioration in asset quality on the back of recessionary pressures and sustained loan book expansion.

Rate cut to Have Negligible impact on Real Sector

Although real GDP expanded by 1.87% YoY in Q1:2020, the growth outlook for subsequent quarters is less benign as the full impact of the Corona Virus pandemic will begin to reflect in economic data. Already, figures from the manufacturing and non-manufacturing PMI point towards a contraction as they both declined to 42.4pts and 25.3pts in May, from 51.1 and 49.2pts in March. On its part, the CBN has sought to mitigate the impact of the pandemic on the economy via a series of stimulus packages and a gradual loosening of credit conditions.

While the cut in the MPR is a positive signal from the MPC, we hold our view that the impact on credit delivery to the real sector will be minimal considering the fact that lending rates are generally sticky downwards. With elevated risk factors and inflation maintaining its uptrend, it is unlikely that the rate cut will lead to a fall in lending rates. Other tools such as the enforcement of the minimum loan to deposit ratio have been more effective in achieving this objective.

Muted Impact on Equities market

The COVID-19 pandemic and fall in global oil prices triggered negative sentiments in the domestic equities markets, leading to profit-taking activities in the first quarter of 2020. This worsened the YtD position to -20.65% on March 31st. Despite prevailing market conditions, the low prices at which counters were trading, prompted bargain hunting activities in April. The bulls held the upper hand throughout the fourth month, cheering the market to a solid close of 8.08% month on month.

Strengthening bargain hunting activities were rotational funds of foreign investors who had been unable to repatriate their funds due to the current CBN's FX restriction policy.

The bullish momentum filtered into the month of May, as the market has been on an uptrend, moderating the YtD loss to -6.24% on the 28th of May.

Despite the MPC's decision to cut rates by 100 basis points in order to support the real sector and stimulate aggregate demand, we do not anticipate an abrupt reversal in prevailing market conditions and activities. The risks associated with the Nigerian economy still persists, and as such, a reduction in the benchmark rate is unlikely to alter investors' sentiment.

Contact Information

Brokerage and Retail Services

topeoludimu@meristemng.com (+234 905 569 0627)
abisoyeoludipe@meristemng.com (+234 708 000 7861)
contact@meristemng.com

Investment Banking/Corporate Finance

seunlijofi@meristemng.com (+234 808 536 5766)

Wealth Management

damilolahassan@meristemng.com (+234 803 613 9123)
www.meristemwealth.com
Tel: +234 01 738 9948

Registrars

martinaosague@meristemregistrars.com (+234 802 303 1783)
www.meristemregistrars.com
Tel: +23401-280 9250

Group Business Development

saheedbashir@mersitemng.com (+234 802 454 6575)
ifeomaogalue@meristemng.com (+234 802 394 2967)

Client Services

omosolapeakinpelu@meristemng.com (+234 803 694 3034)
blessingogwuche@meristemng.com (+234 806 738 5485)

Investment Research

ahmedjinad@meristemng.com (+234 809 187 8917)
research@meristemng.com

Corporate websites: www.meristemng.comwww.meristemwealth.comwww.meristemregistrars.com

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