Post MPC Monitor

July 2020

MPC Holds all Parameters…Adopts Wait and See Approach

The Monetary Policy Committee (MPC) held its fourth (4th) meeting of the year on the 20th of July 2020, where members of the Committee voted to retain the MPR at 12.50% and leave all other key parameters unchanged; Asymmetric Corridor at +200bps/-500bps around the MPR; Cash Reserve Ratio (CRR) at 27.50% and Liquidity ratio at 30%.

The Committee in reaching its decision evaluated the impact of the COVID-19 pandemic in the first half of the year on both the global and domestic fronts. The Committee identified the lingering headwinds to global output such as the persistent decline in global aggregate demand and supply, disruption of trade and supply chains, financial market vulnerabilities, depressed crude oil and commodity prices, amongst others. The Committee further expressed concern over the IMF's recent downgrade of global output contraction to -4.90% (from an initial -3.00%) in 2020 while also voicing its expectation of a U-shaped recovery in 2021.

In the domestic space, the Committee considered the real GDP growth of 1.87% in Q1:2020 (vs. 2.55% in Q4:2019 and 2.10% in Q1:2019), attributing the slow down to the twin effects of a decline in oil prices and Covid-19 shock. The Committee took note of the deterioration of the manufacturing PMI in June 2020 to 41.10 index pts. (vs. May: 42.40 index pts.), and improvement in non-manufacturing PMI to 35.50 index pts. (vs. May: 25.30 index pts.), albeit both still below the 50-point benchmark. The sustained uptick in inflation for the 10th consecutive month to 12.56% also featured in the Committee's deliberations.

The Committee remains resolute in its accommodative stance towards spurring economic growth, although, we expect the decision to leave rates unchanged to have no material impact on the real sector, equities or fixed income markets. We however, reckon that it gives the Committee ample time to fully assess the effectiveness of the past monetary and fiscal actions.

Committee's Considerations

- The Committee, in arriving at its decision, reviewed the continuing impact of the coronavirus pandemic on the global economy, noting the downward revision of growth projections following the extension of lockdowns across countries and continued lack of effective treatment or vaccines against the virus.

- The Committee noted that global growth weakened in H1:2020 due mainly to COVID-19-induced headwinds. Persisting decline in aggregate demand and supply, disruption to supply chains, rising sovereign and corporate debt, increased vulnerability in financial markets, low prices of crude oil and other commodities, and rising unemployment were identified.

- The Committee noted the general optimism for a v-shaped recovery due to the expected early combating of the pandemic and gradual resumption of economic activities. The Committee, however, believes that while a recovery is certain in 2021, it is likely to be U-shaped.

- The Committee observed the downward trend in inflation in advanced economies despite huge monetary and fiscal stimulus injections. The Committee however believes that the easing of lockdowns will drive aggregate demand and thus, inflation will pick up to support the desired level of output growth.

- The Committee observed that emerging markets with less diversified economies suffered higher inflation rates than those with more diversified economies, and that unprecedented public spending may worsen the trend.

- In the domestic space, the Committee noted the sustained decline in manufacturing PMI to 41.1pts in June 2020 (vs. 42.4pts in May 2020). Conversely, non-manufacturing PMI improved to 35.5pts from 25.3pts in June 2020. The observed trend was attributed to slower growth in production, new orders, employment level, raw materials and new export orders. It also noted staff projection of a 1.03% contraction in Q2:2020 on the back of the continued adverse impact of the pandemic on the economy.

- The Committee noted with concern, the continued uptick in inflation as headline inflation rose to 12.56% YoY in June 2020 from 12.40% in May 2020. The Committee further noted the role of structural factors such as disruptions to the supply chain due to security challenges (farmer-herder clashes, banditry), inadequate transport infrastructure, epileptic power supply and low technological advancement, in compounding inflationary pressures.

- The Committee acknowledged the developmental support role of the CBN through its various intervention funds and expressed faith in its potency to stimulate a rebound of the economy.

- The Committee noted that Broad Money Supply (M3) grew by 1.64% in June 2020 (vs. 2.72% in May 2020) largely due to increases in Net Domestic Assets (NDA) and Net Foreign Assets (NFA). M3 growth, however, remains well below the indicative benchmark of 13.09% for 2020. Aggregate Domestic Demand (Net) grew by 5.16% in

June 2020 (vs.7.47% in May 2020). Gross Credit increased by NGN2.33trn between May 2019 and June 2020 as a result of CBN's Loans-Deposit-Ratio (LDR) policy. The stability of Money Market Rates reflected the prevailing level of liquidity in the banking system.

- The Committee noted the decline in non-performing loans ratio to 6.40% at the end of June 2020 from 9.40% in June 2019 due to increased recoveries, write-offs and disposals.

- The Committee was pleased with the CBN's decision to develop a gold purchase framework under the FGN's Presidential Artisanal Gold Mining Development Initiative, as it will help diversify the country's reserve sources.

- The Committee, after reviewing the policy options before it noted that tightening will contradict its goal of expansion of affordable credit to the real sector while a further loosening may not necessarily lead to a decline in interest rates considering the current economic challenges. The Committee also saw the need to allow time for the transmission effect of the last policy rate cut to permeate the economy. The Committee therefore decided by a majority vote to hold all rates constant.

- **Key Decisions**
  - Hold MPR at 12.5%
  - Maintain CRR at 27.5%
  - Retain liquidity ratio at 30.00%
  - Retain asymmetric corridor at +200 and -500bps around MPR

Anticipated Impacts

The Burden of High CRR on the Banking Sector Remains

Regulatory risks continue to cloud the outlook of the Nigerian banking sector in 2020. This is compounded by the COVID-19 pandemic which is expected to bear on gross earnings, loan loss provisioning and asset quality. The decision of the CBN to permit loan forbearance in the banking sector, is expected to result in the restructuring of up to a third of industry loans. While this will help mitigate asset quality deterioration, revenue and profits in the short-to-medium term will expectedly bear the brunt.

We expect the Committee's decision to hold MPR at 12.50% to further support the general downtrend in industry cost of funds, however, we maintain that the impact on lending rates and loan book expansion will be minimal given the relative insensitivity of lending rates to the MPR. We also maintain our earlier concern about the restrictive impact of a 27.50% CRR (effective CRR estimated to be as high as 50%) on banks' capacity to create assets or fund other revenue generating activities. This is expected to drive funding costs upward particularly for banks with relatively fewer funding options. Thus, we maintain our expectations for tight margins in 2020FY.

Although the Committee noted the YoY improvement in asset quality from 9.40% in June 2019 to 6.40% on the back of recoveries, write-offs and disposals, we expect asset quality and capital adequacy to remain pressured in 2020FY given COVID-19-induced threats.

FG Approves Establishment of Infrastructure Development Company

As concerns mount regarding a possible recession in 2020, the CBN has increased its focus on promoting growth in the real economy. Manufacturing PMI readings for June 2020 fell to 41.1 index points, from 42.4 pts in May, and is indicative of further weakness in the manufacturing sector as the effects of the pandemic continues to bite. Non-manufacturing PMI however rose to 35.7 index points in June 2020 from 25.3 index points in May 2020, indicating a gradual expansion the non-manufacturing sector of the economy. These figures point to the slow and sticky progress of the economy. However, in addition to its various stimulus packages, the CBN commended the Federal Government on its recent approval of the establishment an infrastructure development company. This company would be led by the CBN but in partnership with the African Finance Corporation and the Nigerian Sovereign Investment Authority and will be used to finance the development of critical infrastructure across the country.

The cut rates at the last meeting has not been fully transmitted into the real economy and would require additional time for the effects to be evident – even though we expect the impact to be minimal. We laud the CBN's decision to establish an infrastructure development company and an effective administration of the company will go a long way towards addressing the infrastructure deficit in the country

Yields Remain Pressured

Buying pressure has permeated the fixed income market since the last rate cut, sending yields to record lows. The weak investor sentiment in the equities market, as well as the dearth of other alternative investment has aided the bullish momentum in the fixed income. Since the last MPC, average T-bills and Bond yields have declined to 2.24% and 7.79% (vs. 2.64% and 10.28% as at 28th of May 2020) respectively over the period. Likewise, at the primary market auctions, NTB rates have dropped further to 1.30%-3.35% band.

Following the Committee's decision to hold rates, we expect investor participation to remain unchanged in the fixed income market. In addition, the impending inflows from OMO maturities is expected to increase liquidity levels, thus, spurring demand and dragging yields further.

Sell-offs Persist in a build up to Earnings Season

The domestic equities market has witnessed an extended period of bearish run since the last MPC meeting (-3.77%) as investors book profit on counters that have seen some price appreciation, while approaching the earnings season carefully. Year to date, all sectoral indices stand firmly in the negative zone, with the consumer goods index recording the most loss of 31.60%. Amid the subdued participation of foreign investors, we anticipate a continued wave of bearish sentiment as the impact of the COVID-19 pandemic duly reflects in companies H1:2020 earnings.

While improvements in the commodities market bode well for emerging economies, selloffs have been prevalent across equities markets in the region. This is evidenced in the negative YtD return posted by frontier (-22.10%) and emerging market (-5.30%) indices. Although the bourgeoning macroeconomic concerns are similar in most emerging economies, from a valuation perspective, the Nigerian equities market stands out, currently trading at an attractive discount of 8.10x compared to its peers.

Going forward, we expect the CBN's decision to hold all parameters constant to have negligible effect on the direction of the equities market. To a large extent, the exchange rate unification effort of the CBN is likely to abate a mass exodus of offshore investors (*when interventions resume at the I and E FX window*). However, we anticipate share price movements to be reflective of earnings performance in H1:2020 as investors err on the side of caution.

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