

**MPC Retains Benchmark Rate at 11.50%**

The Monetary Policy Committee (MPC) held its first meeting of the year on the 25th and 26th of January 2021. In line with our expectation, the Committee voted to leave all parameters unchanged.

In reaching its decision, the Committee acknowledged the policy dilemma before it but maintained that the need to hasten the recovery process through sustained and targeted spending in collaboration with the fiscal authority was imperative. Given the structural nature of the current inflationary trend, the Committee maintained that raising aggregate supply is necessary to reduce the pressure.

Noting the importance of vaccination to economic recovery, the Committee urged the apex bank to liaise with relevant stakeholders in the fight against COVID-19 to procure and distribute vaccines.

The decision is not expected to significantly impact inflation over the short term until output improves. This means the real rate of return on fixed income instruments will remain negative while equities continue to benefit from the search for attractive investment instruments.

**Committee's Considerations**

The Committee noted the moderation in output contraction in the third quarter of 2020 associated with the news of the discovery of COVID-19 vaccine and rising oil prices. However, it also noted that the outlook on recovery appears to be dampened by the second wave of the COVID-19 pandemic given its intensity.

The Committee also noted that like many countries, the COVID-19 containment measures imposed to forestall the public health impact contributed to a recession in 2020. The MPC, however, agreed that a quick recovery is top priority. Hence, the call for sustained and targeted spending by the fiscal authority, as well as continued interventions by the Central Bank. The MPC also suggested a collaboration with the fiscal authority and presidential task force on COVID-19 through CACOVID in the procurement of vaccines.

The adverse effect of insecurity on food production was noted, stressing that the current inflationary pressure is not solely attributable to monetary factors but also legacy structural and supply bottlenecks across the country. The committee thus called on the Government to strengthen infrastructural efficiency and address the emerging security challenges in the country. The committee also advised an effective partnership with the private sector to improve funding sources to address the infrastructure deficit.

The committee expressed concern over the rising debt stock, especially when compared to capital expenditure which signals future debt servicing challenges. To improve government revenue sources and investment in capital, the committee called on the government to take advantage of the African Continental Free Trade Area (AfCFTA) which could boost domestic production and competitiveness.

The effort of the Central Bank to improve liquidity in the FX Market was commended, however, it was stated that there is a need to continue exploring avenues to improve inflow from sources such as International Money Transfer Operators (IMTOs), Diaspora Remittances and Non-oil export promotion. The committee noted that these sources will boost FX supply and ease exchange rate pressure.

The Committee highlighted the improvement in the equities market as a leading indicator of medium-term macroeconomic recovery. The committee thus urged the banks to continue collaboration with fiscal authorities to improve the investment climate towards attracting sustainable FDI.

Noting Nigeria's low stimulus as a percentage of GDP (4.5%) compared to emerging and advanced economies, the MPC urged the Central bank to boost its intervention programmes to further stimulate growth within the economy. After reviewing available policy alternatives, the Committee voted to maintain the benchmark rate at 11.50%, while also keeping all parameters unchanged.

### Key Decisions

Retained the MPR at 11.50%

Retained CRR at 27.5%

Retained liquidity ratio at 30.00%

Retained the asymmetric corridor at +100bps/-700bps around the MPR

## Anticipated Impacts

### The Banking Sector: Risk Assets Growth is an Imperative

The banking industry's prime and maximum lending rates have generally been on a downtrend since July 2020, (declining from 15.65% and 30.57% as at June 2020 to 11.35% and 28.31% as at December 2020 respectively) as a result of the MPC's accommodative monetary policy stance. **Following the recent decision of the MPC, we expect the downtrend to be sustained over the near term supported by the industry's desire to grow loan book in line with our expectations.** The decision to maintain the 5% interest rate on CBN intervention facilities for another 12 months further supports this position. Therefore, interest income will be supported by loan book growth rather than by interest rates. Furthermore, while we do not envisage a sharp rise in yields on fixed income instruments at this time, the current modest increase in yields, combined with increase in the volume of investment assets should support interest income growth.

The current monetary policy posture also implies that cost of funds will continue to trend downwards and with it, interest expense. We note that both savings and term deposits rates (12-month) have declined to 2.04% and 5.99% as at December 2020 from 3.78% and 7.12% as at June 2020 respectively. We therefore maintain that Net Interest Margin growth will depend largely on the ability to grow risk assets. While risk assets growth may pose a threat to asset quality, our view remains that the industry's overall credit risk management has been bolstered by recent policies such as GSI and the provisions of BOFIA 2020. As such, a material deterioration in asset quality as a result of loan book growth is rather unlikely. Our concern, however, is that maintaining

the CRR at 27.50% (with a potentially higher effective CRR) may limit the capacity to grow loan book, which we consider critical to net interest income growth. This risk is particularly more pertinent for smaller banks.

### **The Real Sector: Recovery to Maintain Current Path**

From the decisions reached at the MPC meeting, we see clearly that the Committee prioritizes economic recovery from the pandemic above the need to curb the mounting inflationary pressure (although it is highlighted that the inflationary pressure is triggered largely by supply side factors). Going by recent PMI statistics, we see that although production activities as of December 2020 looks to have improved (production level index- 51.6pts), a holistic recovery of manufacturing activities is still hindered mainly by subdued employment levels (46.3pts). We recall that the lockdown measures in Q2:2020 had resulted in decline in productivity and loss of jobs. However, we note that the rate of employment level contraction has slowed considerably when compared to the trough (30.1pts) witnessed in May. We thus expect that with sustained accommodative stance, employment conditions and domestic output should maintain the steady recovery path.

Hence, we do not see the MPC's decision to maintain status quo resulting in a faster rate of real sector growth. We are however cheered by the central bank's stance to continue its interventions and drive to improve credit to the private sector.

### **The Fixed Income Market: Status Quo to Remain**

As we had expected, the Monetary Policy Committee (MPC) again voted to retain the benchmark interest rate and all policy parameters constant, in favor of its pro-growth approach. With real returns deep in negative territory (c. negative 7 – 8%) and inflation galloping, fixed income market participants had hoped for a different outcome. The Committee's decision however signals that the status quo (low yield environment) would remain, at least in the short term, pushing investors that are willing to assume risk to seek out opportunities elsewhere.

Unattractive yields notwithstanding, we remain of the view that fixed income offers would continue to attract robust investor patronage, particularly from institutional investors (including PFAs) with low risk appetite and a conservative investment approach. The alternatives to this are either in short supply and/or carry significantly higher risk.

### **The Equities Market: Muted Impact on Equities Market**

Three (3) trading weeks into 2021 and the local bourse has recorded impressive activity levels so far (trading just over NGN11.25bn worth of shares in about 100,000 deals), with year to date return currently at 3.26% (as at 26th January 2021). Our expectation is that investors' interest in equities will be sustained largely by the depressed fixed income yield environment and the hunt for better returns. Also, we expect the release of the 2020FY financial results accompanied by dividend announcements to influence the market's direction in the short term.

Market valuation data suggests that the Nigerian market (which currently trades at a PE of 15.7x) is less attractive when compared to its Egyptian (PE: 12.5x) and Kenyan peers (PE: 11.5x), albeit still has some headroom relative to the South African (PE: 29.1x), frontier (PE: 22.8x) and emerging market (PE: 28.1x) indices respectively.

**Nonetheless, we expect the hunt for attractive returns (both dividends and capital appreciation) and elevated liquidity levels in the financial system to see funds flow into the equities market.**

## Contact Information

---

### Investment Research

ahmedjinad@meristemng.com

(+234 809 183 9487)

[research@meristemng.com](mailto:research@meristemng.com)

---

**Corporate websites:**     [www.meristemng.com](http://www.meristemng.com)   [www.meristemwealth.com](http://www.meristemwealth.com)   [www.meristemregistrars.com](http://www.meristemregistrars.com)

---

### Meristem Research can also be accessed on the following platforms:

**Meristem Research portal:** [meristem.com.ng/rhub](http://meristem.com.ng/rhub)

**Bloomberg:** MERI <GO>

**Capital IQ:** [www.capitaliq.com](http://www.capitaliq.com)

**Reuters:** [www.thomsonreuters.com](http://www.thomsonreuters.com)

**ISI Emerging Markets:** [www.securities.com/ch.html?pc=NG](http://www.securities.com/ch.html?pc=NG)

**FactSet:** [www.factset.com](http://www.factset.com)

---

### IMPORTANT INFORMATION: DISCLAIMER

**Meristem Securities Limited ("Meristem")** equity reports and its attendant recommendations are prepared based on publicly available information and are meant for general information purposes only and it may not be reproduced or distributed to any other person. All reasonable care has been taken to ensure that the information contained herein is not misleading or untrue at the time of publication;

**Meristem** can neither guarantee its accuracy nor completeness as they are an expression of our analysts' views and opinions.

**Meristem** and any of its associated or subsidiary companies or the employees thereof cannot be held responsible for any loss suffered by relying on the said information as this information as earlier stated, is based on publicly available information, analysts' estimates and opinions and is meant for general information purposes and should not be construed as an offer to buy or sell or a solicitation of an offer to buy or sell securities or any financial instruments. The value of any investment is subject to fluctuations, i.e. may fall and rise. Past performance is no guide to the future. The rate of exchange between currencies may cause the value of investment to increase or diminish. Hence investors may not get back the full value of their original investment. Meristem Securities is registered with the Securities and Exchange (SEC) and is also a member of The Nigerian Stock Exchange (The NSE). Meristem Securities' registered office is at 124 Norman Williams Street, South West, Ikoyi, Lagos, Nigeria. Website: [www.meristemng.com](http://www.meristemng.com); Email: [research@meristemng.com](mailto:research@meristemng.com). © **Meristem Securities Limited 2021.**