

## MPC Maintains Status Quo

### ...Favours Pro-Growth Stance

The Monetary Policy Committee (MPC) met for its second meeting of the year on the 22<sup>nd</sup> and 23<sup>rd</sup> of March 2021. As we had anticipated, the Committee voted to leave all parameters unchanged.

The committee was once again confronted with a policy dilemma – having to decide between hiking rates to combat the spiraling inflation, which would jeopardize the economy's fragile escape from recession, or to keep supporting the post-pandemic recovery by maintaining an accommodative stance. The Committee was equally concerned by the rising rate of unemployment in the country. In the end, the committee favored its pro-growth stance, choosing to maintain the benchmark rate at 11.50%. However, we observe that the strength of a wait and see approach is weakening as a third of the Committee voted for policy rate hikes with varying magnitudes. Furthermore, the MPC called for collaboration between monetary and fiscal authorities in funding critical sectors of the economy to boost aggregate supply and tame rising inflation.

Commenting on vaccination efforts, the Committee voiced concerns over the efficacy of vaccines in combating the new strains of the coronavirus, as well as the imbalance in vaccination rates – citing both factors as downside risks to global economic recovery.

**As the committee's decision to hold rates does not signal a change in market dynamics (or change in the direction of inflation) in the near term, we expect yields in the fixed income market to continue its sluggish ascent, while real rate of return remains in negative territory.**

## Committee's Considerations

The Committee noted the moderate growth in output in Q4:2020 owing to coordinated monetary and fiscal measures to reflate the economy. They held that this presented an opportunity for further consolidation. They also noted downside risk to growth outlook in 2021 as challenges trail the vaccination efforts to achieve herd immunity.

As expected, soaring domestic price levels were key considerations for the Committee. They stressed the need for fiscal and monetary collaboration to support productive ventures to increase supply and push down prices. The MPC reiterated concerns over security in food producing areas and highlighted it as a major factor responsible for rising food prices. They thus called for collaboration of all relevant agencies and stakeholders in addressing the issue of insecurity.

The Committee also emphasized the need for effective partnership with the private sector to improve funding sources necessary to address the issue of

infrastructure financing deficit. They, however, acknowledged the constricted fiscal space as side-effects of the pandemic, largely due to crude oil price volatility and the build-up of public debt.

The Committee noted the Central Bank's innovative ways of maintaining exchange rate stability and urged the bank's management to remain focus on its drive to improve accretion to external reserves.

The Committee welcomed the uptrend in money market rates compared to where it was at the end of the lockdown. The committee also emphasized the need for the fiscal authority to improve the investment climate towards attracting sustainable FDI.

The Committee commended the Central Bank on its regulatory efforts despite challenges of the economy, citing the reduction in NPLs to prudential levels even as credit expanded.

They also noted the dilemma of having to tame the rising inflation and the need to drive growth.

### Key Decisions

- Retain the MPR at 11.50%
- Retain CRR at 27.50%
- Retain liquidity ratio at 30.00%
- Retain the asymmetric corridor at +100bps/-700bps around the MPR

## Anticipated Impacts

### The Banking Sector: MPC Decision to Support NIM Growth

Prime and maximum lending rates stood at 11.25% and 28.30% respectively, as at January 2021 (vs 14.97% and 30.77% in January 2020), driven by the accommodative stance adopted by the monetary authority to support real sector investments and drive output growth. However, the downtrend in interest rates in the fixed income has now been reversed with a steady rise in fixed income yields since the beginning of 2021. While the downtrend in yields lasted, banks recorded significantly lower asset yields and interest income, as reflected in 2020FY results so far released. The current uptrend in fixed income yields is expected to be sustained throughout the year, even as banks have hinted on the high likelihood of loan repricing by H2:2021. Thus, we do not expect the committee's decision to have a significant impact on asset yield. However, net interest margins are likely to increase given that savings deposit (which increasingly accounts for the bulk of bank deposits and funding) rate could remain largely unchanged on account of the committee's decision, while asset yields rise, as noted earlier.

Furthermore, it is our view that maintaining the CRR at 27.50% (with a potentially higher effective CRR) could limit loan book growth and liquidity,

especially for smaller industry players. So far, the impact of the recently introduced Special Bills on liquidity remains to be seen.

### **The Real Sector: MPC Decision Buys More Time for Growth Efforts**

Nigeria's fragile exit from the recession in Q4:2020, provides a basis to appraise the collaborative efforts of the CBN and fiscal authorities at stimulating economic growth. Although the 0.11% YoY growth in Q4:2020 appears marginal, sectoral performances reflect segments of the economy gaining traction. According to the NBS report, the non-oil sector was the driver of domestic output, while the oil economy remained subdued from the effect of the pandemic. The growth in telecoms subscribers base certainly contributed to non-oil performance as it emerged the shining light in the category.

Meanwhile, the sustained direct intervention by the CBN also aided growth in agricultural sector. However, we observed that critical sectors such as the manufacturing, accommodation, and food services and financial and insurance remained in the region of contraction. Also, sustained production cuts by OPEC+ and oil price volatility dampens the outlook of Nigeria's oil economy especially when compared to pre-COVID periods. Hence, we align with the Committee's view on the need to strengthen growth to avert a relapse of a recessionary period. While the mounting inflationary pressure poses downside risk to real output, maintaining monetary status quo in our view is optimal, as supply-side bottlenecks are addressed.

**Hence, the MPC's decision to leave all parameters unchanged should allow more time for pro-growth efforts to take effect on National output.**

### **The Fixed Income Market: Minimal Effect on Fixed Income Yields**

The first quarter of the year has been marked by a steady rise in fixed income yields- a reversal of the downward trend which dominated most of last year. Investors have demanded higher rates at primary market auctions due to increasing inflation which has kept real rates of return firmly in the negative territory. The secondary market on the other hand has witnessed a gradual rotation of funds aimed for the primary market, thereby causing an increase in yields in the secondary market. Average Treasury bills and bond yields currently stand at 3.29% and 9.44% respectively, which imply real return rates of -14.04% and -7.89% respectively given the February 2021 inflation rate of 17.33%.

**In our opinion, the committee's decision is unlikely to alter the current trajectory of interest rates in the fixed income space given that the rates are driven by government's strong demand for investor funds, coupled with the high inflationary environment.**

**The Equities Market: Bearish Sentiments to Hold Sway**

Since the Monetary Policy Committee last met, bearish sentiments have surfaced and dominated the equities market – resulting in seven (7) consecutive weekly losses. The All-Share Index has in that time (January 26<sup>th</sup> – March 23<sup>rd</sup>, 2021) shed 6.93% while year to date (YTD) return remains firmly negative (-3.89%). A retracing of fixed income yields to much higher levels (which has attracted most investors) and profit taking activities have been the main drivers of the market's performance. This is despite mixed 2020FY corporate earnings and accompanying dividend announcements.

From a valuation standpoint, the Nigerian equities market (PE: 13.95x) currently trades at an attractive discount relative to the South African (PE: 25.45x), Frontier (PE: 22.87x) and Emerging market (PE: 24.27x) indices.

**The MPC's decision to hold the MPR steady is expected to have muted impact on the direction of yields in the fixed income market, and by extension, the equities market. We think that in the near term, bargain hunting opportunities on tickers that present attractive entry prices would be the main driver of activities in the equities market.**

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