MPC Monitor | May 2021

MPC Leaves Parameters Unchanged

…. Maintains Wait-and-See Stance

The Monetary Policy Committee concluded its two-day policy meeting on Tuesday, 25th of May 2021, with committee members voting unanimously to hold all policy parameters constant. We note that the distribution of votes contrasts with the outcome of the previous meeting held in March, where votes were split 6-3, with the dissenting voices calling for a rate hike.

Engendering economic growth remains at the front burner of the Committee's considerations, after acknowledging that output growth has remained fragile (Q1:2021 GDP – 0.51%), and in need of sustained support. The Committee also applauded the progress recorded with the CBN's targeted credit facilities, which the apex bank continues to deploy to support households, the agricultural and manufacturing sectors. The committee lauded the Government's handling of the challenges introduced by the pandemic, while advising against another widespread lockdown. In the Committee's thinking, this would reverse the gains achieved by the joint efforts of both fiscal and monetary authorities.

Elsewhere, the committee voiced concern on the security situation in the country's food producing regions and the adverse effect this has had on food supply and price levels. The Committee urged the government to intensify its efforts in addressing the security challenge in order to ease supply bottlenecks and moderate food prices.

Ultimately, the Committee's decision to hold rates buys it time for extant policies to achieve the intended objective.

Committee's Considerations

The Committee highlighted the Government's efforts in combating the pandemic and advised against an entire national lockdown as this will reverse the economic growth recorded so far. It reappraised the current measures by the Government to purchase the COVID-19 vaccines and the general preparedness of relevant public health agency to guide against the spread of the mutating strains of the virus and hence sustain economic activities.

The Committee noted the persistent security crisis especially in major food-producing regions of the country and the severe toll on food supply and prices. The Committee also noted the slight moderation in inflation due to the unrelenting effort of the bank in supporting the agricultural sector in a bid to boost food supply.

The MPC further highlighted the need for collaboration with Nigerians in the diaspora through the issue of project-specific diaspora bonds targeted at specific infrastructure projects. It noted the complementary role this would play in boosting foreign exchange supply and easing the current exchange rate pressure.

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The Committee appraised the events in the equities market, stating that the market remains in a comfortable place which indicates investors' confidence in the stability of the Nigerian economy in the medium term. The MPC, thus, urged the bank to maintain its collaboration with the fiscal authority to improve the investment climate toward attracting sustainable Foreign Direct Investment (FDI).

The Committee applauded the developments in the banking sector, specifically the efforts of participants in ensuring a reasonably low and steadily reducing rate of Non- Performing Loans (NPL) even as aggregate credit continues to expand through this crisis period. Although NPL remains marginally above the bank's regulatory threshold, the members of the MPC noted it was at a reasonable level considering the macroeconomic imbalances occasioned by the pandemic.

After reviewing available policy alternatives, the Committee voted to maintain the benchmark rate at 11.50%, while also keeping all parameters unchanged.

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 Further Improve Net Interest Margin

Banking sector prime lending rate has continued to moderate in 2021, from 11.35% in December to 11.24% in April 2021. Average prime lending rate for January to April 2021 is also significantly lower at 11.21% relative to 14.91% during the corresponding period in 2020. Although maximum lending rate has increased marginally to 28.64% in April 2021 from 28.31% in December 2020, we note that average maximum lending rate for the sector during January to April 2021 is also significantly lower at 28.56% (vs. 30.65% during the corresponding period in 2020). The relative decline in lending rates is consistent with lower effective cash reserve requirement (CRR) as at Q1:2021. Banks within our coverage universe recorded a decline in average CRR in Q1:2021 to 30.45% from 32.69% in Q1:2020, suggesting a relatively improved capacity to lend. **However, with CRR retained at 27.50%, and a potentially higher effective CRR, we maintain that smaller banks will continue to be at a relative disadvantage in terms of risk asset creation and liquidity. The increase in average interbank lending rate to 13.93% for January to April 2021 (vs. 8.07% over the corresponding period in 2020) indicates increased pressure on banking system liquidity, which is expected to persist over the near term in view of the committee's decision**.
On the other hand, the decision to hold the MPR constant should bode well for banks' net interest margin (NIM) as industry cost of funds continues to trend

downwards. This is especially due to sustained efforts by players to accumulate low-cost funds. In addition, asset yields continue to benefit from the uptrend in yields on investment securities. Financial reports released so far in Q1:2021 indicate improvements in NIM across board in the sector, and we expect this trend to continue over the near term.

The Real Sector: Impact on Real Sector to Remain Muted

The economy recorded another quarter of expansion (the second quarter in a row) in Q1:2021, consolidating on the fragile exit from recession in Q4:2020. Driven largely by growth in the non-oil sector, the 0.51%YoY expansion in real GDP points partly to positive results from CBN initiatives and fiscal support amid the gradual move towards pre-pandemic levels of economic activity. Meanwhile, the oil sector (-2.21%YoY) remained subdued as compliance to OPEC production quota limited output compared to the corresponding period last year. The committee however commented on the fragility of the GDP growth and the need to consolidate on the previous performance.

Although PMI statistics at 49pts in April suggest that activities still trail the expansion threshold (50pts), it nonetheless shows a significant improvement from the trough (48pts) witnessed in March 2020. Key growth segments in the manufacturing sector include the Cement, Food Beverage and Tobacco as well as the Chemical and Pharmaceutical product subsectors. In our view, improved demand and the apex bank's effort at supplying credit were key tailwinds.
In arriving at its decision, the committee noted the downside risk posed by the prevailing security challenges but expressed optimism on the growth potential of coordinated public-private partnership. Therefore, we expect the hold decision to have a muted impact on the level of real sector output.

The Fixed Income Market: Minimal Effect on Fixed Income Yields

Yields in the fixed income market have trended upward so far in the year even though the MPR has remained unchanged from last year. We note that other factors such as high inflationary pressure and higher primary auction rates have been responsible for the upward trajectory of yields on treasury instruments. The quest for higher yields has also pushed investors towards corporate instruments, leading to a sustained bearish run especially on treasury bills. The decision to retain the policy rate at 11.50% will therefore have minimal impact on pricing in the fixed income market while allowing for the influence of extant factors to run its course. The outlook for fixed income yields over the near term therefore remains positive.

The Equities Market: Bargain Hunting Opportunities to Dominate

The losses recorded on the Nigerian bourse has deepened since the Monetary Policy Committee last met in March, with Year-to-Date (YtD) returns currently at -5.00%. Although, there has been a gradual improvement in the macroeconomic environment, investors' sentiment has remained largely bearish, dominated by profit taking activities and pockets of bargain hunting.

Overall, we do not think that the Committee's decision would have any significant bearing on the performance of the equities market. Our view is that bargain hunting activities would determine the direction of the equities market. At a PE of 12.97x, the Nigerian equities market currently trades at a favorable discount to peers – Ghana (PE of 15.76x) and South Africa – (PE of 23.90x).

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