Macroeconomic Update

# MPC Monitor | March 2023

## MPC Sustains Hawkish Stance

At its 290th meeting which ended on 21st March 2023, the Monetary Policy Committee (MPC) **sustained its tightened stance by raising the Monetary Policy Rate (MPR) by 50bps to 18.00% from 17.50% while holding other parameters constant,** in alignment with our expectation as mentioned in the February 2023 inflation report. The majority of the Committee favored a rate hike although at different magnitudes: 10 members voted 50bps, 1 member voted 25bps, while 1 member voted to hold the MPR.

In making its decision, the Committee considered the negative effects of the ongoing unrest in Eastern Europe and the identification of further COVID-19 strains in China upon the country's reopening. The Committee also reviewed the oil market's erratic behavior, the ongoing global banking sector crisis, possible financial contagion, and highlighted geopolitical tensions between the U.S. and China over Taiwan. These factors are expected to put a strain on global economic recovery.

The Committee anticipates that in 2023, the domestic economy will record growth, albeit at a slow pace. Members expressed worries over the high and persisting inflation, as well as the expected pressure from the planned fuel subsidy elimination on inflation. Regarding the financial crisis currently testing the global financial system, the committee reiterated its confidence in the Nigerian banking sector citing the existence of adequate oversight in place to prevent the likelihood of such occurrences in the country.

**The rate increase would further push up borrowing cost, which could result in less manufacturing activities and adversely impact the real sector. We advise fixed-income investors to position in short-duration and high-yield products as we expect fixed-income yields to rise. For the equities market, we note that the current rate hike does not pose any substantial risk as corporate actions become the main focus for investors.**

## Committee's Considerations

The Committee noted concerns regarding new and pre-existing factors that stifle global economic recovery prospects. These factors include the recent bank failures in the USA and Switzerland amid widespread monetary policy tightening, the resurgence of the Covid-19 pandemic in China, unresolved geopolitical tension between Russia and Ukraine, and disruptions in the energy market. Furthermore, these have all culminated in the IMF's downward revision of the global economic growth forecast.

As regards global inflation, the Committee acknowledged the disinflation observed in most advanced economies but highlighted that inflation still significantly exceeds the target range for these countries. Additionally, the Committee expects that global inflation will remain elevated for the most part of 2023, primarily due to the high cost of food commodities, substantial liquidity, and the expected disruption from the ongoing tussle between the USA and China regarding Taiwan's sovereignty.

On the domestic scene, the Committee noted that the successive MPR hikes have resulted in a slower pace of inflation. It also restated its objective to establish crucial policy mechanisms that would shield the economy from potential disruptions from the global economy while maintaining its emphasis on ensuring stability in domestic prices. Also, the Committee expressed concerns about the likelihood of price fluctuations, citing several significant factors that were viewed as potential obstacles to maintaining price stability. These include persistent shortages of Premium Motor Spirit (PMS), escalating costs of alternative fuels such as diesel and gasoline, the potential removal of fuel subsidies, and exchange rate volatility.

On a positive note, the MPC expressed its satisfaction with the Naira redesign and cash withdrawal limit policies, which have helped to reduce the amount of money in circulation significantly and are expected to enhance the potency of monetary policy tools. For context, money in circulation declined from NGN3.30trn in October 2022 to NGN1.39trn as of January 2023, according to data from the Central Bank of Nigeria (CBN), while money outside the banking system has also dropped to NGN788.92bn from NGN2.84trn within the same period. The Committee also expressed optimism about attracting foreign direct investment (FDI) through ongoing initiatives (like the RT200 and the Naira for Dollar scheme) to improve non-oil revenue and reduce the fiscal deficit and public debt.

### Key Decisions

Overall, the decisions of the MPC were to:

- Raise the MPR by 50bps to 18.00%.
- Retain the Cash Reserve Ratio at 32.50%.
- Retain Liquidity Ratio at 30.00%.
- Retain the Asymmetric Corridor at +100bps/-700bps around the MPR.

## Anticipated Impacts

### The Banking Sector:

### Banks At Comfortable Position Despite Additional Rate Hike

Unsurprisingly, the occurrences in the global banking industry have titled the conversation of the additional rate hike to how comfortable the Nigerian banks are. While the concerns and fear of a spillover effect on the Nigerian banking sector are valid, the CBN governor has reiterated his confidence in the stability of the domestic banking sector. Citing relevant data, the industry's Non-Performing Loans ratio stayed at 4.20% as of February 2023. Also, the capital adequacy and liquidity ratios were 13.70% and 43.10% as of February 2023 – well above the regulatory threshold of 10.00% and 30.00%, respectively. Furthermore, we affirm that the Nigerian banks are in a relatively good position despite the sixth-rate hike implemented by the MPC since 2022.

One primary measure that equips Nigerian banks is the loan-to-deposit ratio, which mandates them to transform 65% of their total deposits into loans. Similar to the trend since the first-rate hike in May, the additional 50bps rate hike is expected to increase the banks' interest income (via loan repricing). Specifically, the average lending rate increased to 20.65% in January 2023 (vs 19.67% in January 2022). For yields on investment securities, we foresee a moderate increase – especially in Q1:2023 – as the rates on treasury instruments are higher than the corresponding period in 2022 (despite the recent muted reaction of T-bills rates to MPR increase). Notwithstanding, the industry's interest income is projected to grow, considering that the interest income on loans typically constitutes the bulk of total interest income (c. 72% as of 9M:2022). On the other hand, the higher benchmark rate will have only a negligible effect on interest expense.

**Thus, in our view, the MPC's decision suggests a net positive outlook for the banking industry's profitability. Equally, the prudential measures implemented by the apex bank put the banks in a comfortable position amid pressure from global players.**

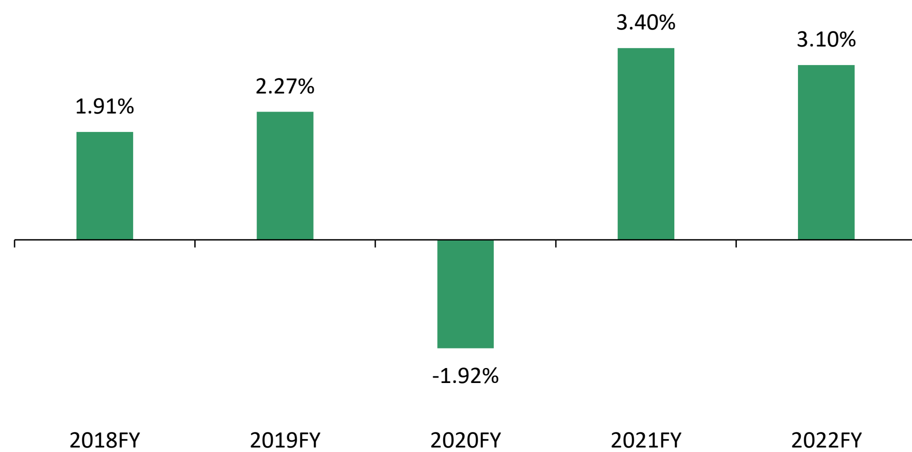
### The Real Sector

### Growth Prospects Remain Slim

Reflective of the collaborative efforts of both the monetary and fiscal authorities, Gross Domestic Product (GDP) growth in 2022 (3.10% YoY) was positive, although marginally lower than that of 2021 (3.40% YoY). According to the report from the National Bureau of Statistics (NBS), the non-oil sector remained the major driver of growth, expanding by 4.84% YoY while the oil sector contracted by **19.22%**, a consequence of the significantly low oil

production volumes recorded. For Q1:2023, economic growth is projected to be slower premised on a couple of factors: the Naira redesign policy and resultant cash crunch in the country would impact consumption expenditure, as a significant portion of transactions in the informal sector are settled in cash; capital raising efforts of corporates (e.g., commercial papers and bonds raises) have also come at higher cost owing to the prior 600bps cumulative rate hikes. While the Apex Bank has continued its intervention policies in the real sector, we observed a reduction in the pace of disbursements for some of these programs. For context, disbursements to farmers through the Anchor Borrowers Program increased by 11.72%YoY as of February 2023 (compared to +62.13% as of February 2022). The Real Sector Support Facility (RSSF) also saw reduced disbursements: NGN23.70bn accumulatively in two months ended February 2023 (vs NGN428.31bn in February 2022). We project that these reductions in disbursements reflect the Committee's commitment to rein in inflationary pressure through its monetary policy tools.

**Chart 1**: **Nigeria's Real GDP Growth Rate**




***Source:*** *NBS, Meristem Research*

Overall, coupled with the unresolved challenges (insecurity, adverse weather conditions, FX volatility) embattling the real sector, the Committee's continuous rate hikes could continue to dent the real sector's growth.

## The Fixed Income Market:
## Yields To Hover Around Current Levels

Since the MPC held its last meeting in January, the sentiment in the Nigerian fixed-income market has been mixed. While bearish sentiment prevailed in the secondary treasury bills (TBills) market as the average treasury yield increased to 6.78% as of March 20, 2023 (vs 3.20% as at the previous MPC meeting), the bonds market was in a relatively quiet mood as the average bond yields declined to 13.27% as of March 20, 2023 (vs 13.35% as at the previous MPC meeting).

In the TBills primary market auctions (PMA), stop rates recorded an uptick, with occasional ups and downs. Specifically, average stop rates across the treasury bills trio instruments increased to 5.81% (vs 2.29% at the last auction in January 2023). Several factors impacted the movement of stop rates, the chief of them being system liquidity which influences subscription levels at the various PMAs. However, investors have continued to demand higher rates to compensate for negative real returns as inflation trends higher. This, coupled with the Government's profound interest in longer-dated instruments to plug its deficits, supported the upward movement of rates, although at a slower pace.

**Going forward, we expect yields to hover around current levels in the short to medium term as investors have already priced in the hike in MPR. While rates might record a gradual uptick as investors continue to demand positive real returns amid surging inflation, we posit that robust system liquidity (a bond maturity of NGN735.96bn in April and coupon payment of NGN535.31bn are expected before the next MPC meeting) will continue to have a higher effect.**

## The Equities Market:

## Impact to Remain Muted on Equities Market

Investors' interest in the equities market remained strong, notwithstanding the MPC's hawkish stance at its January 2023 meeting. Continued interest in the market led the local bourse to gain 4.82% Month-on-Month (MoM) in February 2023 (vs 3.88% MoM in January). Also, the activity level in the market remained strong, as volume traded in February increased by 36.97% MoM to 6.08bn units (the highest in nine months), and market turnover remained elevated at NGN82.02bn. Electioneering activities had a negligible impact on the market, as the broadly positive mood persisted into March, with the market All-Share Index (ASI) reaching its 14-year peak of 55,822pts on the 9th of March. We note that impressive corporate performance contributed to the positive sentiment on the bourse, as investors cherry-picked attractive stocks. However, the bullish sentiment has started to wane, with the market recording a loss of 1.62% so far in March 2022.

The Nigerian equities market currently trades at a higher valuation (Price-to-Earnings ratio of 10.40x) relative to its peers – Ghana (4.0x), Egypt (8.30x), Kenya (5.70x), South Africa (9.90x). This indicates a possibility of further selloffs in the market. Like the last two rate hikes, we do not expect this hike to impact investors' decisions in the equities market significantly. However, we note that the valuation of stocks remains high, and this could cause further profit-taking in the market.

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