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Post MPC Report

March 2024

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In Line with our Expectation: MPC Hikes Rate by 200bps

The Monetary Policy Committee (MPC), chaired by the CBN governor, Olayemi Cardoso, held its second meeting in 2024 on March 25th and 26th. As expected, price stability was the central focus.

In line with our expectation of a 200bps hike, the MPC raised the benchmark interest rate (MPR) by 200bps to 24.75%. Additionally, the cash reserve ratio (CRR) for merchant banks was increased to 14% from 10%, and the asymmetric corridor was reversed to +100/-300 basis points. Meanwhile, other parameters such as liquidity ratio, and CRR of deposit money banks (DMBs) remain unchanged. These measures aim to control the money supply and curb inflationary pressures.

The MPC broadly considered global factors contributing to inflation, such as tightened financial conditions and supply chain disruptions due to regional tensions, which could further increase food and energy prices. In the domestic scene, it also assessed the prevailing inflationary pressures (supply shortages, insecurity, and escalated transportation costs) which poses significant challenges across in the domestic economy.

The committee further emphasized need to address inflation while reaffirming its commitment to maintaining stability in the foreign exchange (FX) market. Moreover, the committee acknowledged the recent stability in the FX market, alluding this to the CBN's resolution of FX backlogs and its recent transparency-focused market reforms.

Additionally, the committee lauded the federal government's endeavours to alleviate strains in the nation's food sector and called for broader fiscal consolidation and improvements to key fiscal indicators. Lastly, the MPC reviewed recent development in the country's banking system, affirming its safety and transparency. It emphasized the imperative for banks to adhere diligently to existing regulatory guidelines to ensure financial stability and integrity.

For the financial markets, the implication of the hawkish stance will be mixed. We foresee higher treasury trends in the fixed income market while the equity market will not be heavily impacted as investors have factored in the hike in their positions. Ultimately, the increased yields are expected to attract foreign investment into the domestic fixed-income market which may help to stabilize exchange rate.

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Committee's Decisions

Overall, the MPC decided to tighten Monetary Policy as follows:

- Increased the MPR by 200bps to 24.75% from 22.75%.
- Retained the Cash Reserve Ratio (CRR) of Commercial Banks at 45.00%.
- Increased the Cash Reserve Ratio (CRR) of Merchant Banks by 400bps to 14.00%.
- Retained Liquidity Ratio at 30.00%.
- Narrowed the Asymmetric Corridor to +100bps/-300bps (from +100bps/-700bps) around the MPR.

Anticipated Impacts

The Banking Sector

Steering Wheels of Change

Unsurprisingly, the initial 400bps hike at the last meeting led to higher yield on investment securities: average treasury Bills and bond yields rose by 75bps and 208bps to 17.67% and 19.29% of 26th of March, respectively. Also, we have seen the impact of higher interest rate environment on average deposit rates, which has continued to increase, suggesting higher interest expense and cost of funds for Nigerian banks. Meanwhile, the prime lending rate is yet to reflect changes in the MPR, as it fell to 26.55% in February from 27.07% in January. We anticipate that banks will reprice the cumulative 600bps change in MPR to their loan advancement, which could bode well for banks' interest income and asset yields.

Furthermore, the reduction of the lower band of the asymmetric corridor to -300 basis points (from -700 basis points) for the CBN's Standing Deposit Facility (SDF) is expected to elevate the rate on banks' deposits with the CBN to 21.75% from 17.75%. This adjustment aims to incentivize deposit money banks (DMBs) to channel funds towards the CBN, thereby reducing excess liquidity in the financial system. Additionally, the decision to raise the CRR for merchant banks by 400bps to 14.00% further emphasizes their contractionary stance. Merchant banks typically focus on short-term financing for businesses, and this targeted increase might aim to moderate their lending activities.

These adjustments are expected to bolster interest income due to higher yields on investment securities. On the flipside, higher rates also imply higher interest expenses, potentially impacting profitability. More so, there is a looming concern regarding asset quality, as higher interest rates could contribute to a rise in non-performing loans.

The Real Sector

Clouded Horizons in the Near Term

With the MPC's recent decision to hike interest rates by 200bps to 24.75%, following a previous 400bps hike, investment spending in Nigeria's real sector is expected to face further constraints. The increase in borrowing costs will likely dampen production activities, particularly as businesses face higher costs of capital.

Moreover, the upward revision of the merchant banks' Cash Reserve Ratio (CRR) to 14.00% from 10.00% will limit the liquidity available to players in the real sector. This could further lower accessibility to credit, potentially constraining the level of capital expenditure (CAPEX) in the sector, leading to lower output.

However, there are potential upsides to the MPC's contractionary stance. The policy could incentivize foreign inflows into the real sector, supported by the relative stability of the currency. Additionally, the federal government's subsidy on agricultural inputs and the recent NGN15bn Yuan received from the Japanese government to support the country's national agricultural scheme project are expected to provide some relief to the adverse impacts of the MPC's decisions.

Overall, while the monetary authority's decision may eventually yield positive outcomes, however, in the near term, we anticipate a continuation of lackluster output for the real sector in Q1:2024.

Anticipated Impacts

The Fixed Income Market

MPR Hike to Support Elevated Yields

The Committee's decision to raise the MPR by an additional 200bps is expected to push treasury rates upward in the fixed income market as investors demand for higher rates, especially in Primary Market Auctions (PMAs) to reflect the prevailing market dynamics. Particularly, in the T-bills auction following the meeting, we foresee the average stop rate to hover around the range of 19.06% - 21.20%. In the secondary market, the sentiment should remain bearish, mirroring activities of the primary market.

Meanwhile, the adjustment of the asymmetric corridor present an attractive investment opportunity for the banks to explore the SDF at a rate of 21.75% (from 17.75% since the last meeting). This alternative may limit the banks' participation in the T-bills market. In addition, the higher borrowing costs for the Federal Government and debt sustainability requirements will be key factors for the FG to consider in raising Treasury rates.

The cumulative 600bps MPR hike within a month serves as a major threat to corporate issuers as borrowing costs have jumped significantly. This may be an hinderance to companies' ability to access the debt market. Given this consideration, issuance of corporate bonds will be limited while commercial papers issuers will remain cautious despite the rising refinancing and meet working capital needs.

Overall, we envisage occasional swings on fixed income yields as the monetary authority's liquidity management strategy and debt management influences market direction from time to time.

The Equities Market

Walking Cautiously on Wobbly Terrains

With the MPC maintaining its hawkish stance, we retain our expectation of a muted reaction on the domestic equities market as investors had mostly factored in the extent of increase in MPR into their positions.

Additionally, recent data from NGX reveled that foreign investors' participation in February 2024 rose to its highest in 3 months to 18.39% (compared to 8.15% in Jan 2024 and average of 11.48% in 2023). The MPC's decision is expected to send positive signals to foreign investors, especially as the exchange rate stabilizes and the Naira continues to appreciate on the official window. This should provide some clarity regarding concerns about repatriation of funds and subsequently, a steady re-entrant of foreign investors.

On the broad market performance, the local bourse has continued to trade both sides recently as investors remain cautious, following sell-off reactions from financial releases and profit-taking across the board. The All-share index has gained 3.97% MtD to reach 103,952.47 points as of March 26, 2024.

In the near term, we anticipate a continuation of mixed sentiment in the local bourse. The expectation of the release of financial services sector earnings is likely to drive an upbeat mood. However, with gloomy outlook for some sectors' Q1:2024 results, we do not overlook the possibility of further selloff triggers.

Finally, given that yields in the fixed income market are trending upward, presenting an attractive option for investors compared to equity assets, we do not foresee strong inflow of funds into the equities market. This supports our expectation of a blended sentiment for the equities market in the near term.

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