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Post MPC Report

May 2024

MPC Maintains a Contractionary Course

The Monetary Policy Committee (MPC), led by the CBN governor, Olayemi Cardoso, held its third meeting of the year on May 20th & 21st, 2024. Price stability remains the major focus of the committee.

The MPC raised the benchmark interest rate (MPR) by **150bps** to **26.25%** (50bps above our expectation of a 100bps hike). Meanwhile, other parameters, such as the cash reserve ratio (CRR) for merchant banks, liquidity ratio, asymmetric corridor, and the CRR of deposit money banks (DMBs), were maintained at current levels.

In line with our expectations, the MPC considered global inflation factors, the stringent interest rate environment, and potential threats to global price levels, such as ongoing regional tensions. The committee also noted the likely impacts of these factors on domestic inflation. In the local scene, while acknowledging factors driving the country's inflation, the MPC noted the recent moderation in Nigeria's headline, food, and core inflation increases (particularly the month-on-month figures), indicating that the central bank's hawkish stance is beginning to yield the desired results. Additionally, the committee highlighted recent measures by the monetary authority to enhance the country's foreign exchange market transparency, attract foreign inflows into the economy, and ultimately stabilize the Naira.

In our opinion, the hawkish stance is expected to have varied implications for the financial markets. In the fixed income market, higher yields could attract foreign investment, improve liquidity in the FX market, and potentially stabilize the Naira. On the other hand, we foresee a tepid inflow of funds into the equities market, with potential outflow as investors are drawn to the allure of attractive yields in the fixed income market.

Committee’s Decisions

In summary, the Monetary Policy Committee (MPC) opted to further tighten Monetary Policy as follows:

- Raised the benchmark rate (MPR) by 150bps to 26.25% from 24.75%.
- Retained the Cash Reserve Ratio (CRR) of Commercial Banks at 45.00%.
- Retained the Cash Reserve Ratio (CRR) of Merchant Banks at 14.00%.
- Retained Liquidity Ratio at 30.00%.
- Retained the Asymmetric Corridor at +100bps/-300bps around the MPR.

Anticipated Impacts

The Banking Sector

Boom or Burst? Rate Hike to Sustain Growth but Risk Looms

The Nigerian banking sector is known for its resilience despite myriad challenges. Earnings releases from the banking sector revealed a 109.52% YoY growth in interest income of the FUGAZ in Q1:2024. This is owing to the impact of the cumulative 600bps hike in the MPR in the first two MPC meetings on interest-bearing assets. For context, average yields on investment securities (treasury bills and bonds) rose to an average of 22.13% and 18.69% (vs 6.29% and 14.13% as at 29th December 2023) respectively. Notwithstanding the lower prime lending rate in April (15.54% vs 15.74% at the end of March), the MPC's decision to raise the MPR to 26.25%, is in line with our expectation of higher interest income supported by real growth in loans and advances to customers.

On the flipside, the elevated rate environment has caused funding cost of banks to rise by 16bps to an average of 1.20% in Q1:2024 (vs 1.04% in Q1:2023), and with it, interest expense. While we acknowledge that the MPC's decision could inflate risky assets and pose a threat to asset quality, the banking sector has largely been proactive in its risk management. Amongst most banks, Non-Performing Loan (NPL) ratio fell to 3.07% from 4.30% YoY showing banks. On a balance of factors, we expect the higher growth in interest income & asset yields to offset higher cost of fund, ultimately, boost bottom-line of banks.

The decision to maintain the asymmetric corridor at +100/-300 around the MPR is in tandem with the monetary authority's liquidity management strategy as the higher MPR implies even higher incentive (23.25% vs 21.75%) for banks to deposit excess funds with the Central Bank of Nigeria (CBN).

The Real Sector

Monetary Tightening to Weigh on Sector's Performance

Nigeria's manufacturing sector demonstrated notable strength in April 2024, with the Purchasing Managers' Index (PMI) climbing to a three-month high of 51.10pts despite the CBN's aggressive monetary tightening measures. The cumulative 600 basis points increase in interest rates over the last two meetings suggests that the sector has adapted to the challenging economic conditions.

Nevertheless, the additional 150bps hike in the MPR to 26.25% is expected to dampen investments, production activities, and expansions in the country's real sector due to the resultant higher borrowing cost. This increased cost of capital and strained profitability may reverse the positive PMI trend and potentially hinder overall GDP growth in the near term.

However, potential upsides exist with the committee's contractionary stance. The increased interest rates could attract more foreign investments, potentially stabilising the foreign exchange (FX) market. A more stable FX market could alleviate some of the pressures the manufacturing sector faces in sourcing inputs and managing borrowing costs.

Despite the potential benefits of the recent rate hikes, we expect tempered growth and a slower contribution to GDP from the real sector in the near term resulting from the impact of higher borrowing costs. Nonetheless, in the long run, improved FX stability could offer some relief and foster growth within the sector.

Anticipated Impacts

The Fixed Income Market

Yields Trajectory to Impel Investors' Sentiment

We expect the additional 150bps MPR hike to trigger a bearish mood in the fixed income market. In our view, investors seeking safe haven will likely increase their demand for higher yields offered in the Primary Market Auctions (PMAs) for treasury instruments. As such, in the upcoming PMA for treasury bills, we anticipate average stop rates to range between *20.00% to 22.00%*. Also, we foresee an uptrend in yields in the secondary market as the surge in demand for new securities with attractive rates is expected to spur sell-offs on existing instruments.

Meanwhile, we note that the CBN's decision to maintain other parameters - CRR (45.00%) and Liquidity Ratio (30.00%), may continue to taper commercial banks' lending activities as CRR remain elevated. On the other hand, the new SDF rate (23.25%) which is higher than the prevailing prime lending rate of 15.54%, may continue to incentivize banks to deposit more funds with the CBN.

For corporates, the rate hike is expected to heighten borrowing cost as companies would need to provide higher premium on new issuances. We expect this to further reduce the activities of corporate debt issuers in the near term.

Overall, we expect a blend of sentiments to impact the direction of yields occasionally in the near term, hinged on the monetary authority's efforts to control system liquidity from time to time. Additionally, the government's focus on managing its borrowing cost and effective debt sustainability may also influence the direction of yields in the near term.

The Equities Market

Investors to Remain Cautious Amid Uncertain Outlook

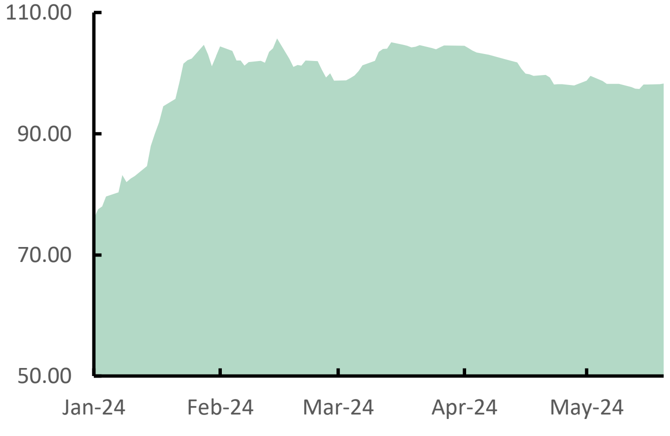
With the MPC maintaining its contractionary stance, we anticipate a continuation of the lackluster sentiment in the equities market. So far this month, the bears and bulls have been in a struggle for dominance. Nonetheless, the renewed buying interests on large cap tickers like **GTCO** (+20.49% MtD) and **MTNN** (+9.76% QtD) propelled the **NGXASI** to a marginal increase of +0.06% MtD, reaching 98,285.33pts as of May 21, 2024.

Based on our expectation of marginal uptrend in fixed income yields, we foresee a tepid inflow of funds into the equities market, with potential outflow as investors are drawn to the allure of attractive yields.

Furthermore, the local bourse is currently overvalued relative to its peers, trading at a higher price to earnings ratio of 12.88x, compared to Ghana (5.15x), Egypt (10.53x), Kenya (5.62x), safe for South Africa (16.75x).

Despite this, we expect buying interest in stocks trading at attractive entry points. Specifically, the sell-off pressure in the banking sector is expected to ease in the near term as investors gain clarity on the direction of the banks' recapitalization plans.

Chart 1: Trend in NGXASI (Jan till Date) points



Source: Bloomberg, Meristem Research.

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