

**Nigeria** | Macroeconomics

# Post MPC Report



July 2024

## MPC Holds Contractionary Line, but Moderates Pace

The Monetary Policy Committee (MPC) convened its fourth meeting of the year on the 22<sup>nd</sup> and 23<sup>rd</sup> of July 2024, with price stability as its main focus. At the meeting, the committee raised the Monetary Policy Rate (MPR) by 50 basis points (lower than our forecast by 50bps) from 26.25% to 26.75% and adjusted the asymmetric corridor from +100bps/-300bps to +500bps/-100bps. Meanwhile, the MPC retained the liquidity ratio at 30.00% and the Cash Reserve Ratio (CRR) at 45.00% for Deposit Money Banks and 14.00% for Merchant Banks.

The committee assessed the ongoing inflationary pressures and the underlying factors contributing to the steady rise in prices, reaffirming its dedication to maintaining price stability in the economy. The MPC recognised recent fiscal efforts to boost food productivity and committed to continuous collaboration with the fiscal authority to tackle the existing food supply shortages and ensure a more sustainable food ecosystem. Additionally, the committee disclosed its ongoing engagements with development finance institutions like the BOI to boost productivity, focusing on SMEs. Noting encouraging developments, including the increase in external reserves and the convergence of foreign exchange rates across various market segments, the committee encouraged exploring opportunities to augment external reserves, enhance diaspora remittances, and improve domestic refining capacity to minimize foreign exchange expenditures. Additionally, the committee acknowledged the banking system's enduring stability and stressed the importance of ongoing watchfulness as the recapitalization exercise progresses.

Although the MPC's interest rate hike reinforces its dedication to combating inflation through a tightening cycle, we anticipate a moderate impact on financial markets. We opine that the 50bps increase will have a limited effect on investor sentiment in the equities market, especially since we don't foresee a substantial rise in treasury yields in the short term.

## Committee's Decisions

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

- Raised the benchmark rate (MPR) by 50bps from 26.25% from 26.75%.
- 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%.
- Adjusted the Asymmetric Corridor to +500bps/-100bps around the MPR.

# Anticipated Impacts

## The Banking Sector

### Tightening Noose: Banking Sector under Pressure

The banking sector often serves as the conduit for monetary policy implementation. By widening the asymmetry corridor to +500/-100bps from +100/-300bps, alongside a modest 50bps increase in the benchmark rate, the CBN has reinforced its commitment to stringent liquidity management. This tighter monetary policy, marked by increased borrowing costs from the CBN, will substantially increase the cost of borrowing for banks, with repayment rates now at MPR+500bps plus principal, while simultaneously incentivising banks to deposit excess funds with the CBN. For context, year-to-date, the banking system has experienced a net liquidity deficit of NGN29.66trn, a stark contrast to a positive liquidity position of NGN78.71trn in 2023.

While banks are likely to increase lending rates and reprice loan portfolios to boost interest income, they are also expected to adopt a more prudent lending approach. This shift will likely involve enhanced risk assessment procedures and more selective lending practices, potentially slowing loan growth as banks prioritise asset quality. The recent improvement in the sector's average NPLs to 3.07% from 4.30% YoY, may be challenged as borrowers face higher debt servicing costs in the new interest rate environment.

As banks adapt to the elevated borrowing costs from the CBN, we anticipate they will increasingly participate in the fixed income market to seek income from investment securities. Additionally, the impact on consumer and business loans could result in reduced borrowing and spending, which is not positive for economic growth. It's important to note that this is coming at a time when banks are also racing to meet higher minimum capital requirements while grappling with a 50% windfall tax.

## The Real Sector

### Real Sector's Productivity to Remain Stifled in the Near Term

The MPR was increased by an additional 50bps leading to a total hike of 800bps in 2024. This cumulative uptick in rate is starting to negatively affect the real sector's productivity, highlighting the challenging macroeconomic conditions. This is evinced by the Purchasing Manager's Index (PMI) dropping to a year-low of 50.10pts in June 2024.

The rate hike, however minimal, will further elevate borrowing costs, placing additional strain on business operations within the sector. Moreover, the considerable adjustment in the asymmetric corridor to +500/-100bps around the MPR could potentially tighten credit availability and constrain liquidity. This could have adverse effects on local businesses, reducing investments and the level of capital expenditure in the sector.

On the other hand, the increase in the MPR may bolster investor confidence, thus sustaining capital inflows into the country. This influx could enhance stability in the foreign exchange market, aiding businesses in more effectively managing and predicting importation costs.

**Due to the rising cost of borrowing from persistent rate hikes and tight liquidity, businesses in the country continue to face increased financial burdens. Consequently, we anticipate lowered productivity and a reduced contribution from the real sector to economic output in Q3:2024. Conversely, the sustained rate hikes could enhance FX stability in the near term.**

# Anticipated Impacts

## The Fixed Income Market

### Multifaceted Drivers; Cautious Tread for Treasury Yields

Following an additional 50bps MPR hike, we expect a sustained bearish mood in the fixed-income market. In our perspective, the increased monetary tightening will likely spur investors' demand for higher rates, particularly on treasury instruments. Based on this expectation, we anticipate the average stop rate at the upcoming treasury bills PMA to print between 18.50% and 19.50%. Similarly, we expect the secondary market activities to mirror the outcome of the primary market.

On the other hand, the committee's adjustments to the asymmetric corridor- +500/-100bps around the MPR (vs +100/-300bps) is expected to put further strain market liquidity in the near term. This is because it provides banks with a lesser incentive to explore the SLF window (at a rate of 31.75% interest rate (vs 29.25% at the last meeting.) Additionally, the new SDF rate of 25.75% may encourage banks to deposit more funds with the CBN

For corporates, we expect borrowing costs to stay elevated, as investors would require higher premiums to subscribe to new issuance. Also, the rate hike may also prompt an upward repricing of existing loans held by corporates. In our view, these factors may further inhibit the activities of corporate debt issuers in the near term.

**Overall, we note that the MPC's decision to hike at a slower pace and narrow the asymmetric corridor may have been influenced by the need to manage rising government borrowing costs and system liquidity. As such, we expect these factors to ultimately influence the trajectory of treasury yields in the near term.**

## The Equities Market

### Mixed Sentiment to Prevail in the Local Bourse

The MPC's decision to maintain its hawkish stance was largely in line with our expectation. In light of this, we anticipate a continued blend of sentiments in the local bourse, driven by occasional buying interest and profit-taking activities across tickers. Meanwhile, the market has witnessed a marginal upbeat mood during the month, as activities, chiefly on banking tickers, pushed the NGXASI up by 0.43% Mtd to reach 100,486.12pts. Thus, the YtD return stood at 34.39% as of 23rd July 2024.

In our view, the 50bps hike will have a milder influence in swaying investors' sentiment away from the equities market, particularly as we do not expect a significant uptick in treasury yields in the near term. Rather, we posit that broader market drivers may pose key factors in shaping investors' sentiments and chiefly spur market activities in the near term. Particularly, we expect investors' reaction to half-year earnings releases and other corporate actions to determine market performance in subsequent weeks. In the same vein, we foresee improved bargain-hunting activities as investors cherry-pick across stocks with attractive upside potential and sound fundamentals.

However, we note that shifts in sentiment, driven by investors' outlook on macroeconomic factors, might occasionally dampen the mood in the local bourse.

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