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Post MPC Report

September 2024

The MPC Continues Tightening with 50bps Rate Hike

At its 297th Monetary Policy Committee (MPC) meeting held on September 23rd and 24th, 2024, the Committee made critical deliberations on monetary policy. The Monetary Policy Rate (MPR) was raised by 50 basis points (bps) to 27.25% from 26.75%. Additionally, the Cash Reserve Ratio (CRR) was increased significantly, by 500bps for Deposit Money Banks and 200bps for Merchant Banks, bringing them to 50.00% and 16.00%, respectively. Meanwhile, the Liquidity Ratio was kept steady at 30.00%, and the asymmetric corridor was maintained at +500bps/-100bps around the MPR.

The Committee's deliberations centred on policy options aimed at balancing the risks to price stability with the recovery of economic growth. Globally, the MPC acknowledged the deceleration of inflation but flagged significant risks, including geopolitical fragmentations and uproars and elevated global debt levels, which pose challenges to global growth and inflation trends. The Committee reiterated its commitment to closely monitor these developments and respond with appropriate monetary measures, as necessary. On the domestic scene, the MPC took note of positive indicators such as moderating inflation, GDP growth, and relative stability in the foreign exchange market. However, rising core inflation, driven by higher energy costs, raised concerns. The Committee stressed the importance of close collaboration with fiscal authorities to address the root causes of inflation. Additionally, while inflation has slowed, real interest rates remain negative, prompting the MPC to advocate for continued efforts to achieve positive real interest rates, which would help attract investment and stabilize the foreign exchange market.
The MPC also assessed the stability of the banking sector, noting its current resilience. However, it emphasized the need for sustained oversight to ensure that the sector remains well-positioned to support the broader economy.

The MPC's continued tightening to rein in inflation and stabilize the market holds some implications for the financial markets. We anticipate a moderate impact on fixed-income yields, particularly as the government seeks to manage its borrowing costs effectively. Consequently, we do not foresee a significant shift of capital away from the equities market, as investor sentiment is likely to remain fundamentals driven despite the policy adjustments.

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 26.75% to 27.25%.
- Raised the Cash Reserve Ratio (CRR) of Commercial Banks by 500bps to 50.00%.
- Raised the Cash Reserve Ratio (CRR) of Merchant Banks by 200bps to 16.00%.
- Retained Liquidity Ratio at 30.00%.
- Retained the Asymmetric Corridor to +500bps/-100bps around the MPR.

Anticipated Impacts

The Banking Sector

Further Tightening: - Banks Yet to Be Out of The Woods

In our view, the MPC's decision to raise rates by an additional 50bps will further drive higher asset yields, as banks benefit from the elevated interest rate environment, boosting returns on investment securities. While this will keep funding costs elevated, we anticipate that banks will continue their efforts to enhance their CASA (Current Account Savings Account) mix to mitigate these pressures. As a result, net interest margins are expected to improve further. This trend was evident in the financial results for H1:2024, and we expect it to persist going forward. Additionally, recent financial performance for our coverage banks reveal that banks have been exploring other non-interest sources of income including trading and FX gains. For context, GTCO, ACCESSCORP, ZENITHBANK, and STERLINGNG recorded higher gains from trading investment securities.

Referencing the recent FAAC inflows of NGN1.20trn and other liquidity sources into the system, the MPC raised the cash reserve ratio by 500bps for commercial banks and 200bps for merchant banks, now at 50.00% and 16.00%, respectively (up from 45.00% and 14.00%). This adjustment is expected to tighten liquidity and constrain banks' ability to expand risk asset creation and loan portfolios. We expect that further growth in banks' interest income will depend on their ability to grow their loan book despite uncertainties in the macroeconomic environment. However, in an effort to keep non-performing loans within prudential limits, we expect banks to tilt towards short-term investments in the fixed-income market, leveraging the elevated yield environment to bolster earnings.

The MPC's decision presents a double-edged sword for banks. While the hawkish stance supports higher asset yields, it also raises funding costs. However, we expect the growth in asset yields, and consequently interest income, to outpace the rise in interest expenses. As a result, banks are likely to remain profitable through the rest of the year.

The Real Sector

The High Cost of Stability: Impact of Rate Hikes on the Real Sector

The MPC's recent decision to raise interest rates by an additional 50bps, bringing the total hike to 850bps in 2024, presents challenges for the country's real sector. Higher borrowing costs and increased financial burdens, compounded by existing macroeconomic headwinds, could hinder productivity and investment in related sectors in the near term. This concern is reflected in the Q2:2024 performance of key sectors such as manufacturing, telecommunications, and real estate, where growth slowed to 1.28% YoY, 5.17% YoY, and 0.75% YoY, respectively (compared to 2.20%, 9.74%, and 1.87% in Q2:2023). The continued implementation of stringent monetary policy measures, especially with an 8.50% interest rate differential from the same period in 2023, may further suppress economic activity in these sectors in the coming quarters.

Additionally, the MPC's decision to increase the Cash Reserve Ratio (CRR) for commercial banks by 500bps to 50.00% and for merchant banks by 200bps to 16.00% is expected to restrict credit to the real sector, limiting access to capital for expansion and working capital purposes, which would further pressure business operations and impact viability.

However, the interest rate hike is expected to sustain investor interest in government securities, supporting capital inflows into the country. This influx could provide liquidity to the foreign exchange market and help stabilize the naira, allowing businesses to manage FX-related costs better.

Overall, while the continued rate hikes may bolster FX stability in the short term, the subsequent surge in borrowing costs and liquidity management constraints are likely to escalate financial pressure on businesses. Consequently, we foresee a decline in productivity and subdued real sector output in Q4:2024.

Anticipated Impacts

The Fixed Income Market

Sifting Dynamics on a Quest for Balance

Since the onset of the MPC's hiking cycle, the fixed-income market has been the preferred destination for investors to leverage the attractiveness of yields. With the recent 50bps increase in the MPR, rates are expected to stay elevated, maintaining investor interest. However, liquidity remains a key driver of yield direction, and we anticipate it will continue to shape market activities. As such, the latest MPC decision is likely to have a muted impact on treasury yields.

From our perspective, the DMO's active debt management strategy—evidenced by lower rates across treasury auctions in the past month—could continue to play a significant role in shaping market direction. On the demand side, buoyant system liquidity (NGN40.38bn as of 24th September 2024), along with coupon payments and FAAC inflows of approximately NGN1.20trn, further bolsters this outlook.

Additionally, the MPC's decision to raise the cash reserve ratio by 500bps for commercial banks and 200bps for merchant banks (to 50.00% and 16.00%, respectively) may drive banks to compete more actively at auctions as an alternative to facing higher reserve requirements with the CBN. Moreover, we recognize that the government is exploring alternative funding options, such as the FGN dollar-denominated bond, to address its budget deficit and finance ongoing capital projects.

For corporate borrowers, we believe that the sustained increase in the MPR will continue to raise their borrowing costs and likely limit their access to the debt market for short-term financing.

The Equities Market

Assessing Opportunities Amid Dampening Momentum

The hawkish stance maintained by the MPC is expected to broadly cast a shadow on the activities of the equities market. We anticipate a mix of sentiments, with a likely bearish tilt, as investors will continue to trade cautiously and cherry-pick across tickers. Particularly, we expect the 9M:2024 earnings releases to chiefly drive market activities in the coming weeks.

In our view, investor's outlook on the impact of the higher interest rate environment on the performance of the listed companies will shape their trading decisions in the near term. As such, the financial services sector, which is poised to benefit from the increased policy rate may witness favourable investors' sentiment. However, sectors like Consumer Goods & Industrial Goods may continue to record lacklustre earnings, thus spurring downbeat sentiment.

Meanwhile, we foresee minimal risk-off bias compared to previous months, as muted fixed-income yields are unlikely to trigger a strong outflow of funds from the equities market. However, movements in treasury yields may occasionally sway investors' sentiment going forward.

On foreign participation, data from the NGX revealed that foreign inflows declined by 11.92% since the previous rate hike in July 2024 (NGN33.09bn in August vs. NGN37.57bn in July). Consequently, we anticipate that the additional rate hike will further taper foreign inflows to the local bourse in the near term.

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