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POST MPC REPORT– CBN HIKES RATE BY 400bps

INTRODUCTION

The Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) voted to increase the benchmark interest rate (MPR) by 400 basis points (bps) from 18.75% to 22.75% in its latest Committee meeting. This is the first time the Committee is meeting since the commencement of the new administration of Yemi Cardoso, after he was announced the CBN Governor in September 2023. This also represents the highest rate in at least 18 years.

According to the CBN, the decision was predicated on the need to address the double whammy issues of exchange rate volatility and unabating inflationary pressure. Recall, that Nigeria's headline inflation rate rose to a record high of 29.9% in January 2024, and is projected to surpass the 30% mark following rising cost of food and imported items in February. In the same vein, naira has witnessed significant depreciation against other currencies, losing about 42% and 35% of the its value YTD against the USD at the official and parallel market respectively.

HIGHLIGHT

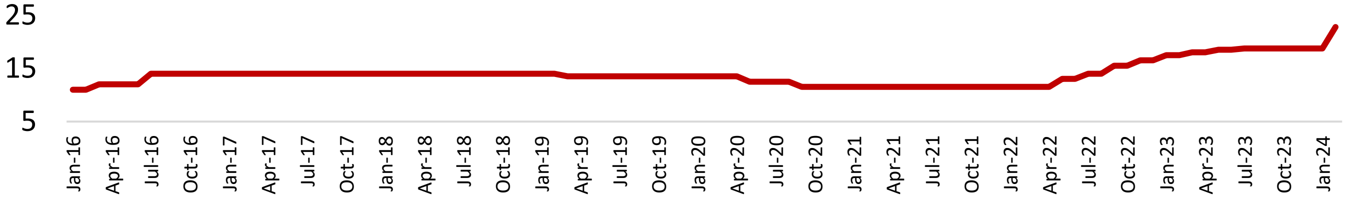
- Raised MPR by 400bps to 22.75%
- Adjusted the asymmetric corridor around the MPR to +100/-700bps from +100/-300 basis points.
- Increased Cash Reserve Ratio from 32% to 45%
- Retained Liquidity Ratio at 30%

While the aggressive interest rate hike is partly aimed at reining in inflation, the Committee noted that the current inflationary trend is driven by non-monetary factors such as persisting insecurity and infrastructural deficit.

On the other hand, in order to liberalize the exchange rate market and improve transparency, the CBN has embarked on several policies, some of which include the unification of the FX markets, removal of limits on margins for IMTO remittances, introduction of a 2-way quote system, reforms in the BDC segment of the FX market amongst others.

The latest increase has helped to reduce the gap between interest rate and inflation, improving the real rate of return to -7.15% from -11.15%. The CBN meanwhile noted an increase in the nation's external reserves level to $34.51 billion as of 20th February 2024 from $32.23 billion at the end of January, which it attributed to the dividends of its new reforms in the FX market and increase in Nigeria's crude oil production.

Monetary Policy Rate (%)

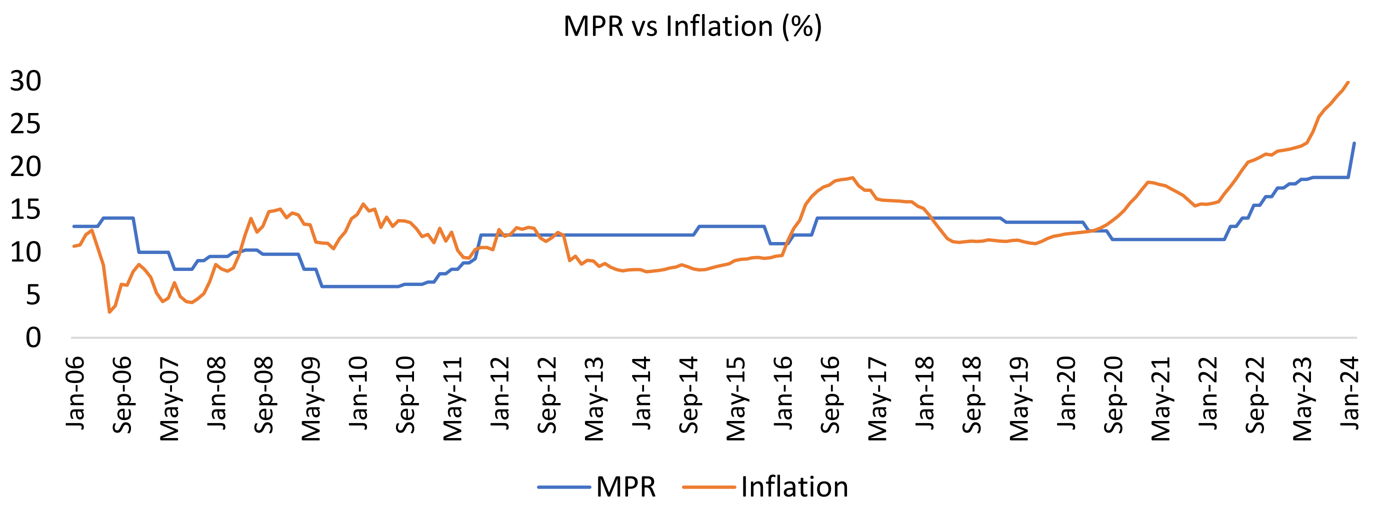


KEY DEFINITIONS

- **MPR:** The monetary policy rate serves as an anchor rate, which determines other rates in the financial system of a country.
- **Asymmetric corridor:** This is a tool used to increase the flexibility of monetary policy and give stakeholders in the market the ability to make timely responses to external finance or risk sentiment shocks. The corridor is of two parts, the lower bound (Standing Lending Facility) and the upper bound (Standing Deposit Facility).
- **Standing Lending Facility (SLF):** This is a lending facility where commercial banks are allowed to borrow from the central bank in a bid to meet immediate short-term withdrawals from their customers. At +100, banks would borrow from the CBN at a rate not more than 23.75%
- **Standing Deposit Facility (SDF):** This is the at which commercial banks deposit money with the central bank. This allows banks to deposit their excess liquidity with the CBN and earn interest. At -700bps, banks can earn at least 15.75% interest rate from the CBN for depositing their funds with the apex bank.
- **Cash Reserve Ratio (CRR):** This is the proportion of banks' deposit that is required to be maintained as a reserve without being allowed to invest or lend it for interest. At 45%, it means that banks are to keep at least 45% of customer deposits in cash or reserves with the CBN.
- **Liquidity Ratio**: The liquidity ratio basically refer to the percentage of banks' liquid assets to their total deposit liabilities.

IMPLICATIONS OF POLICY

- It is worth highlighting that the Committee's decisions at the just concluded meeting is poised to impact both the issues of forex and commodities price stability, especially from a demand perspective.
- Money supply (M3) had surged to its highest level on record in January 2024, standing at N93.72 trillion, while currency in circulation dropped marginally from its all-time high to stand at N3.65 trillion.
- Notably, the increase in the benchmark interest rate and the CRR means that banks will have less lendable resources to customers, while the available credit will come at a higher cost for businesses and individuals.
- While this could drain the system of naira liquidity, which is believed to be used to speculate against the local currency, it could also have intended impact on economic growth, as it stifles the ability of businesses to access credit. Although the CBN projects an economic growth of 3.38% in 2024, 3% by the IMF, the economy might suffer a slower growth on the back of the aggressive tight monetary policy.
- Also, a higher interest rate could present a risk of non-performing loans for banks due to the inability of some businesses to service their debt obligations with the commercial banks.
- The cost of debt through the capital market for corporates will also increase, giving investors more returns on their investments, however, at a higher cost for the business as they strive to make their instruments competitive. Recall that the one-year Nigerian Treasury Bill (NTB) closed at a discount rate of 19% in February, with returns in excess of 24%, hence corporates will have to re-evaluate their go-to market strategy in terms of funding, as investors are likely to have more bias for Treasury Bills.



EXPECTATIONS

- Following the interest rate hike, we expect NTB yield to increase as investors restructure their portfolio towards fixed income assets at the expense of the equities.
- We anticipate a temporary strengthening of the naira against the USD to the region of N1,200/$ to N1,400/$, on the back of the expected $20,000 sale of FX to eligible BDCs by the CBN at N1,301/$, with a restriction to only sell with a margin not more than 1% of the purchase rate.
- A higher interest rate could also stimulate the confidence of foreign portfolio investors, as the CBN governor is set to address them on Thursday, which could in turn improve FX liquidity in the system.
- Money supply indicators such as currency in circulation, broad money supply etc are expected contract as a result of the tight monetary policy.
- In combination with other fiscal measures to address price stability, we anticipate some moderations in the second half of the year.