

MPC RAISES RATES TO 13.00%

... rising inflation counters MPC's pro-growth stance



May 25, 2022

Economic Report

Highlights

As a result of rising inflationary pressures despite steady economic growth, the Monetary Policy Committee (MPC) voted to raise the monetary policy rate (MPR) by 150 basis points to **13.00%**. All other policy parameters left unchanged were:

- The asymmetric corridor: **+100/-700** basis points around the MPR
- The cash reserve ratio (CRR): **27.50%**
- The liquidity ratio: **30.00%**.

The MPC unanimously voted to raise the MPR. During the voting process, six members voted to raise the MPR by 150 basis points. Four members voted to raise the MPR by 100 basis points, while one member proposed to raise the MPR by 50 basis points.

Committee' Considerations

Global Economy

The MPC considered the slowdown in global output amid the intensifying inflationary pressures faced by global economies. These inflationary pressures are largely on account of sustained geopolitical tensions and supply chain disruptions. The Committee also noted that the spillover effect of the stimulus packages offered by central banks across global economies further fueled the inflationary pressures.

In response, the MPC noted that Central banks across major advanced economies are unanimously taking a tighter monetary stance in addressing inflation. Due to these concerns, Global growth is projected to slow from an estimated 6.10% in 2021 to 3.60% in 2022 and 2023. This is 80 and 20 percentage points lower for 2022 and 2023 than projected by International Monetary Fund (IMF) in January.

Domestic Economy

The MPC highlighted the 3.11% YoY real GDP growth recorded in Q1 2022 representing the sixth consecutive quarter of economic growth after the recession witnessed in 2020. According to the Committee, the growth was driven by an increase in aggregate consumption arising from continued policy support and sustained recovery in demand.

The MPC also considered the rising inflationary trend in the economy. Headline inflation stood at 16.82% YoY in April 2022 from 15.92% YoY in March 2022. The inflationary pressure was driven by both core and food inflation which printed at 14.18% YoY and 18.37% respectively in April 2022. The rise in core inflation resulted from higher energy prices, while the rise in food inflation was driven by security challenges in major food-producing areas and perennial infrastructural challenges which hampered food supply.



The Committee's Decision

The committee raised concerns over the increasing downside risks associated with growing rate of inflation despite the positive outcome of its pro-growth stance during the pandemic year. While MPC attributed the rising inflation to supply side pressures, the MPC also identified rising demand pressure that is unlikely to abate until after the 2023 general elections.

The MPC argued that a loosening policy may lead to sharp capital outflows and raise inflationary pressures that could further worsen exchange rate stability. On the other hand, the MPC argued that holding the rates would allow previous policy measures to drive growth but could also leave the rising trend of demand pressure unchecked.

Hence, the MPC felt the need for tightening policies to rein in inflation, reduce the inflationary pressure passed through to exchange rate depreciation, moderate the speed of capital flow reversal, provide incentive for capital inflows and sustain remittance to the external reserve. Additionally, the MPC feels that tightening would moderate the negative real interest rate margin, improve market sentiment and restore investors confidence.

Implications for the Financial Markets

At the MPC meeting in March 2022, we noted that four members considered raising the MPR but the majority fell in favor of holding the rates. It appeared that the CBN has finally yielded to increasing pressures to raise rates. Although, we did not expect the sharp increase by 150 basis points. Apart from the MPR, we maintain that the CRR would be a preferred tool to mop-up the excess liquidity in the market.

By implication, we expect to see a reversal in the prices of fixed income securities in the near term as investors reposition to take advantage of higher yields on the long end of the curve. In the equities market, we have noted a consecutive three-day decline owing to profit-taking activities following impressive earnings release. With the recent increase in rates, we expect a reallocation of funds from the equities market by institutional investors to less risky assets.



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