

MPC HIKES RATES TO 14.00%

... as worry mounts over deteriorating inflationary trend



July 19, 2022

Economic Report

Highlights

In consideration of the steeper rise in inflationary trend, the Monetary Policy Committee (MPC) voted to a hawkish stance by raising the monetary policy rate (MPR) yet again by 100 basis points to **14.00%**. Meanwhile, all other policy parameters held constant were:

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

The decision was made based on the outcome of a poll where six (6) members supported a 100 basis points increase in the MPR. Three (3) members voted to raise the MPR by 50 basis points while one (1) member each voted to raise the MPR by 75 basis points and 150 basis points, respectively.

The Committee's Considerations

Global Economy

The MPC closely assessed the impact of the extended Russia – Ukraine crisis which led to supply blockages of essential input materials. The impositions of sanctions by global economies in protest of the war have tightened global supply and led to increase in commodity prices especially energy prices. The Committee also considered supply chain disruptions induced by the lingering COVID-19 pandemic.

The Committee highlighted these factors as the underlying drivers of record-breaking inflationary levels seen across various global economies. Hence the aggressive policy stance by global central banks with the sole aim of taming inflation and the unintended consequence of rising public debts.

Domestic Economy

The Committee highlighted that external shocks from the global economy reflected in the macroeconomic variables of the domestic economy. The Committee considered that despite its decision to raise the policy rate (MPR) by 150 basis points in May 2022, inflationary pressures continued to rise precipitously. The Committee attributed the inflation pressures to legacy issues including heightened level of insecurity, higher energy cost, and the impact of the Russia-Ukraine war on key input materials.

Furthermore, the Committee noted improvements in the domestic economy, with reference to the Purchasing Managers' Index (PMI) which stood at 50.90 points in June 2022, above the 50.00 points threshold. However, the MPC noted that June 2022's PMI was a decline from 53.90 points recorded in May 2022 due to similar external shocks previously mentioned.



The Committee's Decision

While suggesting that the inflationary trend is both demand and supply driven, the Committee felt that different policy approaches were required in carrying out its constitutional mandate. The MPC argued that the demand side factors were being addressed by the CBN through relevant direct and indirect policy instruments. Concerning the supply side constraints, the MPC urged the commercial and deposit money banks to utilise the development financing provided by the CBN.

The Committee also sought the support of the Federal Government to seek a long-standing solutions to insecurity, transportation challenges and as well implement fiscal policies that are in line with the Central Bank's policies.

The MPC were unanimously against both tightening and holding stances as the approaches in addressing the current macroeconomic challenges. The Committee argued that a loosening policy could dampen market rates, worsen liquidity, and further weaken exchange rates. On the other hand, holding the rates may suggest that the Committee was irresponsible to current economic realities. Hence, the MPC decided to take a more aggressive stance to effectively combat the inflationary pressures to avoid significant erosion of household purchasing power and narrow the widening negative real interest rates to protect savers.

Other considerations of the MPC to tighten rates include to moderate the speed of capital flow reversal and keep exchange rate stable, provide incentive for capital inflows and sustain remittance to the external reserve. Additionally, the MPC feels that tightening would improve market sentiment and investor confidence.

Potential Implications for the Financial Markets

Fixed Income

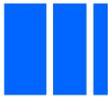
We expect to see an immediate repricing of yields in the fixed income. As things stand currently, the real return in the fixed income market is negative, which is unfavourable to savers. Therefore, we expect yields in the money market and treasury bills market to respond to the rate hike announcement.

Equities

On a year-to-date basis, the equities has gained by 22%. We expect the return to moderate in the near term, based on expectations that investors, especially the domestic institutional investors, would reallocate capital to earn higher yields in the fixed income market. Also, the pass-through effect of higher rates in the form of borrowing costs for households (which will dampen consumption) and firms (which will dampen bottomline) has a negative impact on stocks. Lastly, a higher discount rate to value cash flows of corporates will result in a decline in equities valuation.

Foreign Exchange

We do not expect the Committee's decision to have any material impact on the foreign exchange market. In the near term, we still expect pressures in the foreign exchange rate market, especially in the parallel markets. In our view, it might require more definitive policy to attract capital inflows into the economy.



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- Buy Rating: estimated fair value is $\geq 15\%$ above current market price.
- Hold Rating: estimated change in price is between -10% and 15% of current market price.
- Sell Rating: estimated change in price is $\leq -10\%$ of current market price.

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