

MPC FURTHER HIKES RATES TO 15.50%



... Hike aimed at reining in inflation, stemming naira slump

September 28, 2022

Economic Report

Highlights

The Monetary Policy Committee unanimously voted to increase the monetary policy rate (MPC) to 15.50% from 14.00%, being the third hawkish move in 2022 by the apex bank.

The MPC had increased the interest rate from 11.50% to 14.00% over its two previous meetings, however, with the inflation rate still spiking above 20%, the CBN further raised the rate to 15.50% to combat the rising cost of goods and services

The decision to hike was based on the outcome of a poll where ten (10) members supported a 150 basis points increase. One (1) member voted to raise the MPR by 100 basis points while one (1) member voted to raise the MPR by 50 basis points respectively.

Highlights of the committee's decision

1. MPR raised by 150bps from 14.00% to 15.50%.
2. Asymmetric corridor of +100/-700bps was retained.
3. CRR was raised to a minimum of 32.50% from 27.50%.
4. Liquidity Ratio unchanged at 30%.

The Committee's Considerations

Global Economy

The Committee expressed concerns about the spill-over of the global economy weakening, attributed to geopolitical uncertainties, continued lockdown in China, and global supply chain bottlenecks. Global trade took a hit and inflationary pressures remained unabated across the global economy, despite rate hikes by several central banks across the globe.

A tightening financial market conditions and a global recession will be damaging for the emerging and developing markets which are confronted with capital flow reversals and exchange rate instability.

Domestic Economy

The Committee noted the Q2 2022 GDP growth of 3.54% year-on-year, representing the seventh consecutive output expansion since the exit from recession in Q4 2020. The Committee attributed the steady output trend to continuous policy interventions, as well as credit expansion to the private sector

However, recent data indicate that the economy is weakening. The Purchasing Managers' Index (PMI) in August 2022 declined to 47.20 index points (a contraction). A decline in production and inventory levels, higher unemployment - induced by the existing shocks from the global economy, accounted for the contraction. Nonetheless, the Committee was optimistic of a sustained economic growth in the short-to-medium-term, given the policy supports by both the monetary and fiscal policies.



The Committee's Decision

Consequent to the persistent inflationary pressure, the Committee was left with no other choice but to aggressively tighten. The most recent inflation data (for August 2022) revealed that the general price level (i.e., inflation) increased by 20.52%. Given the primacy of its price stability mandate, the need to rein-in inflationary pressures was necessary. According to the Committee, the previous two hikes reflected in the slowing growth rate of money supply. Therefore, an additional hike would help consolidate the objective of absorbing liquidity in the economy.

The hawkish stance of the Committee is also expected to address the persistent pressures in the foreign exchange market. In our view, we believe that investors lost confidence in holding Naira assets as a store of value due to heightened inflationary pressure over the past months and the resulting erosion of purchasing power. Hence, investors demanded for the USD to preserve capital. Therefore, the Committee could expect its rate hike decision to help reduce the negative real return on Naira assets, and by extension, the demand pressure on the USD.

Potential Implications for the Financial Markets

We expect yields in the fixed income market to reprice aggressively based on not just the rate hike decision, but also the body language of the Committee. As indicated by the extra lever of raising the Cash Reserve Requirement Ratio (CRR), the Committee is on full throttle to its tightening stance.

Thus far in H2 2022, the equities market is on a 5.13% price decline, a reverse from the 21.31% price gain in H1 2022. The bearish trend in H2 2022 is due to the upward trend of fixed income yields which raised the opportunity costs of holding stocks. In view of the policy rate hike, we expect to see a further dip in prices in the equities market.

What Investors Should be Doing?

As expressed in our mid-year outlook, we believe that shortening duration is the optimal investing decision in a rising interest rate environment. This means that investors should focus more on short-term financial instruments. We note that investors are dynamic with different investment objectives. We classify investors as:

i. **Asset-only**: invests for wealth accumulation and long-term capital preservation. For this type of investor, the horizon is typically long, and the aim is to achieve the greatest return relative to risks and volatility. This type of investor could select names in the equities market with positive cash flow and strong fundamentals.



ii. **Liability-driven:** invests based on her stream of liabilities to fund. This type of investor requires to maximise returns to fund her liabilities. In our view, the bearish trend of the equities market is not favourable for this type of investor. Hence, we suggest that this type of investor should focus on the short end of the fixed income market (i.e., fixed term deposits, NTBs etc).

iii. **Goal-based:** invests in view of achieving stated goals. Investors with short-term goals could consider short-term fixed income instruments while longer-term investors could consider stocks with strong fundamentals and economic moat.



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Investment Recommendation

WSTC uses a 3-tier recommendation system for stocks under coverage: Buy, Hold, and Sell.

- 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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