Analyst's Note on: February MPC Meeting – February 2024

CBN on Inflation-Targeting Mode with Aggressive Rate Hike by 400bps to 22.75%......

.... A Trade-off Between Growth and Price Stability

The Monetary Policy Committee (MPC), in its first meeting under the new management of the Central Bank of Nigeria (CBN), and Yemi Cardoso, the new CBN Governor, took to a more aggressive tone in its rate hike, adopting the inflation-targeting framework by raising the MPR by 400 basis points to 22.75% from 18.75%. This move aligns with the earlier expectations for increase in the benchmark interest rate and marks the ninth consecutive meeting since May 2022, during which the committee has adopted a hawkish stance to clip the wings of rising inflation.

It is worth noting that the decision for aggressive tightening by the committee was unanimous while members consider the decision as a the trade-off between output growth and maintaining price stability in the short to medium term. Also, committee noted that option to either hike or hold was premised on previous hikes which has shown a slow rate of inflation acceleration as well as the impact from various reforms within the past months such as the unification of the foreign exchange market; the adoption of the willing buyer; willing seller model within the foregin exchange market; the strengthening of surveillance and guidance in the banking system on the reveluation of foreign exchange gains; the introduction of a two-way quote system in the fx market as part of efforts to encourage price discovery and clip the wings of speculators, among others.

Key Monetary Policy Indicators

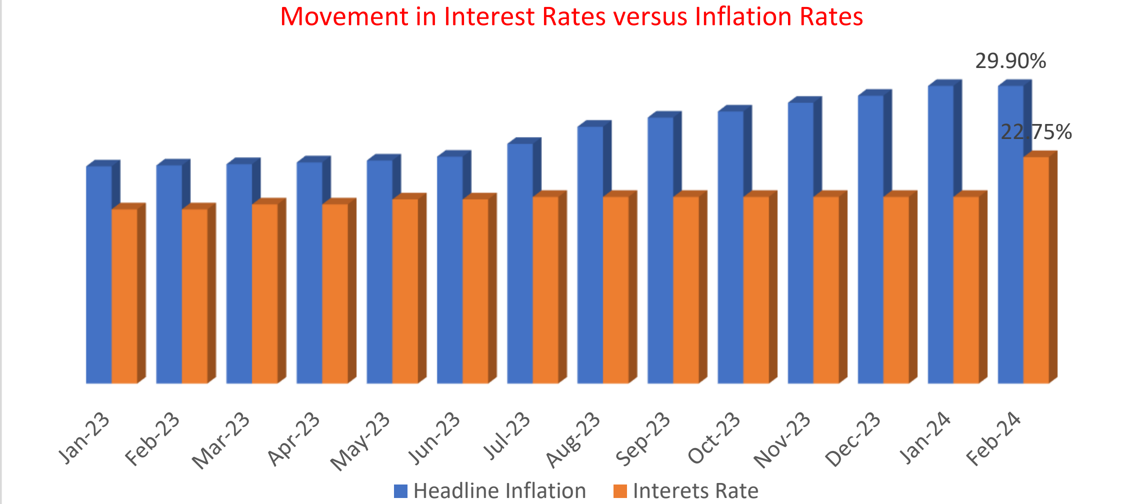
Indicator	Current	Previous
MPR	22.75%	18.75%
Asymmetric Corridor	+100bps /-700bps	+100bps/-300bps
Cash Reserves Ratio	45.00%	32.50%
Liquidity Ratio	30.00%	30.00%

Source: CBN, Cowry Research

The market as well as Cowry Research's expectations had been for a material increase in the benchmark rate at above 20%, as a measure to curb inflation, despite recognizing that many inflationary pressures are beyond the scope of monetary policy. Nevertheless, the committee's choice to raise rates was influenced by ongoing global and domestic economic uncertainties, elevated general price levels, and the need to find a dove landing for economic growth.

In contrast to some advanced economies experiencing a downward trajectory in inflation, Nigeria's headline inflation took a faster foot of athleticism to a 28-year high of 29.90% in January 2024 on the back of insecurity challenges, supply chain disruptions, removal of subsidy on PMS and the pass-through effect of naira devaluation. This reflects a sustained build-up of inflationary momentum, with price increases observed in various divisions, including food and non-alcoholic beverages, housing, transportation, and others.

The decision to implement an aggressive rate hike indicates the committee's commitment to addressing inflation concerns amid the heightened outlook. By this model of inflation-targeting, the committee aims to demonstrate that the current policy is effectively curbing rising



Source: CBN, NBS, Cowry Research

inflation, discouraging excessive aggregate demand in the face of declining output growth, and narrowing the negative real interest rate gap.

Furthermore, the decision was based on expectations of liquidity injections into the economy from recent policy developments and their potential impact on inflation. Consequently, all members agreed to adjust the asymmetric corridor around the MPR to +100/-700 from +100/-300 basis points while expanding the Cash Reserve Ratio (CRR) to 45.00% from 32.5% and maintaining the Liquidity Ratio at 30%, respectively.

Several factors continue to pose downside risks to output growth and present significant challenges to the policy environment. These include the uncertain overall outlook for domestic and global economic recovery, geopolitical tensions such as the war in Ukraine, slow recovery of the Chinese economy, and ongoing uncertainties in trade flows due to the bricsification process. Additionally, insecurity in farming communities, high prices of petroleum and other energy products, as well as foreign exchange market pressures, add to the complexity of the current economic situation.

In 2023, the economic narrative unfolded with a strategic adjustment in monetary policy, as evidenced by the Monetary Policy Committee's (MPC) decision to incrementally raise interest rates by 225 basis points over a 7-month span, culminating in a July 2023 rate of 18.75%. This measured approach marked a departure from the preceding fiscal year's more aggressive 500 basis points hike. Noteworthy was the astute foresight outlined in our FY2023 Outlook, accurately predicting that an excessively stringent stance by the Central Bank of Nigeria (CBN) could precipitate a liquidity crunch due to additional regulatory requirements, all part of a broader strategy to curtail inflationary pressures.

As we navigate the landscape to shape our FY2024 outlook, delves into the intricacies of economic growth and inflation expectations for the upcoming year. This analysis is thoughtfully juxtaposed against the anticipated policy actions of global central banks. In our projections, we anticipate an upswing in inflation attributed to the removal of the Petroleum Motor Spirit (PMS) subsidy. Additionally, there is a compelling need for the central bank to fortify its credibility following earlier forward guidance.

Despite expectations for the monetary policy committee to pedal aggressively on the pace of interest rate hikes in H1-2024, we think the policy committee is poised to attentively monitor potential inflection points in inflation throughout the first six months period. Thus, we expect interest rate hike by 750bps by H1:2024.

While this proactive approach is geared towards addressing potential inflationary pressures, it's crucial to remain mindful of potential drawbacks. The rate hike has the potential to pose challenges for businesses seeking to borrow money, potentially slowing output growth and raising the unemployment rate. As part of efforts to manage excess liquidity in the system and curb inflation, we anticipate a further tightening of liquidity in the financial system.

Turning our attention to the implications for the financial sector, we foresee banks benefiting from the high-interest rate environment. This is expected to result in improved net interest margins due to higher asset yields. However, this could be accompanied by an increase in credit impairments and an acceleration in non-performing loan growth as banks tighten their risk management frameworks. Additionally, investors holding assets sensitive to interest rate variations, such as treasury bills and bonds, are likely to experience increased yields based on liquidity conditions in the system.