Macroeconomic Update: Monetary Policy Rate (MPR)

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CERTARI / ASSET MANAGEMENT

CBN Maintains Tight Monetary Policy Stance

In a bid to fight inflation, Nigeria's Central Bank significantly raised its key interest rate (MPR) for the tenth consecutive time. The Monetary Policy Committee (MPC) increased the MPR by **200 basis points (bps)** to a record high of 24.75% at its meeting on March 26th, 2024.

This move aims to curb inflation by making borrowing more expensive. Additionally, the MPC adjusted the symmetric corridor around the MPR to **+100/-300 bps**. However, other parameters like the cash reserve ratio (45%) and liquidity ratio (30%) remained unchanged.

Macroeconomic implications

- **Bond Market Fluctuations:** The February rate hike initially pushed treasury bill yields higher (**107.7 basis points on average**). However, the March 11th auction saw a reversal, with yields dropping **79 basis points.** We expect renewed volatility as companies grapple with higher borrowing costs.

- **Corporate Challenges:** Increased borrowing costs (due to higher rates) will strain companies, especially in consumer goods. For example, Nestle faces rising finance costs after the naira devaluation, further impacted by the rate hike. Access to debt markets will also be tougher, with A-rated companies already issuing commercial paper at much higher rates (19% in March 2024 vs. 12.4% in July 2023). This rapid rate increase risks slowing down private sector investment and economic growth in 2024.

- **Potential Benefits:** The upside is attracting foreign investment. Similar to the post-February MPC meeting auction, higher rates could entice foreign portfolio investors.

- **Curbing Inflation & Strengthening Naira:** The tighter monetary policy aims to control inflation and support the naira. Our forecasts predict a decline in inflation to 25.79% by December 2024 (due to base effects) and a strengthening naira (₦1,315.78/$ by Q2 2024 and ₦1,173.3/$ by Q4 2024).

- **Lower Currency Risk & Business Benefits:** We expect a decrease in currency risk as the naira appreciates and stabilizes. While companies face higher borrowing costs initially, a stronger naira could help consumer goods companies recover from 2024 losses and potentially reduce input costs.

Nigeria's Central Bank Prioritizes Long-Term Growth with Hawkish Stance

Nigeria's Central Bank (CBN) is adopting a resolute approach to combat inflation, implementing a series of interest rate hikes despite potential short-term drawbacks for businesses. This strategically hawkish stance prioritizes long-term economic growth by fostering a more attractive environment for foreign investors. The CBN anticipates further rate increases, aiming for a 26-27% range by mid-2024. This targeted tightening aims to bolster the credibility and consistency of Nigeria's monetary policy framework and exchange rate management, laying the groundwork for sustained economic expansion.

Fiscal reforms play a crucial role in ensuring the success of this strategy. Steers, a leading financial analysis firm, underscores the importance of implementing prudent fiscal policies, including revenue diversification and expenditure control measures, to reduce the nation's budget deficit. Additionally, comprehensive reforms addressing food security and inflation are paramount to boosting productivity and attracting foreign direct investment (FDI).