ANCHORIA ASSET MANAGEMENT

Post-MPC Note: MPC Delivers Another Rate Hike…Hikes MPR to 14.00%

The CBN's Monetary Policy Committee (MPC) concluded its fourth meeting of the year yesterday July 19th, 2022. In a not so surprising turn of events, the benchmark interest rate was increased by 1.00% to 14.00%, following a decision by eleven members of the committee to hike rates. This decision came after a 1.50% rate hike in May and the committee hinted on a further hike if inflationary pressures persist. The committee however maintained all other policy parameters; the Cash Reserve Ratio (CRR) at 27.50%, the Liquidity Ratio at 30.00%, and the Asymmetric corridor at +100bps and -700bps around the MPR.

Reasons for MPR Hike

- Headline inflation has reached a 5-year peak at 18.60%, significantly eroding the purchasing power of consumers. The committee felt that its primary objective of price stability needed to take precedence as the 1.50% rate increase in May had not sufficiently permeated the economy to curb the excessive inflation.
- Given that inflation remains well above the yield on fixed income assets, the real return to investors has firmed up in the negative territory. Hence, the committee noted that a further rate hike will narrow the negative real rate of return gap.
- The committee stated that the other complementary administrative measures deployed by the Central Bank to address the growth in money supply did not moderate the inflationary trend. Among these additional administrative procedures are discretionary CRR debits and sales of government securities like T-bills and Bonds under repurchase agreements.
- Soaring global commodity prices due to pent-up demand and the prolonged war between Russia and Ukraine.

Implications

- ❖ The rate hike implies that the rate at which the CBN loans money to banks through the Standing Lending Facility (SLF) will increase by 100bps (14% to 15%). This translates to higher interest rate on loans without a fixed rate agreement clause, thus resulting in higher borrowing costs for households and businesses. Although, the committee advised banks to tap into their development finance tools to support key sectors like the manufacturing and agricultural sectors.
- ❖ Banks are expected to reap the benefits of a higher rate as interest income, which is the major revenue driver for banks would be boosted by the increased yield on fixed income instruments and higher interest rates on loans. This will cover up for the expected drop in income from fixed income securities due to the resumption of taxes on some fixed income instruments by the Federal Government.
- ❖ The minimum interest rate on savings accounts is expected to rise to 1.40% (given that the interest on savings deposit is pegged at 10% per annum of the MPR).
- ❖ The rate hike is not expected to moderate inflationary pressures, which is largely affected by supply side constraints as well as some structural deficiencies. These factors include weak infrastructure, FX illiquidity, ongoing insecurity and banditry attacks in food producing states, and higher prices of petroleum products like PMS and Diesel. We expect inflation should reach 19.67% by the end of July.

How Should Investors Position?

Fixed Income Mutual Fund: *The hike in MPR implies that the rates on interest-bearing instruments like bank placements, commercial papers, and long-term government securities should trend higher. This sets the stage for a higher return on money market and fixed income mutual funds, which have significant allocations to these instruments. In addition, compared to a regular savings account, mutual funds typically offer a much higher return.*

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