March 27, 2024

Berkshire Market Briefs

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CBN Maintains its Hawkish Stance

The Monetary Policy Committee (MPC) concluded its two-day meeting yesterday and as widely expected, the committee maintained its hawkish monetary policy stance, raising the monetary policy rate by 200 basis points to 24.75%. This brings the cumulative rate hikes in the last 10 meetings to 1,325 basis points. The committee also narrowed the asymmetric corridor around the MPR from +100/-700 basis points to +100/-300 basis points and increased the Cash Reserve Ratio for merchant banks from 10% to 14% while retaining the Cash Reserve ratio for commercial banks at 45% and liquidity ratio at 30%. The adjustment in the asymmetric corridor around the MPR means that the Standing Deposit Facility (SDF), which is the rate at which the Deposit Money Banks (DMBs) keep funds with the CBN will increase from 15.75% to 21.75% while the Standing Lending Facility (SLF), which is the rate at which the CBN gives funds to the DMBs will increase from 23.75% to 25.75%.

What is the Rationale for the Rate Hike?

At the meeting, the CBN reiterated its commitment to prioritizing its core mandate of price and exchange rate stability. Therefore, the decision to raise interest rates was driven by the current inflation spiral (with headline inflation hitting a 28-year high of 31.7%) and the necessity to anchor inflation expectations while ensuring sustained exchange rate stability. Remarkably, the currency has appreciated by more than 30% in the past five weeks at the parallel market, following the CBN's foreign exchange (FX) reforms. These reforms have bolstered foreign portfolio investment and increased Diaspora remittances through the official channels. Diaspora remittances surged to $1.3 billion in February from $300 million in January and over 70% of participants in Open Market Operations (OMO) and Treasury bills were foreign investors.

How will the Rate Hike Impact You?

The CBN's hawkish monetary policy stance has significant implications for different players in the economy.

Economic Agents	Positive impact	Negative impact
Economy	▪ The hike in interest rates is expected to reduce forex demand (due to reduced Naira liquidity) and increase dollar inflows ▪ Leading to an appreciation in the value of the currency and a reduction in imported inflation	▪ Higher cost of borrowing ▪ Possible crowding-out effect of the private sector

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Economic Agents	Positive impact	Negative impact
	▪ Higher interest rates will also increase the marginal propensity to save, reducing liquidity and leading to a moderation in inflation in the near term	
Government	▪ Service cost of external debts to reduce ▪ Cost of importing equipment for infrastructural development to reduce	▪ Effective interest rates (t/bills, etc.) are expected to move in tandem with the MPR ▪ Pushing up the cost of domestic debt for the government
Businesses/ Corporates	▪ Cost of imports and dollar obligations to reduce as the exchange rate appreciates ▪ Possible increase in corporate and business margins	▪ Lending rates to increase, pushing up borrowing costs ▪ Possible crowd out of private investment
Investors	▪ Higher interest rates to push up the yield on fixed-income securities	▪ Stock market performance likely to be bearish as interest rates remain elevated
Consumers	▪ Commodity prices likely to fall as imported inflation reduces	▪ Increased lending rate to reduce retail borrowing ▪ Could reduce consumption expenditure

What is the Policy Outlook?

The MPC will convene again on May 20/21, and its decision will largely depend on economic indicators and prevailing market conditions. The NBS will release the Inflation figures for March and April before the meeting. We expect inflation to maintain its upward trend but increase at a slower pace as the exchange rate appreciates in the near term.

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