Berkshire Finance Company Limited

Research & Insights

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Berkshire Market Briefs

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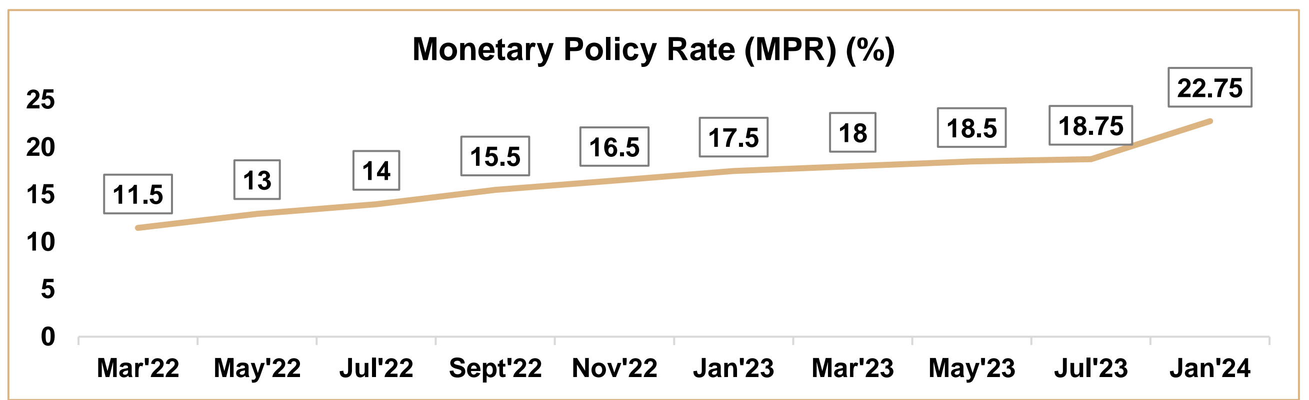
MPC maintains its aggressive monetary tightening, raised the MPR by 400bps

In line with market expectations, the MPC at its inaugural meeting in 2024, maintained its hawkish monetary policy stance, aggressively increasing the monetary policy rate (MPR) by a whooping 400 basis points to 22.75% from 18.75%. This is the biggest rate hike since the MPC began its tightening cycle in May 2022.

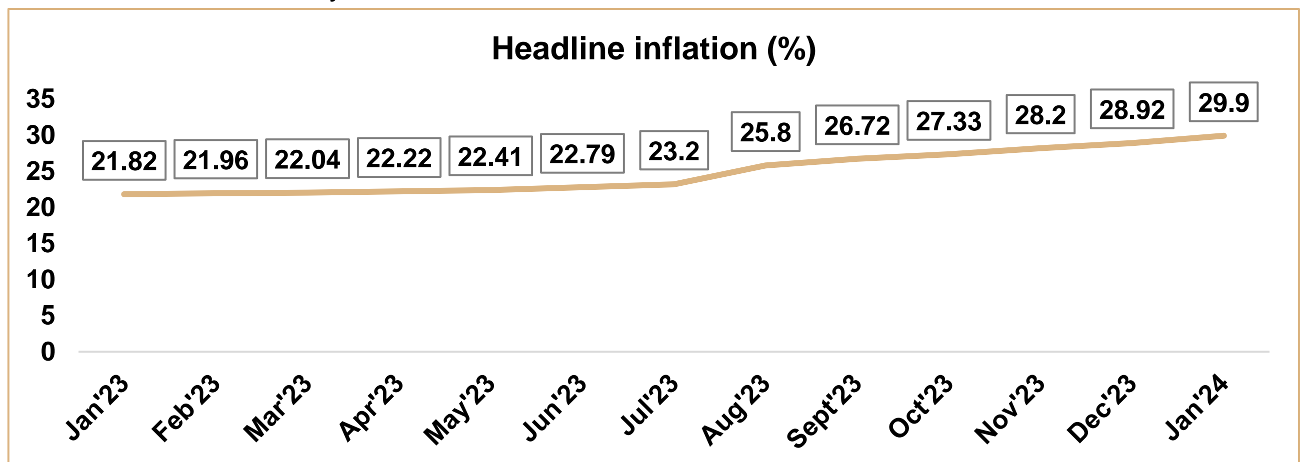


CBN, Berkshire Finance Company Limited

Additionally, the committee increased the cash reserve ratio (CRR) from 23.5% to 45% and adjusted the asymmetric corridor around the MPR to +100/-700 basis points from +100/-300 basis points, while keeping the liquidity ratio unchanged at 30%. This adjustment in the asymmetric corridor implies that the Central Bank of Nigeria (CBN) will lend funds to Deposit Money Banks (DMBs) at a rate of 23.75% (MPR plus 100 basis points), while DMBs will keep funds with the CBN at a rate of 15.75% (MPR minus 700 basis point).

What is the rationale for the policy decision?

The aggressive monetary tightening underscores the committee's dedication and commitment to curbing inflation and addressing the imbalances in the foreign exchange market. It's worth mentioning that Nigeria's headline inflation reached a 28-year peak of 29.9% in January 2024 and is expected to stay elevated in the short term because of both structural and monetary factors.



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The exchange rate has also been on a free-fall due to limited forex supply and increased speculative activities. At the parallel market, the Naira crossed the N1,900/$ threshold before rebounding towards N1,600/$ following the series of circulars and guidelines released by the CBN, including the reform of the BDC segment, removal of limits and margins for IMTO, etc.

Can the CBN’s aggressive monetary tightening do the trick?

Undoubtedly, the hike in the MPR and other monetary parameters is poised to reduce liquidity within the system. The growth in money supply has consistently fuelled inflationary pressures in Nigeria. In January 2024, broad money supply (M3) surged by 76.36% (year-on-year) to N93.72 trillion, while output growth remained subpar at 3.46% in Q4’23, indicating an imbalance of excessive money supply relative to available goods—a situation commonly known as "too much money chasing fewer goods." Despite these measures, the immediate impact of monetary policy on curbing inflation is expected to be constrained by persistent structural obstacles. Consequently, inflation is expected to maintain its upward trend in the short term, albeit increasing at a slower rate. Nevertheless, as monetary authorities collaborate closely with fiscal counterparts to tackle these structural impediments, monetary policies are likely to gain efficacy in mitigating inflation over the medium to long term.

Regarding the exchange rate, the uptick in interest rates is expected to reduce capital flight and bolster inflows of foreign investment. An increase in dollar liquidity, coupled with a potential decrease in demand due to tightened Naira liquidity, is projected to reduce pressure on the currency. However, the enduring stability of the exchange rate hinges significantly on sustained inflows of dollars and coordinated efforts between monetary and fiscal authorities. A promising avenue for long-term dollar inflows lies in non-oil exports, yet this potential has been undermined by heightened insecurity and low infrastructural development.

How will the policy decision affect sectors?

For the interest rate sensitive sectors like the manufacturing, trade, construction among others, the hike in the MPR and other monetary parameters will push up borrowing costs, which could crowd out private investment in the short-term. Relative to 2022, most of these sectors underperformed in 2023.

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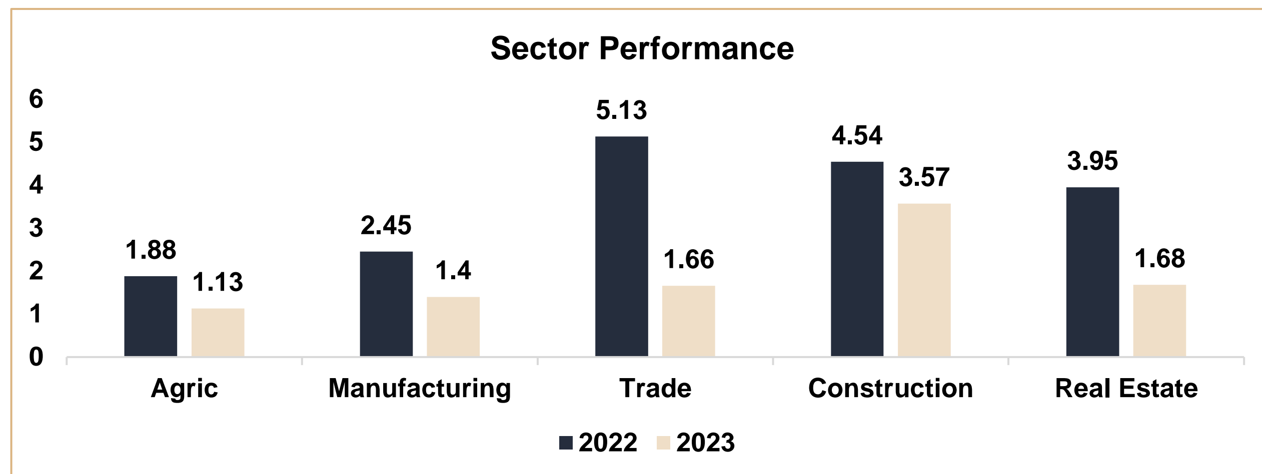

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The good news is that as the exchange rate appreciates, companies that are import dependent will benefit from lower import costs, which is likely to cushion the impact of higher borrowing costs.

For financial institutions, the hike in interest rates is likely to have a positive impact as the interest income on loans is likely to increase faster than the interest expense on deposits. However, the risk of loan default increases as firms struggle in the short-term to stay afloat in a high interest rate environment.

How will the policy decision affect consumers?

As interest rates increase, the marginal propensity to save is expected to rise due to higher return on savings. However, the cost of borrowing for individuals will increase, which is likely to affect aggregate demand.

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