

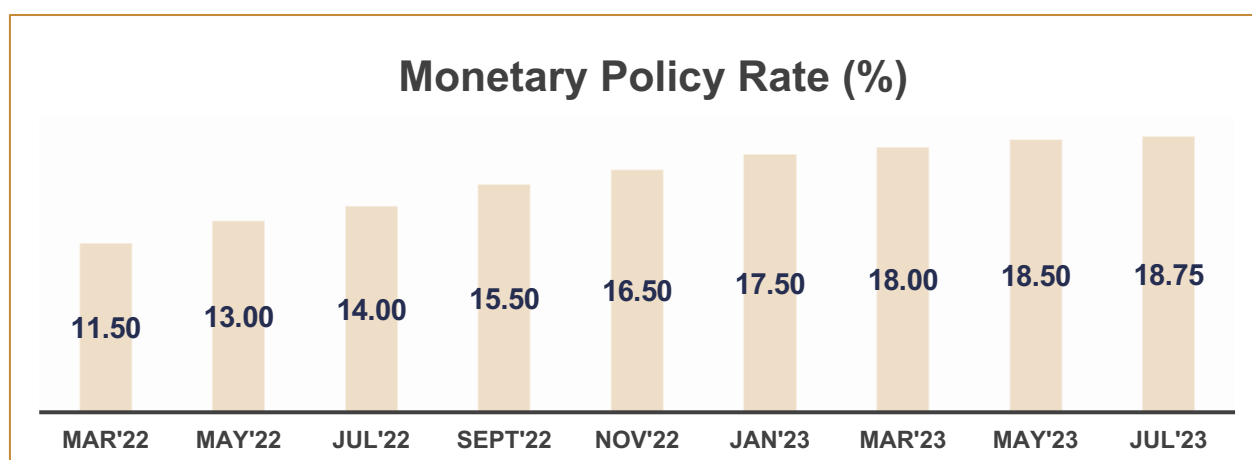


July 26, 2023

Berkshire Market Briefs

MPC raises policy rate by 25bps, adjusts the asymmetric corridor to +100/-300bps

At the recently concluded Monetary Policy Committee (MPC) meeting, MPC increased the monetary policy rate (MPR) by 25 basis points (bps) to 18.75% from 18.5%. This is the 8th consecutive rate hike, with a cumulative increase of 725bps.



Source: Central Bank of Nigeria

The committee also adjusted the asymmetric corridor to +100/-300bps from +100/-700bps around the MPR. This implies that the interest rate on the Standing Lending Facility (SLF), a short-term credit line availed to commercial banks by the CBN will remain at 100bps above the MPR while the interest rate on the Standing Deposit Facility (SDF), an avenue by which commercial banks keep free cash/money with the CBN is now 300bps below the MPR. It is important to note that even though the interest rate on the SLF was left unchanged, the hike in the monetary policy rate (MPR) invariably imply that the CBN will lend money to banks at a higher rate of 19.75% compared to the previous 19.5%. Also, the adjustments in the interest rate on SDF means that commercial banks will now keep money with the CBN at 15.75%, up from 11.5% p.a.

What was the rationale for the policy decision?

The decision to maintain a hawkish monetary policy stance is due to the unrelenting rise in inflation, with the country's headline inflation rate for June 2023 at 22.79%, which is higher than the apex bank's target. More importantly, inflation is likely to remain elevated for a longer period due to the impact of recent policy reforms (petrol subsidy removal and exchange rate convergence).

Another reason for the hike in interest rate is to reduce the negative real returns on investment, which is likely to stem capital flight and boost investment flows. It is believed that the anticipated increase in dollar inflows from the recent policy on foreign exchange market and liquidity mop-up from the hike in MPR, which is believed to reduce forex demand pressures would strengthen the Naira. So far in July, the Naira traded at a band of ₦792/\$ - ₦855/\$ at the I&E window and a band of ₦775/\$ - ₦870/\$ at the parallel market.

How effective is monetary policy in tapering inflation?

The MPC has increased the MPR by a cumulative of 725bps since it began the tightening cycle in May 2022 but inflation has increased by 5.08% to 22.79% from 17.71%. Although, inflation has maintained an upward trajectory, the pace of increase had started slowing before the policy pronouncements on May 29 2023. This suggests that the hike in the MPR had an impact even though marginal.

It is also worthy of note, that there is a time lag between policy pronouncements and impact. For instance, the US Fed increased interest rates ten (10) consecutive times before inflation slowed to 3% in June 2023 from a peak of 9.1% in June 2022.

Author

Funmi Adeyemi

+234 81 3603 0000

www.berkshirefinancecompany.com

Follow us on:





This is also the case in the UK, where the Bank of England had to increase the policy rate thirteen (13) consecutive times to bring down inflation to 7.9% in June 2023 from a peak of 11.1% in October 2022.

With the interest rate hike and adjustment in the asymmetric corridor, we believe that more money will be mopped out of the system, reducing demand for government securities and pushing up effective interest rates.

How will the policy decision affect you?

The monetary policy decision has its pros and cons. On the positive side, it is expected to slow the pace of inflation, reduce the rate of capital flight and keep the Naira relatively stable. It is also expected that effective interest rates will move in tandem with the MPR as excess liquidity is being mopped up. We therefore posit that Treasury bill rates and borrowing costs will likely increase, thus crowding out private investment and slowing the economic growth pace as small and medium enterprises, which are the main drivers of economic development, will pay more to borrow funds required to sustain their businesses.

Follow us on:



© Copyright 2023. Berkshire Finance Company Limited, Gaderik Building, Victoria Island, Lagos, Nigeria. All Rights Reserved. When quoting please cite “Berkshire Market Briefs”.

The above information does not constitute the provision of investment, legal or tax advice. Any views expressed reflect the current views of the author, which do not necessarily correspond to the opinions of Berkshire Finance Company Limited or any of its affiliates. Opinions expressed may change without notice. The above information is provided for informational purposes only and without any obligation, whether contractual or otherwise. No warranty or representation is made as to the correctness, completeness and accuracy of the information given or the assessments made.