Analyst's Note on: Outcome of Latest MPC Meeting – July 2024

CBN Sustains Tightening Measures with 50bps Hike in Anchor Rates to 26.75%......

The July 2024 Monetary Policy Committee (MPC) meeting concluded with members voting for a modest 50 basis point increase in the interest rate, raising it to 26.75%. This decision is part of ongoing efforts to control heightened inflationary pressures and aligns with our expectation of a 50bps increase following the 750bps hike earlier in 2024.

Alongside this rate increase, the committee sought to make deposit placements more attractive by adjusting the asymmetric corridor around the MPR to +500/-100 from +100/-300 basis points. This move aims to further tighten liquidity and discourage banks' reliance on CBN lending. The Cash Reserve Ratio for Deposit Money Banks remains at 45%, and for Merchant Banks at 14%, and the Liquidity Ratio stays unchanged at 30%.

The committee expressed concern about the impact of rising prices on households and businesses and reiterated its commitment to taking necessary measures to control inflation. Despite the June 2024 uptick in headline inflation, the committee remains optimistic that prices will moderate in the near term as monetary policy gains further traction and fiscal measures address food inflation.

The National Bureau of Statistics (NBS) reported that headline inflation rose for the eighteenth consecutive month to 34.19% in June 2024. This slow rate of increase is attributed to the gradual impact of tightening measures and efforts by the MPC and fiscal authorities, despite the removal of fuel subsidies, increased electricity tariffs, higher PMS prices, and the weakening local currency. Drivers of headline inflation included increased prices of housing and utilities, which rose to 30.3% from 29.6%, and beverages and tobacco, which increased to 24.1% from 23.3%. Conversely, prices eased for clothing and footwear, dropping to 16.4% from 16.6%, and recreation and culture, which declined to 9.1% from 9.5%. Transport maintained the same rate of increase at 25.6%.

Food inflation, a significant component of Nigeria's inflation basket, surged to a record high of 40.87% in June 2024, up from 40.66% in May 2024, marking the highest level since 2005. This surge is driven by rising prices of essential food items such as bread, cereals, tubers, fish, and oil, exacerbated by supply-side shocks resulting from security challenges. Core inflation, which excludes volatile agricultural products and energy prices, stood at 27.40% year-on-year in June 2024, up from 20.06% in June 2023. The highest increases were recorded in rents, transportation costs, accommodation services, medical consultation fees, laboratory services, X-ray photography, and pharmaceutical products.

The committee emphasised the urgency of addressing inflationary pressures, particularly persistent food inflation, which undermines price stability. While monetary policy has moderated aggregate demand, rising food and energy costs continue to drive price increases. Insecurity in food-producing areas and high transportation costs for farm produce also contribute to inflation.

To address rising food prices, the committee suggested measures to curb smuggling activities and reduce the food supply deficit in the Nigerian market. The MPC resolved to sustain collaboration with fiscal authorities to subdue inflationary pressures. Recent measures by the Federal Government, such as a 150-day duty-free import window for essential food commodities, aim to moderate domestic food prices without causing further inflation. While these measures are a welcome development and may prove effective in the short term, it is crucial to implement them with a defined exit strategy to avoid reversing recent gains in domestic food production. To support these initiatives, the Bank is engaging with Development Finance institutions like the Bank of Industry (BOI) to ensure adequate support for industries, focusing on Small and Medium Scale Enterprises (SMEs).

Our view on the moderate rate hike to 26.75% hinges on expected CBN activities following the persistent inflation spike in June. The 50bps increase is significant as it allows previous hikes to permeate the economy, aiming to stifle rising inflation. However, the further hike in the MPR may negatively affect real sector players, particularly regarding interest expenses on debt funding. Combined with other headwinds such as inflation pressure and FX volatilities, we expect real output growth to be under pressure for the rest of the year.