

MPC Springs a dovish surprise

The CBN Monetary Policy Committee (MPC) voted to cut the key benchmark interest rate by 50bps to 13.5%, taking the Standing Lending Facility and standing deposit facility to 15.5% and 8.5% respectively. The decision was surprising in that ARM Research and most analysts surveyed by Bloomberg anticipated no change in policy parameters. The MPC also switched its policy stance to ‘easing’ from ‘neutral’, which was a majority decision. What’s more amazing though is the sharp swing in the policy perception within the MPC members. Until yesterday’s meeting, majority of the members expressed caution on exchange rate stability and inflation and advocated for a neutral stance in the last four (4) meetings noting the risk to price and currency stability. Yesterday, 9 out of 11 members voted for a rate cut, though only 6 members voted for a 50bps rate cut.

In the justification for a rate cut, the committee expressed satisfaction with the relative stability in the price level and exchange rate, and thus sought to support growth. Particularly, following the calm outcome of the general election together with the recent resurgence of foreign portfolio investment¹ into the country and continued deceleration in inflation reading, the CBN thought it imperative to signal a new direction.

While recent activities by the apex bank on the OMO leg have signaled a dovish stance of the monetary policy, but a definitive cut of the benchmark rate (which had been rendered ineffective for more than 2 years) was a hard call at our end as the committee’s constant call for caution while expressing the near term risk to price and currency stability suggested a neutral stance for the rest of the year. For context, while recent inflows in the FX market should have necessitated an appreciation in the naira, the CBN continues to opt for prolonged stability.

FX and Price Stability provided the headroom

After a tumultuous end in 2018 following spate of capital repatriation and paucity of flows, the foreign exchange market took a breather over Q1 2019 with a rebound in foreign portfolio inflows. Total FPI inflow over the period expanded 3x QoQ and 47% YoY to \$7.6 billion (which on average accounts for 88% of total foreign inflows), far higher than total inflows over the second half of 2018. Consequently, the intervention by the CBN shrank to \$1.2 billion compared \$3.6 billion in Q4 18, with a slight depletion in the external reserve by \$540 million in Q1 19 (\$2.9 billion in Q4 18).

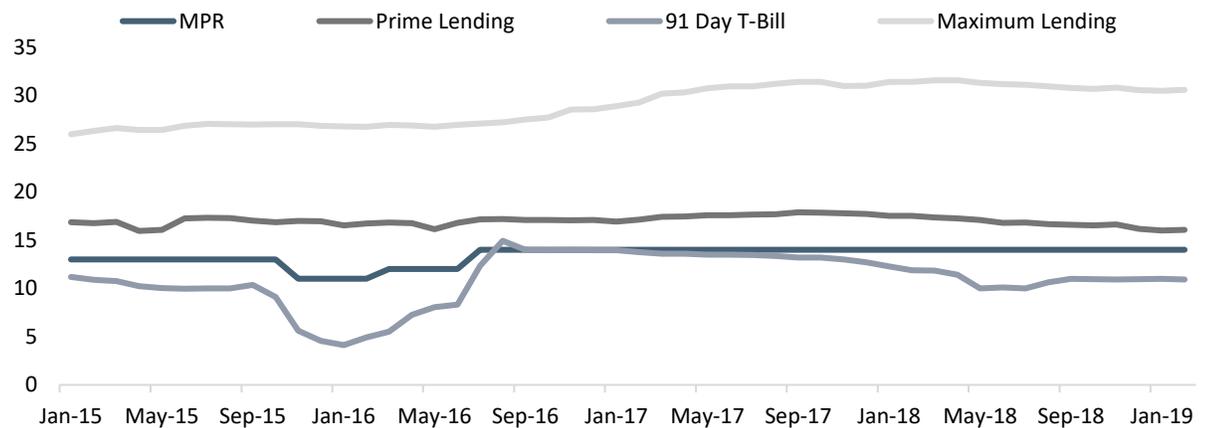
¹ Foreign inflow to the IEW reached a record high of \$3.7 billion in February

On consumer prices, we have seen relative improvement in the first two months of 2019 with inflation rate moderating by 7bps MoM, relative to an average increase of 9bps over the last two months in 2018. Clearly, the downtrend in energy and food prices played a major role in driving the moderation observed thus far.

Will the cut really support growth?

Although the MPC anchored its decision on the need to support growth by way of encouraging credit flow to the productive sectors of the economy, we hold a different view on the impact on bank lending. Our view is based on the inelastic nature of bank's lending rate to the benchmark rate. For context, despite MPR staying unchanged over the past two years, we have seen DMBs reprice their loan rates according to prevailing fixed income yields. Furthermore, a 50-bps cut to the average prime lending rate (16.05%) appears insignificant. We reckon that for the MPR to drive growth as anticipated by the MPC, the CBN will have to do more in lowering the OMO rates with a transmission into effective yields on other treasury assets. As such, if the MPC really follows through on its second mandate of supporting growth, we do not rule out the possibility of a further cut in the near term and a faster cut in subsequent OMO rates.

Figure 1: Historical MPR and Lending rate divergence



Source: CBN, ARM Research

What is the signal for OMO?

In the near term, cross examination of various interlocking variables that anchors CBN's monetary policy direction suggests that there exist room for moderation in OMO rates. For context, barring fresh shocks to the core and food basket from a possible hike in PMS price, Nigeria's headline inflation seems to be on a downward spiral over 2019. With the steady flows at the IEW, at least before upsurge in maturity and possible reversal toward the end of the year, the case for naira stability remain strong. As such, the possibility of further cuts in OMO rates appears justified. However, we expect effective yield on OMO to bottom out at 14.2% (with a stop rate of ~12.4% for the one-year OMO bill) as further reduction to OMO rates would appear unattractive for foreign investors. Our view is premised on inflation differentials between Nigeria and US, credit default swap as well as alternative US return forgone.

Post the lower maturity era (April – August), we believe the apex bank will grapple with spate of repatriations, as we believe current yields will not be enough to induce reinvestment of maturing funds. As a result, we see a slight upward adjustment to the OMO rate to avoid a repeat of the spate of outflows in H2 2018.

Signal for financial Assets

Our view of further temperance in OMO rates provides room for lower NTB yields over the near term (60-100bps). This sits well with FG's quest of reducing its cost of debt service. Corroborating this with FG's recent apathy for short term debt which is reflective of its decision to at best rollover short term debts further entrenches this view. However, at the long end, while the pass-through effect of a loose monetary policy paves way for further downslide in bond yields, FG's preference for long end debt places a lid on yield downtrend at the long end. More so, the higher Bond Maturity this year (N585 billion) and increased borrowings following the implementation of the 2019 budget, provides leeway for higher paper supply which weakens FG's bargaining power at subsequent bond auctions. Thus, we only expect a tamer (30-50bps) reduction in bond yields over 2019.

For the equities market, we believe further moderation in yields across treasury assets, is positive for equities given the recent depression in prices. Beyond price depression, relative to Sub-Saharan Africa peers, current valuation places Nigeria equities at an undeserving discount to peers.

Table 1: Expected total return across coverage

	FY 19 Dividend	Current Price (₦)	FY 19 Div yield	FVE (₦)	Upside/Downside
NB	2.58	67.0	3.9%	75.8	13.2%
Guinness	2.00	64.0	3.1%	77.3	20.8%
Okomu	2.60	79.0	3.3%	97.8	23.7%
Presco	1.13	64.5	1.8%	67.5	4.6%
UBA	0.96	7.8	12.4%	13.0	68.3%
Guaranty	2.82	37.4	7.5%	49.7	32.8%
Zenith	2.96	21.7	13.6%	38.2	75.9%
FBNH	0.34	8.3	4.1%	10.1	22.7%
FCMB	0.10	1.9	5.2%	2.34	20.6%
Fidelity	0.21	2.3	9.2%	2.92	28.1%
Unilever	0.72	39.0	1.8%	49.19	26.1%
Dangsga	0.93	14.1	6.6%	14.44	2.4%
Nestle	65.58	1497.9	4.4%	1,287.54	-14.0%
PZ	0.32	10.2	3.1%	10.12	-0.8%

Source: Bloomberg, ARM Research

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