JOHANNESBURG/LONDON, Feb 28 (Reuters) - Investors cautiously welcomed Nigeria's long-awaited interest rate hike, but warned that the central bank must tighten monetary policy more in order to attract investment and tame soaring inflation and a plummeting currency.
The 4 percentage point hike, to 22.75% (NGCBIR=ECI), opens new tab, was the largest in absolute terms in around 17 years and the first since new Central Bank Governor Olayemi Cardoso took office in September.
The central bank also raised banks' cash reserve ratio from 32.5% to 45%, in a bid to reduce liquidity in the economy.
Investors said the rate hike was a long-awaited step to address an economic crisis that has deepened in Africa's most populous nation since President Bola Tinubu took office in May last year.
Real interest rates remain deeply negative, though, with inflation having rocketed to a three-decade high, close to 30%.
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"We've been holding our breath a little too long after the elections and the central bank governor change, but the decision on the rate hike and accompanying changes gave a reason to be slightly more optimistic about what's to come," said Emre Akcakmak, head of frontier markets at asset manager East Capital.
He said that the bank - and the government - had a long path ahead after "long years of stagnation" under the previous administration, which led to exclusion from some bond indexes.
A string of African countries is still hiking interest rates to tame inflation, even as emerging markets elsewhere, which hiked earlier, have begun easing cycles.
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Nigeria's path has also been politically fraught. Tinubu fired the previous central bank chief, Godwin Emefiele, who now faces fraud charges levelled by the government.
The administration is also working to quell public anger at spiralling food prices, the removal last year of most petrol subsidies and a naira currency that has hit record lows versus the U.S. dollar after two devaluations since June 2023.
Labour unions are protesting this week, opens new tab against the rising cost of living, with many people struggling to feed their families.
CATALYZING INVESTMENT
JPMorgan said it viewed Tuesday's hike as a first step at taming inflation, which could remain "sticky above 30% over the next few months before some disinflation" during the second half of the year.
"We think the CBN is likely to sustain these interventions in the short term with the hope that recent monetary actions will help catalyze some foreign portfolio investments and improve FX liquidity," JPMorgan's Gbolahan Taiwo said in a note.
The CBN changes were welcome but more monetary policy tightening is still needed to boost foreign investment, said Yvette Babb, a portfolio manager at William Blair Investment Management.
"Clearing the pockets of USD backlogs and keeping rates elevated amidst the inflationary environment in Nigeria will, in our view, be essential to attracting inflows," she said.
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But the changes so far could already get more cash into the country.
The interest rate hike, combined with the naira devaluations, make buying the government's locally issued naira currency debt "a more interesting opportunity," said Kevin Daly, a portfolio manager at abrdn, which owned government naira debt from 2013 to 2016 and 2017 to 2020.
A local debt auction next week will provide more information about how the CBN's action feeds into prices and yields, he said.
"We have another MPC (interest rate decision) at the end of March, so there is potential for further rate hikes, in which case it could pay to be patient at this stage," Daly said, adding, "We might dip our toes in the water."