Will A Rate Cut Stimulate Lending?

A reduction in the Monetary Policy Rate (MPR) without addressing the fundamental issues in the Nigerian economy may not stimulate lending. The Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) will hold its final meeting for the year 2015 between November 23-24, 2015. As usual the MPC will consider the domestic and international economic and financial market conditions and their impacts on the Nigerian economy and the financial market in the short-term. At the end of its September 2015 meeting, the MPC maintained the MPR and the Liquidity Ratio (LR) at 13% and 30% respectively, and lowered the Cash Reserve Requirement (CRR) to 25% from 31%.

A rate cut in Nigeria at the moment will be counter-productive for financial investment and the foreign exchange rate.

The International Monetary Fund (IMF) believes that economic activities in advanced economies will improve further in 2016, while it will weaken in China. The Federal Open Market Committee (FOMC) of the United States (U.S.) Federal Reserve System (The Fed) is widely expected to announce a rate hike in December 2015. This will be the first rate hike after June 29, 2006. In anticipation of the rate hike, the yield on the U.S. Treasury Note has been rising. We expect the yield on other Dollar denominated fixed income securities to increase after the rate hike announcement. This will make funds to move from the emerging markets to the U.S. **A rate cut in Nigeria at the moment is counter-productive for financial investment and the foreign exchange rate.**

According to the National Bureau of Statistics (NBS), the Nigerian economy when measured by the Real Gross Domestic Product (GDP) grew by 2.84% in Q3 2015. The GDP growth is lower than the 6.23% recorded in Q3 2014, but higher than 2.35% recorded in Q2 2015. We believe the slowdown in the economy reflects the drop in the oil price and the security challenges. The political transition and the delay in the payment of workers' salaries also contributed to the slowdown. **We do not think a rate cut will address any of these issues.**

A rate cut at the moment is not consistent with the inflation rate outlook in the short-term.

The inflation rate dropped to 9.3% in October 2015, lower than 9.4% recorded in September 2015. The current inflation rate and our forecast to end the year 2015 is higher than the CBN target of 6-9%. **A rate cut at the moment is not consistent with the inflation rate outlook in the short-term.**

A marginal depreciation in the value of the currency may encourage FPIs.

The short-term outlook for oil prices remains weak and tilted to the downside. The oil price declined further between the last MPC meeting and now, reflecting excess supply and weaker global demand. The expectation of a possible increase in the U.S. Fed rate could put further pressure on the oil price. The Bonny Light price decreased by 10.64% to US$42.67/b on November 20, 2015 from US$47.75/b on September 22, 2015. The current low oil price has adverse impact on the foreign exchange rate. **A rate cut under the current scenario will put additional pressure on the foreign exchange rate.**

We do not expect the MPC to announce a devaluation policy.

A reduction in rate without addressing the fundamental issues in the Nigerian economy will not stimulate lending.

The 30-day moving average external reserves remained relatively stable. It declined by 0.85% between the last MPC meeting and November 20, 2015 from N30.52bn to N30.26bn. It is estimated that the level of the external reserves can finance about 5 months of imports. There is a limit to how long the CBN can defend the value of the currency with the external reserves. **A marginal depreciation in the value of the currency may encourage Foreign Portfolio Investments (FPIs). This will boost the supply of U.S. Dollar in the short-term.**

The value of the Naira faces significant pressure in the short-to-medium term. The value of the Naira at the parallel market depreciated by 2.28% to US$/N237 between the last MPC meeting in September 22, 2015 and November 20, 2015. The value of the Naira at the official and inter-bank market segments closed unchanged at US$/N197 and US$/N199.10 during the same period. **Although we expect the value of the Naira to depreciate further to about US$/N215, we do not expect the MPC to announce a devaluation policy.**

The excess liquidity in the system has depressed the yields on fixed income securities. The average excess liquidity in the system in the last two months is about N700bn. The CBN has not been mopping up liquidity through its Open Market Operation (OMO) in the last two months. The Nigerian banks have also reduced lending because of the unfavourable economic conditions and the fear of loan default. Our analysis shows that the current liquidity in the system will go if banks increase lending by 10%. The gross loans of Nigerian banks stood at about N14trn as at full year 2014. A 10% increase in the gross loans of the banks will lead to a loan creation of about N1.4trn. This will completely take out the excess liquidity from the system. **A reduction in rate without addressing the fundamental issues in the economy may not stimulate lending.**

The current tight monetary policy would be appropriate in view of the challenges the Nigerian economy is facing. Monetary policy has limitations to fully address the negative impacts of the external developments on the Nigerian economy. We therefore expect the MPC to maintain the current monetary policy stance. We also note that there is a need for a marginal depreciation in the value of the Naira to about US$/N215. This should help to increase the supply of foreign exchange from the FPIs in the short-term.

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