Rising Inflation Rate – Will MPC Change Stance?

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We expect the Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) to hold rates when it meets on November 21-22, 2016. The choice between stimulating economic growth and curtailing inflationary pressure will dominate the MPC meeting. The stability in the value of the Naira would also be a concern for the MPC members in deciding the appropriate policy measures. We expect the MPC to continue to use the Open Market Operations (OMO) to manage the liquidity in the financial system and to influence yields on fixed income securities. This will enable the Apex Bank to attract investments, both local and foreign, in order to increase the stock of foreign exchange in the short-term. At the end of its September 2016 meeting, the MPC maintained the Monetary Policy Rate (MPR) at 14%, with the asymmetric corridor at +200 basis points and -700 basis points; retained the Cash Reserve Requirement (CRR) and Liquidity Ratio (LR) at 22.50% and 30% respectively.

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The International Monetary Fund (IMF) recently stated that the current global economic outlook is shaped by a complex confluence of ongoing realignments, long-term trends, and new shocks. This is contained in the IMF World Economic Outlook (WEO), October 2016 edition. According to the IMF, global growth is projected to slow to 3.1% in 2016 before recovering to 3.4% in 2017. This represents a 0.1% downward revision for 2016 and 2017 relative to the WEO Update, April 2016 edition. The IMF expects a more subdued outlook for advanced economies following the U.K. Brexit vote and weaker growth in the United States. **The report indicated that financial market sentiment toward emerging market economies has improved**.

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There are indications that the President-elect in the U.S., Mr. Donald Trump will implement policies that will aggressively increase the U.S. Government spending in the short-term. The increase in government spending with the plan to cut tax will increase fiscal deficit of the U.S. and may increase the inflation rate more than the 2% target. **This will elicit monetary policy response in the form of an increase in the Federal Fund Rate (The Fed Rate) at a faster pace than earlier expected. This may also lead to an increase in global yields and interest rates, which would be negative for the emerging market economies.**

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The IMF expects the Nigerian economy to contract by 1.7% in 2016, but to grow by 0.6% in 2017. The economy has been impacted by negative shocks. Some of the shocks are: crash in oil price and production; scarcity of foreign exchange; low electricity generation and distribution; and depressed consumer demand. The appropriate monetary policy response should be to cut rates and boost credit creation to stimulate growth. This is not practicable under the current rising inflation rate and weak currency. **A hold decision is appropriate, while the Federal Government of Nigeria (FGN) should increase her capital expenditure aimed at improving the business environment and stimulate growth. The FGN should also intensify efforts to borrow long-tenored funds from multilateral organizations at low interest rates to increase the stock of foreign exchange.**

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The inflation rate increased higher in October 2016 to 18.33%, from 17.85% in September 2016, and we expect it to increase further in the next three months. This will be driven by structural factors, such as: high costs of electricity; transport; production inputs and; higher prices of both domestic; and imported food products. **A rate cut is not consistent with the short-term inflation rate outlook, while a rate increase will not be good for economic growth. Thus, we expect the MPC to maintain rates at the current levels.**

The average global oil prices increased in October 2016 because of declining U.S. oil inventory levels and discussions to bring forward market rebalancing. However, prices came under pressure from a rise in U.S. oil rig counts, a stronger U.S. Dollar, and profit taking. **The average price of Bonny Light was US$50.32/b in October 2016, up by 4.49% from US$48.16/b in September 2016. However, the price of Bonny Light crude oil decreased by 2.29% to US$45.83b as at November 16, 2016 from US$46.95/b on September 20, 2016.** The secondary data from the Organization of the Petroleum Exporting Countries (OPEC) also showed that Nigeria's oil output increased by 11.64% to 1.63mbd in October 2016, from 1.46mbd as at September 2016. **The low oil revenue on account of production disruptions and low oil price and its impact on foreign exchange inflow, will not justify a rate cut.**

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The demand pressure on the external reserves in the face of low foreign exchange receipts persist. However, we note that the external reserves have recorded more accretion than drawdown since October 20, 2016. The inflow from International Money Transfer Operators (IMTO) has been the major reason for the increase in the external reserves. The increase in oil production has also boosted the external reserves. The 30-day moving average external reserves declined by 2.50% from US$24.78bn at the last MPC meeting to US$24.16bn as at November 14, 2016. **A rate cut may make the Nigerian fixed income securities to be less attractive to investors than other countries. This may lead to capital flight with the attendant negative impact on the external reserves.**

The Naira recorded a gain of 1.42% at the inter-bank market to close at US$1/N305.50 on November 17, 2016 from US$1/N309.83 on September 20, 2016. The premium between the inter-bank and parallel markets averaged about N153 after the last MPC meeting in September 2016. The parallel market rate depreciated by 8.28% to US$1/N465 on November 17, 2016 from US$1/N426.50 on September 20, 2016. **Given the weak foreign exchange rate regime, a rate cut is not appropriate.**

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The average yields on the 91-day, 182-day and 364-day Nigerian Government Treasury Bills (NTBs) decreased to 14.45%, 18.68% and 22.35% in October 2016, compared with 14.51%, 19.19% and 22.52%, respectively in September 2016. The last yields on the NTBs sold on November 16, 2016 were at 14.50%, 19.05% and 23% on the 91-day, 182-day and 364-day NTBs, respectively. However, the average yield on the 16.39% FGN Bond January 2022 increased to 14.82% in October 2016 from 14.76% in September 2016, while it stood at 15.06% as at November 14, 2016. **A rate cut will lower the yields on the fixed income securities, which may be a disincentive to investments.**

The money supply and credits to the private sector grew in the first nine months of the year, and above the annualised target rates for 2016.

The money supply and credits to the private sector grew in the first nine months of the year, and above the annualised target rates for 2016. The growth in credit is due to the impact of devaluation of the Naira. The broad money supply (M2) increased by 10.50% to N22.13trn in September 2016, from N20.03trn in December 2015; an annualized growth of 14.24%. The provisional growth benchmark for 2016 is 10.98%. The narrow money (M1) grew by 16.07% to N9.95trn in September 2016, from the end-December 2015 figure**.** Net domestic credit (NDC) also grew by 21.88% in the same period; an annualized growth of 22.46%. The provisional benchmark growth for 2016 is 17.94%. The credit to government increased by 29.57% during the period. Similarly, credits to the private sector grew by 20.69% for September 2016, compared with December 2015; an annualized growth of 28.50%. The benchmark growth for 2016 is 13.28%.

Table 1: Monetary Aggregates – N'mn

Month	Narrow Money	Quasi Money	Broad Money	Ratio of MI to M2	Net Domestic Credits	Net Credits to Government	Net Credits to Private Sector	Ratio of Private Sector Credits to Domestic Credits
	M1	QM	M2		-	-	-	
Dec-15	8,571,701	11,458,130	20,029,831	43%	21,612,452	2,893,189	18,719,263	87%
Jan-16	8,247,317	11,439,835	19,687,153	42%	22,222,742	3,337,518	18,885,224	85%
Feb-16	9,059,578	11,429,588	20,489,167	44%	22,414,323	3,424,030	18,990,293	85%
Mar-16	9,040,818	11,429,618	20,470,436	44%	22,664,816	3,782,578	18,882,238	83%
Apr-16	9,136,068	11,591,841	20,727,909	44%	23,312,346	3,933,735	19,378,611	83%
May-16	9,391,866	11,330,042	20,721,908	45%	22,852,137	3,803,178	19,048,959	83%
Jun-16	9,125,933	12,559,032	21,684,965	42%	24,318,143	2,893,190	21,424,953	88%
Jul-16	9,230,931	12,951,257	22,182,188	42%	25,159,363	2,784,110	22,375,253	89%
Aug-16	9,125,897	12,521,428	21,647,325	42%	25,955,106	3,290,896	22,664,210	87%
Sept-16	9,949,385	12,184,093	22,133,478	45%	26,341,471	3,748,843	22,592,628	86%
Growth : Dec-Sep	16.07%	6.39%	10.50%		21.88%	29.57%	20.69%	

Source: Central Bank of Nigeria

Expansionary monetary policies at this moment will be counter-productive.

Looking at the economic developments in the country and the impact of the external developments on the Nigerian economy, we expect the MPC to maintain rates at the current levels. The goal of stimulating economic growth will make the MPC to hold rates at current levels. We note that expansionary monetary policies at this moment will be counter-productive.

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