MPC Meeting: Considerations and Policy Options

MPC: Facing Policy Dilemma

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There are arguments to support an increase and a hold in rates when the Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) meets on July 25-26, 2016. Meanwhile, there is no argument in support of rates cut given the current economic situation. The impending recession in the Nigerian economy supports a hold in rates at the current level while the fiscal measures to reflate the economy are implemented. The current high double digit inflation rate supports a rate hike. We however believe that the MPC and other government agencies will pursue growth and trade-off high inflation. At the end of its May 2016 meeting, the MPC retained the Monetary Policy Rate (MPR) at 12% with the asymmetric corridor at +200basis points and -700basis points. It also retained the Cash Reserve Requirement (CRR) and Liquidity Ratio (LR) at 22.50% and 30% respectively.

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The global economy faces significant risk from the United Kingdom's (UK) decision to leave the European Union. The decision has created additional instability in the global economy. The International Monetary Fund (IMF) revised its global Gross Domestic Product (GDP) growth forecasts downwards by 0.1% relative to its April 2016 forecast. The global economy is now to grow at 3.1% and 3.4% for 2016 and 2017 respectively. The latest forecast as contained in the IMF WEO Update July 2016 Edition, which stated that the outlook appears worse for the advanced economies, majorly due to the Brexit. However, the outlook remains broadly unchanged for emerging and developing economies. The IMF added that the GDP in Nigeria is expected to contract in 2016 because of the lower oil receipts, lower power generation, and weak investors' confidence**.** Growth in China and India are also expected to be lower in 2016, compared with 2015. **The weak global economic growth would lead to downward pressure on the oil price.**

We believe that the impending further contraction in the GDP is the major risk the economy faces at the moment, and a hike in rates will worsen the outlook.

The Nigerian economy is moving towards a recession as economic activities have significantly slowed down. The GDP contracted by 0.36% in Q1 2016, compared with the growth of 2.11% in Q4 2015. The Nigerian economy faces risks from shortage of foreign exchange and weak consumer demand. We expect a higher level of contraction in Q2 2016, when the National Bureau of Statistics (NBS) releases the Q2 2016 GDP figure on August 25, 2016. **We believe that the impending further contraction in the GDP is the major risk the economy faces at the moment, and a hike in the MPR will worsen the outlook. A hold decision with complementary fiscal expansionary measures should stimulate the economy.**

The current and short-term inflation rate outlook is higher than the CBN inflation rate target of 6%-9%.

The inflation rate remains on an upward trajectory in 2016, with the momentum driven by both domestic and external factors. The inflation rate in June 2016 shot up to an 11-year high of 16.48%, from 15.58% in May 2016. We expect the inflation rate to remain high and in double digit in 2016. **The current and short-term inflation rate outlook is higher than the CBN inflation rate target of 6%-9%. This should warrant a policy action in the form of a rate increase. However, the need to stimulate economic growth may prevent the MPC from hiking rates at this meeting. It may trade-off high inflation rate for economic growth.**

The crude oil price has stabilized around US$45-US$50/b after the rally recorded in mid-April 2016. The price of Bonny Light crude oil decreased by 4.84% to US$47.16b as at July 19, 2016 from US$49.56/b on May 24, 2016. The Nigerian government did not benefit from the recent oil price rally because of the shortfall in production. The low oil earnings have significantly impacted the FGN revenue with its associated implications on unemployment rate and higher prices. **The government may have to borrow more to fund its 2016 Budget, which should force interest rates to rise.**

We expect the MPC to adopt a hold decision.

The pressure on the external reserves remains unabated since the last MPC meeting in May 2016. The external reserves have not received the anticipated boost from the adoption of a flexible exchange rate policy in June 2016. **The external reserve is still strongly dependent on oil earnings, which has been inadequate because of the output shortfall.** The 30-day moving average external reserves declined marginally by 0.49% from US$26.48bn at the last MPC meeting to US$26.35bn as at July 18, 2016**.** **We expect the MPC to adopt a hold decision.**

The yields on the fixed income securities increased between the last MPC meeting and July 2016, reflecting the macroeconomic risk in the economy.

The value of the Naira remains under strain but relatively stable at the inter-bank market after the implementation of the revised CBN foreign exchange policy in June 2016. The Naira recorded a 29.36% fall in its value to US$1/N281.85 on June 20, 2016 from US$1/N199.10 on June 17, 2016. However, after the adoption of the revised guidelines, the value of the Naira has depreciated by 9.21% to stand at US$1/N310.43 on July 21, 2016 from the start of the single market structure on June 20, 2016. However, the parallel market still exists and at a wide variance from the inter-bank market. **The long-term appreciation and stability in the foreign exchange rate depends on the ability of the Nigeria to grow its export base and attract both Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). The policies to drive these growths are outside the monetary policy.**

The yields on the fixed income securities increased between the last MPC meeting and July 2016, reflecting the macroeconomic risk in the economy. The average yields on the 91-day, 182-day and 364-day Nigerian Government Treasury Bills (NTBs) increased to 12.35%, 14.91% and 18.68% in July 2016, compared with 8.21%, 9.53% and 13.34% respectively in May 2016. The last yields on the NTBs sold on July 20, 2016 were at 14.46%, 16.78% and 19.72% on the 91-day, 182-day and 364-day NTBs, respectively. The yield on the 16.39% FGN Bond January 2022 also increased to 14.01% in June 2016 from 13.51% in May 2016, while it stood at 15.02% as at July 20, 2016. **We believe that the use of Open Market Operation (OMO) to curb inflation is more effective than raising the anchor interest rate.**

Money supply grew slower than the target for the year 2016.

The money supply and credits to the private sector grew in the first five months of the year below the annualised target rates for 2016. This represents a pullback in credit creation because of the perceived business risk in the economy. There is a need for better engagement of all stakeholders to restore confidence in the economy. The broad money supply (M2) increased by 3.46% to N20.72trn in May 2016, from N20.03trn in December 2015; an annualized growth of 8.29%. The provisional growth benchmark for 2016 is 10.98%.

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The narrow money (M1) grew by 9.57% to N9.39trn in May 2016, from the end-December 2015 figure**.** Net domestic credit (NDC) also grew by 5.74% in the same period; an annualized growth of 13.77%. The provisional benchmark growth for 2016 is 17.94%. The credit to government grew by of 31.45% during the period. Similarly, credit to the private sector grew by 1.76% in May 2016, compared with December 2015; an annualized growth of 4.23%. 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 Credit	Net Credit to Government	Net Credit 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%
Growth : Dec- May	9.57%	(1.12%)	3.40%		5.74%	31.45%	1.76%	

Source: Central Bank of Nigeria

Looking at the macroeconomic developments in the economy, we expect that the MPC members will vote to maintain the MPR, CRR and LR at the current levels. However, complementary fiscal measures are required to restore investors' confidence and pull the economy out of recession.

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