Reduce Rates, Hold or Increase?

The MPC of the CBN may hold rates when it meets next week.

The Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) may hold rates when it meets next week. Although there are justifications to ease the policy, the view of the MPC members that fiscal injections and rising rates in the international market would have adverse impacts on price stability in Nigeria may not allow the MPC to ease policy. Weak economic and credit growth in Nigeria do not justify rates hike. The third meeting of the MPC of the CBN in 2018 will hold on Monday, 23 and Tuesday, 24 July 2018. At its meeting in May 2018, the MPC maintained the Monetary Policy Rate (MPR) at 14%, with the asymmetric corridor at +200 and -500 basis points around the MPR; it retained the Cash Reserve Ratio (CRR) and Liquidity Ratio (LR) at 22.50% and 30% respectively.

FSDH Research believes measures to stimulate growth are required.

The International Monetary Fund (IMF) recently noted that the global economic growth is uneven, and risks to the outlook are mounting. This is contained in the IMF's World Economic Outlook (WEO) Update, July 2018. The report maintained the IMF's global growth forecast at 3.9% for 2018 and 2019. While the IMF's growth forecast for Nigeria for 2018 remains at 2.1%, it raised the 2019 forecast to 2.3% from 1.9%. The report added that the rate of expansion seems to have peaked in some major economies. The growth prospects in emerging markets and developing economies are also uneven. It added that the normalisation of monetary policy has led to a drop in capital inflows, higher financing costs, and exchange rate pressures. This is more severe in countries with weaker fundamentals or higher political risks than stable countries. Meanwhile, the Federal Open Market Committee (FOMC) of the United States (US) Federal Reserve (The Fed) increased the Federal Funds Rate (Fed Rate) at its June 2018 meeting. The Fed increased the Fed Rate to 1.75% - 2.00%. **FSDH Research expects that the FOMC may increase the Fed Rate when it meets in September and December 2018. The expected Fed's action may push funds further into the US Treasury market, and also push global yields upwards, leading to additional pressure in emerging markets. Tight monetary policy will be appropriate in this context.**

The expected growth in government's spending in the second half of the year, should increase economic activities, with positive impacts on the income of households and firms.

The Purchasing Managers' Index (PMI) survey the CBN published for the month of June 2018 shows an expansion, and represents an increase over May 2018. The Manufacturing and Non-Manufacturing PMI figures increased marginally to 57.0 and 57.5 points in June respectively, from 56.5 and 57.3 points in May. These marginal increases signify fragile economic recovery. FSDH Research believes measures to stimulate growth are required. **Looking at the economic recovery path in Q1 2018, FSDH Research revised its GDP growth forecast for 2018 to 2.78%, down from our previous forecast of 3.16%.** The expected growth in government's spending in the second half of the year should increase economic activities, with positive impacts on the income of households and firms.

The external reserves remained relatively stable over the last two months. However, FSDH Research observed that it has been dropping consistently since 06 July 2018. The 30-day moving average external reserves decreased by 0.34%, down from US$47.61bn at end-May to US$47.45bn at 18 July 2018.

FSDH Research expects stability in the foreign exchange rate in the short-to-medium term.

Meanwhile, the total foreign exchange (FX) inflows through the Investors' and Exporters' FX Window between January and 19 July 2018 stood at US$18.54bn. The total inflows for the month of July as at 19 July 2018 stood at US$1.17bn. Given the run rate, July may record the lowest inflows since January 2018. Rising rates and yields in advanced countries, coupled with low yields in Nigeria and weak economic recovery may encourage FX outflows. **However, FSDH Research expects that the favourable crude oil production in Nigeria and price in the international market should continue to lead to accretion to the external reserves. This should maintain stability in the foreign exchange rate in the short-to-medium term**.

The inflation rate has maintained a consistent downward trend since January 2018. **FSDH Research's forecast shows that it may drop to single digit in August 2018, provided there is no food crisis that could lead to escalating food prices.** We also observed relative stability in the foreign exchange rate due to favourable crude oil production and price, and foreign capital inflows. **FSDH Research notes that possible capital flight and adverse developments in the crude oil market are possible risks to stable prices**.

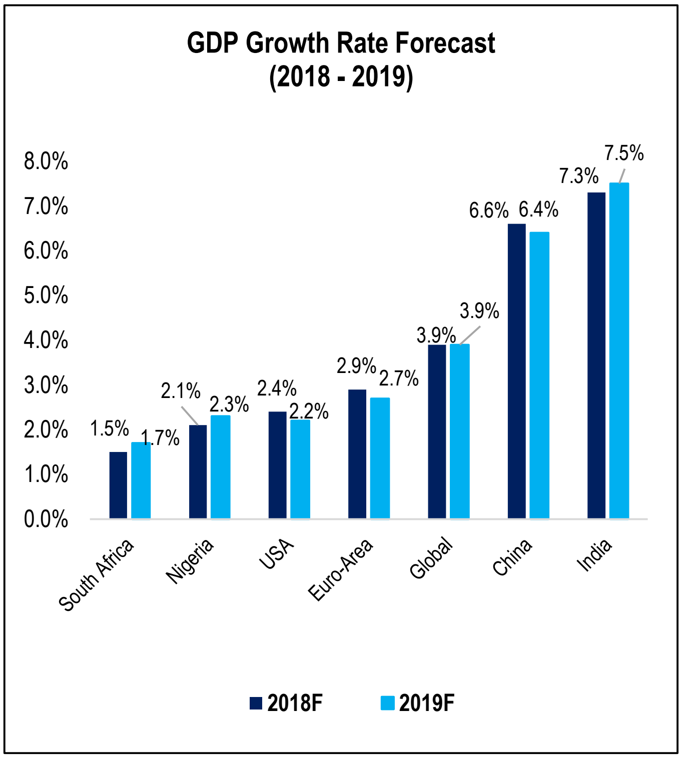
An expansionary policy may be appropriate to expand credit if the social crises are resolved.

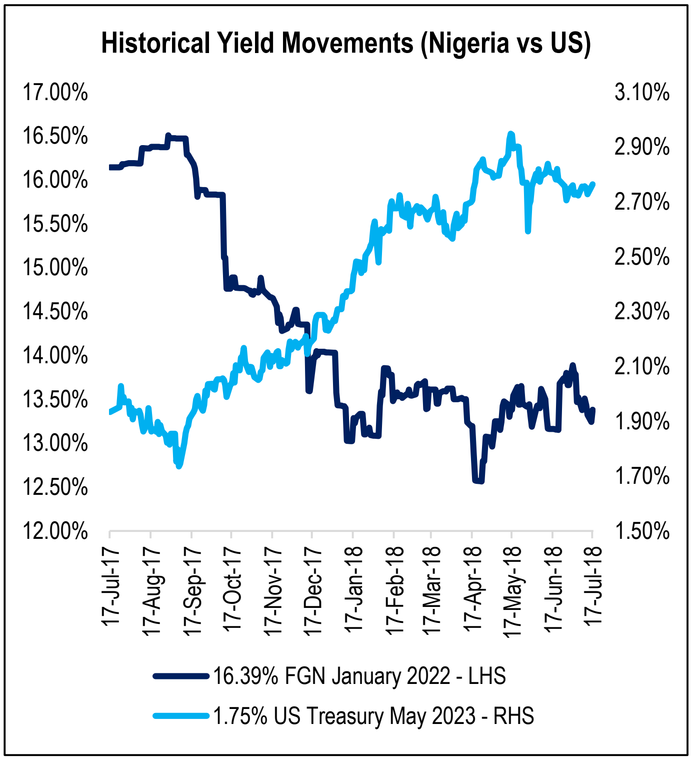
The data from the CBN shows that net domestic credit decreased marginally by 0.57% to N25.72trn in May 2018, from N25.86trn in December 2017. The net credit to the private sector shrank marginally by 0.37% to N22.21trn during the same period. **The weak economic recovery and rising crises in some parts of the country are responsible for the weak credit growth. An expansionary policy may be appropriate to expand credit if the social crises are resolved.**

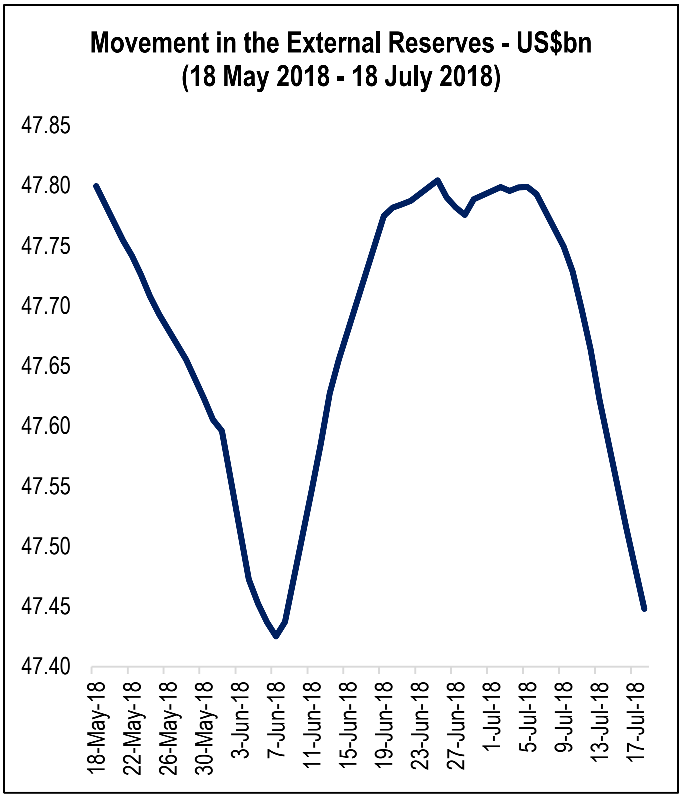
FSDH Research expects the yields on FGN Bonds to rise further from the current levels.

Looking at possible policy options open to the MPC, members may vote to retain rates at the current levels. However, FSDH believes if the MPC members' fear about the impact of fiscal injections and rising rate in the international market on domestic price stability does not materialise; policy easing may be required very soon. **Notwithstanding the hold decision, FSDH Research expects the yields on FGN Bonds to rise further from the current levels. The borrowing needs of the FGN and the rising yields in the international market will be the major drivers.**

MPC Meeting: Considerations and Policy Options







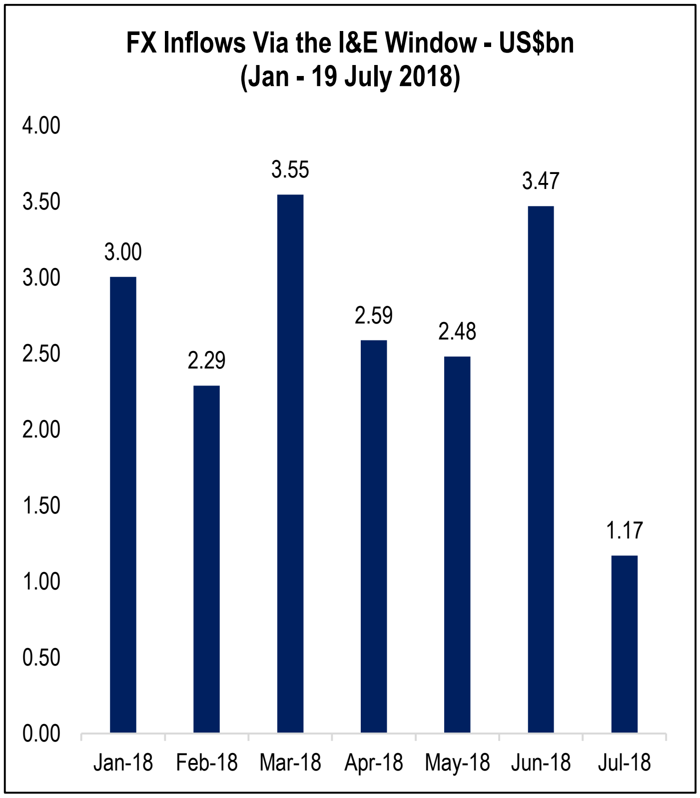


Table 1: Monetary Aggregates (Money Supply) – N'mn								
Month	Narrow Money	Quasi Money	Broad Money	Ratio of MI to M2	Net Domestic Credits	Net Credits to Government	Net Credits to Private Sector	Ratio of Private Sector Credits to Domestic Credits
	M1	QM	M2		-	-	-	
May-17	10,184,904	11,790,439	21,975,343	46%	26,145,051	4,214,341	21,930,710	84%
Jun-17	9,883,821	11,790,391	21,674,213	46%	26,404,355	4,425,788	21,978,567	83%
Jul-17	10,325,981	11,874,338	22,200,319	47%	27,160,163	4,987,790	22,172,373	82%
Aug-17	9,890,813	11,960,641	21,851,454	45%	26,821,447	4,824,226	21,997,221	82%
Sep-17	10,064,248	11,889,746	21,953,994	46%	26,985,305	4,963,406	22,021,899	82%
Oct-17	10,393,062	12,107,556	22,500,618	46%	27,174,806	5,245,889	21,928,917	81%
Nov-17	10,115,050	12,196,068	22,311,118	45%	26,349,069	4,392,408	21,956,660	83%
Dec-17	11,036,352	12,965,060	24,001,412	46%	25,863,281	3,574,029	22,289,252	86%
Jan-18	10,779,944	13,051,972	23,831,916	45%	25,846,386	3,857,433	21,988,953	85%
Feb-18	10,760,862	13,288,231	24,019,092	45%	26,909,597	4,288,313	22,621,284	84%
Mar-18	10,912,604	13,390,446	24,303,050	45%	26,267,137	3,823,345	22,443,791	85%
Apr-18	10,670,629	13,850,006	24,520,635	44%	27,476,827	5,222,737	22,254,089	81%
May-18	11,226,313	13,942,701	25,169,014	45%	25,716,588	3,509,844	22,206,744	86%
Growth : Dec 17-May 18	1.72%	7.54%	4.86%		(0.57%)	(1.80%)	(0.37%)	
Sources: Central Bank of Nigeria and FSDH Research Analysis								

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