

To Hold or Increase Policy Rates – FSDH Research Leans Towards a Hold Decision

Rising demand for foreign exchange leading to a consistent decline in the foreign reserves, and rising inflation rate are major justifications for an increase in policy rates. However, FSDH Research believes members of the Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) may decide to delay an increase in the monetary policy rate until their January 2019 meeting. The MPC will hold its last meeting for the year on Monday, 19 and Tuesday, 20 November 2018. At its meeting in September 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. **The CBN may continue to use the conduct of Open Market Operations (OMO) to manage the temporary liquidity in the financial system that may affect price stability.**

Rising demand for foreign exchange leading to consistent decline in the foreign reserves and the rising inflation rate are major justifications for an increase in policy rates.

A review of the global economy shows that global growth remains fairly strong, but trade restrictions may reduce global growth. This is according to the International Monetary Fund (IMF), which projects a global growth rate of 3.7% for 2018 and 2019. **The growth rate forecast is slightly lower than the growth rate projections the IMF released in July 2018.** Although FSDH Research notes that despite the recent drop in the price of crude oil on the international market, the moderately strong global growth should sustain global crude oil prices around US\$70/b in the short-term. FSDH Research expects the Federal Open Market Committee (FOMC) of the US Federal Reserve to raise the Federal Funds Rate (Fed Rate) by 0.25% when the committee meets in December 2018. The October 2018 US unemployment rate at 3.7% (lower than the target of 6.5%), inflation rate of 2.5% (higher than the target of 2%) and the growth of 3.5% in the economy all support arguments for an interest rate increase. An increase in the Fed Rate may further place additional demand pressure on foreign exchange in Nigeria and possibly increase capital flight from emerging markets. **Thus, a rate cut in Nigeria is not appropriate under these situations.**

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The short-term forecast for the Nigerian economy shows that economic growth remains fragile. The IMF forecasts a growth rates of 1.9% and 2.3% in 2018 and 2019 respectively. These growth rates are lower than the Nigerian population growth rate. Thus, the economy needs policy stimulus to record a growth rate that is inclusive. Nevertheless, monetary policy easing in the form of an interest rate cut may not stimulate growth. Appropriate fiscal measures and incentives that will improve the ease of doing business in Nigeria will lay strong foundation for sustainable growth. The Purchasing Managers' Index (PMI) survey published by the CBN for the month of October 2018 expanded at a faster rate. FSDH Research attributes the expansion in the PMI to the increased economic activities that are usually associated with the last quarter of the year.

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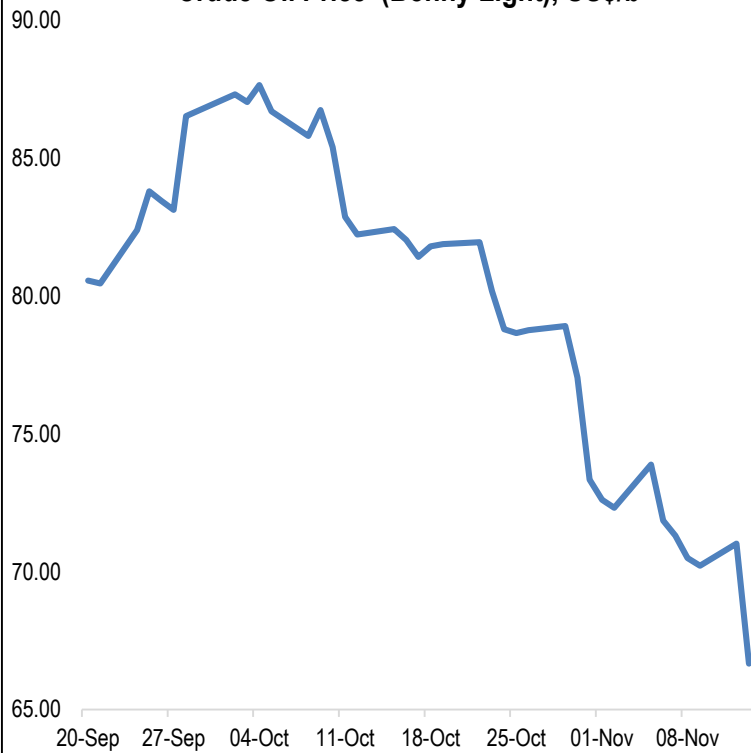
FSDH Research observed a consistent drawdown in the external reserves in order to maintain foreign exchange rate stability in Nigeria. The CBN increased the supply of foreign exchange at the Investors' and Exporters' Foreign Exchange Window and increased the yield at the OMO to douse demand pressure at the foreign exchange market. Consequently, the drawdowns from the external reserves continued until November 2018. CBN remained the largest supplier of foreign exchange at the I & E window in the last three months. **FSDH Research notes that an attractive Nigerian Treasury Bill (NTB) yield around the current level of 16% may help to attract foreign portfolio investment and reduce capital flight. Nevertheless, there is a need for deliberate fiscal measures and engagements that will promote non-oil exports that attract foreign investment into Nigeria and will guarantee foreign exchange stability.**

The inflation rate increased to 11.28% in September 2018, the second increase since January 2017. This was principally due to the increase in the Food Index. FSDH Research expects inflation rate to increase marginally to 11.34% in October and to end the year 2018 at 11.7%. An increase in food prices, electioneering spending, and a possible increase in the minimum wage, are potential factors that will influence the direction of the inflation rate in the next three months. Despite the expected rise in the inflation rate, it will be difficult for a hike in the interest rate to stem the rising inflation rate, as the cause of the rising inflation rate is not within the scope of monetary policy. **The MPC may deal with the possible negative impact of an increase in the minimum wage at its January 2019 meeting. Thus a hold decision may be appropriate.**

Data from the CBN shows that the key monetary aggregates in the country are below the target the CBN sets for the country. This development supports an argument for an expansionary policy to boost credit creation. However, the current structural rigidities in the economy do not support strong credit growth. Therefore, unconventional policies are required to boost credit creation and business expansion to stimulate growth. **Measures that remove the risks inherent in the economy will encourage credit expansion and this will support sustainable growth.**

Looking at possible policy options open to the MPC, FSDH Research is of the opinion that members of the MPC will vote to maintain interest rates at the current levels. The CBN can continue to use the Open Market Operations (OMO) to manage liquidity in the banking industry in order to maintain price stability.

Crude Oil Price (Bonny Light), US\$/b

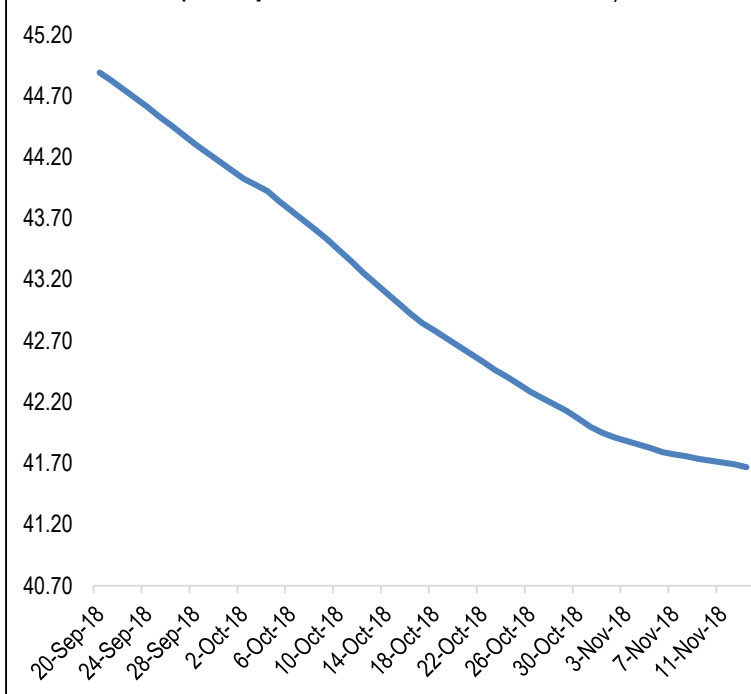


Monthly Inflows through the I & E Window (August – October 2018)

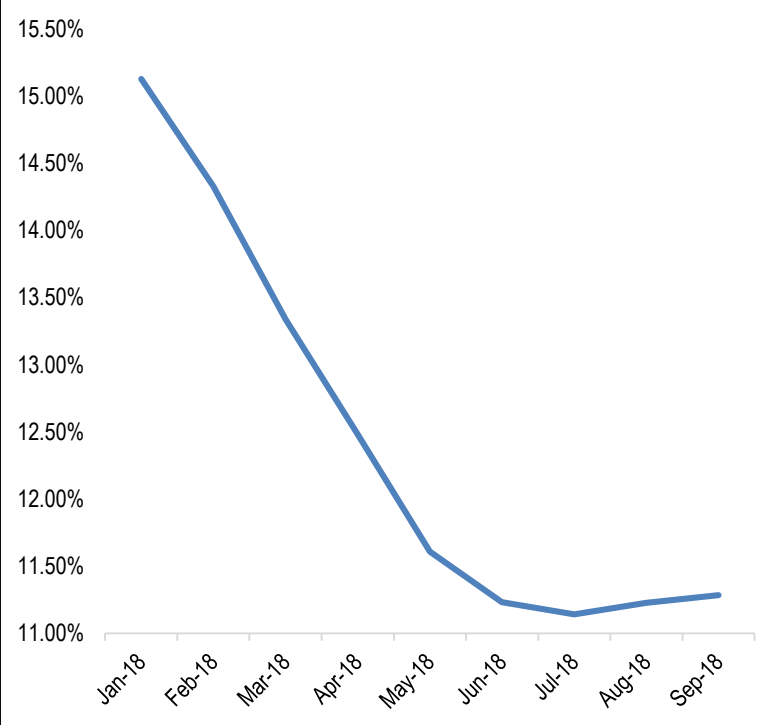
Source	August 2018		September 2018		October 2018	
	Value (\$'bn)	*PT	Value (\$'bn)	*PT	Value (\$'bn)	*PT
FDI	0.01	0.28%	0.05	1.34%	0.06	2.94%
FPI	0.55	17.46%	0.78	21.94%	0.52	25.18%
Other Corporates**	0.10	3.07%	0.05	1.30%	0.04	1.81%
CBN	1.43	45.78%	2.02	56.40%	0.90	43.07%
Exporters	0.08	2.62%	0.08	2.31%	0.11	5.39%
Individuals	0.03	0.91%	0.02	0.53%	0.01	0.46%
Non-Bank Corporates	N/A	N/A	0.26	7.39%	0.44	21.15%
Other Corporates*	0.93	29.87%	0.32	8.81%	N/A	N/A
Total	3.13	100.00%	3.58	100.00%	2.08	100%

Source: FMDQ. *PT = Proportion of Total. ** International. *Domestic

Movement in External Reserves - US\$'bn (20 September - 13 November 2018)



Inflation Rate (January-September 2018)



Sources: Central bank of Nigeria, Thomas Reuters, FMDQ and National Bureau of Statistics (NBS) and FSDH Research

Table 1: Monetary Aggregates (Money Supply) – N'mn

Month	Narrow Money M1	Quasi Money QM	Broad Money M2	Ratio of M1 to M2	Net Domestic Credits	Net Credits to Government	Net Credits to Private Sector	Ratio of Private Sector Credits to Domestic Credits
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	24,140,634	46%	25,929,552	3,638,894	22,290,658	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%
Jun-18	10,701,110	14,112,895	24,814,005	43%	25,568,207	3,286,341	22,281,867	87%
Jul-18	10,668,002	14,303,100	24,971,102	43%	25,654,481	3,393,271	22,261,210	87%
Aug-18	10,448,157	14,411,190	24,859,346	42%	24,848,632	2,378,390	22,470,242	90%
Sep-18	10,681,494	14,595,577	25,277,071	42%	25,971,817	3,411,346	22,560,471	87%
Growth : Dec 17-Sep 18	(3.22%)	12.58%	4.71%		0.16%	(6.25%)	1.21%	

Sources: Central Bank of Nigeria and FSDH Research Analysis

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For enquiries please contact us at our offices:

Lagos Office: 5th-8th floors UAC House, 1/5 Odunlami Street. Tel: 234-1-2702881-2, 234-1-2702887

Port Harcourt Office: 2nd Floor, Skye Bank Building (Former Mainstreet Bank Building), 5 Trans Amadi Road, Port Harcourt. Tel: 234-802 408 1331

Abuja Office: Leadway House (Ground Floor), Plot 1061 Herbert Macaulay way, Central Business District, Abuja-Nigeria. Tel.: 234-9-2918821

Website: www.fsdhgroup.com **Email:** research@fsdhgroup.com. Our Reports and Prices are also Available on Bloomberg {FSDH<GO>}

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