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Keeping Policy Rates at Current Levels is Still Prudent

Although the Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) has kept the policy rates at the current levels since July 2016, FSDH Research believes maintaining rates is still advisable. However, we expect the CBN to continue to use the sales of Government Securities to manage inflation expectation and exchange rate stability. The MPC will hold its first meeting this year on Monday, 21 and Tuesday, 22 January 2019. At its meeting in November 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 also retained the Cash Reserve Ratio (CRR) and Liquidity Ratio (LR) at 22.50% and 30% respectively.

FSDH Research is of the view that developments in the global economy do not support strong growth in the crude oil price. Therefore, Nigeria's ability to generate revenue and foreign exchange may be constrained in the short term. We are already witnessing negative impacts of the trade war between China and the US, the two largest economy in the world and the largest consumers of crude oil. China reported a drop in its December 2018 exports value. Meanwhile, a number of large companies that have headquarters in the US but operating manufacturing plants in China, have given earnings warnings. These are all leading indicators of economic slowdown. Consequently, the price of crude oil may remain around US\$60/b in 2019 in the face of sluggish demand growth and increase in supply from the US. The average crude oil price (Bonny Light) in 2018 was US\$72.38/b. This development may increase Nigeria's fiscal deficit, exert inflationary pressure and exchange rate may depreciate. Under these circumstances, a tight monetary policy stance would be appropriate.

FSDH Research expects the Federal Open Market Committee (FOMC) of the U.S. Federal Reserve (The Fed) to raise the Federal Funds Rate (Fed Rate) three times in 2019 to a range of 3.00%- 3.25%.

There are also strong indications that the Bank of England and the European Central Bank may reduce money in circulation in 2019 leading to an increase in global interest rates. Interest rates and exchange rates in emerging and developing countries may be under pressure because of capital flights to developed countries. **The appropriate policy response to curtail capital flights is to adopt a tight monetary policy stance in the form of an increase in the yields of government securities.**

Although the Nigerian economy is showing signs of recovery, it requires coordinated fiscal and monetary policies to achieve strong growth and to reduce the negative impacts of global economic developments. The World Bank forecasts Nigeria's Gross Domestic Product (GDP) growth rates of 1.9% and 2.2% in 2018 and 2019 respectively. FSDH Research's forecast growth rates are 1.94% and 2.48% for 2018 and 2019 respectively. These growth rates are lower than the Nigerian population growth rate.

Nigerian economy needs policy stimulus that will assist in lifting aggregate demand in the domestic economy.

CBN remained the largest supplier of foreign exchange at the I & E window in the last five months.

The growth in key monetary aggregates in the country are below the targets the CBN sets for the country.

Measures that remove the risks inherent in the economy will encourage credit expansion and this will support sustainable growth.

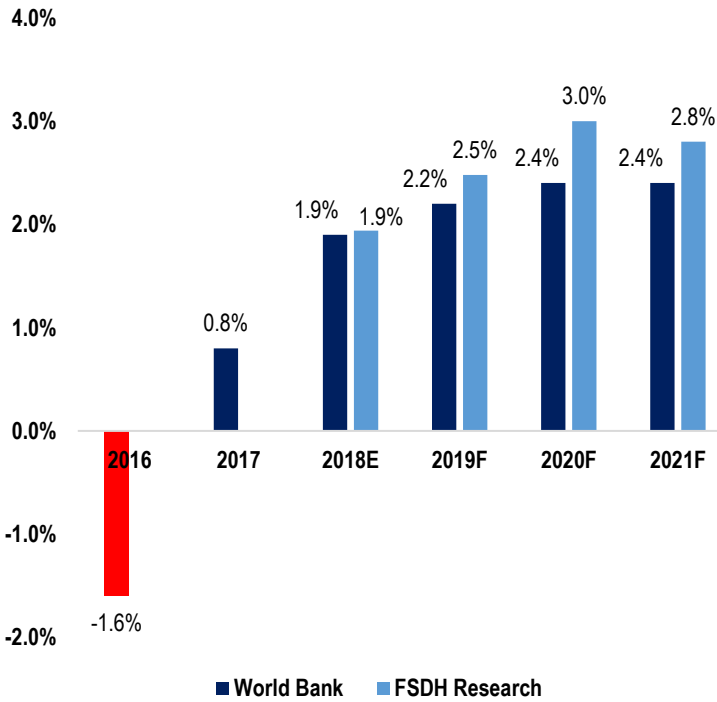
The economy, therefore, needs policy stimulus that will assist in lifting aggregate demand in the domestic economy. Nevertheless, monetary policy easing in the form of a cut in the interest rate may not stimulate growth until certain growth-inhibiting factors in the economy are addressed. Appropriate fiscal measures and investments in critical infrastructure and human capital are required in order to lay the foundation for increased productivity and growth in the key non-oil sectors of the economy.

FSDH Research observes that the positive impact of the proceeds of the US\$2.86bn on the external reserves is now waning. The external reserves at US\$43.10bn as at 15 January 2019 are estimated to cover about 9 months of imports. However, with the expected crude oil production cut approved by the Organization of the Petroleum Exporting Countries (OPEC) amongst its members and partners, and the low crude oil price, there may not be a significant accretion to the external reserves. So far, the CBN's intervention in the foreign exchange market has helped the value of the Naira to remain stable. CBN remained the largest supplier of foreign exchange at the I & E window in the last five months. Despite this, there are signs of demand pressure as the value of the Naira depreciated at the Nigerian Autonomous Foreign Exchange (NAFEX) and the Inter-bank markets in December 2018 compared with November.

FSDH Research expects the average inflation rate in 2019 to be higher than what was recorded in 2018. Our expectation of an increase in Premium Motor Spirit (PMS) pump price, electricity tariff, global food prices, electioneering spending and a possible increase in the minimum wage, may place the inflation rate on an upward trend. Despite the expected rise in the inflation rate, we note that the cause of the rising inflation rate is not within the scope of monetary policy and it will be difficult for a hike in the interest rate to stem rising inflation. **Therefore, a rate hike would not be appropriate.**

Data from the CBN shows that the growth in key monetary aggregates in Nigeria fall short of the targets set by the CBN for the country. This development supports an argument for an expansionary monetary policy to boost credit creation. However, FSDH Research reiterates that the current structural rigidities in the country need to be addressed in order to make lending attractive for banks. 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 members, FSDH Research is of the opinion that they will vote to maintain interest rates at the current levels. The CBN may continue to use the Open Market Operations to manage liquidity in the banking industry in order to maintain price stability.**

Nigeria Economic Growth (Actual vs Forecast)

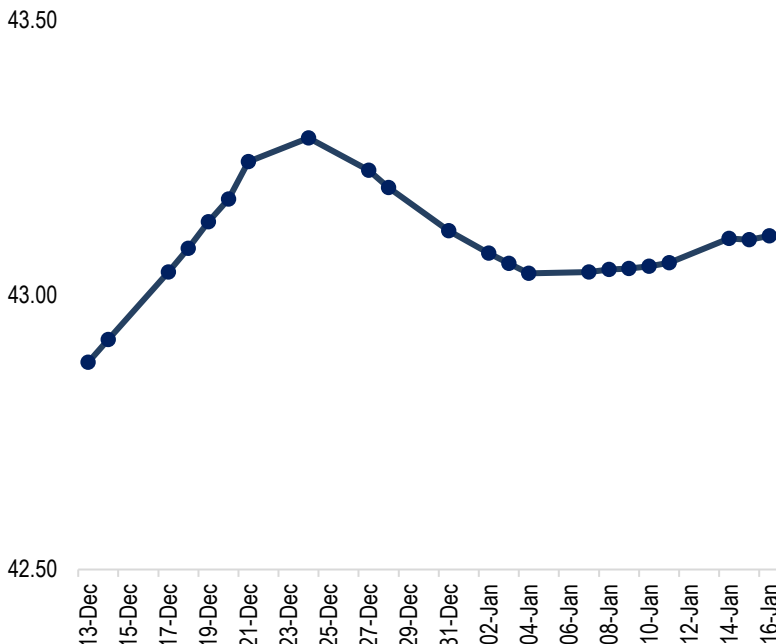


Monthly Inflows through the I & E Window (October – December 2018)

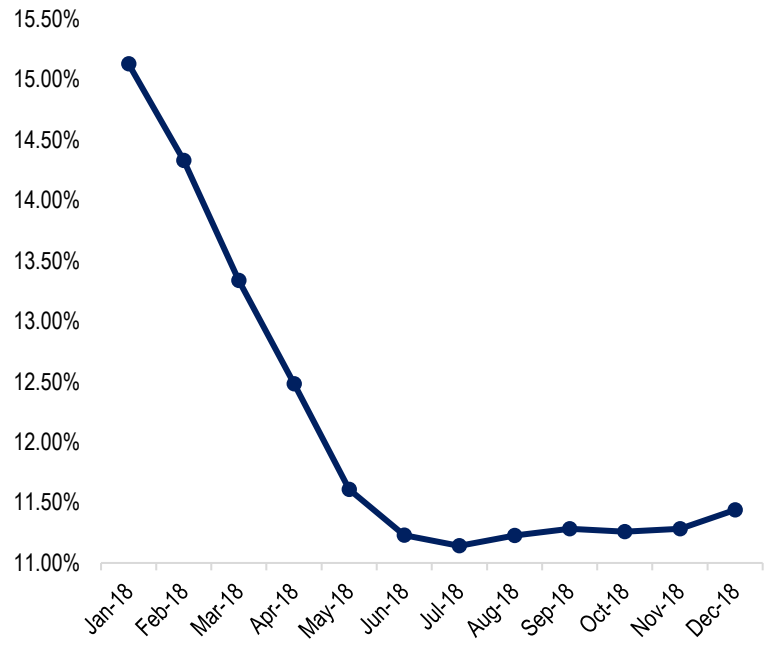
Source	October 2018		November 2018		December 2018	
	Value (\$'bn)	*PT	Value (\$'bn)	*PT	Value (\$'bn)	*PT
FDI	0.06	2.94%	0.05	1.88%	0.06	2.27%
FPI	0.52	25.18%	0.65	22.43%	0.46	17.22%
Other Corporates**	0.04	1.81%	0.04	1.26%	0.04	1.62%
CBN	0.90	43.07%	1.33	45.57%	1.21	45.29%
Exporters	0.11	5.39%	0.13	4.63%	0.14	5.35%
Individuals	0.01	0.46%	0.01	0.45%	0.005	0.18%
Non-Bank Corporates	0.44	21.15%	0.69	23.78%	0.63	23.57%
Other Corporates***	N/A	N/A	N/A	N/A	0.12	4.51%
Total	2.08	100%	2.91	100%	2.67	100%

Source: FMDQ. *PT = Proportion of Total. ** International. *** Domestic
 FDI : Foreign Direct Investment FPI: Foreign Portfolio Investments

External Reserves - U.S.\$bn



Inflation Rate (%)



Sources: World Bank, Thomas Reuters, FMDQ, National Bureau of Statistics (NBS) and FSDH Research

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

Month	Narrow Money	Quasi Money	Money Supply	Money Supply	Net Domestic Credits	Net Credits to Government	Net Credits to Private Sector	Ratio of Private Sector Credits to Domestic Credits
	M1	QM	M3	M2	-	-	-	
Nov-17	10.12	12.20	30.34	22.31	26.35	4.39	21.96	83%
Dec-17	11.18	12.97	28.67	24.14	25.93	3.64	22.29	86%
Jan-18	10.91	13.05	28.21	23.96	25.96	3.97	21.99	85%
Feb-18	10.85	13.29	29.65	24.14	27.10	4.60	22.50	83%
Mar-18	11.03	13.39	29.11	24.42	26.44	4.08	22.36	85%
Apr-18	10.62	13.85	29.06	24.47	27.26	4.99	22.28	82%
May-18	11.23	13.94	29.88	25.17	25.24	3.03	22.21	88%
Jun-18	10.70	14.11	29.34	24.81	25.09	2.81	22.28	89%
Jul-18	10.67	14.30	29.51	24.97	25.50	3.24	22.26	87%
Aug-18	10.45	14.41	29.70	24.86	24.69	2.22	22.47	91%
Sep-18	10.76	14.80	30.85	25.56	26.41	3.44	22.97	87%
Oct-18	11.24	14.80	32.03	26.04	26.89	3.76	23.14	86%
Nov-18	10.69	14.77	31.79	25.46	26.06	2.98	23.08	89%
Growth : Dec 17-Nov 18	-4.36%	13.95%	10.90%	5.47%	0.51%	-18.10%	3.55%	

Sources: Central Bank of Nigeria and FSDH Research Analysis

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