

## After Recession: A Need for Policy Change?

**We expect the Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) to hold rates at the current levels, while the fiscal authority continues to implement policy measures to sustain more growth.**

**The MPC is scheduled to meet on September 25 and 26, 2017.** The current tight monetary policy stance is justified in order to curb the high inflation rate and maintain stability in the foreign exchange (FX) market. At its July 2017 meeting, the MPC maintained the Monetary Policy Rate (MPR) at 14%, with the asymmetric corridor at +200 and -500 basis points; retained the Cash Reserve Requirement (CRR) and Liquidity Ratio (LR) at 22.50% and 30% respectively.

**At the international scene, the International Monetary Fund (IMF) in its World Economic Outlook, July 2017 edition notes that the pickup in global growth anticipated in its April 2017 World Economic Outlook (WEO) remains on track.** The IMF forecasts global economic growth at 3.5% in 2017 and 3.6% in 2018. The major drivers are the growth in global trade and industrial production. It added that Purchasing Managers' Indices (PMIs) also signal sustained strength in manufacturing and services. The IMF indicated that the risks around the global growth forecast appear broadly balanced in the near term, but remain skewed to the downside over the medium term. It added that monetary policy normalisation in some advanced economies, notably the U.S, could trigger a tightening in global financial conditions. Other risks it identified are anti-globalisation stance and geopolitical risks.

**The Federal Open Market Committee (FOMC) of the United States (U.S) Federal Reserve (The Fed) maintained the Federal Funds Rate (The Fed Funds Rate) at its July 2017 meeting.** The Fed maintained the Fed Funds Rate at 1.0% - 1.25%. There have been positive developments in the U.S economy that may justify an increase in rate, and this action may lead to increase in yields. The unemployment rate in the U.S increased to 4.4% in August 2017 from 4.3% in July 2017, but below the 6.5% target. The inflation rate increased to 1.9% in August, from 1.7% in July 2017 but below the 2.0% target of The Fed. Meanwhile, the Gross Domestic Product (GDP) grew at an annualised growth rate of 3% in Q2 2017, from 1.2% in Q1 2017. **The Fed and other central banks in advanced economies may soon commence tight monetary policy actions. Thus, the short-term outlook of monetary policy actions in the advanced economies does not justify a rate cut in Nigeria.**

At the domestic level, after five consecutive quarters of contraction in the Real Gross Domestic Product (GDP), the Nigerian economy exited the first recession in over two decades. The Q2, 2017 figures from the National Bureau of Statistics (NBS) shows that the GDP recorded a growth rate of 0.55%. The growth in the GDP was mainly due to the growth recorded in Agriculture, Financial and Insurance, Electricity, Gas, Steam and Air Conditioning Supply, and Mining and Quarrying sectors of the Nigerian economy. The manufacturing and non-manufacturing activities in the country have increased in the last few months largely because of the CBN's strategy that increased the supply of foreign exchange. This strategy has improved businesses' and consumers' confidence in the economy. The recovery in crude oil production and price and the introduction of the Investors' and Exporters' Foreign Exchange Window (I&E Window), increased the supply of foreign exchange, and helped to pull the economy out of recession. **Fiscal policy measures are appropriate to support the ongoing economic recovery. The MPC may hold**

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*The Nigerian economy grew by 0.55% in Q2 2017.*

rates to maintain stable domestic prices compatible with economic growth objective, while the government implement fiscal measures to sustain growth.

Our forecast shows that the inflation rate will remain in the range of 15.55%-16.20% between September 2017 and December 2017. This is based on the assumption that the Federal Government of Nigeria (FGN) does not increase the price of Premium Motor Spirit (PMS) and Electricity Tariff. **The forecast range is higher than the CBN's target of 6-9% and 12.5%, which is the growth retarding inflation rate benchmark. Thus, a hold in rate is consistent with the short-term inflation rate outlook.**

The daily crude oil production in Nigeria increased by 8.14% to 1.86mbpd in August 2017, from 1.72mbpd in July 2017. This is based on the secondary data available from the Organization of the Petroleum Exporting Countries (OPEC) report for the month of September 2017. The average price of Bonny Light was US\$52.47/b in August 2017, an increase of 7.21% from the average price of US\$48.94/b recorded in July 2017. The price of Bonny Light crude oil increased by 15.79% to US\$57.49/b as at September 15, 2017 from US\$49.65/b on July 25, 2017. The decision of the OPEC and some Non-OPEC members to extend oil output cut till March 2018 has sustained Bonny Light price above the Budget 2017 benchmark price of US\$44.50/b. **We believe the current complementary tight monetary policy to encourage foreign investors is necessary given the current fragile oil market developments.**

**The accretion to the external reserves continued after the MPC meeting in July 2017, as the CBN's I&E Window led to an increase in the supply of foreign exchange.** The 30-day moving average external reserves increased by 3.21% to US\$31.83bn as at end-August 2017, from US\$30.84bn at end-July 2017. The average external reserves stood at US\$31.49bn in August 2017 from US\$30.50bn in July 2017. The external reserves stood at US\$31.88bn as at September 14, 2017. **The MPC may consider a rate hold to avoid any negative impact on the external reserves from a rate cut.**

**The value of the Naira recorded a mixed performance but show relative stability since the last MPC meeting in July 2017. The value of the Naira depreciated at the official market, while it closed unchanged at the parallel market.** The inter-bank market rate depreciated marginally by 0.07% to N305.95/US\$ on September 15, 2017 from N305.75/US\$ on July 25, 2017. **The parallel market closed unchanged at N367/US\$ on September 15, 2017 same as at July 25, 2017.** The premium between the inter-bank and parallel markets averaged about N61 after the last MPC meeting in July 2017 and September 15, 2017 from an average of N66 during the period between the MPC Meeting of May and July 2017 meeting. **A rate cut will lead to a negative real yield, with a possible significant capital flight from Nigeria by foreign investors. Thus, a hold decision is appropriate.**

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The yields on NTBs decreased in August 2017, compared with July 2017. At the NTBs auction, average yield on the 91-day was down at 13.82% in the month of August compared with 13.93% recorded in July 2017. The average 182-Day NTB stood at 19.02% in August 2017, down from 19.11% in July 2017. The average 364-Day NTB yield also closed lower at 22.73% in August 2017, from 22.80% in July 2017. The yields on the FGN Bonds that we monitored closed higher in August 2017 over the preceding month. The average yield on the 16% FGN June 2019 increased to 16.84% in August from 16.62% in July. The 16.39% FGN Jan 2022 closed at 16.33% in August 2017, marginally higher than 16.13% in July 2017; the 10% FGN Jan 2030 also closed at 16.43% in August 2017, higher than 16.12% in July 2017. **We expect the yields on the fixed income securities to trend downward going forward. This is because of FX stability, plans of the FGN to refinance part of the local debt into foreign debt and the positive GDP growth rate expected going forward.**

The monetary aggregates (narrow money and broad money) as at July 2017 show that the annualised growth rate in money supply is below the target that the CBN sets for the year 2017. The broad money supply (M2) decreased by 5.08% to N22.20trn in July 2017 from N23.39trn in December 2016. This is lower than the CBN's growth rate target of 10.29% for the year 2017. The net domestic credit increased marginally by 1.92% to N27.16trn in July 2017 from N26.65trn in December 2016. The annualised growth rate in the net domestic credit in July 2017 was 3.29%, below the target growth rate of 17.93% for 2017. The net domestic credit to the Federal Government increased by 6.88% to N4.99trn in July 2017 from N4.67trn in December 2016. The net domestic credit to private sector also increased marginally by 0.87% to N22.17trn in July 2017 from N21.98trn in December 2016. **The CBN has maintained tight monetary policy to curb high inflation rate and ensure FX stability.**

Looking at the developments both in the domestic and international markets, a hold in rates at this meeting will be appropriate in order to sustain the current growth rate in the economy. However, the MPC may adjust the asymmetric corridor around the MPR to signify easing. Meanwhile, fiscal measures in the forms of tax relief and tariff adjustment are required to boost economic activities.

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**Table 1: Monetary Aggregates – N'mn**

| Month                  | Narrow Money | Quasi Money | Broad Money | 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 |
|------------------------|--------------|-------------|-------------|-------------------|----------------------|---------------------------|-------------------------------|---|
|                        | M1           | QM          | M2          |                   |                      |                           |                               |   |
| Jul-16                 | 9,230,931    | 12,951,257  | 22,182,188  | 42%               | 25,159,363           | 2,786,072                 | 22,373,291                    | 89%   |
| Aug-16                 | 9,125,897    | 12,521,428  | 21,647,325  | 42%               | 25,955,106           | 3,290,896                 | 22,664,210                    | 87%   |
| Sep-16                 | 9,937,237    | 12,184,093  | 22,121,330  | 45%               | 26,307,540           | 3,662,033                 | 22,645,506                    | 86%   |
| Oct-16                 | 10,023,617   | 12,251,896  | 22,275,513  | 45%               | 26,774,684           | 3,705,049                 | 23,069,635                    | 86%   |
| Nov-16                 | 10,429,541   | 11,953,374  | 22,382,915  | 47%               | 26,848,256           | 3,802,861                 | 23,045,396                    | 86%   |
| Dec-16                 | 11,068,107   | 12,320,226  | 23,388,333  | 47%               | 26,649,023           | 4,666,874                 | 21,982,149                    | 82%   |
| Jan-17                 | 10,866,032   | 12,113,228  | 22,979,260  | 47%               | 26,385,468           | 4,509,807                 | 21,875,662                    | 83%   |
| Feb-17                 | 9,994,995    | 12,153,000  | 22,147,995  | 45%               | 27,141,090           | 5,082,024                 | 22,059,065                    | 81%   |
| Mar-17                 | 9,954,591    | 12,069,736  | 22,024,327  | 45%               | 27,390,140           | 5,270,499                 | 22,119,642                    | 81%   |
| Apr-17                 | 9,757,108    | 11,952,562  | 21,709,669  | 45%               | 27,450,334           | 5,507,893                 | 21,942,441                    | 80%   |
| 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%   |
| Growth : Dec16-July 17 | (6.71%)      | (3.65%)     | (5.08%)     |                   | 1.92%                | 6.88%                     | 0.87%                         |   |

Source: Central Bank of Nigeria

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