The U.S Fed Rate Impact – Nigeria's Case

Despite the Fed Rate increase in December 2016, there was increased capital flow from foreign investors into the Nigerian economy in Q1 2017.

Emerging and developing countries, including Nigeria, are expected to be mainly affected by the United States Federal Reserve Rate (U.S Fed Rate) increase action. The International Monetary Fund (IMF) and other multilateral institutions have commented in their various global economic reports about the probable negative impact of the normalisation of monetary policy in the United States (U.S). The Fed Rate increase by the Federal Open Market Committee (FOMC) of the U.S. Federal Reserve (U.S Fed) is expected to bring about currency instability in emerging markets like Nigeria, as foreign portfolio investors may redirect investments towards the U.S Government Treasury Notes. Of note however is the fact that despite the Fed Rate increase in December 2016, there was increased capital flow from foreign investors into the Nigerian economy in Q1 2017, with more inflows expected in Q2 2017.

The Fed highlighted that its recent rate hike decision was based on the realised and expected labour market conditions and inflation rate in the U.S.

The U.S Fed again increased the Fed Rate at its June 2017 meeting to 1%-1.25% from 0.75%-1%, making it the third time the Fed has increased the Fed Rate since December 2015. The Fed highlighted that its recent rate hike decision was based on the realised and expected labour market conditions and inflation rate in the U.S. The inflation rate in the U.S stood at 1.9% in May 2017, down from 2.2% recorded in April 2017, and below the Fed target rate of 2%. It is the lowest inflation rate since November 2016, but above the 1.6% average over the past 10 years. Similarly, the U.S unemployment rate declined to 4.3% in May 2017, from 4.4% in April 2017; and below the Fed target of 6.5%. The May 2017 unemployment rate is the lowest jobless rate since May 2001. The Fed expects that economic conditions in the U.S will evolve in a manner that will need gradual increases in the Fed Rate. Meanwhile, the U.S. economy grew higher than expected in Q1 2017. It grew by 1.2% (quarter-on-quarter), higher than 0.9% expected by the market.

The U.S. Dollar has not significantly benefitted from the increased demand for U.S. Treasury Notes.

The yield on the 1.75% May 2023 U.S Government Treasury Note trended downwards between March 2017 and June 2017, as investors during the period reacted to the actual and anticipated further tightening of the Fed Rate. The average U.S Treasury Note yield between the FOMC meeting of March 2017 and May 2017 decreased to 2.07% from 2.21%. It further decreased to 1.97% between the May 2017 and June 2017 FOMC meetings. However, the U.S. Dollar has not significantly benefitted from the increased demand for U.S. Treasury Notes, as it depreciated by 1.87% to US$1.11 against the Euro, as at June 20, 2017 relative to its value after the Fed meeting of May 2017. The decrease in the inflation rate to 1.9% in May

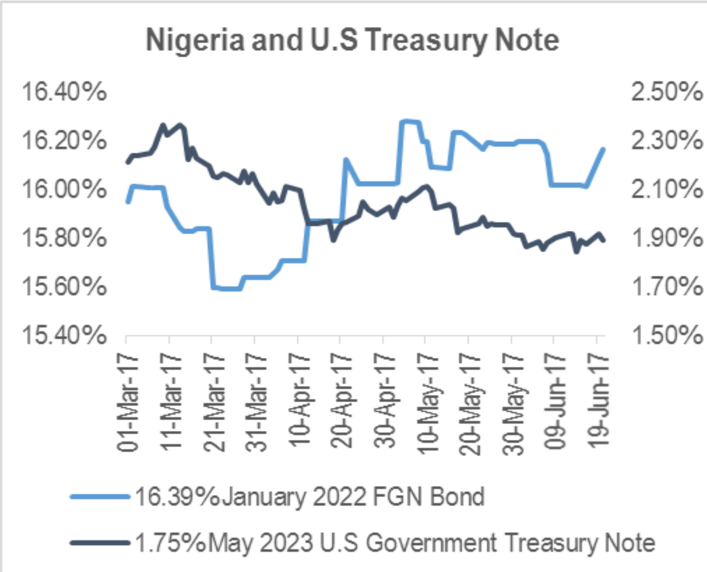
2017 from 2.2% in April 2017 is mainly responsible for the poor performance of the U.S Dollar during the period, as the market weighs the future path of the Fed expected rate increases.

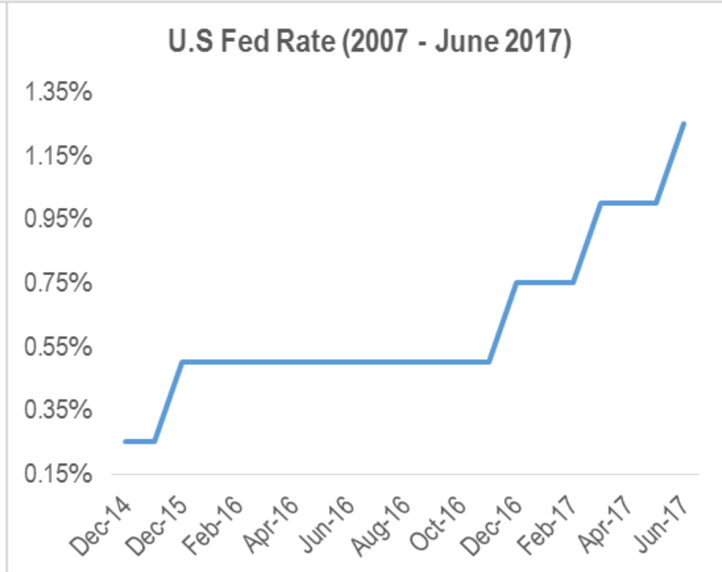
The improved oil production and favourable price of Bonny Light are the major reasons for the boost to the external reserves.

The value of the Naira appreciated at the parallel market, and remained stable at the inter-bank market in the period under review, despite the Fed's rate increase in June 2017. The consistent accretion to the external reserves has enhanced the capacity of the CBN to maintain stability in the foreign exchange market. The improved oil production and favourable price of Bonny Light are the major reasons for the boost to the external reserves. The inflows from foreign investors via Foreign Portfolio Investments (FPI) increased in Q1 2017. FPI recorded growth of 10.34% to US$313.61mn in Q1 2017, compared with Q4 2016, and a growth of 15.71% relative to Q1 2016. It recorded both quarterly and yearly increases, and the first year-on-year increase since Q3 2014. This was boosted by recent successes in stabilizing the value of the Naira. Meanwhile, the 16.39% January 2022 Nigeria Government Bond received a boost from investors, as demand increased between the FOMC meetings of May and June 2017. The yield decreased to 16.16% as at June 20, 2017 from 16.28% as at May 04, 2017. The yields on the Federal Government of Nigeria (FGN) Treasury Bills and Bonds offer attractive returns, as macroeconomic risks in the economy wanes.

The normalisation of monetary policy by the U.S Fed is not expected to have an overtly negative impact on the Nigerian economy in the short-term.

The Nigerian economic environment continues to strengthen, with a positive outlook for consumption and investment expenditure that would lift aggregate demand in the economy. There is a renewed resurgence of foreign capital inflows because of a positive economic outlook for Nigeria. The normalisation of monetary policy by the U.S Fed is not expected to have an overtly negative impact on the Nigerian economy in the short-term. **The Nigerian fixed income market offers attractive yields that will pull foreign capital inflows and help to further strengthen the value of the Naira. However, a negative shock to the level of oil production and oil price remain critical downside risks to the positive economic outlook for the Nigerian economy.**





Sources: Trading Economics, FMDQ and United States Federal Reserves

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