Is Expansionary Monetary Policy Appropriate?

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We expect the Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) to hold rates at the current levels when it meets on January 23-24, 2017. Although the inflationary pressure and weak exchange rate justify a rate hike, it may be a difficult policy given the need to implement policies to boost growth in the economy. The CBN will continue to use the Open Market Operations (OMO) to manage liquidity to achieve the desired goals in the short-term. At its November 2016 meeting, the MPC maintained the Monetary Policy Rate (MPR) at 14%, with the asymmetric corridor at +200 basis points and -700 basis points; retained the Cash Reserve Requirement (CRR) and Liquidity Ratio (LR) at 22.50% and 30% respectively.

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The International Monetary Fund (IMF) stated that economic activity is projected to improve in 2017 especially in emerging market economies. This is contained in its latest World Economic Outlook (WEO) Update for January 2017. The IMF projects global growth at 3.4% in 2017, from an estimated growth of 3.16% in 2016. Advanced economies are projected to grow by 1.9% in 2017, from 1.6% in 2016, led by growth in the United States (U.S). **The IMF projects a growth of 4.5% for the Emerging Markets and Developing Economies from an estimate of 4.1% in 2016, as policy stimulus and improvements in commodity prices aid growth.**

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The new administration in the U.S. led by Mr. Donald Trump has promised to embark on expansionary fiscal policy to build infrastructure and lower taxes. This policy may drive inflation rate in the U.S beyond the 2% target set by the Federal Open Market Committee (FOMC) of the U.S Federal Reserve (The Fed). The FOMC may respond by a rate hike faster than earlier anticipated. Consequently, global yields may rise with a possible capital flight from other countries into the U.S. **The appropriate monetary mitigant in Nigeria under this situation is a tight monetary policy.**

The IMF estimates Gross Domestic Product (GDP) contraction in Nigeria in 2016 at 1.5%, but to grow by 0.8% in 2017. The Nigerian economy has been plagued with a number of macroeconomic issues, as well as insecurity in certain parts of the country that are now experiencing some relief. There is still foreign exchange shortages as a result of lower export revenue linked to the drop in oil price and production. There is an improvement in Nigeria's economic outlook because of the increase in oil output and the impact of the supply cut by the Organization for Petroleum Exporting Countries (OPEC). **In the short-term, a hold decision will be appropriate.**

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The inflationary pressure still persists in Nigeria, as we expect the January 2017 inflation rate to increase further from the December 2016 figure. The inflation rate increased in December 2016 to 18.55%, from 18.48% in November 2016. The inflation rate in the medium term would be driven by the base effect from previous higher prices, expected good food crop harvest and, possible increase in electricity tariff and pump price of Premium Motor Spirit (PMS). **Given the outlook of inflation rate between now and the next MPC meeting, a rate cut will be counter-productive.**

The decision of the OPEC and some non-OPEC countries for coordinated cuts in oil output agreed in November 2016 has led to a significant boost to oil prices. **The average price of Bonny Light was US$54.21/b in December 2016, up by 19.27% from US$45.45/b in November 2016. The price of Bonny Light crude oil also increased by 17.44% to US$55.09b as at January 17, 2017 from US$46.91/b on November 22, 2016.** The secondary data from the OPEC shows that Nigeria's oil output decreased by 7.23% to 1.54mbd in December 2016, from 1.66mbd as at November 2016. **The ongoing talks in the Niger Delta region and the provision for the amnesty programme in Budget 2017 could restore oil output.**

*The ongoing talks with the Niger Delta militants and the provision for the amnesty programme in Budget 2017 could restore oil output***.**

The external reserves increased consistently after the last MPC meeting in November 2016. The 30-day moving average external reserves increased by 11.51% from US$24.50bn as at November 22, 2016 to US$27.32bn as at January 17, 2017**.** The increase in oil production from September 2016 up till November 2016 boosted the external reserves. The support from the African Development Bank (AfDB) contributed to the external reserves. **A rate cut may lead to capital flight. Thus, we expect the MPC to hold rates while it awaits complementary fiscal policy support.**

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The Naira depreciated at the inter-bank and parallel markets between the last MPC Meeting and January 17, 2017. It recorded a marginal depreciation of 0.08% at the inter-bank market to close at US$1/N305.25 on January 17, 2017 from US$1/N305 on November 22, 2016. The premium between the inter-bank and parallel markets averaged about N181 after the last MPC meeting in November 2016. The parallel market rate also depreciated by 6.12% to US$1/N498.50 on January 17, 2017 from US$1/N468 on November 22, 2016**. A rate cut may lead to further depreciation in the value of the Naira.**

The average yields on the 182-day and 364-day Nigerian Government Treasury Bills (NTBs) increased to 19.17% and 22.98% in December 2016, compared with 19.11% and 22.85% respectively in November 2016. The 91-day NTB closed unchanged at 14.50% in December 2016. The yields on the NTBs sold on January 04, 2017 were at 14.51%, 19.17% and 22.98% on the 91-day, 182-day and 364-day NTBs, respectively. However, the average yield on the 16% June 2019; 16.39% FGN Bond January 2022 and 10% July 2030 increased to 15.65%, 15.71% and 15.86% in December 2016 from 14.99%, 15.26% and 15.61% in November 2016. They stood at 16.37%, 16.10% and 16.30% as at January 18, 2017. **The increase in yields reflects the current rising inflation rate and weak exchange rate.**

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The monetary aggregates and credits to the private sector grew in the first ten months of the year, and above the target rates for 2016. The growth in credit was mainly from the impact of devaluation of the Naira. The broad money supply (M2) increased by 11.21% to N22.28trn in October 2016, from N20.03trn in December 2015; an annualized growth of 13.45%. The provisional growth benchmark for 2016 is 10.98%. The narrow money (M1) grew by 16.94% to N10.02trn in October 2016, from the end-December 2015 figure**.** Net Domestic Credit (NDC) also grew by 23.89% in the same period; an annualized growth of 28.67%. The provisional benchmark growth for 2016 is 17.94%. The credit to government increased by 280.06% during the

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period. Similarly, credits to the private sector grew by 23.24% for October 2016, compared with December 2015; an annualized growth of 27.89%. The benchmark growth for 2016 is 13.28%.

Table 1: Monetary Aggregates – 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		-	-	-	
Dec-15	8,571,701	11,458,130	20,029,831	43%	21,612,452	2,893,189	18,719,263	87%
Jan-16	8,247,317	11,439,835	19,687,153	42%	22,222,742	3,337,518	18,885,224	85%
Feb-16	9,059,578	11,429,588	20,489,167	44%	22,414,323	3,424,030	18,990,293	85%
Mar-16	9,040,818	11,429,618	20,470,436	44%	22,664,816	3,782,578	18,882,238	83%
Apr-16	9,136,068	11,591,841	20,727,909	44%	23,312,346	3,933,735	19,378,611	83%
May-16	9,391,866	11,330,042	20,721,908	45%	22,852,137	3,803,178	19,048,959	83%
Jun-16	9,125,933	12,559,032	21,684,965	42%	24,318,143	2,893,190	21,424,953	88%
Jul-16	9,230,931	12,951,257	22,182,188	42%	25,159,363	2,784,110	22,375,253	89%
Aug-16	9,125,897	12,521,428	21,647,325	42%	25,955,106	3,290,896	22,664,210	87%
Sept-16	9,949,385	12,184,093	22,133,478	45%	26,341,471	3,748,843	22,592,628	86%
Oct-16	10,023,617	12,251,896	22,275,513	45%	26,774,684	3,705,049	23,069,635	86%
Growth : Dec-Oct	16.94%	6.93%	11.21%		23.89%	28.06%	23.24%	

Source: Central Bank of Nigeria

Looking at the economic developments in the country and the impact of the external developments on the Nigerian economy, we expect the MPC to hold rates at the current levels. If the peace in the Niger Delta region is maintained, oil output may increase. This will increase exports and inflow of foreign exchange. The need for the Federal Government Nigeria (FGN) to borrow aggressively may reduce and interest rate and inflation rate may drop. All these may take a couple of months to happen.

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