Strong Argument to Lower the CRR:

MPR: Hold
CRR: Reduce
Liquidity Ratio: Hold

The Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) is expected to hold its fifth meeting for the year 2015 between September 21-22, 2015. As usual, the MPC would consider the domestic and international economic and financial conditions in order to implement policies that would influence the Nigerian economy and financial market in the next few weeks. At the end of its July 2015 meeting, the MPC maintained the Monetary Policy Rate (MPR) and the Liquidity Ratio (LR) at 13% and 30% respectively, and maintained the Cash Reserve Requirement (CRR) on public and private sector deposits at 31%. The recent domestic and international economic and financial market developments provide strong arguments for the MPC to change its policy stance in order to increase the level of liquidity in the financial market to support credit growth in the economy.

China's economy is forecast to grow at a slower pace of 6.8% in 2015 and 6.4% in 2016.

According to the latest monthly oil market report for August 2015 of the Organization for Petroleum Exporting Countries (OPEC), the world economic growth is forecast at 3.1% and 3.4% for 2015 and 2016, respectively. The U.S. GDP growth rate was revised up to 2.5% in 2015 from 2.4% previously. The report also noted that the slowing Chinese growth may negatively impact the major economies in the Euro-zone. Japan's close trading ties with China also led to a downward revision of Japan's 2015 GDP growth from 1.2% to 0.8%. China's economy is forecast to grow at a slower pace of 6.8% in 2015 and 6.4% in 2016. India, on the other hand, constitutes an exception, as growth is forecast to rise in 2016 to 7.6% from 7.4% in 2015. Meanwhile, the Federal Open Market Committee (FOMC) of the U.S. Fed has kept the Fed Rate unchanged at 0-0.25% at its September 2015 meeting. The FOMC's decision was hinged on the recent global economic and financial developments, which it said somewhat restrain economic activity and are likely to put further downward pressure on inflation in the U.S. in the near term. *The weak global economic recovery and the negative impact on oil price is a major external shock, and this calls for a monetary policy action to boost credit growth to develop the non-oil sector of the Nigerian economy.*

Looking at the trend analysis of the yield on the 1-year U.S. Treasury Bill and the 1-year Nigeria Treasury Bill (NTB), we observed that the premium between the yields on the two bills increased to 16.84% as at September 14, 2015 from 14.58% as at July 30, 2015. The current yields on the Nigerian fixed income instruments are higher both in relative and absolute terms, compared to its peers. *This may further attract funds to the market.*

We expect the CBN to reduce the CRR in order to inject additional liquidity in the system.

The implementation of the Treasury Single Account (TSA) has brought about liquidity tightness in the system, with about N1.2trn withdrawn from the banking system to the CBN. As at Half Year 2015, we estimated the total deposits of the Nigerian banks at N18.06trn. If N1.20trn, which represents the FGN deposit is withdrawn, the total private, state and local governments' deposits would be N16.86trn. Assuming that the total State Governments of Nigeria (SGN) and Local Governments (LG) deposits represent about 60% of the FGN deposits, N720bn would be withdrawn if all the SGN and LG implement the TSA policy, bringing the total withdrawal to N1.92trn. The total private sector deposit that would be in the system is N16.14trn. Following the full implementation of the TSA on all government deposits, we expect total credits of about N595.2bn into the system via CRR refund, made up of N372bn from FGN deposit and N223.20bn from the SGN and LG deposits. The system liquidity would therefore be short by about N1.33trn compared with the pre-TSA implementation. Meanwhile, the system liquidity would be short by N828bn if only FGN deposits are withdrawn. *We expect credit creation to be adversely affected because of this policy if additional liquidity is not injected into the system.*

With an appropriate policy response from the CBN, the shortage in the system liquidity can be managed. *In our view, the most cost effective policy response from the CBN is through the reduction in the CRR. A reduction in the CRR to 26.09% will completely neutralise the impact of the TSA implementation on the FGN Deposits, while a reduction of CRR to 22.79% will completely neutralise the impact of the implementation of TSA on all government deposits. Any reduction beyond what we mentioned here will inject more liquidity into the system than pre-TSA implementation.*

Our projection shows that the inflation rate would increase to 9.7% at the end of 2015.

The inflation rate increased to 9.3% in August 2015. The increase in the inflation rate was due to the relatively high prices for food products from irregular rainfall and delayed planting, as well as the impact of the devaluation of the Naira on the imported goods. Our projection shows that the inflation rate would increase to 9.7% at the end of 2015 and above the CBN's target range of 6-9%. *We do not expect the MPC to tweak the MPR to mitigate the negative inflationary outlook, as the drivers of the inflation rate are of transient nature and outside the direct control of monetary policy. Moreover, there is a need for a proper and effective coordination of monetary, fiscal and structural policies to mitigate inflationary pressure.*

The turbulence in the Chinese economy has brought further downward pressure on oil prices. The average OPEC Reference Basket fell for the third month in a row in August at US$45.46/b to reach near-January lows of an average price of US$44.41/b, a trend seen during the financial crisis six years ago. The Bonny Light average price for August 2015 was US$47.50/b, also similar to the average price of US$47.82/b in January 2015. The Bonny Light price decreased by 14.51% to US$43.85/b on September 14, 2015 from US$51.29/b on July 27, 2015. *The weak and unbalanced global economic recovery is keeping oil prices at historical low levels. The movement in oil price is outside the control of the Nigerian policy makers. There is a need for policy that will develop the non-oil export and will reduce the country's high oil export dependency.*

There were appreciations in the parallel and inter-bank markets of the foreign exchange market in August 2015.

There were appreciations in the parallel and inter-bank markets of the foreign exchange market in August 2015, as there was increased convergence between the two markets due to the administrative measures put in place by the CBN. The official market closed unchanged at US$1/N197 during the review period. *The Presidency has endorsed the current exchange rate policy of the CBN and we expect it to continue.*

We expect the MPC to reduce CRR to 20% to support credit growth.

The recent build up in the external reserves arising from the demand management of the foreign exchange by the CBN has been reversing since August 13, 2015. The external reserves has been drawn down by the CBN to meet the demand arising from foreign investors that sold and wanted to repatriate their funds after the indication by JP Morgan to remove the included Federal Government of Nigeria Bond from its Global Bond Market Emerging Market Index starting from September 30, 2015 to October 30, 2015. The 30-day moving average external reserves decreased by 1.25% to US$30.69bn as at September 14, 2015 from US$31.08bn on July 27, 2015. *We do not expect a change in the administrative measures put in place by the CBN in the management of the foreign exchange.*

Looking at the recent development, we expect the MPC members to hold the MPR and the LR at the current rate, while the implementation of the TSA is a compelling reason for the reduction of the harmonized CRR to about 20% in order to neutralize the impact of the withdrawal of FGN funds from the banks via the TSA implementation and inject additional liquidity to support create growth in the economy.

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: Mainstreet Bank Building (2nd floor, 5 Trans Amadi Road, Port Harcourt. (Tel): 234-8024081331
Abuja Office: Leadway House (Ground Floor), Plot 1061 Herbert Macaulay way, Central Business District, Abuja-Nigeria. Tel.: 09-6700535, 09-2731170

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