MPC Meeting: Considerations and Policy Options

Time for Monetary Policy Reversal?

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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 the Committee meets on July 24 and 25, 2017. Although the need to stimulate economic growth justifies an expansionary monetary policy decision, it would be counterproductive to cut rates given the weak foreign exchange rate and high inflation rate at the moment. At its May 2017 meeting, the MPC maintained the Monetary Policy Rate (MPR) at 14%, with the asymmetric corridor at +200 and -700 basis points; retained the Cash Reserve Requirement (CRR) and Liquidity Ratio (LR) at 22.50% and 30% respectively.

World Bank forecasts global growth at 2.7% in 2017.

In its June edition of the Global Economic Prospects report, the World Bank notes that, global economic activity is firming broadly as expected. It opined that global manufacturing and trade are picking up, confidence is improving, and international financing conditions remain positive. It forecasts global growth at 2.7% in 2017 and 2.9% in 2018-19, in line with its January 2017 forecasts. The Bank indicated that the risks to the global outlook remain tilted to the downside: increased trade protectionism, elevated economic policy uncertainty, the possibility of financial market disruptions, and, over the longer term, weaker potential growth. In our opinion, the Federal Government of Nigeria (FGN) should continue to implement structural policies that support productivity, investment and trade so that Nigeria will not become a dumping ground.

The FOMC increased the Fed Fund Rate by 0.25% to a range of 1.0% - 1.25%.

The Federal Open Market Committee (FOMC) of the United States (U.S) Federal Reserve (The Fed) increased the Federal Funds Rate (The Fed Fund Rate) at its June 2017 meeting. The Fed increased the Fed Fund Rate by 0.25% to 1.0% - 1.25%. The unemployment rate in the U.S increased to 4.4% in June 2017 from 4.3% in May 2017, but below the 6.5% target. The inflation rate in the U.S dropped to 1.6% in June from 1.9% in May 2017 and below the 2.0% target of The Fed. Meanwhile, the U.S Gross Domestic Product (GDP) grew at 1.4% in Q1 2017, from 2.1% in Q4 2016. **Although we expect the FOMC to hold the Fed Fund Rate on July 25 - 26 2017 when it meets, there are indications that it will increase the rate further in 2017. The short-term outlook of monetary policy in the U.S. does not justify a rate cut in Nigeria at this meeting.**

The Business and Consumer Expectation Surveys that the CBN published for the month of June 2017 show that the confidence of both the firms and consumers about Q3 2017 and next 12months has improved.

The hope that the Nigerian economy will exit the current recession has improved further as the manufacturing and non-manufacturing activities increased in the month of June 2017 despite the decrease in the monetary aggregates. A review of the latest Purchasing Managers' Index (PMI) that the CBN published for the month of June 2017 confirms this. The PMI report shows that the Composite Manufacturing Index (CMI) expanded for the third consecutive month in the year 2017 to attain the highest level since March 2015. The CMI increased to 52.9 points in June 2017 from 52.5 points in May 2017. The Composite Non-Manufacturing Index (CNMI) also expanded to 54.2 points in June 2017 from 52.7 points in May 2017 to attain the highest level since December 2014. PMI below 50 points level suggests a decline in business activity, PMI higher than 50 points level suggests an expansion while PMI at the 50 point level suggests no change. The month of June is the second consecutive month of increase in the CNMI. In addition, the Business and Consumer Expectation Surveys that the CBN published for the month of June 2017 show that the confidence of both the firms and consumers about Q3 2017 and next

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12months has improved. **In our opinion, the current monetary policy stance of the CBN particularly the increase in foreign exchange supply has contributed to this. A hold decision at this meeting is appropriate to achieve stability.**

The inflation rate (Year on Year) dropped to 16.10% in June 2017, from 16.25% in May 2017. This represents the fifth consecutive month of a decline in the inflation rate since January 2017. The month-on-month change in the CPI stood at 1.58% in June 2017, lower than 1.88% recorded in May 2017. M-o-m inflation rate has cumulatively increased by 9.28% since January 2017. Thus, inflationary pressure persists in Nigeria and the current and short-term outlook on inflation are higher than the CBN target of 6% - 9%. **The FGN's decision on Premium Motor Spirit (PMS) price, electricity tariff, and developments in the food market regarding export opportunities remain the downside risks to low inflation rate in the short-to-medium term. Therefore, a rate cut is not appropriate.**

The latest production data from the Nigerian National Petroleum Corporation (NNPC) shows that Nigeria's average oil output decreased by 12.09% to 1.60mbd in March 2017, from 1.82mbd as at February 2016. The average price of Bonny Light was US$47.15/b in June 2017, a decrease of 8% from the average price of US$51.25/b recorded in May 2017. Meanwhile, the price of Bonny Light crude oil decreased by 10.90% to US$48.16/b as at July 13, 2017 from US$54.05/b on May 23, 2017**. The global economic growth recovery signals a positive impact on crude oil prices, but the possibility of excess global supply still persists. Thus, a rate cut is not desirable given these conditions and the impacts on exchange rate in Nigeria.**

The external reserves dropped marginally in June 2017 because of the strategy of the CBN to increase the supply of foreign exchange to meet all genuine demand. The 30-day moving average external reserves decreased marginally by 0.13% to US$30.29bn as at end-June 2017, from US$30.33bn at end-May 2017. The average external reserves stood at US$30.25bn in June 2017, from US$30.73bn in May 2017. The external reserve stood at US$30.36bn as at July 11, 2017. **The MPC may consider a rate hold to avoid any negative impact on the external reserve from a rate cut.**

The value of Naira recorded a mixed performance since the last MPC meeting in May 2017. The value of the Naira appreciated at the parallel market, while it depreciated at the official market. It recorded an appreciation of 2.96% at the parallel market to close at N369/US$ on July 17, 2017 from N383/US$ on May 23, 2017. The inter-bank market rate depreciated by 0.15% to N305.90/US$ on July 17, 2017 from N305.45/US$ on May 23, 2017**.** The premium between the inter-bank and parallel markets averaged about N70 after the last MPC meeting in May 2017, from an average of N90 during the period between March and May 2017 meeting. **A rate cut is not appropriate given the possibility of persisting excess global crude oil glut and interest rates hike by major central banks across the globe.**

The monetary aggregates as at May 2017 show that the annualised growth rate in the money supply is below the target set by the CBN for the year 2017.

The yields on NTBs moved in different directions in June 2017, compared with May 2017. At the June 2017 NTBs auction, average yield on the 91-day closed unchanged at 13.97%, same as in May 2017. The average 182-Day NTB stood at 19.05%, up from 18.79% in May 2017. The average 364-Day NTB yield closed lower at 20.81%, from 23.02% in May 2017. The yields on the FGN Bonds that we monitored also recorded varying performance in June 2017 over the preceding month. The average yield on the 16% FGN June 2019 increased marginally to 16.45% in June from 16.39% in May. The 16.39% FGN Jan 2022 closed at 16.11% in June 2017, lower than 16.18% in May 2017; the 10% FGN Jan 2030 also closed at 16.03% in June 2017, marginally lower than 16.04% in May 2017.

The monetary aggregates (narrow money and broad money) as at May 2017 show that the annualised growth rate in the money supply is below the target set by the CBN for the year 2017. The broad money supply (M2) declined by 6.04% in May 2017, compared with December 2016, and lower than the provisional growth benchmark rate of 10.29% for 2017. Net Domestic Credit (NDC) increased marginally by 0.41% to N26.8trn in May 2017, from N26.6trn in December 2016, representing an annualised growth rate of 1%, and significantly lower than the growth rate target of 17.93% for 2017. The net domestic credit to the Federal Government increased by 3.45% to N4.8trillion in May 2017 from N4.7trillion in December 2016 but the net domestic credit to private sector dropped marginally by 0.23% to N21.93trillion in May 2017 from N21.98trillion in December 2016. **The shortfall in the monetary aggregates compared with the target justifies an expansion in monetary policy. However, the need to maintain foreign exchange rate stability and tame the current high inflation rate will be an overriding consideration to maintain rates.**

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		-	-	-	
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	2,786,072	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%	26,758,769	4,828,059	21,930,710	82%
Growth : Dec16-May 17	(7.98%)	(4.30%)	(6.04%)		0.41%	3.45%	(0.23%)	

Source: Central Bank of Nigeria

Looking at the economic developments in Nigeria and the impact of external developments on the Nigerian economy, we expect the MPC to hold rates at the current levels. The combination of normalization of monetary policy by some central banks in advance economies, the developments in the crude oil markets, the need to ensure foreign exchange rate stability and to tame the high inflation rate do not justify a rate cut. A rate hike would also lead to a negative impact on economic recovery. Thus, we expect the MPC to hold rates at the July 2017 meeting, while it awaits the full impact of its previous monetary policy actions to achieve the desired results.

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:** 2nd Floor, Skye Bank Building (Former Mainstreet Bank Building), 5 Trans Amadi Road, Port Harcourt. Tel: 234-802 408 1331*

***Abuja Office:** Leadway House (1st Floor), Plot 1061 Herbert Macaulay way, Central Business District, Abuja-Nigeria. Tel.: 234-9-2918821*

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