A Change in Monetary Policy-Too Soon

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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 March 20-21, 2017. Although both the inflation rate and foreign exchange rate have shown signs of improvement in the last few weeks, a change in monetary policy might be too soon. We believe more time is required before a monetary policy change can be effective under the current situation. At its January 2017 meeting, the MPC maintained the Monetary Policy Rate (MPR) at 14%, with the asymmetric corridor at +200 basis points and -500 basis points; retained the Cash Reserve Requirement (CRR) and Liquidity Ratio (LR) at 22.50% and 30% respectively.

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The Organization of the Petroleum Exporting Countries (OPEC) in its March 2017 monthly report forecast global growth at 3.2% in 2017, from 3% in 2016. OPEC added that higher-than-anticipated economic growth may come from the U.S. and the Euro-zone, as well as Japan to some extent. Upside potential also exists in the emerging economies of China, India, Brazil and Russia. At the same time, political and economic uncertainties could hamper the global economy from further and faster improvements, including upcoming elections in major European economies, developments regarding Brexit, and fiscal, monetary and trade policies. **The expected growth in the global economy may boost commodity demand, including crude oil, with a positive impact on the value of the Naira.**

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The Federal Open Market Committee (FOMC) of the U.S Federal Reserve (The Fed) increased the Federal Funds Rate (The Fund Rate) at its March 2017 meeting. The Fed increased the Fed Rate by 0.25% to a range of 0.75% - 1.00%, from a range of 0.50% - 0.75%. The unemployment rate dropped to 4.7% in February 2017 below the 6.5% target while the inflation rate increased to 2.7% in February 2017 above the 2.0% target. The expansionary fiscal policy plans of the Trump administration may lead to further rate hike in 2017. **The increase in the Fed Rate may increase the dollar denominated yields and may lead to capital flight from the emerging markets economies. Thus a drop in rate in Nigeria which may lower the yields on the fixed income securities may be counterproductive.**

In line with our expectations, the Nigerian economy contracted in Q4 2016 and Full Year (FY) 2016, according to the Gross Domestic Product (GDP) figures that the National Bureau of Statistics (NBS) published. The real GDP contracted by 1.30% (year-on-year) in Q4 2016, compared with the growth of 2.11% recorded in Q4 2015 but better than the contraction of 2.24% recorded in Q3 2016. The real GDP contracted by 1.51% in 2016, compared with the growth of 2.79% recorded in 2015. **We are of the opinion that the Nigerian economy should move into positive territory in Q2 2017. This recovery is based on the improvements in crude oil production, oil price above US$50/b and the rise in external reserves. The growth in the Agricultural Sector supported by the Anchors Borrowers Program (ABP) of the CBN will also contribute to the recovery of the Nigerian economy. The planned FGN Savings Bond and the efforts of the Federal Government to reflate the economy will also support this argument.**

The imminent increase in the electricity Tariff and the petrol pump price of Premium Motor Spirit (PMS) will limit the rate of drop in the inflation rate in the short-term.

The inflation rate dropped for the first time in 15 months in February 2017 in line with our expectation. The inflation rate decreased in February 2017 to 17.78%, from 18.72% in January 2017. The drop in the inflation rate was because of base effect. **The imminent increases in the electricity tariff and the pump price of Premium Motor Spirit (PMS) will limit the rate of drop in the inflation rate in the short-term. We however note that the**

expected increase in food production in the country on account of favourable policies will dampen food prices, which may lower the inflation rate. We expect the MPC to maintain a "wait and see" approach and hold rates at their current levels.

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The oil production from the Niger Delta has been on a consistent increase, as the FGN continues to engage the region on a sustainable solution to their socio-economic problems. The production data from the Nigerian National Petroleum Corporation (NNPC) shows that Nigeria's average oil output increased by 7.87% to 1.92mbd in November 2016, from 1.78mbd as at October 2016. The average price of Bonny Light was US$55.50/b in February 2017, up marginally by 0.71% from US$55.11/b in January 2017. Meanwhile, the price of Bonny Light crude oil also decreased by 6.94% to US$51.24/b as at March 09, 2017 from US$55.06/b on January 24, 2017**. The combination of improved crude oil production and the increase in oil price have boosted the external reserves. This has increased the supply of foreign exchange necessary to maintain stability in the foreign exchange rate, resulting in an increase in investors' confidence in the economy. A rate cut may be too soon.**

The favourable price of oil in the international market and the consistent increase in oil output has increased the external reserves in recent times. The 30-day moving average external reserves increased by 9.04% from US$27.76bn as at January 24, 2017 to US$30.27bn as at March 15, 2017**. A policy change at this point may reverse the recent gains.**

The Naira depreciated at the inter-bank market, while it appreciated at the parallel market between the last MPC Meeting and March 16, 2017. It recorded a marginal depreciation of 0.41% at the inter-bank market to close at N306.75/US$ on March 16, 2017 from N305.50/US$ on January 24, 2017. The premium between the inter-bank and parallel markets averaged about N180 after the last MPC meeting in January 2017. However, the parallel market rate appreciated by 9.41% to N457/US$ on March 16, 2017 from N500/US$ on January 24, 2017**. The recent policy of the CBN to increase the supply of foreign exchange in the inter-bank market requires some time for the economy to feel the full impact. Thus a hold decision is appropriate.**

The yields on the NTBs sold on March 15, 2017 were at 14.08%, 18.81% and 22.79% on the 91-day, 182-day and 364-day NTBs, respectively.

The average yields on the 91-day Nigerian Government Treasury Bill (NTB) decreased to 14.10% in March 2017, from 14.23% in February 2017. The 182-day NTB remained at 18.81% in March 2017, same as at February 2017. The 364-day NTB however increased to 22.74% in March 2017, compared with 22.69% in February 2017. The yields on the NTBs sold on March 15, 2017 were at 14.08%, 18.81% and 22.79% on the 91-day, 182-day and 364-day NTBs, respectively. Meanwhile, the average yield on the 16% FGN Bond June 2019; 16.39% FGN Bond January 2022 and 10% FGN Bond July 2030 decreased to 16.02%, 16.05% and 16.19% in February 2017 from 16.27%, 16.08% and 16.26% in January 2017. **The decrease in yields reflects the declining inflation rate expectation and confidence of investors, both domestic and foreign, in the short-to-medium term outlook on the Nigerian economy.**

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The monetary aggregates and credits to the private sector grew in 2016, compared with 2015 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 19.02% to N23.84trn in December 2016, from N20.03trn in December 2015. The provisional growth benchmark for 2016 is 10.98%. The narrow money (M1) grew by 34.40% to N11.52trn in December 2016, from the end-December 2015 figure**.** Net Domestic Credit (NDC) also grew by 24.79% in the same period. The provisional benchmark growth for 2016 is 17.94%. The credit to government increased by 58.84% during the period. Similarly, credits to the private sector grew by 19.53% for December 2016, compared with December 2015.

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%
Nov-16	10,429,541	11,953,374	22,382,915	47%	26,848,256	3,802,861	23,045,396	86%
Dec-16	11,520,167	12,320,226	23,840,392	48%	26,970,298	4,595,580	22,374,718	83%
Growth : Dec15-Dec 16	34.40%	7.52%	19.02%		24.79%	58.84%	19.53%	

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. We are also of the opinion that the Nigerian economy should move into positive territory in Q2 2017. This recovery is based on the improvements in crude oil production, oil price above US$50/b and growth in the agricultural sector. The planned FGN Savings Bond and the efforts of the Federal Government to reflate the economy will also support this argument.

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