

Monetary Policy Preview

Growth concern to spur dovish stance

- The Central Bank of Nigeria (CBN) is set to commence its two-day monetary policy committee meeting next week Monday. As its usual practice, the committee will assess developments on both the domestic and global landscape, which we believe will inform its decision at the end of the meeting on Tuesday. In this report, we consider recent global and domestic economic developments since the last MPC meeting in May, and how these developments will inform the committee's decision at the end of the meeting on Tuesday.
- On the global front, dovish stance by various Central banks dominated the global monetary environment over the first half of 2019. As a matter of fact, a rate cut by the US Fed in the coming months now looks more probable than before with the US Fed dot plot indicating support for a rate cut by 8 members out of 12. In the past 3 weeks, the monetary authorities in India, Indonesia, South Korea and South Africa cut benchmark rates all by 25bps each.
- Shifting focus to our domestic environment, headline inflation once again surprised, albeit positive. Notably, inflation for the month of June eased to a 12-month low of 11.22% YoY (May: 11.4%) largely on the back of lower food inflation. In spite of persisting conflicts in the Northern region, food inflation moderated 24bps to 13.6%. We believe the lower food inflation reading reflected a bumper harvest in some states, particularly in Kebbi. Going forward, we expect inflationary pressure to dissipate further. Our forecast suggests headline inflation averaging 10.9% in 2019 (2018: 12.1%).
- **CBN adopts moral suasion.** On other fronts, within a space of two weeks, the CBN issued two different guidelines to the Deposit Money Banks (DMBs), an indirect move to induce banks to give credit to the private sector and support growth. The first one entailed DMBs maintaining a minimum Loan to Deposit ratio of 60% by the end of Q3 19 (**See report: *Love letter from the apex bank***), with the second coming in the form of a voluntary rejection of excess liquidity deposited by the banks to CBN via the Standard Deposit Facility (**See report: *CBN delivers another news***).

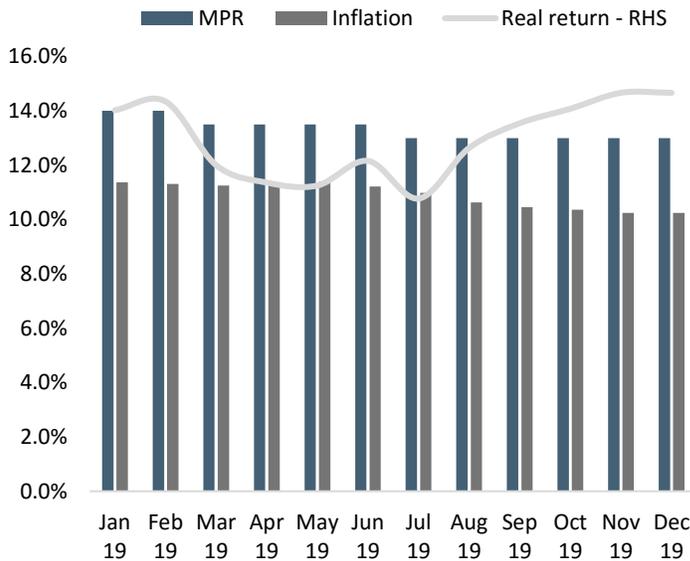
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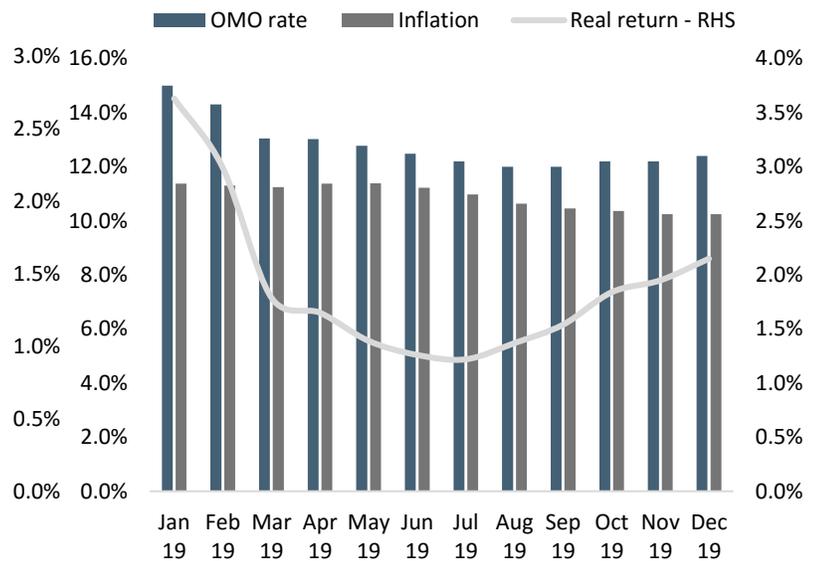
- Slowing tap of offshore funds, but no cause for alarm.** Although, net inflows moderated in June (-16.1% MoM to \$333 million), net flows into the IEW has remained positive for 7 consecutive months. Notably, while inflows have slowed, outflows in the window continue to remain low relative to the latter part of last year. Reflecting the improved liquidity in the window, the apex bank restrained from its usual intervention at the window for two consecutive months. With the slowing inflows to the market, FX reserves depleted slightly (the first in 3 months) by \$54 million to \$45.1 billion – after an accretion of more than \$2.3 billion this year – at the end of June. Nonetheless, the NAFEX rate remained resilient appreciating by 0.02% MoM to ₦360.54/\$. Going into the rest of the year, we reiterate our view on naira stability with FX reserve expected to end the year at \$43 billion on our base case. For clarity, our positive view is anchored on the comfortable FX reserve level as well as less threat to FPI outflow following a dovish stance by major central banks.
- OMO rates slides further.** Taking a look at recent trend in CBN’s OMO auctions, net issuances dropped sharply in June with rates dropping much faster. Since the last MPC meeting, the apex bank has cut OMO rates commutatively by 53bps to 12.25%. In our view, this reflects lesser threat to the naira emanating from lower near-term fixed income maturities as well as the apex bank’s renewed drive to support growth. Going into the rest of the year, we see less room for aggressive tightening – despite higher maturity profile in Q4 19, on the back of: (i) dovish stance of major central banks in advanced economies indicating a less threat to the naira via FPI outflow (ii) and dissipating inflationary pressures in the coming month. Tying this with CBN’s recent posture on persuading banks to give credit to the private sector, we expect same posture trend to extend to the MPC’s decision at the end of its meeting on Tuesday, with our model suggesting a 50 – 100bps reduction in the benchmark MPR rate.

Figure 1: MPR vs Inflation trend



Source: CBN, NBS, ARM Research

Figure 2: OMO rate vs Inflation



Source: CBN, NBS, ARM Research

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