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Monetary Policy review

CBN goes all out on easing

- Yesterday, the Central Bank of Nigeria concluded its two-day policy meeting with the Monetary Policy Committee (MPC) announcing some changes to the policy parameters. Firstly, the Monetary Policy Rate (MPR) was reduced by 100 bps to 11.5%, the lowest since 2016 when the economy was embattled with a recession. Also, the MPC adjusted the asymmetric corridor from +200/-500 bps to +100/-700 bps around the MPR.
- Major deliberations centred on the economy which is currently faced with a recession threat. For clarity, Q2 GDP showed the economy contracted by 6.1% YoY due to the impact of the global pandemic. Furthermore, both the manufacturing (48.5 index points) and non-manufacturing (44.3 index points) PMI continued to remain below the 50-index point benchmark. In addition, the committee expressed its concerns on the increasing trend in headline inflation which has been largely driven by recent supply shocks. Hence, its policy decisions reflected the need to address the weakness in economy growth and in turn curtail the northward trend in inflation rate.
- Particularly, the MPC aims to stimulate economic growth via the provision of cheaper credit. The reduction in the asymmetric corridor translates to a lower rate of 4.5% (previously 7.5%) for the Standing Deposit Facility¹ (SDF). While this should further discourage banks from utilizing the facility, we don't expect the policy to fuel an increase in consumer lending or a reduction in lending rate given the prevailing unattractiveness of the window. Already, most banks have reduced or stopped placing funds at the facility given the modification introduced in 2019. Recall, the CBN revised the guidelines around the SDF earlier in July 2019, wherein deposits from banks in excess of ₦2 billion were excluded from being remunerated. This effectively reduced the daily average funds in the window to ₦26.2 billion (2019: ₦48 billion, 2018: ₦140.8 billion).

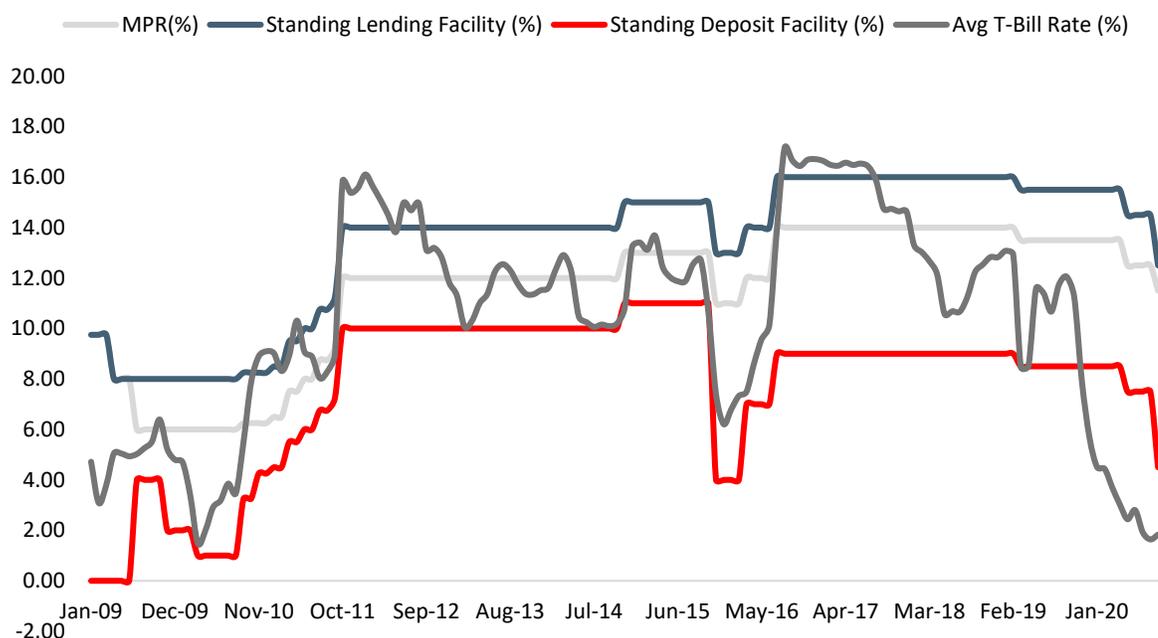
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¹ The SDF is a window where banks can place excess funds overnight with the CBN.

- On the other hand, the reduction in the Standing Facility Rate to 12.5% (previously 14.5%) helps reduce borrowing cost for banks with urgent funding need. For context, the SLF serves as ceiling for applicable interest rates in private funding markets.
- Following the reduction in SDF rate, we believe the CBN has taken a step in correcting the monetary policy transmission to market rates. Historically, the SDF rate had been a floor for the MPR and market rates, not until these rates crashed in 2019 following the exclusion of individuals and local corporates from accessing OMO auctions. In addition, the SDF rate was best suited as a base rate for market yields. For clarity, without the limit placed on the SDF, banks would rotate maturing bills into the SDF should market yields fall below the SDF rate

Figure 1: Trend in policy and market rates



Source: CBN, ARM Research

- Elsewhere, we reiterate the lack of transmission from the MPR to market rates. Hence, we see the reduction in the MPR as only a stronger signal to easing. However, we expect the reduction to effectively reduce savings deposit rate lower to 1.15% (previously 1.25%). Some weeks back, the CBN reduced the rate on savings deposit to a minimum of 10% per annum (previously 30% per annum) of the MPR. The intent here is to boost money supply and encourage spending.
- Meanwhile, despite the reduction in rates, it hasn't done much in boosting loan growth. On the contrary, most of the growth in loans is largely attributable to the moral suasion of the Loan to Funding Requirement. In our view, the former has failed to address the fundamental issues behind banks' reluctance to lend.

- On inflation, the MPC alludes the rising inflation to structural issues rather than expansion in money supply. Precisely, the committee links the increased inflation to inadequate state of critical infrastructure, disruptions to supply chains following restrictions to movement to curb the spread of the pandemic and depreciation in the exchange rate. Typically, lower rates (expansionary policy) should result into increased money supply and consumer spending, which in turn drives inflation higher. However, given Nigeria's inflation is largely tied to supply and cost-push factors, the MPC believes an expansionary policy and development finance policies² would help economy growth and resolve structural issues causing supply shortages and inflationary pressure.
- In summary, we believe structural weakness in the economy needs to be addressed before we see a significant impact of CBN's easing policy. Meanwhile, we see the change in the asymmetric corridor as a welcome development as it would help to restore the relevance of monetary policy to market rates. Going forward, we think the CBN would continue to juggle between economic growth and FX stability given the frail state of the economy and external position. While we expect the CBN to maintain an accommodative stance over the rest of the year, we see a huge possibility of increase in OMO rates in H1 2021 as currency pressure intensify.

² Includes Real sector support facility, commercial agriculture credit scheme

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