

## Monetary Policy review

### *A means to an end*

- In our strategy outlook for the year published some days back, we outlined how CBN policies over H2 19 centered on managing FX stability as well as reducing its cost of liquidity management. In addition, we highlighted why we believe managing FX stability would continue to be the focal point of its policies over the year (**See report: *CBN caressing both FPIs and Economic Growth***).
- At its first MPC meeting of the year, nine out of 11 MPC members voted to hike the Cash Reserve Ratio (CRR) by 500bps to 27.5% while leaving all other policy parameters unchanged. Central to the discussion was the increase in inflation<sup>1</sup>, which the MPC links to structural factors and excess system liquidity due to CBN's policy on excluding non-banks local from OMO auctions. It's decision thus reflected the need to control the impact of money supply on consumer prices. In addition, the committee agreed to continue its drive on improving access to credit via its loan to funding requirement. Particularly, total credit to the private sector increased by ₦2 trillion between May and December 2019.
- On the contrary, we think the basis for the CRR hike was beyond inflationary pressure given that the upward trend seen in inflation has been largely driven by supply bottlenecks from the border closure. As a matter of fact, the MPC alluded to this at its last meeting in November. We believe the intent to its decision its reflective of the apex bank's desire to reduce the cost of managing system liquidity. To buttress, feedback from sources revealed that over the past 7 weeks, CBN had unusually debited banks placing excess bids at both FX auctions and OMO auctions.
- We estimate that the CBN spent an annual average of ₦2.1 trillion within 2018 and 2019 in managing liquidity via its regular OMO auctions. We therefore think the high cost of managing liquidity largely informed the monetary authority's decision. As a matter of fact, we find it hard to reconcile the apex bank desire for banks to grow credit assets while jacking up CRR.

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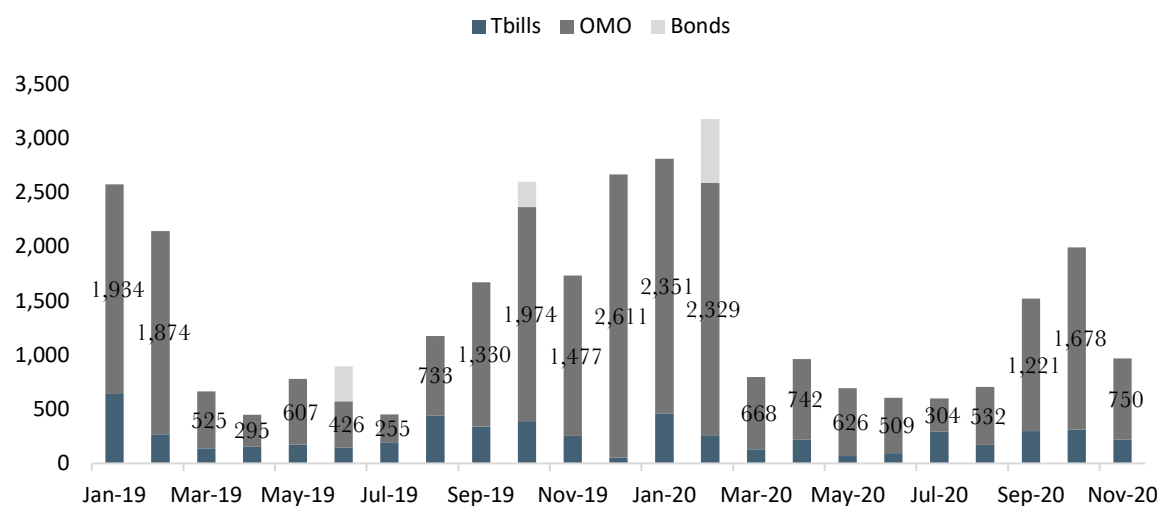
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<sup>1</sup> which has expanded for four consecutive months

## Lower costs but liquidity surfeit to remain

- As at October 2019, we estimate effective CRR for the banks printed circa 29%, which is higher than the 22.5% requirement. With the recent increase to 27.5%, we believe the apex bank would still charge DMBs additional debits regardless of the position of present effective CRR. Based on an assumption the CBN apply the incremental CRR charge of 500bps on existing deposits (~~₦~~16.5 trillion<sup>2</sup>), we estimate a total debit of ~~₦~~831 billion.
- Analyzing the impact on market rates, we expect to see a knee-jerk reaction in interbank rates over the coming days which will eventually normalize back following significant inflow of maturities particularly in February (OMO: ~~₦~~2.3 trillion, FGN Bond: ~~₦~~586 billion<sup>3</sup>, NTB: ~~₦~~259 billion). Elsewhere, we see limited impact on FI yields given the quantum of expected liquidity. Hence, we see limited scope for higher yields over the first half of the year.

**Figure 1: Maturity Profile (₦'billions)**



Source: FMDQ, ARM Research

<sup>2</sup> As at October 2019

<sup>3</sup> Inclusive of non-competitive sales

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