

Economic Report | Monetary Policy

Strategic or Tactical: Which hat will the MPC wear?

Economic Snapshot			
April 2016 Inflation Data/Indices			
	MoM	YoY	Prev YoY
Headline	0.9%	13.7%	8.6%
Food	0.4%	13.2%	9.5%
All Items Less Farm	1.2%	13.4%	7.7%
Imported food	1.2%	16.3%	9.2%
Energy	4.2%	23.7%	7.5%
Currency Markets			
	Latest	Daily Chg	YTD
USDNGN	199.05	0.00%	0.05%
EURNGN	223.31	-0.04%	3.62%
GBPNGN	288.22	-0.13%	1.73%
JPYNGN	181.96	-0.67%	10.78%
Monetary Aggregates –April 2016			
	(N'bn)	MoM	YoY
M2	20,728	1.3%	7.6%
CPS	19,379	2.6%	4.2%
NCG	3,783	4.0%	87.3%
NFA	5,392	-9.1%	-16.1%
NDC	22,665	2.9%	12.6%
External Position			
	Latest	QoQ	YoY
Trade Balance (\$'mn)	-973	-49%	N/A
External Reserves (\$'mn)	29,588	-18.6%	-10.8%
Foreign Debt (\$'mn)	10,718	0.9%	10.4%
Growth Data – Q1 2016			
	(N'bn)	%of total	YoY
Real GDP	15,988	100%	-0.4%
Agriculture	3,275	20.5%	3.1%
Oil	1,646	10.3%	-1.9%
Services	5,918	37.0%	0.2%
Wholesale and Trade	2,909	18.2%	2.0%
Manufacturing	1,578	9.9%	-8.1%

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Ahead of the 2-day MPC meeting which started yesterday, much of the economic commentary has focused on the likelihood of a rate hike as well as currency devaluation, almost to the point where both appear to be foregone conclusions. Such a viewpoint is quite understandable given the two recent decisions—the *officially inflation-linked* hike at the last MPC (and subsequent readings only trending higher) and the implicit devaluation in the fuel-price hike that, based on the PPPRA template, suggested a price of N285/\$ for marketers to source dollars. Reports of banks promptly selling to these petrol marketers at \$290/\$ makes the question of whether the shift in exchange rate level was intentional or not an academic one. For us, our conclusion was that the apparent signs that the CBN was not consulted made upcoming policy actions from the central bank of even more interest. But before delving into that, it perhaps makes some sense to see where the CBN itself was in terms of policy before considering how more recent developments including the PMS hike could affect its decisions if at all.

Challenging environment but curious choices

Any reader of the minutes of the last MPC meeting will realize that with no doubt the MPC is faced with a very challenging environment. Slowing growth, rising inflation and weakening exchange rates form the perfect mix for the best central bank/monetary policy headaches ever. However, we've also found the policy choices a bit curious and said so at the time. Beyond the mismatch of attempting to use monetary policy to ensure price-stability that it had admitted was structurally driven, the MPC

appeared to have been too hard on itself in assessing the impact of its previous measures. In a nutshell, the committee felt that prior easing was not transmitting to the economy with the funds stuck in the interbank market in turn fueling speculative currency demand. Interestingly, in the roughly 2-years since Gov. Emeziele's appointment the 14.1% growth in private sector credit is roughly in line with a similar stretch in Lamido Sanusi's tenure who likewise started with an easing stance. Indeed, in contrast to reports, annualized 22.3% growth in net domestic credit was tracking ahead of benchmark and even private sector growth has made up some ground since that meeting. In opting for the hike in March it seemed the MPC somehow hoped to use the tightening to dry up financial system liquidity and lessen currency pressures but that was always unlikely to happen. Aside that the currency arbitrage just seemed too deeply entrenched, such policy action also seemed to downplay the imminent pressures on growth.

Can growth alone shape the latest choice?

Not to say we told you so but outright negative GDP in Q1 16 now starkly highlights the conundrum the MPC faces in terms of policy choices. Whilst inflation has only pushed higher since the last meeting, we still find it hard to see how monetary policy would influence the cost of tomato (and other farm commodities) or affect the black market price of PMS—the two main causes of the inflation push thus far. Hence, we don't expect the MPC to continue tightening regardless of its desire to see positive real interest rates—with a rate cut possibly only ruled out by face-saving. For the currency, the MPC either needs to remove the demand or remove the arbitrage. In light of the earlier point about the enduring attraction of that arbitrage, channeling any available liquidity away from it will be a tall order. Nonetheless, to our mind, a volume- and not price-focused control of liquidity, that sees the apex bank suck up large amounts at low rates, remains a better way to handle the demand side. An even more sustainable way is to remove the arbitrage altogether. On this wise, we fail to see how a devaluation would help, especially when it would appear to simply-rubber stamp a decision apparently made outside the apex bank. Instead, we would expect to see some inkling of the revamp of the forex market architecture which we had been calling for and which the last MPC minutes indicated was a work in progress. To us, that will be of more value.

In terms of hard choices, it is perhaps the combination of those two currency-focused measures that is most compatible with the other items the MPC has to juggle, especially the need to reinvigorate growth. Of all the factors competing for attention, this is perhaps the one that we feel deserves the most attention and the CBN governor's Vision paper at the beginning of his tenure also seemed to lay the same emphasis.

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