FDC Economic Bulletin

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MPC adopts Lame Duck Approach

The MPC met today and as widely expected in line with consensus view, the committee left monetary policy parameters unchanged. This was one of the most anticipated MPC meetings in recent times owing to Nigeria's slowing growth, higher inflation, dwindling oil prices, depleting external reserves and exchange rate pressures. Also, the exchange rate process has been a subject of intense politicization.

The markets expected to gain clarity on the Nigerian foreign exchange rate markets as well as a clearer outlook picture on the direction of monetary policy. Exchange rate is important because it is the price at which the external and domestic sectors of the economy are aligned. It has immense impact on the budget and cost of doing business. These key macroeconomic issues are pertinent to the success of the budget.

The Decisions

- Retained MPR at 11% p.a with an asymmetric corridor of +200/- 700bps
- CRR on public and private sector deposits maintained at 20%
- Liquidity ratio was retained at 30%
- Net open foreign exchange trading position was retained at 1%
- Left controls in place

Impact of decision on markets

By kicking the can down the road, the CBN has increased uncertainty in the economy and heightened exchange rate pressures. The decision to maintain status quo does not do much to support the stock market as sell pressures caused by speculation on possible naira devaluation are expected to persist. In

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addition, the decision is unlikely to incentivize international investors, many of whom have remained on the sidelines.

Furthermore, the inflationary impact of a currency adjustment will be avoided for now. However, the combination of increased government expenditure as well as the removal of fuel subsidies and higher electricity tariffs are a concoction for a higher rate of inflation in the near term. In addition, with administrative controls still stringent, higher costs of importing goods is likely to feed into consumer prices.

Speculative attacks and uncertainty with regards to a possible exchange rate adjustment will continue to mount, thus weighing down on the currency. In addition, with the exchange rate still pegged at N199/$ at the IFEM, unethical practices such as round-tripping will persist. The level of external reserves is likely to deplete to $25bn as the CBN continues to defend the currency.

Outlook

There will be further uncertainty in the economy unless the CBN implements measures to stem pressures at the forex market. There is not a more critical time for the CBN to implement a flexible exchange rate policy than now. This will bridge the gap between the official rate and parallel market rate which is currently at N105.