FDC Economic Bulletin

March 26, 2020

MPC maintains status quo on all parameters

The MPC, at its recently concluded meeting, unanimously voted to keep all monetary policy parameters unchanged. This is the 6th consecutive meeting at which the benchmark interest rate was held at 13.5%p.a. The Committee's decision was premised on the need to fully ascertain the impact of its recent regulatory measures including the cut in lending rates to 5% from 9% and the N50bn credit support to SMEs and households. The decision to maintain status quo is however coming at a time when countries are lowering interest rates to mitigate the impact of the Covid-19 outbreak on financial markets, oil market and economic activities. The US Fed, in an emergency move reduced its benchmark interest rates to 0-0.25%p.a. Other countries that have reduced interest rates in recent times include the U.K, Kenya, Ghana, and South Africa.

Rationale/Justification

The move to leave the monetary policy rate (MPR) unchanged was premised on:

Monetary Concerns

- ***Inflationary pressure:*** Inflation has increased for the 6th consecutive month to 12.20% in February to mark a 22-month high. The increase was largely driven by higher food prices as producers pass the increased cost burden amid the implementation of VAT of 7.5% in February to consumers. The upward trend in inflation is expected to be sustained in the coming month owing to panic buying and scarcity of goods as the spread of Covid-19 in Nigeria causes a shortfall in supply.

- ***Negative growth outlook:*** GDP growth increased to 2.55% in Q4'19 from 2.28% in the preceding quarter. However, the growth outlook for 2020 particularly in the second quarter is negative because of the tepid global demand owing to the recent outbreak of COVID-19, decline in oil prices and negative balance of trade.

- ***Emergence of exchange rate pressures:*** The drop in oil prices led to a decline in Nigeria's oil receipts. This increased forex demand pressure which triggered hoarding of funds and speculative buying in the forex market. The fallout of this was the devaluation of the naira at the official and I&E windows to N360/$ and N380/$ respectively on March 20.

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Fiscal Concerns

- ***Weakened fiscal position:*** Nigeria's fiscal revenue has been hampered by dwindling oil prices and in response to this, the 2020 fiscal budget has been cut by N1.5trillion to N9.09trillion. The oil price benchmark on which oil revenues was based was also slashed by 47.37% to $30pb from $57pb.
- ***Subdued aggregate demand:*** Aggregate demand was subdued due to low purchasing power with the implementation of a VAT rate of 7.5%.
- ***Health crisis:*** MPC underscored the Covid-19 pandemic as a public health crisis which will continue to undermine any monetary and fiscal stimulus unless the spread of the virus in Nigeria is curtailed. The FGN placed a travel ban on passengers from thirteen (13) countries, restricted religious gatherings to twenty (20) individuals, introduced the closure of schools and the closure of all airports to incoming international flights to contain the spread of the disease.

Peer comparison

In line with the shift to a more accommodating monetary policy stance in advanced economies such as the US and UK, three of the Sub-Saharan African (SSA) countries under our review (Kenya, South Africa and Ghana) have cut their interest rates to cushion the effect of the Covid-19 outbreak on their economies.

The decision to maintain status quo is an indication that Nigeria is committed to sustaining measures aimed at maintaining relative stability in its economy. The Nigerian economy is more sensitive to the changes in the exchange rate than the changes in interest rates. The slide in external reserves amid dwindling oil prices and receipts makes the exchange rate threat a major issue.

Country	February Inflation (%)	March Policy rate (%)
Nigeria	12.20	13.50
Angola	18.74	15.50 (Jan)
Kenya	6.37	7.25
South Africa	4.60	5.25
Ghana	7.8	14.50
Uganda	3.40	9.00 (Feb)
Zambia	13.9	11.50 (Feb)

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[1]Trading Economics, FDC Think Tank

Implications

The MPC's decision to leave the MPR unchanged at a time when the global economy is slowing coupled with the growing threat of external imbalances on Nigeria's economy will have a mixed impact on the country. On the positive side, it will likely increase the capital inflows into Nigeria as a result of a higher interest rate differential relative to advanced countries.

The decision to maintain rates will be neutral on short-term investments as the returns on most asset classes will remain the same in the short-term.

On the downside, it may not give enough room for the deposit money banks to channel their loans and credit towards the critical sector of the economy particularly the agricultural and manufacturing sectors.