FDC Economic Bulletin

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MPC maintains status quo

Bored analysts and indifferent consumers yawn

The Monetary Policy Committee (MPC) maintained status quo for the sixth consecutive time since it last changed its benchmark policy rates 12 months ago. At that time, the MPC tightened in response to a weak currency and dwindling external reserves. Ever since, headline inflation has increased six times and declined five times. The CBN is of the school of thought that Nigeria's inflation is driven by demand pull factors rather than production shocks. Hence, it believes that reducing interest rates could increase liquidity and the demand for forex, thus inducing inflationary pressures.

As businesses have become averse to borrowing due to high interest rates, the economy is facing capacity underutilization and higher unemployment. The MPR is an anchor rate that is having less of an influence on market participants as the rates for T/Bills seem to reflect the cost of borrowing. The MPR really has no impact on the investment and savings function of households and firms. Nonetheless, an accommodative policy is necessary at a time when growth is paramount, as it sends the right signals to economic agents.

In addition, the CBN's decision confirms its preference for exchange rate stability over growth stimulation. The apex bank is of the view that with a high marginal propensity to import, an increase in liquidity will magnify the pass-through effect of imported inflation. Furthermore, with fiscal injections such as the Paris club refund and budget disbursements, the resulting increase in liquidity in the system could stoke inflationary pressures and lead to a buildup in demand pressure in the forex market. Also, the N3.4trn of promissory notes, if mismanaged, could be a trigger for runaway inflation.

In adopting a wait and see approach the CBN will be able to track the effectiveness of the IEFX window, the inflationary path and the growth trajectory. We do not expect the decision to have any major impact on the markets as it has already been factored in.

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Country Comparison

According to the newly revised World Economic Outlook published by the IMF, inflationary conditions have softened on the backdrop of relative recovery in commodity prices. Some emerging market economies such as Russia and Brazil have recorded large cuts in their core inflation rates.

In Africa, inflationary trends are generally mirroring global realities. However, policy responses to this trend in consumer prices are mixed. In the month of July, six countries have met so far to alter/maintain their monetary policy stances. Countries such as Angola and Kenya are in harmony with Nigeria as they have maintained status quo on benchmark rates.

Angola, as is the case with Nigeria, continues to monitor inflationary pressures on the backdrop of a volatile oil market and increased exchange rate pressures. Real returns in both countries remain negative. Kenya remains the poster child of East Africa. Improved macroeconomic fundamentals and stronger economic resilience is causing a tapering in consumer prices. Hence, a 'do nothing' approach to monetary policy is adopted to hedge inflation expectations.

Ghana's move to cut rates by 150bps shocked analysts. The magnitude of the cut is attributed to increased oil production in the West African nation as well as expectations of a further decline in inflation.

Country	Inflation (%)	Policy rate (%)
Angola	30.51 ↓	16 ↔
Kenya	9.21 ↓	10 ↔
South Africa	5.1 ↓	6.75 ↓
Egypt	29.8 ↑	18.75 ↑
Ghana	12.1 ↓	21 ↓
Malawi	11.3 ↓	18 ↓

Outlook

Given increasing political pressure to lower interest rates to encourage growth, we believe that the CBN may yield and thus review the MPR at its next meeting. Nigeria's increasing debt service burden (70% of independent revenue) is becoming an impediment to fiscal consolidation. This is likely to force a review of the interest rate policy in the short to medium term. A reduction in MPR may be more likely if Q2 growth figures released on August 23 is positive.

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