FDC Economic Bulletin

March 28, 2019

MPC cut benchmark interest rate by 50bps

The monetary policy committee (MPC), at its meeting on March 25/26, took investors by surprise by cutting the monetary policy rate (MPR) by 50bps to 13.5%pa. This happened after it maintained status quo for 16 consecutive sessions (33 months). The voting pattern showed an almost equal vote (6:5) in favour of the rate cut. Of the 11 members present at the meeting, 10 voted to leave all other monetary parameters unchanged, while one was in favour of a cut in the cash reserve ratio (CRR) by 100bps.

Rationale/Justification

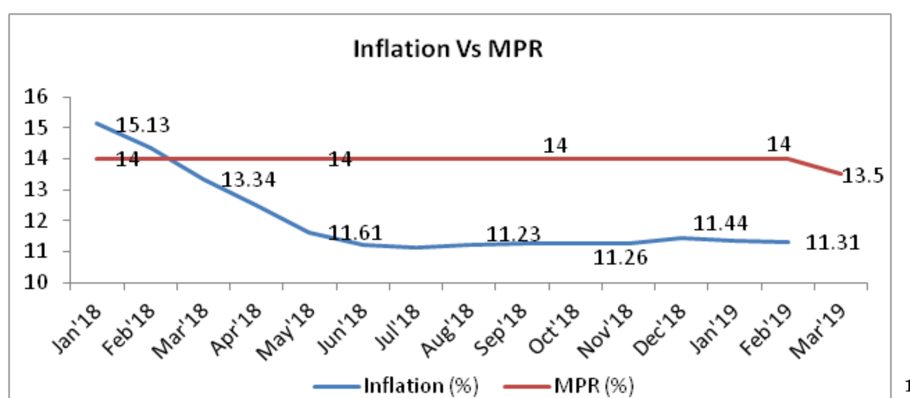
The move to cut the monetary policy rate (MPR) was premised on:

- **Tepid GDP growth**: GDP growth increased to 2.38% in Q4'18 from 1.81% in the preceding quarter. This level of growth is below potential GDP, population growth and full employment of 2.9%, 3% and 6% respectively. There is a need for increased flow of credit to the employment elastic sectors. Credit to the private sector (CPS) grew by 6.41% in February, below the target of 9.41%.

- **Moderation in the general price level:** The headline inflation slowed for two consecutive months to 11.31% in February 2019. However, the risks to inflation include - high energy costs and insecurity in the food producing states.

- **Strengthening currency:** The exchange rate was relatively stable within a range of N359/$-N361/$ at the IEFX window and parallel market.

- **Robust external buffers:** The external reserves have increased steadily in the last four weeks. This was partly due to an increase in foreign capital inflows.



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[1]NBS, CBN, FDC Think Tank

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Implications

Rate easing but not accommodating stance

The decision to reduce the MPR is essentially a rate easing exercise which is expected to reduce cost of government borrowing - a critical determinant of the level of fiscal stability. Lending rates which currently hover around 21%p.a - 22%p.a, are expected to slide marginally.

However, the decision to leave the CRR at 22.5% coupled with aggressive OMO auctions means that the supply of money will be fixed and the interest rate inelastic nature of supply of credit will remain unchanged. This implies that the transmission effect of the rate cut might have limited impact on access to credit. Reducing CRR and increasing money supply will have a greater impact on the price and availability of credit.

Stock Market – Reaction Muted

So far in March, the stock market gained 5 days and lost 14 days. In all, it has lost 3.01% this month. Market sentiment has been driven by profit taking and sell pressures, despite positive earnings. Typically, there is an inverse relationship between interest rates and asset prices. A reduction in interest rates would push up price of assets such as bonds and equities.

Fiscal stability

A drop in the monetary policy rate will reduce Government debt service burden and create additional room for new projects. This is likely to increase output and taper inflationary pressures.

Country comparison

Economists sometimes argue that a fall in interest rates will stimulate growth but could also stoke inflation. In recent times, the Ghanaian Cedi came under intense pressure in the forex market. It lost 11% in four weeks. Investors are of the view that the Bank of Ghana's (BOG) aggressive rate cutting precipitated the fall in the value of the Cedi in the forex market. The BOG had cut rates 3 times in the last 12 months, raising GDP growth to as high as 7.4% and bringing inflation down to 9.0%. The last cut though triggered an overreaction. It is pertinent for Nigeria to learn from Ghana's experience and be cautious of the possibility of the rate cut leading to currency weakening in the near term.

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Country	Inflation (%)		Policy rate (%)	
Nigeria	11.31	↓	13.5	↓
Kenya	4.14	↓	9.0	↔
Ghana	9.2	↑	16	↓
Uganda	3.0	↑	10	↔
South Africa	4.1	↑	6.75	↔
Angola	17.96	↓	15.75	↓

Outlook

The new fiscal team of the FGN will be in place in June. Apart from other tasks, one of its first assignments will be to present a supplementary budget to the National Assembly to accommodate the new minimum wage and other shortfalls arising from significant changes in the macro-economic environment. The monetary policy authorities are thus unlikely to make any major changes at their next meeting in May.

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