FDC Economic Bulletin

May 29, 2020

MPC defies analysts expectations, embraced a dovish stance

The MPC, at its recently concluded meeting, voted 7:3 to cut the benchmark interest rate by 100bps to 12.5% pa from 13.5%pa. This will be the first rate cut since March 2019 and the largest since November 2015. All other monetary policy parameters were left unchanged. It was mainly a signalling move to anchor expectations of economic agents.

At a time of macroeconomic challenges as a result of the twin shocks of the Covid-19 pandemic and oil price crash, the Committee emphasized the need for price and exchange rate stability. While noting the slow rate of the increase in inflation, the Committee did not ignore its potency. It hopes that the falling interest rates will complement the fiscal stimulus of the Finance Ministry. The President has also submitted a revised 2020 budget of N10.51trn ($29.19bn) to the National Assembly for approval. The revision was premised on the need to adjust revenue projections to capture current market realities and make provision for increased healthcare spending. The stimulus package is less than 3% of GDP. Other African countries like Kenya have stimulus packages of approximately 5% of their GDPs. Fiscal policies complemented by effective monetary policies help to jumpstart economies that are languishing.

The CBN seems to be in lock step with its peers who have mostly adopted very aggressive accommodative stances.

Rationale/Justification

Monetary Concerns

- **Inflationary pressure:** Inflation has increased for the 8th consecutive month to 12.34% in April from 12.26% in March, largely driven by increases in the food and core components. Inflationary pressures are expected to persist in the coming months owing to supply chain disruptions, palliative demand by corporates and the exchange rate pass through effect.

- **Emergence of exchange rate pressures:** Investors are becoming increasingly worried about a repetition of the 2016 forex crisis – dollar scarcity, increased capital controls by banks amongst others. Since the resumption of forex sales on May 4, dollar availability has been insufficient to meet the demand. If this persists once the economy is fully reopened, there will be increased exchange rate pressure and the Naira could depreciate to N470-N490/$.

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Fiscal Concerns

- **Negative growth outlook:** GDP growth slowed to 1.87% in Q1'20 from 2.55% in the preceding quarter. The growth outlook for the remaining quarters of 2020 remains bleak as the contraction in economic activities caused by the lockdown restrictions becomes manifest.

Health Concerns

The MPC highlighted the Covid-19 pandemic as a health crisis which has morphed into an economic crisis. Since its last meeting in March, the number of Coronavirus cases has spiked to 8,915 (May 28) from 139 (March 31). Fatalities have also increased significantly to 259 (as at May 28). Government response to curbing the spread of the virus includes policies such as lockdown restrictions in Lagos, Kano and FCT. The continued rise in the number of cases amid the negative impact of the lockdown measures on economic activities put the government in a dilemma.

Peer comparison

Within the sub-Saharan African (SSA) region, Nigeria is not alone in its decision to cut its benchmark interest rate. Three of the countries under our review (South Africa, Uganda and Zambia) have cut their interest rates as a way of stimulating growth and kick-starting the recovery process.

The decision to adopt an accommodative stance is an indication that Nigeria is committed to boosting growth and withstanding the pandemic-induced economic shock.

Country	May Policy rate (%)
Nigeria	12.50 ↓
Angola	15.50 ↔
Kenya	7.00 ↔
South Africa	3.75 ↓
Ghana	14.50 ↔
Uganda	8.00 (Apr) ↓
Zambia	9.25 ↓

Implications

Prior to the last meeting, the CBN had adopted unorthodox monetary policies to boost lending to the critical sectors. Some of the measures include: the loan-to-deposit ratio (LDR) directives (65%), intervention loans and OMO restrictions. The impact of this has been a 20.45% (N3.1trn) spike in total credits. In response to the negative economic impact of Covid-19, the CBN also launched a stimulus program in total of N3.4trn

(2.4% of GDP) and reduced interest rates on intervention funds by 400bps to 5%pa from 9%pa. The 100bps cut in the benchmark interest rate was mainly a signalling move to anchor expectations of economic agents. This is evident in the muted impact that the last rate cut in March 2019 had on the market. However, the current low interest rate environment amid rising inflation will reduce the real rate of return on investment. This is likely to discourage foreign portfolio investors and increase capital flight.

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