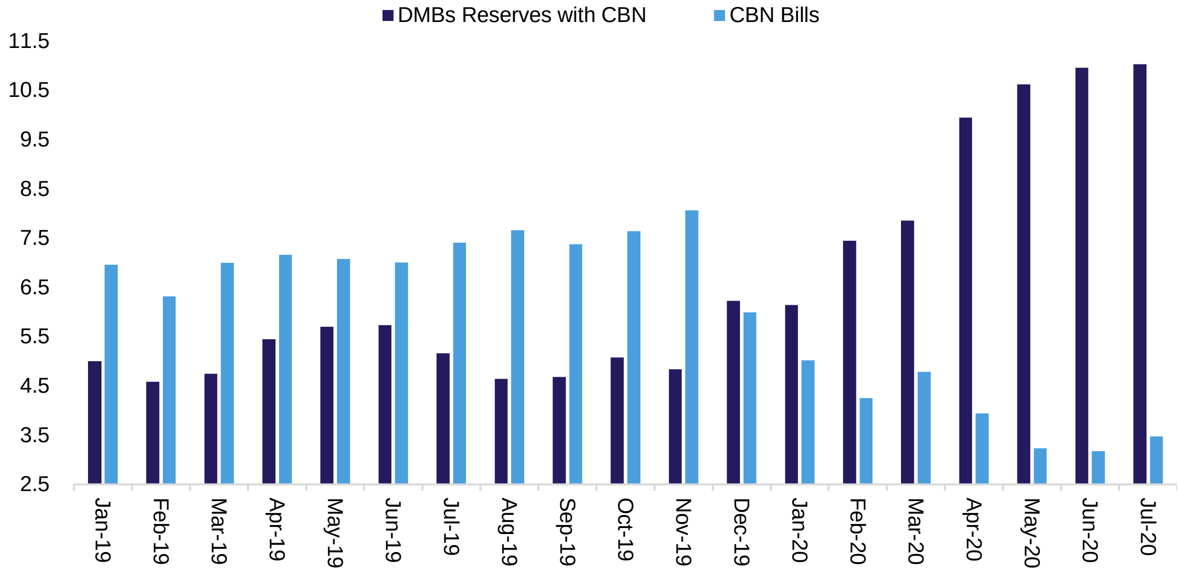
Economic Commentary

Low Liquidity Expected to Dampen Impact of Lower Rates

Not so surprising for us, the Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) at the end of its meeting yesterday lowered the Monetary Policy Rate (MPR) for the second time this year by 100bps to 11.5%. Also, the committee voted to reduce the asymmetric corridor around the MPR to +100/-700bps from +200/-500bps and to maintain the Cash Reserve Ratio (CRR) at 27.5% and Liquidity Ratio at 30%. Beyond signaling an accommodative posture, the committee cited the need to complement the CBN's commitment to sustain the trajectory of the economic recovery and reduce the negative impact of COVID-19. Also, they expect the liquidity injections from the downward review of the MPR to stimulate credit expansion to the critically impacted sectors of the economy and offer impetus for output growth and economic recovery.

Looking beyond the actual decision, the MPC recognition of the impact the constrained liquidity in the banking system bodes largely well with our view. As mentioned in our Pre-MPC note (See report: Balancing FX Stability and Moderating Economic Contraction), beyond actual nominal interest rates, the cost of funds across the banking system is adjusted higher by the CRR impact to arrive at a CRR weighted cost of funds. As such, we stated that a gradual refund of CRR will have more positive impact on rates in the interim. While the downward adjustment of the MPR and further downward review of the standing lending facility (SLF) should suggest cheaper funds for DMBs accessing the CBN window (with SLF rates adjusted lower by 200bps to 12.5% from 14.5%), the CBN sterilization of banks CRR (through unusual debits and LDR punitive measures) already signals minimal interest from banks in taking cheap funding from the apex bank. Without any doubt, a downward adjustment of effective CRR compared to a lower SLF rate, will be more favorable to banks.

Figure 1: Trend in DMBs Reserves with CBN and CBN Bills



Source: CBN, NOVA Research

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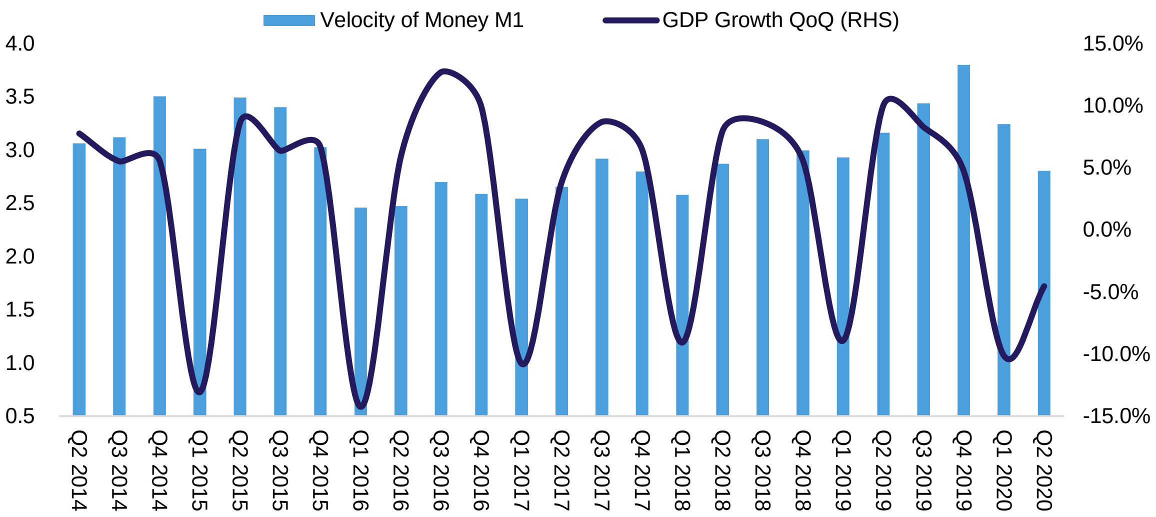
In our view, we believe the CBN action yesterday further consolidates its recent adoption of a more direct measure to reducing the cost of funds of DMBs and by extension attempt to moderate the cost of borrowing. We believe the policy will have more positive impact on the savings rate, with a transmission to overall banking sector cost of funds in the medium term. With the MPR review translating to a further fall in the savings rate to 1.15% (a cumulative fall of 260bps in September alone) and largely benefiting banks with sizeable savings accounts, restructuring of savings deposit to longer dated time deposits by customers to earn better yields will further moderate rates on time deposits with a transmission to even banks with lower savings deposit reach. As we have mentioned, any policy that focuses on stimulating credit growth alone without a major revamp of the structural bottlenecks in the economy will do little to provide cheaper credit (even credit in itself) to the growth stimulating sectors of the economy.

Supply-Side Jump in Prices… Monetary Policy Action Could be Growth Negative

Beyond the MPC decision, we have received series of comments from the market about the reduction in the MPR considering the elevated inflationary pressure. While we understand that inflation is always and everywhere a monetary phenomenon, the Nigeria current inflation expectation is largely structural beyond doubt. The combined impact of increased cost of intercity transportation, security challenges, border closure and FCY shortage have necessitated the jump in inflation over the last couple of months. As we have often mentioned, the rising inflation are largely supply-side factors and monetary policy will largely fail in this sense. As such, a monetary policy focused on addressing the current inflationary trend in the face of stagflation will have even more negative impact on economic growth.

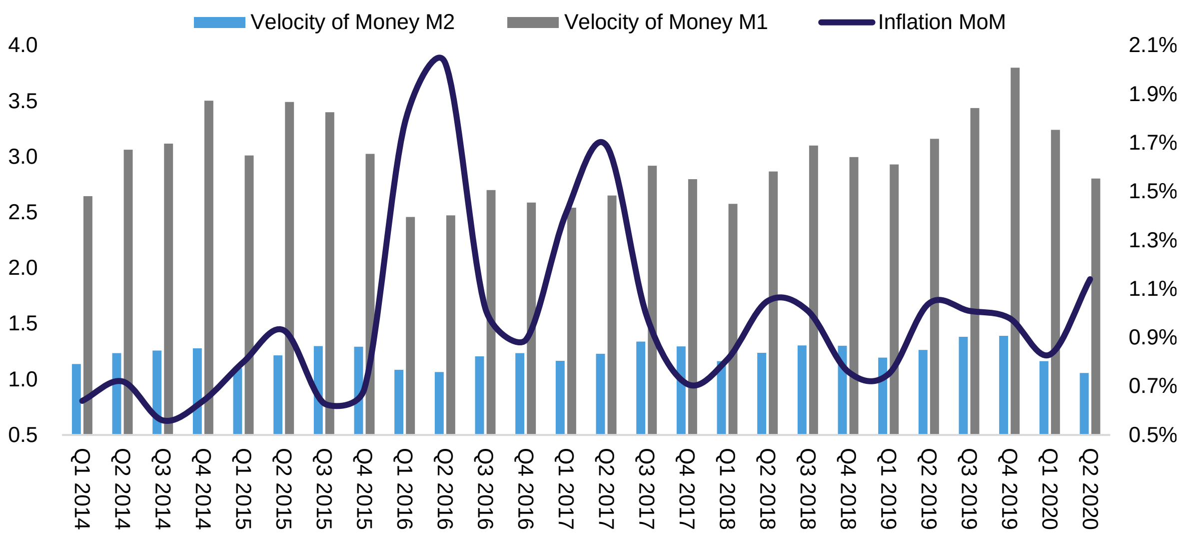
Figure 2: Money Velocity and Nominal GDP Growth



Source: NOVA Research Estimate

Inflation expectation over the next couple of months will be dominated by recent upward adjustment in electricity prices and rising PMS/diesel prices due to increasing global crude oil prices. On electricity tariff, the increase will result in ~89% jump in cost of electricity, with the impact likely to reverberate across the core and even the food inflation. While noting the potency of MPR (at least theoretically), it will do little to address the gloomy outlook for inflation, which are largely resulting from structural factors. Also, the CBN has largely showed it will not be responding to inflationary pressures necessitated by structural factors.

Figure 3: Money Velocity and Price Level



Source: NOVA Research Estimate