

The Monetary Policy Committee (MPC) met on November 21, 2011 to review domestic economic conditions up to the early part of Q4 2011 and the challenges facing the Nigerian economy against the background of developments in order to reassess the options for monetary policy for the remaining part of the year and Q1 2012.

Concerns of the Committee

The key concerns noted by the Committee were:

1. The deterioration of international economic and financial conditions
2. The limited available fiscal space in the industrial economies
3. Impending decline in oil demand
4. The impact of external developments on the domestic economy
5. Need to diversify the domestic economy away from oil

Decisions of the Committee

1. Retained the current Monetary Policy Rate (MPR) of 12.00% and the symmetric band at +/-200 basis points;
2. Retained the Cash Reserve Ratio (CRR) at 8%; and
3. Adjusted the mid-point of target official exchange rate from N150.00/US\$1.00 to N155.00/US\$1.00 and maintained the band of +/-3.0%. This means that the Naira should float roughly within a range of N150.00/US\$1.00 – N160.00/US\$1.00, unless extraordinary shocks necessitate a change in stance.

Our opinion

The decision to retain the MPR at 12% by the Monetary Policy Committee at its meeting of November 21, 2011, was well anticipated given the ripple effect of the last hike in the MPR on interest rates in the short and long end of the market. It has far reaching implications for the economy and other macroeconomic variables as detailed below:

Interest rates

Interest rates across board are expected to remain fairly stable at the current levels with occasional volatility caused by mop up activities of the CBN, activities of NNPC and other oil companies in the market and release of Federation Account Allocation Committee (FAAC) allocations into the system. We expect the cost of borrowing to remain fairly stable and no further deterioration in credit expansion. This is because the already “high” MPR is still working its way through the system as it is impacting on the real sector of the economy. Furthermore, economic activities are beginning to slowdown as the year is gradually coming to an end.

On the other hand, we expect the current MPR to translate into higher deposit rates for savers.

Foreign Exchange

The official devaluation of the naira may partially address the concern of the MPC on the continuing pressures in the foreign exchange market and the slow rate of reserve accretion which the hike in interest rates could not halt. It would also become more expensive for currency speculators to bet against the Naira as the devaluation would serve as disincentive for speculators, and hopefully this should translate to stability of the Naira.

Stock Market

The stock market has always been at the receiving end of the hike in MPR. The retention of the MPR at 12% may not translate to a positive outlook for the stock market, as a flight to cash in the face of the bearish stock market persists. The performance of leveraged quoted companies with variable interest rate debt would further be marred by high interest expense that may significantly lower dividend payments and dividend yields to the investors. Just like we mentioned in our last MPC meeting commentary, stock prices may decline further if the long awaited market rally continues to be a mirage.

Bond Market

The prices of existing bonds are not expected to be affected significantly as yields have already aligned with current market conditions while new bond issues would have to be issued at market rates in line with the current interest rate regime.

The Macro Economy

We expect the retention of the MPR at 12% to further reduce disposable income of Nigerians that have borrowed at variable interest rates and lower aggregate demand. Manufacturing companies sourcing their raw materials outside the country would have to pay more as the Naira depreciates. If they are not able to pass the cost to the consumers, this may lead to reduction in profitability of the firms and job losses. Government would continue to incur higher interest expense on domestic debt. If this trend continues in the long term and oil prices decline, we might see cuts in expenditure and the tightening of austerity measures.

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