

The Monetary Policy Committee (MPC) of the CBN met on September 19, 2011, to review domestic economic conditions during the first eight months of 2011, and the challenges facing the Nigerian economy against the backdrop of developments in the international economic and financial environment in order to reassess the challenges facing monetary policy for the rest of 2011.

The Committee noted the following on the domestic economy:

- The inflationary pressures being faced by the domestic economy had slightly moderated as a result of the series of monetary policy tightening measures put in place by Central Bank of Nigeria (CBN) coupled with the favourable agricultural harvest.
- Although, output growth remains robust, the current security situation in the country if not properly checked may dampen investors' confidence.
- The outlook for inflation is uncertain even in the face of expected favourable agricultural production, the expected stability in the banking industry as the capitalization exercise is near conclusion, and the recent reconstitution of the Federal Government of Nigeria Economic Management Team.

### Concern of the Committee

The key concerns noted by the Committee were:

1. Continuing expansionary fiscal stance and high component of recurrent expenditure;
2. Liquidity surge expected from AMCON intervention, following conclusion of bank recapitalization;
3. Sharp rise in the month-on-month headline inflation rate despite falling year-on-year headline inflation;
4. Need to have positive real interest rates; and
5. Persisting demand pressure in the foreign exchange market, driven by significant liquidity injections and reflecting structural deficiencies that have perpetuated the import dependence of the economy

### Decisions of the Committee

1. Increase in Monetary Policy Rate (MPR) by 50 basis point from 8.75% to 9.25%
2. Maintain the current symmetric corridor of +/-200 basis point around the MPR; and
3. Retention of the current Cash Reserve Ratio (CRR) of 4%.

### Our opinion

The monetary policy tightening measures adopted by the MPC since January 2011 appear to be working. A cursory look at the five meetings of the MPC in 2011 revealed that the MPR has been increased at each meeting by at least 25 basis points. It was increased from 6.25% to 6.50% in January, 6.50% to 7.50% in March, 7.50% to 8.00% in May, 8.00% to 8.75% in July, and now to 9.25% on September 19, 2011. On the other hand, year-on year headline inflation rate decreased from 12.4% in May to 10.2% in June, 9.4% in July and 9.3% in August 2011. It recorded its highest in May (12.4%) and lowest in August (9.3%). Core inflation also decelerated from 11.5% to 10.9% in August 2011. On the face of it, the evidence would suggest that the CBN is achieving the objectives of its monetary policy stance, which is to moderate inflation. The corollary of constantly increasing the MPR which is the benchmark rate for other interest rates in the economy is that it has implications for other markets and indices.

### **Interest rates**

The consistent hike in the MPR may result in high lending cost. If the trend continues, it may become even more difficult for Small-Medium Scale Enterprises (SMSEs) to reasonably access funds as banks price their funds off the MPR. If this happens, it would be counter-productive and have adverse consequences for economic growth and job creation.

On the other hand, we expect deposit rates to rise and perhaps encourage savings as nominal interest rates tend towards real interest rates.

### **Foreign Exchange**

We opine that the increase in MPR may play a stabilizing role for the naira vis-à-vis the dollar as it could help to moderate speculative demand particularly if lending rates start to trend northwards. In recent times, the CBN has put in place measures to stabilize the naira including increasing the weekly sales of foreign exchange to BDCs from \$50,000 to \$100,000. This and other measures appear to be having the desired effect as the volatility of the naira has moderated in recent trading sessions.

### **Stock Market**

If the increase in MPR translate into higher deposit rates, it may not augur well for the Nigerian Stock market as investors in the money market who might be contemplating a shift into the stock market to take advantage of 'bargain prices' may be dissuaded from doing so, whilst those who are already in the stock market and are perhaps ready to tough it out may be encouraged to cut and run.

### **Fixed Income Market**

As interest rates rise the prices of bonds are likely to fall to realign the yield in line with current market conditions.

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